S B
493

SENATE COMMITTEE REPORT

DATE: 3/5/90 FURTHER: Finance

DATE TURNED INTO OFFICE: 5/1/90

Resources Committee considered SB 493

Act relating to the reconstitution and administration of the mental health trust.

and recommended:

[✓] replace with _____ CS SB493(Res) [ ] same title
[ ] or adopt _____ CS _____ [✓] new title
[ ] technical title change (HB only)

[ ] attached amendment(s)
[ ] _____ letter of intent adopted

[ ] do pass

[ ] do not pass

[ ] no recommendation

[✓] individual recommendations

[ ] further referral to _____

ATTACHES NEW FISCAL NOTE(S): Dept/Date:

[ ] fiscal note(s) _____

[ ] zero fiscal note(s) _____

[ ] appropriation-no fiscal note

APPROVES PREVIOUS: Dept/Date:

[✓] fiscal note(s) _____

[✓] zero fiscal note(s) _____

[ ] Governor's bill w/fiscal note

SIGNING DO PASS:

OTHER RECOMMENDATIONS:

Rick Halford NO REC
No Rec
No Rec
Do not pass

Do Pass

Chair: Signature and Recommendation

SB 493 Mental Health Lands

THE HOUSE FINANCE VERSION OF SB 493, MENTAL HEALTH LANDS

HCS CS SB 493 (FIN)
THE VERSION COMING BACK TO THE SENATE FOR CONCURRENCE MAKES THESE CHANGES.

1. The rental value constituting the mental health trust corpus is equal to six percent of the unrestricted general fund revenue.

2. The legislatively designated lands as of 9/7/87. Income from the legislatively designated lands is deposited into the mental health trust income account.

The House Finance letter of intent is not adopted

The SENATE FINANCE VERSION PROVIDES:

1. The rental value constituting the mental health trust corpus is equal to five percent of the unrestricted general fund revenue.

2. No revenue stream from the legislatively designated lands.

6-2242D
Bradley
4/28/90

Original sponsor(s): SEN. COGHILL

IN THE SENATE BY THE RESOURCES COMMITTEE

CS FOR SENATE BILL NO. 493 (Resources)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the reconstitution and administration of the mental health trust."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 37.14.011(b) is amended to read:

(b) The amount determined under (c) of this section as the [FAIR MARKET] rental value of the land constituting the mental health trust corpus is the earnings of the trust and the commissioner of revenue shall annually allocate that amount from the general fund to the mental health trust income account.

* Sec. 2. AS 37.14.011(c) is repealed and reenacted to read:

(c) The rental value of the land constituting the mental health trust corpus is equal to eight percent of the value of the land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act. At least every five years, commencing with 1992, the value of the land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act, shall be redetermined as follows:

(1) the number of acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act in each municipality that assesses land for property tax purposes shall be divided by the total number of acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is located in municipalities that assess land for property tax purposes; the result of this division is the "weighting factor";

(2) the weighting factor for each municipality that assesses land is multiplied by the average percentage change in assessed land values for that municipality since that municipality's assessed values were used to revalue land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act; the result is the "weighted value change" for that municipality;

(3) all of the weighted value changes must be added together to arrive at the "revaluation factor," expressed as a decimal;

(4) one plus the revaluation factor must be multiplied by the previous total value of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act to arrive at the redetermined value of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act.

* Sec. 3. AS 37.14.011 is amended by adding a new subsection to read:

(d) The commissioner of natural resources shall calculate the redetermined value of the trust under (c) of this section and provide the redetermined value to the commissioner of revenue and the board established under AS 47.30.661.

* Sec. 4. AS 38.05.800 is repealed and reenacted to read:

Sec. 38.05.800. RECONSTITUTION AND ADMINISTRATION OF MENTAL HEALTH LAND TRUST. (a) The value of all land selected by or patented to the state under the Alaska Mental Health Enabling Act, as of September 7, 1987, is $1,800,000,000.

(b) All land within legislative designations on September 7, 1987, constitutes the corpus of the mental health land trust.

(c) On reconstitution of the trust under this section, land selected by or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is not within legislative designations is removed from trust status.

(d) The land within legislative designations that constitutes the mental health land trust shall be administered for the legislatively designated purposes. The state shall continue to manage the legislatively designated areas in accordance with state law and policy; the authority of the state includes the issuance of permits, rights-of-ways, mining leases, oil and gas leases, coal leases, timber contracts, and other actions that do not constitute a conveyance in fee simple. The income from the use of the trust land shall be deposited into the general fund.

(e) Before the state may remove land that is part of the mental health trust corpus from trust status, and in addition to any other requirements of law, the commissioner, consistent with the state's trust responsibilities, shall identify replacement land, equal in value at the time of replacement, within legislative designations and incorporate them into the mental health trust corpus. The commissioner annually shall report any actions under this subsection to the board established under AS 47.30.661.

* Sec. 5. Section 2(a), ch. 132, SLA 1986, as amended by sec. 9, ch. 48, SLA 1987, is repealed.

April 30, 1990

AMENDMENTS TO THE 4/28/90 DRAFT CS FOR CSSB 493 (HESS)

In the Senate

P. 1, l. 7: Add "; and providing for an effective date" between "trust" and "."

P. 1, l. 17-18: Delete "selected or patented to the state" and substitute " the state receives"

P. 1, l. 19: Delete "At least every five years, commencing," and insert "Commencing"

P. 1, l. 21: Insert "annually" between "redetermined" and "as"

P. 2, l. 21-22: Delete "selected by or patented to the state" and substitute "the state receives"

P. 2, l. 27: Delete "selected by or patented to the state" and substitute "the state receives"

P. 2, l. 20: Add new sections to read:

* Sec. 6. The provisions of this Act are not severable.

* Sec. 7. This Act takes effect immediately in accordance with AS 01.10.070(a).

April 30, 1990

ADDITIONAL AMENDMENT TO DRAFT CS FOR CSSB 493 (HESS)

P. 1, l. 23-29 and p. 2., l. 1-13: delete all text and insert:

(1) the commissioner of natural resources shall, in consultation with the commissioner of community and regional affairs, assign all of the original mental health land grant received by the state under the Alaska Mental Health Enabling Act to georgraphic areas;

(2) the number of acres of mental health land in each area shall be divided by the total number of acres received by the state to determine the "weighting factor;"

(3) the weighting factor for each area shall be multiplied by the annual average percentage change in value of the land in that area, as determined by the commissioner of community and regional affairs under the full value determination procedure specified in AS 14.17.140, to determine the "weighted value change" for that area;

(4) all of the weighted value changes shall be added together to determine the "revaluation factor," expressed as a decimal; and

(5) one plus the revaluation factor shall be multiplied by the previous total value of mental health land received by the state to arrive at the redetermined value of the mental health trust corpus.

Beneficiaries want to think this over before endorsing. (Adopt in finance?)

STATE OF ALASKA
1990 LEGISLATIVE SESSION

BILL VERSION : CSSB 493
PUBLISH DATE :

FISCAL NOTE

REQUEST:
Revision Date: 2-Mar-90
Agency Affected: Natural Resources
Title: An Act relating to the reconstitution and administration of the mental health trust.
BRU: Land & Water Mgmt
Management & Administration
Sponsor: Coghill
Components: Land & Water Mgmt
Requestor: Senate HESS
Commissioner's Office

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

See Attached

Prepared by: Larry Ostrovsky
Phone : 465-2400
Division: Commissioner's Office
Date : 2-Mar-90

Approved by Commissioner: Lennie Gorsuch
Date: 2-Mar-90
Agency: Department of Natural Resources

Distribution (by preparer) :
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

STATE OF ALASKA
1990 LEGISLATIVE SESSION

BILL VERSION: SB493
PUBLISH DATE: 02/22/90

FISCAL NOTE

REQUEST: SB493

Revision Date:
Title: An Act relating to the reconstitution and administration of the Mental Health Trust
Sponsor: Sen. Coghill
Requestor: Sen. Coghill

Agency Affected: Health & Social Services
BRU:
Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY92	FY93	FY94	FY 95	FY 96
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL	0.0	0.0	0.0	0.0	0.0	0.0
REVENUE	0.0	0.0	0.0	0.0	0.0	0.0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

No fiscal impact in FY90.

Prepared by: Richard Rennninger
Division: Administrative Services
Phone: 465-3331
Date: March 1, 1990

Approved by Commissioner:
Agency: Health & Social Services
Date: 3/2/90

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

POSSIBLE COMMITTEE SUBSTITUTE FOR CSSB 493 (HESS)

For an Act entitled: "An Act relating to the reconstitution and administration of the mental health trust; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. FINDINGS. The legislature finds:

(1) in chapter 48, SLA 1987, the legislature enacted a framework for settlement of the mental health trust controversy;

(2) under chapter 48, it was contemplated that

(i) the state and the plaintiffs and intervenors in the mental health trust land litigation, Weiss v. State, 4FA-82-2208, would reach consensus on procedures to determine the value of the original one million acre mental health land grant,

(ii) the original mental health land not in legislatively designated areas (e.g., parks, game refuges, etc.) would be exchanged for equal value general grant land in such areas,

(iii) the original mental health land and the equal value exchange land in those areas then would constitute the mental health trust corpus which the state would lease from the trust for eight percent of its fair market value per year, and

(iv) the original mental health land not in legislatively designated areas would be removed from trust

tatus;

(3) the state and the plaintiffs and intervenors in the Weiss case have been unable to reach consensus on the procedures to be used to value the original one million acre land grant and the pool of potential exchange land, the plaintiffs and intervenors arguing that procedures producing a value of $2.243 billion should be used and the state arguing that procedures producing a value of $564.7 million should be used;

(4) continued controversy over land issues, matters having nothing to do with the state's mental health program, is not in the best interest of either the trust or the public;

(5) instead, it is in the best interest of both the trust and the public to ask the court, before the legislature acts to finally resolve this matter, to determine under AS 13.36.035 the state's powers and duties as trustee under the mental health trust;

(6) while the process of determining what the state's powers and duties as trustee are, it is in the best interest of both the trust and the public to permit some transactions with respect to mental health land (i.e., transactions other than sales, leases, or exchanges) to go forward, as long as the trust is fairly compensated for the use of its land;

(7) the trust is currently being compensated for the use of its land under sec. 11, ch. 48, SLA 1987, which requires that five percent of the state's unrestricted general fund revenues be allocated annually to the mental health trust income account, AS

37.14.011;

(8) annually allocating five percent of the state's unrestricted general funds to the mental health trust income account fairly compensates the mental health trust for the current use of its land because

(a) even the most aggressive management of the land for the purpose of generating revenue cannot be guaranteed to generate any given amount of funds,

(b) the dedication of five percent of the state's unrestricted revenues to the mental health trust income account provides predictability in the amount of funds available,

(c) there are no administrative expenses associated with generating funds for the account in this manner, while there would be substantial administrative expenses if funds had to be generated for the account through aggressive management of the land for that purpose, and

(d) the average per acre earnings for trust lands in other states in fiscal year 1988 was $8.97, the highest per acre earnings (in the State of Washington because of its prime and easily accessible timber lands) was $45.68, and the dedication of five percent of the state's unrestricted revenue will result in earnings of approximately $100 per acre for the the mental health trust;

(9) under sec. 2(d), ch. 132, SLA 1986, as repealed and

reenacted in sec. 9, ch. 48, SLA 1987, "the commissioner of natural resources may not sell, lease, or exchange mental health trust land of the state without the prior approval of the [interim mental health trust] commission," a majority of which represents the plaintiffs and intervenors in the Weiss case;

(10) at its January 25, 1990 meeting, the majority of the interim mental health trust commission representing the plaintiffs and intervenors voted to disapprove any further transactions on mental health land, an action which if interpreted to preclude transactions other than sales, leases, and exchanges will have serious adverse effects on the economy of the state and, as a result, have serious adverse political consequences for the recipients of mental health services; and

(11) it is in the best interest of both the trust and the public, in light of the compensation currently paid under sec. 11, ch. 48, SLA 1987, for the use of mental health land, to allow transactions other than sales, leases, or exchanges, including the granting of rights-of-way, permits, and other authorizations, to go forward so long as provision is made for any additional compensation to which the trust may be entitile beyond that already provided by the state.

* Sec. 2. PURPOSES. The purposes of this Act are:

(1) to direct the attorney general to seek a determination from the court under AS 13.36.035 of the state's powers and duties under the mental health trust; and

(2) to make clear that the commissioner of natural resources has the authority to enter into transactions other than sales, leases, or exchanges with respect to mental health land, including the granting of rights-of-way, permits, and other authorizations, while providing for any additional compensation to which the trust might be entitled beyond that already provided by the state.

* Sec. 2. (a) The attorney general will seek a determination from the court under AS 13.36.035 of the state's powers and duties under the mental health trust. At minimum, the attorney general will seek a determination with respect to the following possible resolutions of the mental health trust land controversy:

(1) the approach taken in ch. 48, SLA 1987 (i.e., valuing the original one million acre land grant, exchanging it for land of equal value in legislative designations, and renting it back for 8 percent of its value per year);

(2) making permanent ch. 48's transitional provision (i.e., paying the trust 5 percent of the state's unrestricted general fund revenues) in return for removing mental health land from trust status;

(3) implementing ch. 48 with the value of the original one acre land grant determined to be $2.43 billion, $564 million, or some other value;

(4) eliminating the trust over time by paying the trust for its land and then appropriating the money paid for

mental health programs; and

(5) any other approach for which the attorney general, in his or her discretion, believes it is appropriate to seek a determination from the court whether such an approach might satisfy the state's obligations under the mental health trust.

(b) To enable the legislature to deal with this issue in a timely manner, the attorney general will request that the court give expedited consideration to determining the state's powers and duties as trustee under the mental health trust.

(c) The attorney general will report the court's determination with respect to the state's powers and duties as trustee under the mental health trust to the legislature no later than the tenth day of the First Session, Seventeenth Alaska Legislature.

* Sec. 4. Section 2(d), ch. 132, SLA 1986, as repealed and reenacted in sec. 9, ch. 48, SLA 1987, is amended to read:

(d) The commissioner of natural resources is responsible for the management of the mental health land of the state as public trust under P.L. 84-830, 70 Stat. 709. Except as provided in (e) of this section, the commissioner of natural resources may not sell, lease, or exchange mental health trust land of the state or an interest in the mental health trust land of the state without the prior approval of the commission. In reviewing a proposal for the sale, lease,

or exchange of mental health trust land from the commissioner of natural resources, the commission may approve the proposal of the commissioner on its determination that the proposal is consistent with the terms of the trust established by the Alaska Mental Health Enabling Act. A proposal for something other than a sale, lease, or exchange of mental health trust land of the state, including a proposal for a right-of-way, permit, or other authorization, may be approved by the commissioner of natural resources on a determination that the proposal is consistent with the terms of the trust established by the Alaska Mental Health Enabling Act. A proposal for something other than a sale, lease, or exchange of mental health trust land of the state is consistent with the terms of the Alaska Mental Health Enabling Act if it includes a provision for any additional compensation to which the trust may be entitled beyond the compensation already provided by the state.

* Sec. 7. This Act takes effect immediately in accordance with AS 01.10.070(c).

6-2242D
Bradley
4/27/90

Original sponsor(s): SEN. COGHILL

IN THE SENATE

CS FOR SENATE BILL NO. 493 ( )

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the reconstitution and administration of the mental health trust."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 37.14.011(b) is amended to read:

(b) The amount determined under (c) of this section as the [FAIR MARKET] rental value of the land constituting the mental health trust corpus is the earnings of the trust and the commissioner of revenue shall annually allocate that amount from the general fund to the mental health trust income account.

* Sec. 2. AS 37.14.011(c) is repealed and reenacted to read:

(c) The rental value of the land constituting the mental health trust corpus is equal to eight percent of the value of the land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act. At least every five years, commencing with 1992, the value of the land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act, shall be redetermined as follows:

(1) the number of acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act in each municipality that assesses land for property tax purposes shall be divided by the total number of acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is located in municipalities that assess land for property tax purposes; the result of this division is the "weighting factor";

(2) the weighting factor for each municipality that assesses land is multiplied by the average percentage change in assessed land values for that municipality since that municipality's assessed values were used to revalue land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act; the result is the "weighted value change" for that municipality;

(3) all of the weighted value changes must be added together to arrive at the "revaluation factor," expressed as a decimal;

(4) one plus the revaluation factor must be multiplied by the previous total value of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act to arrive at the redetermined value of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act.

* Sec. 3. AS 37.14.011 is amended by adding a new subsection to read:

(d) The commissioner of natural resources shall calculate the redetermined value of the trust under (c) of this section and provide the redetermined value to the commissioner of revenue and the board established under AS 47.30.661.

* Sec. 4. AS 38.05 is amended by adding a new section to read:

Sec. 38.05.801. RECONSTITUTION AND ADMINISTRATION OF MENTAL HEALTH LAND TRUST. (a) The value of all land selected by or patented to the state under the Alaska Mental Health Enabling Act, as of September 7, 1987, is $2,243,000,000.

(b) All land within legislative designations on the effective date of this Act constitutes the corpus of the mental health land trust.

(c) On reconstitution of the trust under this section, land selected by or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is not within legislative designations

is removed from trust status.

(d) The land within legislative designations that constitutes the mental health land trust shall be administered for the legislatively designated purposes. The state shall continue to manage the legislatively designated areas in accordance with state law and policy; the authority of the state includes the issuance of permits, rights-of-ways, mining leases, oil and gas leases, coal leases, timber contracts, and other actions that do not constitute a conveyance in fee simple. The income from the use of the trust land shall be deposited into the general fund.

(e) Before the state may remove land that is part of the mental health trust corpus from trust status, replacement land, equal in value at the time of replacement, shall be designated mental health land and added to the trust corpus. Before replacement, the commissioner shall identify the land proposed as replacement land and recommend the proposed replacement to the board established under AS 47.-30.661. If the board approves the replacement, the commissioner shall transfer the land to the trust. If the board does not approve the transfer, the question of whether the proposed replacement land is equal in value to the land proposed to be removed from the trust shall be referred for decision to the legislative budget and audit committee.

* Sec. 5. AS 38.05.800 and sec. 2(a), ch. 132, SLA 1986, as amended by sec. 9, ch. 48, SLA 1987, are repealed.

6-2242D
Bradley
4/28/90

Original sponsor(s): SEN. COGHILL

IN THE SENATE BY THE RESOURCES COMMITTEE

CS FOR SENATE BILL NO. 493 (Resources)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the reconstitution and administration of the mental health trust."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 37.14.011(b) is amended to read:

(b) The amount determined under (c) of this section as the [FAIR MARKET] rental value of the land constituting the mental health trust corpus is the earnings of the trust and the commissioner of revenue shall annually allocate that amount from the general fund to the mental health trust income account.

* Sec. 2. AS 37.14.011(c) is repealed and reenacted to read:

(c) The rental value of the land constituting the mental health trust corpus is equal to eight percent of the value of the land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act. At least every five years, commencing with 1992, the value of the land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act, shall be redetermined as follows:

(1) the number of acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act in each municipality that assesses land for property tax purposes shall be divided by the total number of acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is located in municipalities that assess land for property tax purposes; the result of this division is the "weighting factor";

(2) the weighting factor for each municipality that assesses land is multiplied by the average percentage change in assessed land values for that municipality since that municipality's assessed values were used to revalue land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act; the result is the "weighted value change" for that municipality;

(3) all of the weighted value changes must be added together to arrive at the "revaluation factor," expressed as a decimal;

(4) one plus the revaluation factor must be multiplied by the previous total value of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act to arrive at the redetermined value of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act.

* Sec. 3. AS 37.14.011 is amended by adding a new subsection to read:

(d) The commissioner of natural resources shall calculate the redetermined value of the trust under (c) of this section and provide the redetermined value to the commissioner of revenue and the board established under AS 47.30.661.

* Sec. 4. AS 38.05.800 is repealed and reenacted to read:

Sec. 38.05.800. RECONSTITUTION AND ADMINISTRATION OF MENTAL HEALTH LAND TRUST. (a) The value of all land selected by or patented to the state under the Alaska Mental Health Enabling Act, as of September 7, 1987, is $1,800,000,000.

(b) All land within legislative designations on September 7, 1987, constitutes the corpus of the mental health land trust.

(c) On reconstitution of the trust under this section, land selected by or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is not within legislative designations is removed from trust status.

(d) The land within legislative designations that constitutes the mental health land trust shall be administered for the legislatively designated purposes. The state shall continue to manage the legislatively designated areas in accordance with state law and policy; the authority of the state includes the issuance of permits, rights-of-ways, mining leases, oil and gas leases, coal leases, timber contracts, and other actions that do not constitute a conveyance in fee simple. The income from the use of the trust land shall be deposited into the general fund.

(e) Before the state may remove land that is part of the mental health trust corpus from trust status, and in addition to any other requirements of law, the commissioner, consistent with the state's trust responsibilities, shall identify replacement land, equal in value at the time of replacement, within legislative designations and incorporate them into the mental health trust corpus. The commissioner annually shall report any actions under this subsection to the board established under AS 47.30.661.

* Sec. 5. Section 2(a). ch. 132, SLA 1986, as amended by sec. 9, ch. 48, SLA 1987, is repealed.

6-2242D
Bradley
4/28/90

Original sponsor(s): SEN. COGHILL

IN THE SENATE BY THE RESOURCES COMMITTEE

CS FOR SENATE BILL NO. 493 (Resources)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the reconstitution and administration of the mental health trust."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 37.14.011(b) is amended to read:

(b) The amount determined under (c) of this section as the [FAIR MARKET] rental <u>value</u> of the land constituting the mental health trust corpus is the earnings of the trust and the commissioner of revenue shall annually allocate that amount from the general fund to the mental health trust income account.

* Sec. 2. AS 37.14.011(c) is repealed and reenacted to read:

(c) The rental value of the land constituting the mental health trust corpus is equal to eight percent of the value of the land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act. At least every five years, commencing with 1992, the value of the land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act, shall be redetermined as follows:

(1) the number of acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act in each [municipality that assesses land for property tax purposes shall be] divided by the total number of acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is located in municipalities that assess land for property tax purposes; the result of this division is the "weighting factor";

(2) the weighting factor for each municipality that assesses land is multiplied by the average percentage change in assessed land values for that municipality since that municipality's assessed values were used to revalue land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act; the result is the "weighted value change" for that municipality;

(3) all of the weighted value changes must be added together to arrive at the "revaluation factor," expressed as a decimal;

(4) one plus the revaluation factor must be multiplied by the previous total value of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act to arrive at the redetermined value of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act.

* Sec. 3. AS 37.14.011 is amended by adding a new subsection to read:

(d) The commissioner of natural resources shall calculate the redetermined value of the trust under (c) of this section and provide the redetermined value to the commissioner of revenue and the board established under AS 47.30.661.

* Sec. 4. AS 38.05.800 is repealed and reenacted to read:

Sec. 38.05.800. RECONSTITUTION AND ADMINISTRATION OF MENTAL HEALTH LAND TRUST. (a) The value of all land selected by or patented to the state under the Alaska Mental Health Enabling Act, as of September 7, 1987, is $1,800,000,000.

(b) All land within legislative designations on September 7, 1987 constitutes the corpus of the mental health land trust.

(c) On reconstitution of the trust under this section, land selected by or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is not within legislative designations is removed from trust status.

(d) The land within legislative designations that constitutes the mental health land trust shall be administered for the legislatively designated purposes. The state shall continue to manage the legislatively designated areas in accordance with state law and policy; the authority of the state includes the issuance of permits, rights-of-ways, mining leases, oil and gas leases, coal leases, timber contracts, and other actions that do not constitute a conveyance in fee simple. The income from the use of the trust land shall be deposited into the general fund.

(e) Before the state may remove land that is part of the mental health trust corpus from trust status, and in addition to any other requirements of law, the commissioner, consistent with the state's trust responsibilities, shall identify replacement land, equal in value at the time of replacement, within legislative designations and incorporate them into the mental health trust corpus. The commissioner annually shall report any actions under this subsection to the board established under AS 47.30.661.

* Sec. 5. Section 2(a), ch. 132, SLA 1986, as amended by sec. 9, ch. 48, SLA 1987, is repealed.

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

M E M O R A N D U M April 23, 1990

SUBJECT: Mental health land
(CSSB 493 (Resources))

TO: Senator Bettye Fahrenkamp
Chair, Senate Resources Committee

FROM: Richard A. Bradley
Legislative Counsel

Nancy Petersen has requested the enclosed CS.

Some points may be made.

While we have not altered the draft, we note that the "except as provided in (e)" has been repealed in Sec. 4 of the bill. But since (e) itself is not repealed, the authority granted under (e) continues, notwithstanding the elimination of the reference to it.

Note that I added "fee" in the phrase "transfer fee title" in the second sentence; it seems to be what is implied.

I have not revised the third sentence though it seems adequately clear that an exchange may well involve the transfer of the fee; since an equivalency may result, there may have been an implicit acceptance of those transfers.

In that sentence, I have changed "material" to "materials"; compare AS 38.05.110.

If I may be of further assistance, please advise.

RAB:gc
G14/027

Enclosure

6-2242J
Bradley
4/23/90

Original sponsor(s): SEN. COGHILL

IN THE SENATE BY THE RESOURCES COMMITTEE

CS FOR SENATE BILL NO. 493 (Resources)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the reconstitution and administration of the mental health trust; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. FINDINGS. The legislature finds that

(1) in ch. 48, SLA 1987, the legislature enacted a framework for settlement of the mental health trust controversy;

(2) under ch. 48, SLA 1987, it was contemplated that

(A) the state and the plaintiffs and intervenors in the mental health trust land litigation, Weiss v. State, 4FA-82-2208, would reach consensus on procedures to determine the value of the original 1,000,000 acre mental health land grant;

(B) the original mental health land not in legislatively designated areas such as parks and game refuges, would be exchanged for equal value general grant land in such areas;

(C) the original mental health land and the equal value exchange land in those areas then would constitute the mental health trust corpus that the state would lease from the trust for eight percent of its fair market value a year; and

(D) the original mental health land not in legislatively designated areas would be removed from trust status;

(3) the state and the plaintiffs and intervenors in Weiss v. State have been unable to reach consensus on the procedures to be used to value the original 1,000,000 acre land grant and the pool of potential

exchange land, the plaintiffs and intervenors arguing that procedures producing a value of $2,243,000,000 should be used and the state arguing that procedures producing a value of $564,700,000 should be used;

(4) continued controversy over land issues, matters having nothing to do with the state's mental health program, is not in the best interest of either the trust or the public;

(5) instead, it is in the best interest of both the trust and the public to ask the court, before the legislature acts to resolve this matter, to determine under AS 13.36.035 the state's powers and duties as trustee under the mental health trust;

(6) while the process of determining what the state's powers and duties as trustee are, it is in the best interest of both the trust and the public to permit transactions with respect to mental health land, other than fee simple sales, to go forward, as long as the trust is being fairly compensated for the use of its land and the integrity of the mental health trust corpus is preserved;

(7) the trust is currently being compensated for the use of its land under sec. 11, ch. 48, SLA 1987, which requires that five percent of the state's unrestricted general fund revenue be allocated annually to the mental health trust income account, AS 37.14.011;

(8) annually allocating five percent of the state's unrestricted general funds to the mental health trust income account fairly compensates the mental health trust for the current use of its land because

(A) even the most aggressive management of the land for the purpose of generating revenue cannot be guaranteed to generate a given amount of funds;

(B) the dedication of five percent of the state's unrestricted revenue to the mental health trust income account provides predictability in the amount of funds available;

(C) there are no administrative expenses associated with generating funds for the account as there would be if funds had to be generated for the account through aggressive management of the land for that purposes; and

(D) the average per acre earnings for trust lands in other states in fiscal year 1988 was $8.97, the highest per acre earnings, in Washington state because of its prime and easily accessible timber lands, was $45.68, and the dedication of five percent of the state's unrestricted revenue will result in earnings of approximately $100 per acre for the mental health trust;

(9) under sec. 2(d), ch. 132, SLA 1986, as repealed and reenacted in sec. 9, ch. 48, SLA 1987, "the commissioner of natural resources may not sell, lease, or exchange mental health trust land of the state without the prior approval of the [interim mental health trust] commission," a majority of which represents the plaintiffs and intervenors in Weiss v. State;

(10) at its January 25, 1990, meeting, the majority of the interim mental health trust commission representing the plaintiffs and intervenors voted to disapprove further transactions on mental health land, an action which, if allowed to stand, will have serious adverse effects on the economy of the state and, as a result, have serious adverse political consequences for the recipients of mental health services; and

(11) it is in the best interest of both the trust and the public, in light of the compensation currently paid under sec. 11, ch. 48, SLA 1987, for the use of mental health land, to allow transactions other than fee simple land sales or transfers, including leases and exchanges of mental health land, to go forward so long as provision is made to compensate the trust for its loss.

* Sec. 2. PURPOSES. The purposes of this Act are to

(1) direct the attorney general to seek a determination from the court under AS 13.36.035 of the state's powers and duties under the mental health trust;

(2) limit the interim mental health trust commission's disapproval of transactions with respect to mental health land to fee simple land sales or transfers; and

(3) authorize the commissioner of natural resources to enter into transactions other than fee simple land sales with respect to mental health land, including leases, exchanges, material sales, rights-of-way, permits, and other authorizations, while providing compensation to the trust for a loss that is not otherwise compensated for by the state.

* Sec. 3. The attorney general shall seek a determination from the court under AS 13.36.035 of the state's powers and duties under the mental health trust. At minimum, the attorney general shall seek a determination with respect to the following possible resolutions of the mental health trust land controversy:

(1) the approach taken in ch. 48, SLA 1987, that is, valuing the original 1,000,000 acre land grant, exchanging it for land of equal value in legislative designations, and renting it back for eight percent of its value per year;

(2) making permanent the transitional provision of ch. 48, SLA 1987, that is, paying the trust five percent of the state's unrestricted general fund revenue in return for removing mental health land from trust status;

(3) implementing ch. 48, SLA 1987, with the value of the original 1,000,000 acre land grant determined to be $2,430,000,000, $564,000,000, or some other value;

(4) eliminating the trust over time by paying the trust for its land and then appropriating the money paid for mental health programs; and

(5) any other approach which the attorney general believes to be appropriate to seek a determination from the court if the approach might satisfy the state's obligations under the mental health trust.

(b) To enable the legislature to deal with this issue in a timely manner, the attorney general shall request that the court give expedited consideration to determining the state's powers and duties as trustee under the mental health trust.

(c) The attorney general shall report the court's determination with respect to the state's powers and duties as trustee under the mental health trust to the legislature no later than the 10th day of the First Session of the Seventeenth Alaska State Legislature.

* Sec. 4. Section 2(d), ch. 132, SLA 1986, as amended by sec. 9, ch. 48, SLA 1987, is amended to read:

(d) The commissioner of natural resources is responsible for the management of the mental health land of the state as a public trust under P.L. 84-830, 70 Stat. 709. <u>The</u> [EXCEPT AS PROVIDED IN (e) OF THIS SECTION, THE] commissioner of natural resources may not sell <u>or transfer fee title to</u> [, LEASE, OR EXCHANGE] mental health trust land of the state [OR AN INTEREST IN THE MENTAL HEALTH TRUST LAND OF THE STATE WITHOUT THE PRIOR APPROVAL OF THE COMMISSION]. In reviewing a proposal for the [SALE,] lease [,] or exchange of mental health trust land<u>, or for a material sale, other disposal of less than a fee simple interest in mental health trust land, right-of-way, permit, or other authorization, the commissioner may approval the proposal on a</u> [FROM THE COMMISSIONER OF NATURAL RESOURCES, THE COMMISSION MAY APPROVE THE PROPOSAL OF THE COMMISSIONER ON ITS] determination that the proposal is consistent with the terms of the trust established by the Alaska Mental Health Enabling Act. <u>A proposal is consistent with the terms of the Alaska Mental Health Enabling Act if it is not a sale and, for</u>

leases, material sales, and other disposals of less than a fee simple interest, includes a provision for compensating the trust for a loss that is not otherwise compensated for by the state.

* Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

STATE OF ALASKA
1990 LEGISLATIVE SESSION

BILL VERSION: SB493
PUBLISH DATE: 02/22/90

FISCAL NOTE

REQUEST: SB493

Revision Date:
Title: An Act relating to the reconstitution and administration of the Mental Health Trust
Sponsor: Sen. Coghill
Requestor: Sen. Coghill

Agency Affected: Health & Social Services
BRU:
Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY92	FY93	FY94	FY 95	FY 96
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL	0.0	0.0	0.0	0.0	0.0	0.0
REVENUE	0.0	0.0	0.0	0.0	0.0	0.0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

No fiscal impact in FY90.

Prepared by: Richard Rennninger (fe)
Division: Administrative Services
Phone: 465-3331
Date: March 1, 1990

Approved by Commissioner: Mona M Mennon
Agency: Health & Social Services
Date: 3/2/90

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

STATE OF ALASKA
1990 LEGISLATIVE SESSION

BILL VERSION : CSSB 493
PUBLISH DATE :

FISCAL NOTE

REQUEST:

Revision Date: 2-Mar-90
Agency Affected: Natural Resources
Title: An Act relating to the reconstitution and administration of the mental health trust.
BRU: Land & Water Mgmt
Management & Administration
Sponsor: Coghill
Components: Land & Water Mgmt
Requestor: Senate HESS
Commissioner's Office

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS,CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

See Attached

Prepared by: Larry Ostrovsky
Phone : 465-2400
Division: Commissioner's Office
Date : 2-Mar-90

Approved by Commissioner: Lennie Gorsuch
Date: 2-Mar-90
Agency: Department of Natural Resources

Distribution (by preparer) :
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

A M E N D M E N T

Offered in the
Senate Resources Committee

TO: CSSB 493 (HESS)

Page 1, line 8:

Insert the following section and renumber the remaining sections accordingly:

"*Section 1. AS 37.14.011 (b) is amended to read:

(b) The amount determined under (c) of this section as the [FAIR MARKET] rental of the land constituting the mental health trust corpus is the earnings of the trust and the commissioner of revenue shall annually allocate that amount from the general fund of the state to the mental health trust income account"

Page 1, line 10:

Delete "fair market"

Page 1, line 25, after "assessed" insert "land"

Page 2, lines 19 - 20:

Delete "and all land made subject to legislation designations in the future constitute" and insert "constitutes"

Page 2, line 27, following "purposes." delete the last sentence of (d) and insert: "The state will continue to manage the legislatively designated areas in accordance with state policy; the state's authority includes, but is not limited to the issuance of permits, rights-of-way, mining leases, oil and gas leases, coal leases, timber contracts, and other actions that do not constitute a conveyance in fee simple. The state is entitled to all income derived from the use of the trust land."

Page 3, line 10:

Delete all material and insert "*Sec. 5. Sec. 2(a), ch. 132, SLA 1986, and AS 38.05.800 are repealed."

A M E N D M E N T

Offered in the
Senate Resources Committee

TO: CSSB 493 (HESS)

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Page 1, line 10:

Delete "fair market"

Page 1, line 25, after "assessed" insert "land"

Page 2, lines 15 - 17:

Delete subsection (a) and insert the following:

(a) The legislature reaffirms 1987 SLA Chapter 48 (Chapter 48) as a proposed mechanism to settle the Mental

Health Trust Lands litigation (Weiss v. State, 4FA-82-2208 Civil). The legislature accepts the Final Report of the Interim Mental Health Trust Commission on Approved Procedures for Determining the Fair Market Value of Alaska's Mental Health Trust Lands, dated December 20, 1989, and finds that the Commission has satisfied the procedural requirements and followed the process established by Chapter 48. The value of land selected by or patented to the State under the Alaska Mental Health Enabling Act is the value calculated under the procedures approved by the Interim Mental Health Trust Commission by its resolution of November 7, 1989.

(3) Page 2, lines 19 - 20:

Delete "and all land made subject to legislation designations in the future constitute" and insert "constitutes"

Page 2, line 27, following "purposes." delete the last sentence of (d) and insert: "The state will continue to manage the legislatively designated areas in accordance with state policy; the state's authority includes, but is not limited to the issuance of permits, rights-of-way, mining leases, oil and gas leases, coal leases, timber contracts, and other actions that do not constitute a conveyance in fee simple. The state is entitled to all income derived from the use of the trust land."

(4)

Page 3, line 10:

Delete all material and insert "*Sec. 5. Sec. 2(a), ch. 132, SLA 1986, and AS 38.05.800 are repealed."

MENTAL HEALTH TRUST CORPUS
REVENUES
STATE CONSERVATION SYSTEMS
(pre 1987)

Designation	Annual Revenue	Source
Parks	$160,000	user fees, permits & concessions
Public Use Areas	$100,000	leases, timber, gravel sales, permits
Forests	$150,000	timber sales
Refuges	$2,500,000	oil & gas rents and royalties
9.5 million acres	$2,910,000	

These estimates are approximate and reflect averages and activities with variable terms.

BREAKING THE MENTAL HEALTH LAND IMPASSE

As a possible means of breaking the current impasse over mental health land, the state could ask the court for instructions before taking further legislative action to resolve the controversy. Unlike the normal situation where the courts only decide whether legislative action is legal after the Legislature acts, courts will give advisory opinions when a trust is involved. Trustees can obtain such advisory opinions by asking the court for instructions with respect to trust administration. See Restatement (Second) of Trusts § 259 (1959); AS 13.36.035(a), especially subsection (3).

The obvious advantage to asking the court for instructions is that the court can answer all of the legal questions surrounding various policy options before the Legislature decides, as a policy matter, which option is most appropriate. By limiting its consideration to those options which the court will already have ruled are consistent with the state's powers and duties as trustee, the Legislature will know that, whatever option it chooses, it will be acting consistently with the trust.

Questions which could be asked include:

1. Is the approach taken by the Legislature in chapter 48, SLA 1987 -- i.e., valuing the original one million acre land grant, exchanging it for land of equal value in legislative designations, and renting the land back for 8 percent of its value per year -- consistent with the state's trust obligation? Could other percentages -- 5? 10? etc.? -- be used?

2. Would it be consistent with the trust to make permanent chapter 48's transitional provision -- paying the trust 5 percent of the state's unrestricted general fund revenues -- in return for removing mental health land from trust status? Could other percentages -- 2? 8? etc.? -- be used?

3. Would determining the value of the original one million acre land grant to be $2.43 billion, as the Weiss plaintiffs' representatives on the Interim Mental Health Trust Commission believe and as reflected in SB 483 and HB 548, be consistent with the trust? Would determining it to be $564 million, as the Department of Natural Resources believes, be consistent?

4. May the state eliminate the trust over time by paying the trust for its land and then appropriating the money paid for mental health programs? Normally, trustees may not expend trust principal. In the Weiss case, however, the court said the state must reimburse the trust for the fair market value of all mental health land which the state has sold, but that the state should receive a set-off against that liability for mental health expenditures and that the state, as a consequence, may end up with no monetary liability to the trust. If the state can sell mental

health land and spend the proceeds, the state presumably also could eliminate the mental health trust over time by purchasing land from the trust and then spending the money for mental health programs.

Other questions also could be asked, limited only by the ingenuity of those considering this issue. The primary point is that the Legislature would know the answers before acting, and not be subject to judicial second-guessing after-the-fact.

VALUATION PROCEDURES

Valuation Procedures were obtained through extensive review of all methods of land valuation used by real estate and natural resources assessors. They were determined after adoption of standard and specific industry methodologies, modified for use within the severe constraints of available time and money. Above all, Commission actions reflected the necessity for deriving fair market value — instead, for example, of obtaining an inflated value — from the procedures in order to assure fairness to all residents of Alaska.

1. Surface Estate

Procedures: The difference between the results of the State appraisal and that of the Plaintiffs, split equally between the two values, was approved.

Methods Explored: The original procedure provided for an *opinion of value* process by three geo-panels of appraisers, an opportunity for review and questioning by interested parties, referral back to the panels for re-evaluation of their original values when necessary, and mediation, including the possibility of site visits.

However, due to the large number of questioned values and the limited funds available, the Commission agreed to use a *sampling strategy* for the review. Results varied widely. The State assigned a value of $499.8 million. The Plaintiff's appraisers assigned a value of $833,280,096.

Decision of Commission: The Commission recognized that such differences are usually resolved through mediation. However, mediation was not an option due to limited funds. The Commission determined that the only reasonable procedure it could approve was to split the difference between the two figures.

2. Timber

Procedure: The methodology, data, assumptions and judgments utilized in *An Economic Evaluation of Timber Potential on Mental Health Grant Lands and Legislatively Designated Replacement Lands - Final Report* by McMahon, Wallingford, and Wehrman, August, 1988 was approved.

Opinion of the Plaintiff: The Plaintiffs disputed the appropriateness of deducting the approximately $31 million in reforestation costs, because the timber should be valued as if "sold" to the State as "standing timber."

Decision of Commission: The Commission regarded these costs as essential to sustained yield forest management and because the original selections were made with the intention that they would become the core of a State forest system.

3. Oil and Gas

Procedure: The methodology, data, assumptions and judgments utilized in the *Hydrocarbon Potential of Mental Health Grant (Trust) Lands and Legislatively Designated Replacement Pool Lands in Alaska* by Ariey, Hansen, Kornbrath, Philips, Ryherd and Smith, July, 1988, with the fair market value being the midpoint between the low to the high range, was approved.

Opinion of the Plaintiff: The Plaintiffs assert the State's analysis did not follow the procedures approved by the Commission and that the value range appears grossly low, although no separate valuation was submitted to support this assertion.

Decision of Commission: The Commission rejected the assertion, in light of the lack of any specific valuation from the Plaintiffs.

4. Minerals, Coal and Aggregate

Procedure: The methodology, data assumptions and judgments utilized in *Mineral, Coal and Aggregate Resource Appraisal of Alaska Mental Health Trust Lands* by Paul Metz and Colin Dixon, dated Decebmer 31, 1988 was approved.

Methods Discussed: The industry standard for valuation of minerals, coal and aggregate is the *income or discounted cash flow approach.* This approach, adopted by the Commission, resulted in an estimated $1.5 billion value. DNR used the *comparable sales approach*, which produced an intial value of zero and later, after revision, a value of approximately $16 million.

Decision of Commission: The Commission rejected the use of the comparable sales approach because it was 1) not in accordance with accepted industry valuation practices, 2) considered unrealistic and unreasonable in light of the fact that these lands were all within the three major active mining districts of Alaska and had been selected by a team of experts as representing the most promising lands in these areas, 3) not pursued with any sort of rigor by the State, and 4) not supported by its own independent study.

ALASKA'S MENTAL HEALTH TRUST LANDS

A Summary of

Procedures For Determining the Fair Market Value of Alaska's Mental Health Trust Lands

March, 1990

OVERVIEW

The Interim Mental Health Trust Commission approved its *Procedures for Determining the Fair Market Value of Alaska's Mental Health Trust Lands* on Dec. 20, 1989. The Department of Natural Resources (DNR), in a dissenting report released Feb. 1, 1990, disputed the Commission's findings.

The Commission, DNR, and the Plaintiffs in the Mental Health Trust Lands lawsuit have now reached a standstill. At stake are services for developmentally disabled and seriously mentally ill individuals, including senior citizens with Alzheimer's and dementia and alcoholics with psychoses, as determined by Judge Greene in the 1988 **Weiss v. State** decision. These persons are the beneficiaries of the trust.

Using valuation procedures adopted by the Commission, the total value of the original one million acre trust is $2.2 billion. Under DNR's valuation procedures, this figure approximates only $564 million. This difference amounts to over $1.6 billion.

The Legislature must now reaffirm the process it established in 1986, when it created the Commission and in 1987, when it passed Chapter 48, SLA 1987, of effecting a resolution of the litigation. It must either confirm the work adopted by its mandated Commission or provide sufficient funds to allow for complete valuation.

Without legislative action, Plaintiffs to the lawsuit may be forced to challenge title to approximately 750,000 acres of Mental Health Trust lands and take other actions, as necessary steps to protect their rights against the continuing breach of the trust by the State of Alaska in properly discharging its fiduciary responsibilities in managing the trust.

RECOMMENDATIONS

Beneficiaries of the Mental Health Trust, through the Mental Health Trust Coalition, recommend that the Legislature:

1. recognize the dilemma over valuation procedures; and
2. intervene on behalf of disabled people to confirm the Commission's adopted valuation procedures; and
3. pass legislation that acknowledges the Commission's work under Chapter 48 and adopt its conclusions in the Final Report.

BACKGROUND

This brochure is based on the results of the Mental Health Trust Commission's report of Dec. 1989 and borrows heavily from other documents used to develop the procedures. It identifies the valuation procedures approved by the Commission, indicates points of agreement and disagreement, and recommends action to resolve the issue.

The Mental Health Trust Coalition, formed in Fall, 1989, represents the beneficiaries. Its express purpose is to be an active voice in administrative, legislative, judicial and other matters which may affect the provision of services for these disabled individuals.

The Coalition endorses the Commission's Final Report, *Approved Procedures for Determining the Fair Market Value of Alaska's Mental Health Trust Lands.* Its conclusions were the result of several years of intensive research, analysis, negotiation, scrutiny, and public review, which have combined to create procedures widely accepted as industry standard, within the necessary constraints of time and money.

The task given to the Commission was an exceedingly difficult one, one which was made even more difficult by the discord among the members over which procedures were acceptable to consider and the exact application of the term **fair market value** in consideration of those procedures. Of concern to observers of the process was the apparent lack of good faith and unwillingness of DNR to reach a compromise.

As the Commission noted in its report, "the actual task of arriving at satisfactory valuation procedures was much bigger, complicated and controversial than anyone initially envisioned. Indeed, for a brief period between April and July, 1989, the Commission considered publicly stating that "continued work on valuation procedures no longer appeared possible."

Part of the problem may lie in the composition of the Commission itself. During the entire process, the State of Alaska has had a built-in conflict of interest. Not only does the Commissioner of Natural Resources sit on the Commission, but the Commission must submit its report to the Commissioner, who then decides whether or not to agree with the Commission's majority viewpoint.

The second conflict of interest lies in the assignment of a single Attorney General (AG) to act as counsel both to DNR and to the Commission. Again, if all three Commissioners were in agreement, any conflict of interest would be suppressed or minimized by agreement. However, as long as DNR is in the minority, the AG must answer to two masters. Throughout the entire process, it became clear that the AG has consistently taken the side of the State.

Between June 9, 1986 and November, 1989 the Commission held over 30 meetings, all open to the public, for discussion of the valuation procedures. Because the Coalition has a vested interest in the Commission's proceedings, representatives have attended almost every meeting. On our own initiative, we have independently hired consultants to review industry-accepted standard valuation procedures of the various categorical lands and requested the right to present their findings to the Commission. Due to the open nature of the meetings, the Commission granted this right.

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AMI

State of Alaska
Refuges, Forests and Parks

February 1990

Name	Statute	Acres
Fish & Game Designations (AS 16.20)		
Walrus Island State Game Sanctuary	(AS 16.20.090-140)	9,700
McNeil River State Game Sanctuary	(AS 16.20.160-170)	83,800
	Total sanctuary acres	**93,500**
Palmer Hay Flats State Game Refuge	(AS 16.20.032)	26,000
Mendenhall Wetlands State Game Refuge	(AS 16.20.034)	3,800
Susitna Flats State Game Refuge	(AS 16.20.036)	300,800
Trading Bay State Game Refuge	(AS 16.20.038)	160,960
Cape Newenham State Game Refuge	(AS 16.20.030)	14,000
Izembek (Lagoon) State Game Refuge	(AS 16.20.030)	181,440
Creamer's Field Migratory Waterfowl Refuge	(AS 16.20.039)	1,664
Goose Bay State Game Refuge	(AS 16.20.030)	10,880
Anchorage Coastal Wildlife Refuge	(AS 16.20.031)	32,500
Minto Flats State Game Refuge	(AS 16.20.037)	500,000
	Total refuge acres	**1,232,044**
Port Moller Critical Habitat Area	(AS 16.20.550)	127,000
Port Heiden Critical Habitat Area	(AS 16.20.555)	72,000
Cinder River Critical Habitat Area	(AS 16.20.560)	26,000
Egegik Critical Habitat Area	(AS 16.20.565)	8,000
Pilot Point Critical Habitat Area	(AS 16.20.570)	46,000
Kalgin Island Critical Habitat Area	(AS 16.20.575)	3,500
Fox River Flats Critical Habitat Area	(AS 16.20.580)	7,100
Chilkat River Critical Habitat Area	(AS 16.20.585)	4,800
Kachemak Bay Critical Habitat Area	(AS 16.20.590)	222,000
Clam Gulch Critical Habitat Area	(AS 16.20.595)	2,500
Copper River Delta Critical Habitat Area	(AS 16.20.600)	597,000
Anchor River & Fritz Creek Critical Habitat Area	(AS 16.20.605)	19,000
Tugidak Island Critical Habitat Area	(AS 16.20.615)	50,240
Dude Creek Critical Habitat Area	(AS 16.20.610)	4,083
Willow Mountain Critical Habitat Area	(AS 16.20.620)	22,720
Redoubt Bay Critical Habitat Area	(AS 16.20.625)	183,640
	Total critical habitat area acres	**1,395,583**
Forestry Designations (AS 41.15-17)		
Tanana Valley State Forest	(AS 41.17.400)	1,786,000
Haines State Forest Resource Mgmt. Area	(AS 41.15.300-330)	247,000
	Total forestry acres	**2,033,000**

Park Units (AS 41.21-23)

Chilkat State Park	(AS 41.21.111-120)	6,045
Chugach State Park	(AS 41.21.121-125)	495,000
Kachemak Bay State Park	(AS 41.21.131-134)	165,370
Kachemak Bay State Wilderness Park	(AS 41.21.140-143)	210,240
Denali State Park	(AS 41.21.151-152)	421,120
Wood/Tikchik State Park	(AS 41.21.161-167)	1,428,320
Shuyak Island State Park	(AS 41.21.172-178)	11,000
Pt. Bridget State Park	(AS 41.21.181-183)	2,800
Marine Parks:	(AS 41.21.300-306)	*14,440

Beecher Pass, Bettles Bay, Chilkat Islands, Dall Bay, Funter Bay, Horseshoe Bay, Joe Mace Island, Oliver Inlet, Saint James Bay, Sawmill Bay, Security Bay, Shelter Island, Shoup Bay, South Esther Island, Sullivan Island, Surprise Cove, Taku Harbor, Thoms Place, Zeigler Cove

* does not include 22,510 acres of water

Captain Cook State Recreation Area	(AS 41.21.415-425)	3,620
Caines Head State Recreation Area	(AS 41.21.435-445)	5,961
Nancy Lake State Recreation Area	(AS 41.21.455-465)	22,685
Chena River State Recreation Area	(AS 41.21.475-490)	254,080
Willow Creek State Recreation Area	(AS 41.21.491-495)	3,583
Kenai River Special Management Area	(AS 41.21.502-514)	2,693
Alaska Chilkat Bald Eagle Preserve	(AS 41.21.611-630)	49,000
	Total Park Acres	**3,095,957**

Other Designations

Delta Junction Bison Range Area	(AS 16.20.300)	*72,000
Matanuska Valley Moose Range	(AS 16.20.340)	**132,500
Nelchina Public Use Area	(AS 41.23.010-040)	2,350,000
Hatcher Pass Public Use Area	(AS 41.23.100-130)	5,100
Ernie Haugen Public Use Area	(AS 41.23.050-080)	420
Recreation Rivers:	(AS 41.23.400-510)	***243,000

Alexander Creek, Kroto Creek & Moose Creek, Lake Creek, Little Susitna River, Talachulitna River, Talkeetna River

Total other designations 2,803,020

* does not include additional 17,500 acres within military withdrawal

** does not include selected land

*** does not include borough or private land

NOTE: Most figures are approximate and many include tide and submerged acreage. Fish & Game estimates that half of the acreage designated in Title 16 is submerged.

Fish & Game designations	2,721,127
Forestry designations	2,033,000
Park designations	3,095,957
Other designations	2,803,020
Total legislative designations	10,653,104

Alaska Department of
NATURAL
RESOURCES

METZ, DELONG & ASSOCIATES
CONSULTING MINING GEOLOGISTS
P.O. BOX 73606
FAIRBANKS, ALASKA 99707
PHONE (907) 479-2874

MINERAL, COAL, AND AGGREGATED RESOURCE
APPRAISAL OF
ALASKA MENTAL HEALTH TRUST LANDS
BY
PAUL A. METZ and COLIN DIXON

December 31, 1988

C O N F I D E N T I A L

MINERAL, COAL, AND AGGREGATE RESOURCE APPRAISAL

OF

ALASKA MENTAL HEALTH TRUST LANDS

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PAUL A. METZ and COLIN DIXON

December 31, 1988

prepared at the Request of

DAVID T. WALKER, ESQ., and JAMES B. GOTTSTEIN, ESQ.

for

The Interim Mental Health Trust Commission

C O N F I D E N T I A L

TABLE OF CONTENTS

Appendices

Tables

Introduction

The United States Congress passed the Alaska Mental Health Enabling Act of 1956, P.L. No. 84-830, 70 Stat. 709, "To confer upon Alaska autonomy in the field of mental health, transfer from the Federal Government to the Territory the fiscal and functional responsibility for the hospitalization of committed mental patients, and for other purposes." In Sec. 202 of the Act, Congress granted the territory the right to select up to 1,000,000 acres of federal land to serve as a source of revenue to support a mental health program in Alaska. In subsection (202)e, the Alaska Mental Health Enabling Act specifically prescribed that the land grant and any income from the land grant be administered as a "public trust and such proceeds and income shall be applied to meet the necessary expenses of the mental health program of Alaska."

The Tenth Alaska State Legislature enacted Chs. 181 and 182, SLA 1978, which in part reclassified mental health lands as general grant lands. The Supreme Court of the State of Alaska held that the Act established a public trust and that the Tenth Legislature breached that trust by reclassifying mental health land as a general land grant. State v. Weiss, 706 P.2d 681 (Alaska 1985). As a remedy the court ruled that former trust land still in state ownership be returned to the

trust and that the trust be compensated for the fair market value of former trust lands that were sold, disposed, or transferred from state ownership less the value of state expenditures for the mental health program up to the time of disposition. Id. at 683-684.

In 1987 the Alaska Legislature passed an Act Relating to the Alaska Mental Health Trust to: establish a Mental Health Trust Income Account, Reconstitute and provide administrative structure for the Mental Health Land Trust, and establish the Alaska Mental Health Board. In Sec. 2C of this act, Alaska Statute 37.14.011 is amended to direct the Commissioner of Natural Resources (the "Commissioner") to determine the fair market value as of September 6, 1987 of the lands selected by and patented to the state under Sec. 202 of the Alaska Mental Health Enabling Act.

Although the Commissioner has initiated some action to comply with Alaska Statute 37.14.011 in "Minerals, Coal, and Aggregate Potential of Alaska Mental Health Trust and Related Lands", by the Staff of the Alaska Division of Geological and Geophysical Surveys ("ADDGS"), January 4, 1988 and "Hydrocarbon Potential of Mental Health Grant (Trust) Lands and Legislatively Designated Replacement Pool Lands in Alaska (with Coal Valuation) by Ariey, Hansen, Kornbrath, Phillips, Ryherd and Smith, July 1988, these reports do not place a fair

market value on the subject lands as required by law. The purpose of this report is to provide an estimate of the contribution of metallic minerals, coal, and sand and gravel resources to the fair market value of the subject lands.

This report is divided into four parts. Part I covers metallic mineral resources, Part II covers coal resources, Part III covers sand and gravel resources, and Part IV presents the summary and conclusions. The divisions are necessary not only to distinguish the major commodity groups but to separate the distinctly different evaluation methods for the three groups.

Part I -- Metallic Mineral Resources

Previous Investigations

Harris (1968) made a probabilistic regional appraisal of the base and precious metal resources in 126 million of the 375 million acres of Alaska. The model was based on a comparison of the base and precious metal mineral wealth of a control area including parts of Arizona, New Mexico and Utah that total 99 million acres. In selecting the appraisal technique Harris (1968) examined two basic methodologies.

The first is a simple appraisal based on a comparison of mineral density of the control area relative to the mineral density of Alaska. Mineral density is defined as the sum of the gross value of mineral production plus the gross value of proven mineral reserves divided by the total land area. The relatively well explored control area of Arizona and New Mexico had a base and precious metal density of $270,000 per square mile in 1967 while the area of Utah had a comparable density of $299,000 per square mile. The price vector for the gross metal value estimates was: Au, $35.00/oz; Ag, $1.30/oz; Pb, $0.14/lb; Zn, $0.13/lb; Cu, $0.30/lb. Adjusting the above base metal price with the wholesale price index would result in calculated base metal prices nearly equivalent to actual prices in 1987. Adjusting the above mineral densities with

the August 1987 Consumer Price Index (CPI) relative to 1967 of 342.7 (Department of Commerce, 1988) would result in estimated densities of $754,000 and $1,025,00 per square mile, respectively. The above estimates would understate the true densities since precious metal prices have increased five fold for silver and 12.9 fold for gold. Assuming that the precious metals account for 50 percent of the gross metal value and that the average precious metal index is 800, the densities in 1987 would have been $1,290,000 and $1,760,000 per square mile, respectively.

The mineral density method does not directly account for the relationship of differences in geology to differences in mineral wealth. This is a fundamental limitation of the method and it follows from the above limitation that the mineral density method does not account for extremely high density values in historic mining districts and values approaching zero outside such districts.

In order to avoid this limitation, Harris (1968) divided the control area up into 387 unit cells (20 miles by 20 miles) and the area of interest in Alaska into 493 unit cells. For each cell in the control area, 25 geologic parameters were defined and measured. The cells were divided into three groups, group one density of $10,000, group two density of $10,000-$100,000,000 and group three density greater than

$100,000,000. A discriminant analysis was then completed on the control area cells to determine the contribution of the various geologic parameters to the assignment of the various cells to each of the groups. The discriminant equations explained between 25 and 75 percent of the variance between the groups. From the discriminant functions, probabilities were calculated for the assignment of each cell in the study area to a particular group. Expected values were then determined for each cell in Alaska.

The result indicated five cells with gross metal value that would exceed $400 million (1967 dollars) and sixteen additional cells that range from $100 million to $400 million. The total gross value of these 21 cells is estimated at $5.7 billion (1967 dollars). The value of these cells is based primarily on gold mineralization. Thus in 1987 dollars the total gross metal value would have been 12.9 x 5.7 billion = $73.5 billion. The mineral density of the five highest cells in 1987 dollars would have exceeded $12.9 million per square mile or $20,000 per acre.

Harris (1968) considered the appraisal conservative due to the very limited extent of outcrop in Alaska (large amount of alluvial and vegetative cover) and the limited availability of geologic data.

The U.S. Geological Survey ("USGS") was called upon to prepare an appraisal of the mineral resources of Alaska as part of the drafting process of the Alaska National Interest Lands Conservation Act. The results of the appraisal were published as USGS Open-File Reports 78-1-B through F (Grybeck and DeYoung, 1978; Hudson and DeYoung, 1978; Eberlein and Menzie, 1978; MacKevett, Singer, and Holloway, 1978; and Patton, 1978). These investigations utilized the Delphi method whereby each of several U.S. Geological Survey experts examined the geologic literature for a particular area and estimated the number of mineral occurrences of particular ore deposit types in that area at the 10th, 50th, and 90th percentile levels of confidence. An average tonnage and grade for each deposit type was estimated from producing ore deposits in other parts of the world. The investigation does not allow direct calculation of either total gross metal content or gross metal value since the percentile estimates are not probabilities.

In order to expand the utility of the above USGS reports and to estimate the total number of probable mineral deposits with a particular average grade, Charles River Associates (1978) assumed two common discrete probability distributions (the Poisson and the negative binomial) and fitted these distributions to the percentile data. This resulted in the determination of an expectation of the number of mineral

occurrences for each area of the USGS investigations. From the average tonnage and grade data an expected gross metal content could be estimated for all the areas included in the USGS appraisal.

The above two investigations were limited by the same constraints as the Harris (1968) investigation. In addition, the studies did not include all metallic mineral deposit types nor did they include industrial minerals. Neither of the investigations resulted in a value per unit area estimate.

Metz (1987) examines the mineral potential of a 18,936 square mile area of Interior Alaska. A portion of the area includes several mining districts with significant placer gold production, known lode mineralization, and recent detailed geologic mapping and geochemical sampling. From the number of known mineral occurrences, geochemical anomalies, and probabilities of discovery of particular deposit types, and the mean gross metal value of each deposit type, an expected gross metal value and mineral density is estimated for each of the four areas as follows:

1. Birch Creek Drainage
   a. Gross metal value: $2.3 billion
   b. Mineral density: $420,000 per square mile or $656 per acre.

2. Beaver Creek Drainage
   a. Gross metal value: $17.9 billion.
   b. Mineral density: $4.74 million per square mile or $7,400 per acre.

3. Fortymile River Drainage
   a. Gross metal value: $29.0 billion
   b. Mineral density: $4.80 million per square mile or $7,500 per acre.

4. Minto Flats Drainage
   a. Gross metal value: $23.3 billion
   b. Mineral density: $6.41 million per square mile or $10,000 per acre.

The range in density estimates reflect the diverse geology of the four areas and the limited geological data available due to the sparse outcrop particularly in the Birch Creek drainage relative to the other drainages. However the estimates for Beaver Creek, Fortymile River and the Minto Flats drainages are in the same order of magnitude as the constant dollar adjusted estimate from Harris (1968).

The ADGGS Staff Report (1988) is another attempt to use the Delphi methodology. This methodology is also used by Harris and Azis (1970); Barry and Freeman (1970); Harris (1973); Freyman and Barry (1971); Harris and Euresty (1973) for various mineral resource appraisals in western USA and Canada.

For the evaluation of the potential metallic mineral resources of the Alaska Mental Health Lands, ADGGS reviewed pertinent data by 1:250,000 scale quadrangle. Areas with potential for the discovery and development of one or more

mineral deposit types were rated on a scale of one to five indicating very low to very high potential, respectively.

Of the 27 mineral deposit models described by the ADGGS, only 21 were considered to occur in the subject lands. The ADGGS mineral deposit models are only qualitatively defined and contain no tonnage or grade data. Tonnage and grade data are essential in determining gross metal value of each expected deposit and the expected net present value of the subject lands. Such tonnage and grade data are available for the various mineral deposit models in Cox and Singer (1986).

The ADGGS mineral potential estimates of one through five are relative estimates only and are not probabilities of the discovery and development of a mineral deposit. Without some probability estimate, expected mineral values of the Alaska Mental Health Lands could not be determined from the ADGGS Staff Report (1988). Such probability estimates could be made from the data of Koulomzine and Dagenais (1959), Bailey (1964), Charles River Associates (1978), Peters (1978), and DeGeoffroy and Wignall (1985).

Methodology

General Assumptions

Harris (1984 at p.1) provides a succinct perspective on mineral resource appraisal.

> "Mineral resources exist only with respect to an economic and technological framework. A useful statement on mineral resources must also be a statement on specific economic conditions, technological capabilities, and the state of nature.
>
> The term 'mineral' resources includes reserves, those accumulations of a mineral that are known and have been explored to the extent that there is reasonable assurance that the mineral could be produced from them economically, and minerals in known deposits that cannot be exploited economically. Together, these two kinds of mineral resources comprise the category of known resources, for these are the resources that we know most about and for which we have an immediate interest because of their support of current and near-future economic activities.
>
> Appraisal of unknown resources, the category of resources that we know least about, is the subject of this book. These resources consist of both economic and subeconomic unknown resources. Obviously, the motivation for the appraisal of unknown resources must stem from issues that relate to a moderate- or long-term time frame. Such issues may include resource adequacy and mineral policy, issues that recently have received considerable attention and, in the case of oil, have become topics of household conversation. While these issues may be of primary concern to governments, because of the time lag from exploration to production, the large mineral firm also may be motivated to examine the long-term outlook for mineral consumption and potential mineral supply, hence mineral resources.
>
> There is no elegant nor ultimately definitive means for estimating unknown mineral resources short of direct sampling of the earth's crust, e.g.

> drilling at a spacing sufficient to locate and delineate the mineral deposits. While such a programme would most assuredly provide the best possible data for the appraisal of resources, it has not been demonstrated to be the most efficient means for appraisal, although some scholars urge its implementation (Ridge, 1974). Arguments justifying such a programme on the basis of economics have so far been superficial. At present, and probably in the future, unknown resources are inferred by models, hopefully founded on fact, of aspects of the economic-physical system within which resources are defined."

The concept that unknown resources can be appraised implies that within economic conditions, technological capabilities and the state of nature unknown resources have value. Value is a function of the expectation of their existence and the degree of effort expended in their discovery and development. The conversion of resources into reserves is a time consuming and expensive process that greatly increases the value estimates. In this appraisal, we will be considering primarily unknown resources although there are considerable proven reserves on some lands adjacent to the subject lands. In order to complete the appraisal, the following assumptions are necessary.

First, within the next twenty years, world economic conditions are not expected to be significantly different than today. Demand for mineral commodities will remain similar to current levels. Production from Alaska or lack thereof will not affect world markets. There will be no differential

inflation with respect to mineral commodities and there will be no price controls imposed on mineral commodities. All the metallic mineral commodities to be produced from the subject lands can be sold on the world market at the prevailing prices.

The time frame of twenty years is utilized since major deposits (gross metal value over $1 billion) would be evaluated on a twenty year mine life. Smaller tonnages of ore for bulk mineable deposits would not provide economies of scale. However, small high grade deposit types may have smaller reserve bases and thus mine lives less than twenty years. Additional reserves over the minimum mine life will have little effect on the net present value even at low interest rates. This does not mean that the ultimate mine life may not be many multiples of twenty years. For instance Almaden mercury mine, Spain, has been in continuous production for 400 years, Rio Tinto copper-pyrite mine, Spain, for over 100 years, and Bingham Canyon copper mine, Utah, for about 80 years.

Brooks (1976) has modeled mineral supply as both a fixed stock and as a flow. A given mineral deposit is expected to have a finite life within its dimensional limits. However there is increasing evidence that metallogenic provinces and even mining districts within metallogenic provinces may act as

large reservoirs of mineral supply. Thus the flow model may be appropriate to both global supply and regional supply. Increasing regional metal production at decreasing constant dollar price level over the last century supports the flow model on at least the metallogenic province level. Since Alaska Mental Health Trust Land extend over several metallogenic provinces, the expected life of metal production from these lands will exceed our 20 year time frame.

Worldwide demand functions for the various mineral commodities have changed dramatically during this century but have remained relatively predictable over the last twenty years. Aluminum consumption has increased 1300 times since 1900 while tin consumption doubled in the same time period. Over the last two decades the aluminum and tin consumptions have changed by annual compound rates of 2 percent and -1.5 percent respectively. With relatively constant rates of growth in consumption, metal prices are expected to change at the same rate as the general price level and thus there will be no differential inflation. Thus prices of mineral commodities and the factor inputs for production in 1987 can be utilized to calculate discounted cash flows over the next twenty years.

Second, there will be no technological changes over the next twenty years that will affect either the demand for

mineral commodities or the costs of production. Current levels of technology are adequate to produce the mineral commodities that are expected to be found on Alaska Mental Health Lands. In addition current costs of production in Alaska particularly in areas of the Mental Health Trust Lands are comparable for comparable deposits in other parts of the world.

Third, there are several significant differences in the state of nature with respect to mineral deposits in Alaska versus other areas of western USA and Canada. Alaska has been subjected to considerably less public and private sector exploration activity than the above areas and thus it is expected that the marginal cost of exploration per dollar value of mineral commodity discovered will be less. This is a well recognized function in under-developed and under-explored regions of the world.

Since the mid to late 1970's mineral explorationists and mining geologists have begun to recognize the relationships between global plate tectonics and the concentration of metals in ore deposits (Mitchell and Garson, 1976, 1981). Specifically, metals are concentrated in the earth's crust due to the transfer of energy (primarily thermal) and mass. Plate boundaries are regimes of energy and mass transfer and thus are foci for metal deposit formation. Jones et al (1981) note

that Alaska is formed by a collage of micro-plates thus the region is composed of an anomalously high concentration of plate boundaries. This high concentration of plate boundaries should also result in a higher than worldwide average concentration of ore deposits. Similarly the size of ore deposits is related to the total energy and mass transfer, thus it is expected that ore deposits in Alaska may be anomalously large as well as anomalously numerous per unit area.

This anomalous size phenomenon is exemplified by the fact that although essentially unexplored Alaska contains the largest sedimentary-exhalative massive sulfide deposit (Red Dog) and the largest of the molybdenum porphyry type deposits (Quartz Hill) in the world. Also, the Alaska Juneau Mine was the largest underground bulk mineable gold deposit in the world. The Kennecott Mine was a major copper producer with an extremely high grade and no analogue deposit has been discovered in any other part of the world. The gold placer deposits of Fairbanks and Nome are giants by worldwide standards and precoursers to the recent major lode discoveries in these two mining districts. The Goodnews Bay platinum deposit remains the largest U.S. source of platinum, the tin granites of the Seward Peninsula contain 90 percent of the U.S. tin resources, and the Ni-Cu-Co deposits of Brady Glacier contain most of the U.S. resource of cobalt.

From the above and from the fact that higher grade deposits are discovered and utilized first, it can be inferred that the major mineral deposits to be discovered in Alaska over the next few decades will have tonnages and grades that will greatly exceed the worldwide averages.

As a final state of nature it is assumed that there was in 1987 legal access to the mineral resources on the Mental Health Lands. Furthermore, the Trust would act as any other landowner with respect to the economic rent it charged on its land for mineral resource extraction and that prudent mineral industry decision makers would not be adversely affected by the litigation and recent legislation with respect to the subject lands.

Delphi Method

Dalkey (1969) describes the Delphi Method and Harris (1984) details its use in various mineral resource appraisals. For this appraisal we supplement the Delphi procedure of ADGGS. The mineral deposit types described in the ADGGS Staff Report (1988) and assigned to the various parcels of Mental Health Trust Lands were correlated with the mineral deposit models of Cox and Singer (1986). The models of Cox and Singer (1986) are much more comprehensive and descriptive than the ADGGS models but more importantly the former models include

tonnage and grade data from numerous analogue deposits that are currently in production in various locations worldwide (See Appendix A).

The second step of this investigation is to calculate probabilities of discovery and development of each mineral deposit type. The categories of potential (one through five) assigned by ADGGS to each parcel (section) of the subject land must be considered in the calculation of the above probabilities.

As previously discussed the USGS mineral potential assessment in Open-File Reports 78-1-B through F (1978) do not directly provide probabilities of discovery of commercial deposits. Charles River Associates (1978) calculate probabilities for various deposit types for each area of the USGS inventory. The expected number of deposits for the various areas in the USGS investigation ranged from 0.55 to 51.21. On a per acre basis these expectations can be restated as probabilities that range from 1 in 1×10^6 to 1 in 3×10^5.

The above probabilities, although small, agree well with the range of probabilities for success in regional exploration programs for metallic minerals in Canada and other parts of the United States (Koulomzine and Dagenais, 1959; Bailey, 1964, and Peters, 1978). North American exploration activity

over the last 40 years has resulted in the discovery of at least one major mineral deposit (gross mineral value in excess of $1 billion) for every one thousand mineral properties examined. Although mineral properties constituting a mineral holding have a great range in size an average of about 1000 acres per property is assumed.

In Alaska there have been approximately 250 major mineral occurrences discovered in the last 20 years with limited mineral exploration activity. Of the 375 million acres of land in Alaska only about 20 percent is open to mineral entry thus the success rate in Alaska is about 3 per million acres (Metz, 1978; Bundtzen et al, 1988).

Within mining districts, success rates may be much higher and may exceed 10 per 100 properties examined. For properties in mining districts that have been the subject of detailed geochemical and geophysical surveys the success rate may reach 1 in 3 (Koulomzine and Dagenais, 1959).

Each parcel (section) of the subject land is listed in Appendix B. For each parcel, the various mineral deposit types are listed as are the probabilities of discovery of each deposit type.

Geologic Models

The geologic models of Cox and Singer (1986) were used to replace the ADGGS models. The former models are detailed enough to check the ADGGS assignments of mineral deposit types to each of the parcels and the relative potential for that deposit type within the parcel.

The ADGGS investigation included descriptions of 27 mineral deposit models but only 21 were actually projected to occur in the subject lands. There are an additional 13 mineral deposit models in Cox and Singer (1986) that were not considered by the ADGGS staff and are listed as follows:

1. Duluth or Noril'sk, Cu-Ni-PGE.
2. Synorogenic-Synvolcanic, Ni-Cu.
3. Alaska PGE (Cr-Pt).
4. Replacement, Mn.
5. Volcanogenic, Mn.
6. Volcanogenic, U.
7. Epithermal, Mn.
8. Volcanic hosted, Sn.
9. Simple, Sb.
10. Sandstone hosted, Pb-Zn.
11. Sedimentary, Mn.
12. Sedimentary, P_2O_5.
13. Beach, Ti.

Also the ADGGS inventory did not include industrial minerals such as limestone (portland cement and agricultural grades), dimension stone, clays including kaolinite, zeolites and heavy minerals such as monozite, olivine, and zircon. Although some of these categories could add significantly to

the inventory such as Alaska PGE, Simple Sb, and the heavy minerals from beach deposits such as titanium, monozite, olivine, and zircon, these additional commodities could not be included in the current evaluation due to time and cost constraints. Future inventories by ADGGS must include all of the above commodities. Of particular significance are heavy mineral concentrate that form as beach deposits. Alaska has an extremely large coastal area that could be a major source of these commodities.

Tonnage Grade Models

The tonnage and grade models from Cox and Singer (1986) allow the estimation of the gross metal value of each of the deposit types (See, Appendix A). For the various reasons previously stated, the tonnage and grade data used to calculate gross metal value for each type of deposit was the minimum tonnage and grade of the upper ten percent of all the deposits used in the tonnage and grade models. The utilization of these tonnage and grade estimates can be further justified by the fact that the tonnage and grade models are derived from operating mines. Published tonnage and grade data for operating mines usually only includes measured reserves for a twenty year or less mine life and not indicated or inferred ore. Ultimate production may be many times the actual measured reserve of a mine in any time period. An

extreme case is the Keno Hill Mine, Yukon Territory, Canada that has operated since the late 1920's with only two years of proven reserves blocked ahead of production. The mine is the largest current silver producer in Canada with total production in excess of 250 million ounces but with proven reserves of less than 10 million ounces.

Even at the upper ten percent level the placer gold model underestimates the tonnage and grade of the giant Alaska placer deposits such as Fairbanks and Nome. Fairbanks and Nome have produced an order of magnitude more gold than the largest deposits listed for the placer model.

The production of gold from the Tertiary continental clastics of the Las Medulas deposit of northern Spain was nearly two orders of magnitude greater than the largest deposits listed in the placer model. There are numerous Tertiary continental clastic deposits in Alaska that have potential for Las Medulas size placer gold deposits (Metz, 1985). Furthermore, these Tertiary sediments are found on Mental Health Trust Land in the Healy, Tyonek, and Kenai Peninsula areas. These sediments were not considered as sources of placer deposits by ADGGS. They are considered in this investigation but the gross metal value estimates are based on the tonnage and grade data from Cox and Singer (1986). The discovery of one Las Medulas size placer gold

deposit on the subject lands would more than double the currently estimated net present value.

Cash Flow Models

The gross metal value as of August 1987 is calculated from the tonnage and grade data and the London Metal Exchange average monthly prices (See Table 1). A mine life for the various deposit types is estimated from the mining rates of comparable deposits and an annual gross revenue to the property owner (the Trust) is calculated as a net smelter return ("NSR"). This NSR methods is an industry norm that avoids the problem of determining reasonable direct and indirect cost of extraction, mineral beneficiation, and smelting or refining. Net smelter return royalties in Canada and the U.S. range from 2 to 10 percent for lode deposits and 10 to 15 percent for placer deposits. For this investigation 4 percent NSR will be used for lode deposits and a 10 percent NSR will be used for placer mineralization. These royalty rates then allow the calculation of a gross annual revenue to the Trust from each deposit type (See Table 2).

This method of calculating cash flow to the Trust does not ignore the economic constraints of cost or the minimum required rate of return on investment of the operating mining company. First, the assumption that the deposits are in the

upper ten percent of those worldwide assures that the gross revenue generated by these deposits will be greater than 90 percent of the operating mines worldwide.

Second, the probabilities that were used to calculate expectations were not just probabilities of discovery but were probabilities of the discovery of world class size economic concentrations of metal. The economic viability of the deposits that are expected to be discovered on the subject lands is also enhanced by two major factors. First, the Mental Health Trust Lands are located primarily near population centers with established infrastructure thus decreasing the capital cost requirements of the expected mining operations. Second, two of these population centers, Juneau and Fairbanks, were established as mining communities. The potential for major ore deposits in these areas is much higher than that for areas outside these historic mining districts. In fact, the five highest potential cells defined by Harris (1968) were located adjacent to Juneau (2 cells) and Fairbanks (3 cells).

Third, the major population centers of Alaska are currently experiencing low cost electrical energy relative to other mineral producing centers in western Canada and the U.S.A. For instance, commercial rates in Fairbanks are approximately $0.05/kw-hr while in Elko, Nevada (a major gold

mining center), the rate is 50 percent higher at $0.075/kw-hr (Schumacher, 1987). Similarly, fuel oil and gasoline are cheaper in both Fairbanks and Anchorage than in Elko. With high unemployment, wage rates are lower in Alaska than they are in most of the active mining centers in western Canada and the U.S.A. The expectations of low operating costs and the minimum royalty payments considered in the cash flow models act as an incentive for major companies to invest in mineral exploration and development on the subject lands.

Net Present Value Estimate

The fair market value of the subject lands is the net present value of the cash flow that can be expected from the land over the period of mineral resource utilization. In the tonnage and grade models and in the cash flow models it is assumed that the total endowment of a given deposit is known and fixed. As previously discussed mineral deposits may produce minerals for several multiples of the estimated mine life. Mining districts and metallogenic provinces tend to act as a source of material flow rather than as a source of a fixed or limited stock (Brooks, 1976; Morse, 1976). The questionable total exhausibility of the subject lands not withstanding, it is assumed that the cash flows will be discounted over the minimum expected mine life for each deposit type.

The net present value of the expected net smelter returns depends on the selection of an appropriate interest rate. Arguments can be made for utilizing the prime lending rate, the average rate of return on capital for the industry, or a rate that the owners of the resource may receive on invested capital. Prime lending rates have fluctuated dramatically over the last two decades and have ranged from less than 5 to over 20 percent since World Way II. Rates of return on capital in the mining industry over the same period have averaged just above 5 percent. For this investigation an interest rate of 10 percent is assumed and is considered to be conservative.

Appendix C is an example of the calculation of an expected value of a parcel of land.

The net present value of the expected 4 percent NSR royalty is listed for each parcel of land in Appendix B. The total of the expected net present values for all parcels is $1.51 billion. This is the estimated fair market metallic mineral value of the subject lands.

This value is considered a minimum estimate for the following reasons:

1. Not all possible metallic mineral deposit types were considered and no industrial mineral deposits were considered.
2. The tonnage and grade models although for the upper ten percent of all deposits do not reflect the ultimate recoverable metal from the various deposit types.
3. The discovery of a single world class size placer deposit similar to Fairbanks or Nome would substantially increase the net present worth while the discovery of a Las Medulas size deposit would increase the net present worth by 50 percent.
4. The interest rate of 10 percent is very conservative.

Multiplier Effects

Major mineral discoveries have had dramatic effects on the economies of nations and/or entire regions. The discovery of vast quantities of precious metals in the Americas in the 16th century greatly stimulated the economy of Spain and that of all of western Europe. The discovery of oil in the Middle East in the 20th century has changed the economic structure of the host countries as well as the economic structures of all free market countries.

The quantification of these effects is difficult and not unequivocal. The effects are less dramatic for minerals than for petroleum development and are dependent on the degree of processing, refining, fabrication, or manufacturing that takes place. The multiplier effects of mineral development in industrialized economies that are also mineral producers have been estimated. From the Canadian experience the effects range from three to more than 5 times the value of the mineral commodities produced.

Multiple Use Values

During the exploration phase of mineral utilization, large tracts of land (up to one million acres) may be required to support a single major discovery. During this phase, other uses generally can take place on the land without materially affecting the exploration process. Upon discovery, the land area required for mineral development is reduced to several thousand or even several hundred acres. During this phase, single use will occur at the mine and mill site. After extraction these areas may again return to multiple use. (Examples include the iron ranges of Michigan, Wisconsin, and Minnesota, the Pb-Zn districts of the Mississippi Valley, and the precious metal mining areas of the Colorado Mineral Belt, all of which are major recreational areas today.) In extreme cases the land may be converted into a single use such as

national parks, wilderness areas or wildlife refuges (examples include Isle Royal National Monument, major historic copper mining; Death Valley National Monument, current and historic industrial mineral mining; Wrangel-St. Elias National Park, copper and gold mining).

At the local levels the effects of mineral utilization are more obvious with the formation of town and even major cities (San Francisco, California; Sudbury, Ontario; Denver, Colorado; Johannesburg, South Africa; Butte, Montana; Spokane, Washington; Juneau, Alaska; Whitehorse, Yukon Territory; Fairbanks, Alaska) to support mineral exploration and extraction. Initially during the discovery phase land values are based on the value of the contained minerals however during the development and production stage local land values are established and increased by the need for infrastructure, service industries, and housing facilities.

After the extraction of minerals from a particular deposit, the surface value of the land may exceed the initial acquisition cost of the mineral estate. As an example, the predecessor of Alaska Gold Company consolidated the placer gold properties of the Fairbanks District in the 1920's to facilitate large scale dredging operations. Mineral claims were purchased at $100 per acre. Recently, the reclaimed dredge areas have been sold for more than $10,000 per acre.

In terms of constant dollars (CPI 1920-1997 = 519.4), this is about 20 times the original mineral value of the land.

The need for land reclamation after mining has been recognized for decades. In 1977, Congress passed the Surface Mining Act to ensure continued productivity of land after mineral extraction has been completed. The law not only specifies reclamation practices but in certain cases mandates that the land be returned to at least its original level of productivity.

From the above discussion it must be emphasized that mineral values and surface values are additive rather than one exclusive of the other.

Although the multiplier effects and multiple use values of the subject land cannot be quantified with respect to this mineral appraisal, these factors should be considered with respect to the surface value appraisal and with respect to land use policy decisions affecting the Alaska Mental Health Trust Lands.

Part II -- Coal Resources

Previous Investigations

Merritt and Belowich (1988) review the potential coal resources on Alaska Mental Health Lands. Also included in their investigation is a bibliography of coal publications by quadrangle. However, no estimates are made of the potential tonnages of coal or the contribution of coal to the value of either the Trust or Replacement Pool Lands.

Methodology

Coal resource values must be appraised differently than metallic mineral resources. Coal, like industrial minerals, is usually sold to a specified final consumer (i.e. steam coal to a utility or metallurgical coal to a steel mill). Coal has a market because it meets a particular metallurgical specification or because it provides the lowest cost of delivered thermal units. Thus, the markets for coal are more restricted than those of metallic minerals and in-situ values are very sensitive to those markets. Most of the potential coal resources of the subject lands are low rank steam coals and the following discussion of markets will be limited to steam coal.

Currently the Alaska market for coal is very small with respect to the potential supply and even the Pacific Rim market is small compared to the total potential Pacific Rim supply. As an example, up to September 1987 Australia, the largest exporter of coal in the Pacific Rim, had a 30 percent excess capacity over its markets while only operating its mines on a single eight hour shift six days per week. Most coal mines operate 24 hours per day seven days per week.

In order to establish a value to a given potential coal mining site, a market must be defined. Markets for coal from the subject lands include both domestic and export.

Domestic markets for coal in addition to those served by the Usibelli Coal Mine are limited by the current excess power generating capacity of the power networks in central and southcentral Alaska. The completion of the Bradley Lake Hydroelectric Project will exacerbate the oversupply situation.

Excess electric power supply in the Railbelt and the Kenai Peninsula areas could be diminished by the development of several large scale open-pit metal mines. A 10,000 ton per day mining and milling operation would consume 15 to 20 megawatts. Two such deposits would eliminate the current excess capacity in the Healy-Fairbanks area.

With the current mineral development in southeastern Alaska including the Greens Creek Mine, the Alaska Juneau Mine and various properties in the Berners Bay area, there could be an electric power shortage in the near future. Coal fired steam plants could provide additional generating capacity at a lower capital and operating cost than either hydroelectric or oil fired plants.

Other domestic coal markets may include:

1. Small scale power plants in support of military projects such as the Air Force's Over-the-Horizon Radar System.
2. Small scale portland cement manufacturing.

Assuming that a coal demand of 150,000 tons per year resulted from either mineral development or one of the above two other potential markets, an estimated value of in-situ coal resources can be calculated. In order to complete such a calculation the following assumptions are made:

1. The revenue to accrue to the property owner (the Trust) would be a royalty based on the value of the coal delivered.
2. The above royalty would be 6.25 percent (which is greater than the current state royalty rate but only one half the federal rate).

3. The entire production would come from the subject lands.
4. The project life is twenty years.
5. The interest rate at which the cash flow is discounted is 10 percent.
6. The price of coal is $40 per ton (comparable to the $45 per ton for the Over-the-Horizon Radar Project).
7. There is no differential inflation over the life of the project.

The net present value of the cash flow to the Trust would be $3.2 million. With the large quantities of coal on adjacent state and federal lands in Alaska it is probably unrealistic to expect more than 10 percent of the model production to come from Trust lands.

Net Present Value Estimate

Using the above methodology, it is possible to calculate a range of potential values of coal production from Trust lands. It is obvious from the above calculation that unless total demand for Alaska coal would increase by an amount equivalent to the current production of 1.5 million tons from the Usibelli Coal Mine, that the net present value of coal resources to the Trust is small. There is an extremely small probability that total demand will increase to 3.0 million

tons per year and there is even a smaller probability that the increase will be produced from Mental Health Trust Lands. The maximum expected net present value contribution of coal to the Trust lands is estimated at $3.2 million.

Part III -- Sand and Gravel (Aggregate) Resources

Previous Investigations

Reger (1988a and 1988b) described the potential for sand and gravel on the subject lands and the Replacement Lands. Also included in (Reger 1988b) are references with respect to the evaluation of sand and gravel resources on state and federal land adjacent to the subject lands. No estimates of the potential volume or tonnage of material on the subject lands were provided by either Reger (1988a and 1988b) or by the authors of the references cited.

Methodology

Sand and gravel, as other industrial mineral resources, must be appraised differently than metallic mineral resources. It is generally assumed that the production from a single metal mine will not account for a major portion of the world supply, will not affect the price level of the commodity, and the total mine production can be sold at the prevailing world market price. The same assumptions are not true for industrial minerals including sand and gravel. Industrial minerals are sold to particular markets and usually at specifications defined by and unique to the purchaser. Generally the low unit value of the industrial mineral necessitates production

near the point of sale so as to minimize the relatively high cost of transportation. Thus the markets for industrial minerals are local rather than worldwide and more restricted with respect to quality. These factors limit the in-situ value of industrial minerals to the definition of a specific market.

In the case of sand and gravel, the total potential supply in Alaska is enormous. Even though the total endowment is large, material cannot be shipped great distances to areas of high demand such as Tokyo, Japan. Within Alaska, specific areas may have periods of high demand that cannot be met with local supply. The periods of rapid development in Anchorage and Prudhoe Bay are well documented periods of major shortages of sand and gravel and high unit prices of the commodity. In the case of Anchorage, peak demand periods allowed the economic transport of sand and gravel up to 50 miles. In the case of petroleum development on the North Slope of Alaska material was hauled in excess of 100 miles. However this is a relatively rare event and predicated on environmental as well as economic considerations.

Without defining a specific market, sand and gravel at a given site has zero value. Defining markets over a twenty year period for each potential material site on the subject lands would be a futile exercise. As an alternative, an

estimate may be made of the sand and gravel market share that may be supplied by the subject lands. This market share would be dependent on policy decisions of the Trust as well as policy decisions of the other major suppliers of material such as the State of Alaska and the federal government. Since much of the subject land is near population areas where demand is usually greatest, public policy could maximize the value of the sand and gravel resources on the subject lands.

The demand for sand and gravel rose rapidly with the discovery and development of oil in Alaska. Prior to 1962 annual consumption fluctuated near 5 million tons (3.5 million cubic yards) per year. From 1963 to 1973 the annual figures approached 20 million tons (14 million cubic yards). With the construction of the Trans-Alaska Pipeline haul road and the development of Prudhoe Bay, annual consumption ranged from over 110 million tons (78 million cubic yards) in 1974 to about 20 million tons (14 million cubic yards) in 1985. Levels of consumption would have continued to decrease in 1986 and 1987 without the major mineral developments at the Red Dog and Greens Creek Mines (Bundtzen et al, 1988).

The price levels for sand and gravel in 1987 ranged from $2.40 to $10.50 per ton ($3.40 to $14.90 per cubic yards), with a weighed average price of $3.00 per ton ($4.25 per cubic

yard). Royalty payments to land owners probably averaged $0.30 per ton ($0.42 per cubic yard).

In order to calculate a fair market value for the sand and gravel on the subject lands, the following assumptions are made:

1. Annual consumption of sand and gravel over the next twenty years will be at least 20 million tons (14 million cubic yards).
2. There will be no differential inflation with respect to the commodity and the price paid to landowners in 1987 is a fair market price.
3. With no major marketing effort by the Trust (Case I), 5 percent of the production in Alaska will come from the Mental Health lands.
4. With a major marketing effort by the Trust (Case II), 50 percent of the production in Alaska will come from the subject lands.
5. There exists adequate sand and gravel resources on the Trust lands to meet the largest levels of demand.

Net Present Value Estimate

Case I. Assuming total annual statewide consumption of 20 million tons (14 million cubic yards), a royalty payment of

$0.30 per ton ($0.42 per cubic yard), a market share of 5 percent, and an income stream for twenty years discounted at 10 percent, the net present value of sand and gravel resources is $2.55 million.

Case II. With the same assumptions as Case I except a 50 percent market share, the net present value of the sand and gravel resources is $25.54 million. The most probable scenario would be a market share of 20 to 30 percent, with a net present value of about $13 million. In any case the contribution to the total mineral resource value of the subject lands is small. The contribution however will increase with the development of metallic mineral resources. Just as demand remained relatively high during the construction of the Greens Creek and Red Dog Mines, demand is expected to increase with similar other mining projects. Unless there is an order of magnitude increase in either the price or demand for sand and gravel in Alaska, the contribution of this commodity to the total of Mental Health Trust Lands will remain small.

Part IV -- Summary and Conclusions

The expected fair market value of the Alaska Mental Health Lands with respect to metallic minerals, coal, and sand and gravel is $1,506 million, $3.2 million, and $13 million, respectively. Thus, the corpus of the Trust is rounded out at $1,522 million.

The value for metallic minerals is considered a conservative estimate. The value attributable from coal and sand and gravel is highly dependent on development of markets for these commodities. The development of markets is in part a function of public policy which in turn increases the level of uncertainty in the value estimates.

As defined in state law, the fair market value of the Mental Health Trust corpus is 8 percent of the fair market rental value of the land. From the above, the fair market annual rental value of the corpus of the Trust is calculated at $121.8 million.

FY 91 MENTAL HEALTH TRUST INCREMENTS

	PROGRAM	AMHB REQUEST	DHSS REQUEST	GOV FY 91 INCREMENT	HOUSE ADD ON	TOTAL Gov+House
	HEALTH & SOCIAL SERVICES					
	Comm Mental Health Grants					
MH	Comprehensive Services	1,500.00				
MH	Anchorage Crisis Facility		793.70		700.00	700.00
MH	Prevention: Fund Additional Programs	100.00	50.00			
MH	Maintain Clinic Services	481.60	481.60	481.60		481.60
MH	Child & Adolesc. Serv.: Unmet need	750.00				
MH	Institutional Discharge/ Kids		500.00	312.50	100.00	412.50
MH	Day Treatment for Youth		150.00	150.00		150.00
MH	Victims of Family Violence		-400.00	-400.00		-400.00
	Designated Evaluation & Treatment					
MH	Short Term Hospital/Volunt Commit	350.00	100.00		100.00	100.00
	SVCS to CMI					
MH	Comm. Support Serv: Red Unmet Need	3,500.00				
MH	Institutional Discharge/Adults		1,286.10	250.00	1,000.00	1,250.00
MH	Replace Fed$-Crossover House		206.30	206.30	-100.00	106.30
MH	OBRA-Nursing Home Discharges	500.00	500.00	500.00		500.00
MH	Forensics Halfway House	400.00	400.00	400.00		400.00
MH	OBRA-Active Treatment	200.00	200.00	200.00		200.00
	MH Admin					
MH	Increase Admin Support Staff	100.00	100.00	100.00		100.00
MH	Management Info System	250.00	225.00	225.00		225.00
DD	OBRA DD Specialist		32.50	32.50		32.50
DD	Admin/ Quality Assurance	105.00	60.00			
ALL	Address Human Resource Dev Needs	200.00	200.00			
MH	Planning	150.00				
	Reduce Needs Assessment Funding				-50.00	-50.00
	Replace lost fed$ for planner	80.00	80.00			
OAC	Respite Care/ Alzheimers/RSA to OAC	500.00	500.00		150.00	150.00
	Emphasize Small Communities					
	Community DD Grants					
DD	OBRA- Active Treatment	700.00	700.00	700.00		700.00
DD	DD Residential Services: Unmet Need	855.00	705.00	200.00	500.00	700.00
DD	DD Vocational Services: Unmet Need	750.00	700.00	500.00	200.00	700.00
DD	Case Managers for DD Clients	250.00	200.00			
DD	DD Respite Services	650.00	400.00	200.00	300.00	500.00
	Health Grants					
DD	Infant Learning	425.00	1,120.60	200.00	600.00	800.00
DD	Strengthen Child Care/DD	159.00				
DD	Improve Homemaker Services	150.00				
DD	Data Process Clerk	22.00	21.80			
DD	Statewide Database for DD	45.00	45.00			
	Foster Care					
MH	Treatment Services		400.00	400.00		400.00
	API					
MH	Nurses Reclassification	266.80	266.80	266.80		266.80
MH	Strengthen Treatment at API	8.50	8.50			
	AK Youth Initiative					
MH	Increase Service Capacity	225.00	300.00	300.00		300.00
MH	Western Region Coordinator	75.00				
	SOADA					
ALC	Detoxification Centers	2,000.00	1,830.00	600.00	400.00	1,000.00
ALC	Long Term Treatment Beds	1,003.65	1,003.70		500.00	500.00
ALC	Resident Care for Preg Women	270.00	270.00	200.00	448.20	648.20
ALC	Service Level Maintenance				458.40	458.40
MH	Additional EMS Patrols	640.00	200.00			
ALC	Hospital Emergency & Detox	750.00	470.00			
ALC	Coord for Alc & Drug Ab Advisor Bd		88.60			
	AMHB					
MH	Position Reclassify	20.00				
MH	Study MH Researh & Training Institute	25.00				
	DH&SS TOTAL	**18,456.55**	**14,195.20**	**6,024.70**	**5,306.60**	**11,331.30**

Rep Boyer
18-Mar-90

FY 91 MENTAL HEALTH TRUST INCREMENTS

	PROGRAM	AMHB REQUEST	DHSS REQUEST	GOV FY 91 INCREMENT	HOUSE ADD ON	TOTAL Gov+House
	ADMINISTRATION					
	Older Alaskans Commission					
OAC	Day Care Services: Alzheimers	520.00	520.00	520.00		
OAC	Functional & Psych Assess: Alzheim	82.50	81.00	81.00		
OAC	Family Support & Community Ed	70.00	70.00	70.00		
OAC	Statewide Comm Needs Assessment	50.00	50.00			
	CORRECTIONS					
MH	Cook Inlet Pretrial		379.00	189.00		
	GRAND TOTAL	**19,179.05**	**15,295.20**	**6,884.70**	**5,306.60**	**12,191.30**

Rep Boyer
18-Mar-90

STATE OF ALASKA
GENERAL FUNDS AUTHORIZED FOR MENTAL HEALTH PROGRAMS

	AUTHORIZED								GOV REQ
	1983	1984	1985	1986	1987	1988	1989	1990	1991
HEALTH & SOCIAL SERVICES									
Foster Care	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	400.0
Manilaq Mental Health	0.0	0.0	218.6	278.1	249.9	207.8	207.8	207.8	207.8
Norton Sound Mental Health	0.0	0.0	211.0	385.5	276.7	229.3	229.3	229.3	229.3
TCC Mental Health	0.0	0.0	0.0	249.0	236.6	196.6	196.6	196.6	196.6
YKHC Mental Health	0.0	0.0	0.0	0.0	0.0	0.0	436.9	436.9	436.9
Public Health Admin	0.0	0.0	0.0	0.0	0.0	0.0	134.0	0.0	0.0
Vital Statistics	0.0	0.0	0.0	0.0	0.0	0.0	150.0	150.0	150.0
Infant Learning Program	0.0	0.0	0.0	0.0	0.0	0.0	0.0	280.0	480.0
SOADA/Admin	1,364.5	1,240.3	1,140.4	1,193.5	1,142.4	883.3	948.5	1,085.5	1,056.2
Alcohol Abuse Grants	11,008.8	9,495.6	10,176.0	10,338.4	9,789.0	8,126.0	7,687.0	8,830.4	9,630.4
Comm Mental Health Grants	4,428.9	4,512.1	7,256.3	8,270.2	6,917.9	7,181.9	10,449.9	10,542.1	10,761.2
Fairbanks Comm Mental Health	0.0	0.0	0.0	0.0	1,562.6	1,573.9	2,271.9	0.0	0.0
Svc/Chronically Mentally Ill	0.0	0.0	0.0	0.0	489.1	3,270.1	6,545.1	9,758.0	11,314.3
Designated Eval & Treatment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	588.3	588.3
Comm Dev Disability Grants	4,634.2	4,874.6	7,449.2	8,732.9	8,485.1	7,490.4	9,231.5	11,543.1	12,443.1
Mental Health Admin	1,422.7	2,331.6	1,059.4	1,562.2	1,078.3	1,453.3	2,275.0	2,496.4	2,634.8
API	12,777.9	12,836.6	13,123.1	13,577.6	11,467.1	11,349.6	12,515.4	13,244.8	13,561.1
Harborview	5,544.2	5,490.5	5,522.4	5,291.6	4,945.2	5,141.3	4,151.4	4,151.4	4,151.4
Ak Youth Initiative	0.0	0.0	0.0	0.0	0.0	502.2	687.2	793.8	1,097.0
Office of Prevention	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	209.8
Ak Mental Health Board	0.0	0.0	0.0	0.0	0.0	193.1	327.5	313.6	313.6
Hlth Benefits Supplemental							401.7		
H&SS TOTAL	41,181.2	40,781.3	46,156.4	49,879.0	46,639.9	47,798.8	58,846.7	64,848.0	69,861.8
ADMINISTRATION									
Older Alaskans' Commission	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	996.0
CORRECTIONS									
Cook Inlet Pre-Trial	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	189.0
STATEWIDE TOTAL	41,181.2	40,781.3	46,156.4	49,879.0	46,639.9	47,798.8	58,846.7	64,848.0	71,046.8
% Change		-0.97%	13.18%	8.07%	-6.49%	2.48%	23.11%	10.20%	9.56%
% Change FY83 to FY91									72.52%

The following components are shown as attributable to Mental Health Programs even though the funding source may not reflect it: Alcohol Abuse Grants, Community DD Grants, Harborview Dev Center, and a portion of SOADA Admin. associated with alcohol grants.

LFD 3/19/90

STATE OF ALASKA
GENERAL FUNDS AUTHORIZED FOR MENTAL HEALTH PROGRAMS

	AUTHORIZED								GOV REQ
	1983	1984	1985	1986	1987	1988	1989	1990	1991
HEALTH & SOCIAL SERVICES									
Maniilaq Mental Health	0.0	0.0	218.6	278.1	249.9	207.8	207.8	207.8	207.8
Norton Sound Mental Health	0.0	0.0	211.0	385.5	276.7	229.3	229.3	229.3	229.3
TCC Mental Health	0.0	0.0	0.0	249.0	236.6	196.6	196.6	196.6	196.6
YKHC Mental Health	0.0	0.0	0.0	0.0	0.0	0.0	436.9	436.9	436.9
Comm Mental Health Grants	4,428.9	4,512.1	7,256.3	8,270.2	6,917.9	7,181.9	10,449.9	10,542.1	10,761.2
Fairbanks Comm Mental Health	0.0	0.0	0.0	0.0	1,562.6	1,573.9	2,271.9	0.0	0.0
Svc/Chronically Mentally Ill	0.0	0.0	0.0	0.0	489.1	3,270.1	6,545.1	9,758.0	11,314.3
Designated Eval & Treatment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	588.3	588.3
Mental Health Admin	1,422.7	2,331.6	1,059.4	1,562.2	1,078.3	1,453.3	2,275.0	2,496.4	2,634.8
API	12,777.9	12,836.6	13,123.1	13,577.6	11,467.1	11,349.6	12,515.4	13,244.8	13,561.1
Ak Mental Health Board	0.0	0.0	0.0	0.0	0.0	193.1	327.5	313.6	313.6
TOTAL	18,629.5	19,680.3	21,868.4	24,322.6	22,278.2	25,655.6	35,455.4	38,013.8	40,243.9
% Change - Annual		5.64%	11.12%	11.22%	-8.41%	15.16%	38.20%	7.22%	5.87%
% Change FY83 to FY91									116.02%

ALPHA CENTERPIECE
A Report on Health Policy Issues

OCTOBER 1986

REDIRECTING STATE DOLLARS TO BUILD COMMUNITY-BASED MENTAL HEALTH SYSTEMS

In 1955 the number of inpatients in state mental hospitals in the United States reached a peak of 560,000, after a period of steady increase, and then began to decline. Today, the state hospital population is about 120,000, almost an 80 percent drop, according to 1985 National Institute of Mental Health (NIMH) data. At the same time that the inpatient population in state institutions was shrinking, the total number of seriously mentally ill persons treated as outpatients was increasing dramatically, the result of the expanding community mental health care movement. While in 1955 about 75 percent of all mental health episodes were treated in mental hospitals, today the situation is reversed: an estimated 80 percent or more of mental health episodes are now handled on an outpatient basis.

The move toward state hospital depopulation began shortly after World War II, triggered mainly by advances in drug therapy and other treatment approaches, humanitarian concerns, and changes in reimbursement policies. The federal government gave a significant impetus to community-based treatment with the establishment in 1965 of the Community Mental Health Center (CMHC) program, aimed at reducing the utilization of public mental hospitals and developing community alternatives.

Today the concept of comprehensive and community-based mental health service systems has been further bolstered by studies showing that nonhospital alternatives are more effective and less expensive than inpatient care.

But in practice mental health policy throughout the country still focuses on hospitalization. Despite the fact that the vast majority of mentally ill patients are now treated in community settings, about 65 percent of state mental health dollars go to support public psychiatric institutions. Of the $7.1 billion spent by state mental health agencies in FY 1983, only $2.11 billion was directed to community-based services, or about 30 percent, while $4.65 billion was spent on state mental hospitals, the National Association of State Mental Health Program Directors (NASMHPD) reports; the remainder went for prevention, research, training and administration.

As their budgets are squeezed tighter each year and as the cost of operating public mental hospitals continues to go up, state mental health officials will find it increasingly difficult to fund the development and expansion of community-based programs. The challenge they face is how to reduce the share of resources going to state institutions, without jeopardizing the quality of inpatient care, and to shift the savings to underfunded community alternatives.

This issue of ALPHA CENTERPIECE reviews some of the strategies states can adopt to achieve a more balanced and more cost-effective mental health system that gives priority to meeting the total needs of persons with serious and long-term mental disorders. Although many states continue to emphasize inpatient treatment in their practices, some have made considerable progress in shifting the focus from facility-based care to community treatment, rehabilitation, and support services. The examples in this report describe the innovative approaches some of these states have taken to restructure their public mental health systems.

Deinstitutionalization and Development of Community Programs

The deinstitutionalization movement began in the 1950s in response to public concerns about the quality of care provided in state mental hospitals. State-administered institutions tended to be overcrowded, poorly maintained and understaffed. Often, seriously mentally ill patients were involuntarily committed to a restrictive hospital environment far away from their communities.

While public attention was being drawn to the serious deficiencies in mental hospitals, interest in community-based care was spreading. The concept of community mental health care was based on the premise that people with serious mental disabilities should be treated in their communities rather than "warehoused" in distant state facilities. The concurrent development of new psychoactive drugs and new modes of psychotherapy enabled the theory to be put into practice by making it possible for the first time for many patients to function outside the institutional environment.

The 1961 report of the Joint Commission on Mental Illness and Health gave further support to the community care movement, pointing to the problems with state psychiatric hospitals and recommending the development of community alternatives. Two years later Congress adopted the Community Mental Health Centers Act, which provided funding to develop community mental health centers (CMHCs) throughout the country.

From 1965, when the first CMHCs were funded, through 1981, when the final project grants were awarded, NIMH supported 768 centers in all 50 states, the District of Columbia and Puerto Rico. After 1981, NIMH began providing mental health funds to the states in the form of block grants. Although state mental health agencies (SMHAs) were given more latitude in the use of the funds, state and local agencies received less total federal support than under the categorical grant program.

The national policy of deinstitutionalization and community-based care, new therapeutic approaches, court decisions mandating treatment in the least restrictive setting, changes in third-party payment policies -- all of these factors contributed to a dramatic decline in the use of state and county mental hospitals. In 1955 the number of inpatient episodes in state psychiatric hospitals was about 819,000 compared to just under 500,000 in 1981, according to NIMH. During this same period, the number of outpatient episodes (which includes outpatient treatment in all types of hospitals as well as in CMHCs and other public or private facilities) increased from 379,000 to 4.4 million.

Mixed Success of Deinstitutionalization

In terms of the significant depopulation of state hospitals since the 1950s, and the simultaneous increase in the number of people with severe mental illness being served in the community, deinstitutionalization has been successful. But in terms of its implementation, deinstitutionalization has not always achieved the policymakers' expectations. The public mental health systems developed during this era of deinstitutionalization have varied widely throughout the country. A basic problem, as government, consumer, and professional critiques have found, was that many communities did not develop an adequate array or amount of support services to meet the mental health as well as other health, human service, and community living needs of seriously mentally ill patients discharged from, or denied admission to, state hospitals. CMHCs varied in their capacity and efforts to address this challenge, and James Stockdill, director of NIMH's Division of Education and Services System Liaison, has noted that "many times they could not and should not have been expected to provide for the other comprehensive health and social services that were necessary for community life."

Often the process of hospital depopulation has not resulted in a commensurate increase of resources in the community or a proportional decrease and consolidation of inpatient capacity. In many cases the myriad federal, state and local agencies have not coordinated their activities, resulting in diffusion of responsibilities and fragmentation of services. Further, some of the most innovative approaches developed during the late 1960s and early 1970s, providing more cost-effective and higher quality treatment, were not rapidly disseminated and adopted throughout the nation's public mental health systems.

In brief, many mentally disabled individuals have been deinstitutionalized over the last 30 years, but essential funds and professional staff have not been deinstitutionalized to develop comprehensive, community-based service systems that could assure the successful transition to community life.

To accelerate the development and dissemination of the innovative community approaches, and to address problems associated with deinstitutionalization, NIMH launched the Community Support Program in 1977. The program's objective is to help states and communities develop systems offering a full range of services to seriously mentally ill persons in the community. All 50 states have received grants to stimulate the development of community support systems.

Conflicting Policies on Mental Hospitalization

Although the national mental health policy is deinstitutionalization, says researcher Charles Keisler of Vanderbilt University, in practice the policy is hospitalization. Nationally, about 70 percent of public and private mental health dollars are spent for inpatient care and 25 percent of all hospital inpatient days are for mental disorders, he reported in an April 1982 article in American Psychologist. While the number of episodes in state and county mental hospitals dropped substantially between 1955 and 1975, the number of inpatient episodes in all other types of hospitals (except Veterans Administration psychiatric hospitals) increased during that period, from 477,000 to 1.2 million. Forty percent of all inpatient episodes for mental problems occur in general hospitals without psychiatric units, resulting in direct costs of almost $6 billion annually, he added.

Similarly, as the population in public mental institutions has gone down, the number of mentally ill patients in nursing homes has risen, according to William Gronfein of Rutgers University. In 1963 about 42 percent of the 356,000 mentally ill elderly receiving institutional care were in state hospitals, compared to 53 percent in nursing homes, he said in a September 1985 article in the Journal of Health and Social Behavior. By 1969, 23 percent of the almost 500,000 institutionalized mentally ill elderly were in state hospitals and 75 percent were in nursing homes and related facilities. According to recent estimates, 750,000 out of the 1.7 million persons with chronic mental illness are in nursing homes.

Researchers have attributed this "transinstitutionalization" of mentally ill persons to third-party reimbursement programs that undercut national deinstitutionalization policy. Most private and public insurance plans, especially medical assistance, provide fiscal incentives for institutional care, hampering state efforts to develop community programs and discouraging beneficiaries from seeking nonhospital alternatives where they do exist. In addition, the current exemption of psychiatric services from Medicare's diagnosis-related groups (DRGs) gives hospitals further incentive to increase the supply of psychiatric beds and thus the demand for services. Many general acute care hospitals, faced with declining utilization and empty beds, are converting excess capacity to psychiatric units, where Medicare continues to reimburse for services on the basis of cost. (See the May 1986 ALPHA CENTERPIECE.)

Another factor accounting for the increase in mental hospitalization, Keisler explains, is public attitude. Many people still look upon mental illness with fear and oppose any move to place seriously mentally disturbed individuals in their neighborhoods. Also, there is a widespread belief by the public, and by some mental health professionals as well, that serious mental problems, like serious medical problems, should be treated primarily, or even exclusively, in hospitals. For some families and other persons dealing with seriously mentally ill individuals, hospitalization may be the easiest or most feasible answer to a difficult-to-handle situation.

Research Shows Cost-Effectiveness of Alternatives to Hospital Care

The national trend toward increased funding for mental hospitalization continues today in spite of recent research documenting the benefits of nonhospital alternatives for persons with severe mental disorders. Keisler, for example, reviewed 14 studies conducted by several researchers over the last 20 years, comparing hospital treatment of seriously mentally ill patients with alternative treatment approaches, which involved psychological and social interventions, usually with some drug therapy. "In no case has mental hospitalization produced better treatment outcomes than any alternative care," he told a Senate appropriations subcommittee in 1984.

Keisler also found evidence of the "self-perpetuation" of mental hospitalization: hospital-treated patients were more likely to be readmitted to the hospital than nonhospital-treated patients ever to be admitted. In addition, most of the studies he reviewed showed that the alternative treatment cost less than hospital care. In one study the alternative care was significantly more effective and 40 percent less expensive. Research reviews by others have come to similar conclusions.

State Budgets Skewed Toward Public Mental Institutions

Even with these findings on the benefits of alternatives to hospital treatment, many states

have not developed sufficient community programs for seriously mentally ill persons. A 1978 NIMH review of surveys on state hospital populations found that although over 50 percent of inpatients did not require institutional care, they remained hospitalized only because alternative treatment was not available in their communities.

The biggest deterrent to the large-scale development of community treatment is inadequate funding. Most states devote more of their mental health budgets to their state hospitals than to community programs, even though the majority of patients are served in community settings. In FY 1983 the average SMHA spent about two-thirds of its budget on its public psychiatric hospitals and slightly less than one-third on community-based programs, according to NASMHPD statistics. (See Figure 1 on the following page for a breakdown of SMHA-controlled expenditures by service setting, and Figure 2 for a breakdown by major program type.) But the share allotted to community services varies widely among the states, ranging from roughly 15 percent to about 65 percent.

The dilemma facing state mental health authorities is how to develop needed community services when state hospitals consume a greater share of limited public funds each year. Publicly funded inpatient treatment facilities, victims of the vicious cycle of declining occupancy and rising fixed costs, are often overbedded and inefficient. Further, they are subject to increasing competition from more cost-effective nonhospital treatment alternatives as well as from general acute care hospitals and private psychiatric facilities. Eventually, states may be forced to develop more community alternatives because these "large, obsolete and outmoded" facilities will no longer be able to provide quality care, and states won't be able to afford "to rebuild or update them," said NIMH's Stockdill in a 1984 speech to mental health planners in Nashville, Tennessee.

But the immediate solution to the problem lies in lowering inpatient utilization and costs in such a way that savings are channeled to cost-effective community-based alternatives. As health care competition increases while federal and state revenues for human services decline, states have a growing awareness of trade-offs between inpatient and community-based services and recognize the difficulties in shifting resources. By redirecting state resources to priority service gaps, SMHAs can not only address unmet service needs, but can also help contain overall state health care expenditures at a time of growing fiscal constraint.

Strategies for Resource Shifting

In seeking ways to move mental health resources from hospitals to community alternatives, states must develop strategies for reshaping their mental health systems. Three years ago NIMH and the Center for Public Representation sponsored a conference in Madison, Wisconsin, to discuss some strategies that states can adopt.

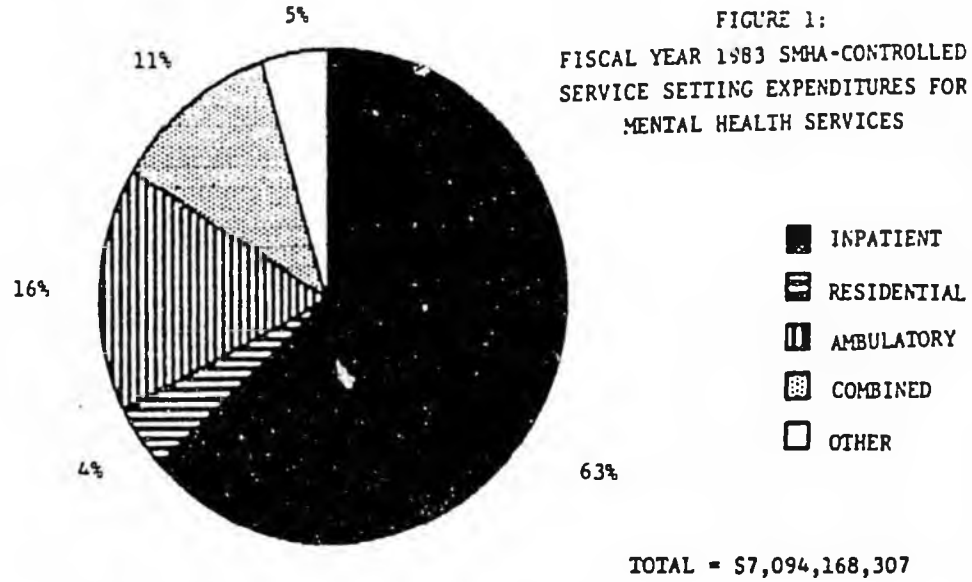
Policymakers, planners and other participants from the eight states represented outlined a common strategic planning process for successful change. The first step is to define the future direction of the mental health system. The system envisioned should provide an array of services, community-based but including facility care, to address the multiple needs of different population groups. Planning should involve both the public and private sectors.

Next, state policymakers must identify and analyze all funding sources so that they can be coordinated and redirected to strengthen community alternatives. There must also be "a critical mass of resources" developed in every mental health service area to assure the provision of a full range of services. Finally, strategies for changing the systems should be coordinated among federal, state, and local government to promote community-based programs.

Looking at the experiences of states that have made significant progress in shifting to a community-based system, conference participants identified the following as successful strategies in redirecting resources to community care:

- strong state leadership, with a policy commitment to quality community-based services;
- strong advocacy groups willing to work with state and local governments to expand community services;
- development of a consensus among key actors -- government, providers, consumers, families, and other advocacy groups -- on the future shape of the system;

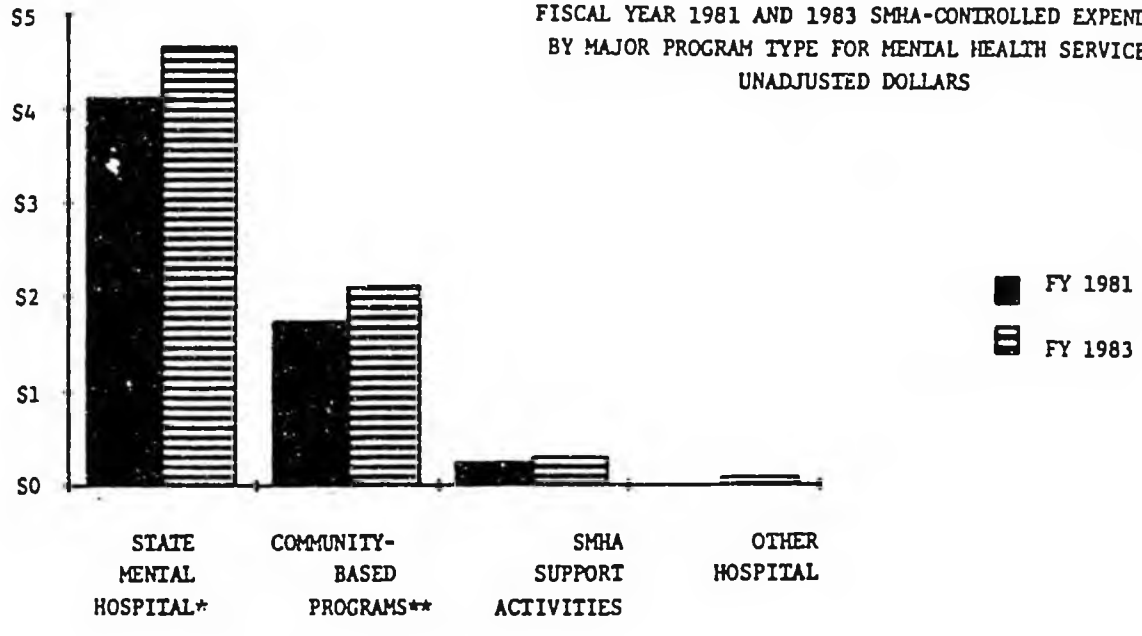
FIGURE 1:
FISCAL YEAR 1983 SMHA-CONTROLLED SERVICE SETTING EXPENDITURES FOR MENTAL HEALTH SERVICES



TOTAL = $7,094,168,307

EXPENDITURES IN BILLIONS

FIGURE 2:
FISCAL YEAR 1981 AND 1983 SMHA-CONTROLLED EXPENDITURES BY MAJOR PROGRAM TYPE FOR MENTAL HEALTH SERVICES: IN UNADJUSTED DOLLARS



* In a few states, expenditures for state hospitals include hospital-based outpatient services.

** Some states use community-based program allocations for inpatient services in general hospitals as well as in county- and state-operated psychiatric facilities.

Source: Funding Sources and Expenditures of State Mental Health Agencies: Revenue/Expenditure Study Results, Fiscal Year: 1983. June 1985. The study was conducted by NASMHPD for NIMH.

- knowledge about the legislative process and ability to work with state legislators;
- development of a single point of authority, either state, regional or local, over all government funds and over the delivery of all services, both institutional and community-based;
- creating additional incentives for decreasing inpatient utilization;
- targeting funds for particular services, such as Community Support Programs (CSPs);
- knowledge about the process of hospital closure or consolidation; and
- technical assistance and consultation on shifting resources.

In moving beyond deinstitutionalization, SMHAs can take additional steps to expand community-based services. Some measures adopted or under development in a number of states include the following:

1. allow local managers and clinicians to act as prudent brokers of services -- This increases the likelihood that they will neither exclude clients from community treatment nor place them unnecessarily in hospital settings.
2. develop gate-keeping mechanisms -- Such mechanisms permit a careful review of clients' clinical needs and available community resources before considering inpatient services and also establish a single point of entry into the community-based mental health system.
3. give highest service priority to individuals who are seriously mentally disabled or who are most at risk of placement in hospitals.

Innovative efforts to expand community-based mental health services are being made in all state mental health systems. For instance, all states, as well as the District of Columbia and Puerto Rico, have received CSP development grants to expand comprehensive community-based services to persons with severe and persistent mental disabilities. Further, most SMHAs are engaged in activities to contain or reduce the proportion of funds allocated for inpatient treatment and to expand community-based treatment alternatives. Among the states that have taken such action are California, Colorado, Connecticut, Florida, Kentucky, Michigan, New Hampshire, Ohio, Oregon, Pennsylvania, Rhode Island, Vermont, Washington and Wisconsin.

But each state faces unique obstacles and opportunities for redirecting state dollars to build its community-based mental health system; many may be able to adapt some of the approaches described above.

The four states in the examples below -- Colorado, Ohio, Vermont and Wisconsin -- have been selected because they either have developed a strong community-based mental health system, or they are in the process of making major changes in the structure and functioning of their mental health service systems. They are recognized by advocates and policymakers at the state and national levels for expanding community mental health services. For instance, the Public Citizen Health Research Group's recent report describing and ranking state programs for seriously mentally ill people rated Wisconsin and Colorado among the top public mental health systems. The four states are also developing innovative mechanisms and incentives for reducing inpatient utilization and capacity to clinically appropriate levels and for investing saved resources in expanding community alternatives to inpatient treatment. Some of the means used by these states in successfully shifting resources and building community-based treatment systems may be useful in other states' planning efforts.

Two other elements in the planning and policy development process found in all four states, as well as others that have been successful in expanding their community programs, are strong state mental health agency leadership as well as consumer and family involvement. Many states are increasingly involved in building coalitions with families, consumers, advocates, professional associations, and other groups interested in more responsive and comprehensive community-based mental health services.

Wisconsin
COUNTIES CONTROL MANAGEMENT, FUNDING OF MENTAL HEALTH SERVICES

Wisconsin's community-based mental health system, with its emphasis on serving people with serious and persistent mental disabilities, is widely

regarded as a highly successful and efficient public mental health system. And yet Wisconsin spends far less per capita for mental health than most other states ($20.32 in FY 1983, compared to the national average of $30.27, according to NASMHPD data).

Like other states, Wisconsin has seen a significant reduction in the number of inpatients in its public hospitals; today, it has one of the lowest inpatient utilization rates in the nation. But unlike many others, Wisconsin has also succeeded in dramatically reducing inpatient capacity in its state and county-administered psychiatric hospitals. In 1970, the state had over 13,000 public inpatient psychiatric beds; today, there are about 1,100, in a state with a population of approximately 5 million. By reducing inpatient capacity, Wisconsin has been able to decrease the share of state expenditures going to its public hospitals and to shift the savings to community-based programs. The $96.4 million SMHA budget for FY 1983 was split about 50-50 between inpatient and community services.

The key to Wisconsin's more balanced approach, according to mental health professionals both inside and outside the state system, was the transfer of mental health service funding and management authority from the state government to the counties and local mental health service providers. Under legislation enacted in 1973, every county must either provide or contract for a full range of inpatient and outpatient services. The local programs are financed mainly through state appropriations, allocated to each county based on a distribution formula, and through county funds. Because the county governments have control over mental health funds, they have financial incentives to keep inpatient treatment to a clinically appropriate minimum. Extensive and inappropriate use of expensive public or private hospitals means that fewer dollars will be available for community-based programs.

The change in focus in Wisconsin's mental health system was also due to the state's early backing of Community Support Programs. Through NIMH-funded research at Mendota State Hospital in the early 1970s, the pioneer Program for Assertive Community Treatment (PACT) demonstrated the effectiveness, improved quality of life, and cost savings from community treatment of people with serious and long-term mental disabilities. PACT later provided technical assistance and contributes to the establishment of more than 20 CSPs during the mid-1970s, and it continues to contribute to state CSP development. As interest in community care for the seriously mentally ill population grew in the state agency and the mental health community, the legislature authorized additional funding to encourage the expansion of CSPs. Then in 1984, Wisconsin became the first state to require all of its counties to establish CSPs. Today, 56 CSPs serve more than 5,000 severely mentally disabled persons throughout the state.

This legislative mandate grew out of an ongoing debate over the application of the state's involuntary civil commitment laws. The statute was revised in 1974 to include strict dangerousness criteria, which made involuntary inpatient admissions more difficult and thus led to an overall decrease in hospitalization. State agency officials, local providers, families, and legal advocates who opposed a nondangerous criterion for involuntary inpatient admissions formed a coalition to work for the expansion of Community Support Programs in every part of the state.

While Wisconsin as a whole contributes a greater share of state mental health funds to community treatment than most other states, the proportion is even higher in Dane County: about 85 percent for community-based services and 15 percent for inpatient care. Dane County is nationally recognized for its system of comprehensive, high-quality community-based services for several hundred adults with severe mental disabilities, but the county receives less per capita in mental health dollars than the average Wisconsin county. The county is able to achieve such a high level of quality and efficiency by concentrating its limited resources on the population most in need -- people in crisis and people with severe and persistent mental disabilities.

Another reason for the program's success is that the county's budget process offers financial incentives for the providers under contract to treat these patients in the least restrictive and least expensive setting, explained Drs. Leonard Stein, medical director of the Dane County Mental Health Center, and Leonard Ganser, state mental health commissioner during the 1960s and 1970s. Because of the availability of a full range of community services, hospital utilization, length of stay and readmission rates have declined

dramatically over the last 10 years, they concluded in their 1983 report on Wisconsin's system, published in Unified Health Systems: Utopia Unrealized.

Colorado

DATA SYSTEM IS DRIVING FORCE BEHIND BED ALLOCATION, PERFORMANCE CONTRACTING

Like Wisconsin, Colorado spends less for mental health services ($24.88 per capita in FY 1983) than the national average, but it has also been able to build a highly acclaimed public mental health system. Despite the pressures from decreasing revenues and rising service demands, Colorado's mental health system is on a forward track. The state has been particularly successful in identifying the seriously mentally ill population and in planning for the development of services to meet those needs. According to the Division of Mental Health's (DMH's) three-year plan for the chronically mentally ill population, over half of the approximately 20,000 adults with chronic disabilities are not being served. One of the reasons for Colorado's success in addressing the needs of seriously mentally ill people is its sophisticated data system. The comprehensive, statewide database contains a wide range of information on every client served by the state's two public hospitals -- Colorado State Hospital (CSH) and the Fort Logan Mental Health Center (FLMHC) -- and its 20 community mental health centers. The data allow DMH to determine which type of service each type of patient is receiving and to estimate what kinds of services are still needed by different population groups. The information can then be used to develop new or expanded programs to meet those needs. The most important feature of Colorado's data system is that the information feeds into the division's planning, policy and program management decisions, said Nancy Wilson, Director of Program Information, Evaluation and Research.

Colorado's innovative bed allocation program is another example of how the system depends on data. Bed allocation was devised as a solution to two related problems facing the Denver area CMHCs: increasing difficulty in admitting clients to state hospital inpatient beds and sharply rising costs of inpatient services at local general and private psychiatric hospitals. Under the program first implemented in 1981 at FLMHC, which serves the Denver area, and later at CSH, each center is allotted a certain number of hospital beds annually. The beds are assigned on the basis of the needs assessment data for the center's service area. Local agencies may negotiate for utilization of each other's bed allocations. To be admitted to a hospital, a patient must be referred by a CMHC and a bed must be available either from that center's allotment or through that center's arrangement with another center. Patients are discharged by the hospital psychiatrist, with the advice of the center.

Bed allocation has been considered generally successful. In the Fort Logan service area, nonstate hospital inpatient costs declined by 34 percent and in the CSH area, by 7 percent. In addition, efficiency improved at FLMHC, with admissions per bed per month going up by almost 100 percent. Length of stay at both hospitals also decreased because of the more direct involvement of the CMHCs in the treatment and discharge of patients, said DMH's Richard Ellis in a recent paper describing the bed allocation program.

But the most important effect of bed allocation, Ellis said, was that communications and cooperation among the mental health agencies improved. All components of the system -- DMH, the hospitals and the centers -- were drawn together to plan and implement the program. In the process, they "learned more about each other, gaining mutual respect, trust and confidence in each other's abilities and motives," explained a 1984 DMH report evaluating the program.

Another example of Colorado's use of data is performance contracting. Every year DMH negotiates a contract with each CMHC, establishing specific targets on the number of persons admitted to the center's service programs. Separate targets are set for each of several different populations: children, adolescents, the elderly, minorities, and persons who are either seriously, critically, or chronically mentally ill. The information system's needs assessment data are used to determine the target levels for each population classification.

The centers can renegotiate the contracts after six or nine months if they are having trouble meeting the requirements; DMH then suggests remedial action to improve performance. But if a center still fails to meet a target, the division can levy financial penalties. DMH also uses the data system to evaluate the performance of the centers in meeting the requirements of their contracts.

Ohio

MULTISOURCE FUNDING IS A KEY ELEMENT IN SHIFT TO COMMUNITY-BASED SYSTEM

Ohio is widely recognized for the rapid improvements it has made in its system of services for seriously mentally disabled persons. The Department of Mental Health (DMH) is making major strides in transforming the mental health system from a traditional, hospital-based approach to one based on a network of community support services, especially for people with severe and long-term mental disabilities.

The state hospital patient population has dropped from over 20,000 in 1960 to about 4,200 in 1986, part of the national deinstitutionalization trend. During this same period the outpatient average daily census of community mental health agencies rose from around 12,000 to close to 140,000. Yet in FY 1985 DMH spent almost 53 percent of its $392 million budget to operate its 17 hospitals, while only 29 percent went to the 53 community boards that plan, fund, monitor, and contract for comprehensive mental health services, with the remainder for debt retirement and administrative expenses. One of the major policy issues the department is addressing in reshaping the mental health system is how to manage the changing, and sometimes diminishing, sources of mental health funds and redirect them to where the clients are, said DMH Director Pamela Hyde in testimony before the state legislature in January 1985.

A crucial element in the department's plan to shift resources to a community-based system is the use of funding from other federal, state and local agencies. The rationale for pursuing multisource funding is that persons with serious mental disorders have a wide range of mental health, residential, human services, health and vocational needs that can be addressed by a variety of public agencies. Sharing responsibility, information, and funds with other agencies helps to fill in service gaps, reduce duplication and fragmentation, and improve treatment effectiveness and cost-efficiency, DMH explains.

An example of department efforts to utilize the expertise and resources of other authorities is in the area of housing. Most of the severely mentally disabled population live in the community and are served by the approximately 350 community nonprofit agencies under contract with the mental health boards to provide an array of treatment, rehabilitation and support services. These clients have varied and changing residential needs, ranging from living alone or with friends, to living with families, to structured, supervised living. But for many, housing conditions may be inadequate, substandard or inappropriate. In 1984 DMH Director Hyde named a 35-member Housing Task Force, with funding from NIMH, to study the housing needs of mentally disabled people and to recommend policies and programs to meet their needs. The task force's 1985 final report emphasized that federal, state and local agencies should collaborate and pull together their resources to help solve the problems of persons with mental disabilities. DMH is now implementing the panel's 49 recommendations.

In response to one task force proposal, DMH is working with other state agencies to maximize the entitlements of hospital inpatients preparing for discharge to the community. Persons released from mental hospitals often experience delays in receiving the financial support they are entitled to, such as food stamps, medical assistance, general relief, Social Security Disability Insurance (SSDI), or housing. By ensuring that patients receive the aid they are due upon hospital discharge, the department hopes to reduce recidivism as well as to improve their quality of life. Recently the Department of Human Services agreed to revise its rules on general relief so that persons could receive assistance immediately upon release instead of having to wait a month. In addition, DMH was able to increase substantially medical assistance support for mental health when the medical assistance agency agreed to allow reimbursement for case management services for seriously mentally disabled persons in the community.

DMH is also working on a plan to require that one staff person in each local service area be responsible for keeping up with the complicated and ever changing income entitlement requirements administered by numerous government agencies. This staff person would advise case managers on the support available to their clients and would serve as liaison to the other agencies.

Another example of multisource funding is Ohio's Interdepartmental Cluster for Services for Youth, established in 1984 by Governor Richard Celeste. Under the cluster approach, local agencies involved with youth cooperate to plan and jointly fund services for individual children and adolescents with

mental health problems. But if an individual's multiple needs cannot be fully met through such collaborative efforts, or if the local agencies do not reach agreement on the joint allocation of resources, the case may be referred to the state level cluster, composed of representatives of the Departments of Mental Health, Mental Retardation and Development Disabilities, Youth Services, Health, Human Services, and Education. These six agencies then pool their funds to provide the services needed. Representatives of the six departments also meet regularly to develop jointly-funded special programs for the target population.

In another initiative, DMH and the Bureau of Disability Determination have recently completed a series of training sessions for case managers and other mental health personnel. The aim of the program is to upgrade the quality of reports used to support disability determination: improved reports increase the likelihood that clients will receive disability benefits for which they are eligible, said DMH's Rick Tully.

DMH also has an agreement with the Rehabilitation Services Commission to provide matching funds to enhance federal support for vocational rehabilitation and to target case services for persons with severe and long-term mental disabilities. A total of $2.5 million became available in FY 1985 through 's cooperative effort.

Vermont

PLAN UNDERWAY TO DECENTRALIZE STATE HOSPITAL, REGIONALIZE SERVICES

Vermont is among the smallest states, with a population of 500,000, more of whom live in rural areas than any other state, and it is among the poorest, with a per capita income of about $10,000. Yet the state is willing to spend almost $50 per capita on mental health, far more than the national average and more than all but three other states.

Vermont has also long been committed to a community-based mental health system, devoting a higher proportion of its mental health resources to community services than any other state. Of the $20.8 million spent by the Department of Mental Health (DMH) for mental health services in FY 1983, $11.8 million, or about 58 percent, went for community services. In addition, the state has chosen to concentrate over 75 percent of its mental health budget on services for adults with severe and chronic mental disabilities. Further, Vermont supports and funds more consumer-operated mental health service alternatives than any other state.

Now the department is in the first stages of implementing a plan to regionalize the system even further. An integral part of Vermont's regionalization plan is to reduce the size of its only public inpatient facility, the Vermont State Hospital (VSH). Bed reductions during the past 20 years have decreased VSH's capacity from 1,100 to 180 beds; the new plan would reduce it further to 80 beds, including a 25-bed forensic unit. The hospital would then be used only to care for certain groups of long-term, difficult-to-manage mentally ill patients (in addition to the forensic patients): the frail elderly, those with medical problems, brain-damaged individuals, and patients with multiple diagnoses. All other patients would receive mental health care and other rehabilitation and support services through the state's 10 community mental health centers.

The rationale for decentralizing the state hospital is based not only on the mental health system's view that community care for the seriously mentally ill is more effective and more humane than institutional care, but on important cost considerations as well. Anticipated cuts in federal and state funding over the next five years mean that the department's limited resources must be targeted to the most cost-effective services: community programs. Another major cost concern was that "longstanding treatment problems at Vermont State Hospital will require substantial investment of funds if improvement is to be achieved, and costly improvements would compete for funds for community services," said the state's five-year mental health plan, "Mental Health Directions for the Future, 1986-1991." The plan was prepared by a 15-member steering committee following a series of public hearings throughout the state.

Although the current plan is to maintain VSH for a certain patient population, earlier the state legislature considered shutting down the hospital entirely, except for the forensic unit. In December 1984 a joint legislative study committee on Vermont's mental health system ordered DMH to examine the feasibility of developing regional service alternatives to VSH. The committee was concerned about the quality of care at the hospital, but also questioned whether community alternatives would be available if the seriously mentally

disabled patients were no longer treated at the state hospital.

Paul Carling, La Vonne Daniels, and Fran Randolph of Boston University's Center for Psychiatric Rehabilitation, with assistance from other consultants including the Alpha Center, studied the issue and concluded that the development of a regionalized system based on the rehabilitation approach, and the closure of VSH, except the forensic unit, is both feasible and desirable. The legislature then adopted a resolution supporting the concept of regionalization. The Governor and the Agency of Human Services agreed with the concept, but, reluctant to endorse closure, proposed a compromise aimed instead at greatly reducing the system's use of VSH. The plan is widely endorsed by parent and consumer groups and by mental health providers.

According to the five-year planning document, many of the community services needed for the patients now served at VSH are available because the state has already developed an extensive community-based system in response to previous bed reductions at the hospital. But the further decentralization of the hospital will require the development or expansion of some kinds of services to meet all the needs of this population. For example, based on the feasibility study, the plan projected the need for about 14 to 17 new inpatient beds for involuntary and voluntary patients, about 31 to 36 new nursing home beds, and approximately 15 nonhospital crisis beds, plus additional voluntary and involuntary residential options, intensive day treatment programs, emergency and crisis services, vocational programs and legal advocacy services. With the exception of one-time start-up funds in the first years of development, a regionalized system is not expected to cost the state any more in the long run than it pays now for care of these patients at VSH; overall costs may increase, but these costs should be offset by increased revenues from Medicaid and other third-party reimbursements, the study said.

Some progress has already been made in providing these needed services, said Andrea Blanch, DMH's coordinator of training. In some parts of the state, additional day services, residential units, and case management services are being developed. In addition, two CMHCs are working on proposals to provide for involuntary inpatient care in local general hospitals; such treatment is now available only at VSH.

The next step is for the department to find out about local program and funding needs. DMH asked each CMHC to submit information on projected VSH utilization, a description of its existing services, and proposals for new and expanded local and regional services that would be needed to reduce the VSH census for the area even further. The department will then use the centers' estimates on the costs and revenues for each program to prepare its budget request for FY 1988, to be presented next January.

The Alpha Center recently received a grant from the National Institute of Mental Health to train state mental health agency program directors and their key management and planning staff in strategic planning, with an emphasis on expanding community-based mental health service systems. Persons interested in applying strategies on shifting funding and workforce resources from inpatient facilities to community-based mental health services may contact David Goodrick, Ph.D., Associate Director of the Alpha Center, for further information.

A "Mental Health System Strategic Planning Guide," prepared under contract with NIMH's Division of Education and Service System Liaison, is also available from the Alpha Center for $5 per copy prepaid.

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PUBLIC HEALTH CARE FOR THE CHRONICALLY MENTALLY ILL: FINANCING OPERATING COSTS
Issues and Options for Local Leadership

Barbara Dickey, Ph.D.,
and Howard H. Goldman, M.D., Ph.D.

ABSTRACT: Revenue sources for mental health care for the chronically mentally ill are fragmented, and services limited. What services are provided are frequently underfunded, and gaps in the "safety net" undermine a continuum of care. Given this situation, what can local units of government do to leverage multiple funding streams in a way that makes optimal use of scarce resources? The authors describe different types of reimbursement, noting that every method of health care reimbursement carries different response incentives and disincentives for providers and patients. They frame an analysis of long term care financing models that may have heuristic value for systems of public care for this special population.

INTRODUCTION: ISSUES IN FINANCING

The purpose of this paper is to review the issues that relate to the financial structure that supports services to the chronically mentally ill. It is intended to assist local policy-makers weigh the implications of different fiscal alternatives and strategies. The issue for local planners is how to develop a financial structure at the local level that will encourage clinically sound care and incorporate appropriate incentives for both providers and clients.

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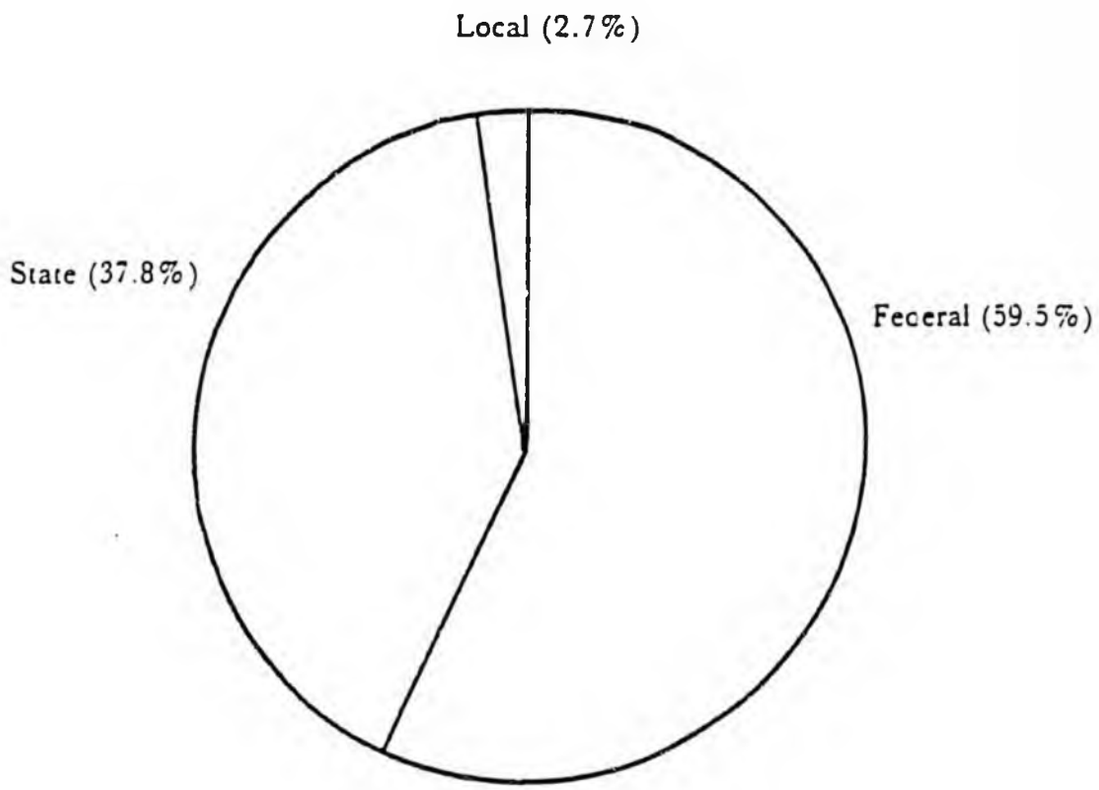
It is evident that if local units of government want to improve the current delivery system of care to the chronically mentally ill, localities must have greater financial control of their resources available to them for that purpose (see Figure 1). When we consider who pays for the care of the chronically mentally ill, we arrive at an inescapable conclusion: counties play only a small role and cities almost none.

Furthermore, at other levels of government, there are multiple categorical aid and entitlement programs that form an uneven patchwork of support for this neediest segment of the mentally ill. These multiple funding sources contribute to the problems in the system today: diffusion of authority, weak

Figure 1
ESTIMATED EXPENDITURES FOR THE CMI
by Governmental Level, 1983



Total expenditures = $11.1 billion. Federal category includes expenditures for the following programs: Medicare, Medicaid, SSI, SSDI, block grants, Title XX, and housing. State category includes Medicaid and direct allocations.

accountability structures, inadequate product definition, inflexibility in the management of cash flow and limited ability to generate capital. The chronically mentally ill, least able to advocate on their own behalf, are the ones most likely to suffer the consequences of this situation: disruption in continuity of care, inadequate or inappropriate provision of services, neglect and abandonment. It is the cities, however, that must pay for the inadequacies of the system through their fire, police, courts and welfare support.

The complexity of the issues that must be considered is linked to the fact that for the chronically mentally ill, mental health care is only one type of service required. Housing, social and rehabilitation services, medical care and basic minimum maintenance needs also have to be met. Multiple funding sources support these needs, some more adequately than others, within a maze of regulations, eligibility criteria, and benefits. The resources available to meet these needs vary by state and locality, but barriers to using these resources optimally exist everywhere.

The central theme of this paper is that a reconsideration of how to surmount those barriers must include examination of how public mental health care is reimbursed. We know that with greater control of financial resources there should be increased efficiency. This control might be accomplished by channeling the multiple revenue streams into one pool where the local agency can redistribute the funds according to whatever distributive model is most appropriate for the locality. It is the structure of the model that interests us here. We assume that each type of payment mechanism has particular economic incentives and disincentives; therefore these mechanisms will drive the system in different ways. The goal would be to come as close as possible to the ideal payment mechanism, which would result in a system that would balance provider and client interests at the lowest possible cost. The next section of the paper describes different types of payment mechanisms and the implications for the provision of public services.

In the final section of the paper we will review some ways in which others have considered these same issues and proposed solutions. Each model for financing long term care that we describe has considerable strengths, but some weaknesses as well. These models illustrate some of the inherent tensions in the delivery of public services. A delicate balance must be struck between the civil rights of the chronically mentally ill and society's right to manage cost-effective services thought necessary for this population. The manner in which the different revenue streams are brought together and redistributed plays an important role in striking that balance.

This paper will address the financial issues related only to the operating costs for the care of the chronically mentally ill. Raising capital for public facilities is at least as difficult a problem for local communities, but the issues are somewhat different and we save them for future study.

PAYMENT MECHANISMS: USING REVENUES EFFICIENTLY

As a framework for considering financial models for long term care, this section summarizes the three major methods of paying for mental health services. As we review different options in payment—direct allocation, cost-based or fee-for-service reimbursement, and prospective payment—we will comment on the incentives embedded in the method, and the likely consequences for quality of care and service demand by chronically mentally ill clients.

Direct Allocation

Historically, the public provision of mental health services has been in the form of state supported services-in-kind, most notably state hospitals. Budget allocations are determined by the legislature, and set independently of actual service utilization. In most states, the budget process does not specify the number of units of service to be delivered, nor do state legislators rely on product definition to determine the allocation.

Because of the direction of the flow of funds, i.e., typically, through the state department of mental health (SDMH) directly to service programs, continued allocations to agencies are dependent on their ability to design services to fit the SDMH's current funding priorities. These may be heavily influenced by political or social pressures; therefore, service provision at any given time may be an expedient response to these priorities. Some states have recognized this problem and have experimented with a number of different payment methods to minimize it.

At least three-quarters of the states do have a systematic mathematical formula for distributing the appropriations among counties or areas (Stephen Leff, personal communication concerning work in progress). Leff, in categorizing resource allocation models, has been able to identify models that fall into three general types: equity models, efficiency models and mixed equity/efficiency models. Most states use equity models that rely on determination of what clients need and what resources exist to serve those needs. Efficiency models, on the other hand, make allocations based on provider performance and production. Because client outcome is difficult to measure and product definition is hazy, only a small percentage of states use this concept. New Jersey is one example of a successful statewide implementation. Some states use a mix of equity and efficiency models. For example, in Pennsylvania (Miller, 1985), each CMHC receives a portion of its allocation based on relative need for services, and the remainder is determined by a number of performance factors, such as prevention of state hospital admissions.

Virtually every state has developed some financial mechanism for reducing dependence on state hospitals for the provision of services. In Texas, for example, the reduction of state hospital bed days is encouraged by returning $35.50 to

CMHCs for every bed day less than their annual baseline number of days. The funds accrued through this mechanism are expected to be used for community-based services for those at greatest risk for rehospitalization. In Rhode Island, allocations to CMHC's are based, in part, on the number of discharged state hospital patients they admit to their systems. For every former patient, the center is allotted $500 a month, which they lose if the patient is returned to the hospital for more than thirty days.

Cost-based Reimbursement and Fee-for-Service

Cost based-reimbursement for hospitals and fee-for-service for physicians have been described by some as a "blank check" rewarding providers for high utilization of services. For this type of reimbursement, the fee charged is directly related to the demonstrated costs to provide the service to the patient. Hospital charges have been based on patient-specific resource use calculated after the services have been delivered. The physician's fees are established through a normative process by insurance companies, although physicians can, of course, choose to set their fee at any level. To deviate from the "usual and customary" range of charges for a service is to put reimbursement by a third party payer at risk.

The strength of these approaches to payment lies in the choice they provide consumers, which is thought to provide beneficiaries with sufficient leverage to ensure high quality care. However, these payment mechanisms have come under heavy criticism for their open ended-nature and influence on the cost and delivery of services. Spiralling health care costs have resulted, in part, from economic incentives to provide more services than are thought to be necessary. These types of payment mechanisms are not exclusive to private insurance: over 95 percent of all those eligible for Medicare or Medicaid select (or change) providers with the same freedom as those with private insurance.

Preferred Provider Organizations (PPOs). Faced with escalating costs, policymakers, insurers, and providers have devised various cost containment strategies. The most widely discussed method of reducing costs while keeping the fee-for-service system intact is the preferred provider organization (PPO). In a PPO, a group of providers, e.g., physicians or hospitals, join together and provide care at a discounted rate negotiated with an insurance carrier or other third party payer. The PPO's appeal is that it preserves the choice of providers associated with traditional health care delivery while minimally disrupting the provision and billing of services. Payers save through discounted rates, and providers benefit from increased volume.

PPO-type arrangements between state or local governments and vendors of mental health care would work best when there is an oversupply of providers, which would be an incentive for providers to accept a reduced fee in exchange for a greater share of patients. PPOs identify certain providers with enough financial flexibility to absorb the discounted rate that characterizes PPO contracts.

Typically, vendors of services to the chronically mentally ill are scarce and underfunded, conditions which suggest that PPOs would be difficult to arrange.

Prospective Payment

In prospective payment systems (PPS), the level of payment is determined before services are provided. The level of payment may be derived by a number of means, but it is always independent of the cost of services for a particular case. Paying prospectively requires that the "product" be defined, that is, by a description of the type of service or services, including some temporal characteristic. Payments might be for a hospital admission, for an episode of illness, or for some specified length of time, irrespective of illness or treatment considerations. Prospectively-determined fixed payments have incentives to increase the efficiency of service delivery, but utilization controls may result in underserving the chronically mentally ill.

Hospital Admissions. Since 1983, Medicare psychiatric admissions, in general acute care hospital scatter-beds have been paid prospectively at a predetermined rate. The rates vary depending on the patient's discharge diagnosis and within which Diagnostic-Related-Group (DRG) it falls. Because the hospital is at risk for costs that exceed the reimbursement, there is a clear financial incentive to minimize costs.

Unfortunately, there is also a clear financial incentive to increase the volume of admissions, especially those admissions that are likely to be the least costly to treat, since hospitals retain the entire reimbursement for each admission, irrespective of the cost of the admission. Although the average length of stay for disabled adults paid for by Medicare is no longer than that for the elderly, there is a widely held assumption that this is not the case. Although evidence is to the contrary, the perception is that chronic mental patients often present more, rather than less, complex treatment problems, and are thought to be bad financial risks. This may be true over the course of a year, but it is not true for each hospital stay. This perception probably leads to undertreatment and premature discharge. It is already known that limits on stay in general hospitals lead to increased admissions to state hospitals (Frank and Lave, 1985).

Medicare's PPS was the subject of intensive study in 1985, as Congress considered whether or not specialized psychiatric and substance abuse facilities or units in general hospitals should be included and, if so, under what conditions. HCFA's report to Congress at the end of the year recommended that more research be undertaken before including psychiatric and substance abuse admissions in speciality settings under PPS.

Episode of Illness. We know of no reimbursement mechanisms that make payments at the level of episode of illness, but health policy researchers have begun to use this concept in their analysis of mental health care utilization. The way in which an episode of illness is defined is shaped by whether the concept

is going to be used by researchers, reimbursers of treatment, or monitors of quality of care. For the chronically mentally ill, the task of setting parameters around "episode of illness" may be so difficult and of such limited value that this approach to reimbursement does not hold much promise.

Capitated Payments. Capitated payments are a prospective rate for health care per member (or per family) per year, regardless of the level of use. In capitated systems, the payment to the provider is in the form of annual premiums, derived in part from actuarial data that determine the level of financial risk borne by the provider relative to a given population. Whether the payment is defined as a fixed annual per-patient rate or as an annual per-member premium, providers enter into a contract to deliver comprehensive services and assume financial risk. This arrangement has appeal both to large purchasers of services hoping to contain costs and to providers in areas where their oversupply has lead to competitive efforts to gain a share of the market. Health Maintenance Organizations (HMOs) are the most common example of capitated payment systems.

Under a provision of the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, Medicare eligibles can enroll in federally-qualified HMOs for their care. The Health Care Financing Administration negotiates an annual (adjusted) premium rate with the HMO; this represents about a five percent saving over equivalent fee-for-service treatment.

In order to enroll Medicare beneficiaries in a prepaid managed health care project, the project must be a federally qualified health maintenance organization, a health insuring organization that subcontracts services, or a formal demonstration project under Section 1115 of the Social Security Act, which permits waivers of federal Medicare requirements for demonstration purposes.

The usefulness of a capitated system as a mechanism for providing long-term care for the chronically mentally ill is limited by the nature of the benefits (acute and short-term) offered by Medicare and HMOs. Furthermore, there are incentives to limit access to these expensive patients, and if enrolled, incentives to underserve.

In a recent review, Bonanno and Wetle (1984) identified two additional problems. HCFA regulations for Medicare enrollment in federally qualified HMOs result in two major disincentives to enroll the chronically mentally ill: first, the method of arriving at the rate of reimbursement means that some HMOs may systematically incur financial losses; and second, HMOs that do realize savings, must return them in the form of increased benefits or reduced premiums rather than use them to establish a reserve fund to cover risk exposure.

Another critic of prepaid settings for chronic illness is Schlesinger (1985), who argues that the quality of care will decrease, not increase, for chronic patients treated in these settings for two reasons: health care professionals consider it more prestigious and satisfying to treat acute illness, and the financial incentives

embedded in the prepaid setting lead to the likelihood that the chronically mentally ill will be underserved. He points out, as have others, that the services most needed by this population are non-medical in nature and not likely to be offered within the HMO benefit package.

Schlesinger also makes another point: being able to use vouchers to purchase from among several capitated plans is thought to guard against reductions in the quality of care. For the chronically mentally ill, however, the advantages of such choice seem illusory. There is evidence that the chronically mentally ill undervalue long-term care coverage, and that they are ill-equipped to weigh the differential advantages of complex benefit plans.

EXAMINING LONG-TERM CARE FINANCING MODELS

Each of the following models is an example of pooled revenue streams combined with payment mechanisms designed to accomplish certain goals of the system. The Somers, Ruchlin and Santiago models are proposals made by health policy researchers and planners. The S/HMO model is currently in a HCFA demonstration phase and the Marshall model is a pilot project, about to become operational. The Dane county model has been operational for many years. Only evaluation of the projects in operation will answer questions about their utility, but their promise to provide mental health, medical and social services deserves attention.

Somers: Increased, Locally Administered Medicare Coverage

Of the models presented, this one proposes the fewest changes in the current system: pooling existing resources, paying them out in a capitation mechanism, and adding long term care to the benefits to those already established. This proposal, first presented to the National Council on Aging in 1981 (Somers, 1982) suggests that both acute and long-term care for the elderly and disabled could be covered by Medicare. Within guidelines established by HHS, the program would be administered by a public or private body in the local community.

The program would have three primary functions: 1) to ensure co-ordination among health-care institutions, agencies, and other programs for the elderly and disabled, 2) to allocate resources, equitably and effectively, and 3) to provide assessments, placement, and case management for patients. The program would be supported by transferring funds, currently budgeted under Medicaid and Title XX, to Medicare. All Medicare providers would be paid fixed rates prospectively as a cost control measure. Cost-sharing formulas for various long term benefits would be developed by HHS.

The author states that

> [the proposed program] aims to retain the proven strengths of Medicare, including its nearly universal entitlement for the elderly and seriously disabled, its requirement for physician

> responsibility, its quasi-insurance type of financing, its tremendous resources and its high standards of quality, while suggesting new restraints on provider payments for all types of benefits. . . . To private health-insurance carriers, it offers a new market for supplementary coverage for long-term care, even more extensive than the Medigap market opened up in 1965, because cost sharing will inevitably be required. To . . . others who may fear the "medical model" it offers a piece of the action in the mainstream rather than an illusory independence in a peripheral program.

While this model appears to have something for everyone, it may benefit consumers the least and providers the most.

Ruchlin, Morris and Eggert: Local Area Management Organization (LAMO)

This proposal is designed for the frail elderly and the portion of the disabled population that requires institutional care (Ruchlin, *et al.*, 1982). It differs from the preceding model by identifying a sub-population where needs are primarily non-medical and best met through a set of comprehensive support services which include acute medical care when it is needed. Local boards, comprised of individuals representing public and private interest, make policies but delegate operational authority to the LAMO. In turn, each LAMO has the power to determine which individuals are eligible for public services, which services they should receive and for how long, and which providers will be certified to receive reimbursement from public funds. The LAMO is at risk for all necessary medical, rehabilitative, and maintenance services for its enrollees, thus encouraging cost-effective care and placement. It proposes a community level program with four functions: gate-keeping and service allotment, case-management, quality of care assessment, and payment of care.

Initially, funds for operating costs would come from pooling federal block grants, SSA Titles XIX (Medicaid), and XX (Social Services) revenues, and turning over in the form of a capitated annual payment, a lump sum payment to each LAMO. The authors argue for gradual privatizing of the programs.

Ruchlin, *et al.* see LAMOs as benefitting not simply the medically indigent but all those who need its services. To accomplish this, they suggest that private support for LAMOs might supplement public funds by operating in much the same way as individual retirement accounts. Employers and employees would make regular contributions to an account (a "medical" IRA) and an employee, on retirement, would annually receive a set of vouchers earmarked for the purchase of long-term care, either for the employee or his/her relatives. These long-term care accounts would have characteristics similar to IRAs, e.g., tax credits for contributions, provision for disposition of unused vouchers, and penalties for early withdrawal of contributions.

The authors contend that the advantage of encouraging private enrollment in a LAMO is that it avoids the development of a second class system of care for the indigent. Vouchers would be used to purchase the minimum package

of services (or more, if additional vouchers had been accumulated), encouraging competition among LAMOs with the presumed benefits that are believed to accompany competition.

The authors acknowledge that setting up such a system like the one described carries with it some difficult problems: excessive or unplanned start-up costs, delays in seeking waivers or negotiating necessary agreements and contracts, and resistance from care-givers or family members who are reluctant to agree to moving institutionalized patients into less resource-intensive settings. Critics of the proposal have pointed out that setting up a special program for a small segment of the population may make it too vulnerable to political pressures to be financially viable.

Diamond and Berman: Social and Health Maintenance Organizations (S/HMOs)

S/HMOs (Diamond and Berman, 1981) are designed to provide a comprehensive package of social, medical, and personal care services to anyone over age sixty-five and are currently being tested in Medicaid demonstration projects around the country. The service packages offered are similar to those that would benefit chronic mental patients: inpatient and outpatient medical and mental health services; physical and occupational therapy; home health services including skilled nursing care and home health aides; homemaker and chore services; prescription drugs; and transportation. The inclusion of long-term care services with case management is thought to improve continuity of care and reduce costly inpatient utilization.

Capitation payments would come from pooled Title XIII (Medicare) and Title XX (Social Services) monies, with additional premiums for Medigap-equivalent coverage and for personal services. Enrollment would be voluntary. The financial viability of the plan rests on selecting a target group which spans a wide range of conditions and needs so that the risk pool is large enough to absorb the costs of the most vulnerable enrollees. Analysis of the pilot projects have not yet reported whether adverse selection (i.e., the enrollment in a plan of a disproportionate share of "bad risks") has resulted in financial overruns. While dependence on a target group with a varied range of conditions is not very realistic if the only enrollees are the chronically mentally ill, the program might work if they were a small subset of all enrollees. The following plan addresses this problem directly by establishing a different mechanism for assigning annual payments.

Marshall: Integrated Mental Health, Inc.

This unusual public-private system, designed specifically for the chronically mentally ill, has joined local businessmen, community providers, and state public planners and bureaucrats (Marshall, 1986). It is now in the final planning stages in Monroe and Livingston counties, New York. A public corporation, Integrated Mental Health Inc., (IMH) was set up five years ago to plan for and ultimately

administer services to the chronically mentally ill under an annual reimbursement plan.

A lead agency (usually a local CMHC) would receive a budget allocation determined by number of enrollees and their levels of need. Four or five lead agencies are expected to compete for enrollees. All must offer a comprehensive set of services. Direct mental health services are likely to be provided by the agency (probably a CMHC), and all other services, such as housing, social, or rehabilitation services will be purchased from other local agencies. The lead agency would also pay for state hospital admissions and all medical care.

IMH has identified about 1800 chronically mentally ill eligible for services based on utilization over the past three years. They are categorized into three levels of expected need: those with a long history of state hospital use, those who have a history of "revolving door" hospital treatment, and those who are at risk for hospital admission and have high need for ambulatory care. The estimated annual allocations by category (in 1982 dollars) are $32,000, $8,000 and $5,000 per person.

These annual payments would cover all the enrollees' needs. Budget allocations would be adjusted annually for inflation and for changes greater than five percent in enrollment figures. Adjustments that do occur will be made only on that portion of the budget accounting for variable (rather than fixed) costs.

Lead agencies benefit in a number of ways from this plan. The predictable income level provides increased stability which permits long range planning, efficient expenditure of funds and management of cash flow. The agencies are protected from unpredictable catastrophic expenses through reinsurance provided by IMH and paid for by ten percent of the total annual allocation.

The provision of cost-effective care is encouraged by allowing agencies to retain ten percent of their net revenues. The agencies return additional excess to IMH for redistribution to other lead agencies with deficits. Redistribution might be necessary because of unexpected population shifts or other factors, beyond the control of the lead agency, that affect income levels. Excess revenues returned to IMH might also be used to start up needed services.

This system was designed to provide sufficient financial incentives to drive itself without bureaucratic oversight and monitoring constraints. Any revenues generated from third party reimbursement or categorical aid are collected by the agency that delivers the service and are returned to the lead agency. The lead agency returns the state and county share to the respective governmental units, but the federal share is returned to the state for redistribution to IMH later as a portion of their budget allocation.

Santiago: Regional Authorities for Comprehensive Care

The Arizona legislature has approved a plan to provide all the care for the chronically mentally ill through nine public corporations with regional responsibility (Santiago, 1986). Funding for each Regional Authority will be

pooled from county, state and federal sources and distributed across the state regions by a formula that may be weighted to take case mix into account. The Regional Authority will fund multi-disciplinary clinical teams who in turn will arrange for the provision of all services needed by chronically mentally ill clients assigned to them by the authority.

Services are rank-ordered in the proposal as essential, necessary, or helpful to ensure that state planning priorities are consistently followed and the neediest patients are cared for adequately. The continuum of care described in the proposal begins with food, shelter, and clothing as essential. Institutionally based services, including acute and long term hospitalization are purchased by the team, but other services such as outreach, evaluation, and family education and support are provided by team members.

The proposal outlines a number of principles that guide the plan: dollars follow the client; the Regional Authority, the clinical team, and the institutional providers must be independent of each other to ensure that there is no conflict of interest; families and clients must be represented by advocates and actively encouraged to participate in the system; special emphasis must be on very low functioning and difficult clients; and the system must be flexible to accomodate individual, local and regional variations in culture.

Quality of care will be subject to scrutiny by an external evaluation agency that will report to the Governor. Another feature of the plan expected to ensure quality of care is that each Regional Authority will select the teams through a competitive review and, once selected, each team will have its performance reviewed before contract renewal. The team, in turn, will be selective in purchasing services. Where more than one provider offers the same service(s), presumably the team will select the provider that offers the best value for the money.

Stein and Ganser: Dane County, Wisconsin Mental Health Services

In Wisconsin, the provision of public mental health services is the responsibility of counties, rather than being centalized at the state level. Each county must pay for the inpatient stays of its residents as well as community-based services using state allocated funds supplemented by local monies. This type of financial structure exemplifies the money following the patient, in a system that encourages (but does not guarantee) cost-effective case management through the use of hospital alternatives. The assignment of total responsibility to the county for the comprehensive care of the mentally ill has centralized both clinical responsibility and financial accountability in the same administrative structure. The state has gradually reduced its share of the funding, forcing counties to increase their contribution. This has had the effect of further solidifying the responsibility within the county structure.

Dane County, which has a population of 300,000, has identified 1,002 individuals with chronic mental illness. County officials have developed several

mechanisms to reduce the use of inpatient care: Crisis Intervention Service, which provides crisis intervention and acts as a "gatekeeper" to hospital treatment; Mobile Community Treatment Team, which helps patients develop and maintain support systems and encourages work activity; Support Network, a day activity program with comprehensive services that support disabled adults to live more fulfilling lives in the community; and specialized living arrangements for over two hundred of the chronically mentally ill.

In Dane County, about eighty-three percent of the mental health dollars go for community-based services. However, some Wisconsin counties have not developed community alternatives to inpatient care and have hospital expenditures as high as seventy percent of their total budget. Merely assigning responsibility to the county will not guarantee cost-effective programs. Commitment to the development of services and housing in the community must be a priority with the management team.

Model Building and Conflicting Assumptions. The models described illustrate some of the implicit choices that planners must make in devising new financial structures. These models tend to highlight current trends in the health care field, trends that have come about because of past failures in existing systems. The trends most apparent here are cost-containment, usually in the form of capitation or capped budget allocations; competition among providers for market share; and the designation of case management as a function distinct from service provision.

Cost-containment Strategies. Capitation, as a cost containment strategy, is a powerful tool for limiting expenditures, especially when there is some financial incentive for the capitated providers. Only one of the models described, the S/HMO, is a true capitation model, opening enrollment to all those who think that they may some time in the future need the services the S/HMO offers at a fixed premium, not those actually needing services at the time of enrollment. In capitated systems, if the expenditures exceed the revenues in any given year, the annual premium can be raised the following year. This is not the case with budget allocations, as in Wisconsin and New York, which have some of the same cost-containment effect, but the incentives are somewhat different: more a stick than a carrot. New York allows the lead agencies to keep ten percent of the "excess" after expenditures as an incentive to providers. In general, however, the notion of "excess" in public agencies implies poor allocation planning and is unlikely to be viewed favorably by taxpayers. Publicly funded services are not designed to be profit-making, although competitive salaries and attractive facilities may be attained if it can be shown that reimbursable services (i.e., revenue generation) can be provided in settings that meet private sector standards.

Client Choices. Pressures to reconsider traditional health care financing mechanisms (e.g., fee-for-service) have led policymakers to look closely at alternative approaches. Two themes that reoccur in many of the proposed payment systems

currently being considered are fiscal incentives and marketplace competition. Current thinking favors systems that are in line with our commercial economic values: marketplace incentives will keep "product" costs competitive while informed "consumers" shop around for the best value for their money.

Implicit in the theory of free markets is the notion of informed choice on the part of the consumer, which results in shifts away from the purchase of overvalued products. Although the idea of informed choice in health care is appealing, there is little evidence that the forces described have operated as predicted. Therefore, we are not optimistic about the ability of the chronically mentally ill, whose judgment may be impaired, to be more discerning consumers than other segments of society.

It has been acknowledged by those who favor competition of some kind that there are some potential dangers in this approach. Attracting and keeping members enrolled may lead to excesses in promised but undelivered services. However, changing providers to improve the quality of care (or to save money) is likely to be in conflict with assumptions about the need for continuity of care and the importance of stable relationships to the chronically mentally ill.

Related indirectly to client choice is the geographic site of the provider(s), important to the chronically mentally ill who may have difficulty with transportation. Even when transportation is not a special problem, it is not uncommon for all health care consumers to limit their actual choice to the provider most conveniently located.

Case Management and Service Provision. Each of these models offers a somewhat different approach to solving the inherent conflict of interest in traditional models of care, where the same provider identifies and assesses the (mental) health care problem, prescribes treatment and delivers the treatment. The Santiago model is the most explicit in its statements about separating case assessment and management from service provision. Dane County and the LAMO proposal appear to be structured in this way as well. While this issue of who controls service delivery may seem to be removed from the financial aspects of system planning, control of expenditures is a key factor and, depending on where the control resides, both revenues and costs will be affected. Case management teams add a level of bureaucracy to the system that is an additional expense, but may be necessary when the administration of multiple providers is unable to ensure continuity and quality of care.

SUMMARY

Problem-solving must begin with identifying the available resources, taking maximum advantage of them, and exploring avenues for generating new revenue. Once all possible revenues and resources have been identified, the methods by which they can be most efficiently used is the next step in the problem-solving

process. The ability to determine the method of payment is not contingent on pulling all the revenues and resources into a pool managed by a single administrative structure. However, if local units of government are to be held accountable for the efficient expenditure of those resources, they must have the capability to manage their resources.

Clearly, a large part of the challenge will be the political barriers that surround the process just described. Although we must leave the discussion of the political issues to others, we do not want to appear to underestimate them. Of singular importance is the fact that the segment of the population with the greatest need, the chronically mentally ill, is also the population least able to leverage the political system and has the fewest advocates.

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Senator John B. (Jack) Coghill
Alaska State Legislature

Box V
Juneau, Alaska 99811
(907) 465-4797

Box 55028
North Pole, Alaska 99705
(907) 488-0862

MEMORANDUM

DATE: March 17, 1990

TO: Senator Bettye Fahrenkamp
Senate Resource Committee Chair

FROM: Senator Jack Coghill

SUBJECT: Sponsor Statement: CS SB 493; Mental Health Trust.

BILL SUMMARY
This legislation basically does three things:

1) it establishes a value for the Mental Health Trust Lands, as required by SLA 1987 Ch. 48;
2) it reconstitutes the corpus of the Mental Health Lands Trust; and
3) it establishes an indexed, revaluation process.

FISCAL IMPACT
The Department of Natural Resources has given this bill a zero fiscal note. The Department of Health & Social Service gave the original bill a zero fiscal note, and we have not received an updated version, but we anticipate that it has not changed.

ABOUT THE BILL
The Senate HESS committee made several technical changes to the original bill. Page 2 of this memorandum contains those changes.

The purpose of the bill is rectify the impasse that was reached in November of 1989, regarding the value of the Mental Health Trust Lands, between the interim mental health trust commission and the commissIoner of natural resources. The source of the impasse is the value placed on mental health lands as established under SLA 1987 CH. 48. Two members of the interim mental health commission endorsed the $ 2.2 billion arrived at through their process. The third member, DNR, believes the valuation process was flawed. In DNR's minority opinion, the bench mark value should be approximately $ 622,525,043.00. The largest area of disagreement is the value of mineral resources. DNR places a value of $ 73.4 million and the independent appraisers estimate a value of $ 1.5 billion.

SENATE HESS AMENDMENTS TO SB 493

Page 1, line 11: Delete, "fair".

Page 1, line 12: Delate, "market".

Page 1, line 12: After "land" insert,

"selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act."

Page 1, line 20: After "Act" insert,

"that is located in municipalities that assess land for property tax purposes;"

Page 1, line 24: After "municipality" delete the comma and insert,

"since that municipality's assessed values were used to revalue land selected or patented to the state under sec. 202 of the Alaska Mental Health;"

STATE OF ALASKA
THE LEGISLATURE

POUCH Y · STATE CAPITOL
JUNEAU, ALASKA 99811
907·465·3800

LEGISLATIVE AFFAIRS AGENCY

M E M O R A N D U M April 25, 1990

SUBJECT: Mental health trust
(CSSB 493 (HESS))

TO: Senator Jack Coghill

FROM: Richard A. Bradley
Legislative Counsel

Bruce Geraghty has requested a sectional analysis that points out the differences between SB 493 as introduced and CSSB 493 (HESS).

Section 1 of both bills repeals and reenacts AS 37.14.011(c).

In the introductory paragraph of (c), the words "fair market" are deleted in CSSB 493 from the phrase "fair market value of the land" on lines 11 - 12 of SB 493. Similarly, after the "value of the land" on line 12 in SB 493, the phrase "selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act" is added in the CS.

In [illegible] after the phrase "acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act" in SB 493 at line 20 is added the phrase "that is located in municipalities that assess land for property tax purposes" in the CS.

In (c)(2), after the phrase "the average percentage change in assessed values for that municipality" in SB 493 at line 24 is added the phrase "since that municipality's assessed values were used to revalue land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act;" in the CS.

There are no other revisions from SB 493 to the CS.

If I may be of further assistance, please advise.

RAB:gc
G14/032

MEMORANDUM

State of Alaska

Community and Regional Affairs

TO: G. Thomas Koester
Asst. Attorney General
Department of Law

DATE: April 26, 1990

FILE NO: 0526T/MW/cbs/1410.12

TELEPHONE NO: 465-4750

THRU:

SUBJECT: CS HB 493 (HESS)

FROM: Michael Worley
State Assessor
Municipal and Regional
Assistance Division

You have requested my comments with regard to the revaluation formula contained in CS HB 493 (HESS).

Under the proposed formula, the actual assessed value for land in property taxing municipalities would be used to develop the ratios and resulting "revaluation factor" for time-adjusting the estimated values for these lands. That approach raises three concerns:

1. Municipalities have the flexibility under AS 29.45.050 to exempt property from local taxation by local option. Property values which are optionally exempted, or for which an optional exemption is removed, would change the levels of actual local assessed values. Changes in assessed land values resulting from these actions would skew the ratios and factors set out in the current version of the revaluation procedure.

2. The proposed revaluation procedure does not provide for geographic differentials in the increases (or reductions) in land values. The proposal calls for land value changes only in property taxing jurisdictions to serve as a basis for all of these lands statewide. In fact, there are often wide disparities in the rates of property value changes, based on their geographic location within the State. In addition, Alaska's property taxing jurisdictions tend to be more highly populated than other jurisdictions and areas of the State. In highly populated areas, supply and demand generally causes annual property appreciation rates to be higher than those in lower populated areas. Therefore, under the current proposal, remote properties would likely be revalued using rates which are too high, and therefore inaccurate.

3. The proposal calls for these properties to be revalued every five years. In the five year period from 1980 through 1985, taxable property values in Alaska experienced a change equal to plus 64.25%. In the four year period from 1986 through 1989, those values dropped 24.23%. Because Alaska's boom and bust history, it is likely similar drastic changes in property values will occur in the future. To reflect a true picture of the rises or drops in property values, a revaluation of these lands should be conducted annually.

Each of three concerns noted above could be successfully addressed if, instead of using the actual local assessed values in the proposal procedure, the Full Value Determination (under AS 14.17.140) were used. The Full Value Determination takes into account locally exempted property values and is estimated virtually for all areas of the State, not just for those municipalities which levy a property tax. Therefore, the Full Values could, and should be, geographically segregated to reflect more accurate adjustments to these lands according to their location. In addition, the Full Value Determination is already required under statutes to be developed annually. Therefore, an annual revaluation of the lands would be relatively simple to accomplish.

In the event the Full Value Determination were used for this purpose, and assuming geographic differential adjustment factors were established in regulations, the cost to the Department of Community and Regional Affairs for the public hearing process would be approximately $5,000.

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM February 13, 1990

SUBJECT: Mental health trust (SB 493)

TO: Senator Jack Coghill

FROM: Richard A. Bradley
Legislative Counsel

Bruce Geraghty has requested a sectional analysis of the above described bill.

As a preliminary matter, note that a sectional analysis or summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents. If you would like an interpretation of the bill as it may apply to a particular set of circumstances, please advise.

Section 1 of the bill repeals and reenacts AS 37.14.011(c). AS 37.14.010 - 37.14.050 establishes the "Mental Health Trust Income Account; AS 37.14.011 also establishes the "mental health trust income account." The subsection now provides:

> (c) The fair market rental value of the land constituting the mental health trust corpus is equal to eight percent of the fair market value of the land. Following the initial determination of the fair market value of the land selected by and patented to the state under sec. 202 of the Alaska Mental Health Enabling Act, the commissioner of natural resources shall redetermine the fair market value of the land constituting the mental health trust corpus at least every five years and provide the redetermined value to the commissioner of revenue and the board established under AS 47.30.661.

As repealed and reenacted (it would not have been possible to "amend" it), the section continues the value at "eight

percent of the fair market value of the land" but it affirmatively establishes a mathematical formula for that valuation. I believe that since that formula is all critical to the definition, it would be inappropriate to recast the language in a "sectional analysis" format and I believe that the four paragraphs of (c) should be read directly. While they are technical, they are understandable.

Section 2 of the bill adds a new subsection (d) to AS 37.14.011; the subsection directs the commissioner of natural resources to "calculate the redetermined value of the trust under (c) and provide the redetermined value to the commissioner of revenue and the board."

Section 3 of the bill provides for the "reconstitution and administration of mental health land trust." Note that Section 4 of the bill repeals AS 38.05.800, a section with the same caption; in drafting this section, I made the judgement that it was not possible to "amend" existing AS 38.05.800 and hence the suggested approach was taken. In the nature of things, it will be necessary to quote much of the language directly-- and then to comment on it. I do not want to misstate any of the language in this analysis.

Sec. 38.05.801(a) states that the "value of all land selected by or patented to the state under the Alaska Mental Health Enabling Act as of September 7, 1987, is $2,243,000,000." I do not know the source of the figure but I believe that the date is the effective date of ch. 48, SLA 1987 (CSHB 92 (Fin) am), the Act that responded to the Alaska Supreme Court's decision invalidating the earlier legislative management of the land received under the Alaska Mental Health Enabling Act, P.L. 84- 839, 70 Stat. 709.

Sec. 38.05.801(b) provides that "[a]ll land within legislative designations on the effective date of this Act and all land made subject to legislative designations in the future constitute the corpus of the mental health land trust." As I understand the usage, a "legislative designation" is an Act by the legislature that withdraws land for a particular purpose. The land established for parks, state forests, public use areas, recreational rivers, and so forth, primarily within AS 41 but also within AS 16.20 (sanctuaries, critical habitats, etc.) would be within these "designations."

The term "corpus" is legalese for the "body" or the substance of the trust.

Thus, if this section is enacted, the future establishment of land within a "legislative designation" would, by that act, commit the land to the corpus of the trust.

Sec. 38.05.801(c) provides that "[o]n the reconstitution of the trust under this section," the remainder of the land of the state "that is not within legislative designations is removed from trust status." The provision seems self-explanatory.

Sec. 38.05.801(d) provides that the land within the "legislative designations" shall be managed under the provisions of law now governing them. The trust will be compensated under AS 37.14.011; see existing law as amended by Sections 1 and 2 of this bill.

Sec. 38.05.801(e) provides that "[b]efore the state may remove land [from a legislative designation], replacement land equal in value at the time of replacement shall be designated mental health land and added to the trust corpus." What this means is that land may not be withdrawn from a legislative designation (park, state forest, etc.) until equal value land is added to a legislative designation. The latter portion of the section outlines this procedure.

While it seems that there is a Catch 22 here in that when land is established as a legislative designation, by that designation it becomes part of the trust corpus and thus not available for use as replacement land, it seems that there may be an option for the state to establish the new legislative designation conditionally; that is, to create it subject to its use as matching land for land removed from designation. While the legislature has not removed land from a legislative designation very often, the legislature may wish to avail itself of this option prospectively to protect itself and to maintain flexibility.

Section 4 of the bill repeals AS 38.05.800. Note my comments on the repeal under Section 3.

If I may be of further assistance, please advise.

RAB:pl
WKP2/037

ALASKA MENTAL HEALTH BOARD

STEVE COWPER, GOVERNOR
STATE OF ALASKA

ST. ANN'S CENTER
419 6th STREET, SUITE 124
JUNEAU, ALASKA 99801
907-465-3071

February 28, 1990

Senator Jack Coghill
Room 30, Capitol
P.O. Box "V"
Juneau, AK 99811

Honorable Senator Coghill,

The Alaska Mental Health Board(AMHB) had the opportunity to review your legislation, SB493, "An Act relating to the reconstitution and administration of the mental health trust." The AMHB Legislative Committee reviewed the bill and the full board heard comment on the legislation this past weekend. The AMHB took action in support of the intent of SB493 including that:

(1) the Legislature recognize the trust value of $2,243,000,000 established under procedures approved by the Interim Mental Health Trust Commission,

(2) land and resources in legislatively designated areas be identified as security for the trust corpus, and

(3) revaluation procedures be established which effectively continue to reflect the value of the original trust lands over time.

In actions related to the AMHB discussion of SB493, the Board re-affirmed its prior action supporting appointment of an independent trustee for the mental health trust and urging the appointment of an interim trustee pending final resolution of issues in the Weiss v. State litigation.

On behalf of the Alaska Mental Health Board I convey their support for the intent of SB493. Your continued efforts to resolve the long standing problems caused by the state's breach of the mental health trust are greatly appreciated.

Sincerely,

Dennis M. Scholl, Ph.D.
Executive Director

cc.
AMHB
Rep. Miller

selected by and patented to the state under sec. 202 of the Alaska Mental Health Enabling Act that is not within legislative designations is removed from trust status.

(e) The land within legislative designations that constitutes the mental health land trust shall continue to be administered for the legislatively designated purposes. The trust shall be compensated for the continued use of the mental health trust land for the legislatively designated purposes as provided in AS 37.14.011.

(f) Before the state may remove land that is part of the mental health trust corpus from trust status, and in addition to any other requirements of law, the commissioner of natural resources, consistent with the state's trust responsibilities, shall identify replacement land, equal in value at the time of replacement, within legislative designations and incorporate them into the mental health trust corpus. The commissioner of natural resources annually shall report any actions under this subsection to the board established under AS 47.30.661.

* Sec. 5. AS 39.25.120(c)(9) is amended by adding a new subparagraph to read:

(L) Alaska Mental Health Board;

* Sec. 6. AS 47.30 is amended by adding new sections to read:

Sec. 47.30.661. ALASKA MENTAL HEALTH BOARD. The Alaska Mental Health Board is established. For budgetary purposes, the board is located within the Department of Health and Social Services. The board is the state planning and coordinating agency for the purposes of federal and state laws relating to the mental health program of the state. The purpose of the board is to assist the state in ensuring an integrated comprehensive mental health program.

Sec. 47.30.662. COMPOSITION. (a) The board consists of the

Table 1 - MENTAL HEALTH TRUST LANDS
Inventory by status as of October 4, 1985

		Acres	Acres Remaining
1.	Trust Land Base (as corrected 1/23/87)		
	Patented to state	845,838.84	
	Approved for patent	159,872.00	
	Possible overconveyance	(5,710.84)	1,000,000[a]
2.	Conveyed Out of Trust and State Ownership		
	Land sales to individuals	46,137.49[b]	
	Condemned for Chena River Lakes Project (1978)	5,148.86	
	Total Out of Trust and State Ownership	51,286.35	948,713.65
3.	Conveyed Out of Trust & State, by Exchange and Settlement of Litigation[c]		
	Native Corporation land exchanges		
	- CIRI/USA (1979)	34,507.70	
	- Saldovia (1979)	1,768.11	
	U of A Settlement (1982)	2,993.37	
	Total Out Of Trust & State	39,269.08	909,446.27
4.	Conveyed Out of Trust to Municipalities[d]		
	- Patented to municipalities	22,680.73	
	- Approved for patent	20,407.01	
	Total Conveyed to Municipalities, Ownership in Question	43,087.74	866,358.53
5.	Conveyed Out of Trust, In State Ownership for Non-trust Purposes		
	State Refuge & Habitat Areas	85,709.61	
	State Forests	131,955.00	
	State Parks	150,576.35	
	Interagency Land Management/Transfer Agreements (ILMA's & ILMT's)	4,027.27	
	Total former M.H. Lands Designated For Non-trust Purposes	372,268.23	494,090.30
6.	Immediately Returnable to Trust, Encumbered with Lease & Sale Contracts		
	Land Leases	1,913.74	
	Mining Claims[e]	61,825.71	
	Coal Leases	54,563.22	
	Oil & Gas Leases	131,904.40	
	Material & Timber Sale Contracts	29,815.63	
	Permits	1,767.87	
	Total Returnable with Encumbrances	281,790.57	212,299.73
6.	Immediately Returnable Unencumbered[f]	212,299.73	

[a] The state--and therefore the trust-- retains all mineral rights on former mental health trust lands, except the 36,275 acres conveyed to Native corporations.

[b] Includes 19,797.52 acres conveyed prior to 7/19/78. Includes patented lands and lands under sales contracts in which vested interests exist.

[c] Lands received by state in exchange not readily identifiable.

[d] State may have legal authority to rescind, in which case title uncertain.

[e] Not tied to revenue production for trust. Holders required only to perform $200 of "annual labor."

[f] Includes 12,552.33 acres selected by municipalities but not yet approved for patent.

SOURCE: Alaska Department of Natural Resources, Inventory of Land Activities On Mental Health Lands, July 19, 1978 - October 4, 1985.

BREAKING THE MENTAL HEALTH LAND IMPASSE

As a possible means of breaking the current impasse over mental health land, the state could ask the court for instructions before taking further legislative action to resolve the controversy. Unlike the normal situation where the courts only decide whether legislative action is legal after the Legislature acts, courts will give advisory opinions when a trust is involved. Trustees can obtain such advisory opinions by asking the court for instructions with respect to trust administration. See Restatement (Second) of Trusts § 259 (1959); AS 13.36.035(a), especially subsection (3).

The obvious advantage to asking the court for instructions is that the court can answer all of the legal questions surrounding various policy options before the Legislature decides, as a policy matter, which option is most appropriate. By limiting its consideration to those options which the court will already have ruled are consistent with the state's powers and duties as trustee, the Legislature will know that, whatever option it chooses, it will be acting consistently with the trust.

The attached possible committee substitute for CSSB 493 (HESS) would (1) direct the attorney general to seek such instructions from the court, and (2) make clear that, while sales, leases, and exchanges of mental health trust land would continue to be precluded because of the interim mental health trust commission's disapproval, the commissioner of natural resources can approve proposals for other kinds of actions on mental health lands, including the granting of rights-of-way, permits, and other authorizations, as long as provision is made for any additional compensation to which the trust may be entitled beyond that already provided by the state through the interim allocation of five percent of unrestricted general fund revenues to the mental health trust income accoutn.

The result of the possible committee substitute would be that the Legislature would know what possible resolutions of this controversy are legal before it acts, and not be subject to judicial second-guessing after-the-fact, and certain limited actions with respect to mental health land could go forward without jeopardizing either the trust or the state's economy.

C. C. HAWLEY

Mining Geologist

941 E. Dowling Road. Anchorage, Alaska 99518 (907) 562-4673
Suite #300 FAX (907) 562-7284

January 10, 1990

Lydia Selkregg and James Gottstein, Esq.
c/o Law Offices of James B. Gottstein
406 G St.
Anchorage, Alaska 99501

Re: Mental Health Land mineral evaluation reports

Dear Lydia and Jim:

This letter responds to a meeting on January 8, 1990 where I volunteered to review the various reports on mineral evaluation in the light of an act, "Relating to the Alaska Mental Health Trust; and providing for an effective date" in Chapter 48 AS, and give you the benefits of my opinions on these reports and any suggestions as how the apparent gap on mineral value between the Mental Health Commission and DNR could be narrowed.

The mineral evaluation is significant because it is a component of the fair market value; an actual dollar amount is necessary because the legislation establishes that an annual rental amount is to be appropriated by the legislature yearly to the mental health trust income amount and the fair market rental value of the land is valued at 8 % of the fair market value of the land.

The fair market value is the sum of three components, surface estate, forestry value and mineral value. Surface estate and forestry value have been agreed to by the parties in the issue, but there is a large gap on mineral value.

At issue, also is the means of establishing mineral value; two approaches have been advocated, comparable sales, and net present value of the mineral resource on the lands in question. It is my opinion that the net present value is the proper choice, largely because of two reasons, both already cited in the dispute, namely the sparcity of comparable sales, and secondly, that outright sales are not ordinarily the means of transfer of mineral interest.

But, the determination of net present value is difficult almost to the point of impossibility because of the sparsity of data on the mineral estate. The consultants were really asked to carry out a more or less theoretical exercise: To provide the net present value of mineral resources that could exist and be

developed on a analogue of 1,000,000 acres with some existing known resources and an approximately known geologic framework under Alaska cost and operating conditions. They were also given this task with a relatively low budget and tight time frame. This in itself can be argued to be an error, but it is also possible that the product might not have been much better if more rigorous methods were used and a great deal more money expended.

Harris (a reviewer and commentor for DNR) proposes a more rigorous methodology and would change some assumptions, as to the timing of development of the mineral estate, but his approach would also have been theoretical. From my point of view, the results are always going to be highly uncertain because it is a long extrapolation of what resource modeling can and should do.

Agencies like the USGS, ADDGS, certain Universities and consulting groups with good mineral economic capabilities are often asked to do mineral resource appraisals. Generally these are broad in scope, deal with resources not reserves, and serve to answer public policy questions like land closures rather than to quantify the dollar value of mineral estate for transfer purposes.

These agencies and groups are also commonly most qualified to deal with the broad issues, not whether a deposit can actually be produced at a profit; they rarely have current mineral knowledge and they have only a general knowledge of cost of production; therefore even if it is necessary to use them because they are without conflicts in commercial transactions, they are likely to be very limited in their ability to ascribe real dollars to their models.

In summary so far, I've endorsed net present value as the means to be used, but have tried to point out why its difficult to get good numbers out of the process. There just has be a lot of uncertainty.

Assuming we operate under the existing legislative guidelines, I would suggest using a panel of experts to examine and adjudicate the differences and to suggest a reasonable range of mineral values which would then be finally compromised by the Commission. The panel would be composed of engineers, Mining Company CEOs, and geologists from the private sector that have the operating experience and investment background to place the mineral evaluation on a firmer footing. They would have to be given only a certain amount of material and asked one or two questions. They would have no direct conflicts of interest on mental health lands and would be convened and give their results in a 3-5 day period; ideally it would include some Alaska experts and some that are mainly "outside", but with Alaska background.

As possible panelists I would suggest:

C. P. Herbert, P.E.
Richard Hughes, P.E.
Paul Glavinovich, Mining Geologist
Norm Anderson, former CEO of Cominco
Hugh Matheson, President of CoCa Mines, Denver, and former VP of Placer Development
Stan Dempsey, President of Royal Gold, Denver

I believe such a panel would be competent to evaluate and recommend within the range of values already established. It is important to have input from the type of people that will actually develop the resources, yet deferring the final decision to the judgement of the Commission.

I further have the opinions that the State's mineral valuation is unreasonably low, but that MDA is overly optimistic on most grounds, including:

1. Number of economic discoveries per unit area

2. Value of discoveries, in relation to tonnage and grade percentile

3. Cost of capital development and production in Alaska (ie, assumptions are that things don't cost as much as they do)

4. NSR obtainable from mineral production.

I would disagree that a 4 % NSR is a low royalty figure on hard rock deposits. 4-6 % NSRs are obtainable on precious metal deposits, but large base metal deposits could easily go at 1-3 percent. Even if 4-5 percent was obtainable, there would likely be clauses to recover capital first or to allow for reductions depending on metal price which would actually reduce the average royalty available.

In regard to coal land evaluation, I would regard both the State and MDA as being too low, although I recognize that the time factor of evaluation would perhaps need to be addressed. Many tens of millions of dollars have been spent in the last 25 years on evaluation of Alaska's subbituminous coal resource; leases are still being held and the companies holding the leases actively pursue marketing. Even if this coal doesn't enter into the next round of steam coal contracts, it has immense future value for synthetic uses and chemical feedstocks; because the coal hasn't been dehydrogenated to the extent of bituminous coal, it ultimately could have a premium value with respect to harder coal.

Finally, I would still propose that a better long term solution might be to go back to royalty production from actual trust lands, to use the existing coal and 6i schedules (5 and 3%) to be

paid into a working trust, but I'm also aware that the courts, legislature, and all parties have got a solution going that doesn't use this approach, and that it is critical to get a solution that the parties can agree to in place.

Sincerely,

Chuck Hawley

Mining Geologist

MINORITY RECOMMENDATION

TO THE COMMISSIONER OF NATURAL RESOURCES

Regarding Procedures to Determine the
Fair Market Value of Alaska's Mental Health
Trust and Replacement Lands

Submitted by: Rod Swope
Commissioner's Designee to the
Interim Mental Health Trust Commission
February 1, 1990

CONTENTS

EXECUTIVE SUMMARY

This minority report documents my dissent from the majority report of the Interim Mental Health Trust Commission (IMHTC) regarding procedures to be used by the Commissioner of the Department of Natural Resources (Commissioner) to determine the fair market value of both the original one million acre mental health trust land grant and the replacement lands in accord with Chapter 48, SLA 1987. In addition, I have set out the procedures which I believe should be used in order to comply with Chapter 48 and the land and resource values which those procedures produce.

I do not take this step lightly. Since joining the IMHTC as the Commissioner's designee in January, 1988, my goal has been to reach consensus with my fellow IMHTC members if and whenever possible.

While I believe my fellow IMHTC members also shared this goal, that approach was abandoned with respect to the valuation procedures finally adopted in the IMHTC majority report. By adopting, in large measure, valuation procedures urged by the attorneys for the plaintiffs and intervenors in the Weiss case, procedures designed to maximize value and not to produce fair market value as required by Chapter 48, the majority left me with no alternative but to dissent.

I dissent from the IMHTC majority report for the following reasons:

1. **The IMHTC exceeded its statutory authority by proposing and adopting its own valuation procedures instead of reviewing and approving only those procedures proposed by the Commissioner**.

Chapter 48 specifies that the IMHTC is to review and approve valuation procedures proposed by the Commissioner. As contemplated by the Legislature, the valuation procedures accordingly would be acceptable to both the plaintiffs' and intervenors' representatives on the IMHTC and to the Department of Natural Resources ("department"). Certain procedures contained in the majority report, however, were not proposed by the Commissioner, are unacceptable to the department, and therefore should not have been approved by the IMHTC majority. By proposing and adopting valuation procedures over the department's objections, the IMHTC has ignored the legislative requirement that, in effect, there be consensus as to the valuation procedures to be employed.

2. **The procedures proposed and adopted by the IMHTC in the majority report do not produce fair market value, as required by Chapter 48; instead, they produce a value substantially greater than fair market value.**

The importance of the value determinations used to determine fair market value cannot be overstated because of the dramatic effect they will have on the overall state budget. Under the valuation procedures adopted by the majority of the IMHTC, the total value of the original one million acre mental health trust land grant would exceed $2.2 billion. Under AS 37.14.021(c), this would result in more than $178 million in otherwise unrestricted state general funds being restricted in the Mental Health Trust Income Account. Under the valuation procedures I believe should be employed, the fair market value of the original one million acre grant equals just over $564 million, resulting in more than $45 million annually in the Mental Health Trust Income Account.

While the remainder of this minority report documents the fact that the procedures adopted by the IMHTC in the majority report do not produce fair market value, the point can be illustrated with three examples.

> Example 1: Surface Estate. The IMHTC initially defined "fair market value," the value required by Chapter 48, as "the most probable selling price in a free and open market," a standard definition in the real estate business. Panels of independent expert appraisers were then given instructions (prepared jointly by the majority of the IMHTC, the lawyers for the plaintiffs and intervenors and the department) to determine fair market value as defined. The lawyers for the plaintiffs and intervenors retained consultants (at state expense and without formal approval of the IMHTC) who were not asked to determine fair market value as defined by the IMHTC and required by Chapter 48. Instead, they were directed to determine "the highest value that can be supported in the market." Following review by those consultants, the panels increased their initial values, on the average, by about 20 percent. The procedures adopted by the IMHTC majority require that those values be further increased by splitting the difference between the final fair market values as determined by the panels and "the highest values that can be supported in the market" as determined by the consultants for the plaintiffs and intervenors.

Example 2: Hardrock Minerals. The procedures adopted by the IMHTC majority to determine the fair market value of the hardrock mineral estate, among many other shortcomings, begin with the assumption that all mineral deposits on mental health lands were developed on the date of valuation. That, of course, is not the case. In fact, there is very little mineral production from mental health lands even today. The consultants hired by the lawyers for the plaintiffs and intervenors acknowledge that this assumption alone produces value many times higher than would be produced if it was assumed that mineral deposits on mental health lands are not developed until sometime in the future:

A. Deposits are developed as of 2006 - the net present value (NPV) is $225 million.

B. Deposits are developed as of 1996 - the NPV is $585 million.

C. Deposits are developed as of 1987 - the NPV is $1.5 billion.

The procedures adopted by the IMHTC majority value the mineral estate at the $1.5 billion figure. It's also conceivable that major deposits will never be discovered in which case the NPV would be zero.

Example 3: Integration. The procedures adopted by the IMHTC combine the various value components -- surface estate, timber, oil and gas, hardrock minerals, coal, and sand and gravel--by simply adding them up. A prospective purchaser in the real world, of course, would not simply add up all the values. He or she would instead determine which uses, if any, are compatible. For example, residential subdivision development and strip mining for coal are not compatible.

3. **The procedures proposed and adopted by the IMHTC in the majority report create substantial problems with respect to reconstituting the trust and periodically redetermining its value.**

Chapter 48 contemplated an exchange of some original mental health lands for other state lands on the basis of equal value. The procedures adopted by the majority of the IMHTC have been used to value the original mental health lands, but they have not been used to value the pool of potential exchange lands. This precludes the exchange contemplated by the Legislature. In

addition, Chapter 48 contemplated periodic revaluation of the lands following the exchange. If the exchange cannot go forward, the legislatively contemplated revaluation also cannot go forward.

In my opinion, the failure of the IMHTC to reach consensus on valuation procedures makes it impossible for the Commissioner to comply with Chapter 48. The procedures approved by the IMHTC majority were not proposed by the Commissioner as required by law; the procedures I believe should be used have not been approved by the IMHTC as required by law. For this reason, I believe the Commissioner should transmit both the majority and minority IMHTC reports to the Legislature, explain that she is unable to comply with Chapter 48 at present, and list three options for legislative consideration: (1) change the law to accept the value determined under the procedures adopted by the IMHTC majority; or (2) change the law to accept the value under the procedures I believe should be used to comply with Chapter 48; or (3) appropriate additional funds to permit the IMHTC to continue seeking consensus. I believe the Commissioner should recommend that the Legislature choose option (2), accepting the value determined under the procedures I believe should be used to comply with Chapter 48.

BACKGROUND

The IMHTC was created by the Legislature in Chapter 132, SLA 1986, to oversee state management of mental health trust lands. In Chapter 48, SLA 1987, the Legislature established a statutory framework for resolving the mental health trust land issue. The three main elements of that resolution are: (1) valuing the original one million acre land grant and all lands in legislatively designated areas (parks, wildlife refuge, etc.) under procedures proposed by the Commissioner and approved by the IMHTC; (2) "exchanging" those original mental health trust lands not in legislatively designated areas for "replacement" lands of equal value in such areas; and (3) "renting" the original mental health trust lands in such areas and the equal value "replacement" lands for 8 percent of their fair market value annually.

Following the passage of Chapter 48, SLA 1987, the Governor appointed Dr. George Rogers of Juneau and Dr. Lidia Selkregg of Anchorage to join the Commissioner to compose the membership of the IMHTC. Dr. Rogers was then selected chairman of the IMHTC. Originally, Deputy Commissioner Lennie Gorsuch represented the Commissioner on the IMHTC, followed later (after January, 1988) by Deputy Commissioner Rod Swope. Assistant Attorney General Tom Koester of the Department of Law served as legal counsel to the IMHTC, while representatives of the Department of Natural Resources (department) provided staff support.

The IMHTC met on August 19 and 20, 1987, and continued to meet regularly through January, 1990. Since passage of Chapter 48, a total of thirty-five (35) IMHTC meetings have been held in either Anchorage or Juneau following at least fourteen (14) days prior public notice.

Although not part of the IMHTC, the attorneys for the plaintiffs and intervenors in the Weiss lawsuit, David Walker and Jim Gottstein, attended almost every IMHTC meeting and actively participated in all aspects of the discussions and valuation process, even to the point of proposing valuation procedures and resultant values. The IMHTC allowed the plaintiffs and intervenors to join in all discussions during IMHTC meetings.

At times, this degree of participation made it extremely difficult to differentiate between IMHTC conclusions and those of the lawyers for the plaintiffs and intervenors. The plaintiffs' and intervenors' lawyers also independently hired appraisal

consultants to review the work of contractual appraisers, retained by the department under procedures developed by the department, the IMHTC, and the lawyers for the plaintiffs and intervenors, and working under instructions developed in the same way, to compose the opinion of value panels for the surface estate valuation. In addition, the plaintiffs and intervenors, acting without formal IMHTC authorization, hired independent mineral consultants, Paul Metz and Colin Dixon, to compile a value for hardrock minerals, coal, and material sources (within the mental health trust land portfolio) using a procedure not previously recommended by the Commissioner or formally discussed or approved by the IMHTC. Mr. Metz and Mr. Dixon also attended several meetings of the IMHTC to present their information and viewpoints.

The most difficult aspect of the entire valuation process proved to be the development and approval of specific procedures under which the department would value mental health trust lands. On several occasions the IMHTC chose to adopt a new valuation methodology even after the department had already completed, at considerable time and expense, the valuation process using the original IMHTC approved methodology. Development of a new valuation methodology frequently seemed to be motivated more by the desire to produce a higher value than to correct the original methodology. As a result, procedures were adopted by the IMHTC that were not proposed by the Commissioner (as required under Chapter 48) and which do not produce fair market value (as Chapter 48 also requires).

Throughout my participation in this process, I strived toward achieving consensus and a common resolution of the various issues with my fellow IMHTC members. However, as it became apparent that the majority of the IMHTC was dissatisfied with the results of the initially approved procedures and began amending them to produce higher values, the consensus approach began to erode. This became particularly apparent in discussions regarding the results of the opinion of values for the surface estate and values for the mineral estate. Thus, as a dissenting member of the IMHTC, I felt it was necessary to submit a minority report.

FINDINGS

1. **The IMHTC exceeded its statutory authority by proposing and adopting its own procedures instead of reviewing and approving only those procedures proposed by the Commissioner.**

The Legislature contemplated and specified that the Commissioner propose valuation procedures which then would be approved by the IMHTC. Section 90 of Chapter 48, SLA 1987 repealed and reenacted section 2(a) of Chapter 132, SLA 1986 to read: "The commission shall approve procedures proposed by the Commissioner of Natural Resources to determine the fair market value, as of the effective date of AS 38.05.800, of all lands selected by and patented to the state under sec. 202 of the Alaska Mental Health Enabling Act, and review the final determination of the fair market value determined under those procedures." (Emphasis added.)

Under AS 38.05.800(a), also enacted as part of Chapter 48, the Commissioner is to determine the fair market value of the original mental health land grant "under procedures approved by the Interim Mental Health Trust Commission."

Simply stated, the Commissioner is to propose valuation procedures to be reviewed and approved by the IMHTC. Once a set of procedures have been approved by the IMHTC, the application of those procedures to the valuation of the mental health land grant and replacement lands is the responsibility of the Commissioner, with the results then reviewed by the IMHTC. The Legislature thus contemplated a three-step process: (1) consensus would be reached as to the procedures to be followed; and (2) the Commissioner would unilaterally implement those procedures to determine fair market value; and (3) the IMHTC would review the final fair market value determined by the Commissioner.

Although the IMHTC initially approved certain valuation procedures proposed by the Commissioner, the IMHTC majority eventually proposed and adopted many of its own procedures not proposed by the Commissioner. Specifically, the procedures adopted by the IMHTC majority for the surface valuation and for the mineral valuation were not proposed by the Commissioner. These actions removed from the Commissioner all discretion and thereby effectively excluded the Commissioner from the valuation process, a result certainly not intended by the Legislature.

Furthermore, the IMHTC in its majority report adopted not only procedures, but also an actual set of resultant values. As mentioned above, only the Commissioner has the authority and responsibility to determine the fair market value of the land. Therefore, the IMHTC again clearly exceeded its statutory authority.

2. **The procedures proposed and adopted by the IMHTC in the majority report do not result in fair market value, as required by Chapter 48; initially they produce a value substantially greater than fair market value.**

AS 38.05.800(a) requires the Commissioner to "determine the fair market value, as of September 6, 1987 of all land selected by and patented to the state under the Alaska Mental Health Enabling Act." At its September 21-22, 1987 meeting, the IMHTC initiated the valuation process by adopting, as proposed by the department, the definition of fair market value found in American Institute of Real Estate Appraisers/Society of Real Estate Appraisers, Real Estate Appraisal Terminology (rev. ed. 1981). This definition specifies "The most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale." Employing that definition and procedures, the department determined the fair market values for the surface estate and resources associated with the mental health and replacement lands (timber, oil and gas, coal, material sources, and hard rock minerals). Those procedures and values are outlined in this section.

The surface estate of all mental health trust and replacement land was valued by the department using the opinion of value approach. This approach, as amended by the IMHTC to make adjustments for certain disputed values submitted by the lawyers for the plaintiffs and intervenors, was approved by the Commissioner and became the accepted procedure for valuing the surface estate. However, the IMHTC majority report reflects a surface estate valuation procedure and value different from that developed by the IMHTC, approved by the Commissioner, and employed by the department. As a result of this significant departure from accepted and approved procedures, the resulting value does not reflect fair market value and is inconsistent with the fair market value requirement. Once the opinion of value panels completed their work, the plaintiffs and intervenors hired their own appraisal consultants to examine the results. The review appraisers, however, did not employ the same valuation approach used by the department. Instead, the plaintiffs' and intervenors' appraisal consultants were given the following

written instruction: "For all parcels that appear to have been undervalued, provide your estimate of the highest value that can supported in the market." [Walker letter to MacSwain, Olson, Sopp, dated July 19, 1988.] In State v. Alaska Continental Development Corp., 630 p.2d 977, 991 (Alaska, 1980), the Alaska Supreme Court specifically disapproved of a valuation process reflecting "the high end of the market spectrum," stating that such an approach "is contrary to the law in Alaska" that fair market value," or the price a willing buyer would pay a willing seller for the property, is the appropriate measure of just compensation. There was no mention in the instructions to the appraisal consultants of fair market value or most probable selling price. The values determined by the review appraisers, therefore, have no relevance to the task with which the Legislature charged the Commissioner, that of determining the fair market value and not "the highest value that can be supported in the market" of the original one million acre mental health land grant.

The IMHTC also approved the department's recommendation that determination of resource values would employ a two step approach. The first step was to quantify the particular resource(s) in place. The second step was to determine the value to the landowner of that quantity of the particular resource(s) in place.

For the hardrock portion of the mineral valuation, the IMHTC majority report simply adopted the procedures and value contained in the Report by Paul Metz and Colin Dixon ("MDA Report"). The MDA approach employed procedures not recommended by the Commissioner or previously discussed or approved by the IMHTC. Furthermore, it produced a value which is substantially too high for the hardrock mineral component, and suggests a hardrock mineral endowment considerably greater than the facts support.

The resultant surface and resource values then were integrated by the department, recognizing that values could be added where use of the surface was compatible with other resource development, but not where surface use was incompatible with resource development. This was in accord with integration procedures already approved by the IMHTC. However, the majority report uses a different integration approach which involves simple addition of all values--a process totally inconsistent with standard valuation procedures. The issues of parcelization, integration,

replacement lands, redetermination of values, and the valuation process used to determine fair market value for the various resources, are described in more detail in the sections that follow.

Parcelization

The department began the valuation process by proposing procedures for the parcelization of all land. After review by the lawyers for the plaintiffs and intervenors and their "expert appraisers" regarding the parcelization procedures, the department's proposed parcelization procedures were approved by the Commissioner and the IMHTC. Department personnel then parcelized approximately 7.5 million acres of land (mental health trust and replacement land) into over 10,000 parcels.

This parcelization process used the standard larger parcel criteria set out by the courts for determining fair market value in condemnation litigation. The criteria include: unity of ownership, unity of use, and contiguity. There was one exception to this rule. Where an approved survey was in existence identifying separate lots, tracts, or metes and bounds surveys, those surveyed tracts were segregated out from the larger into separate individual parcels.

Surface Estate Valuation

In accordance with the intent of the Legislature, as reflected in the fiscal note accompanying the bill that became Chapter 48, an opinion of value process was to be used to determine the value of the surface estate.

During the legislative discussion concerning Ch. 48, SLA 1987, the department explained the opinion of value process to the Legislature and submitted two different fiscal notes, one to cover the cost of individual standard appraisals and one for the opinion of value process. The Legislature recognized the potential costs and lack of available money to fund individual appraisals for all mental health and replacement lands. Therefore, money was appropriated for the department to conduct the fair market valuation through an opinion of value process, consisting of three panels of appraisers. In other words, funds were appropriated to cover only the cost of an opinion of value process.

This opinion of value process involved three panels comprised of three very experienced and knowledgeable independent appraisers from each of three geographic areas of the state (Southeast, Southcentral, and Northern). These appraisers sat as a panel according to geographic area, examined plats, maps and legal descriptions of mental health land, and rendered an opinion of value for each parcel of property examined. They brought a variety of work experience and market knowledge with them to contribute to the opinion of value panel process. The use of a three member panel for each geographic area provided an optimum cross section of local market conditions, market demand, and varied sales data. The comprehensive appraisal files of the department were also made available to each panel.

The IMHTC and the lawyers for the plaintiffs and intervenors approved, word by word, the "Request for Proposal" (RFP) sent out by the department to all appraisers in the state in order to solicit interest in being a member of one of the opinion of value panels. Two department employees and the two IMHTC members representing the plaintiffs and intervenors, after consultation with their respective attorneys, evaluated all of the RFP's submitted. They scored each proposal and selected nine appraisers to compose the three separate panels of the most qualified appraisers in the respective regions (i.e, Southeast, Southcentral and Northern).

The process used by the panels was not an "appraisal" in the strictest accepted definition of the term. Appraisal reports were not required nor were field inspections conducted for every parcel. However, this was fully recognized by both the Legislature and IMHTC.

The theory of the opinion of value process is that some parcels may be valued high and some parcels may be valued low, but they average themselves out. This theory was given credibility when the IMHTC conducted a check of the results of an earlier opinion of value process (one panel of three appraisers for all three regions of the state with only one appraiser representing each region) on all original mental health land that had been selected by the state or conveyed to municipalities. The IMHTC selected parcels, in the Northern, Southcentral and Southeast regions, that it felt were most likely to be valued too low, and had them appraised under standard appraisal procedures. The result of this exercise was that, on total, the actual appraised values and the opinions of value for the parcels the IMHTC believed were the most undervalued were within 4 percent. While some differences were dramatic--the IMHTC majority report notes one 800 percent difference (interestingly, the high value was produced by the opinion of value process) they balanced out overall as expected. This is contrary to the IMHTC majority report which infers that the opinion of value process produces values which are uniformly too low.

As soon as contracts were awarded, the department convened the three opinion of value panels for each region to render their best collective professional opinions of fair market value for each parcel. The opinion of value panels were instructed to determine fair market value using the definition found in the American Institute of Real Estate Appraisers/Society of Real Estate Appraisers, Real Estate Appraisal Terminology, adopted by the IMHTC at its September, 1987 meeting. The opinion of value panels also were instructed to consider reparcelizing if, in their best professional judgement, reparcelization was necessary to enable them to determine the land's fair market value.

The panel's findings were recorded on forms provided by the department and approved by the IMHTC and attorneys for the plaintiffs and intervenors. The forms contained all available information relative to the parcels and were supplemented by land status plats and maps. At least two members of each three member panel signed signature blocks on each form indicating panel concurrence with the specific value for each parcel.

The IMHTC had, in the RFP, provided that the plaintiffs and intervenors could review and challenge any of the values established by the panels. The lawyers for the plaintiffs and intervenors independently hired their own "appraisal review consultants" to review the work of the opinion of value panels (paid for by the state as court-ordered costs in the Weiss case).

The appraisal consultants hired by the lawyers for the plaintiffs and intervenors were directed to determine "the highest value supported by market data." (Walker letter to Mac Swain, Olson, et.al., dated July 19, 1988). They were not instructed to determine what, in their best professional opinion, they considered to be fair market value (using the definition adopted by the IMHTC). Under their instructions, they valued the surface estate at $833,280,096 compared to the opinion of value panels' initial value of $392,000,000.

Their review took approximately nine months and resulted in approximately two-thirds of the values of original mental health trust parcels being questioned.

Due to the large number of questioned values by the appraisal consultants and limited funding, the department proposed a sampling strategy which was adopted by the IMHTC. Certain groups of disputed values along with a computer-generated random sample of the remaining disputed values, were identified and returned to the Southeast panel for review. A representative sampling of large (over 1,000 acres) parcels was submitted to the Southcentral panel for review. The review of these disputed values by the panels resulted in a small increase in the value of some of the parcels. This occurred only after the lawyers for the plaintiffs and intervenors and the chairman of the IMHTC instructed the panels on how to value certain classes of parcels.

The method of applying the sampling results to all three regions resulted in a 30 percent increase in the opinion of value panels' initial $392 million value for the surface estate, thus increasing it to a final value of $511,949,467. The value determined by the plaintiffs' and intervenors' review appraisers, however, was not similarly revised downward, but instead was held at $833,280,096; no downward adjustment in their value was made.

The IMHTC, acting without a recommendation from the Commissioner, adopted the procedure to determine the value of the surface estate by simply splitting the difference between the revised value determined by the opinion of value panels (which was

increased by 30 percent over the initially determined value) and the unadjusted total determined by the appraisal consultants retained by the lawyers for the plaintiffs. This resulted in an arbitrary value of $672,614,782., halfway between the panels' final recommended surface value of $511,949,467. and the review appraisers' initial value of $833,280,096.

The basic flaw in the procedures adopted by the IMHTC majority is that those procedures incorporate, in large measure, the values determined by the plaintiffs' and intervenors' review appraisers. The appraisal consultants were instructed to determine the "highest value that can be supported in the market," a value which is not the same as fair market value. Using the value those procedures produce is not consistent with fair market value specified in Chapter 48. Instead it is simply the average of the fair market value determined by the opinion of value panels as the Legislature contemplated and "the highest value supported by market data" as determined by the review appraiser. The fair market value of the surface estate should be the final value determined by the opinion of value panels, which was $511,949,467.

Hard Rock Mineral Evaluation

The procedures proposed and adopted by the IMHTC to assess and value hard rock mineral resources (MDA Report) produced a value which is substantially greater than the facts support.

The initial hardrock mineral assessment was completed, using available information, by the department's Division of Geological and Geophysical Survey (DGGS). However, DGGS did qualify their assessment with the observation that there are inadequate data to perform a comprehensive mineral assessment. In addition, the parcels being studied were too scattered and too varied in size to make any very specific quantitative determinations without a great deal of expense. The department also sought assistance from the U.S. Bureau of Mines, WGM (a private mineral consulting firm), and the department's Division of Mining to quantify these resources. These sources also indicated that there are insufficient data and the parcels are too scattered.

The DGGS did, however, identify the potential for mineral occurrences on mental health trust lands and the pool of potential replacement lands by ranking them from 1 (low potential) to 5 (high potential), with category 5 subsequently broken down by DGGS at the request of the IMHTC to identify the lands with the highest high potential ("Super 5s"). No consideration was given, however, to quantity of potential mineral resources or the economic feasibility of their development. The Super 5 category identified only the highest potential for occurrence of a mineral deposit, not the highest probability of a commercial discovery.

The IMHTC, at a March 17 - 18, 1988 meeting, determined that it was impracticable to determine mineral value in light of the information from DGGS, the U.S. Bureau of Mines, WGM, and the Division of Mining. The department was, therefore, originally instructed by the IMHTC to consider the potential of the land (according to the DGGS assessment) only for replacement purposes.

The department continued, however, to seek procedures to present to the IMHTC that would reflect, to the extent possible, the fair market value of the hardrock minerals on both the original mental health land and the potential replacement land. Eventually, a small number of comparable sales of patented and unpatented mining claims in the state were identified for that purpose.

When presented to the IMHTC, however, the comparable sales approach was rejected. The initial value determined --$16 million--admittedly seemed quite low.

Unknown to the IMHTC minority, the lawyers for the plaintiffs and intervenors retained two consultants, Paul Metz and Colin Dixon, to estimate the value of the hardrock minerals on the original one million acre grant using a discounted cash flow methodology. Employing a variety of assumptions and probability analyses, Metz and Dixon concluded that the hardrock mineral value of the original grant was $1.51 billion. The lawyers for the plaintiffs and intervenors presented this information to the IMHTC in the form of a report ("MDA Report").

The MDA Report was criticized by a variety of expert analysts.

The department's natural resource economist, Ed Phillips of the Division of Oil and Gas, reviewed the MDA Report from an economic standpoint and concluded that the methodology, assumptions and judgments were so manipulated that the values are excessively high.

The DGGS geologists responsible for developing the geological data reviewed the MDA report. Their review raised substantive questions relating to the assumed probabilities of discovery and the range of estimated deposit sizes.

The University of Alaska's Institute for Social and Economic Research (ISER) conducted a thorough review and analysis of the MDA Report. Their analysis concluded that <u>if</u> the geologic assumptions, probabilities and costs in the MDA Report are found to be valid, the economic considerations are not. The ISER economists (Dr. Bradford H. Tuck and Dr. Matthew Berman) who reviewed the MDA Report estimated that the net present value of the original one million acre grant would not exceed between 10 and 30 ($177,000,000. and $460,000,000. respectively) of the value contained in the MDA Report, and would be in the 10 to 30 percent range <u>only</u> if the geologic assumptions, probabilities and costs are valid. Thus, only under the optimum set of circumstances--i.e., all of the analysts' expectations are realized--would the values even approach one-third of the total estimate in the MDA Report?

The following is the "<u>Summary</u>" from the ISER report (dated March 22, 1989):

"In summary, our review has identified a number of points that question some of the assumptions underlying the Metz appraisal. The three that are critical relate to the assumed probabilities of discovery, the assumed net smelter return, and the timing of the income stream. The assumed values in the appraisal result in projected revenue and production estimates that do not currently exist and are highly improbable in the future.

"The test of an appraisal, as mentioned above, is whether it approximates fair market value. Fair market value is what the asset would bring in a competitive market disposal held today. The historic levels of mining industry activity in Alaska, coupled with long term trends in world mineral markets, simply do not support the notion that the mineral rights on the Mental Health Trust Lands would command 1.5 billion dollars today, or at any time in the foreseeable future."

Perhaps more telling, the MDA Report used a number of works by Dr. DeVerle P. Harris of the University of Arizona for its methodological basis and to justify the numbers that were produced. Dr. Harris was recognized by the IMHTC as one of the leading authorities in the nation in the area of discounted case flow valuation methodology. To determine if the MDA report properly interpreted his own works, the department entered into a contract with Dr. Harris to review and analyze the report. In his critique of the MDA Report, Dr. Harris found numerous problems with the report and its ultimate value estimate.

Because of Dr. Harris's preeminence in the field, I have included extensive excerpts from his summary as follows:

"The least equivocal judgment that can be made about the analysis performed by MDA is that there can be little confidence that the fair market value of the Alaska Mental Health lands is $\$1.5 \times 10^9$ because of (1) great uncertainties that exist about critical factors, e.g., mineral endowment, probability for discovery, costs of development and production, and future markets, (2) subjective judgments made, and (3) rough approximations employed in computation of fair market value..."

"Those who use the number, particularly when uninformed about evaluation and estimation practices, ascribe to it much greater confidence than it deserves. Intelligent decision making requires a description of uncertainties about the estimate of a highly uncertain quantity. Clearly, the fair market value of Alaska Mental Health Lands is a highly uncertain quantity. Representing so uncertain a quantity as the fair market value of unseen mineral deposits by a single-point estimate (1.5×10^9) begs some explanation, for such analysis clearly is not best practice, nor even usual practice, in evaluation of a complex and uncertain quantity.

"There is another dimension to the neglect of uncertainty besides that of information to the user, namely, the implication of uncertainty to fair market value as perceived by those who would purchase the rights to explore for and exploit the mineral resources. In this case, these buyers are private corporations. Corporations behave generally as though they are risk averse, meaning that the investment value (fair market value) of a highly uncertain venture is less than its expected monetary value. The greater the uncertainty about the outcome, the greater the expected value is discounted by the investor. Thus, <u>fair market value</u> to a private corporation of a highly uncertain venture, such as exploration, development, and exploitation of unseen mineral deposits, is not independent of the magnitude of uncertainty; consequently, a comprehensive evaluation itself requires a probability distribution of the uncertain quantity, which in this case is the fair market value of MHL.

"One may agree with the foregoing but still press the question of whether or not $\$1.5 \times 10^9$ is a "reasonable" single-point estimate of fair market value when risk is not explicitly accounted for. Responding to this question in an absolute sense is nearly impossible because of the great uncertainties mentioned above, the subjective judgments made, and the approximations employed.

"A more answerable question is whether within the context of the approach used by MDA there were judgments made or procedures employed which, everything

else being equal, tend to over or underestimate fair market value. Clearly, as indicated in the body of the report, such can be identified. The most obvious of these is the ignoring of lead times in the computation of net present value. This neglect leads to overestimation by a factor of 2 or 3. Similarly, neglect of market impacts leads to overestimation. Ascribing to every discovery the 90th percentile tonnage and grade also leads to overestimation, perhaps a large overestimation, unless compensating adjustments are made in discovery probabilities. There is no documentation of such adjustment, but the selection of discovery probabilities by MDA is heavily subjective and especially vague, making it difficult to draw firm conclusions. If, as suggested by the MDA report, the discovery probabilities selected were predicated in part upon the CRA analysis of regions in Alaska that were appraised by the U.S. Geological Survey, then the discovery probabilities probably are considerably too large, because these (CRA) numbers of deposits are expectations for occurrence (not discovery) of deposits of all sizes and grades (not just 90th percentile value).

"The treatment of exploration and mineral potential is particularly vague and unrationalized. This is a serious deficiency of the report, because analysis of value is so sensitive to the treatment of these factors. The effect of this neglect is to create low confidence in the specified probabilities for discovery and in the computed expectations for fair market value. The fact that discovery probabilities were estimated directly using exploration outcomes from other regions, and that these were subjectively adjusted to reflect mineral potential rankings, makes a careful description of the estimation even more important and necessary if the resulting estimate of fair market value is to be credible, because the very foundation upon which the process rests (exploration outcomes) is very difficult to interpret. This is especially the case when these outcomes are to serve as the basis for discovery probabilities for a host of different mineral commodities and different deposit types. The use of constant discovery probabilities for all deposit types and all metals for a given mineral potential ranking is at best a crude approximation and lacks credibility when the objective is fair market value.

"Finally, a fair market value as large as $1.5 x 10^9$ does not seem consistent with economic conditions and factors. As fair market value, $1.5 x 10^9$ represents an estimate of the net present value of profits (net of all costs, royalties, and taxes) that firms could earn by acquiring rights to exploration for and exploitation of minerals on the Alaska Mental Health Lands. Such a large value, if correct, would be a strong incentive for acquisition of tenure and exploration of these lands. While the author has little first-hand knowledge about recent metal resource development on the Mental Health Lands, or in Alaska in general, it is his understanding that such activity is and has been at a low level (Tuck and Berman, March 22, 1989; Paul Metz, May 20, 1989, personal communication). Such circumstances challenge a value as large as $1.5 x 10^9$ as a credible estimate of the fair market value of metal resources of the $1 x 10^6$ acres of Mental Health Lands. Moreover, rationalizing inactivity by institutional impediments or by stringent tenure requirements does not lend credence to such a high value. Unless such impediments and stringent tenure provisions are to be altered, fair market value appropriately reflects the impact of current conditions on profitability of resource development."

The foregoing expert critiques, questioning the credibility of the MDA Report's $1.51 billion estimate for the value of the original one million acre grant, are supported by a number of objective considerations. WGM, a private mineral consulting firm, determined in March, 1988 that the market value of 2.2 million acres of Bering Straits Native Corporation land in Northwest Alaska was $343 million, an average of $156 per acre. That land is located in the vicinity of the Seward Peninsula, historically the most productive mineral province in the state. While some mental health land was specifically selected for its mineral potential (as was a considerable portion of the Bering Straits Native Corporation's selections), more was selected for other values (e.g., residential, timber, etc.). Given those facts, I cannot accept the MDA Report's average mineral estate value of $1,510 per acre for mental health lands. This is particularly true as the Bering Straits Native Corporation lands are in large continuous tracts, which a prospective purchaser could evaluate through appropriate and efficient exploration

strategies. The mental health lands are generally in much smaller parcels scattered throughout the state and could not be explored in as cost-effective a manner.

Furthermore, the MDA Report's conclusions regarding total mineral production from mental health lands appears extremely optimistic in light of existing mineral production in Alaska. The MDA Report used the following formula to estimate the mineral estate value of the original one million acre grant: net present value (NPV) equals the gross value of annual production (GVAP) times the landowner's royalty, measured as a percentage of the net smelter return (NSR), times a uniform series present worth factor (PWF) to discount future income to present value:

NPV - GVAP x NSR x PWF (see MDA Report, p. C-1)

Working backwards, the gross value of annual production necessary to produce a given net present value can be determined as follows:

GVAP = NPV (NSR X PWF)

Under the assumptions in the MDA Report (4 percent NSR, 10 percent discount rate for 20 years for a PWF of 8.514), the gross value of annual production required to produce the MDA Report's $1.51 billion net present value is more than $4.43 billion:

GVAP = $1.51 billion (0.04 x 8.514) = $4.43 + billion

Total mineral production for the entire state in 1987 was $202,389,898. A production increase of 14.7 percent was seen in 1988, and further development of projects such as Greens Creek and Red Dog (none of which, incidentally, are on state or mental health land; furthermore, a third "world-class" deposit, Quartz Hill, also not on state or mental health land, is not commercially viable at this time) undoubtedly will result in further annual increases. However, $4.43 billion in gross value of annual production statewide is unrealistic given the current status and most optimistic projection by the mining industry in this state. I simply cannot accept that the gross annual value of production from mental health lands alone (one-third of one percent of the state's land mass) would exceed $4.43 billion.

A survey of fifteen other states with trust lands (including Texas, where the Texas Railroad Commission administers a substantial quantity of oil-rich lands for the University of Texas' benefit) reveals that the subsurface income from those

lands averages $4.57 per acre per year based on 1987 returns. Under the analysis in the MDA Report, the mental health lands would produce $120.80 per acre per year based on the eight percent per year rental provision of AS 37.14.011(c) although differences certainly exist between Alaska and other states. I cannot accept that even the most aggressive trust management could produce results so dramatically different from those in other states, including even those states with substantial known subsurface resources (unlike the Alaska mental health land situation) and where transportation and infrastructure systems are much more developed and extensive than in Alaska.

In responding to the various expert critiques of the MDA Report, Metz and Dixon argue that the current lack of mineral production from mental health lands is not a consequence of a lack of interest on the part of industry but instead is the result of state mismanagement. Their report states that, "The failure of the State of Alaska to fully implement a mineral location/leasing system and the various types of land withdrawal and restrictions, have acted as a major disincentive to investment in prospecting and exploration on state land in general and the mental health land (MHL) in particular."

The fact, of course, is that most mental health lands have been available for claim-staking--i.e., the mineral rights were available <u>for free</u> from the time they were selected until they were closed to mineral entry by order of the Commissioner following the <u>Weiss</u> decision in 1985. While some claims were staked, industry interest in mental health lands was not great. It is hard to imagine that a vigorous state leasing program, where industry would have to <u>pay</u> for mineral rights, would result in increased industry interest, particularly where (as Dr. Harris noted) there is a world market in rights to mineral lands and substantial amounts of state and federal land would continue to be open to claim-staking for free.

At the request of the department, Dr. Harris also outlined the activities required to produce a credible estimation of the market value of the mineral resources using the discounted cash flow analysis and the costs of these activities. Dr. Harris estimated that the costs of estimating the market value of the original mental health land and replacement land would be about $350,000, plus funding for additional DGGS work.

Given the amount of time and money expanded to date in an effort to value mental health lands has taken to date, I cannot recommend that additional funds be requested from the Legislature to continue the process.

As an alternative, department staff have suggested employing a comparable sales approach to determine the value of the mineral estate of both the original one million acre mental health land grant and the pool of potential replacement land. The department has received information regarding sales of the mineral rights to certain lands in DGGS's classes 4, 5, and Super 5s for which the mineral endowment is unknown (although suspected), which is the case with the land to be valued. Those sales revealed the following per acre market values:

Super 5	$2,000/acre
5	1,135/acre
4	108/acre

Using those figures, the value of the mineral estate of the original grant would equal $73,403,459.

In my opinion, this is a more than reasonable value for the mineral estate. Under the MDA Report assumptions (four percent net smelter return, ten percent discount rate for 20 years), the gross value of annual production from mental health lands would have to exceed $215 million to produce a net present value of $73 + million. That is more than the total of statewide mineral production in 1987. In addition, the eight percent annual rent required under AS 37.14.011(c) would result in the subsurface income from mental health lands equalling $5.87 per acre, substantially greater (more than 28 percent) than the $4.57 per acre earned on average by trust lands in the 15 lower 48 states surveyed.

The IMHTC majority has made it clear they do not believe a comparable sales approach is a valid method for determining the value of the mineral estate. Even though I believe the foregoing comparisons to current statewide mineral production and subsurface income from trust lands in other states reveal that the result of this approach is eminently fair to the trust, it has been suggested that a panel of Alaska mineral consultants could quickly and inexpensively provide an additional review of both the MDA Report and this comparable sales approach. You may wish to consider that option.

In my opinion, however, the final value of the mineral estate should be that produced by the comparable sales approach which is $73,403,459.

Timber Valuation

A timber resource valuation was prepared at the request of the IMHTC and the Commissioner. The valuation considered all original mental health trust lands, which total approximately one million acres, and all legislatively designated replacement pool lands, which encompass over six and one half million acres.

A detailed process to delineate and value lands suitable for commercial timber activities was developed in concert with the IMHTC and the consultants hired by the plaintiffs and intervenors. The results of this process are a series of 123 forestry potential maps, published as overlays to the USGS one inch-per-mile quadrangles, inventory estimates of commercial standing crop on these lands, and estimates of timber resource values reported on a parcel-by-parcel basis.

The conclusion of this process was that the one million acres of original mental health trust land contained $36,243,253. in commercial timber. I agree with the timber valuation procedures employed and the value derived.

Oil and Gas Valuation

At the request of the IMHTC, a report was written to describe the geology and exploration activity pertinent to establishing a "best estimate" of the oil and gas potential of the legislatively designated replacement pool lands and the original mental health trust lands within Alaska.

For general evaluation, the state was divided into four regions: (1) Gulf of Alaska (including Southeast, Prince William Sound, and the Kodiak area), (2) Alaska Peninsula and Southwestern Alaska, (3) Central and East-Central Interior, and (4) Cook Inlet and Susitna Basins (including the Talkeetna and Chugach Mountains and a portion of the Copper River Basin). Each of these was assigned to a petroleum geologist or geophysicist. These four regions were further subdivided in order to produce a more precise and detailed evaluation. Information from surface geologic mapping and from nonconfidential drilling well logs was utilized. Confidential well log information and data from proprietary seismic surveys were not included in this study.

Of the four areas studied, only the Cook Inlet Basin contains known natural gas fields which underlie some of the mental health and legislatively designated parcels. Where sufficient data were available, an economic analysis was completed for those parcels.

There are no known oil fields beneath any of the parcels.

This process concluded that the oil and gas value of the one million acres of original mental health trust land was $495,998. I concur with the oil and gas valuation procedures employed and the value derived.

Coal Value

At the request of the IMHTC, a coal valuation was prepared by the department. The valuation considered all original mental health trust land and all legislatively designated replacement pool land.

The conclusion of this process was that, although coal is present in a number of areas, it is currently economic to produce in only two areas (Nenana and Wishbone Hill). The value of this coal on original mental health trust land was determined by the department to be $432,866.

The IMHTC proposed and adopted the MDA Report as its procedures and resultant value. The MDA Report states that a current market does not exist for coal other than that identified in the DNR coal valuation. The authors then hypothesize that "several large scale open pit metal mines" in the railbelt and Kenai Peninsula areas could serve to diminish the "current excess electrical generating capacity" and provide additional coal marketing opportunities, with similar opportunities arising elsewhere. The MDA Report then makes a number of assumptions about the mines to produce figures for a cash flow analysis. One of these assumptions is that "The entire production would come from the subject land (i.e. mental health trust land)."

Using the hypothetical developments and related assumptions, the MDA Report concludes that "the net present value of the cash flow" from coal on mental health land would be $3,200,000. The MDA Report then states: "With the large quantities of coal on adjacent state and federal land in Alaska, it is probably unrealistic to expect more than 10 percent of the model production to come from trust lands."

This statement from the MDA Report infers that under that analysis, the best estimate of net present value is $320,000. I believe $432,866. should be used as the value for coal on the original one million acres.

Material Sources

The DGGS conducted a review of all mental health trust land and replacement pool land in order to assess potential mineral sources. Unfortunately, there is little detailed inventory information available. The DGGS estimated the cost of data gathering sufficient to enable them to determine material sources volumes and quality to be between $65.4 and $85.2 million. However, this would still be inadequate data upon which to base a value determination because material source values are heavily influenced upon their proximity to the market. Also, prices fluctuate upon demand. If there is no demand, then there is no value.

At a June, 1989 meeting of the IMHTC, Dick Rieger of DGGS presented three options available for material source valuation. At that meeting, the IMHTC determined that the valuation of material sources was simply not a fruitful exercise, given the uncertainty over material source location, quality and volume. As a result, the IMHTC approved a process whereby the value of the material sources on mental health land would be addressed through the designation of equal potential replacement lands.

However, the IMHTC reversed itself when it adopted the MDA Report. The MDA Report established a range of value between $2.5 million and $25.4 million for material sources, with a most likely value of $13 million. This value was based upon an average of 14 million cubic yards consumption per year statewide, with the original mental health trust land producing 24 percent, or 3.5 million cubic yards. Unfortunately, these assumptions cannot be substantiated since, in reality, only 1.275 million cubic yards were produced in that timeframe (425,000 cubic yards/year) from mental health lands. In fact, if the average annual production level of 425,000 cubic yards were to be maintained into the future, the discounted cash flow for 20 years would be approximately $420,000/year.

For the above reasons, I reject the MDA Report as a basis for material source value determination. However, I also conclude that we do not presently have sufficient data to produce a meaningful value for this resource. Because there are

insufficient funds available to produce these data, at least at this time, it is impossible to produce fair market value for this resource. Alternately, the trust should be protected if lands of equal material source potential are designated as replacement lands.

Integration Procedure and Valuation

On October 21, 1987, the full IMHTC approved the department's recommendation for integrating the various land values (e.g., surface estate value, timber value, mineral value, etc.). Under those approved procedures, values for compatible uses--e.g., a subdivision for residential or commercial use and oil and gas development (i.e. North Kenai area--would be simply added together. Where uses would be incompatible--e.g. subdivision for residential use and coal development (i.e. Beluga area)--the highest value (i.e., the value for the highest and best use) would be used. Generally, those initially approved procedures could result in one of three possible values being selected: (1) the sum of the surface value and the resource value, where extraction or removal of the resource would not affect the surface value; or (2) the resource value where it exceeds the surface value and extraction or removal would diminish the surface value; or (3) the surface value where it exceeds the resource value and extraction or removal of the resource would diminish the surface value.

The IMHTC majority, however, substituted an integration process which simply adds the various value elements, with no consideration given to whether the various uses are compatible or not.

I initially went along with this revised integration procedure, despite objections by department staff, in the spirit of compromise and my desire to achieve consensus. It is well-recognized, however, that a proper valuation procedure cannot simply add separate value elements where use of the property to exploit one element is incompatible with use of the property to exploit another. See, e.g., W. Mason, Jr., M. Azar, and G. Anderson, "Condemnation Value: The Taking of Mineral Bearing Lands," Mining Engineering 10986 (November 1989).

In my opinion, the integration procedures first determined by the IMHTC are the only ones which can produce a credible integrated value. I therefore believe that the following procedures should be used:

(1) Add the surface value and the oil and gas value;

(2) Add the mineral value, timber value, oil and gas value, coal value, and material source value; and

(3) for each parcel, select the highest value developed under (1) and (2) as the fair market value for that parcel.

Using those integration procedures and the per parcel values for each value element as outlined above, the total integrated fair market value for the original one million acre grant equals $564,700,728. Using the same integration procedures, the pool of potential replacement lands would have a fair market value of $910,103,205.

Replacement Pool Lands

As stated earlier, the IMHTC majority report failed to address the replacement land valuation requirements altogether. Using the procedures included in the majority report, the trust simply cannot be reconstituted by the Commissioner as contemplated by the Legislature and required by AS 38.05.800(b) and (c).

The procedures that I recommend will allow the trust to be reconstituted with equal value land from the replacement pool of legislative designations. Each of the procedures that I recommend has been followed for the replacement pool land on a parcel by parcel basis (with exception of material sources).

Redetermination of Values

AS 37.14.011(c) provides for the redetermination of the fair market value of the land constituting the mental health corpus at least every five years. The statute does not provide any further guidance on how this revaluation shall be accomplished.

This requirement can be fulfilled in any number of ways. I feel that the least desireable is to repeat a valuation process modeled on the one that we have just finished. I feel that the time, effort, and continual disagreement with the results would not be productive for all concerned.

I therefore recommend the following revaluation process.

1. Valuation of mental health corpus land will be conducted on an 18 month basis by region. Each of three regions, Northern, Southcentral and Southeast will be valued during successive 19-month periods. The same criteria previously recommended will be used to integrate values and to determine the fair market value of the parcels and the trust corpus as a whole.

2. Surface valuation will consist of an indexing of value increases, or decreases, within each region and application of the appropriate increase or decrease in market value occurring in each area since the previous valuation. Municipal property assessment records (for lands within municipalities) and paired market sales data (for lands outside municipalities or where property taxes are not levied) will be used to determine land value increases or decreases in each area.

3. Mineral values will be indexed to the mineral production in Alaska with the appropriate increases or decreases made for each region on a parcel-by-parcel basis.

4. Coal and oil and gas values will be indexed to the world market with appropriate increases or decreases made statewide on a parcel-by-parcel basis.

5. Timber values will be indexed to the market and conditions for the region with appropriate increases or decreases made regionally on a parcel-by-parcel basis.

3. **The procedures proposed and adopted by the IMHTC create substantial problems with respect to reconstituting the trust and periodically redetermining its value.**

AS 38.05.800(b) specifically states:

> "The Commissioner of natural resources, with the approval of the Interim Mental Health Trust Commission, shall identify land within legislative designations that is equal in value to all land selected by and patented to the state under Sec. 202 of the Alaska Mental Health Enabling Act that is not in legislative designation."

The value of the original mental health land trust is so high under the procedures specified in the majority report of the

IMHTC, that the trust cannot be reconstituted as contemplated by the Legislature. The value of the mental health trust, as established in the majority report, exceeds the value of all possible replacement lands.

Under AS 38.05.800(b) and (c), moreover, the trust is to be reconstituted with land in legislatively designated areas (e.g., parks, wildlife refuges, etc.) which is equal in value to the original mental health land grant. To do this, both the original grant and the pool of potential replacement land must be valued under the same procedures. The majority report of the IMHTC fails to address the replacement land valuation requirement altogether.

Because it is unnecessary to replace every parcel of original trust land (since some trust lands are already within legislative areas), and because the procedures proposed and adopted by the IMHTC make no attempt to value parcels individually, the trust simply cannot be reconstituted through the majority report approach.

Under AS 37.14.011(c), moreover, the trust as reconstituted under AS 38.05.800(b) and (c) must be periodically revalued at least once every five years. Therefore, because the pool of potential replacement land has not been valued under the same procedures used to value the original grant and therefore cannot be reconstituted, it also cannot be periodically revalued as contemplated by the Legislature.

CONCLUSIONS AND RECOMMENDATIONS

For the foregoing reasons, I have concluded that the Commissioner simply cannot comply with the applicable provisions of law at this time. The valuation procedures set out in the IMHTC majority report were adopted over my objection on behalf of the department, and therefore are not the product of consensus as contemplated by the Legislature and specified by law. The procedures that I believe should be employed, on the other hand, have not been approved by the IMHTC as required by the Legislature and specified by law.

I therefore recommend that the Commissioner send letters to both the Speaker of the House of Representatives and the President of the Senate explaining that she is unable to comply with the law as currently written, enclose copies of both the IMHTC majority and minority reports, and list three options for legislative consideration: (1) change the law and accept the $2.2 + billion value determined under the procedures adopted by the IMHTC majority; or (2) change the law and accept the $564 + million value determined under the procedures I believe should be used to comply with Chapter 48; or (3) appropriate additional funds to permit the IMHTC to continue seeking consensus.

I believe that the Commissioner should recommend to the Legislature that they adopt option (2) and accept the 564 + million value for the original one million acre mental health trust land grant. The procedures used to determine that value have been subject to review by outside professional experts and developed, reviewed, and approved by department staff who have a wide variety of expertise in valuing the various resources found on mental health lands. Furthermore, the Attorney General's Office advises that such a procedure would be legally defensible since the United States Supreme Court ruled that it is permissible to use "procedures established by the Commissioner's rules, or any other procedures reasonably calculated to assure the integrity of the trust and to prevent misapplication of its lands and funds." Lassen V. Arizona Highway Department, 385 U.S. 758, 465 (1967).

It also would be eminently fair to both the trust and the state. It would establish the various elements of value as follows:

Surface Estate	$511,949,467.00
Hardrock Minerals	73,403,459.00
Timber	36,243,253.00
Oil and Gas	495,998.00
Coal	432,866.00
Material Sources	undetermined

Following the integration procedures outlined above, the total integrated fair market value of the original one million acre grant would equal $564,700,782.82.

As an objective measure of the fairness of this value to the trust, the eight percent of this amount which the Commissioner of Revenue annually must allocate to the mental health trust income account under AS 37.14.011(c) until revaluation takes place equals $45,176,058. or $45.18 per acre per year; this compares very favorable to the national average of $8.97 per acre per year returned for trust lands in other states.

At first blush, this figure might appear unfair to the state. After all, it is more than five times the national average, and exceeds even Washington which, at $45.68 per acre (as a consequence of its prime and easily accessible timber resources), has the highest average in the nation. At the same time, it must be remembered that, following the exchange contemplated by Chapter 48, all of the newly reconstituted mental health trust will consist of land within legislatively designated areas which the state will continue to administer for legislatively designated purposes. In other words, unlike the case in most states, the state here will be using every acre of the newly constituted mental health trust for its own purposes. It therefore is only fair that the state compensate the trust for that use. One consequence of this is that, unlike the case in other states, every acre of the mental health trust will be productive in terms of generating revenue. That has the effect of raising the per acre earnings of the entire trust, a result which I believe is not inappropriate.

SENATE SPECIAL COMMITTEE ON MENTAL HEALTH

SECOND SESSION

16TH ALASKA STATE LEGISLATURE

Senator Pat Pourchot, Chairman

Senator Jack Coghill
Senator Paul Fischer

Report to the Senate

January 1990

Alaska State Legislature

Sen. Pat Pourchot, Chairman

Sen. Jack Coghill
Sen. Paul Fischer

P.O. Box V
State Capitol
Juneau, Alaska 99811

907-465-3712

Senate Special Committee on Mental Health

January 8, 1990

The Honorable Tim Kelly
President, Alaska State Senate
Post Office Box V
Juneau, Alaska 99811

Dear Senator Kelly:

Passage of SR 10 by the 1989 Legislature established the Senate Special Committee on Mental Health and charged it with the following:

-- conducting oversight hearings on the implementation of the settlement of the mental health trust litigation and

-- facilitating resolution of the problems hindering settlement.

The Committee is authorized to meet during and between sessions of the Legislature, and terminates upon convening of the First Session of the Seventeenth Legislature. The Committee conducted two public hearings during the past interim and met individually with many of the participants in this issue. At this time, we are submitting an interim report that provides an overview and status of the mental health trust issue.

The work of the groups involved in resolving the litigation (primarily the Interim Mental Health Trust Commission, the Department of Natural Resources, and the Alaska Mental Health Board) is ongoing, so final recommendations are not contained in this report. The Senate Special Committee will continue to work with these groups during the upcoming session, and will bring before the Senate any items requiring legislative action or oversight.

The Committee would like to extend special thanks to Sandra Schubert, who was instrumental in the drafting of this report.

Sincerely,

Pat Pourchot
Senator Pat Pourchot, Chairman

Senator Jack Coghill

Paul Fischer
Senator Paul Fischer

MENTAL HEALTH TRUST LANDS SETTLEMENT

BACKGROUND

THE FEDERAL GRANT

In 1956 the U.S. Congress passed the Alaska Mental Health Enabling Act (PL 84-830). The Act authorized the Territory of Alaska to administer a mental health program and, to ensure that the territory had adequate financial resources to do so, granted Alaska 1 million acres of land. The Act required that the land be administered as a public trust and that the income from the land "first be applied to meet the necessary expenses of the mental health program of Alaska". The land was selected but no trust fund was established.

THE LEGISLATIVE REDESIGNATION

In 1978, public pressure to make state land available for use and development prompted the legislature to abolish the land trust and redesignate all mental health land as general grant land. A monetary trust fund, to be financed by 1.5% of revenues from all state lands, was established in its place. No revenues were ever appropriated to the fund.

THE WEISS LAWSUIT

In 1982 a suit was filed on behalf of Carl Weiss and Earl Hilliker, two Alaskans in need of mental health services not available in Alaska. The suit contended that the law which abolished the land trust was a breach of the federally-created trust.

THE COURT DECISION

In 1984 the Alaska Superior Court ruled in favor of the plaintiffs; the state appealed. The Alaska Supreme Court agreed with the Superior Court and held that the 1978 redesignation law was invalid. The Court directed the state to reconstitute the 1 million acre trust as nearly as possible, reimbursing the trust for land which had been sold, offset by mental health expenditures made by the state since 1978. At the time of the court decision 90,000 of the original 1 million acres had been patented to private parties, 43,000 acres had been conveyed to municipalities, 370,000 acres were in legislative designations (parks, refuges, forests, public use areas), and 290,000 acres were under special use (rights-of-way, timber sales, mining claims, oil and gas leases, etc.).

THE SETTLEMENT PROPOSAL

In 1986 the legislature appointed a special committee to develop a means of implementing the Court's decision. The committee's proposal, introduced as HB 92 and signed into law as Chapter 48, SLA 87:

1. Directed the Department of Natural Resources (DNR) to reconstitute the trust with land currently in state parks, refuges, forests, and public use areas that is equal in value to the original 1 million acres of land. "Value" was defined as the July 1987 fair market value as determined by DNR under procedures approved by an Interim Mental Health Trust Commission.

2. Required, in lieu of managing the replacement lands for maximum revenue generation as is required under general trust law, that the state annually allocate an amount equal to 8% of the fair market value of the land to the Mental Health Trust Income Account in the state's general fund. These "trust earnings" would be appropriated first to meet the necessary expenses of the state's mental health program, and then for other public purposes. Pending reconstitution of the land trust, 5% of the state's annual unrestricted revenue would constitute the trust earnings.

3. Established the Alaska Mental Health Board (9-12 members who represent consumers, providers, and the public at large). The Board was charged with determining the need for mental health services in Alaska, reviewing the state's mental health program, and reporting its findings to the Legislature and the Governor.

The settlement proposal was seen by the parties to the lawsuit and the Legislature to have the following advantages:

1. Satisfies state's legal obligation under federal law to create a permanent funding source for mental health while retaining the Legislature's discretion in appropriating funds.
2. Allows the original 1 million acres to continue to be used for general public purposes, removing the "cloud" on title and/or use of trust lands selected by municipalities and purchased by third parties.
3. Provides immediate financial support for the mental health program but doesn't require a major cash outlay.
4. Avoids further costly and time consuming litigation.
5. Is relatively easy to administer.

MENTAL HEALTH TRUST LANDS SETTLEMENT

STATUS

DETERMINATION OF LAND VALUE

DNR hired appraisers who, using an opinion-of-value methodology and procedures approved by the Interim Mental Health Trust Commission, calculated the surface value of the original 1 million acres to be $499.8 million. This figure was disputed by appraisers hired by the plaintiffs' attorneys who, asserting that DNR's appraisers had not properly interpreted the Commission's procedures, calculated a value of $833.3 million.

DNR calculated the value of the timber resource on the original 1 million acres to be $41.0 million. This figure was disputed by the plaintiffs' attorneys who objected to the deduction of reforestation costs.

The federal land grant included the subsurface estate. DNR calculated the value of the minerals/coal/aggregate on the original 1 million acres to be $16 million. The minerals/coal/aggregate figure was disputed by geologists hired by the plaintiffs' attorneys who calculated the value at $1.5 billion. DNR calculated the mineral value based on "comparable sales" -- the plaintiffs argue this does not accurately reflect the development potential of the resources; DNR argues that comparable sales is the established procedure for determining fair market value.

DNR calculated the value of the oil/gas to be somewhere between $135,953 and $856,040. The plaintiff's attorneys did not submit an oil/gas valuation, but asserted that DNR's range was grossly low.

THE NEGOTIATIONS

Because of the large discrepancy between the values determined by DNR's procedures and the plaintiffs'procedures, the Commission requested that the state and the plaintiffs attempt to negotiate a value that would be acceptable to both parties. On October 27, 1989 the negotiators reported to the Commission that they were at impasse. The plaintiffs' final offer was $2.325 billion; the state's final offer was undisclosed, but at least $1.5 billion less than the plaintiffs' offer.

THE COMMISSION'S FINAL DECISION

Unable to reach consensus, on November 7, 1989 the Commission adopted by a 2-1 vote a resolution approving final procedures for determining the value of the land. The DNR representative voted no, the plaintiffs' and intervenors' representatives voted yes. The procedures lead to the following values:

Surface		$ 666.5 million
Minerals/Coal/Aggregate		1,534.7 million
Oil/Gas		.5 million
Timber		41.0 million
	TOTAL	$2,242.7 million

(The Alaska Mental Health Board has endorsed these values.)

THE DNR COMMISSIONER'S FINAL DETERMINATION

The settlement proposal requires that the Commissioner of DNR determine the fair market value of the land based on the Commission's procedures. The Commission submitted its final procedures to Commissioner Gorsuch on November 7, 1989. Before responding, Gorsuch requested a written justification of the procedures from the Commission, which was submitted on December 20, 1989.

If the Commissioner does not endorse the Commission's procedures (which the Department of Law has advised she can do if she finds the procedures to be arbitrary or capricious), it is unclear what the next step would be. The parties could request legislative clarification of "fair market value", legislative confirmation of a particular value, judicial intervention, or possibly some other action.

RECONSTITUTION OF THE TRUST

Once the value of the original 1 million acres is determined, lands of equal value from legislatively designated areas (parks, refuges, forests, and public use areas) are to be identified by DNR and approved by the Commission; these replacement lands would constitute the trust corpus. There has not been a formalized appraisal process for the replacement land as there was for the original 1 million acres. As of this writing, the Commission has not finalized its recommendation on valuation of replacement lands.

Once the trust is reconstituted, the DNR Commissioner must certify the reconstitution to the Revenue Commissioner, the Alaska Mental Health Board, and the Lieutenant Governor. Upon certification, an amount equal to 8% of the land value will be segregated in the state's general fund as the Mental Health Trust Income Account.

Every five years, the fair market value of the replacement land is to be reappraised and the 8% adjusted accordingly. As of this writing, the Commission is considering recommending that the reevaluation be of the original 1 million acres, not the replacement land, and that it be tied to a cost-of-living index, rather than an actual reappraisal.

MENTAL HEALTH TRUST INCOME ACCOUNT
Until the trust is reconstituted, an amount equal to 5% of the state's annual unrestricted revenue constitutes the Mental Health Trust Income Account. In FY 89, 5% was $97.7 million. The Department of Revenue's November 1989 mid-case revenue forecast projects 5% to be $114.8 million in FY 90 and $113 million in FY 91.

The Legislature has appropriated from the Mental Health Trust Income Account what, in its collective judgment, has been necessary to fund the mental health program. The appropriations have been less than the Alaska Mental Health Board's recommendations and significantly less than the funds in the Account.

	5%	Board Recommendation	Appropriation
FY 89	$ 97,724,965	$ 54,992,300	$ 39,596,800
FY 90	$114,800,000(est.)	$ 54,260,800	$ 43,426,100

(NOTE: Not all state mental health services are included in the "appropriation" figure. Only services for the "traditional" mentally ill and FY 90 budget increments for the developmentally disabled, senile, and chronic alcoholics are currently being funded from the trust account. See program discussion following.)

Each year the unappropriated balance of the Mental Health Trust Income Account has been transferred in accordance with Chapter 48 to the state's general fund for general expenditure.

THE MENTAL HEALTH PROGRAM

Although not a part of the Supreme Court's ruling or the settlement proposal embodied in Chapter 48, the plaintiffs and intervenors have made it clear that the determination of "the necessary expenses of the mental health program of Alaska" is integral to settlement. Clearly, the goal of the 1956 enabling act, the Weiss lawsuit, and the settlement proposal is to provide a funding source for mental health services. However, none provide a definition of "necessary expenses" or "mental health program". Some guidance has come from the court, but many questions remain unresolved.

THE GREENE DECISION

The Weiss lawsuit was filed on behalf of chronically mentally ill individuals. After the Supreme Court ruled in the plaintiffs' favor, additional groups intervened in the lawsuit, wanting to be recognized as beneficiaries of the mental health trust. In 1988 Superior Court Judge Greene ruled that Congress intended that the trust benefit the recipients of the services of a "comprehensive mental health program".

Prior to passage of the Alaska Mental Health Enabling Act and the concomitant assumption of mental health responsibilities by the Territory, Alaskans in need of mental health services were sent to Morningside Hospital in Oregon. Judge Green ruled that Alaska's program must serve, at a minimum, those populations that were treated at Morningside -- the mentally ill who may require hospitalization, the mentally retarded (developmentally disabled), chronic alcoholics suffering from psychoses, and persons who suffer mental illness as a result of senility. Judge Greene's decision did not preclude the addition of other populations.

THE GREENE GROUP

The ad hoc "Greene Group", consisting of state officials and representatives of each of the four beneficiary groups named by the court, was formed to make recommendations to the Alaska Mental Health Board on which specific programs should benefit from the trust. Their final report, issued in April 1989, provides a definition of each of the four beneficiary groups. The definitions are based on clinical diagnoses and functional limitations that effectively limit the beneficiaries to the most severely ill in each group. The position of the Greene Group is that these "core beneficiaries" must have their needs met before additional beneficiaries may be served.

The Greene Group did not reach a consensus on what specific services should be provided or whether additional beneficiaries should be included.

THE ALASKA MENTAL HEALTH BOARD

The Alaska Mental Health Board issued a policy paper in July 1989 supporting funding of a "comprehensive mental health program", which would serve a broader group of beneficiaries than that identified by the Greene Group. For example, under the Board's definition, services provided by the state's Community Mental Health Centers to persons who are not severely ill would be funded from the trust.

At its December 1989 meeting the Board recommended that the following guidelines be used to determine what specific services should be funded from the trust:

1. The service must be included in the most current approved State Mental Health Plan or the Governor's Council Plan for Services to People Who Experience Developmental Disabilities;
2. The service is not one for which eligibility is determined on a basis other than trust beneficiary status (e.g. age, income);
3. The service is not one to which beneficiaries are otherwise entitled under state law; and
4. The service has been determined by the Alaska Mental Health Board or in statute to be a necessary expense of the state's mental health program.

THE ADMINISTRATION

As of this writing, the administration has not taken a position on who the trust beneficiaries should be and has not responded to the Board's recommended guidelines for identifying services. The state's current operating budget appropriates from the trust only for "traditional" mental health services and for FY 90 budget increments for the developmentally disabled, senile persons, and chronic alcoholics.

Appropriations from the trust are done simply by identifying the trust as the funding source in the state's operating budget. Identification of the traditional mental health program was done in FY 89 prior to the Greene decision. Since the decision, additional programs in the base budget have not been identified because of a lack of consensus over what services are "necessary". Once these issues are resolved, the budget will be revised to show the trust as the funding source for all eligible programs.

TRUST APPROPRIATIONS IN FY 89 AND FY 90

	FY 89	FY 90
Chronically Mentally Ill	8,003.0	9,758.0
Community Mental Health Centers	11,263.9	10,542.1
API/AYI/Designated BRUs/Administration	17,479.9	18,557.5
Developmentally Disabled	0	1,653.5
Alcohol Abuse	0	1,064.0
Alzheimers	0	325.0
Capital projects	2,850.0	1,526.0
TOTAL	39,596.8	43,426.1

TOTAL PROGRAM FUNDING IN FY 89 AND FY 90

	FY 89	FY 90
Chronically Mentally Ill	9,058.0	9,758.0
Community Mental Health Centers	11,248.3	11,967.3
API/AYR/Designated BRUs/Administration	18,527.2	19,965.1
Developmentally Disabled	17,248.7	18,998.9
Alcohol Abuse	14,479.3	15,905.7
Alzheimers	0	325.0
Capital projects	2,850.0	1,526.0
TOTAL	73,411.5	78,446.0

MENTAL HEALTH TRUST LANDS SETTLEMENT

DISCUSSION

THE GOAL

The common goal of the federal enabling act, the Weiss lawsuit, and the settlement agreement is to provide a funding source for mental health services. Under the settlement proposal, the amount of funds available is tied directly to the value of the original 1 million acres of land. Under both the federal enabling act and the settlement proposal, the amount of funds actually appropriated is tied directly to the "necessary expenses of the mental health program". This has led to there being two major unresolved issues:

1. The value of the land trust.
2. The determination of "necessary expenses", which involves both a determination of who the trust beneficiaries are and the services to be provided to each beneficiary group.

THE LAND VALUE

A basic conclusion at the time the settlement statute was enacted was that returning the original 1 million acres to trust status would create too many conflicts with current land uses. Hence, the concept of selecting replacement lands of equal value was endorsed. As is standard procedure in any equal value land exchange conducted by the state, both the original and replacement lands need to be appraised. As is also fairly standard, the land valuation process has become very controversial.

Because the amount of money in the Mental Health Trust Income Account will be a direct result of the land value (through the 8% payment mechanism), there is a tremendous interest on the part of the plaintiffs in a "high" land value. The administration asserts that its interest is in the "correct" value. It has voiced concern that "fair market value" has a specific meaning in its determination on a wide variety of land management actions, and that a different approach for mental health lands could set a detrimental precedent. However, because there are many approaches to land appraisal and because appraising involves some subjectivity, it is hard to say what is "correct". What can be said is that the value supported by the administration is much lower than that supported by the plaintiffs.

One might argue that the land value itself is irrelevant, because it simply generates a revenue stream that is available for appropriation by the Legislature; it is not a dedicated fund and hence there is no mandate to spend the full stream on mental health. The administration has asserted throughout the settlement negotiations that Congress, by allowing trust revenues not needed for the mental health program to be spent on other public purposes, intended that the determination of "necessary expenses" be the prerogative of the Legislature.

However, when the Legislature appropriated for other public purposes $60 million from the trust account in FY 89, the Governor received over 100 letters from the mental health community requesting that he veto the transfer on the grounds that the necessary expenses of the mental health program had not been met.

The Governor did not veto the transfer. The Alaska Mental Health Board's response has been to conduct public hearings on the concept of an independent board of trustees that would oversee the Legislature's distribution of trust revenue. In addition, David Walker, attorney in the Weiss suit, testified to the Board at its November 17, 1989 meeting that "that situation that happened last year [expenditure of trust funds on other public purposes] we don't see happening again frankly.... The way you would enforce against that is you would say this Board has determined the need and the Legislature has not appropriated to meet that need and therefore the fund ... cannot be used for any other purpose. We do not see a way that the Legislature can be forced [by the court] to appropriate ... but we do see a way that says they can't spend it on other things if they don't appropriate."

The Board's hearings and Walker's comments tightly tie the question of necessary expenses to the land valuation process.

In addition to possible action attempting to block return of unused trust monies to the general fund, failure to resolve the land valuation question could block future management actions on mental health lands. The Interim Mental Health Trust Commission currently approves on-going DNR management activities on all mental health lands. The Commission, by a 2-1 vote, could refuse to approve DNR's proposed actions. Additionally, the plaintiffs could file a lis pendens, which would notify all involved that action is pending against the mental health lands and calls title to the property into question.

NECESSARY EXPENSES

The more people served by the trust, the fewer funds there are for each; and the more services provided to any beneficiary group, the fewer funds there are for other beneficiary groups. To ensure that the trust is not "diluted" to the point that it is unable to meet the needs of the most severely ill, the Greene Group and others advocate using the trust to increase services to a narrow band of beneficiaries, and not increasing the potential number of beneficiaries. The Greene Group supports serving first the most severely ill (the "core beneficiaries" named by the court), and serving other persons in need of mental health services only after all the needs of the core beneficiaries have been met. Others support serving all Alaskans in need of mental health services, regardless of the severity of their illness.

The Greene Group's position results from the court's ruling that the trust must serve those persons who, prior to passage of the Alaska Mental Health Enabling Act, were sent to Morningside Hospital. However, the Greene decision also concluded that Congress intended that the Territory establish a "comprehensive mental health program", and that those illnesses treated at Morningside represented the minimum of services which should be provided. In addition, Judge Greene ruled that in the administration of the trust the state must treat all beneficiaries impartially. This is the basis for arguing for the provision of a full range of services.

The different approaches raise both policy questions and administrative concerns. For example, the core beneficiary approach, although not without merit, would be difficult budgetarily. In the provision of services by Community Mental Health Centers, it would require distinguishing between services provided to the severely ill and services provided to other Alaskans, with trust funds being spent only on the severely ill. Currently, all funds for the centers, which are established in statute to comply with federal law, are appropriated from the Mental Health Trust Income Account. Similarly, services provided by the state's alcohol program to chronic alcoholics who suffer psychoses would need to be distinguished from services provided to other alcoholics.

The question of who the trust should serve is important, but equally important is the question of who makes the determination. If the Legislature makes the determination of necessary expenses, should it do so in a "mental health vacuum" or in comparison to how it addresses other state needs? In other words, should the Legislature use different criteria in determining mental health needs than it does in determining education needs or the need for police services? How much weight should the needs assessments conducted by the Alaska Mental Health Board have? Should it dictate the budget recommendations of the administration, and effectively bind the Legislature? Are the Legislature and Board both too political in nature to adequately defend the trust so that an independent trustee should be given trust management responsibility?

While these questions are unresolved, the Alaska Mental Health Board adopted a policy paper at its December 1989 meeting endorsing the creation of an independent board of trustees to oversee the actions of the state in funding and administering the mental health program. The paper stresses that the Weiss lawsuit is still pending, and until the litigants are satisfied with the management of the program there is always the option of returning to court to seek restoration of the original land trust.

MENTAL HEALTH LANDS TRUST

OPTIONS

LAND VALUE
As of this writing, the Interim Mental Health Trust Commission has recommended the value of the original 1 million acres be set at $2.24 billion. The DNR Commissioner has not yet accepted the procedures resulting in this value.

A. If the Commissioner endorses the Commission's procedures, the trust will be reconstituted with replacement lands and 8% of the value will be segregated in the state's general fund as the Mental Health Trust Income Account.

B. If the Commissioner does not endorse the Commission's value:
   1. The Legislature could statutorially establish the value based on recommendations of DNR and the Commission.
   2. The Legislature could clarify the valuation procedures in Chapter 48, for example, the term "fair market value" could be further defined for the specific purpose of mental health land appraisal.
   3. The parties could return to court for guidance on the valuation.

C. The designation of replacement lands and a reappraisal methodology would also require Commission agreement or legislation or court direction.

NECESSARY EXPENSES
As of this writing, the Alaska Mental Health Board and the Greene Group have made conflicting recommendations on who should be beneficiaries of the trust; the Board has recommended guidelines for determining what services should be funded from the trust. The administration has not taken a position on beneficiaries or services, but, at the request of the Senate Special Committee, is beginning to identify costs of a wide range of services so they may be considered for funding from the trust.

A. The determination of necessary expenses could be made by:
   1. The Legislature, through statutory designation of groups and services or the annual budget process.
   2. The Alaska Mental Health Board, based on needs assessments that, through a settlement agreement, the Legislature would be bound to address.
   3. An independent board of trustees, with responsibility for approving expenditures from the trust.
   4. The state administration, through regulatory designation of groups and services.
   5. The court, through the parties' request for guidance on this issue.

B. Beneficiaries could include:
   1. Only the "core" groups named in the Greene decision (mentally ill who may require hospitalization, developmentally disabled, chronic alcoholics suffering from psychoses, and persons who suffer mental illness as a result of senility).

2. Any additional group receiving mental health services and currently recognized by statute or appropriation, such as clients of Community Mental Health Centers.
3. Additional groups, such as other alcoholics.

C. Services could include:
1. Those services currently identified in statute (AS 47.30: outpatient and inpatient treatment, consultation, prevention and education, crisis stabilization, patient treatment, case management, daily structure and support, vocational services).
2. Those services identified in the state's 5-year comprehensive plan.
3. Services identified through needs assessments conducted by the Alaska Mental Health Board.
4. Any services identified by the Legislature either by statute or appropriation.

RECOMMENDATIONS

Because the work of the administration, the Alaska Mental Health Board, and the Interim Mental Health Trust Commission is ongoing, no specific recommendations are contained in this report. The Senate Special Committee on Mental Health will continue to work with these groups during the Second Session of the Sixteenth Legislature, and will bring to the full body any items that require legislative action. The Special Committee terminates upon convening of the First Session of the Seventeenth Legislature.

ACTIVITIES AND COSTS
for the
ESTIMATION OF MARKET VALUE OF MINERAL RESOURCES
of
ALASKA MENTAL HEALTH TRUST LANDS

Prepared
by

DeVerle P. Harris

Submitted to

Alaskan Department of Natural Resources
Division of Land and Water Management
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INTRODUCTION

This report describes the activities required to produce a credible estimate of the market value of mineral resources of the lands of the Alaska Mental Health Trust and the costs of these activities. Basically, evaluation of these lands requires first the probabilistic estimation of mineral endowment (number of deposits and their features) and second, the estimation of the economic value of the mineral endowment so as to produce a probability distribution of market value. Details on information, method, activities and their costs are provided in the sections that follow.

MINERAL ENDOWMENT ESTIMATION

Perspective

A credible estimate of market value of Alaska's Mental Health Lands (MHL) for their potential mineral resources must rest upon a credible estimate of the number of undiscovered mineral deposits that occur in said lands and characteristics of the deposits, e.g., ore tonnage and average grade, depth to deposit. Inasmuch as potential deposits are not visible, their number and characteristics can only be inferred from indirect information, e.g., observed geological features and characteristics of deposits of the same type and geologic environment but in other well explored, analogous regions. Because of incomplete geological information on the region being evaluated, number of deposits is an uncertain quantity and is appropriately described by a probability distribution. Similarly, since potential deposits cannot generally be seen, their characteristics, e.g., size, grade, morphology, and depth of cover are unknown and should be described probabilistically. Estimation of the number of deposits occurring in a region and their characteristics is generally referred to as mineral endowment estimation.

This probabilistic description of undiscovered mineral endowment (inventory of undiscovered deposits), which is the foundation for mineral resource appraisal or for the description of the market value of potential mineral resources, was not made by the ADGGS nor by Metz, Delong, and Associates (MDA). Consequently, the first, most fundamental, and most important task in the estimation of fair market value of MHL is to describe probabilistically the mineral endowment of these lands.

Appraisal Methodology

Time considerations preclude the generation of quantified geology, geochemistry, geophysics, structure, alteration, and mineralogy and comprehensive synthesis of information in such data sets for the objective quantitative estimation of mineral endowment, as described in Harris and Pan (19). Instead, the estimation of mineral endowment must rely upon the subjective integration by well qualified geologists of geoinformation and resource information with geoscience. Experience has shown that at best this is a very difficult task and requires support by relevant data and an appraisal methodology. When not supported by controls (analogue areas, genetic models, deposit models, etc.) estimates of an uncertain event even by experts may exhibit strong biases, both motivational and cognitive. While an appraisal methodology cannot totally remove these, it can mitigate to some degree the magnitude of biases, and it provides a "track" of data and reasoning that lead to the mineral endowment estimates. Consequently, it is important that a methodology be identified and consistently administered. In that regard, at least one individual who is highly experienced in mineral resource estimation should oversee and manage the mineral endowment estimation process. An even better appraisal would result if the appraisal process were monitored by two experts, one whose expertise is in Alaskan geology and mineral deposits, and one whose expertise is appraisal methodology. Together, these individuals could provide assistance to the geologists who estimate the mineral endowment, and they could lend credence to appraisal estimates as being unbiased and made by good procedures.

Necessity for Reexamination of Geology

A natural inclination is to consider the endowment estimation as an add-on to the product of the ADGGS effort, which produced rankings: the first ranks MHL from 5 to 1 by their favorability for mineral deposits; the second ranks MHL from 5 to 1 by the amount and quality of information available. Moreover, for favorability rankings of 3, 4, or 5, the mineral deposit types to which the geologic environment is permissive were identified. An initial perception may be that the same ADGGS geologists who made the rankings could also provide subjective probabilities for number of deposits simply as an extra, independent effort, based upon consideration of the favorability rankings only. In other words, the geologists would convert the favorabilities to probabilities for number of deposits. Unfortunately, such an approach is strongly discouraged, because it does not recognize the need of the geologist to consider geology, spatial dimensions of the parcel, and deposit features explicitly and critically vis-a-vis geology in the estimation of the probability distribution for number of deposits. Clearly, probabilistic estimation of number of deposits is far more difficult than favorability ranking because it requires the relating of geology to magnitude of mineral endowment and probability. Examination and analysis of the geology for that purpose requires information about mineral deposit densities and methodological support for elicitation of subjective probabilities. Both of these are major tasks not undertaken in the previous effort by ADGGS.

Basically, the point to be made in the foregoing is that much of the geologic analysis by ADGGS personnel will have to be redone for the estimation of mineral endowment. This effort will be more extensive than it would normally be, because the various data sets, e.g., geochemistry,

geophysics, lithology, etc., were not compiled at constant scale to new maps nor to composites. Due to shortage of time and resources, the data sets were assembled from various sources and utilized in their original forms to perform the favorability rankings, after which the data were returned to their sources. Since compilations and composites to constant scale were not made, the geologic analysis for endowment estimation would have to repeat this initial data and information acquisition.

Study of Analogue Areas

A well designed and executed estimation of mineral endowment differs from favorability ranking in another very important regard, the use of analogue areas. When the objective of the geological analysis is mineral endowment estimation, the study of analogue areas is nearly as important as is the geological analysis of the MHL themselves.

An analogue area is a well explored area having a geologic environment similar to the region or land parcel under appraisal. Ideally, several analogue areas would be identified and studied for each specific geologic environment or deposit type, e.g., volcanogenic massive sulfides or epithermal gold, etc. Besides providing information on geologic particulars, these areas support the geologic estimation of mineral endowment by providing information on deposit density and on how that density varies in response to geologic differences. Such information is of great value to the geologist in estimating probabilities for numbers of deposits indicated by the geology of a MHL parcel. Of course, wise use of deposit density information requires that the criteria used to

delineate permissive or favorable areas are compatible with criteria used to delineate the analogue area; consequently, geology of the analogue areas also must be carefully reviewed and compared with that of MHL land parcels to assure uniformity.

Important Information From Other Work

Mineral Endowment Appraisals.

One of the first tasks in preparation for estimation of mineral endowment of MHL is the review and use, where relevant, of resource appraisals made by other institutions or agencies of parts of Alaska. Probabilistic estimates of the mineral endowment of much of the MHL have been made at one time or another by U.S. agencies. Generally, the tracts or favorable areas appraised in previous studies are much larger than the parcels of MHL; consequently, few of these estimates could be used directly. But, they provide information that represents considerable effort for the explicit purpose of mineral endowment estimation. Such information is available at a very small cost and should be considered and evaluated as a starting point in the mineral endowment estimation of MHL.

AMRAP. In 1974, the U.S. Congress mandated the U.S. Geological Survey to appraise the "mineral resource potential" (mineral endowment) of the d-2 lands of Alaska as support for approaching land classification decisions in December of 1978. Geologic, gravity, and aeromagnetic maps were compiled at a 1:1,000,000 scale for all of Alaska and geochemical data were assembled for local areas. Deposit models

were compiled for several types of deposits, and favorable areas were delineated for these deposit types throughout all of Alaska except the North Slope, Aleutian Islands, islands of the Bering Sea, and Southeastern Alaska. Using expert judgment, numbers of deposits for specified probabilities were estimated for each deposit type and favorable area. These estimates are available in various USGS Open File Reports. A brief description of the study is reported by D. A. Singer and A. T. Ovenshine in "Assessing Metallic Resources in Alaska," American Scientist, v. 67, no. 5, 1979, pp. 582-589. Besides this work done at the 1:1,000,000 scale, mineral endowment of a few regions, e.g., Nabesna Quadrangle by Richter, et al (1975), was completed at the 1:250,000 scale. It is my understanding that the boundaries of the favorable areas delineated in the AMRAP mineral endowment appraisal have been digitized and processed to a GIS file and that a map of these areas can be obtained from the ERDAS Center at Sioux Falls , South Dakota, by contacting Ray Arndt, Program Manager, National Mapping Division, U.S.G.S.

Other Mineral Endowment Appraisals. In addition to the AMRAP appraisal, more recent appraisals by the USGS include Chugatch National Forest, Open File; some Southeastern Alaska regions, Open File; and Seward Peninsula tin (D. Menzie) forthcoming in Economic Geology. Finally, a mineral endowment appraisal of the Tongas Forest is currently under way by the U.S.G.S.

Analogues and Deposit Densities.

A common reference for mineral endowment appraisal and resource evaluation is USGS Bulletin 1693, entitled "Mineral Deposit Models," edited by D. P. Cox and D. A. Singer, which gives descriptions of geologic environments and size and grade distributions for many deposit types. Additional deposit models as well as new developments in resource appraisal methods are forthcoming in a new USGS Bulletin to be published sometime this year. Information on this work could be obtained from Jim Bliss of the Tucson Field Office of the USGS, 210 E. 7th St., Tucson, AZ 85705.

As indicated in an earlier discussion, one of the most difficult tasks of the geologist in estimating mineral endowment is the associating of number of deposits with the geology of a region. Accordingly, statistical information on deposit density of analogue regions is extremely important support for this task and should be made available whenever possible. In that regard, work completed or in progress on deposit density by the USGS could be highly beneficial to the estimation of mineral endowment of MHL. Studies of deposit densities have been completed or are in progress on the following: Cyprus massive sulfides, gold placers, mercury, bedded barite, podiform chromite, and gold veins. For further information, contact Jim Bliss, USGS Tucson Field, Office, Tucson, AZ.

Logistics of Endowment Estimation

Kinds of Expertise.

A credible estimation of undiscovered mineral endowment brings together three kinds of expertise: geoscience of mineral resource formation, specific knowledge of the geology of the region and of the land parcel, and estimation methodology. Seldom is any one individual truly expert in all three kinds of knowledge, particularly when the endowments of several deposit types must be estimated. Consequently, a credible endowment estimation entails "engineering" the contributions from multiple sources so as to produce the desired probabilistic estimates of endowments of the land parcels in specific metals.

Having recently completed the favorability ranking of the MHL and having first-hand knowledge of the geology of some areas, geologists of the ADGGS are especially well qualified in the second expertise, knowledge of the regional and local geology. Moreover, some of them are well qualified in the first expertise, at least for certain deposit types. While not highly experienced in expertise three, estimation methodology, some of them have had some experience in that regard.

There is little doubt that there is no other group of geologists having as much collective experience in mineral endowment estimation using subjective probability as the geologists of the U.S. Geological Survey, Office of Mineral Resource Analysis, under the direction of Dr. Glenn Allcott. These geologists include prominent names in mineral endowment estimation, e.g., David Menzie, Don Singer, Norm Page, Greg McKelvey, Jim Bliss, to name a few. These and other

USGS geologists also are highly knowledgeable of the geoscience of resource formation, at least for some deposit types. Some USGS geologists undoubtedly have expert knowledge of the regional and local geology.

The Estimators.

Since estimates of market value of MHL could influence future land tenure decisions by the State of Alaska or the bases for royalty assessments, the possibility for conflict of interest of geologists employed in the mining industry of Alaska preempts their performing of the endowment estimation itself, even though they may be very excellent sources of geologic and mineral resources information. Exclusion of this body of expertise leaves two groups of geologists who by virtue of their knowledge and experience could produce credible estimates of mineral endowment of the MHL: the U.S. Geological Survey and the ADGGS geologists. Even for one of these, the ADGGS, someone or some institution seeking to discredit or taint an estimate by ADGGS may suggest conflict of interest because they are employed by the State of Alaska, one of the principals in previous litigation. While in concept, such conflict of interest may be possible, I found no evidence for it. Quite to the contrary, the personnel of ADGGS seem to be possessed mainly of professional concerns regarding geoinformation, methodology, and the scientific basis for endowment estimates. If the illusion of conflict of interest should be considered an issue, it could be mitigated by either (1) contracting the estimation task and responsibility with someone or some institution other than ADGGS with the understanding that the ADGGS personnel would perform the estimation under his supervision, or (2) contracting directly with the

ADGGS with the requirement that the ADGGS obtain the services of two highly qualified and prominent experts to monitor and supervise the estimation; one of these should be an expert in appraisal methodology, and the other should be an expert in mineral deposits and the geology of their formation.

Alternatively, the mineral endowment estimation could be contracted directly with the U.S. Geological Survey. Clearly, such a plan would remove the issue, or illusion thereof, of vested interest. I have checked informally with personnel of the U.S. Geological Survey and found that such a plan in its broadest generality is feasible. However, I cannot comment upon the terms (budget and time) required of the U.S. Geological Survey to perform the estimation. DNR would need to explore this directly with Dr. Glenn H. Allcott, Chief, Office of Mineral Resouces, U.S. Geological Survey, 12201 Sunrise Valley Drive, MS 917, Reston, VA 22092.

If there were no special contracting considerations, e.g., an Alaskan contractor, other than the engineering of an impartial, highly credible endowment estimation, there would be considerable merit to contracting the work with the Center for Mineral Resources Science (CMRS) currently being created at the University of Arizona. The purpose of the CMRS is to coordinate interaction of geologists, mineral resource specialists, and mineral economists of the University with those of the Tucson Field Office of the USGS specifically for the estimation of mineral endowment and the economic analysis of mineral resources. Prominent USGS mineral resource assessment specialists at Tucson include Norm Page, Jim Bliss, and Greg McKelvey. Participation of personnel of ADGGS,

USGS, and the University of Arizona could be very effectively coordinated through CMRS for the estimation of MHL mineral endowment. Moreover, the CMRS could also perform the other tasks required to convert the mineral endowment distributions to market value distributions through the expertise of the mineral economics faculty, who are members of the CMRS. Such a plan would increase both the level of expertise brought to bear upon the endowment estimation and maximize, given the time constraint, information availability. Of course, costs of implementing such a plan would, everything else being equal, increase simply because of the involvement of more individuals and institutions and because of the increased management task.

Complications Due to Scattered and Small Land Parcels

Some of the MHL land parcels are very small and widely scattered as compared to the tracts of land for which endowment estimates are usually performed. Being both small and widely scattered compounds endowment estimation scientifically and increases considerably the effort required. Metallogenetic processes that are reflected in the geological information customarily available to and used by geologists to estimate mineral endowments of unexplored areas have natural scales, some of which are regional. Analogue regions, as well as regions of geologic experience with regard to endowment estimation, are usually larger than these small parcels. Moreover, larger regions generally have more varied geology and provide robustness to endowment estimates. For all of these reasons, a geologist is reluctant to estimate mineral endowment of a small land parcel. While there is no way to remove totally these conceptual and logistical issues, they can

be mitigated to some degree by aggregating land parcels in a given region when they exhibit geology of a like geologic environment and deposit type. When this cannot be done, it may be useful for the geologist to select the best matching analogue and to evaluate the analogue area as though it possessed the geology of the parcel and then to use a programmed mathematical procedure to compute from the adjusted analogue distribution the probability distribution for number of deposits that is consistent with the size of the parcel. This could serve directly as the desired probability distribution or it could be taken as a first approximation, one that could be modified by the geologist. Of course, such an approach relies even more heavily upon analogue areas and the availability of a computer algorithm to support the estimation process. Moreover, complications may arise when the geology of a small land parcel is consistent with more than one possible analogue. These could be treated by either compiling a composite analogue or by estimating endowment separately for each analogue and requiring the geologist to provide numerical expressions of the similarity of the parcel to each analogue. Either procedure requires both data and computational support.

Cost of Endowment Estimation

Estimation of costs for the mineral endowment estimation of MHL requires fixing some parameters. Accordingly, for the purpose of cost estimation, I have made the assumption that the ADGGS would perform the endowment estimation via budget appropriation by the State of Alaska. Table 1 itemizes costs by major activity. Most of these costs were estimated jointly with personnel of the ADGGS, drawing upon costs of activities in the previously completed favorability ranking project.

TABLE 1

ESTIMATION OF COSTS FOR ENDOWMENT ESTIMATION*

Activity	Estimated Cost
Acquisition of basic geodata and information[1]	$ 20,000
Preparation of analogues and supportive information	35,000
Information enhancement	20,000
Preparation of map overlays (personnel and materials)	14,000
Analysis of MHL geology and of analogues in preparation for endowment estimation	50,000
Estimation of subjective probabilities for endowment by deposit type and geologic environment	25,000
Experts serving as monitors and consultants	21,000
Special support required because of small land parcels	15,000
TOTAL	$200,000

*Based upon direct costs for ADGGS and supplementary assistance.

[1]This includes the re-creation of the data base used in the favorability study and the acquisition of information on previous mineral endowment estimations and on previous, relevant analogue studies.

Moreover, these costs were made for a minimum acceptable effort to produce a credible endowment estimation, without the generation of additional geoscience information. To these base activity costs made jointly with ADGGS, I have added some additional ones, such as experts serving as monitors and consultants, and special support required because of small land parcels; these were described in previous sections and do not require additional comment. One cost item not yet described is information enhancement. Although no new geodata will be generated by primary surveys, there may be a need for the enhancement of selected geodata used in the previous favorability ranking so as to better support the estimation of number of deposits. The cost of $20,000 is to permit enhancement on a very limited scale, leaving the specification of data and kind of enhancement to be made by the ADGGS working in conjunction with the consulting experts.

A cost of $25,000 allowed for the estimation of subjective probabilities for endowment is to include some pre-estimation experimentation with and calibration of estimation methodology, with direction from the experts on methodology, e.g., use of analogue areas, and the preferred procedure for estimating probabilities.

A sizeable cost has been allocated to the preparation of analogues and supporting information because of their importance in supporting the endowment estimation process. Even so, this activity is viewed as incremental to the work already done, as described in previous sections, on deposit density studies and deposit models. This additional effort is required because for some deposit types, density studies are not available. Moreover, a geologist never has enough analogue information when he attempts to consider the effects of

geologic differences between land parcel and analogue on number of deposits. Typically, given the importance of good analogues, too little effort is given to preparation and study of analogues.

Experience may show that any one of the estimated costs may vary considerably from actual costs, but overall I believe these differences will offset each other so that overall, a cost of $200,000 for direct costs of all activities leading to a credible estimate of mineral endowment of MHL will not vary much from actual costs (see Table 1).

MINING AND MILLING COSTS

Perspective

One of the most glaring deficiencies of the analysis by Metz and Dixon of the market value of the MHL is the failure to consider explicitly costs of mining and milling by deposit type. No matter how comprehensive the geological estimation of metal endowment is, it will not result in a credible estimate of market value unless the major costs incurred in the production of a marketable commodity are credibly estimated and are integrated with relevant recoveries and revenues for the computation of net present value. Inasmuch as production costs and recoveries vary by deposit type, they must be described by deposit type.

Operating and capital costs of mining and milling are affected by a host of factors, such as kind of host rock, rock fracturing, deposit tonnage and average grade, mineralogy, spatial distribution of mineralization, depth to deposit, surface and subsurface water conditions, terrain, climate, etc. However, since the market value of MHL derives from deposits not yet known, most of the factors affecting costs are not known either. Thus, the approach to cost analysis is to describe how costs on average vary with the major determinants of costs, such as deposit type, deposit size, grade, depth, and mineralogy when the deposits are in Alaska.

The task of re-estimating market value of MHL could benefit greatly from mineral resource studies performed in the past few years by the U.S. Bureau of Mines (BOM). Some objectives of these studies are similar to those of the MHL. Accordingly, the BOM describes the major costs incurred in translating an in-ground, postulated resource into a marketable commodity.

The approach taken by BOM was to use its extensive, computerized costing system, known as CES, to create simplified descriptions of capital and operating costs for mining, processing, and local infrastructure. These cost relations, with adjustments for inflation and cost differentials by region, could be used in the economic analysis of market value of MHL. Estimated cost relations developed by BOM that are relevant to the analysis of MHL are described below.

Previous Work

Tonopah.

A 1988 Open File Report (OFR 31-38) of the U.S. Bureau of Mines, authored by T. Gunther, B. White, R. Gillette, and R. Adams, describes the economic evaluation of selected undiscovered precious metal deposits in the Tonopah Quadrangle of Nevada. The appendix to this report, entitled Engineering Cost Analysis of the Potential Mineral Supply of the Tonopah Quadrangle, Nevada, contains mining and milling cost relations for the deposit types listed in Table 2. Clearly, these cost relations are for precious metal deposits in Nevada in January 1986 dollars. As such they do not apply to deposits in Alaska. Best practice would require that these relations be re-estimated for deposits in the various regions of Alaska; however, Alaskan costs could be approximated by adjusting the Nevada equations for inflation and for cost differentials for Alaska relative to Nevada using adjustment factors estimated by the U.S. BOM.

TABLE 2

MINE AND MILL MODELS FOR DIFFERENT DEPOSIT TYPES

Deposit Type	Proposed Mining Method		Proposed Milling Method
	Surface	Underground	
Carbonate-hosted (Carlin-type)	Open Pit	Room-and-Pillar	Heap leaching or Carbon-in-pulp[1]
Comstock/Sado Epithermal	NA_p	Room-and-Pillar	Heap leaching or Merril-Crowe[1]
Hot Springs	Open Pit	Room-and-Pillar	Flotation
Polymetallic Replacement	Open Pit	Room-and-Pillar	Flotation
Polymetallic Vein	NA_p	Cut-and-Fill	Flotation

NA_p - Not applicable

[1]The mill method used depends on the ore grade.

Source: U.S. Bureau of Mines OFR 31-38.

Juneau Mining District.

In March, 1989, an Open File Report, entitled Mine and Mill Models for the Juneau Mining District, by Thomas W. Cram, was completed by the Western Field Operations Center of the U.S. Bureau of Mines. This report describes cost relations by deposit type, mine type, and process, as indicated in Table 3. Clearly, these cost models are highly relevant to the evaluation of MHL in the Juneau area. Especially noteworthy is the fact that some of these same deposit types are among those having the greatest potential in the MHL lands in general; consequently, this study is of considerable value to an effort to re-estimate the market value of MHL. With adjustments for regional cost differentials in Alaska, these cost relations could be used for the same deposit types occurring elsewhere in Alaska. These regional cost differentials can be approximated using adjustment factors estimated by the U.S. Bureau of Mines.

White Mountains-North Steese Areas.

A report entitled The Potential Supply of Minerals from the White Mountains National Recreation Area and part of the North Steese National Conservation Area, Alaska, February, 1989, was prepared by the Division of Policy Analysis, U.S. Bureau of Mines, for the Fairbanks Alaska District Office of the Bureau of Land Management. This report describes the estimation of mineral endowment and the economic analysis of estimated mineral endowment for the estimation of potential mineral supply. Although the objective of that study is potential supply, not market value per se, the estimation of potential supply requires the same cost analysis of endowment as does the estimation of market value; consequently, the cost relations developed for that study are of potential use in the evaluation of

TABLE 3

GEOLOGIC MODELS AND CORRESPONDING MINE AND MILL TECHNIQUES

U.S.G.S. Bull. 1693[1]		Mine	Mill
p. 49	Alaska PGE	Open Pit 1,000-10,000 mt/d	Flotation, 1 product Gravity, 1 product
p. 86	Cu Skarn	Open Pit 1,000-10,000 mt/d	Flotation, 1 product
p. 120	Mo Porphyry-low F	Open Pit 1,000-10,000 mt/d Sublevel longhole 500-5,000 mt/d	Flotation, 1 product
p. 125	Polymetallic Vein	Overhand Stopes 100-500 mt/d	Flotation, 2 products
p. 189	Kuroko Massive Sulfide	Open Pit 1,000-10,000 mt/d Cut-and-fill 400-4,000 mt/d	Flotation, 2 products
p. 211	Sedimentary Exhalative	Open Pit 1,000-10,000 mt/d	Flotation, 2 products
p. 239	Vein Gold	Sublevel longhole 500-5,000 mt/d Overhand stope 100-500 mt/d	Flotation, 1 product
p. 261	Placer Gold	Placer 20-250 LCY/h	

[1]Source: Cram, U.S. Bureau of Mines, 1989.

MHL. The appendix of the report on that study (Appendix A--Potential Supply Methodology) contains a detailed description of procedures and relations, including the deposit models and cost relations, as shown in Table 4. Most of these same deposit types are among those identified in the MHL; consequently, these mine-mill cost relations could be used in the re-evaluation of MHL by making adjustments for regional cost differentials based upon U.S. Bureau of Mines cost studies.

Implications to Analysis and Costs

Restricting attention to those cost relations developed explicitly for areas in Alaska reveals that 12 cost models for 12 deposit types have been estimated which, with adjustments for regional capital and operating cost differentials, could be used in the re-evaluation of MHL. In view of the 29 deposit types recognized in the ADGGS favorability study, there remain about 17 deposit types for which cost relations have not been estimated. If cost analysis were to be performed separately for each of the remaining 17 deposit types, the cost would be approximately $100,000; this estimate is based upon the costs of previous work of about $6000/deposit type (Tom Gunther, U.S. BOM, personal communication, 1989).

Costs for estimating additional mine and mill cost relations probably can be reduced considerably below $100,000 by taking advantage of commonalities among deposit types, especially for capital and operating costs of mining. Examination of the foregoing cost analysis reveals that cost relations in Alaska have been estimated for seven different mining methods:

TABLE 4

DEPOSIT TYPES AND ASSOCIATED MINE AND MILL METHODS[1]

Deposit Type	Recovered Commodities	Mine Methods	Mill Methods
Alkalic-associated gold	Au	Open Pit VCR	Heap leaching CIP process
Gold Placer	Au	Placer	Placer
Gold Vein	Au, Ag	Open-Pit Cut-and-fill VCR	Heap leaching CIP process
Polymetallic Vein	Pb, Zn, Ag	Open Pit Cut-and-fill	Polymetallic flotation
Sediment-hosted Pb-Zn	Pb, Zn, Ag	Open Pit Room-and-Pillar	Pb, Zn flotation
Tin greisen	Sn, Ta, Ag	Open-Pit Cut-and-fill VCR	Sn flotation gravity
Tungsten skarn	W, Au	Open-Pit Shrinkage stope VCR	W flotation W gravity
Uranium	U, REO	Open-Pit VCR	REO flotation

[1]Source: Division of Policy Analysis, U.S. Bureau of Mines, 1989.

Open pit

Overhand stopes

Sublevel longhole

Cut and fill

Placer

Shrinkage stope

Room and pillar

Mining costs for a deposit type are a function directly of deposit size or indirectly via output rate or mine life, one of which is related to deposit size. Since mining costs are described in terms of dollars per ton of ore, mining costs at this level of abstraction are not sensitive to deposit type mineralogy, or grade of mineralization, as long as the mine type is appropriate for the morphology, size, and depth of the deposit. Since mining cost relations estimated for a deposit type are parameterized either directly or indirectly on deposit size and depth or stripping ratio, as long as the morphology is consistent with the mining method, mining cost relations estimated for one deposit type may be used for a different one by making adjustments for regional cost differentials. Thus, with the aid of mining engineering experitse, some of the mining cost models developed for specific commodities could be used for other commodities with minor adjustments.

Commonalities among milling costs of different deposit types are much rarer than they are for mining, but when one deposit type yields an ore similar to that for which mining and milling costs have been estimated, the milling cost relation may be useful with only minor modification. Less likely, but still possible, is the use of mill cost

relations estimated on one deposit type when the ores differ but are concentrated by a common technology, e.g., jigging. In some cases, the previously estimated mill cost relation may be useful with only minor modification.

Finally, if the re-analysis of the geology of MHL for endowment estimation produces no surprises in the identification of favorable areas and their deposit types, there are several deposit types for which the amount of MHL involved is very small, so small that investment in the estimation of cost models is not justified by the contribution of that (those) land parcel(s) to market value of MHL. In other cases, when the size and grade and location of known suppliers to the world market are compared to the sizes and grades indicated by the deposit models of the deposit type identified by MHL, some deposit types a priori will not contribute to market value given current expectations for demand and cost differentials for Alaska. Accordingly, cost models for such deposit types need not be estimated.

Taking into account the foregoing considerations, a cost of $40,000 is estimated for the development of new cost models for mining and milling and/or the modification of existing models for use in the re-estimattion of value of MHL. If possible, this work should be coordinated through Burt Gosling, Supervisor Physical Scientist, Western Field Operations Center, U.S. Bureau of Mines, Spokane, Washington. Since Gosling supervised the work cited in the foregoing studies, e.g., Juneau and White Mountain-North Steese area, it would be logical to enlist his expertise in the MHL evaluation.

Long Term Trends in Metal Prices

The indisputable finiteness of the earth and its mineral resources often leads physical scientists and engineers to predict rising future prices as mineral resources are depleted. The appeal of this view is strengthened further by the fact that a mineral deposit is a very rare geologic event and that depletion of the earth's crust in low cost, easy-to-find mineral deposits will inevitably cause prices to increase across time as man is forced to find and exploit lower quality mineral resources. Moreover, the pure theory of exhaustible resources also predicts that net price, meaning rent, will rise across time at the rate of interest. However, historical evidence indicates that mineral prices have not behaved this way; Barnett and Morse showed in their seminal work Scarcity and Growth and later in Scarcity Revisited, that in real terms (adjusted for inflation), metal costs and metal prices have decreased across time from the late 1800s to the 1970s. In essence, technical change in exploration, mining, processing, smelting, and refining when combined with increased efficiency of metal use, substitution, and scrap recycle combine to give declining metal prices. These studies and others, e.g., Cranstone's demonstration of constant discovery costs and Malenbaum's "life cycle" in intensity of metal use, indicate that the value of MHL should be predicated on the continuation of the trend to declining unit costs and real prices of metals. Of course, there will be periods of price increases for one or more specific metals because of market imperfections, speculation, or trade interruptions, just as there have been in the past, but these are expected ultimately to adjust and to continue the long term trends to decline. The market value of MHL should not be based upon expectations for higher future metal prices.

Market Inpacts

Even if trends in real prices can be identified and credibly projected, if the supply of a metal from MHL were large enough, new supply would cause a decrease, at least for a few years, of metal price below the long term trend in price. In concept, this impact could cause a serious price adjustment, particularly in local markets. However, most metals today are traded in world markets; consequently, price response to potential supply from MHL may be minor except for markets with stagnating demand and for large supply increments. Consequently, potential impacts of new supply from MHL are expected a priori to be nil for some commodities, small for others, and significant for a few, at least for a few years.

Approach to Analysis

A rigorous econometric modeling of world markets for all mineral commodities that could be produced from the identified deposit types would cost several hundreds of thousands of dollars. Such an in-depth and extensive analysis is not justified in this case. First of all, for a number of commodities, price response would cost of little or no consequence in terms of its effect on market value of MHL. This arises when the deposits are small enough that their production would have little effect on world markets or when the deposits are not likely to be economic given a priori evidence about their features, about costs, and about expected future prices. For example, podiform chromite deposits are small and high cost even when located in more favorable economic circumstances, e.g., those of the lower 48 states. Such deposits located in Alaska probably are not likely to be economic given the significantly higher costs in Alaska and given expected long-term prices. Moreover, even if

they were to be economic, such deposits are small, and the amount of MHL having such potential also is small; consequently, nothing is lost if market response for chromite deposits of MHL is ignored, and expected long-term price is used for the computation of market value.

As another example, consider price response to copper production from MHL. Certainly, bringing on to the market of a world class porphyry copper deposit in MHL would impact copper price, at least for a few years. But, the probability for the occurrence of a world class copper prophyry in MHL is very small. Moreover, Cu porphyries tend to be smaller and lower in grade the further north they occur, and in Alaska annual operating costs and capital costs are approximately twice those of the southwestern U.S. Finally, the amount of MHL lands having potential for Cu porphyries is not large. On the other hand, copper production from Cu skarn deposits and from massive sulfides may be economic either as a main product with other by-products or as a by-product. But, such production is not likely to be a major supply factor, given the magnitude of the copper market. Consequently, ignoring price response to potential copper supply from MHL and the use of long term Cu price for the computation of market value probably is acceptable.

It is expected that similar analysis of MHL deposit types, economics of supply, and markets would reduce the number of metal markets for which market response is important to at most a few. One approach would be to contract for econometric modeling of these few markets, but even this would be costly if done comprehensively.

An alternative to formal econometric modeling of markets is an eclectic approach of demand and price projections and an analysis of resource depletion and capacity constraints on supply to estimate the timing of MHL

supply as that supply on the margin that is allowed by projected consumption requirements. This approach avoids the need to determine price using demand and supply price elasticities. Instead, projected long-term price is used to determine revenue and projected consumption is used to govern the timing of incremental supply from MHL. In other words, only when projected consumption exceeds supply capacity can new supply from MHL be generated, given the assumption that the new supply will come from MHL if such is economic at projected long-term price.

As stated, the eclectic approach requires the long-term projection of consumption and price. While this has been done by various methods, some recent work at the University of Arizona has shown that the intensity of use models stated as either translogue consumption models in which consumption is a function of GNP (GDP) or learning models of consumption and GNP generally produce better forecasts than direct trend projection. Of course, use of such models requires projected GNP. These projections are periodically made by the World Bank or IMF. So as to take advantage of individual specific growth patterns, consumptions should be projected separately for the major consuming nations. The analysis of supply of a metal would begin by documenting reserves, current capacity, by-product capacity, recently shut-in capacity that could be reactiviated, and future new capacity that is currently under development. These provide a measure of the magnitude of supply at long run expected price. Year by year projected consumption and supply capacity would be compared. When projected consumption exceeds supply capacity significantly, supply is incremented by new production from a simulated discovery on MHL lands. Clearly, this is simplistic because in the real world new supplies could

INFRASTRUCTURE AND TRANSPORTATION COSTS

Costs considered here are in addition to mine site infrastructure costs, which are estimated by the U. S. BOM cost relations for mining and milling. The additional costs include the capital costs of access roads, costs of over-land transporting of concentrate to either a smelter or to a water-way transportation linkage, and the cost of transporting by water to smelter. Transportation costs are an especially important element in the evaluation of MHL because the land parcels are so widely scattered. Fortunately, much of this work has already been completed in the evaluation of forest lands by the Division of Forestry. According to Rick McMann, the Division of Forestry prepared worksheets for land parcels having forest resources; these worksheets provide estimates of the length of access road, construction costs, and haulage costs for primary and secondary roads. Thus, for those land parcels having forests, much of the cost analysis required for economic analysis of minerals has already been completed. For such land parcels, the only costs remaining to be estimated and considered in evaluation are those for transportation from parcel to smelter. According to McMann, there is high conformity of the lands with mineral potential favorability rankings of four and five with those lands having forest resources. Accordingly, McMann expressed the sentiment that since infrastructure costs were accounted for in the evaluation of forest resources, to also consider them in the evaluation for mineral resources would be double counting. For those land parcels for which both forest and mineral resources can be exploited, that perception is accurate. But, for those parcels for which

only one of these kinds of resources can be exploited, infrastructure costs should be considered separately in both evaluations, and the value ascribed to the parcel should be the greater of the two evaluations.

Land parcels having no forest resources would need an estimation of infrastructure and transportation costs; for the sake of uniformity these should be estimated using the same procedures and bases employed by McMann for forest resources.

Because of the work already completed by the Division of Forestry, the effort required to treat explicitly infrastructure and transportation costs is not great, being that it is incremental. It is estimated that approximately $10,000 should be allocated to this effort.

EXPLORATION MODELING

Exploration models vary greatly in structure and in complexity, depending upon the intended use of the model. Accordingly, for a pre-exploration analysis of target objective, budget, and risk, an exploration model may be highly structured by stage and activity and focus upon a detailed analysis of risk and its economic consequences (see Harris, 1989). On the other hand, for the analysis of potential supply, which is a stock analysis, exploration models generally are quite simplistic as they are designed to describe generally exploration outcomes in terms of effort, and the ordering of discoveries by selected features, e.g., size and grade, so as to permit an approximation of the optimum exploration expenditure and the outcomes that such would yield, given the estimated endowment of the region.

Two feasible approaches to exploration modeling that should be examined for the evaluation of MHL are (1) the adaptation of EADS, an exploration model developed for the U.S. Bureau of Mines' potential supply system (PSACM), and (2) the use of exploration experts to construct exploration models explicitly for Alaska.

EADS is an acronym for Exploration and Discovery Simulation, a computer simulation model of exploration developed by ICF, Inc., 1987, to interface with ROCKVAL and to generate discoveries from the estimated mineral endowment. The simulation program merits examination particularly because it was designed for the potential supply analysis computer system, PSACM, and because that system could be used in the evaluation of MHL, thereby avoiding the expense of constructing computer simulation programs especially for the evaluation of MHL. However, to my knowledge, the BOM has not yet

used EADS; consequently, some research and development would be involved in (1) the integration of EADS with other components of PSACM, and (2) parameterizing EADS for the various deposit types and for Alaskan conditions. I cannot provide informed comments about the magnitude of this effort. I did acquire copies of the ICF reports, but the reports are quite brief and time did not permit creating the program from the listings and experimentation with the program. Moreover, although I requested copies of the PSACM system a few weeks ago, I have not yet received them. Consequently, while this approach seems feasible, its implemention is somewhat uncertain. Nevertheless, it should be investigated early in the re-evaluation of MHL.

An alternative to EADS is to identify one or more experts for each of the important deposit types and to elicit from them a description of exploration so structured that it provides information by deposit type on probability of discovery of deposits by deposit tonnage, ore grade, and depth and kind of cover (alluvium, ice, sedimentary rocks, etc.) as both density of deposits and intensity of search effort vary. This approach, which has been used before (CRA, 1978; Harris et al, 1981; Harris, 1989), permits models to be highly relevant to Alaskan conditions. Of course, after the relevant responses have been obtained from the expert explorationists, they must be processed and used to construct a computer model of the exploration process. Moreover, it must interact with the endowment model so that the amount expended on exploration is consistent with exploration economics. In other words, the system must be programmed to allocate exploration economically - see Harris, 1989, for further information on this approach.

Individuals or firms thought by personnel of the ADGGS to be highly qualified by their exploration expertise in Alaska include, but are not limited to the following: Cominco, Inc. (Anchorage); C. C. Hawley (Anchorage), Watts, Griffith & McHewitt (Anchorage), Don Stevens (Anchorage), Nuerco Exploration (Vancouver, Washington), Ed Chipps (Minden or Gardnerville, Nevada), On-Line Exploration Services, Inc. (Anchorage), and Ernie Wolf and Doug Coulp (Fairbanks). A separate model would need to be constructed for each important deposit type. The costs of constructing exploration models for the important deposit types is estimated to be approximately $30,000. This cost includes the costs of an expert as a consultant for two days for each deposit type, the cost of travel, the cost of processing responses and the construction of a computer program to integrate the processed responses into a computerized exploration submodel. As with other components of the evaluation of MHL, such analysis would not be performed on all 29 deposit types identified in the favorability analysis by ADGGS, because the contribution of some of these to market value on a priori grounds can be judged to be negligible; consequently, estimating and programming exploration models for them would not be cost effective.

in Appendix A—Potential Mineral Supply Analysis Methodology, of the report entitled The Potential Supply of Minerals from the White Mountains National Recreation Area and Part of the North Steese National Conservation Area, Alaska, written by the Division of Policy Analysis, Bureau of Mines, Washington, D.C., February, 1989. Although this system was designed to interface with ROCKVAL, it could be modified to accept a different probabilistic description of endowment. Moreover, the system would need to be modified to include the simulation of discoveries and the optimum allocation of effort using the exploration models.

Costs for systems design, modification, and of programming are very vague in advance of knowledge of the exploration modeling and without having the program to examine. As stated elsewhere in this report, I did request a copy of the computer program but have not yet received it. With great uncertainty, I suggest that $30,000 be allocated to the constructing of necessary subprograms, modification of PSACM, and the processing of the data for MHL to produce a probability distribution for estimated market value.

SUMMARY

The direct costs of estimating the market value of lands of the Alaska Mental Health Trust and replacement lands is estimated to be about $350,000. Of this cost, $200,000 is allocated to the estimation of the mineral endowment of said lands, and $150,000 is allocated to the estimation of the market value of the mineral endowment. The breakdown of the $200,000 and of the $150,000 is as follows:

Estimation of Mineral Endowment

Acquisition of basic geodata and information	$ 20,000
Preparation of analogues and supportive information	35,000
Information enhancement	20,000
Preparation of map overlays (personnel and materials)	14,000
Analysis of MHL geology and of analogues in preparation for endowment estimation	50,000
Estimation of subjective probabilities for endowment by deposit type and geologic environment	25,000
Experts serving as monitors and consultants	21,000
Special support required because of small land parcels	15,000
TOTAL	$200,000

Estimation of Market Value of Endowment

Estimation of mine, mill, and on site infrastructure cost relations	$ 40,000
Estimation of infrastructure and transportation costs	10,000
Exploration modelling	30,000
Market analysis	40,000
Computer systems and processing	30,000
TOTAL	$150,000

In both cases (endowment estimation and economic analysis), individual costs may err considerably, but overall, the estimate of total cost is thought to be quite robust.

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DAVID T. WALKER
ATTORNEY AT LAW
MENDENHALL BUILDING
326 FOURTH STREET, SUITE B
JUNEAU, ALASKA 99801
(907) 586-3537

January 23, 1990

HAND DELIVERED

Senator Jack Coghill
Senate
Capitol Building, Room 30
P. O. Box V
Juneau, Alaska 99811

Re: Mental Health Trust Land Settlement

Dear Senator Coghill:

I have enclosed a copy of Jim Gottstein's January 19, 1990 legal memorandum addressing the status of the mental health trust lands litigation settlement under Chapter 48 (48 SLA 1987).

It remains Jim's and my fervent hope that the consequences described in the memorandum can be avoided. The Plaintiffs have followed and supported the legislative solution and proposed settlement provided by Chapter 48. Chapter 48 requires the Commissioner of the Department of Natural Resources to determine the value of the trust under the procedures approved by the Interim Mental Health Trust Commission. The Commission has established the procedures to be followed by the Commissioner in valuing the trust. Now the valuation, and necessarily the settlement, is in the hands of the Commissioner. Unless the Commissioner follows the valuation procedures established by the Interim Mental Health Trust Commission the beneficiaries will have no real choice but to pursue the remedies discussed in the memorandum to protect their interests and the trust. I will be happy to meet with you at any time to discuss this matter. I will contact you following the January 24, 1990 meeting of the Interim Mental Health Trust Commission to provide an update on the status.

Very truly yours,

David T. Walker
Counsel for the Class

DTW:ndp

Enclosure

Law offices of
JAMES B. GOTTSTEIN
[illegible] STREET, SUITE 200
[illegible] ANCHORAGE, ALASKA 99501
[illegible]

James B. Gottstein
Lawrence V. Albert

MEMORANDUM

FROM: JAMES B. GOTTSTEIN
TO: INTERESTED PARTIES
DATE: January 19, 1990
RE: LEGAL ANALYSIS OF STATUS OF MENTAL HEALTH TRUST LANDS AND RELATED ISSUES

Summary and Purpose

The Commissioner of the Department of Natural Resources is expected to announce on January 24, 1990 that she does not intend to follow the procedures to determine the fair market value of one million acres of Mental Health Trust Lands which the Interim Mental Health Trust Commission (Commission) approved pursuant to Chapter 48 SLA 1987 (Chapter 48). If this expected action occurs, the Plaintiffs in the Mental Health Trust Lands lawsuit, Weiss v. State, 4FA-82-2208 Civ., will be forced to challenge title to approximately 750,000 acres of Mental Health Trust Lands and take other actions, as necessary steps to protect their rights against the continuing breach of the trust by the State of Alaska in properly discharging its fiduciary responsibilities in managing the trust.

The land categories are:

-	370,000	acres designated as state parks, refuges, etc.;
	40,000	acres to Municipalities;
	40,000	acres to Native corporations[1];
	45,000	acres to individuals;
	3,000	acres to the University of Alaska; and
	280,000	acres in less than total conveyances.
	778,000	

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1. It does not appear this would include a large portion of the Beluga Coal Field conveyed to Cook Inlet Region Inc., as a result of its exchange under the Alaska Native Claims Settlement Act.

The purposes of this memorandum are to outline the relevant facts and legal authority for such actions.

I. FACTUAL BACKGROUND

In 1956, the Congress, in order to correct a longstanding problem in providing an adequate mental health program in Alaska, granted Alaska, in trust, one million acres of land to generate income "first for the necessary expenses of the mental health program of Alaska". Unfortunately, after selecting the best lands available, Alaska never administered the trust properly. This included transferring Mental Health Trust Lands to third parties without adequate compensation. Starting in the mid-Seventies, the State began to recognize this was illegal, and at the same time there was a tremendous clamor for land by municipalities and other interested parties (without paying for it, of course).[2] In 1978[3] the legislature purported to abolish the trust by "redesignating" Mental Health Trust Lands as General Grant Lands.[4] While a theoretical compensatory monetary fund was established, Mental Health Trust Lands were never valued to determine the proper compensation, and more importantly, **not a single penny was ever paid into this account.** Immediately after the "redesignation", municipalities, Native corporations and individuals began to receive large amounts of the best Mental Health Trust Lands without paying fair value for them.

A lawsuit was brought in 1982 by the Alaska Mental Health Association, through Steve Cowper[5], naming Vern Weiss and Karl Hilliker as representatives of people needing mental health services, the beneficiaries of the Mental Health Lands Trust, to declare the legislative action in abolishing the trust invalid. The Supreme Court, in 1985, did just that and ordered "the trust be reconstituted to match as nearly as possible the holdings which comprised the trust when the 1978 law became effective." State v. Weiss., 706 P.2d 681 (Alaska 1985). However, the state

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2.This was the period of the "Beirne Initiative" where residents were to be allowed to stake "undesignated" state land for private ownership.

3.In the same package of legislation providing land to residents enacted as a response to the "Beirne Initiative".

4.Chapters 181 and 182 SLA 1978.

5.Governor Cowper has apparently been advised by the Attorney General's Office that as former attorney for the plaintiffs it is inappropriate or improper for him to take an active role in resolving the lawsuit. This has left a policy vacuum.

desired to avoid reversing previous actions it had taken on Mental Health Trust Lands, and the plaintiffs in the lawsuit were challenging conveyances of trust lands to third parties (for the reasons set forth below). An alternative method of reconstituting the trust was agreed on between the plaintiffs and the state. This approach was enacted as Chapter 48 SLA 1987 (Chapter 48).

Among other things, Chapter 48 provided that Mental Health Trust Lands be valued and an equal value of lands in legislative designations (state parks, refuges, critical habitats, and the like) be constituted as a replacement trust, with 8% of the value being deposited every year into the Mental Health Trust Income Account. Under Section 4 of Chapter 48, the value is to be determined by the Commissioner of the Department of Natural Resources under procedures approved by the Interim Mental Health Trust Commission (Commission). On November 7, 1989, after more than two years of a tremendous amount of work, the Commission approved its final procedures for determining the value of Mental Health Trust Lands. At this time, all indications are that the Commissioner is intending to refuse to follow these procedures. If the Commissioner fails to follow the approved valuation procedures the proposed settlement of the litigation will be nullified and the plaintiffs will be forced to challenge the legal status of the hundreds of thousands of acres of Mental Health Trust Lands described above and take other steps to protect their rights.

II. APPLICABLE LAW

A. General Considerations. In the Weiss decision (this case), supra., the Alaska Supreme Court confirmed that "basic trust law principles" apply to the administration of the Mental Health Lands Trust. In doing so, at footnote 3, the court cites the United States Supreme Court case of Lassen v. Arizona, 385 U.S. 458, 87 S. Ct. 584, 17 L.Ed.2d 515 (1967), and its own previous decision in State v. University of Alaska, 624 P.2d 807 (Alaska .).

76 American Jurisprudence, 2d, Trusts, Section 315 describes generally the trustee's duties as follows[6]:

> A trustee must act in good faith in the administration of the trust, and this requirement means that he must act honestly and with finest and undivided loyalty to the trust, not merely with that standard of honor required of men dealing at arm's length in the workaday world, but with a punctilio of honor the most sensitive. He must act with such high good faith in the

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6.References to footnotes are generally omitted throughout this memorandum.

> exercise of decisions in the administration of the trust, and in the investigation and determination of facts as a basis for his judgment and decisions. He must avoid all situations and relations tending in the least to interfere with the discharge of his duties, or in which honesty may be a strain on him. Any exceptions in his conduct to the high standard of honor governing him renders him fully liable for all ensuing damages to the trust estate. Courts of equity have been uncompromising in their hostility to any laxness on the part of a trustee and inquire in proper cases into his administration of the trust to determine his honesty and loyalty. The liberality with respect to a trustee of provisions in a trust instrument or declaration in no way diminishes the trustee's duty to act in utmost good faith.

Section 316, Trusts, 76 American Jurisprudence, 2d., describes how a trustee must act exclusively in the trust's interests:

> A trustee in his administration of the trust is under the duty of acting exclusively and solely in the interest of the trust estate or the beneficiaries within the terms of the trust, and is not to act in his own interest or in the interest of a third person. He must act for and not against the trust estate or the beneficiary. In general, any act of the trustee in hostility to the interest of the trust estate is a breach of trust. He may not without breach of duty take part in any transaction concerning the trust, where he has an interest in such transaction adverse to that of the beneficiary.
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> A trustee is under a duty to refrain from situations wherein his own interests are brought into conflict with those of the trust, irrespective of good or bad faith on his part. He must not do anything tending to interfere with his exercise of a wholly disinterested and independent judgment.

In conformance with the above described standard of conduct by a trustee, one of the basic principles of trust law is that the trustee must keep trust property separate from his individual property. Section 179 Restatement of the Law of Trust, 2d.

Similarly, a trustee may not engage in self-dealing with trust property.

> A trustee is not permitted to place himself in a position where it would be for his own benefit to violate his duty to the beneficiaries, and it is a well established general rule that a trustee should not engage in self-dealing * * *.

* * *

> The prohibition against self-dealing or mingling of funds by a trustee does not depend upon any question of fraud, but is made absolute to avoid the possibility of fraud and to avoid the temptation of self-interest.

76 American Jurisprudence, 2d., Section 319. This is not a new principle. In the 1823 United States Supreme Court case of Wormley v. Wormley, 8 Wheaton 421, 5 L.Ed 651 (1823), Justice Story wrote:

> No rule is better settled than that a trustee cannot become a purchaser of the trust estate. He cannot be at once vendor and vendee. He cannot represent in himself two opposite and conflicting interests. As vendor he must always desire to sell as high, and as purchaser to buy as low, as possible; and the law has wisely prohibited any person from assuming such dangerous and incompatible characters.

In the case of the Mental Health Lands Trust, the dishonest and unscrupulous actions of the state[7] in the administration of the trust[8] makes a mockery of the just enunciated standards of conduct. The following is a description of the remedies appro

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7.While the state, as a whole, has acted abominably with respect to the trust, the state is composed of many different parts, and with some notable exceptions it is hard to cast particular individuals as culpable. The 1978 legislature, for example, can say it intended to compensate the trust and no bad faith was involved. From 1978 until the lawsuit, DNR can say it was just following state law. The 1987 Legislature can say it acted in good faith in enacting Chapter 48 and expected the Commissioner of DNR to follow the procedures approved by the Commission. On the other hand, the administration's budgeting process clearly does not properly allocate trust funds "first to the necessary expenses of the mental health program", and the Legislature certainly has not corrected this in its appropriations. Similarly, DNR has not been at all concerned with making sure the trust is fairly compensated.

8.The barest outline of facts given here does not even scratch the surface of the repeated, deliberate and determined efforts of the state to avoid its trust responsibilities and convert trust property to its own use without compensation to the beneficiaries of the trust, who, after all, are among the most defenseless in the population.

priate for this breach of trust, including the rights of the beneficiaries to pursue trust property into the hands of third parties, and hold third parties accountable to the trust in the event of their participation in the breach of trust.

B. Only Purchasers For Value Without Notice Have Valid Title to Mental Health Trust Lands.

1. General Requirements.

Only bona fide purchasers -- that is people who have paid value for trust property and are without notice, either actual or imputed of the trust or the breach of trust have valid title to Mental Health Trust Lands. The reason for this rule is that as between the clearly innocent beneficiary and a third party who has obtained trust property, the beneficiary should not suffer the loss, unless the third party can prove he was innocent as well. In proving his innocence, the law charges the third party with knowledge of certain facts and with the duty to make an inquiry into other facts where he should have been wary. Bogert[9] in The Law of Trusts and Trustees, Revised Second Edition., devotes a whole chapter (43) to the "Bona Fide Purchaser Rule".

Section 881 of Bogert states the basic bona fide purchaser rule:

> A most important rule which limits the power of a beneficiary or other holder of an equitable interest to pursue and claim property is the doctrine to the effect that the transfer of the legal estate in property to a bona fide purchaser for value cuts off all equities in the same property. Thus if a trustee holds under the trust the legal title to real estate (the trust not being on the record), and the trustee sells the land to a purchaser who does not know of the trust, or have reason to know of it, and who pays a valuable consideration for the legal title, the latter gets an interest free and clear of the trust, and the beneficiary cannot get the aid of a court of law or equity in obtaining the legal title or possession.

Section 887 of Bogert states:

9.Hereafter referred to as "Bogert".

It is well settled that in order to have the benefit of the bona fide purchaser rule, the taker of the legal title must have "paid value," or must have been a taker "for a valuable consideration."

2. Notice.

Section 891 of Bogert discusses the various categories of notice as follows:

> The cases and statutes describe the person who can qualify for the protection of the rule as "an innocent purchaser", or a "bona fide purchaser", or a "purchaser without notice" of the equity in favor of another person which, it is claimed, has been cut off. The fact of which it is alleged the purchaser had no notice may be either (1) the mere existence of the trust or other equity or (2) the extent of the powers of the trustee under a known trust. In discussing these problems the courts and writers use various words and phrases, not always consistently, for example, "knowledge", "notice", "actual notice", "implied notice", "constructive notice", "absolute notice", and "facts putting on inquiry". It is believed that confusion can be avoided by using the single word "notice", and defining it to include awareness of a fact which the party either had actually, or should have possessed, or which the law regards him as possessing.
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> One who is a purchaser of property which is subject to an equity may be in any one of several different situation with regard to notice as to whether the property comes to him charged with an equity or free from all equities.
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> (1) He may have no knowledge or information, either actual or imputed under a statute or otherwise, which would lead a reasonable man either to know that there was an equity attached or to inquire further with respect to the possibility of such equity being attached. In this case he is an "innocent purchaser," or "purchaser without notice."
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> (2) He may have knowledge, coming to him or his agent through the senses of sight or hearing, which shows that the property in question is being transferred to him subject to an equity. In this case he may be said to be a "purchaser with actual notice."

(3) He may have notice of an equity, imputed to him through recording or other statutes, in which case he is usually called a purchaser "with constructive notice." For purposes of public policy the tatutes treat him as having notice, whether or not he .s actually conscious of the existence of the equity.

(4) He may have knowledge of facts about the ownership of the property, either actually acquired by himself or his agent, or imputed to them under statutes, which, while not sufficiently strong to lead an ordinarily prudent man to a positive belief that the property is subject to an equity, is of sufficient force to compel an ordinarily careful man to inquire further regarding a possible equity. If such is the case, the purchaser is charged by the court with notice of the facts regarding the equity which a reasonable inquiry would have revealed. A purchaser of this type is one "put upon inquiry," and if the inquiry ought to have led to notice of the equity he is treated by the court as if he had had actual notice of it.

(5) A purchaser may become a purchaser with notice because of a combination of the factors of actual notice, constructive notice, and notice acquired from facts putting on inquiry. Thus he may have information from each of the three types of sources, no one of which, standing alone, would make him a purchaser with notice of an attached equity, but which, in combined effect, give him the requisite knowledge to make him a mala fide purchaser.

(Emphasis added)

Section 892 states:

If the proof shows that the purchaser was conscious of the existence of any equity against the property, there is no doubt that he cannot get the benefit of the bona fide purchaser rule.

Section 893 of Bogert "Constructive Notice under Recording Acts", states:

From the time of filing for record, all purchaser of the property involved, and in many cases creditors are charged with knowledge of the existence and contents of the document in question. It is clear that these statutes are frequently of importance in giving to a purchaser from a trustee or other holder of property subject to an equity notice of the existence and terms of the trust. This notice is generally called "constructive". It exists no matter what may be the purchaser's actual knowledge. Thus one purchasing land

is charged with notice of the terms of the recorded deed to his grantor and with the terms of all prior recorded deeds in the chain of title. If the grantor or a predecessor of the grantor is described in the deed by which he acquired title as a trustee, with or without details of the trust, the purchaser is deemed to know of the existence of such a trust and of such details as to names of beneficiaries, purposes of the trust, powers of the trustee, etc., as are given in the recorded instrument. Such facts thus treated as being known to the purchaser may give him constructive notice that he will take the property subject to an equity in favor of the beneficiary, or they may merely put him on inquiry as to whether he will get title free of the trust or not.

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At common law the mere pendency of some actions with regard to the title to property made a purchaser during the pendency of the action take subject to the claims of the parties as later adjudicated. Statutes now provide that in an action affecting the title to realty a notice of the pendency of the action may be filed in the real property record office, and that it shall be constructive notice to purchasers of the realty pendente lite. These statutes constitute another source of constructive notice to purchasers of realty who claim to be bona fide purchasers.

Section 894 of Bogert states:

If the prospective purchaser of the trust property, or of other property subject to an equity, learns of facts personally or through an agent which, while not conclusively showing the existence of a trust or other equity, would lead an ordinarily prudent man to a belief that there was a possibility that an equity existed, the purchaser has a duty to make a reasonable inquiry concerning the existence and nature of the possible equity, and he will be charged with knowledge of the facts concerning the equity which a reasonable investigation would have brought to light.

Section 894 of Bogert, states:

In most cases where there is a written trust instrument, and the purchaser knows of it, or could have learned of it with reasonable effort, he will be charged with the duty of examining that instrument.

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> The duty to inquire may be merely as to the existence of a trust or other equity, or it may include also the extent of the powers of the trustee and the question whether the trustee has duly exercised the powers granted to him.

The 1823 United States Supreme Court case of Wormley v. Wormley, cited above, demonstrates again this is not a new legal principle.

> The next point for consideration is, whether the defendants, Veitch, and Castleman and McCormick, were bonae fidei purchasers of the Frederick lands, without notice of the breach of trust. If they had notice of the facts, they are necessarily affected with notice of the law operating upon those facts; and their general denial of all knowledge of fraud will not help them, if in point of law, the transaction is repudiated by a court of equity. If they were bonae fidei purchasers, without notice, their title might have required a very different consideration.
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> It appears to us therefore, that the circumstances of the case can lead to no other result than that Castleman and McCormick were not purchasers without notice of the material facts constituting the breach of trust; and that, therefore, the Frederick lands ought in their hands to stand charged with the trust in the marriage settlement.

Interestingly, in Justice Johnson's separate opinion he objected to the characterization of the transactions as being in bad faith or unfair, but nevertheless agreed with the result:

> I can see nothing but liberality in the conduct of Strode towards Wormley, and little else than improvidence, caprice, and ingratitude in the conduct of the latter.
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> Nevertheless, there are canons of the court of equity which have their foundation, not in the actual commission of fraud, but in that hallowed orizon, "lead us not into temptation."
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> It is unquestionable, from the evidence, that both Veitch, and Castleman and M'Cormick, must be affected by both legal and actual notice of the transactions of

Strode. They are, therefore, liable to the same decree which ought to be made against the latter.

It is, however, some satisfaction to me to be able to vindicate their innocence, while I feel myself compelled to subject them to a serious loss. The rule which requires this adjudication, may, in many cases, be a hard one, but is a fixed rule, and has the sanction of public policy.

C. Identifiable Trust Property not in the Hands of a Bona Fide Purchaser Can be Returned to the Trust.

Bogert at Section 866 states:

"The law is now well settled that as between the cestui que trust[10] and trustee, and all parties claiming under the trustee otherwise than by purchase for valuable consideration without notice, all property belonging to a trust, however much it may be changed or altered in its nature or character, and all the fruit of such property, whether in its original or altered state, continues to be subject to or affected by the trust." [citation omitted]

This doctrine has been expressed by the Supreme Court of California in the following words: "It is well settled that the beneficiary of a trust may follow and recover the trust fund if any property in the hands of the trustee or of those taking with notice can be identified either as the original property of the cestui que trust, or as the product of it."

This right of the beneficiary is not that of a lienholder or a preferred creditor. It is based on a property right in the res or its substitute. "The right of the beneficiary to pursue a fund and impose upon it the character of a trust is based on the principle that it is the property of the beneficiary, not upon any right of lien against the wrongdoer's general estate; and this, whether the property sought to be recovered is in the form in which the beneficiary parted with its possession or in a substituted form.

(Emphasis added).

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10. Beneficiary or purpose of a trust.

The court in Rogers v. Rogers 473 N.E. 226 (N.Y. 1984) stated:

> [O]ne who possesses equity in an asset is entitled to restitution of the asset by a subsequent title holder who paid no value even if the latter had no knowledge of the predecessor's equitable interest.

In Paolino v. Channel Home Centers, 668 F.2d 721, 723 (3rd Cir. 1982) the court said:

> If a purchaser of property from a trustee knew, or should have known, that disposition of the property was a breach of trust, the purchaser is charged with the same trust.

With respect to a donee of trust property, Section 868 of Bogert states:

> A donee who receives trust property transferred to him in breach of trust, although he does not know of the breach, is liable to return the trust property or its product as long as he holds it.

That these general trust law principles apply to trust lands such as Mental Health Trust Lands cannot be seriously questioned. See Murphy v. State of Arizona, 181 P.2d 336 (Ariz. 1947). Indeed, Murphy held that deeds issued in violation of the trustee's authority were "null and void" and subsequent holders whether bona fide purchasers or not did not have good title because there was nothing to purchase[11]:

> If * * * these enactments [conditions upon which trustee may dispose of trust property] are mandatory upon

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11. The court in Murphy described the reasons for the trust restrictions thusly:

> The sad experience of Congress with the handling by these twenty-three states of the granted lands, the sale thereof, and the investment of monies derived from a disposition of the granted lands, brought about a new policy which found expression in the Enabling Act for New Mexico and Arizona. The dissipation of the funds by one device or another, sanctioned or permitted by the legislatures of the several states, left a scandal in virtually every state, and these granted lands and the monies derived from a disposition thereof were so poorly administered, so unwisely invested and dissipated, that Congress concluded to make sure, in light of experiences of the past, that such would not occur in the new states of New Mexico and Arizona.

> the Board, or are jurisdictional in effect, or conditions to be performed before power vests in it to make the conveyance, then their deed is a nullity and gives rise to no rights whatever either in the grantee or in purchasers for value from him.

See also The United States Supreme Court case of Alamo Land & Cattle Co. v. Arizona, 424 US 295, 47 L.Ed 2d 1, 96 S.Ct 910 (1976) and U.S. v. 78.61 Acres, 265 F.Supp 564 (USDC Neb. 1967), which was cited with approval by the U.S. Supreme Court in Alamo.

E. Parties who have "Participated in the Breach of Trust are Liable for the Damages Occasioned Thereby.

Bogert, Section 901 states persons participating in a breach of trust can be held liable for the damages to the trust:

> The wrong of participation in a breach of trust is divided into two elements: (1) an act or omission which furthers or completes the breach of trust by the trustee; and (2) knowledge at the time that the transaction amounted to a breach of trust, or the legal equivalent of such knowledge.
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> [I]f the third party by any act whatsoever assists the trustee in wrongfully transferring the benefits of the trust property to the trustee, another person, or the alleged participant, or aids in destroying or injuring that property, there has been conduct upon which liability can be predicated, * * *.

Section 868 of Bogert states:

> [N]o third person shall knowingly aid the trustee in committing a breach of his duties.
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> If a third party takes part with the trustee in a breach of trust, the alternative remedies of money claim or tracing of trust property may be applied to him and, as to the trustee, in addition to other relief.
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> [T]he trust property or its product has been traced to the hands of the third party-participant and the beneficiary has been able to reach it there. If the bene-

ficiary believes that the third party has participated in a breach and has proceeds of the trust property in his hands, the beneficiary may obtain an accounting from the third party and may ask, in the same it, for tracing as to all property identified and money judgment as to the balance.

D The State should be Enjoined[12] from Further Transfers of Mental Health Trust Lands and Possibly All State Lands; Receipts from All State Lands Are Subject to Impoundment; Traceable Trust Property in the Hands of Third Parties is Subject to the Trust's Claims.

Section 861 of Bogert states:

> The court may order the trustee or his successor in interest to perform the trust as a whole, or to take some particular step in trust administration.
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> The court may in its discretion require the defaulting trustee to restore to the trust fund or deliver to the beneficiary particular property other than money, by way of restitution in kind.
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> [T]he beneficiary may claim part of a trust fund under a constructive trust theory and recover money damages for conversion or misappropriation of the other part.

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12. Under Civil Rule 65(c) a bond will normally be required to obtain an injunction in order to cover any costs which may be incurred if the injunction later turns out to have been wrongfully issued. There are numerous cases, however, which hold that such a bond is not necessary (or may be posted in a nominal amount) if the party seeking it is a public interest litigant, or is indigent. The beneficiaries of the Mental Health Lands Trust qualify under both criteria. See People of State of Cal. ex rel. Van De Kamp v. Tahoe Regional Planning Agency, 766 F.2d 1319 (9th Cir. 1985); Natural Resources Defense Counsel v. Morton, 337 F.Supp. 167 (D.C.D.C. 1971); West Virginia Highlands Conservancy v. Island Creek Coal Co., 441 F.2d 232 (4th Cir. 1971); Environmental Defense Fund, Inc., v. Corps of Engineers, 331 F.Supp. 925 (D.C.D.C.. 1971); Orantes-Hernandez v. Smith, 541 F.Supp. 351 (D.C. Cal. 1982); Bartels v. Biernat, 405 F.Supp. 1012, 1019 (D.C. Wis. 1975); Bass v. Richardson, 338 F.Supp. 478 (D.C.N.Y. 1971); Denny v. Health & Social Services Bd., 285 F.Supp 526, 527 (D.C. Wis 1968).

Section 862 of Bogert states:

> For a breach of trust the trustee may be directed by chancery to make a payment of damages to the beneficiary out of the trustee's own funds.

Section 865 of Bogert states:

> [I]f the trustee who has defaulted has in his hands the trust res or its substitute, the right of the beneficiary to hold the trustee to personal liability may in some cases be supplemented by a lien upon the res or its substitute.
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> And so too, if a third person has in any way rendered himself liable to the beneficiary to pay damages in money and such third person is not a bona fide purchaser but has title to part or all of the trust res, or to any property which is the successor or product of part or all of the trust property, the beneficiary may obtain a decree from the court that the beneficiary's claim for money damages be declared a lien on such property and be satisfied out of it.
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> If the beneficiary chooses to rely on money liability plus this equitable lien on the trust property or its proceeds, he has obviously made an election inconsistent with tracing the trust property and claiming it as his equitable property. Under this lien theory the property is that of the defendant trustee or third person absolutely. Under the tracing plan the plaintiff claims that legal title to the res in question is held by the defendant but that it is equitably owned by the plaintiff. The value of the traceable property will usually determine the beneficiary's choice between the lien theory and the tracing method. If a trustee, for example, has stolen trust funds in the amount of $10,000 and invested them in realty in his own name, and the realty has become worth more than $10,000 it will be advantageous for the beneficiary to elect to recover that realty in complete satisfaction of the claim for conversion of trust principal. On the other hand, if the real property has decreased in market value to $8,000, it will be expedient for the beneficiary to obtain a money judgment against the trustee for $10,000 on account of the misappropriation of the trust principal, sell the realty under a lien and realize $8,000 therefrom, and still have a claim for $2,000 under his judgment.

In Moody v. Pitts, 708 S.W. 930 2d. (Texas App. 1986), the court stated:

> If a trustee commingles trust funds with the ustee's own, the entire commingled fund is subjec to the trust.

In Blair v. Trafco Products, Inc., 369 N.W.2d 900 (Mich. App. 1985) the court said:

> [W]here mingling of trust funds with other funds occurs, the cestui que trust has a lien upon the entire fund, and the law presumes that the trust fund was not paid out so long as an amount equal to the trust fund remained.

F. Appointment of A Receiver on Mental Health Trust Lands and Replacement of the State as Trustee.

Restatement of Trusts 2d., Section 107 (a) states a trustee can be removed by a proper court. Relevant comments to that section state:

> a. **Removal by Court.** A court may remove a trustee if his continuing to act as trustee would be detrimental to the interests of the beneficiary. The matter is one for the exercise of a reasonable discretion by the court.
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> b. **Grounds for Removal.** The following are, among others, grounds for removal of a trustee: * * * the commission of a serious breach of trust

Section 108 of the Restatement of Trusts 2d., states if a trustee has been removed the court can appoint a new trustee.

Section 199(e) of the Restatement of Trusts 2d., states the beneficiaries can maintain a suit to remove the trustee. Section 519 of Bogert states, "When in the course of the administration of a trust it becomes apparent that the trustee cannot in fairness to the beneficiaries be allowed to continue in the exercise of his powers, he may be removed."

Bogert states at section 867:

> Sometimes a court can be induced to appoint a receiver for the trust property in order to protect the trust and conserve its assets, pending its decision on an application for the removal of a trustee or for other relief. The rule regarding receivers has been stated by a Georgia court: "Besides it is an established rule of the Court of Chancery, that when a trust fund is in

danger of being wasted or misapplied, it will interfere on the application of those interested in the d, and by the appointment of a receiver, or in sc other mode, secure the fund from loss."

A New York court has said: "it is said that the appointing of a receiver rests in discretion. This proposition does not teach much. A receiver is proper, if the fund is in danger; and this principle reconciles the cases found in the books.

III. APPLICATION OF THE LAW TO THE FACTS HERE

A. Notice Through Public Records.

There is a very strong argument that everyone is charged with notice of the trust and later the breach thereof because of the following.

(a) Deed. The Patents (deeds) to the state indicate that the grant is pursuant to the Alaska Mental Health Enabling Act.

(b) Provisions of the Alaska Mental Health Enabling Act. The Alaska Mental Health Enabling Act is a public law and all persons taking Mental Health Trust Lands should be either charged with constructive notice of the trust requirements or put on inquiry.

(c) The 1978 Trust Abolishment. The purported redesignation of Mental Health Trust Lands by the legislature in 1978 and the failure to compensate the trust one penny was a matter of public record and persons taking Mental Health Trust Lands should be either charged with constructive notice thereof or put on inquiry.

The legal result of being charged with notice is that one can not be a bona fide purchaser. Thus, under this analysis no third party can have good title to Mental Health Trust Lands, no matter how far removed down in the chain of title.[13] Even if the court does not conclude everyone is charged with notice, under the specifics of many cases, third party conveyees do not have good title.

13.Of course, there very well may be a cause of action against the State for conveying bad title.

B. Specific Examples.

1. Legislative Designations (Parks, Refuges, etc).

As indicated previously, some 370,000 acres of Mental Health Trust Lands has been designated as state parks, refuges, etc. Since title remains in State ownership there can be no real argument but that these lands remain trust property. Just as clear is that the legislative designations are an improper method of management of Mental Health Trust Lands. Instead these lands have to be managed to achieve maximum income for the beneficiaries (as do all Mental Health Trust Lands). Thus, all of these lands must be commercially developed to the extent it is possible and furthers the purpose of providing income to the Trust. For example, when it will be in the best interests of the beneficiaries of the trust to do so these lands must be opened for mineral development.[14]

2. Municipalities

Since the municipalities were in the forefront of pressuring the state to redesignate Mental Health Trust Lands, not only must the 40,000 acres selected and/or conveyed to Municipalities be returned, but municipalities should be liable to the beneficiaries for participating in the breach of trust.

3. Native corporations.

By far, Cook Inlet Region Inc., has received the lion's share of the 40,000 acres that have been conveyed to Native corporations.[15] There is no question but that Cook Inlet knew of the trust status of the lands and the breach of the trust. It has been Cook Inlet's legal position that Congress authorized its receipt of the bulk of the Beluga Coal Field when it approved the Cook Inlet Land Exchange. However, counsel for Cook Inlet has not explained how Congress could give away something it no longer owned.

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14. That the lands have to be managed to produce maximum income does not mean that the trustee may sacrifice long-term income for immediate income.

15. The 40,000 acre figure does not include lands lost by the state in its lawsuit with Tyonek Native Corporation over conflicting selection rights under the Alaska Mental Health Enabling Act and the Alaska Native Claims Settlement Act Tyonek Native Corp. v. Secretary of the Interior, 836 F.2d 1237 (9th. Cir. 1988), nor the Beluga Coal Field lands exchanged to Cook Inlet in its exchange.

4. Individuals.

(a) Constructive Notice. As indicated above, title to all Mental Health Trust Lands is in dispute, even if formerly conveyed by the state to individuals. All of these third party conveyees will be brought into the lawsuit[16] and notified that their rights to Mental Health Trust Lands is in dispute. They will then have to defend their title to Mental Health Trust Lands as a Bona fide purchaser. As outlined above, however, it seems that "constructive notice" of the trust and breach of the trust will be imputed to individuals on the basis of the public records by the court. Even if the court does not charge every individual recipient with constructive notice, then each person receiving Mental Health Trust Lands or interests therein must prove that he paid value for the land and that he did not otherwise have notice, either actual or constructive, of the trust or the breach.

(b) Leases. The same analysis would hold for leases.

5. University of Alaska.

There is no question but that the University of Alaska knew about the trust status of the 3,000 acres it received conveyances of. Indeed, it is particularly flagrant since it received these conveyances in settlement of its lawsuit with the state for the same breach of trust in redesignating University Trust Lands as General Grant Lands.

6. Less than total Conveyances.

Again, the same sort of analysis applies to the other 280,000 acres in less than total conveyances that have been made on Mental Health Trust Lands. However, certain categories of less than total conveyances merit discussion.

(a) Mining Leases. Since the state did not have real mining leases prior to the decision of the Alaska Supreme Court in the 6(i) case[17] and no rents or royalties were ever paid these

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16. Whether individually or as a member of one or more defendant classes.

17. Trustees for Alaska v. State Department of Natural Resources, 736 P.2d 324 (Alaska 1988). In this case, the Alaska Supreme Court ruled that the state's practice of granting rights to extract minerals, although denominated a "lease" was not truly a lease because no rents or royalties were due and that this violated Section 6(i) of the Statehood Act which requires a lease of mineral resources.

leases are invalid.[18] Of course, the operators of these mineral properties are accountable for royalties due to the trust for the minerals that have been removed and arguably for minimum royalty and/or rental payments.

(b) Oil & Gas Leases. It strains credulity to believe that oil companies did not actually know of the trust status of the lands because a detailed assessment of land status and title is normally done by any prudent potential oil and gas lessee.[19]

(c) Public and Charitable Uses. As described above, trust property given for a charitable purpose, where payment of value and lack of notice is not present normally must be returned to the trust.

There are many other types of transactions and circumstances that will no doubt be revealed. The foregoing, rather than intended to be exhaustive, is to illustrate the general principles involved and how they should be applied in particular circumstances.

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18. As recently as May of 1989, the United States Supreme Court held that a flat rate royalty for mineral lands was an invalid method of leasing mineral trust lands and the statute authorizing it invalid as applied to Arizona's School Trust Lands. Asarco v. Kadish, 490 US ___, 104 L.Ed 696, 109 S.Ct. ___ (1989). This would appear to invalidate the state's current leasing program with respect to its application to Mental Health Trust Lands (However, no new mineral leases have been issued on Mental Health Trust Lands since the Alaska Supreme Court's decision in this case in October of 1985). Interestingly, at footnote 3, the United States Supreme Court specifically acknowledged the difficulty of determining fair market value of minerals, but reaffirmed its previous pronouncements that "whatever the difficulties may be in making such appraisals with complete accuracy, it does not defeat the existence of a "market value" in mineral rights, and it does not suffice as a reason to depart from the ordinary requirements that the law imposes on such transactions.

19. The same is true for mineral properties, but to a lesser extent where the lessee is a "mom and pop" operation which is much more prevalent in mining, particularly placer.

ALASKA MENTAL HEALTH BOARD INTERIM REPORT ON CHAPTER 48 REVISIONS (6.6.4)

January 1990

INTRODUCTION

In 1987, when the Alaska State Legislature adopted revisions to Alaska law which reconstituted the Mental Health Lands Trust and created the Alaska Mental Health Board, it was with the hope that these changes would resolve the issues raised in the Weiss v. State lawsuit. All parties to the suit felt that a workable compromise was better than the continuation of litigation, and they expected that the Legislative changes set forth in Chapter 48 would form the basis of a settlement.

The plaintiffs in the Weiss suit expected that these legislative changes would ensure that the monies set aside for the Alaska Mental Health Trust would be used first and foremost to meet the needs of the mentally ill. They contemplated that these needs would be determined by the Alaska Mental Health Board and that upon identification the Legislature would appropriate funds to meet those needs. It was their expectation that only after the basic needs of the trust beneficiaries were met would the Legislature take advantage of the statutory provisions that allowed excess revenues from the trust to be used for general expenses of the State.

The legislative changes have not worked. First, the Greene decision identified a group of beneficiaries not contemplated by the original Weiss litigants. Not only were considerable questions raised about the proper way to identify who beneficiaries of the Trust were, but also considerable confusion was created about the role of the Alaska Mental Health Board. The Board has been forced to function in two conflicting roles at once. As the statutorily mandated body charged with responsibility to identify needs of Trust beneficiaries, it has had to act as a neutral arbiter of claims to the Trust's funds from all of the beneficiaries, including those identified in the Greene decision. At the same time, as the body charged with representing the mentally ill, the Board has been required to be an advocate on behalf of a

specific population that competes with other trust beneficiaries for the Mental Health Trust Funds.

Second, and perhaps more important, there has been insufficient appropriation of Trust funds to meet the needs of the Trust beneficiaries. Over the last three years, the Alaska Mental Health Board has identified needs far in excess of those being presently met. Each year, the Board has made modest recommendations, not sufficient even to meet identified needs, but at least sufficient to begin to redress some of the severe shortcomings of Alaska's Mental Health Program. Even these minimal recommendations have not been accepted. More money has been transferred from the Mental Health Trust Lands income account into the general fund than was spent on the entire Mental Health Program. The Weiss litigants, have concluded -- reasonably in the estimate of most members of the Alaska Mental Health Board -- that the reconstitution of the Mental Health Trust has resulted in no real change in the way in which Trust revenues are spent. An additional concern, which may become more important over the years, is that the Department of Natural Resources (DNR), which has a broad range of responsibilities for the management of State lands, has full authorization over the management of Mental Health Trust lands as well. There is no agency or group with a particular mandate to represent the beneficiaries of the Trust who can review the management decisions of the DNR to make sure that, over the years, management decisions which are a based solely on the best interests of the Trust are made and that the value of trust lands are not eroded over time.

The Alaska Mental Health Board, has recognized the serious nature of these problems for some time. Beginning in July of 1988 the Board facilitated a series of meetings with affected groups to discuss the proper way to define the beneficiaries of the Trust. After this Greene group issued its report the Board adopted "A Policy Report Pertinent to the Greene Decision", a report discussing the implications of the Greene decision. In April of this year, the Board passed a resolution calling for public hearings to examine the role of the Board in light of the Greene decision. The Board delegated to its Legislative Committee the task of gathering information that might lead to proposed changes to Chapter 48. The Committee has

held public hearings and devoted two work sessions to the subject. The purpose of this report is to outline the conclusions and recommendations of the committee.

BACKGROUND

None of these issues is new. The Legislature reviewed the proper role of a mental health board and the proper mechanism for funding programs from the Trust in-depth in 1986 when originally attempting to reach a settlement of the Weiss litigation. At that time, the Joint Special Committee on Mental Health Trust Land suggested three possible alternatives. The first alternative was a "secured revenue stream". Under this proposal, eight percent of all State unrestricted general fund revenues would be dedicated to the mental health program, secured by a pledge of State assets which could be executed upon in the event that the Legislature failed to appropriate sufficient funds to meet the necessary expenses of the mental health program.[1]

The second alternative was reconstitution of the Mental Health Land Trust and the creation of a Mental Health Trust Corporation which would be responsible for managing the assets of the Trust. The unencumbered Trust land would be re-transferred, and a cash settlement of lands encumbered or patented would be made. This alternative was less desirable, because of the difficulty and expense inherent in identifying, transferring, and then subsequently managing the Trust lands.

Finally, the Legislature recognized the alternative of permitting the court-ordered reconstitution of the Trust to take place under court supervision.

In supporting the secured income stream alternative, the Joint Committee recognized the inherent difficulty with that solution. There was no way to guarantee that the Legislature would necessarily appropriate sufficient funds each year to meet the needs of the Mental Health program.

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1 *See report to the Legislature of the Joint Special Committee on Mental Health Trust Land, January, 1987, pg. 14, this was the preferred alternative*

> "Earmarking" Trust land income in the general fund and appropriating an amount equal to the income is permissible, but it does not insure that income will go toward funding mental health programs. Since one Legislature cannot bind future Legislatures, enactment of a law stating that income will be spent on mental health programs is subject to the will of each Legislature and dependent on annual appropriation of funds.[2]

The Joint Committee recommended a Statement of Legislative Intent as a means of guiding future legislatures as to the appropriate levels of funding.

At the same time, the joint Committee recognized that present funding levels were inadequate.

> State appropriations for mental health programs have grown from slightly less than $1.2 million in 1959 to slightly more than $23.4 million in 1986. However, when an inflation factor is applied, actual State spending on mental health has declined over the last few years.
>
> The draft Mental Health Plan, released in August 1986, estimates the cost of developing a comprehensive mental health system at $106.9 million in annual operating costs, an increase over FY87 operating expenditures of approximately $82.1 million. It also identifies a need for $102.1 million in one-time capital costs.
>
> . . .
>
> [I]n the Committee's view, the draft clearly demonstrates that Alaska's current level of mental health funding is

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2 *Id.* pg 8-9

> insufficient to serve our mentally ill population. It should be noted that the Alaska Alliance for the Mentally Ill has testified that the draft falls short of the goals of an adequate program.
>
> The Committee's view is supported by testimony received from the National Conference of State Legislatures (NCSL). Their review of Alaska's mental health program led to several recommendations, primarily that our programs be expanded.[3]

The Interim Mental Health Trust Commission reached a similar conclusion, ultimately suggesting that a revenue-stream option be adopted by the Legislature.[4] The Interim Mental Health Trust Commission also recognized the necessity of binding the Legislature in a constitutionally accepted manner so that future legislatures would be required to use the revenues generated to meet the needs of the mental health program:

> Furthermore, the enabling legislation should be very clear that the Legislature intends to fully fund an adequate mental health program in perpetuity. To satisfy the court-ordered reconstitution, such an arrangement would have to include collateral -- an identifiable, quantifiable entity -- which could be redeemed by the Trust in the event that the promised revenue stream failed to materialize or was somehow diverted. . . . While falling short of binding the hands of future legislatures, such a surety bond would make them always cognizant of the revenue stream legislation's original intent.[5]

These recommendations were the genesis of the present Chapter 48.

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3 *Id. at pg. 19-21*

4 *Report to the Legislature by the Interim Mental Health Trust Commission, February 1987, at pg 199*

5 *id at pg., 19-21.*

As enacted, Chapter 48 did not include any provisions for enforcement. Over the last three funding cycles, funding for the mental health program has continued to be inadequate. In FY88, the Alaska Mental Health Board, recognizing the need for a phasing in of increased funding for mental health programs, recommended increased program funding of $15,322,400 over the Governor's proposed operating budget. Despite the fact that even this recommendation was far below the minimum necessary to fund an adequate program for the State and meet the goals of the Comprehensive Mental Health Plan, only $8,868,900 in additional operating funds was appropriated. Similarly, FY89 recommendations of the Alaska Mental Health Board were $15,791,800 in additional operating funds over the prior year's base budget. Only $5,026,000 more than the base, was appropriated while $47,072,733.93 was transferred from the Mental Health Trust income account into the general fund.[6] The result has been that mental health services throughout the state have failed to keep pace with rising demand. Similarly, the Board's recommendations to meet long standing capital improvement requirements have been rejected. The needs identified in the State Comprehensive Mental Health Plan are being funded at a fraction of the amount necessary to meet the Plan's goals.

In 1978, when the Legislature re-designated Trust lands as general grant lands, the Legislature failed to ever make the necessary appropriations to compensate for the loss, and the Mental Health Trust was never funded. This was the reason for the Weiss suit in the first place. It is the perception of many members of the Alaska Mental Health Board, as well as of the Weiss litigants, that a variation of this situation continues to exist under the Chapter 48 revisions. Mental Health Trust funds are used for general fund purposes with little regard to the requirement that the Mental Health Trust account be spent first to meet the needs of the mental health program.

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6 *Letter from Milt Barker, Department of Revenue, December 1, 1989*

PROPOSED RESOLUTIONS

The AMHB, IMHTC, relevant advocacy groups, and litigants generally agree that changes to the present structure must be made. The Legislative Committee has received a broad spectrum of recommendations. These range from recommendations that nothing be done or that the status of the Alaska Mental Health Board be diminished, to proposals that the entire way in which the State approaches funding and operation of mental health programs be modified. Some examples of proposed ways of resolving the conflicts raised by the present Chapter 48 follow.

PROPOSAL A — Status quo with a Re-definition of the Alaska Mental Health Board's Responsibilities

The Legislative Committee received several suggestions to the effect that little change should be made to the present system. In response to our request for information, the Department of Natural Resources indicated that:

> The only change the Commission anticipates at this point is a proposal to alter the five-year reappraisal requirement. We have indicated support for an indexing system which would automatically adjust the value of the trust lands. As yet, however, there has been no uniform agreement concerning the adjustment methodology.[7]

Under this approach, there would be no changes to the present procedure for determining how Trust revenues are spent. The provisions of Chapter 48 requiring that eight percent of the land value be place in the Mental Health Trust income account would remain in effect and the Legislature would continue to appropriate on the basis of its perception of the needs of

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7 *Letter, Rod Swope, Commissioner Designate to the Interim Mental Health Trust Commission, to Nelson G. Page, September 6, 1989.*

the mental health program of the State, with unexpended revenue going to the general fund.

The Division of Mental Health and Developmental Disabilities also prefers a limited approach.

> I would like to have the presently constituted Mental Health Board able to give its entire attention and effort to the hospital and community mental health services administered by the Division.
>
> The Governor's Council for the Handicapped and Gifted, the Older Alaskans' Commission, and the SOADA Board are already serving planning, advisory, evaluative and advocacy functions for the other Mental Health Trust beneficiaries, and there is no other board to provide these functions for the "mentally ill who may require hospitalization" nor for the other recipients of traditional mental health services.[8]

Thus, the Mental Health Board would be divested of its present responsibility for oversight and budget recommendations regarding all trust beneficiaries. Although this would eliminate the confusion which has resulted from the Greene decision, relieving the Board from its dual, and often conflicting role of being an advocate for one group while being an umbrella organization representing all groups, it would leave no entity with responsibility for trust oversight and would tend to perpetuate a fragmented and uncoordinated approach to the delivery of mental health services.

In the Committee's view, limited modifications to the Alaska Mental Health Board's role and structure do not change the problems with the

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8 *Letter, Todd R. Risley, Director, Division of Mental Health and Developmental Disabilities, to Nelson G. Page, October 16, 1989.*

present system. Rather than strengthening the level of commitment the Legislature must make to using Mental Health Trust funds for mental health programs, this approach would decrease what, in the view of many, is an already inadequate incentive on the part of the Legislature to spend Trust funds appropriately. At present, despite the conflicting nature of its role, the Alaska Mental Health Board does serve as a guardian and watchdog over the Trust and the uses for which Trust revenues are spent. There is no other group which has either the legislative mandate or the responsibility to act as an umbrella speaking on behalf of all beneficiaries of the Trust. Although a re-definition of the Alaska Mental Health Board's responsibilities would end the ambiguity in the Board's role, it would also end the Board's ability to protect and defend the Trust leaving nothing in its place. For these reasons, it is the view of the Committee that an independent board of trustees whose responsibility is to the Trust, and not just to the individual constituent groups, must exist. The Committee has been struck by the unanimous nature of the consensus among all affected groups on that principle, even if the details remain to be worked out.

PROPOSAL B <u>Creation of a Separate Trustee Without Operating Authority</u>

A more extensive modification of Chapter 48 would be to create a separate board of trustees with responsibility for the Trust. Such a separate board of trustees would not have responsibility for advocacy on behalf of any one group of beneficiaries to the Trust. At a minimum, the Board would be given responsibility for oversight of the way in which the Department of Natural Resources manages Trust land, would have responsibility for ensuring that the value of the Trust lands was maintained over time, and would have responsibility for defining who are the beneficiaries of the Trust and what services can properly be funded from the Trust. The Alaska Mental Health Board would remain the advisory and planning board advocating on behalf of the "traditional" mental health programs, similar to the Governor's Council for the Handicapped and Gifted, the Older Alaskans' Commission, and the Advisory Board on Alcoholism and Drug Abuse. At the same time, however, the independent Trustee Board would

take over the responsibility for protecting and advocating on behalf of the Trust itself.

Although the exact scope and nature of the independent Board of Trustees remains to be determined, at a minimum, the Board would be a separate entity with separate legal status akin to the Alaska Power Authority, the Alaska Public Utilities Commission, or the Permanent Fund Board. As such, it would have the capacity to sue and be sued and to hire its own counsel to provide independent legal representation. At a minimum, the Board of Trustees would be charged with the responsibility to :

1. Oversee and approve land management decisions of the Department of Natural Resources, as they affect the Mental Health Trust lands, and to negotiate with the State when it became necessary to revalue State land. Under the present Chapter 48, such re-valuation is to take place every five years;

2. Invest and oversee any designated funds, such as funds appropriated for capital improvements;

3. Determine annually the extent to which the needs of the beneficiaries of the Mental Health Trust have been met, based on the goals and objectives of the Alaska State Comprehensive Mental Health Plan, and to certify annually the extent to which the needs have been met or not met;

4. To review and approve expenditures from the Trust to ensure that the expenditures are properly charged to the Trust.

This independent Board of Trustees would have the power to promulgate regulations to implement its authority, the power to hire and fire its employees, and the power to set employees salaries, as a necessary element of its independence.

Under this proposal, the language of Chapter 48 would be amended to prohibit the expenditure of funds held in the Mental Health Trust revenue

account without either (1) approval of the Board of Trustees, or (2) in the event that the Board of Trustees does not approve, a specific finding from the Legislature that the expenditure is necessary and appropriate to meet the needs of the Mental Health program of the State of Alaska. In addition, Chapter 48 would be amended to provide that no reappropriation to the general fund from the Mental Health Trust revenue account could take place unless (1) the trustees had certified that the necessary expenses of the Health program had been met for the previous year, or (2) in the event that the trustees did not so certify, the Legislature had made a specific finding to that effect.

For this structure to work, the members of the Board of Trustees would have to act with a clear fiduciary responsibility for the Mental Health Trust and the beneficiaries of that Trust. It would be essential that members of the Board of Trustees consist of individuals who could fairly, impartially and knowledgeably review and evaluate the needs of the Trust and of the beneficiaries of the Trust. Ideally, this Board of Trustees would take over the present responsibility of the Alaska Mental Health Board to ensure that the plans of the various entities and agencies responsible for the mental health program are integrated and comprehensive.

PROPOSAL C <u>Separate Trust with Operating Authority</u>

Most proposals for modification of Chapter 48, however expansive, do not change the underlying way in which mental health services are provided in the State of Alaska. The services are delivered through the Department of Health and Social Services and funding levels are determined by the legislative process. Recent actions in other parts of the United States have focused attention upon the feasibility of creating a public authority or corporations into which the assets or income of the Alaska Mental Health Trust would be transferred. This public authority would be empowered and authorized to do those things set forth in Proposal B. In addition it would act as an operating authority, providing mental health services for the State of Alaska. The general outlines of the program and the goals of the program would be set by the Legislature, and additional funding, as necessary, would be available through appropriations through the

Legislature or, in the case of capital expenditures, through a bonding power given to the public authority. The primary responsibility for the payment for and delivery of mental health services would be with this "Mental Health Authority".

Similar broad and sweeping changes to the method for delivering mental health services have been enacted in the states of Washington and Wisconsin. In those states, the legislature contracts through a separate authority with regional mental health entities to provide mental health services on a local level. The overriding advantage of this system is that it provides incentives for greater local responsiveness to meet individual needs and creates a system which de-emphasizes institutionalization and in which dollars more closely follow patient needs.

RECOMMENDATIONS

It has become obvious to the Legislative Committee that additional work needs to be done. There is a clear consensus that Chapter 48 needs to be amended, and that the Amendments need to include the creation of an independent Board of Trustees which can, at a minimum oversee the actions of the State in funding and administering the Mental Health program and the Mental Health Trust lands. It is important to remember that the Weiss lawsuit is still pending. Unless and until the Weiss litigants are satisfied that a reasonable structure has been created, there is always the possibility that a court-ordered restructuring of the Trust will be required, which all parties presently still agree is an undesirable outcome.

Realistically, it is unlikely that the necessary study and review of these issues can be completed in time for any action to be taken by this legislative session. The Legislative Committee recommends, therefore, that work be done with an eye toward creating well thought-out and comprehensive changes during the 1990/91 legislative session. In the meantime, the Board, the Legislature, and the Executive Branch, should work toward reaching a consensus on the necessary changes. Specifically, the Committee recommends the following:

A. Approve the Recommendations of the Interim Mental Health Trust Lands Commission.

The Legislative Committee is not prepared to recommend changing some basic aspects of Chapter 48. Specifically, the "dedicated revenue stream" approach to funding has much to recommend it. The alternative, a re-transferring of Mental Health Trust lands to create a trust corpus, has the same problems and difficulties as always: it will be difficult to do, very expensive, and may result in a situation in which Mental Health Trust dollars go to managing the Trust lands, and not toward benefitting the beneficiaries of the Trust. After 2-1/2 years of study and deliberation, the Interim Mental Health Trust Lands Commission has issued its recommendations regarding the value of Mental Health Trust lands.

These important recommendations are the result of careful analysis and reasoned decision-making. They are essential to making the "dedicated revenue stream" approach successful. At a minimum the Legislature should act this session to adopt procedures approved November 7,1989 by the IMHTC. Thus, the Committee's first recommendation is that the Legislature should resolve the long-standing issue of Mental Health Trust lands valuation by accepting the procedures adopted by the recommendation of the Interim Mental Health Trust Commission during this legislative session.

B. PREPARE COMPREHENSIVE PROPOSALS FOR THE 1991 LEGISLATIVE SESSION

The Committee recommends that no specific changes in Chapter 48 be made during this legislative session so that a more comprehensive approach to an overhaul of Chapter 48 and of the Alaska Mental Health program can be undertaken during the following legislative session. The changes outlined in this report provide only a summary of possible options and do not purport to be a comprehensive view of the possible ways in which a separate Board of Trustees could function. Alaska is not the only state that has been faced with these issues over the last few years. There is a wealth of information and knowledge which can and should be evaluated for precedent to determine the best way to structure mental health services delivery for the State of Alaska. The Legislative Committee recommends, therefore, that the Legislature appropriate sufficient funds for the purpose of conducting a study which will lead to comprehensive recommendations for enactment of legislation during the 1990/91 session.

C. AUGMENT THE BOARD'S COMMITTEE STRUCTURE ON AN INTERIM BASIS

Finally, the Legislative Committee recognizes that if no changes are made to Chapter 48 and to the structure of the Alaska Mental Health Board at the present time, the built-in conflict between the Alaska Mental Health Board's role as an advocate for the traditional Mental Health program and its role as a neutral arbiter of claims to the Trust's funds will continue, at

least on an interim basis. The Legislative Committee wishes to emphasize its belief that the Alaska Mental Health Board, on the whole, has done an excellent job of attempting to juggle these conflicting responsibilities. However, those beneficiaries of the Trust who are not presently required by statute to be represented on the Alaska Mental Health Board must be made to feel that their interests are being given full and fair consideration by the Board when it acts in its capacity as planning and oversight body for the Mental Health Trust as a whole. This issue was recognized by Governor Cowper in a letter which he sent to the Board February 17, 1989, in which he requested that the Board itself make recommendations as to any changes that should be implemented in its membership and structure.

The Legislative Committee believes that, for the time being, no formal changes need to be made to the structure and membership of the Board. Instead, in order to ensure that the interests of all of the beneficiaries are represented on an interim basis, and, as importantly, in order to ensure that these beneficiaries perceive that their interests are adequately represented, the Legislative Committee recommends that the Board take the step of augmenting its Committee structure by adding to each of its committees voting members from one or more of the affected beneficiary groups. This augmentation would be on an interim basis until final recommendations can be made as to changes in the Board's structure and in Chapter 48. This recommendation can be implemented by the Board itself, and does not require any legislative changes. The Board has already had experience with this arrangement. Its Budget Committee has been an augmented committee for the last year, and the Legislative Committee itself welcomed and benefitted substantially from the participation of several interested parties. Thus, the Legislative Committee recommends Board Committees be expanded by the Executive Committee in accordance with established Board procedures to provide reasonable representation of beneficiary groups. The Committee further recommends that the committee expansions include coordination with the three affected boards and coalition attorneys representing plaintiffs in the litigation.

CONCLUSION

The challenge that is faced by the Board, the State, and the Weiss litigants is to find a way to make a permanent, binding commitment that adequate funding for the State's mental health program will be provided in the future. It is disheartening that the problems which led to the present dissatisfaction with Chapter 48 as a proposed resolution to the Weiss litigation are in many respects the same problems which existed and led to the Weiss lawsuit in the first place. Without a commitment to an enforceable and workable arrangement for funding the mental health programs, the Weiss litigants have no incentive to abandon their original demand that the Trust be reconstituted in its entirety. The State has at the present time an opportunity to look carefully at the way in which mental health services should be funded and delivered in the State of Alaska. The Legislative Committee recommends that steps be taken so that the mental health program and the Mental Health Trust can be structured in a manner that is forward looking and takes into consideration the needs of the State of Alaska over the next several decades.

Interim Report 6.6.4

Related to SB493

March 20, 1990

Mrs. Lennie Gorsuch
Commissioner of Natural Resources
State of Alaska
Willoughby Center, 5th Floor
Juneau, Alaska 99801

Dear Commissioner Gorsuch:

With this letter I am transmitting the Interim Mental Health Trust Commission's response to Rod Swope's Minority Report. I wanted to get this response to you earlier, but I was hospitalized resulting in the delay.

I suggest we meet, at the earliest possible time, to discuss where the Commission should go from this juncture. We have yet to finalize the reevaluation and the replacement lands.

If you agree with the minority report, and are unable to follow the Commission's procedures, then there may be reason for us not to proceed with the rest of our task. We do need to discuss these options.

A process for reevaluation was suggested to the Commission by David Walker and Jim Gottstein. Tom Koester was to review this suggestion and give the Commission his recommendation. It would be helpful to have his response.

Sincerely,

Dr. George Rogers
Chairman
Interim Mental Health
Commission

INTERIM MENTAL HEALTH TRUST COMMISSION (IMHTC)
RESPONSE TO
MINORITY RECOMMENDATION TO THE COMMISSIONER OF NATURAL RESOURCES

March 20, 1990

George Rogers, Ph.D.
Chair

Lidia Selkregg, Ph.D.
Commissioner

K.J. Metcalf
Alternate

Dennis Scholl, Ph.D.
Alternate

Introduction:

The Commission members and alternates have reviewed the "Minority Recommendation to the Commissioner of Natural Resources" (Minority Report) submitted February 1, 1990 by Rod Swope, the Commission member serving as the Designee for the Commissioner, Department of Natural Resources (DNR). The review of the Minority Report by the Commission majority produced no basis for modification or revision of the "Interim Mental Health Trust Commission Draft Final Report" (Commission Report) of December 20, 1989. The Commission Report stands as the final report on the "Approved Procedures for Determining the Fair Market Value of Alaska's Mental Health Trust Lands." The public members of the Commission and their alternates re-affirm their recommendations.

General Nature and Character of the Minority Report:

The nature of the Minority Report was a significant disappointment to the other members of the Commission. While failing to substantiate DNR's findings and conclusions, the Minority Report attempted to discredit the Commission's work by portraying the public members as unprofessional, not acting in the public interest and in fact acting illegally. These are serious personal allegations that require a personal response.

The Minority Report opens on the first page by asserting that the Commission exceeded its authority and adopted,

> *"...valuation procedures urged by the attorneys for the plaintiffs and intervenors in the Weiss case, procedures designed to maximize value and not to produce fair market value as required by Chapter 48."*

The Minority Report is laced with similar implications of professional misconduct by the public members of the Commission. Designee Swope portrays himself as the lone champion of reason and legality, and by implication, and sometimes directly, portrays the public members as being the reverse. On page 6, for example, Swope claims

> *"I strived toward achieving consensus and a common resolution...*[On the other hand] *it became apparent that the majority of the IMHTC was dissatisfied with the results of the initially approved procedures and began amending them to produce higher values."*

It is extremely unfortunate that the Minority Report personally attacked two professionally respected, long time Alaskans who have dedicated their lives to public service, by

implying they would put their professional and personal reputations on the line for the benefit of an interest group.

The public members of the Commission volunteered over three years of their time without compensation to develop a legitimate process for arriving at the "fair market value" of the original Mental Health Trust. The process is legitimate and the Commission Report accurately documents the effort.

Another tactic used at the outset of the Minority Report has nothing to do with the Commission recommendations as such, but is designed to create an attitude in the mind of the reader that would be antagonistic to the Commission and favorable to the Minority Report. At the top of the second page the Minority Report introduces a half truth to portray the dire consequences to the State budget of following the Commission's recommendations.

> *"The importance of the value determination used to determine fair market value cannot be overstated because of the dramatic effect they will have on the overall state budget. Under the valuation procedures adopted by the majority of the IMHTC...this would result in more than $178 million in otherwise unrestricted state general funds being restricted in the Mental Health Trust Income Account."*

The omitted half of the whole truth is that the restriction to the Mental Health Trust Income Account is only a temporary accounting transaction required by Chapter 48 in an attempt to comply with the 1956 Congressional Alaska Mental Health Enabling Act which created the Trust. After payment from the account of only the necessary expenses (not the unnecessary expenses) of the Mental Health Program, the balance of the income is transferred to the General Fund for other public purposes. The value of the land corpus (whether it be high or low) does not determine the Mental Health Program budget as Designee Swope states. The Program budget is determined by Legislative appropriation after consideration of the recommendations of the Alaska Mental Health Board. In short, the effect of the valuation procedure upon the overall State budget is neutral, not "dramatic" as alleged.

The public member majority of the Commission do not feel resolution of the issue is served by trying to alarm Alaskans, rightfully concerned with fiscal solvency of the State, by painting a fiscal horror story not supported by facts. They further believe that the tactic was used to justify DNR's own fanatical efforts throughout the process to drive down the estimated value of the original Trust Lands.

The personal attacks in the Minority Report are distressing and had to be addressed. But, to belabor this does not serve the purpose of resolving the complex Mental Health Lands Trust issue. The technical questions raised in the Minority Report are more appropriate to address.

Technical Questions Raised by the Minority Report:

The Minority Report fails to address directly the Commission Report. Instead, Designee Swope's dissent is based upon two charges, (1) that the Commission exceeded its statutory authority, and (2) that the Commission adopted "procedures designed to maximize value and not to produce fair market value."

> Minority Report Finding 1: "The IMHTC exceeded its statutory authority by proposing and adopting its own valuation procedures instead of reviewing and approving procedures proposed by the Commissioner."

The long and arduous task of developing a procedure for identifying fair market value was undertaken by the Commission in an atmosphere of cooperation and trust. We, the public members, assumed all parties were working toward a solution. This enormous task was made difficult by shortages of data, time, and funds and by the limited expertise of DNR staff. The Commission Report adequately details the process. The Commission followed the advice and counsel of the Attorney General's office in developing the fair market value procedures. It therefore came as a shock to find DNR and/or the Attorney General's office, in the Minority Report, creating a new interpretation of the Commission task in an apparent attempt to invalidate our years of effort. It is all too apparent this new interpretation evolved because DNR disagreed with the Commission's approved procedures. This unfortunate "eleventh hour" tactic suggests the Commission's assumption of trust and good faith was ill-founded.

Chapter 48, SLA 1987 revised and replaced certain sections of Chapter 132, SLA 1986 which created the Commission to oversee interim management of the Trust lands and work with the Legislature in establishing a statutory basis for resolving the Trust land issues. The Commission membership was reduced from five (5) to three (3) -- the Commissioner of DNR and two public members -- and its mission redefined in terms of the negotiated settlement framework. The reduced Commission assumed sections of Chapter 132 not replaced or revised were still in effect and for more than two years continued operations much as it had in its original form without question or challenges.

Throughout this period the Commissioner of DNR participated continuously (through various designees) and the Attorney General was represented by Tom Koester. It came as a surprise, therefore, to be informed three months after the Commission submitted its final approved procedures and two months after forwarding its draft final report that the Commission had "exceeded its statutory authority."

The Minority Report further alleges,

> *"By proposing and adopting valuation procedures over the department's objections, the IMHTC has ignored the legislative requirement that, in effect, there be consensus as to the valuation procedures to be employed. ... In my opinion, the failure of the IMHTC to reach consensus on valuation procedures makes it impossible for the Commissioner to comply with Chapter 48."*

Consensus was not a "legislative requirement". Chapter 132, SLA 1986 provided that motions could be adopted by majority vote and, in fact, many of the "action items" treated by the present Commission were resolved by a two yea vote (the other member voting nay or abstaining). The actions resulting in the final approved procedures and the Commission Report were carried out, at the suggestion of Designee Swope, as a means of bringing the whole issue of valuation to a close. He also stated, and it was agreed, there might also be a minority report.

In the Minority Report Designee Swope also charges the Commission improperly changed the originally approved procedures and he implies this was a frequent practice aimed at producing a value substantially greater than fair market value. In fact, the originally "accepted and approved" procedures were observed to the very end of the Commission deliberations adjusted only when required by lack of funds or data. This is more fully discussed in the final section of this reply (page 10, below).

> Minority Report Finding 2: "The procedures proposed and adopted by the IMHTC in the majority report do not produce fair market value, as required by Chapter 48; instead they produce a value substantially greater than fair market value."

The bulk of the Minority Report attempts to discredit the Commission's fair market procedures. After careful review of the Minority Report, the Commission determined there is no reason to alter its conclusions. The Commission Report sets forth the final approved procedures in detail. Rather than

repeat that substantial information, a summary response is given to key challenges in the Minority Report.

Given the limitations of budget, time, data and staff the final approved procedures are appropriate, legal and lead to a mid-range value, not a high value. This is summarized in the text of the resolution adopted November 7, 1989 (see Appendix A in the Commission Report of December 20, 1989).

The largest differences between DNR's preferred values and the values arrived at by the Commission's final approved procedures are in the surface estate and the mineral resources. Further clarification on surface estate valuation and procedure for valuing mineral resources follows.

Surface Estate Valuation Procedures

Because of time and financial constraints the Commission could not use "best practices" (i.e. appraisals). Instead, three geo-panels of appraisers were selected to give opinions of value for parcels in their regions. At best the process was highly judgmental and subjective, but in addition only an estimated seven to ten minutes was spent on each parcel and data was limited to that provided by DNR or brought to the meetings by the appraisers. Because of inevitable differences of opinion between appraisers and the probability of error due to time and data limitations, the approved procedures provided for a review and discussion of questioned values. In the event the review step did not resolve differences, the Commission could utilize a mediator to recommend resolution.

The review stage was never completed and the mediation stage never reached.

Although problems arose in connection with the operations of the geo-panels, it was with the initiation of the review stage of the approved procedures that the surface estate valuation process began to break down. Through various tactics the DNR staff attempted to thwart the proper implementation of this stage of the surface valuation with the justification that the approved procedure might result in increases in values. After several bitterly fought meetings, the process was allowed to continue with modifications. The Minority Report chose to ignore the review aspects of the approved procedures and wrongfully portrays the role of the review appraisers as something added later at the insistence of attorneys for the plaintiff and intervener.

The Southeast geo-panel was provided a random sampling of the questioned surface estate values. On the basis of the geo-panel's accepted adjustments the initial geo-panel value for

Southeast parcels was increased by 30%. However, of the 387 sample parcels reviewed more than half (207) were recommended for further mediation, a step of the originally approved procedures that never came to fruition.

The Southcentral geo-panel was called into review session, but DNR staff neglected to invite the review appraiser. Although an apology was made to the Commission, the end result was the reviewer could only be present for a few hours of one morning. At that time he did present comparable sales for large parcels which the geo-panel did not know existed. Once provided this useful large parcel information, the Southcentral geo-panel recommended five of six large parcels re-examined be increased in value by 68%. If the southcentral review had been possible, as provided by the approved procedures, there was a high probability other similar adjustments would have been made.

A review of the Northern geo-panel was never even initiated. At this point the Commission was informed by the DNR staff that funds had been exhausted.

In the course of carrying out the approved procedures it became apparent the opinion of value approach was seriously flawed. The State's appraiser provided the geo-panels during their deliberations with interpretation of the valuation instructions for application to actual cases. The review step disclosed the State's interpretations as not totally unbiased. During the geo-panels' deliberations the State appraiser reported to the Commission problems between members of the Southeast panel in coming to agreement. Additionally, the members of the Southcentral geo-panel submitted a memorandum to the Commission designed to protect their professional reputations. The memo stated the product of the abbreviated valuation process was "not even 'preliminary opinions of value' as commonly understood in the appraisal profession" and listed other limitations such as time and funding and the manner in which the State had parcelized the land for appraisal(see Commission Report, Appendix B, page B4).

The unfinished process of carrying out the approved procedures left the Commission with a wide range of surface estate values -- the adjusted values of the geo-panels advocated by DNR and the values presented by the review appraisers advocated by the plaintiffs. The Commission chose a procedure leading to a mid-level value between these extremes.

Procedures for Valuing Mineral Resources -- A Question of Most Appropriate Methodology

The National Appraisers Association Standards for determining fair market value recognized three general approaches: market (comparable sales), income (capitalization of income stream from the property) and replacement cost. From the beginning the public member majority of the Commission have insisted the methodology most appropriate to the type of estate being valued would be employed and the various Commissioners of DNR and designees understood this requirement. On September 29, 1987, for example, the then Commissioner of DNR directed the Division of Geological and Geophysical Surveys (DGGS) to "assess the quantity and quality of known and potential hard rock minerals...followed by a resource valuation." This value was to "be determined by an independent entity, likely retained under contract to the department."

In April 1988 DGGS maps reflecting mineral potentials and favorability of mineral occurrence on Trust Land were presented to the Commission. In preparing for the next phase, the Commission was informed

> *"assuming it proves impossible to complete an in-house mineral valuation (for whatever reason), we will be prepared to proceed with contract solicitation to complete the work."*

The Commission assumed it had approved procedures that included mineral valuation by outside consultants using the income approach. This is the point at which DNR decided to depart from the previously approved procedures and to use instead the comparable sales approach. The comparable sales approach was considered totally inappropriate by the public members as well as the State's own professional consultant, (Dr. Harris). Using the wrong approach, DNR first set the mineral value at zero and later at $16 million. In commenting on the Commission's rejection of this value, the Minority Report author agrees, "The initial value determined--$16 million--admittedly seemed quite low." (see Minority Report, page 16).

To bring these mineral valuation procedures to a conclusion, therefore, the plaintiffs and interveners entered into a contract with independent consultants as provided in the originally approved procedures. The Minority Report asserts wrongfully that the consultants used "a procedure not previously recommended by the Commissioner or formally discussed or approved by the Commission." This statement is an outrageous distortion of the truth. From the very beginning the Commission has distinguished between procedures and the methodology selected to implement the procedures and also has always held the most appropriate methodology would be used in implementing the procedures. This was formally reiterated by the Commission and agreed upon by all members at the July 12, 1989 meeting. "Fair market value for

purposes of Chapter 48 means utilization of the best information and methodology available." (see Commission Report, page 5, emphasis added).

Designee Swope and the DNR staff, however, have overlooked this Commission direction. Instead, at the September 5, 1989 meeting the lead DNR staff member emotionally exclaimed

> *"we have been faithful to the market approach because that is what the Legislature required."*

(Commission Report, page 5). We have searched the statute in vain for any such requirement! Stonewalled by DNR staff the Commission was left with two mineral values ranging from the unacceptable "comparable sales" value of $16 million and the $1.5 billion value arrived at by employing an appropriate "income" methodology.

DNR staff have consistently insisted on or returned inappropriately to reliance upon only one methodology -- comparable sales -- and have gone to the extreme of insisting this and nothing else results in fair market value. This entrenchment is clearly because their valuation experience has been primarily in "condemnation litigation" (the Minority Report at least twice, pages 10 and 27, admits these are the DNR standards). This is the methodology DNR has always used and they are most comfortable with. But, the present transaction is not a condemnation valuation and comparable sales are totally inappropriate to determining fair market value of a mineral endowment.

This view of limitations of DNR experience and capability was shared by DNR's own expert consultant, Professor Harris, who also provided possible explanation for DNR's very narrow interpretation. Dr. Harris diplomatically worded an evaluation of the technical expertise of the DNR staff (see Harris, September 1989, pages 8-9). Of the types of expertise required for the mineral estate valuation estimates attempted, he found the DNR staff qualified "as to certain types of deposits...especially well qualified as to regional knowledge...[but] not highly experienced in estimation methodology." He also noted the possibility of bias or at least the "appearance of conflict of interest," due to the State being defendant in litigation.

In his conclusion as to the requirements for a process following "best practices," Harris reiterated his evaluation of the in-house expertise by stating the DGGS work on mineral endowment would have to be redone. He recommended this work and the estimation of value not be done in-house. Instead, the mineral endowment should be done by contract with the U.S. Geological Survey (he confirmed USGS could and were willing to do the work) and the valuation work should be done

by independent economic consultants such as the Center for Mineral Resource Science in Arizona (Ibid. page 10). Ironically, these recommendations by DNR's mineral valuation expert consultant coincide with the recommendations of the Commission Chairman made in a memo over two years previously, June 19, 1987.

In Search of a Resolution:

The task of valuation was far more complex, controversial and time consuming than anyone had contemplated beforehand. The public Commission members entered the effort, more than three years ago, with the belief that fair resolution of the Trust valuation was in the best interests of Alaska. To not resolve the issue and continue the legal battle could be disastrous to the well-being of all Alaskans, not just the primary beneficiaries of the trust. The Commission believed at the outset that it had the latitude to craft a resolution that could be recommended to the Legislature. This goal was pursued until mid-1989 when it became apparent DNR and the public members of the Commission could not achieve accord on the methodology to be used in implementing the approved procedures.

Only at this point did the Commission contemplate amending the originally approved procedures. At its May 16, 1989 meeting the Commission discussed (but did not adopt) a draft report submitted by the three lawyers in the case which noted "Continuing with the Commission's currently approved valuation procedures no longer appears possible" and also recommending amended procedures. These would attempt to narrow the range of values calculated by use of the two sets of methodology and the Commissioner of DNR would determine a value within the narrowed ranges.

No progress was made toward narrowing the range and a team composed of the three lawyers in the Weiss case and a DNR staff member explored the possibility of using negotiation to arrive at an acceptable value for purposes of settlement. The defendants made a token increase (mineral value from $16 to $73 million) and the plaintiffs decreased their value by $200 million. At the October 1989 Commission meeting the team announced an impasse leaving a difference of more than $1.5 billion.

At this point Designee Swope agreed that a resolution setting forth procedures should be placed before the Commission for a vote. This was done on November 7th, 1989. The public members and their alternates stand firm on their final approved recommendations. We followed the law. We recognize a divergence of opinion exists. We see it as unfortunate complete consensus was not achieved. However, complete consensus may never be reached. We feel it is essential to

complete the task of reconstituting the Trust and removing the threat of continued litigation and resulting disruption.

We urge the Commissioner of the Department of Natural Resources to use the Commission procedures in establishing a fair market value for the Mental Health Trust.

Senate Resources Committee Briefing: by Alaska Mental Health Board Lands Committee, February 14, 1990

- PURPOSE FOR AMHB APPEARING BEFORE RESOURCE COMMITTEES
- STATUS OF THE VALUATION PROCESS & STATUS OF THE LAND
- History of the Selections: Multiple Estates for Income Production
- A Review and Critique of the Process of Valuation
- "The Linking of the Appraisal Process"
- The TRUST
- Chapter 48 SLA 1987, The Legislature's Settlement Proposal
- The Opportunity for Legislative Action

PURPOSE FOR AMHB APPEARING BEFORE RESOURCE COMMITTEES

- REVIEW REPORTS FROM THE DEPARTMENT OF NATURAL RESOURCES REGARDING THE VALUATION OF THE MENTAL HEALTH LAND TRUST AND THE STATUS OF MENTAL HEALTH TRUST LAND
- MEET WITH APPROPRIATE LEGISLATIVE COMMITTEES CONCERNING THE BOARD'S ACTIVITIES

STATUS OF THE VALUATION PROCESS & STATUS OF THE LAND

- IMHTC Final Approved Procedures, November 7th, 1989
- IMHTC Majority Report, (Final Draft), December 20th, 1989
- Minority Report by Designee Swope, Febraury 1, 1990
- Senate Special Committee on Mental Health Report, January 1990
- Impasse
- Final IMHTC Resolution, January 24, 1990

History of the Selections: Multiple Estates for Income Production

- Surface Estate: Municipal Expansion
- Forrest
- Mineral

A Review and Critique of the Process of Valuation

- Envisioned mutuality of purpose: fair market value
- The reality of IMHTC dealing with a matter in litigation

THE LINKING OF THE APPRAISAL PROCESS

- VALUE THEORY
- VALUATION THEORY
- APPRAISAL THEORY
- VALUE PREMISE

VALUE THEORY

- A. Answers why a particular property, or an interest therein, has worth
- B. Defines the sources and bases of an asset's worth
- C. Currently recognized elements of an asset's worth include:
- ---Utility (both as the ability to satisfy needs and for practical use)
- ---Scarcity (of supply)
- ---Demand
- ---Ratio of exchange
- ---Ability to transfer ownership

VALUATION THEORY

- A. Valuation theory is the method of estimating, measuring and predicting a defined worth.
- B. Valuation theory enables us to focus on the various methods that are used to arrive at a value estimate.
- C. Valuation theory further allows and recognizes that there is a distinction between value and price that may be commanded in a market at a given point in time. This suggests the following:

C. Valuation theory further allows and recognizes that there is a distinction between value and price that may be commanded in a market at a given point in time. This suggests the following:

1. Value is a collection of elements that comprise worth, each of which must be defined.
2. Price is an historical fact that may or may not coincide with an assets recognized worth at the same point in time.
    a. Some examples of Price not being representative of Value are seen during periods of economic depression and recession and in liquidation sales.

APPRAISAL THEORY

- A. Appraisal theory is the logic format by which Value Theory is linked to Valuation Theory as it relates to a specific defined interest, i.e. any one of several estates subject to ownership in any given parcel of real property at a specific point in time.
- 1. Appraisal theory is the logical relationship between the Source of Value and its estimation.
- B. It is perhaps the failure to recognize the theoretical underpinnings of this analysis that results in the inability to link different value concepts, such as sales comparison, income capitalization or cost approach, to an assets worth.
- 1. There is still a lingering perception that within the many land estates that are the subject of valuation, that these approaches somehow constitute equivalent value measures. They do not.

VALUE PREMISE

- A. DEFINITION OF VALUE PREMISE
- B. EXAMPLES OF VALUE CHARACTERISTICS
- C. POSITIONING THE VALUE PREMISE
- D. THE NATURE OF THE DEBATE

A. DEFINITION OF VALUE PREMISE

- The emphasis of the appraisal logic placed on the **characteristics of value** as they relate to an identified estate, i.e. timber, mineral, surface etc..

B. EXAMPLES OF VALUE CHARACTERISTICS

1. Surface estate: Dependent on size, location and market activity may be valued by all three methods. Comparable sales would only be appropriate where such a market within a comparable context exists for the subject being valued.

a. Surface estates are unique in that demand must be created in place. Commodity estates (minerals, oil & gas, etc.) in theory can respond to demand anywhere within the global market place.

2. Large mineral estate: Typically by income approach

a. Large mineral estates have a very limited market of qualified developers.

b. Large mineral estates are usually developed via Joint Venture and leasing arrangements, not outright purchase.

c. Large mineral estates are usually promoted into development by their owners.

C. POSITIONING THE VALUE PREMISE

Identifying the varying value premises and the different emphasis that can be placed on each value characteristic, leads to a valuation process that supports the appropriate positioning of the value premise.

1. Here is where Highest and Best Use analysis focuses.

   a. The considerations in such analysis generally are:
      - Is the use legally permissible?
      - Is the use currently feasible?
      - Is the use functionally compatible?
      - Is the use most profitable?

   b. Current management practices are not a consideration in this evaluation. It is assumed that a property shall be managed to its highest and best use.

2. Highest and Best Use is not a fact to be found. It is a judgment decision on the part of the valuator.

D. THE NATURE OF THE DEBATE

- The foregoing considerations applied to the IMHTC/DNR rendering of value for Mental Health Trust Lands shows that the debate is not one of Value or Valuation Theory, but where the parties asserted a different value premise for several estates under consideration that led to different appraisal methodologies being applied. The failure of DNR to accept the value characteristics of the mineral estate, as approved by the majority of the IMHTC, led to the most serious value diminution of the trust corpus.

The TRUST

- The Supreme Court stated there is a Trust.
- To have a Trust there must be a Corpus.
- There appears to be no Statutory Authority to manage the Trust properly.
- Reserving: No provision for reserving for the depletion of non-renewable resorces.

Chapter 48 SLA 1987, The Legislature's Settlement Proposal

- Purpose: To reconstitute a mental health trust through identification of land in legislatively designated areas that is equal in value to the land selected by and patented to the state under section 202 of the Alaska Mental Health Enabling Act.

The Opportunity for Legislative Action

- Return to the Courts
- SB493/ HB548

[redacted]

[redacted] OF
ALASKA [redacted] TRUST LANDS

BY

PAUL [redacted] METZ and COLIN DIXON

December 31, 1988

[redacted]

Part IV -- Summary and Conclusions

The expected fair market value of the Alaska Mental Health Lands with respect to metallic minerals, coal, and sand and gravel is $1,506 million, $3.2 million, and $13 million, respectively. Thus, the corpus of the Trust is rounded out at $1,522 million.

The value for metallic minerals is considered a conservative estimate. The value attributable from coal and sand and gravel is highly dependent on development of markets for these commodities. The development of markets is in part a function of public policy which in turn increases the level of uncertainty in the value estimates.

As defined in state law, the fair market value of the Mental Health Trust corpus is 8 percent of the fair market rental value of the land. From the above, the fair market annual rental value of the corpus of the Trust is calculated at $121.8 million.

Older Alaskans Commission

Box C
Juneau, Alaska 99811-0209
907/465-3250

POSITION PAPER ON CS FOR SENATE BILL 493 (HESS)

The Older Alaskans Commission supports CS for Senate Bill 493 (HESS), which would finish the process started in 1987, of reconstituting the mental health lands trust.

The OAC was appointed by Governor Cowper to represent the interests of one of the mental health "beneficiary" groups as declared by Judge Greene's April 1988 decision in the second part of the Weiss v. State lawsuit, namely "senile seriously mentally ill" persons (known today as Alzheimers and related disorders).

Since mid-1988, the OAC has worked extensively with the Alaska Mental Health Board on issues related to the mental health trust. We have become acutely aware of the need to get the lands trust reconstituted and the valuation of the lands settled, so that the present "interim settlement" of the Weiss litigation can come to final resolution--and remove the overshadowing threat of more court battles.

The OAC would also urge legislators to remember that the 8% fair "rental value" which the State would pay each year into the Mental Health Trust Income Account is a compromise figure already adopted in Chapter 48 of the 1987 Session Laws. As we understand the situation, the 1987 Legislature wrote Chapter 48 to avoid continued litigation over all the various trust lands which had been disposed of by the state for less than full market value, or otherwise in contradiction of the state's trust duties.

The Older Alaskans Commission does not have expertise on these land valuation matters. However, the OAC feels that the 1987 Legislature set up the Interim Mental Health Lands Commission, in Chapter 48, and that the current Legislature should give great weight and deference to the majority report of that Commission, a report which would support the system and valuation contained in CSSB 493 (HESS).

The Older Alaskans Commission urges your early and favorable action on this bill.

APPROVED:

Peggy A. Burgin

Peggy A. Burgin, Chair
Older Alaskans Commission

DATED: March 27, 1990

REVIEWED AND "no comment":

Frank S. Baxter, Commissioner
Department of Administration

DATED: 3/25/90

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES
OFFICE OF THE COMMISSIONER

STEVE COWPER, GOVERNOR

400 WILLOUGHBY AVE.
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400

April 17, 1990

Ms. Thelma Langdon
Chair
Alaska Mental Health Board
2363 Captain Cook Drive
Anchorage, AK 99517

Dear Ms. Langdon:

In accord with AS 38.05.800(a), the commissioner of natural resources is charged with determining the fair market value of the original one million acre mental health land grant under procedures approved by the Interim Mental Health Trust Commission (commission). In addition, the commissioner, with the approval of the commission, is to identify land within legislative designations that is equal in value to the original mental health trust lands.

On February 1, 1990, my designee to the commission submitted a minority report regarding procedures to determine the fair market value of the mental health trust and replacement lands. The report detailed the reasons for his dissent from the majority report, and outlined procedures used by the Department of Natural Resources (department) to produce a fair market value of $564,700,782.82 for the total original mental health trust lands.

On March 20, 1990, I received the final majority report of the commission. The report critiqued the minority report and confirmed a December 20, 1989 draft as the commission's final report. The December 20, 1989 report of the commission specifically approved procedures for determining the fair market value of the original mental health trust lands. The procedures produced a value of $2,243,000,000 for all land selected by or patented to the state under the Alaska Mental Health Enabling Act.

After reviewing the two reports and their respective valuation procedures, I have concluded that I cannot use either set of procedures and still act consistently with the law. Therefore, I have no choice but to declare an impasse as I am prevented from

fulfilling my statutory mandate of determining the fair market value of the mental health land grant, as well as to identify equal value replacement land.

In retrospect, I believe Chapter 48, SLA 1987 set an unrealistic goal when it contemplated that all parties could work together on a consensus basis to implement the law. Initially, it appeared as though the consensus approach would be successful. Later in the process, particularly after initial land values began to emerge, the consensus process began to deteriorate as the parties began to disagree over valuation approaches. Since the legislation provided no specific mechanism to resolve such disagreements other than through the commission, the process soon became unworkable as the parties gravitated to their respective positions.

The Commission's Report

Chapter 48, SLA 1987 specifically required a determination of "fair market value." However, my reading of the commission's December 20, 1989 report causes me to conclude that fair market value is not what is produced by the procedures the commission majority approved.

For example, the review appraisers (who examined the work of the three opinion of value geo-panels valuing the surface estate) were instructed in writing by the lawyers for the plaintiffs and intervenors to determine "the highest value that can be supported in the market." Under the procedures approved by the commission majority, the resultant value was later averaged with the final adjusted fair market value determined by the geo-panels. These same review appraisers were also instructed by the same lawyers to look only at those individual mental health parcels which might have been "undervalued" by the geo-panels. As there was no corresponding search or review of any "overvalued" parcels, I believe this approach was disproportionately weighted to the high value end of the spectrum. I also conclude the commission acted arbitrarily when it decided to establish a final value of the surface estate by simply splitting the difference between the revised parcel values determined by the geo-panels and the unadjusted values determined by the review appraisers. In my opinion, the resultant compromise value bears no relationship to fair market value.

The most significant problem in the procedures approved by the commission majority in the December 20, 1989 report, however, lies with the hard rock mineral valuation. The commission

majority based its hard rock mineral value on the work and recommendations of two consultants hired independently by the lawyers for the plaintiffs and intervenors. The consultants used a discounted cash flow approach, producing a hard rock mineral value of $1.51 billion for the original mental health land grant. The minority member used a comparable sales approach, the standard for determining fair market value, producing a value of $73.5 million.

While I do not necessarily disagree with the income value approach, several assumptions used in that approach were incorrect. Dr. DeVerle Harris, a nationally recognized expert on valuation procedures and the discounted cash flow approach, noted several incorrect assumptions used by the consultants which resulted in a gross overestimation of the hardrock mineral value, as did the University of Alaska's Institute for Social and Ecoromic Research. One such assumption was that there was full mineral production from all one million acres of the original grant on the date of valuation. The reality is that there is little if any production even today. The unreasonableness of the $1.5 billion value is clear when it is recognized that more than $4 billion in annual mineral production would be required to support that figure. Annual statewide production in 1987 was only $200 million.

Finally, in my view, the majority report also fails to adhere to the statutory requirement that there be consensus on the valuation procedures used. Section 2 of chapter 132, SLA 1986, as amended by section 9 of chapter 48, requires the commission to review valuation procedures proposed by the commissioner. AS 38.05.800(a), also enacted as part of chapter 48, requires the commissioner to use valuation procedures approved by the commission. Section 2 of chapter 132, as amended, requires the commission to then review the value thus determined. Particularly when it is remembered that chapter 48 was viewed by all parties as a framework for settlement, the only reasonable construction of these provisions is that neither the plaintiffs and intervenors nor the department can adopt valuation procedures over the other's objection. Yet that is what the commission majority has done. The December 20, 1989 majority report reflects the use of numerous procedures which were not proposed by the commissioner and are unacceptable to the department.

The Minority Report

AS 38.05.800(a) requires the commissioner to determine "fair market value" based on procedures approved by the commission. Several of the procedures included in the minority report were not approved by the commission.

I do believe, however, that the department took very seriously its charge to determine the fair market value of the mental health lands. Under the statutes the department normally operates under, there are numerous references to "fair market value" (i.e. AS 38.05.055, 38.05.057, 38.05.067, 38.05.068, 38.05.075, 38.05.087, 38.05.102, 38.05.105, etc.). The department has operated most of its disposal and lease programs using this appraisal standard. The interpretation of fair market value has been consistently interpreted and applied by the department over the years. I also believe that the values provided in the minority report accurately reflect fair market value.

Among the first procedural decisions made by the commission in September, 1987 was its adoption of the definition of "fair market value" proposed by the department. This definition was the same as that used by the American Institute of Real Estate Appraisers/Society of Real Estate Appraisers, and the same one used over the years by the department. Based upon this action, the department consistently used this definition while the commission later departed from its use.

Summary

Although I have no recourse but to declare an impasse, I believe there are ways to break this procedural logjam so as to achieve the primary goal of all affected parties--namely **to ensure that there is a guaranteed source of state funds from which the legislature would first appropriate to cover the needs of the state's mental health programs:**

1. Request that the court issue instructions prior to any further legislative action. There are several legal questions which could be answered before policy options are pursued. The Department of Law has advised that the court will issue advisory opinions which involve a trust, and trustees can obtain such instructions as they relate to their trust administration powers and responsibilities. I believe these instructions could be timely obtained and pledge to assist in their

development. The interim provision in Chapter 48, SLA 1987 that pays the trust five percent of the state's unrestricted general fund per annum could remain in effect until an advisory opinion is rendered.

2. Replace "fair market value" with "value" as it appears in AS 38.05.800(a).

3. Remove the requirement in AS 38.05.800(a) that the commission approve the procedures to be used to value the original grant and the replacement lands.

4. Again, consistent with #1 above, another possibility (although one which would not provide a guaranteed source of funds for the state's mental health program in perpetuity) would be to purchase the lands from the trust at fair market value over time and appropriate the proceeds for the state's mental health program. Over time, this would result in all the mental health lands being purchased from the trust and removed from trust status, with the proceeds of the sales going to the state's mental health income trust account. The Alaska Supreme Court seemed to authorize this approach in the Weiss decision when it stated that the remedy for lands which the state has sold is to pay the trust the fair market value of the lands at the time of sale, but that the state should receive a set-off against that liability for money it has spent for the state's mental health program, and that this could result in the state having no monetary liability to the trust (In pointing out this alternative, I am not suggesting that this is an appropriate policy for funding the state's mental health program. As the state's land manager, however, I feel compelled to point it out as a possible option for removing mental health lands from trust status so they can be managed for their highest and best use and not merely to raise revenue).

5. Replace the five year reappraisal requirement in Chapter 48, SLA 1987 with a simple index formula which accounts for inflation and appreciation. This index could then be implemented automatically, with the mental health income trust account adjusted on an annual basis.

I appreciate the immense importance and timely resolution of this very complex and sensitive matter. Accordingly, the department is prepared to offer any assistance that may be required to resolve this dilemma consistent with the Alaska Mental Health Enabling Act.

Sincerely,

Lennie Gorsuch

Lennie Gorsuch
Commissioner

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

MEMORANDUM April 25, 1990

SUBJECT: Mental health trust
(CSSB 493 (HESS))

TO: Senator Jack Coghill

FROM: Richard A. Bradley
Legislative Counsel

Bruce Geraghty has requested a sectional analysis that points out the differences between SB 493 as introduced and CSSB 493 (HESS).

Section 1 of both bills repeals and reenacts AS 37.14.011(c).

In the introductory paragraph of (c), the words "fair market" are deleted in CSSB 493 from the phrase "fair market value of the land" on lines 11 - 12 of SB 493. Similarly, after the "value of the land" on line 12 in SB 493, the phrase "selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act" is added in the CS.

In (c)(1), after the phrase "acres of land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act" in SB 493 at line 20 is added the phrase "that is located in municipalities that assess land for property tax purposes" in the CS.

In (c)(2), after the phrase "the average percentage change in assessed values for that municipality" in SB 493 at line 24 is added the phrase "since that municipality's assessed values were used to revalue land selected or patented to the state under sec. 202 of the Alaska Mental Health Enabling Act;" in the CS.

There are no other revisions from SB 493 to the CS.

If I may be of further assistance, please advise.

RAB:gc
G14/032

INTERIM MENTAL HEALTH TRUST COMMISSION

FINAL REPORT

(December 20, 1989)*

on

Approved Procedures for Determining the Fair Market Value
of
Alaska's Mental Health Trust Lands

George Rogers, Ph.D.,
Chair

Lidia Selkregg, Ph.D.,
Commissioner

K.J. Metcalf,
Alternate

Dennis Scholl, Ph.D.,
Alternate

*Appendix D is a copy of Minority Recommendations submitted February 1, 1990, and Appendix E is the Response to the Minority Recommendations, dated March 20, 1990. Other than these additions and minor corrections, this Final Report is identical to the Draft Final Report of the same date.

I. INTRODUCTION AND BACKGROUND

In 1956, the Congress granted the Territory of Alaska the right to select one million acres of land to be managed as a public trust to produce income that would be, "applied first for the necessary expenses of the mental health program of Alaska." However, after selecting the most promising income producing potential lands available at the time, the State never actively managed these lands as a trust. There was no effort to protect the corpus from dissipation or to generate maximum income in the interest of the primary beneficiaries.

To the contrary and from the beginning, lands were conveyed from the trust at, frequently, less than fair market value and for purposes not allowed in the 1956 legislation. The Alaska Legislature even attempted to dissolve the trust in 1978. (Ch. 181, 182, SLA 1978) By October 4, 1985, of the original one million acres, only 194,672 acres of land remained in unencumbered grant land status. (Interim Mental Health Trust Commission, Report to the Legislature, February 1987, "APPENDIX C: THE MENTAL HEALTH LAND TRUST")

In 1982, beneficiaries of the trust sued the state for breach of its trust responsibilities. In October, 1985, the Alaska Supreme Court agreed the state had breached its trust responsibilities and ordered that, "the trust must be reconstituted to match as nearly as possible the holdings which comprised the trust when the 1978 law became effective." State v. Weiss

706 P.2d 681 (1985). This reconstitution was deemed impracticable at best by the State and it strenuously resisted the reversal of previous actions taken on mental health trust lands that would be required. Therefore, to help devise an acceptable method of alternative or constructive reconstitution of the trust, and to assure proper trust management in the interim, the legislature in 1986 created this Interim Mental Health Trust Lands Commission (Commission). See Ch. 132 SLA 1986. Under legislative auspices, discussions thereafter took place between all interested parties to seek acceptable alternative means of reconstituting the trust.

In its February, 1987 report to the Legislature, at page 20, the Commission concluded that, "[t]he number, complexity and importance of the questions raised by the Weiss Opinion's trust reconstitution instructions urges a negotiated settlement." The concurrent work of special legislative committees also all supported and adopted the concept of a negotiated resolution. This unanimity culminated in the passage of Chapter 48, SLA 1987 (Chapter 48). Chapter 48 directed a replacement trust corpus be created from lands currently in legislatively designated areas equal in value to the September, 1987, value of the original one million acres received by the State under the 1956 legislation, with the state then to pay "rent" at 8% per year on this value into the mental health trust income account.

Under Chapter 48, this Commission, composed of the Commissioner of the Department of Natural Resources (or her designee),

and two public member, Dr. George Rogers, and Dr. Lidia Selkregg[1] was directly charged with approving procedures on behalf of the Commissioner of the Department of Natural Resources for determining the 1987 fair market value of the original one million acres of mental health trust lands and, also, of identifying lands of equal value among eight million acres of potential replacement lands within legislatively designated areas.

Commencing with its June 9, 1987 meeting and continuing through its meeting of November 7, 1989, the Commission held over thirty public meetings or work sessions in order to evolve its finally approved procedures for determining the fair market value of the original mental health trust lands. Each meeting was public and its subject matter was noticed to all interested parties and an opportunity allowed for all to present and argue their views both orally and in writing[2].

1.The chairman of the Commission, Dr. George Rogers, is a professional resource and general economist, having his first contact with Alaska resources in 1937 while working in the economics department of Standard oil of California. He has been an Alaska resident since 1945, serving as an economist with the Department of Interior, Resources for the Future and the University of Alaska where he established its Institute of Social and Economic Research in 1960-61 and is Professor Emeritus. The other public member of the Commission, Dr. Lidia Selkregg, a professional geologist and planner has been involved in land and resources issues in Alaska since 1958. She is the author of the 6 volume "Alaska Regional Profiles" and a Professor Emeritus of the School of Public Affairs at the University of Alaska, Anchorage. Both of these members have served on many State and Federal land use and natural resources commissions and committees and bring decades of experience in many of the issues being addressed by the Commission.

2.References to documents herein that have not been published, are to documents presented to or prepared by the Commission and kept on file by DNR, acting as the Commission's staff.

At its November 7, 1989 meeting, the Commission (with one dissent) adopted final valuation procedures in conformity with the legislative intent (copy attached as Appendix A). In all instances, standard and specific industry methodologies were adopted, as necessarily modified for use within rather severe constraints of available time and money. The procedures were then forwarded on the same date to the Commissioner of Natural Resources to make the resulting determination of fair market value for the one million acres of mental health trust lands, as required by Chapter 48. This Report is intended to provide in one document the background and rationale supporting adoption of these procedures.

II. DISCUSSION

A. FAIR MARKET VALUE

Chapter 48 requires the determination of the "fair market value" of the original corpus and replacement lands. While there was consensus on the general approach and procedures to be followed, the precise definition and means of determining the fair market value has caused continuing disagreement.

In legal memoranda to the Commission, attorneys for the Plaintiffs and the State agreed that "fair market value is the highest price which a hypothetical willing buyer would pay a hypothetical willing seller in a free and open market." (Gottstein, May 4, 1989, Re: Definition of Fair Market Value;" Koest-

er, May 9, 1989, "Fair Market Value.", emphasis added) Additionally, they agreed "that there is no 'inexorable rule' by which fair market value is to be determined, and that the comparable sales method is not the only one which may be used." (Koester, op. cit., page 4) All parties also agreed on the following statement at the July 12, 1989 Commission meeting:

> Fair Market Value for purposes of Chapter 48 means utilization of the best information and methodology available within time and funding constraints to arrive at fair market value.

(Transcript, page 54)

While recognizing the income approach was an appropriate methodology for valuing resources, DNR applied only the market or "comparable sales" approach in valuing the mineral endowment. As late as the September 5, 1989, meeting, the lead staff member for DNR, Mr. Gustafson, stated: "The market approach [comparable sales] is what we always felt is required under terms of the legislation. There are a lot of other ways that you could put a value on this thing. We could have done that too, but we have been faithful to the market approach because that is what the Legislature required." (Transcript, page 55). The Commission does not agree that the Legislature required use of only the "comparable sales" ("market") approach for valuation.

Under Congress' intent in the 1956 legislation and subsequent selection of the lands by Alaska, mental health trust lands were to be managed as a public trust for income production rather

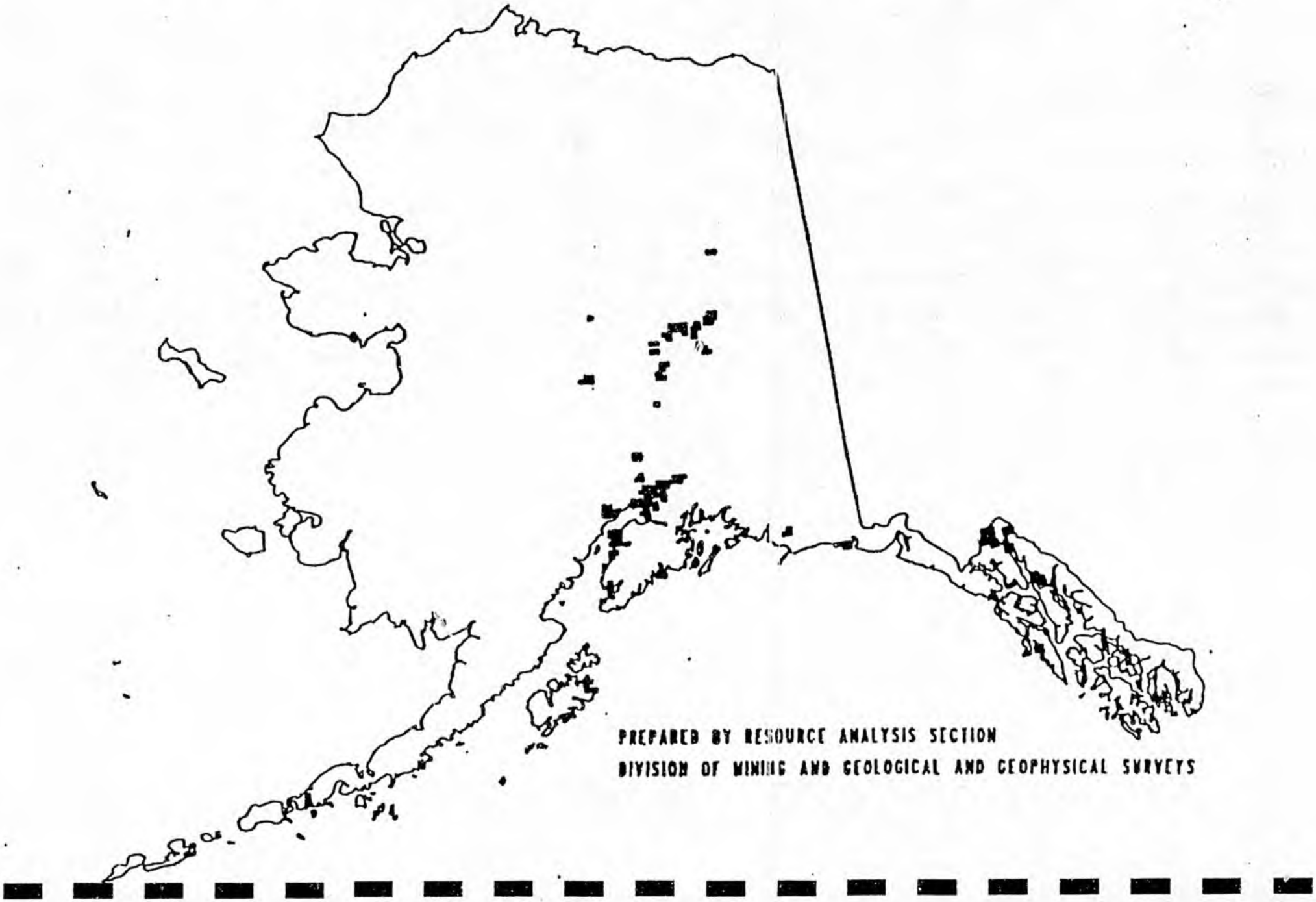
than as a repository of land for resale. Pursuant to that intent, the land selections made by the Territory and State of Alaska between 1956 and 1965 were based upon income analysis. Selections were anticipated to be suitable for development and targeted lands surrounding the principal urban centers and known commercially valuable natural resource lands along or adjacent to the main rail, water, highway and road transportation systems. (Refer to Figure 1).

Approximately half the mental health trust lands were urban and sub-urban lands, selected because their values would appreciate at a high rate in response to community growth. Timber lands were selected with the view that they would become the core of the State's forest system (which they are) and hydrocarbon and mineral lands were selected from the major active mining areas of the State.

These selection methodologies are inherently inconsistent with an intent to base mineral value on comparable sales, as value or income would have been derived from these lands without any sales, but through mineral leases, joint ventures, and similar transactions between the trust and developers. Accordingly, rather than being restricted to the comparable sales approach, the Commission adopted procedures that are most appropriate to the valuation being performed. As noted, these are in all instances those used in practice by industry, with appropriate adjustments dictated by lack of funds and time.

FIGURE 1.

TRUST LANDS: MENTAL HEALTH GRANT (1956)



B. ESTABLISHING PROCEDURES

In his June 1987 Review, Commission Chairman Dr. George Rogers recommended that:

> Rather than use one appraisal approach (market data) as was done in 1985 and 1986, the accepted approaches most appropriate to each classification should be used. For example the market approach would appear suited to urban residential and commercial lands while the income discounting approach would be best for. . . lands which were selected not for resale but income production management. . . [these] should be valued by contract with a firm experienced in natural resource analysis and valuation rather than another panel of real estate appraisers.

This was not acceptable to DNR but, since consensus was desired, a compromise was reached. The surface estate of the entire corpus would be valued by means of three geographic opinion-of-value panels of three appraisers each, with provision for review, questioning and mediation of any remaining differences. The "review process" of Plaintiffs submitting questions regarding valuations through their review appraisers and the subsequent consideration and resolution of these questions, was deemed

essential to the legitimacy of the process and to overcoming the demonstrated shortcomings of the opinion-of-value process[3].

The natural resource endowment and value estimates would be accomplished by the natural resources division of DNR, with input

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3.In 1985 the State attempted to put a value on the trust corpus in response to the initial lower court decision in the Weiss litigation. This effort is an illuminating case study of the role of procedure design and implementing methodology in determining the outcome of a process. A rough opinion of value process was used for the surface, a token value for only part of the sub-surface endowment, and addition of 10.5% interest annually from July 1978 to July 1985. (Alaska Department of Natural Resources, May 1985, "Value Summary Mental Health Land Retained in State Ownership.") To this was added the estimated value of conveyances from the trust prior to July, 1978, giving a total estimate of approximately $600 million as of July 1985.

There was a great deal of criticism of this 1985 opinion of value panel process, and the majority of the Commission as well as others believed the figure arrived at was too low. During their study of settlement options, for example, the 1986 special legislative joint committee and the Commission used a proxy value for the trust of $2 Billion. According to the Commission's chairman, the low 1985 estimate was due to an inadequate and incomplete value definition and use of inappropriate methodology. (Rogers, June 19, 1987, "Analysis of Valuations and Appraisals of Mental Health Trust Lands.") Coal, oil and gas subsurface values were limited to token estimates based only on proven reserves, and no value was assigned to other resources with development potential. The surface value panel's instructions were that "only the Market Data Approach [comparable sales] will be used" as the "subject property is being valued as vacant [and unimproved] and no income stream is projected." This further biased the results toward a low value. Value of improvements on MHTL and much of the income producing values were lost without the cost and income approaches.

DNR staff did not agree with the conclusion that the 1985 opinion of value panel results were invalid and defended its exclusive use of the comparable sales approach on grounds of practicality -- it was used customarily by the State, would cost less than other approaches, and the results would not significantly differ (Gustafson letter to Rogers, July 24,1 987). Other methodologies were also deemed by the State to be speculation.

from the beneficiaries. Where it was not possible to arrive at a value in-house, this task would be contracted to a consultant.

The actual task of implementation was much bigger, complicated and controversial than anyone envisioned initially and for a brief period between its April and July, 1989 meetings, the Commission explored alternative paths to valuation.[4] However, recognizing that none of these approaches might prove feasible, the Commission remained oriented towards completion of its mandate in Chapter 48 to approve procedures to determine the fair market value of the original mental health trust lands. In this

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4.At its May 16, 1989 meeting the Commission discussed (but did not adopt) a draft report to the Legislature which concluded: "Continuing with the Commission's currently approved valuation procedures no longer appears possible." It was proposed, alternatively, that (1) a range of values be determined for each category, (2) mediation between Commission members would attempt to narrow this range "to the maximum extent possible," (3) these values would be integrated into two sets of values, and (4) the Commissioner of Natural Resources would determine a value within these ranges (Draft of "Interim Mental Health Trust Commission Report Sixteenth Alaska Legislature", dated April 1989, submitted by G. Thomas Koester in response to a "Discussion Draft", dated April 13, 1989 with the same title submitted by J. Gottstein).

By the July 1989 meeting no significant progress had been made in narrowing the range and the Commissioner of Natural Resources indicated she would not necessarily determine the value between the range established by the procedures. Further options were then examined. The first was to go beyond Chapter 48 and negotiate a value for settlement purposes only. The Commission appointed a team (the three attorneys active in its work and the chief DNR staff member) to explore the feasibility of negotiation. The final report of the negotiating team of October 27, 1989 stated that "the parties are at impasse" and the remaining difference of more than $1.5 billion can not be resolved through negotiation at this time."

connection, the attorney for the State advised the Commission[5] that these procedures,

> could be as general as . . . [saying] the Commissioner will come up with a value based on all the information of record and justify it. . . or they could be as detailed and specific as to say, with respect to mineral valuation, the Commissioner shall determine the value of the subsurface estate by employing a ten percent discount factor, assuming production begins in year five, you know, all those assumptions that go into that kind of an economic analysis. Those can be specified. It seems to me those are part of the procedures that the Commission can approve.

(July, 12, 1989, Commission Meeting Transcript, P. 59). And as observed earlier, all parties agreed such procedures could reflect compromises and abbreviations necessitated by funding and time constraints.

C. IMPLEMENTING THE PROCEDURES

The procedures approved match as closely as possible accepted valuation methodology for the various estates and result in an appropriate determination of fair market value for the purposes

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5.The Attorney General's office, at its insistence, represents, through the same Assistant Attorney General, both the State as the Defendant in the Weiss litigation and the Commission in performing its duties under Chapter 48.

of Chapter 48. This is so despite the lack of a completed surface estate valuation and despite the lack of formal "appraisals" occasioned by the previously noted funding and time constraints.

The surface estate valuation was terminated before the first review step was completed because funds and time were exhausted. This was due, in large part, to the approximately 4,000 parcels questioned by the review appraisers[6]. The total fair market value of the original mental health trust lands recommended by the review appraisers was $833.3 million. The total fair market value of the original mental health trust lands found by the panels, after adjustment to reflect as much of the review process that did occur was $499.8 million. Recognizing that differences of this percentage magnitude between appraisers' opinions of value were not uncommon[7], the Commission determined that the only reasonable procedure to approve was simply to "split the difference" between these two figures, as is more fully discussed in Appendix B.

With respect to the mineral endowment, the Alaska Division of Geological and Geophysical Services, (DGGS) provided an esti-

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6.All of the parcels questioned by the Plaintiffs' review appraisers that were looked at by the Commission appeared to have a reasonable basis for the question.

7.Even where formal "appraisals" have been commissioned, the appraiser's "appraisal" is that appraiser's opinion of the value of the subject property. The percentage difference between the panels opinions' of value and the review appraisers' would not be unusual if full appraisals had been used in both instances. Appraisals are simply an "estimate" or "approximation" of "the highest price a willing buyer would pay a willing seller, . . .",

mate of the physical endowment for the mineral estate of mental health trust lands. However, instead of pursuing the industry standard discounted cash flow ("income") approach as agreed, DNR reverted to use of the comparable sales approach. DNR's use of the comparable sales approach first produced a zero value, as in 1985, and was later revised to approximately $16 million on the basis of three alleged comparable sales.

The use of the comparable sales approach for valuing the mineral estate was summarily rejected by the majority of the Commission as not being in accordance with accepted industry valuation practices and, moreover, as being manifestly unreasonable and unrealistic. These lands were all within the three major active mining districts of Alaska and had been selected by a team of experts as representing the most promising lands in these areas.[8] (See Appendix C).

In the absence of a viable valuation of the mineral estate, a team of consultants was commissioned by the Plaintiffs to estimate the mineral endowment value using accepted industry methodology, i.e., the income approach, as originally proposed in June of 1987. Their report (Paul Metz and Colin Dixon, December 31, 1988, "Mineral, Coal and Aggregate Resource Appraisal of

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8.The reason offered by DNR for failing to utilize the income approach was DGGS's estimated cost of providing a value estimate at $53 million, which involved a surveying and drilling program. In this connection, it may be worth noting that D. Harris, the State's consultant later estimated the cost of estimating a value at $350,000 using essentially the same data that the Commission ultimately approved (Harris, Sept. 1989).

Alaska Mental Health Trust Lands") discussed their methodology, data and assumptions and the decisions they made, based upon their professional judgments, regarding the best way to value the mineral estate under the circumstances. At the presentation of their Report to the Commission at its February 24, 1989, meeting, Metz and Dixon also reviewed for the Commission the areas of uncertainty and the "safety factors" they used to insure the value was not overstated. Their analysis resulted in an estimated $1.5 Billion value for the mineral estate of mental health trust lands. Following intensive critical review by DNR staff and others, an independent study commissioned by DNR concluded that although not always following "best practices," the methods and assumptions were acceptable " . . . if only approximations were required and that their methods were consistent with the data available through DGGS's mineral endowment assessment" (Harris, May 30, 1989).

In the follow-up study by Harris issued in September, 1989, "Activities and Costs for the Estimation of Market Value of Mineral Resources of Alaska Mental Health Trust Lands," and the earlier study by Bradford Tuck and Matthew Berman commissioned by DNR entitled, "Review and Analysis of 'Mineral, Coal, and Aggregate Resource Appraisal of Alaska Mental Health Trust Lands' by Paul A. Metz and Colin Dixon" (March 1989), there was also agreement as to utilization of the income approach as being the appropriate methodology. DNR nevertheless remains insistent, but without any expert having indicated it was a valid methodology, that they would only accept their comparable sales approach.

Since the State's approach had no expert support, resulted in an unrealistically low value, was not pursued with any sort of rigor by the State, and was not even supported by its own independent study, it was rejected by the Commission. On the other hand, there was general agreement by all experts that the income approach used by Metz/Dixon to arrive at their valuation was the appropriate one and that, while perhaps "best practices" were not used for every element because of time and funding constraints, the methodology, data, assumptions and judgment utilized were the result of informed decisions by knowledgeable experts. Therefore, the Commission approved the procedures used in the Metz/Dixon valuation (see Appendix C for a complete description).

For the remaining land categories, the dollar differences were not so great and the Commission's basis for resolving the differences has therefore not been as controversial. The Commission approved the report of the Division of Forestry in its valuation of timber resources (August 1988). Plaintiffs argued that reforestation costs (approximately $31 million) should not have been deducted from the value because the timber should be valued as if "sold" to the State as "standing timber." The Commission rejected their approach and agreed with DNR's position that these costs were essential to sustained yield forest management and that the original mental health trust lands selections were made with the intention that they would become the core of a State forest system (which they are).

The Division of Oil and Gas proposed a plan for valuing hydrocarbon (oil, gas and coal) potential which was accepted by the Commission (October 13, 1987). A preliminary report (July 1988) and a revised report (November 2, 1988) were criticized because they did not accomplish what the accepted plan proposed to do, and because they considered only known reserves (Vreeman, March, 1989). The range of values presented ($135,953 to $856,040) appears grossly low in light of the State having received over $25 million for exploration and development rights on mental health trust lands. Although clearly needed, no attempt by the Plaintiffs was made to produce an alternative estimate. In light of the lack of any alternative estimate and the necessity of arriving at procedures for determining the fair market value of the oil & gas resources, the Commission approved as its procedures those presented by DNR, using the midpoint between the high and low range.

DNR staff bogged down in an effort to put a value on aggregate (sand, gravel and crushed rock) by first attempting to estimate the quantity and quality of the resource. The Commission ordered this halted because the task was approached from the wrong side (the supply side). Aggregate in Alaska is ubiquitous and its economic value determined by demand. DNR staff were directed to estimate demand and value this, possibly using Department of Revenue's methodology for estimating State revenues from this resource. This was not done by DNR and the Plaintiff's consultants included the task in their assignment.

There was full agreement that integration of surface and resource values would be achieved by adding the values to produce the total fair market value of the trust and replacement lands. The forest lands have been valued on the basis of sustained yield management. Metz and Dixon, while not quantifying the "multiplier" or "knock on" effects of mineral development, informed the Commission that any loss of surface value for particular acreage actually being mined, would be more than offset by increasing values of lands in the vicinity due to the increase in demand as a result of the economic activity generated by the mine. Additionally, it was noted the Surface Mining Act of 1977 requires restoration of land after completion of mineral extraction. Mineral and timber values and surface values were therefore treated as additive rather than one exclusive of the other.

III. SUMMARY AND CONCLUSION

In presenting the final approved procedures to the Commissioner of Natural Resources, the majority of the Commission agree that they follow the law, will be fair to all parties, and accomplish the objectives of providing a reconstituted trust and removing the threat of continued litigation and resulting disruption.

APPENDIX A

INTERIM MENTAL HEALTH TRUST COMMISSION

RESOLUTION

(Final Approval of Procedures for
Determining Fair Market Value)

BE IT RESOLVED, the Interim Mental Health Trust Commission hereby approves the following final procedures for determining the fair market value of mental health trust lands under AS 38.05.800(a):

1. Surface. The Commission previously approved procedures for determining the fair market value of the surface estate. Because of insufficient funding to conduct appraisals, these procedures provided for an opinion of value process by three geo-panels of appraisers; an opportunity for review and questioning by interested parties; referral back to the panels for reevaluation of their original values when necessary; and mediation, including the possibility of site visits.

Due to the large number of questioned values and limited funding, a sampling strategy was used for the review. The State's method of applying the southeast region's sampling results to all three regions results in a figure of $499.8 million. The Plaintiffs' appraisers assigned a value of $833,280,096.

The Commission is fully aware that appraisers often have such large differences in their opinions. Such differences are resolved through mediation but because of lack of funds and time, mediation of the fair market value as the original procedures contemplated was not possible. Therefore, the Commission approves as the final procedure for determining the fair market value of the surface estate that the difference between these two figures be split equally between the two values.

2. Timber. The Commission has approved as the procedures for arriving at the fair market value of the timber resource, the methodology, data, assumptions and judgments which were utilized in "An Economic Evaluation of Timber Potential on Mental Health Grant Lands and Legislatively Designated Replacement Lands - Final Report", by McMahon, Wallingford, and Wehrman, August, 1988. The Plaintiffs dispute the appropriateness of deducting reforestation costs, but the Commission has rejected their view.

3. Oil and Gas. The State has estimated the value of oil and gas resources on mental health trust lands after consultation with the Commission regarding appropriate procedures to be in a range from $135,953 to $856,040. The Plaintiffs have not submitted their own valuation, but assert the State's analysis did not follow the procedures approved by the Commission, and the value range appears to be grossly low in light of the State having received over $25 million for exploration and development rights on mental health trust lands. In light of the lack of any specific valuation from the Plaintiffs

and the necessity of arriving at procedures for determining the fair market value of the oil and gas resources of mental health trust lands, the Commission hereby approves as its procedures, the methodology, data, assumptions and judgments utilized in the "Hydrocarbon Potential of Mental Health Grant (Trust) Lands and Legislatively Designated Replacement Pool Lands in Alaska", by Ariey, Hansen, Kornbrath, Phillips, Ryherd and Smith, July, 1988, with the fair market value being the midpoint between the low to the high range.

4. Minerals, Coal, and Aggregate. After review of proposals by both sides, and much consideration, the Commission approves as the procedures for determining the fair market value of the mineral, coal and aggregate resources on mental health trust lands, the methodology, data, assumptions, and judgments utilized in "Mineral, Coal, and Aggregate Resource Appraisal of Alaska Mental Health Trust Lands," by Paul Metz and Colin Dixon, dated December 31, 1988.

5. Integration of Values. The Commission has approved adding the values as its procedure for integrating the surface and resource values to arrive at the total fair market value of mental health trust lands.

Approving	Disapproving	Abstaining
Commissioner Rogers	Commissioner Swope	
Commissioner Selkregg		

Date: November 7, 1989

George W. Rogers, Chairman
Interim Mental Health Trust Commission

APPENDIX B: SURFACE VALUATION

SUMMARY

When the Mental Health Lands Trust was originally selected at least half of the million acres were specifically selected for their proximity to communities. It was believed by those selecting the trust that these lands would be in demand for community expansion and the surface value would appreciate at a greater rate than more remote lands. It was also expected that active trust management of these community expansion lands would add substantially to the value of the trust.

The fair market value of the surface estate of the original one million acre Mental Health Lands Trust is thus a major component of the overall trust value. Different strategies have been tried to place a dollar value on this estate. In 1985, in response to the trial court's directive to value the land, the State used a modified opinion of value approach to establish a cash value for purposes of compensating the trust for the illegal redesignation of the Mental Health Trust Lands as general grant lands by the Legislature in 1978 (This effort is discussed in the Report above, at page 8, footnote 3).

In 1986 the State used a similar approach to value some 55,000 acres of Mental Health Trust Lands that had been approved for conveyance or conveyed to Municipalities. A value of some $100 million resulted from that effort. Traditional appraisals were done in 1987 on 15 of these parcels as a "validity check" on

the opinion of value effort. For Anchorage the appraisals ranged from 47% below to 30% above the panel's value for the same parcels. For Juneau the range of variation was from 467% above to 214% below, and in Fairbanks from 76% above to 798% below! The totals ended up within 4% of each other, however, and DNR asserted this demonstrated the opinion of value process created "offsetting errors". The plaintiffs' review appraiser reviewed these appraisals and found that where the appraisal valuation was substantially below the opinion of value valuation, the appraisal was in error. Due to the change in direction with the enactment of Chapter 48, these differences were never addressed by the Commission. In any event 800% differences in values for specific parcels are clearly cause for concern about the validity of the opinion of value panel process that does not allow for adequate review. The entire exercise reinforced the Commission's appreciation of the subjective nature of appraisals as well as the wide variation of opinions of value even of qualified appraisers.

The task of valuing the entire million acre mental health surface estate using standard appraisals was beyond the resources of funds and time available to the Commission. The previous efforts to value the surface estate of the trust had proven so unreliable that the Commission was faced with quite a challenge. To develop a surface value the Commission approved a set of procedures that relied on a panel of three expert appraisals for each of the SouthEast, SouthCentral and Northern regions in which Mental Health Trust Lands (and the replacement lands) were locat-

ed. Due to the funding and time constraints an "opinion of value" approach had to be utilized. However, in fashioning the opinion of value panel process to be utilized, certain safeguards not present in the earlier attempts were created, in an attempt to arrive at valid results.

The approach adopted by the Commission was designed to use the appraisers' regional knowledge of property values as in past opinion of value panels, with the very important check that interested parties (primarily the plaintiffs) could raise questions which would be resolved through a review and mediation process that would include site visits where necessary. The three member panels were required to value a total of approximately 8,000 parcels of which approximately 5,700 were Mental Health Trust Lands and 2,300 were replacement lands. Only 10 minutes could be spent on each parcel. The panels were not allowed any site visits -- their examination consisting of reviewing a written description of the parcel, referencing available maps, aerial photos, plus any comparable sales information provided by DNR or the appraisers brought with them. In assigning a value to a parcel agreement between two of the three panel members was required. When the parcel was completed a written form was used to document the decision, but the basis of the valuation was normally not provided because DNR insisted the panels did not have time to do so. However, the panels' deliberations were tape recorded to provide a complete record.

Once the panels had submitted their opinions of value and

they were reviewed by the State's review appraiser, the plaintiffs were provided an opportunity to review the values and raise questions by submitting a written form outlining the question and basis for a different value. These "Questioned Values" were to be submitted to the panels for a "collegial" discussion with the plaintiffs' review appraiser(s) and, hopefully, resolved at that point. Failing resolution at that point, mediation could be directed by the Commission where it deemed it warranted, including the possibility of site visit(s).

As they neared completion of their work, the SouthCentral panel sent a letter to the DNR review appraiser itemizing the limitations on their product. The first was that "our value estimates are not appraisals, and in fact they are not even 'preliminary opinions of value' as commonly understood in the appraisal profession, wherein the appraiser states that an appraisal would conclude within a stated range or near a given figure and material to support this conclusion is on file." Other comments noted the limited time, that the work was performed "within the confines of State offices", the problem with finding large parcel comparable sales, and the like (April 22, 1988).

The results of the opinion of value panels, before review, was a total of $407,668,683, for a per acre value of $407.67. A total of just over 4,000 parcel values were questioned by the plaintiffs' review appraisers. The result of accepting the

review appraisers' opinions with respect to the Questioned Values was to more than double the value of the surface estate by adding some $426 million to the value for a total of $833.28 million[1].

To address all of the Questioned Values in the manner initially approved by the Commission would have required far more time and funds than available. Therefore, in order to obtain information about the validity of the opinion of value panel valuations and the validity of the Questioned Values, the Commission directed that a sample of 387 of the 2,103 Questioned Values for SouthEast proceed through the process. Another goal of this sampling process was to determine if the results could be applied to the rest of SouthEast, and perhaps the other regions. Even without any mediation the SouthEast panel increased their total value by 42% for the parcels that were questioned on the basis of comparable sales (excluding large parcels). All categories of SouthEast values questioned increased an average of 22%.

Unfortunately, the process could not even be carried through to completion with respect to these 387 parcels because of lack of time and funds. However, what did occur was illuminating. A number of Questioned Values focused on consideration of site

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1.In addition to the "Questioned Values" submitted by the Plaintiffs through their review appraisers, well over one hundred "Technical Corrections" were submitted by the Plaintiffs to correct mathematical and other errors identified through their computerized "error checking routines". In many case, although the validity of the corrections was not challenged, DNR did not make the corrections saying that only the panels could do so. Since the panels were never called together for this purpose most of these errors were never corrected.

improvements and the proper way to value rights-of-ways (given no value by the panel). Additionally, there were a number of Questioned Values where comparable sales data presented by the review appraiser(s) seemed to support a higher value than accepted by the SouthEast panel. Perhaps the most difficult valuation problem was handling the "large parcels", that is those parcels that were larger than normally sold in the market place. Because of continuing disagreements, some 25 or so parcels were addressed by the panel members and review appraisers before the Commission in order for it to have first hand knowledge of the nature of the continuing differences. Without ever attempting to decide what the fair market value of any particular parcel was, the Commission did not find any Questioned Value that did not have a reasonable basis for the questions. While 207 parcels were recommended for mediation, a mediator was never engaged for any parcels because of lack of funds.

Because the SouthCentral region had the most large parcels, the SouthCentral panel was reconvened, with the Commission and panel members in attendance to consider the review appraiser's presentation of information developed regarding large parcels. Unfortunately, due to an oversight by DNR staff, the Review Appraiser was not invited. He was, however able to briefly attend a short morning session. During his brief appearance he presented numerous large parcel comparables, including three very important large parcel sales occurring in late 1988 -- early 1989. Until compiled by the plaintiffs' review appraiser(s),

the panel members were apparently unaware of the relatively few comparables for large parcels that did exist when the panel was doing its work. When reconvened, the SouthCentral panel agreed the market information provided by the review appraiser shed new light on large parcels and increased their opinion of five of the six parcels reexamined an average of 68%.

An issue never adequately addressed was the difficult one of "parcelization." In order to initiate the valuation process it was necessary to determine what parcels were to be presented to the panels for their consideration. The decision was made to simply use the parcels that in fact existed, which was a matter of historical happenstance, with the largest tract being a township. In many cases the parcel presented to the panel was a township of 22,000+ acres. While the panels were allowed to "reparcel" tracts, they did not do so, apparently due to lack of time and misunderstanding of its appropriateness. The panels thus concluded that if an entire township, or other large parcel was sold as a single parcel, the per acre value would be quite low. The plaintiffs' review appraisers, in such instances, in addition to the market information they had for some large parcels, suggested that since township size (and other large parcel) sales normally do not occur, the parcels should be valued on the size that the land involved would normally sell, taking into consideration platting requirements (or the lack of a platting requirement).

The Plaintiffs supported this approach by reference to an

Alaska condemnation case where the Special Master accepted the approach and rejected the condemnor's (the State) objections to it (Report of Master, Alaska v. 17.183 Acres and Sloboda, 3VA 86-145 Civ.). However, DNR strenuously objected. When appraisers were asked about the issue, they replied it was not up to them to decide -- that they could do it either way, but would need direction. The only other apparent method of resolving the issue was litigation. Since the Commission did not desire to be in the position of directing the panel members how to decide the issue, and litigation of the issue considered undesirable, "parcelization" was never decided. However, if resolved in plaintiffs favor, there is no doubt but that substantial additional increases in the surface value would have resulted.

In analyzing the results of the relatively small percentage of Questioned Values addressed by the panels, the State applied a 45% increase for all SouthEast parcels questioned by the review appraisers. For the other regions, the state applied a 21% increase to all Questioned Values where the acreage was under 1,000 acres and 67% where the acreage was greater than 1,000 acres. These adjustments resulted in a total increase of $91.6 million for a new total of $499.8 million. However, this increase does not reflect the additional increase that would have necessarily occurred if mediation had taken place (leaving aside the increase that would have occurred if parcelization had been allowed). The Plaintiffs contend that their estimate of $833.28 million is closer to the actual total fair market value for the

surface estate, and may even be low because their review appraisers also did not have an adequate opportunity to perform their work.

The Commission, lacking the necessary funds to resolve the Questioned Values, and recognizing that pursuing the process initially approved would have necessarily increased the values, approved as its final procedures for determining the fair market value of the surface estate that the difference between the $499.8 million figure and the $833.28 million figure should be split equally.

The Commission recognizes that in approving procedures that "split the difference" it may be perceived as having crossed over the line from approving "procedures" to approving "values" as directed by Chapter 48. However, it is the Commission's belief that "splitting the difference" was the only procedure that could logically be utilized under the circumstances. It must be remembered the original procedures promulgated called for a review and mediation process for every parcel's value that was questioned. This procedure could not be carried out due to funding deficiencies. It was clear that following the procedures as originally promulgated would have necessarily increased the surface value. Since, there was absolutely no basis to determine where the final value would have ended up between the $499.8 million and $833.3 million, the Commission believes "splitting the difference" was the only objective approach.

The alternative would have been to fail to achieve the

legislative mandate to value the land, and more importantly, defeated Chapter 48's entire purpose of resolving the litigation. However, in the event it is determined such a "splitting the difference" is not a procedure, the Commission strongly recommends that it be adopted as the basis for the final valuation of the surface estate.

APPENDIX C: MINERAL ENDOWMENT VALUATION

To accomplish the mineral endowment valuation for Mental Health Trust Lands, following the August 19-20, 1987, meeting of the Commission, the Commissioner of Natural Resources directed "DGGS to assess the quantity and quality of known and potential hard rock minerals... The assessment reports will then be followed by a resource valuation process....The value of the minerals will be determined by an independent entity, likely retained under contract to the department." (Emphasis added, Brady, Sept. 29, 1987. The deleted material refers to other natural resources.)

Mineral Endowment Estimation

In the process of discharging the task of mineral endowment estimation, DNR informed the Commission that serious budgetary data and time constraints "will result in the deletion of numerous tracts from the mineral valuation process" (Gustafson, "Outline of Mineral Valuation Process", November 23, 1987). The first deletions were in the inventory of mineral types to be evaluated. A number of available mineral deposit models were not projected and the DGGS inventory did not include industrial and heavy minerals. Although these deletions may have had low unit values, they did constitute a deletion from the valuation of the total mineral endowment.

In its second step, DGGS ranked the Mental Health Trust Lands (MHTL) from 5 to 1 by their favorability for mineral deposits and, secondly, from 5 to 1 by the amount and quality of information available. In April, 1988, DGGS presented maps of mineral potentials of the MHTL by these rankings. A further major short-cut introduced at this point was to consider only areas with favorability rankings of 4, 5 and "super-5's" (an added sub-category) for classification by deposit types and for valuation. In discussions with staff, furthermore, it was learned that the low rankings included areas that had simply not been evaluated yet, as well as areas that had been given evaluations that their potential was low.

It was noted by Plaintiffs that the combination of these deletions and short-cuts would significantly impact the mineral valuation process and result in a lower value. "While having no solution within the budgetary constraints that exist, we must repeat our oft-stated observation that lack of sufficient appropriations and an unrealistically short time frame does not reduce the state's legal obligation to fairly value mental health lands. Please be assured, this does not change our approach which is to try and work with the administration to develop the absolutely best valuation process possible within budgetary constraints." (Gottstein, December 14, 1987, "Re: Outline of Mineral Valuation Process").

Staff compiled the following statistics for use in valuations:

"Mental Health Grant Lands -- Mineral potential

93,213 acres have high mineral potential	("4's")
15,221 acres have very high mineral potential	("5's")
47,565 acres have super high mineral potential	("Super 5's")

155,999 acres total"

Similar statistics were compiled for the replacement lands. (McMahon, August 23, 1988).

Mineral Endowment Valuation by DNR

With this data DNR was prepared to attempt the actual valuation, but "assuming it proves impossible to complete an in-house mineral valuation (for whatever reason), we will be prepared to proceed with contract solicitation to complete the work "(Gustafson, November 23, 1987, "Outline of Mineral Valuation). The Division of Geological and Geophysical Services (DGGS) then, however, said that they could not use the information they had compiled to value the mineral endowment without an exploration program consisting of surveying and drilling all MHTLs that received mineral potential rankings of 4 or 5. DGGS proposed a program for doing so and estimating the value of the mineral endowment that cost $53 million. (Wiltse, March 1988, "Cost of

generating valid gross metal value estimates for mineral-potential Category 4 and 5 Mental Health Trust and Replacement Pool lands").

Instead of following the agreed upon procedure to contract out the mineral valuation to qualified experts in the event DNR could not do it in-house, DNR made a valuation using only the total acres (i.e ignoring the breakdown given by rankings) and the "comparable sales" approach. DNR valued the trust's highest ranked mineral lands as having no value because they could not find any comparable sales! Later they announced that diligent search had discovered three sales which when applied to the "4's", "5's" and "Super 5's" yielded a total value of $16,040,000 for the mineral endowment of MHTL. The MHTL mineral lands are undoubtedly the most promising in the State. Furthermore, the areas selected from this larger pool by DGGs for actual valuation were only in the high to super-high potential classifications.

The value of $16 million did not appear to be near, let alone "in the ball park". The disclosure of the actual basis for DNR's calculation raised further basis for rejection (letter and attachments to J.B. Gottstein from G.T. Koester, August 23, 1989). The "sales" cited by the State were too small in size and few in number (three) to be statistically significant. Furthermore, their comparability was questionable. One purchase appeared to be for recovery of "construction and road gravel" from tailings. Although traces of gold were present, production was

reported as uneconomic. Another was the purchase of adjacent land by an active miner for "site expansion" and overburden disposal. In addition, other comparable sales not used by DNR, but that were identified by Metz and Dixon (October 1989) supported the Metz/Dixon valuation arrived at by the income approach.

In any event, the "comparable sales" approach for valuing mineral values for MHTLs was not supported by any economist or other mineral valuation expert and was rejected by the Commission. All the experts agreed that the comparable sales approach for valuation was inappropriate for valuing mineral endowment because of problems of comparability and the limited use of sales in large mineral transactions. Valid comparable sales are not normally available due to differences in grade, tonnage and similar factors. As noted previously, mineral rights to lands are typically subject to agreements in which the seller receives a a share on production, whether through a lease, a joint venture or some other arrangement rather than simply a sale of the land or the mineral rights. All the experts agreed that a discounted cash flow method (the "income approach") was the industry standard method.

Several recent mineral discoveries and resultant mines lend additional support to the Commission's conclusion to reject comparable sales in favor of the income approach as a method of mineral valuation. The Greens Creek silver discovery 20 miles west of Juneau has proven and estimated reserves worth $3.6

billion. As of this date the Greens Creek mine is the largest silver mine in North America. The Red Dog Mine has much greater reserves with a gross value of $20 Billion at current market prices. Both were developed without any direct sales of surface or subsurface estates. The Greens Creek discovery was on Federal land and patented land resulted. Red Dog is a joint venture involving a Native corporation with no sale involved. These and a number of other significant discoveries have occurred and are being developed without "sales". In fact, active management of the original trust would have utilized these types of transactions to generate income.

Mineral Endowment Valuation by Plaintiff's Consultants

To complete the mineral valuation in accordance with the procedures originally accepted by the Commission (Brady, September 29, 1987; Gustafson, November 23, 1987), the Plaintiffs commissioned a study of the mineral, aggregate and coal potential of the MHTL by an internationally known consultant and an Alaskan mineral consultant. The consultants (Professor Paul Metz of UAF and Colin Dixon, Senior Lecturer in Mining Geology, Imperial College of Science and Technology, London) were instructed to follow as closely as data (that provided by DGGS) and time available (two months) allowed, the normal methods used by the minerals industry in determining the fair market value.

Their report (Metz and Dixon, December 11, 1988) produced within the specified time and data constraints a range of probable values for mineral resulting in a final estimated value of $1.5 billion. After preliminary review by DNR staff and the Institute of Social and Economic Research, DNR contracted with a methodology expert (Professor DeVerle Harris of the University of Arizona) to critique the report using "best practices" as the standard of criticism without allowance being made for cost, time or data limitations.

Harris fully stated the restricted nature of his charge at the outset. Although finding that it did not always follow "best practices", he noted "such analysis is very difficult and usually entails compromises of best practices.. and approximations" and that the less than best practices used by Metz/Dixon might be accepted "if a rough estimate of value is adequate". Harris goes on to say "In fairness to Metz and Dixon, the use of net smelter return methods is consistent with the simplistic treatment of mineral potential and exploration [provided by DGGS]." (Harris, May, 1989, p 16).

He further noted that "replacing [the Metz/Dixon] estimate by best practice will require a much greater effort" and still would result in an estimate based upon professional judgment (Harris, May 23, 1989, p. 33). Apparently this was too inconclusive for DNR and a second contract was entered into with Harris in which

he presented the design of a best practices undertaking and estimated the price at $350,000 (report September 1989)[1].

"Best practices", however, under Harris' proposal would require much more than money. "Much of the geologic analysis by ADGGS personnel will have to be redone for the estimation of mineral endowment". (Harris Sept., 1989, p 3). The product of the DGGS effort was a ranking of MHTL by their favorability for mineral deposits, not probabilities for number of deposits required by "best-practices". Metz/Dixon, having no alternative but to use this data, introduced an additional step converting the DGGS rankings into probabilities. They would have preferred to have had the best practices version advocated by Harris (Metz/Dixon, October 1989, pp. 6-7). Harris also noted shortcomings and gaps in the basic data collection and compilations requiring that "the geologic analysis for endowment estimation would have to repeat this initial data and information acquisition" (Harris, September 1989, pp. 3-4)[2]. However, at the November 7, 1989, Commission meeting, which Harris declined to attend, C. Dixon explained how they used generally accepted "rules of thumb" that would not be seriously in error and built in "safety factors" at each step to insure that the valuation would not be overstated.

1.DGGS had previously advised DNR and the Commission that a $53 million surveying and exploration program would be necessary before they could attempt a valuation.

2.This would not involve acquiring new geologic data, but reworking the same data that DGGS utilized.

In discussing the kinds of expertise required (geoscience of mineral resource formation, regional knowledge of geology, and estimation methodology), Harris rated some of DGGS personnel as "well qualified' for the first expertise, at least as to certain deposit types", as "especially well qualified for the second expertise", and "not highly experienced in expertise three". Beyond expertise, Harris noted the appearance of conflict of interest because of the litigation (Harris, Sept., 1989, pp. 8-9). He recommended contracting with the USGS for mineral endowment estimate and with an outside contractor (such as his Center for Mineral Resource Science) for other phases. (Ibid, p. 10).

Commission Decision

On the basis of the two Harris reports, the ISER study commissioned by DNR ("Review and Analysis of 'Mineral, Coal, and Aggregate Resource Appraisal of Alaska Mental Health Trust Lands," Tuck and Berman, March, 1989), and the Metz/Dixon Reply (October 12, 1989) important areas of broad agreement between all the mineral valuation experts emerged. There was consensus that: (1) a value can be estimated for undiscovered mineral deposits (Harris devoted an entire book to appraisal of undiscovered mineral resources, Mineral Resources Appraisal, Clarendon Press, Oxford, 1984), (2) the comparable sales approach was not an appropriate method to value the mineral endowment of MHTLs, (3) the use of a discounted net income stream is the appropriate means of estimating the fair market value, and (4) the dominant mineral production from a district comes from a few very large

deposits (Harris, p. 17, Metz/Dixon, p. 12), . The areas of disagreement were related to degree of refinement of the analysis and estimates, on techniques used at each point of procedure (i.e costly econometric modeling vs. accepted industry practices).

Given (1) the unanimity that the discounted cash flow approach utilized by Metz/Dixon was the appropriate methodology; (2) that compromises made from "best-practices" for other portions of the total valuation process were far more serious than for the minerals valuation (e.g. surface and oil & gas), and (3) the complete lack of any viable alternative, the Commission approved the Metz/Dixon approach and methodology for determining fair market value for the mineral endowment of MHTL.

While not approving the values per se, the Commission also notes that the estimate of $1.5 Billion, as a "reality check" of the processes generating the figure, is a reasonable and conservative one. That the Greens Creek mine has a $3.6 billion estimated reserve and Red Dog $20 Billion, lends ample supports that the $1.5 billion advanced by Metz/Dixon for <u>all</u> MHTL is reasonable. Other new projects in stages of exploration and/or initial development are the Fort Knox near Fairbanks, the Kensington Mine project in the Juneau area, and the Golden Zone between Anchorage and Fairbanks.

MINORITY RECOMMENDATION

TO THE COMMISSIONER OF NATURAL RESOURCES

Regarding Procedures to Determine the
Fair Market Value of Alaska's Mental Health
Trust and Replacement Lands

Submitted by: Rod Swope
Commissioner's Designee to the
Interim Mental Health Trust Commission
February 1, 1990

APPENDIX D

CONTENTS

EXECUTIVE SUMMARY

This minority report documents my dissent from the majority report of the Interim Mental Health Trust Commission (IMHTC) regarding procedures to be used by the Commissioner of the Department of Natural Resources (Commissioner) to determine the fair market value of both the original one million acre mental health trust land grant and the replacement lands in accord with Chapter 48, SLA 1987. In addition, I have set out the procedures which I believe should be used in order to comply with Chapter 48 and the land and resource values which those procedures produce.

I do not take this step lightly. Since joining the IMHTC as the Commissioner's designee in January, 1988, my goal has been to reach consensus with my fellow IMHTC members if and whenever possible.

While I believe my fellow IMHTC members also shared this goal, that approach was abandoned with respect to the valuation procedures finally adopted in the IMHTC majority report. By adopting, in large measure, valuation procedures urged by the attorneys for the plaintiffs and intervenors in the Weiss case, procedures designed to maximize value and not to produce fair market value as required by Chapter 48, the majority left me with no alternative but to dissent.

I dissent from the IMHTC majority report for the following reasons:

1. **The IMHTC exceeded its statutory authority by proposing and adopting its own valuation procedures instead of reviewing and approving only those procedures proposed by the Commissioner.**

Chapter 48 specifies that the IMHTC is to review and approve valuation procedures proposed by the Commissioner. As contemplated by the Legislature, the valuation procedures accordingly would be acceptable to both the plaintiffs' and intervenors' representatives on the IMHTC and to the Department of Natural Resources ("department"). Certain procedures contained in the majority report, however, were not proposed by the Commissioner, are unacceptable to the department, and therefore should not have been approved by the IMHTC majority. By proposing and adopting valuation procedures over the department's objections, the IMHTC has ignored the legislative requirement that, in effect, there be consensus as to the valuation procedures to be employed.

2. **The procedures proposed and adopted by the IMHTC in the majority report do not produce fair market value, as required by Chapter 48; instead, they produce a value substantially greater than fair market value.**

The importance of the value determinations used to determine fair market value cannot be overstated because of the dramatic effect they will have on the overall state budget. Under the valuation procedures adopted by the majority of the IMHTC, the total value of the original one million acre mental health trust land grant would exceed $2.2 billion. Under AS 37.14.021(c), this would result in more than $178 million in otherwise unrestricted state general funds being restricted in the Mental Health Trust Income Account. Under the valuation procedures I believe should be employed, the fair market value of the original one million acre grant equals just over $564 million, resulting in more than $45 million annually in the Mental Health Trust Income Account.

While the remainder of this minority report documents the fact that the procedures adopted by the IMHTC in the majority report do not produce fair market value, the point can be illustrated with three examples.

> Example 1: Surface Estate. The IMHTC initially defined "fair market value," the value required by Chapter 48, as "the most probable selling price in a free and open market," a standard definition in the real estate business. Panels of independent expert appraisers were then given instructions (prepared jointly by the majority of the IMHTC, the lawyers for the plaintiffs and intervenors and the department) to determine fair market value as defined. The lawyers for the plaintiffs and intervenors retained consultants (at state expense and without formal approval of the IMHTC) who were not asked to determine fair market value as defined by the IMHTC and required by Chapter 48. Instead, they were directed to determine "the highest value that can be supported in the market." Following review by those consultants, the panels increased their initial values, on the average, by about 20 percent. The procedures adopted by the IMHTC majority require that those values be further increased by splitting the difference between the final fair market values as determined by the panels and "the highest values that can be supported in the market" as determined by the consultants for the plaintiffs and intervenors.

Example 2: Hardrock Minerals. The procedures adopted by the IMHTC majority to determine the fair market value of the hardrock mineral estate, among many other shortcomings, begin with the assumption that all mineral deposits on mental health lands were developed on the date of valuation. That, of course, is not the case. In fact, there is very little mineral production from mental health lands even today. The consultants hired by the lawyers for the plaintiffs and intervenors acknowledge that this assumption alone produces value many times higher than would be produced if it was assumed that mineral deposits on mental health lands are not developed until sometime in the future:

A. Deposits are developed as of 2006 - the net present value (NPV) is $225 million.

B. Deposits are developed as of 1996 - the NPV is $585 million.

C. Deposits are developed as of 1987 - the NPV is $1.5 billion.

The procedures adopted by the IMHTC majority value the mineral estate at the $1.5 billion figure. It's also conceivable that major deposits will never be discovered in which case the NPV would be zero.

Example 3: Integration. The procedures adopted by the IMHTC combine the various value components -- surface estate, timber, oil and gas, hardrock minerals, coal, and sand and gravel--by simply adding them up. A prospective purchaser in the real world, of course, would not simply add up all the values. He or she would instead determine which uses, if any, are compatible. For example, residential subdivision development and strip mining for coal are not compatible.

3. **The procedures proposed and adopted by the IMHTC in the majority report create substantial problems with respect to reconstituting the trust and periodically redetermining its value.**

Chapter 48 contemplated an exchange of some original mental health lands for other state lands on the basis of equal value. The procedures adopted by the majority of the IMHTC have been used to value the original mental health lands, but they have not been used to value the pool of potential exchange lands. This precludes the exchange contemplated by the Legislature. In

addition, Chapter 48 contemplated periodic revaluation of the lands following the exchange. If the exchange cannot go forward, the legislatively contemplated revaluation also cannot go forward.

In my opinion, the failure of the IMHTC to reach consensus on valuation procedures makes it impossible for the Commissioner to comply with Chapter 48. The procedures approved by the IMHTC majority were not proposed by the Commissioner as required by law; the procedures I believe should be used have not been approved by the IMHTC as required by law. For this reason, I believe the Commissioner should transmit both the majority and minority IMHTC reports to the Legislature, explain that she is unable to comply with Chapter 48 at present, and list three options for legislative consideration: (1) change the law to accept the value determined under the procedures adopted by the IMHTC majority; or (2) change the law to accept the value under the procedures I believe should be used to comply with Chapter 48; or (3) appropriate additional funds to permit the IMHTC to continue seeking consensus. I believe the Commissioner should recommend that the Legislature choose option (2), accepting the value determined under the procedures I believe should be used to comply with Chapter 48.

BACKGROUND

The IMHTC was created by the Legislature in Chapter 132, SLA 1986, to oversee state management of mental health trust lands. In Chapter 48, SLA 1987, the Legislature established a statutory framework for resolving the mental health trust land issue. The three main elements of that resolution are: (1) valuing the original one million acre land grant and all lands in legislatively designated areas (parks, wildlife refuge, etc.) under procedures proposed by the Commissioner and approved by the IMHTC; (2) "exchanging" those original mental health trust lands not in legislatively designated areas for "replacement" lands of equal value in such areas; and (3) "renting" the original mental health trust lands in such areas and the equal value "replacement" lands for 8 percent of their fair market value annually.

Following the passage of Chapter 48, SLA 1987, the Governor appointed Dr. George Rogers of Juneau and Dr. Lidia Selkregg of Anchorage to join the Commissioner to compose the membership of the IMHTC. Dr. Rogers was then selected chairman of the IMHTC. Originally, Deputy Commissioner Lennie Gorsuch represented the Commissioner on the IMHTC, followed later (after January, 1988) by Deputy Commissioner Rod Swope. Assistant Attorney General Tom Koester of the Department of Law served as legal counsel to the IMHTC, while representatives of the Department of Natural Resources (department) provided staff support.

The IMHTC met on August 19 and 20, 1987, and continued to meet regularly through January, 1990. Since passage of Chapter 48, a total of thirty-five (35) IMHTC meetings have been held in either Anchorage or Juneau following at least fourteen (14) days prior public notice.

Although not part of the IMHTC, the attorneys for the plaintiffs and intervenors in the Weiss lawsuit, David Walker and Jim Gottstein, attended almost every IMHTC meeting and actively participated in all aspects of the discussions and valuation process, even to the point of proposing valuation procedures and resultant values. The IMHTC allowed the plaintiffs and intervenors to join in all discussions during IMHTC meetings.

At times, this degree of participation made it extremely difficult to differentiate between IMHTC conclusions and those of the lawyers for the plaintiffs and intervenors. The plaintiffs' and intervenors' lawyers also independently hired appraisal

consultants to review the work of contractual appraisers, retained by the department under procedures developed by the department, the IMHTC, and the lawyers for the plaintiffs and intervenors, and working under instructions developed in the same way, to compose the opinion of value panels for the surface estate valuation. In addition, the plaintiffs and intervenors, acting without formal IMHTC authorization, hired independent mineral consultants, Paul Metz and Colin Dixon, to compile a value for hardrock minerals, coal, and material sources (within the mental health trust land portfolio) using a procedure not previously recommended by the Commissioner or formally discussed or approved by the IMHTC. Mr. Metz and Mr. Dixon also attended several meetings of the IMHTC to present their information and viewpoints.

The most difficult aspect of the entire valuation process proved to be the development and approval of specific procedures under which the department would value mental health trust lands. On several occasions the IMHTC chose to adopt a new valuation methodology even after the department had already completed, at considerable time and expense, the valuation process using the original IMHTC approved methodology. Development of a new valuation methodology frequently seemed to be motivated more by the desire to produce a higher value than to correct the original methodology. As a result, procedures were adopted by the IMHTC that were not proposed by the Commissioner (as required under Chapter 48) and which do not produce fair market value (as Chapter 48 also requires).

Throughout my participation in this process, I strived toward achieving consensus and a common resolution of the various issues with my fellow IMHTC members. However, as it became apparent that the majority of the IMHTC was dissatisfied with the results of the initially approved procedures and began amending them to produce higher values, the consensus approach began to erode. This became particularly apparent in discussions regarding the results of the opinion of values for the surface estate and values for the mineral estate. Thus, as a dissenting member of the IMHTC, I felt it was necessary to submit a minority report.

FINDINGS

1. **The IMHTC exceeded its statutory authority by proposing and adopting its own procedures instead of reviewing and approving only those procedures proposed by the Commissioner.**

The Legislature contemplated and specified that the Commissioner propose valuation procedures which then would be approved by the IMHTC. Section 90 of Chapter 48, SLA 1987 repealed and reenacted section 2(a) of Chapter 132, SLA 1986 to read: "The commission shall approve procedures proposed by the Commissioner of Natural Resources to determine the fair market value, as of the effective date of AS 38.05.800, of all lands selected by and patented to the state under sec. 202 of the Alaska Mental Health Enabling Act, and review the final determination of the fair market value determined under those procedures." (Emphasis added.)

Under AS 38.05.800(a), also enacted as part of Chapter 48, the Commissioner is to determine the fair market value of the original mental health land grant "under procedures approved by the Interim Mental Health Trust Commission."

Simply stated, the Commissioner is to propose valuation procedures to be reviewed and approved by the IMHTC. Once a set of procedures have been approved by the IMHTC, the application of those procedures to the valuation of the mental health land grant and replacement lands is the responsibility of the Commissioner, with the results then reviewed by the IMHTC. The Legislature thus contemplated a three-step process: (1) consensus would be reached as to the procedures to be followed; and (2) the Commissioner would unilaterally implement those procedures to determine fair market value; and (3) the IMHTC would review the final fair market value determined by the Commissioner.

Although the IMHTC initially approved certain valuation procedures proposed by the Commissioner, the IMHTC majority eventually proposed and adopted many of its own procedures not proposed by the Commissioner. Specifically, the procedures adopted by the IMHTC majority for the surface valuation and for the mineral valuation were not proposed by the Commissioner. These actions removed from the Commissioner all discretion and thereby effectively excluded the Commissioner from the valuation process, a result certainly not intended by the Legislature.

Furthermore, the IMHTC in its majority report adopted not only procedures, but also an actual set of resultant values. As mentioned above, only the Commissioner has the authority and responsibility to determine the fair market value of the land. Therefore, the IMHTC again clearly exceeded its statutory authority.

2. **The procedures proposed and adopted by the IMHTC in the majority report do not result in fair market value, as required by Chapter 48; initially they produce a value substantially greater than fair market value.**

AS 38.05.800(a) requires the Commissioner to "determine the fair market value, as of September 6, 1987 of all land selected by and patented to the state under the Alaska Mental Health Enabling Act." At its September 21-22, 1987 meeting, the IMHTC initiated the valuation process by adopting, as proposed by the department, the definition of fair market value found in American Institute of Real Estate Appraisers/Society of Real Estate Appraisers, Real Estate Appraisal Terminology (rev. ed. 1981). This definition specifies "The most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale." Employing that definition and procedures, the department determined the fair market values for the surface estate and resources associated with the mental health and replacement lands (timber, oil and gas, coal, material sources, and hard rock minerals). Those procedures and values are outlined in this section.

The surface estate of all mental health trust and replacement land was valued by the department using the opinion of value approach. This approach, as amended by the IMHTC to make adjustments for certain disputed values submitted by the lawyers for the plaintiffs and intervenors, was approved by the Commissioner and became the accepted procedure for valuing the surface estate. However, the IMHTC majority report reflects a surface estate valuation procedure and value different from that developed by the IMHTC, approved by the Commissioner, and employed by the department. As a result of this significant departure from accepted and approved procedures, the resulting value does not reflect fair market value and is inconsistent with the fair market value requirement. Once the opinion of value panels completed their work, the plaintiffs and intervenors hired their own appraisal consultants to examine the results. The review appraisers, however, did not employ the same valuation approach used by the department. Instead, the plaintiffs' and intervenors' appraisal consultants were given the following

written instruction: "For all parcels that appear to have been undervalued, provide your estimate of the highest value that can supported in the market." [Walker letter to MacSwain, Olson, Sopp, dated July 19, 1988.] In State v. Alaska Continental Development Corp., 630 p.2d 977, 991 (Alaska, 1980), the Alaska Supreme Court specifically disapproved of a valuation process reflecting "the high end of the market spectrum," stating that such an approach "is contrary to the law in Alaska" that fair market value," or the price a willing buyer would pay a willing seller for the property, is the appropriate measure of just compensation. There was no mention in the instructions to the appraisal consultants of fair market value or most probable selling price. The values determined by the review appraisers, therefore, have no relevance to the task with which the Legislature charged the Commissioner, that of determining the fair market value and not "the highest value that can be supported in the market" of the original one million acre mental health land grant.

The IMHTC also approved the department's recommendation that determination of resource values would employ a two step approach. The first step was to quantify the particular resource(s) in place. The second step was to determine the value to the landowner of that quantity of the particular resource(s) in place.

For the hardrock portion of the mineral valuation, the IMHTC majority report simply adopted the procedures and value contained in the Report by Paul Metz and Colin Dixon ("MDA Report"). The MDA approach employed procedures not recommended by the Commissioner or previously discussed or approved by the IMHTC. Furthermore, it produced a value which is substantially too high for the hardrock mineral component, and suggests a hardrock mineral endowment considerably greater than the facts support.

The resultant surface and resource values then were integrated by the department, recognizing that values could be added where use of the surface was compatible with other resource development, but not where surface use was incompatible with resource development. This was in accord with integration procedures already approved by the IMHTC. However, the majority report uses a different integration approach which involves simple addition of all values--a process totally inconsistent with standard valuation procedures. The issues of parcelization, integration,

replacement lands, redetermination of values, and the valuation process used to determine fair market value for the various resources, are described in more detail in the sections that follow.

Parcelization

The department began the valuation process by proposing procedures for the parcelization of all land. After review by the lawyers for the plaintiffs and intervenors and their "expert appraisers" regarding the parcelization procedures, the department's proposed parcelization procedures were approved by the Commissioner and the IMHTC. Department personnel then parcelized approximately 7.5 million acres of land (mental health trust and replacement land) into over 10,000 parcels.

This parcelization process used the standard larger parcel criteria set out by the courts for determining fair market value in condemnation litigation. The criteria include: unity of ownership, unity of use, and contiguity. There was one exception to this rule. Where an approved survey was in existence identifying separate lots, tracts, or metes and bounds surveys, those surveyed tracts were segregated out from the larger into separate individual parcels.

Surface Estate Valuation

In accordance with the intent of the Legislature, as reflected in the fiscal note accompanying the bill that became Chapter 48, an opinion of value process was to be used to determine the value of the surface estate.

During the legislative discussion concerning Ch. 48, SLA 1987, the department explained the opinion of value process to the Legislature and submitted two different fiscal notes, one to cover the cost of individual standard appraisals and one for the opinion of value process. The Legislature recognized the potential costs and lack of available money to fund individual appraisals for all mental health and replacement lands. Therefore, money was appropriated for the department to conduct the fair market valuation through an opinion of value process, consisting of three panels of appraisers. In other words, funds were appropriated to cover only the cost of an opinion of value process.

This opinion of value process involved three panels comprised of three very experienced and knowledgeable independent appraisers from each of three geographic areas of the state (Southeast, Southcentral, and Northern). These appraisers sat as a panel according to geographic area, examined plats, maps and legal descriptions of mental health land, and rendered an opinion of value for each parcel of property examined. They brought a variety of work experience and market knowledge with them to contribute to the opinion of value panel process. The use of a three member panel for each geographic area provided an optimum cross section of local market conditions, market demand, and varied sales data. The comprehensive appraisal files of the department were also made available to each panel.

The IMHTC and the lawyers for the plaintiffs and intervenors approved, word by word, the "Request for Proposal" (RFP) sent out by the department to all appraisers in the state in order to solicit interest in being a member of one of the opinion of value panels. Two department employees and the two IMHTC members representing the plaintiffs and intervenors, after consultation with their respective attorneys, evaluated all of the RFP's submitted. They scored each proposal and selected nine appraisers to compose the three separate panels of the most qualified appraisers in the respective regions (i.e, Southeast, Southcentral and Northern).

The process used by the panels was not an "appraisal" in the strictest accepted definition of the term. Appraisal reports were not required nor were field inspections conducted for every parcel. However, this was fully recognized by both the Legislature and IMHTC.

The theory of the opinion of value process is that some parcels may be valued high and some parcels may be valued low, but they average themselves out. This theory was given credibility when the IMHTC conducted a check of the results of an earlier opinion of value process (one panel of three appraisers for all three regions of the state with only one appraiser representing each region) on all original mental health land that had been selected by the state or conveyed to municipalities. The IMHTC selected parcels, in the Northern, Southcentral and Southeast regions, that it felt were most likely to be valued too low, and had them appraised under standard appraisal procedures. The result of this exercise was that, on total, the actual appraised values and the opinions of value for the parcels the IMHTC believed were the most undervalued were within 4 percent. While some differences were dramatic--the IMHTC majority report notes one 800 percent difference (interestingly, the high value was produced by the opinion of value process) they balanced out overall as expected. This is contrary to the IMHTC majority report which infers that the opinion of value process produces values which are uniformly too low.

As soon as contracts were awarded, the department convened the three opinion of value panels for each region to render their best collective professional opinions of fair market value for each parcel. The opinion of value panels were instructed to determine fair market value using the definition found in the American Institute of Real Estate Appraisers/Society of Real Estate Appraisers, Real Estate Appraisal Terminology, adopted by the IMHTC at its September, 1987 meeting. The opinion of value panels also were instructed to consider reparcelizing if, in their best professional judgement, reparcelization was necessary to enable them to determine the land's fair market value.

The panel's findings were recorded on forms provided by the department and approved by the IMHTC and attorneys for the plaintiffs and intervenors. The forms contained all available information relative to the parcels and were supplemented by land status plats and maps. At least two members of each three member panel signed signature blocks on each form indicating panel concurrence with the specific value for each parcel.

The IMHTC had, in the RFP, provided that the plaintiffs and intervenors could review and challenge any of the values established by the panels. The lawyers for the plaintiffs and intervenors independently hired their own "appraisal review consultants" to review the work of the opinion of value panels (paid for by the state as court-ordered costs in the Weiss case).

The appraisal consultants hired by the lawyers for the plaintiffs and intervenors were directed to determine "the highest value supported by market data." (Walker letter to Mac Swain, Olson, et.al., dated July 19, 1988). They were not instructed to determine what, in their best professional opinion, they considered to be fair market value (using the definition adopted by the IMHTC). Under their instructions, they valued the surface estate at $833,280,096 compared to the opinion of value panels' initial value of $392,000,000.

Their review took approximately nine months and resulted in approximately two-thirds of the values of original mental health trust parcels being questioned.

Due to the large number of questioned values by the appraisal consultants and limited funding, the department proposed a sampling strategy which was adopted by the IMHTC. Certain groups of disputed values along with a computer-generated random sample of the remaining disputed values, were identified and returned to the Southeast panel for review. A representative sampling of large (over 1,000 acres) parcels was submitted to the Southcentral panel for review. The review of these disputed values by the panels resulted in a small increase in the value of some of the parcels. This occurred only after the lawyers for the plaintiffs and intervenors and the chairman of the IMHTC instructed the panels on how to value certain classes of parcels.

The method of applying the sampling results to all three regions resulted in a 30 percent increase in the opinion of value panels' initial $392 million value for the surface estate, thus increasing it to a final value of $511,949,467. The value determined by the plaintiffs' and intervenors' review appraisers, however, was not similarly revised downward, but instead was held at $833,280,096; no downward adjustment in their value was made.

The IMHTC, acting without a recommendation from the Commissioner, adopted the procedure to determine the value of the surface estate by simply splitting the difference between the revised value determined by the opinion of value panels (which was

increased by 30 percent over the initially determined value) and the unadjusted total determined by the appraisal consultants retained by the lawyers for the plaintiffs. This resulted in an arbitrary value of $672,614,782., halfway between the panels' final recommended surface value of $511,949,467. and the review appraisers' initial value of $833,280,096.

The basic flaw in the procedures adopted by the IMHTC majority is that those procedures incorporate, in large measure, the values determined by the plaintiffs' and intervenors' review appraisers. The appraisal consultants were instructed to determine the "highest value that can be supported in the market," a value which is not the same as fair market value. Using the value those procedures produce is not consistent with fair market value specified in Chapter 48. Instead it is simply the average of the fair market value determined by the opinion of value panels as the Legislature contemplated and "the highest value supported by market data" as determined by the review appraiser. The fair market value of the surface estate should be the final value determined by the opinion of value panels, which was $511,949,467.

Hard Rock Mineral Evaluation

The procedures proposed and adopted by the IMHTC to assess and value hard rock mineral resources (MDA Report) produced a value which is substantially greater than the facts support.

The initial hardrock mineral assessment was completed, using available information, by the department's Division of Geological and Geophysical Survey (DGGS). However, DGGS did qualify their assessment with the observation that there are inadequate data to perform a comprehensive mineral assessment. In addition, the parcels being studied were too scattered and too varied in size to make any very specific quantitative determinations without a great deal of expense. The department also sought assistance from the U.S. Bureau of Mines, WGM (a private mineral consulting firm), and the department's Division of Mining to quantify these resources. These sources also indicated that there are insufficient data and the parcels are too scattered.

The DGGS did, however, identify the potential for mineral occurrences on mental health trust lands and the pool of potential replacement lands by ranking them from 1 (low potential) to 5 (high potential), with category 5 subsequently broken down by DGGS at the request of the IMHTC to identify the lands with the highest high potential ("Super 5s"). No consideration was given, however, to quantity of potential mineral resources or the economic feasibility of their development. The Super 5 category identified only the highest potential for occurrence of a mineral deposit, not the highest probability of a commercial discovery.

The IMHTC, at a March 17 - 18, 1988 meeting, determined that it was impracticable to determine mineral value in light of the information from DGGS, the U.S. Bureau of Mines, WGM, and the Division of Mining. The department was, therefore, originally instructed by the IMHTC to consider the potential of the land (according to the DGGS assessment) only for replacement purposes.

The department continued, however, to seek procedures to present to the IMHTC that would reflect, to the extent possible, the fair market value of the hardrock minerals on both the original mental health land and the potential replacement land. Eventually, a small number of comparable sales of patented and unpatented mining claims in the state were identified for that purpose.

When presented to the IMHTC, however, the comparable sales approach was rejected. The initial value determined --$16 million--admittedly seemed quite low.

Unknown to the IMHTC minority, the lawyers for the plaintiffs and intervenors retained two consultants, Paul Metz and Colin Dixon, to estimate the value of the hardrock minerals on the original one million acre grant using a discounted cash flow methodology. Employing a variety of assumptions and probability analyses, Metz and Dixon concluded that the hardrock mineral value of the original grant was $1.51 billion. The lawyers for the plaintiffs and intervenors presented this information to the IMHTC in the form of a report ("MDA Report").

The MDA Report was criticized by a variety of expert analysts.

The department's natural resource economist, Ed Phillips of the Division of Oil and Gas, reviewed the MDA Report from an economic standpoint and concluded that the methodology, assumptions and judgments were so manipulated that the values are excessively high.

The DGGS geologists responsible for developing the geological data reviewed the MDA report. Their review raised substantive questions relating to the assumed probabilities of discovery and the range of estimated deposit sizes.

The University of Alaska's Institute for Social and Economic Research (ISER) conducted a thorough review and analysis of the MDA Report. Their analysis concluded that <u>if</u> the geologic assumptions, probabilities and costs in the MDA Report are found to be valid, the economic considerations are not. The ISER economists (Dr. Bradford H. Tuck and Dr. Matthew Berman) who reviewed the MDA Report estimated that the net present value of the original one million acre grant would not exceed between 10 and 30 ($177,000,000. and $460,000,000. respectively) of the value contained in the MDA Report, and would be in the 10 to 30 percent range <u>only</u> if the geologic assumptions, probabilities and costs are valid. Thus, only under the optimum set of circumstances--i.e., all of the analysts' expectations are realized--would the values even approach one-third of the total estimate in the MDA Report?

The following is the "<u>Summary</u>" from the ISER report (dated March 22, 1989):

"In summary, our review has identified a number of points that question some of the assumptions underlying the Metz appraisal. The three that are critical relate to the assumed probabilities of discovery, the assumed net smelter return, and the timing of the income stream. The assumed values in the appraisal result in projected revenue and production estimates that do not currently exist and are highly improbable in the future.

"The test of an appraisal, as mentioned above, is whether it approximates fair market value. Fair market value is what the asset would bring in a competitive market disposal held today. The historic levels of mining industry activity in Alaska, coupled with long term trends in world mineral markets, simply do not support the notion that the mineral rights on the Mental Health Trust Lands would command 1.5 billion dollars today, or at any time in the foreseeable future."

Perhaps more telling, the MDA Report used a number of works by Dr. DeVerle P. Harris of the University of Arizona for its methodological basis and to justify the numbers that were produced. Dr. Harris was recognized by the IMHTC as one of the leading authorities in the nation in the area of discounted case flow valuation methodology. To determine if the MDA report properly interpreted his own works, the department entered into a contract with Dr. Harris to review and analyze the report. In his critique of the MDA Report, Dr. Harris found numerous problems with the report and its ultimate value estimate.

Because of Dr. Harris's preeminence in the field, I have included extensive excerpts from his summary as follows:

"The least equivocal judgment that can be made about the analysis performed by MDA is that there can be little confidence that the fair market value of the Alaska Mental Health lands is $\$1.5 \times 10^9$ because of (1) great uncertainties that exist about critical factors, e.g., mineral endowment, probability for discovery, costs of development and production, and future markets, (2) subjective judgments made, and (3) rough approximations employed in computation of fair market value..."

"Those who use the number, particularly when uninformed about evaluation and estimation practices, ascribe to it much greater confidence than it deserves. Intelligent decision making requires a description of uncertainties about the estimate of a highly uncertain quantity. Clearly, the fair market value of Alaska Mental Health Lands is a highly uncertain quantity. Representing so uncertain a quantity as the fair market value of unseen mineral deposits by a single-point estimate (1.5×10^9) begs some explanation, for such analysis clearly is not best practice, nor even usual practice, in evaluation of a complex and uncertain quantity.

"There is another dimension to the neglect of uncertainty besides that of information to the user, namely, the implication of uncertainty to fair market value as perceived by those who would purchase the rights to explore for and exploit the mineral resources. In this case, these buyers are private corporations. Corporations behave generally as though they are risk averse, meaning that the investment value (fair market value) of a highly uncertain venture is less than its expected monetary value. The greater the uncertainty about the outcome, the greater the expected value is discounted by the investor. Thus, <u>fair market value</u> to a private corporation of a highly uncertain venture, such as exploration, development, and exploitation of unseen mineral deposits, is not independent of the magnitude of uncertainty; consequently, a comprehensive evaluation itself requires a probability distribution of the uncertain quantity, which in this case is the fair market value of MHL.

"One may agree with the foregoing but still press the question of whether or not $\$1.5 \times 10^9$ is a "reasonable" single-point estimate of fair market value when risk is not explicitly accounted for. Responding to this question in an absolute sense is nearly impossible because of the great uncertainties mentioned above, the subjective judgments made, and the approximations employed.

"A more answerable question is whether within the context of the approach used by MDA there were judgments made or procedures employed which, everything

else being equal, tend to over or underestimate fair market value. Clearly, as indicated in the body of the report, such can be identified. The most obvious of these is the ignoring of lead times in the computation of net present value. This neglect leads to overestimation by a factor of 2 or 3. Similarly, neglect of market impacts leads to overestimation. Ascribing to every discovery the 90th percentile tonnage and grade also leads to overestimation, perhaps a large overestimation, unless compensating adjustments are made in discovery probabilities. There is no documentation of such adjustment, but the selection of discovery probabilities by MDA is heavily subjective and especially vague, making it difficult to draw firm conclusions. If, as suggested by the MDA report, the discovery probabilities selected were predicated in part upon the CRA analysis of regions in Alaska that were appraised by the U.S. Geological Survey, then the discovery probabilities probably are considerably too large, because these (CRA) numbers of deposits are expectations for <u>occurrence</u> (not discovery) of deposits of all sizes and grades (not just 90th percentile value).

"The treatment of exploration and mineral potential is particularly vague and unrationalized. This is a serious deficiency of the report, because analysis of value is so sensitive to the treatment of these factors. The effect of this neglect is to create low confidence in the specified probabilities for discovery and in the computed expectations for fair market value. The fact that discovery probabilities were estimated directly using exploration outcomes from other regions, and that these were subjectively adjusted to reflect mineral potential rankings, makes a careful description of the estimation even more important and necessary if the resulting estimate of fair market value is to be credible, because the very foundation upon which the process rests (exploration outcomes) is very difficult to interpret. This is especially the case when these outcomes are to serve as the basis for discovery probabilities for a host of different mineral commodities and different deposit types. The use of constant discovery probabilities for all deposit types and all metals for a given mineral potential ranking is at best a crude approximation and lacks credibility when the objective is fair market value.

"Finally, a fair market value as large as $1.5 x 10^9$ does not seem consistent with economic conditions and factors. As fair market value, $1.5 x 10^9$ represents an estimate of the net present value of profits (net of all costs, royalties, and taxes) that firms could earn by acquiring rights to exploration for and exploitation of minerals on the Alaska Mental Health Lands. Such a large value, if correct, would be a strong incentive for acquisition of tenure and exploration of these lands. While the author has little first-hand knowledge about recent metal resource development on the Mental Health Lands, or in Alaska in general, it is his understanding that such activity is and has been at a low level (Tuck and Berman, March 22, 1989; Paul Metz, May 20, 1989, personal communication). Such circumstances challenge a value as large as $1.5 x 10^9$ as a credible estimate of the fair market value of metal resources of the $1 x 10^6$ acres of Mental Health Lands. Moreover, rationalizing inactivity by institutional impediments or by stringent tenure requirements does not lend credence to such a high value. Unless such impediments and stringent tenure provisions are to be alleged, fair market value appropriately reflects the impact of current conditions on profitability of resource development."

The foregoing expert critiques, questioning the credibility of the MDA Report's $1.51 billion estimate for the value of the original one million acre grant, are supported by a number of objective considerations. WGM, a private mineral consulting firm, determined in March, 1988 that the market value of 2.2 million acres of Bering Straits Native Corporation land in Northwest Alaska was $343 million, an average of $156 per acre. That land is located in the vicinity of the Seward Peninsula, historically the most productive mineral province in the state. While some mental health land was specifically selected for its mineral potential (as was a considerable portion of the Bering Straits Native Corporation's selections), more was selected for other values (e.g., residential, timber, etc.). Given those facts, I cannot accept the MDA Report's average mineral estate value of $1,510 per acre for mental health lands. This is particularly true as the Bering Straits Native Corporation lands are in large continuous tracts, which a prospective purchaser could evaluate through appropriate and efficient exploration

strategies. The mental health lands are generally in much smaller parcels scattered throughout the state and could not be explored in as cost-effective a manner.

Furthermore, the MDA Report's conclusions regarding total mineral production from mental health lands appears extremely optimistic in light of existing mineral production in Alaska. The MDA Report used the following formula to estimate the mineral estate value of the original one million acre grant: net present value (NPV) equals the gross value of annual production (GVAP) times the landowner's royalty, measured as a percentage of the net smelter return (NSR), times a uniform series present worth factor (PWF) to discount future income to present value:

NPV - GVAP x NSR x PWF (see MDA Report, p. C-1)

Working backwards, the gross value of annual production necessary to produce a given net present value can be determined as follows:

GVAP = NPV (NSR X PWF)

Under the assumptions in the MDA Report (4 percent NSR, 10 percent discount rate for 20 years for a PWF of 8.514), the gross value of annual production required to produce the MDA Report's $1.51 billion net present value is more than $4.43 billion:

GVAP = $1.51 billion (0.04 x 8.514) = $4.43 + billion

Total mineral production for the entire state in 1987 was $202,389,898. A production increase of 14.7 percent was seen in 1988, and further development of projects such as Greens Creek and Red Dog (none of which, incidentally, are on state or mental health land; furthermore, a third "world-class" deposit, Quartz Hill, also not on state or mental health land, is not commercially viable at this time) undoubtedly will result in further annual increases. However, $4.43 billion in gross value of annual production statewide is unrealistic given the current status and most optimistic projection by the mining industry in this state. I simply cannot accept that the gross annual value of production from mental health lands alone (one-third of one percent of the state's land mass) would exceed $4.43 billion.

A survey of fifteen other states with trust lands (including Texas, where the Texas Railroad Commission administers a substantial quantity of oil-rich lands for the University of Texas' benefit) reveals that the subsurface income from those

lands averages $4.57 per acre per year based on 1987 returns. Under the analysis in the MDA Report, the mental health lands would produce $120.80 per acre per year based on the eight percent per year rental provision of AS 37.14.011(c) although differences certainly exist between Alaska and other states. I cannot accept that even the most aggressive trust management could produce results so dramatically different from those in other states, including even those states with substantial known subsurface resources (unlike the Alaska mental health land situation) and where transportation and infrastructure systems are much more developed and extensive than in Alaska.

In responding to the various expert critiques of the MDA Report, Metz and Dixon argue that the current lack of mineral production from mental health lands is not a consequence of a lack of interest on the part of industry but instead is the result of state mismanagement. Their report states that, "The failure of the State of Alaska to fully implement a mineral location/leasing system and the various types of land withdrawal and restrictions, have acted as a major disincentive to investment in prospecting and exploration on state land in general and the mental health land (MHL) in particular."

The fact, of course, is that most mental health lands have been available for claim-staking--i.e., the mineral rights were available <u>for free</u> from the time they were selected until they were closed to mineral entry by order of the Commissioner following the <u>Weiss</u> decision in 1985. While some claims were staked, industry interest in mental health lands was not great. It is hard to imagine that a vigorous state leasing program, where industry would have to <u>pay</u> for mineral rights, would result in increased industry interest, particularly where (as Dr. Harris noted) there is a world market in rights to mineral lands and substantial amounts of state and federal land would continue to be open to claim-staking for free.

At the request of the department, Dr. Harris also outlined the activities required to produce a credible estimation of the market value of the mineral resources using the discounted cash flow analysis and the costs of these activities. Dr. Harris estimated that the costs of estimating the market value of the original mental health land and replacement land would be about $350,000, plus funding for additional DGGS work.

Given the amount of time and money expanded to date in an effort to value mental health lands has taken to date, I cannot recommend that additional funds be requested from the Legislature to continue the process.

As an alternative, department staff have suggested employing a comparable sales approach to determine the value of the mineral estate of both the original one million acre mental health land grant and the pool of potential replacement land. The department has received information regarding sales of the mineral rights to certain lands in DGGS's classes 4, 5, and Super 5s for which the mineral endowment is unknown (although suspected), which is the case with the land to be valued. Those sales revealed the following per acre market values:

Super 5	$2,000/acre
5	1,135/acre
4	108/acre

Using those figures, the value of the mineral estate of the original grant would equal $73,403,459.

In my opinion, this is a more than reasonable value for the mineral estate. Under the MDA Report assumptions (four percent net smelter return, ten percent discount rate for 20 years), the gross value of annual production from mental health lands would have to exceed $215 million to produce a net present value of $73 + million. That is more than the total of statewide mineral production in 1987. In addition, the eight percent annual rent required under AS 37.14.011(c) would result in the subsurface income from mental health lands equalling $5.87 per acre, substantially greater (more than 28 percent) than the $4.57 per acre earned on average by trust lands in the 15 lower 48 states surveyed.

The IMHTC majority has made it clear they do not believe a comparable sales approach is a valid method for determining the value of the mineral estate. Even though I believe the foregoing comparisons to current statewide mineral production and subsurface income from trust lands in other states reveal that the result of this approach is eminently fair to the trust, it has been suggested that a panel of Alaska mineral consultants could quickly and inexpensively provide an additional review of both the MDA Report and this comparable sales approach. You may wish to consider that option.

In my opinion, however, the final value of the mineral estate should be that produced by the comparable sales approach which is $73,403,459.

Timber Valuation

A timber resource valuation was prepared at the request of the IMHTC and the Commissioner. The valuation considered all original mental health trust lands, which total approximately one million acres, and all legislatively designated replacement pool lands, which encompass over six and one half million acres.

A detailed process to delineate and value lands suitable for commercial timber activities was developed in concert with the IMHTC and the consultants hired by the plaintiffs and intervenors. The results of this process are a series of 123 forestry potential maps, published as overlays to the USGS one inch-per-mile quadrangles, inventory estimates of commercial standing crop on these lands, and estimates of timber resource values reported on a parcel-by-parcel basis.

The conclusion of this process was that the one million acres of original mental health trust land contained $36,243,253. in commercial timber. I agree with the timber valuation procedures employed and the value derived.

Oil and Gas Valuation

At the request of the IMHTC, a report was written to describe the geology and exploration activity pertinent to establishing a "best estimate" of the oil and gas potential of the legislatively designated replacement pool lands and the original mental health trust lands within Alaska.

For general evaluation, the state was divided into four regions: (1) Gulf of Alaska (including Southeast, Prince William Sound, and the Kodiak area), (2) Alaska Peninsula and Southwestern Alaska, (3) Central and East-Central Interior, and (4) Cook Inlet and Susitna Basins (including the Talkeetna and Chugach Mountains and a portion of the Copper River Basin). Each of these was assigned to a petroleum geologist or geophysicist. These four regions were further subdivided in order to produce a more precise and detailed evaluation. Information from surface geologic mapping and from nonconfidential drilling well logs was utilized. Confidential well log information and data from proprietary seismic surveys were not included in this study.

Of the four areas studied, only the Cook Inlet Basin contains known natural gas fields which underlie some of the mental health and legislatively designated parcels. Where sufficient data were available, an economic analysis was completed for those parcels.

There are no known oil fields beneath any of the parcels.

This process concluded that the oil and gas value of the one million acres of original mental health trust land was $495,998. I concur with the oil and gas valuation procedures employed and the value derived.

Coal Value

At the request of the IMHTC, a coal valuation was prepared by the department. The valuation considered all original mental health trust land and all legislatively designated replacement pool land.

The conclusion of this process was that, although coal is present in a number of areas, it is currently economic to produce in only two areas (Nenana and Wishbone Hill). The value of this coal on original mental health trust land was determined by the department to be $432,866.

The IMHTC proposed and adopted the MDA Report as its procedures and resultant value. The MDA Report states that a current market does not exist for coal other than that identified in the DNR coal valuation. The authors then hypothesize that "several large scale open pit metal mines" in the railbelt and Kenai Peninsula areas could serve to diminish the "current excess electrical generating capacity" and provide additional coal marketing opportunities, with similar opportunities arising elsewhere. The MDA Report then makes a number of assumptions about the mines to produce figures for a cash flow analysis. One of these assumptions is that "The entire production would come from the subject land (i.e. mental health trust land)."

Using the hypothetical developments and related assumptions, the MDA Report concludes that "the net present value of the cash flow" from coal on mental health land would be $3,200,000. The MDA Report then states: "With the large quantities of coal on adjacent state and federal land in Alaska, it is probably unrealistic to expect more than 10 percent of the model production to come from trust lands."

This statement from the MDA Report infers that under that analysis, the best estimate of net present value is $320,000. I believe $432,866. should be used as the value for coal on the original one million acres.

Material Sources

The DGGS conducted a review of all mental health trust land and replacement pool land in order to assess potential mineral sources. Unfortunately, there is little detailed inventory information available. The DGGS estimated the cost of data gathering sufficient to enable them to determine material sources volumes and quality to be between $65.4 and $85.2 million. However, this would still be inadequate data upon which to base a value determination because material source values are heavily influenced upon their proximity to the market. Also, prices fluctuate upon demand. If there is no demand, then there is no value.

At a June, 1989 meeting of the IMHTC, Dick Rieger of DGGS presented three options available for material source valuation. At that meeting, the IMHTC determined that the valuation of material sources was simply not a fruitful exercise, given the uncertainty over material source location, quality and volume. As a result, the IMHTC approved a process whereby the value of the material sources on mental health land would be addressed through the designation of equal potential replacement lands.

However, the IMHTC reversed itself when it adopted the MDA Report. The MDA Report established a range of value between $2.5 million and $25.4 million for material sources, with a most likely value of $13 million. This value was based upon an average of 14 million cubic yards consumption per year statewide, with the original mental health trust land producing 24 percent, or 3.5 million cubic yards. Unfortunately, these assumptions cannot be substantiated since, in reality, only 1.275 million cubic yards were produced in that timeframe (425,000 cubic yards/year) from mental health lands. In fact, if the average annual production level of 425,000 cubic yards were to be maintained into the future, the discounted cash flow for 20 years would be approximately $420,000/year.

For the above reasons, I reject the MDA Report as a basis for material source value determination. However, I also conclude that we do not presently have sufficient data to produce a meaningful value for this resource. Because there are

insufficient funds available to produce these data, at least at this time, it is impossible to produce fair market value for this resource. Alternately, the trust should be protected if lands of equal material source potential are designated as replacement lands.

Integration Procedure and Valuation

On October 21, 1987, the full IMHTC approved the department's recommendation for integrating the various land values (e.g., surface estate value, timber value, mineral value, etc.). Under those approved procedures, values for compatible uses--e.g., a subdivision for residential or commercial use and oil and gas development (i.e. North Kenai area--would be simply added together. Where uses would be incompatible--e.g. subdivision for residential use and coal development (i.e. Beluga area)--the highest value (i.e., the value for the highest and best use) would be used. Generally, those initially approved procedures could result in one of three possible values being selected: (1) the sum of the surface value and the resource value, where extraction or removal of the resource would not affect the surface value; or (2) the resource value where it exceeds the surface value and extraction or removal would diminish the surface value; or (3) the surface value where it exceeds the resource value and extraction or removal of the resource would diminish the surface value.

The IMHTC majority, however, substituted an integration process which simply adds the various value elements, with no consideration given to whether the various uses are compatible or not.

I initially went along with this revised integration procedure, despite objections by department staff, in the spirit of compromise and my desire to achieve consensus. It is well-recognized, however, that a proper valuation procedure cannot simply add separate value elements where use of the property to exploit one element is incompatible with use of the property to exploit another. See, e.g., W. Mason, Jr., M. Azar, and G. Anderson, "Condemnation Value: The Taking of Mineral Bearing Lands," Mining Engineering 10986 (November 1989).

In my opinion, the integration procedures first determined by the IMHTC are the only ones which can produce a credible integrated value. I therefore believe that the following procedures should be used:

(1) Add the surface value and the oil and gas value;

(2) Add the mineral value, timber value, oil and gas value, coal value, and material source value; and

(3) for each parcel, select the highest value developed under (1) and (2) as the fair market value for that parcel.

Using those integration procedures and the per parcel values for each value element as outlined above, the total integrated fair market value for the original one million acre grant equals $564,700,728. Using the same integration procedures, the pool of potential replacement lands would have a fair market value of $910,103,205.

Replacement Pool Lands

As stated earlier, the IMHTC majority report failed to address the replacement land valuation requirements altogether. Using the procedures included in the majority report, the trust simply cannot be reconstituted by the Commissioner as contemplated by the Legislature and required by AS 38.05.800(b) and (c).

The procedures that I recommend will allow the trust to be reconstituted with equal value land from the replacement pool of legislative designations. Each of the procedures that I recommend has been followed for the replacement pool land on a parcel by parcel basis (with exception of material sources).

Redetermination of Values

AS 37.14.011(c) provides for the redetermination of the fair market value of the land constituting the mental health corpus at least every five years. The statute does not provide any further guidance on how this revaluation shall be accomplished.

This requirement can be fulfilled in any number of ways. I feel that the least desireable is to repeat a valuation process modeled on the one that we have just finished. I feel that the time, effort, and continual disagreement with the results would not be productive for all concerned.

I therefore recommend the following revaluation process.

1. Valuation of mental health corpus land will be conducted on an 18 month basis by region. Each of three regions, Northern, Southcentral and Southeast will be valued during successive 19-month periods. The same criteria previously recommended will be used to integrate values and to determine the fair market value of the parcels and the trust corpus as a whole.

2. Surface valuation will consist of an indexing of value increases, or decreases, within each region and application of the appropriate increase or decrease in market value occurring in each area since the previous valuation. Municipal property assessment records (for lands within municipalities) and paired market sales data (for lands outside municipalities or where property taxes are not levied) will be used to determine land value increases or decreases in each area.

3. Mineral values will be indexed to the mineral production in Alaska with the appropriate increases or decreases made for each region on a parcel-by-parcel basis.

4. Coal and oil and gas values will be indexed to the world market with appropriate increases or decreases made statewide on a parcel-by-parcel basis.

5. Timber values will be indexed to the market and conditions for the region with appropriate increases or decreases made regionally on a parcel-by-parcel basis.

3. **The procedures proposed and adopted by the IMHTC create substantial problems with respect to reconstituting the trust and periodically redetermining its value.**

AS 38.05.800(b) specifically states:

> "The Commissioner of natural resources, with the approval of the Interim Mental Health Trust Commission, shall identify land within legislative designations that is equal in value to all land selected by and patented to the state under Sec. 202 of the Alaska Mental Health Enabling Act that is not in legislative designation."

The value of the original mental health land trust is so high under the procedures specified in the majority report of the

IMHTC, that the trust cannot be reconstituted as contemplated by the Legislature. The value of the mental health trust, as established in the majority report, exceeds the value of all possible replacement lands.

Under AS 38.05.800(b) and (c), morecver, the trust is to be reconstituted with land in legislatively designated areas (e.g., parks, wildlife refuges, etc.) which is equal in value to the original mental health land grant. To do this, both the original grant and the pool of potential replacement land must be valued under the same procedures. The majority report of the IMHTC fails to address the replacement land valuation requirement altogether.

Because it is unnecessary to replace every parcel of original trust land (since some trust lands are already within legislative areas), and because the procedures proposed and adopted by the IMHTC make no attempt to value parcels individually, the trust simply cannot be reconstituted through the majority report approach.

Under AS 37.14.011(c), moreover, the trust as reconstituted under AS 38.05.800(b) and (c) must be periodically revalued at least once every five years. Therefore, because the pool of potential replacement land has not been valued under the same procedures used to value the original grant and therefore cannot be reconstituted, it also cannot be periodically revalued as contemplated by the Legislature.

CONCLUSIONS AND RECOMMENDATIONS

For the foregoing reasons, I have concluded that the Commissioner simply cannot comply with the applicable provisions of law at this time. The valuation procedures set out in the IMHTC majority report were adopted over my objection on behalf of the department, and therefore are not the product of consensus as contemplated by the Legislature and specified by law. The procedures that I believe should be employed, on the other hand, have not been approved by the IMHTC as required by the Legislature and specified by law.

I therefore recommend that the Commissioner send letters to both the Speaker of the House of Representatives and the President of the Senate explaining that she is unable to comply with the law as currently written, enclose copies of both the IMHTC majority and minority reports, and list three options for legislative consideration: (1) change the law and accept the $2.2 + billion value determined under the procedures adopted by the IMHTC majority; or (2) change the law and accept the $564 + million value determined under the procedures I believe should be used to comply with Chapter 48; or (3) appropriate additional funds to permit the IMHTC to continue seeking consensus.

I believe that the Commissioner should recommend to the Legislature that they adopt option (2) and accept the 564 + million value for the original one million acre mental health trust land grant. The procedures used to determine that value have been subject to review by outside professional experts and developed, reviewed, and approved by department staff who have a wide variety of expertise in valuing the various resources found on mental health lands. Furthermore, the Attorney General's Office advises that such a procedure would be legally defensible since the United States Supreme Court ruled that it is permissible to use "procedures established by the Commissioner's rules, or any other procedures reasonably calculated to assure the integrity of the trust and to prevent misapplication of its lands and funds." Lassen V. Arizona Highway Department, 385 U.S. 758, 465 (1967).

It also would be eminently fair to both the trust and the state. It would establish the various elements of value as follows:

Surface Estate	$511,949,467.00
Hardrock Minerals	73,403,459.00
Timber	36,243,253.00
Oil and Gas	495,998.00
Coal	432,866.00
Material Sources	undetermined

Following the integration procedures outlined above, the total integrated fair market value of the original one million acre grant would equal $564,700,782.82.

As an objective measure of the fairness of this value to the trust, the eight percent of this amount which the Commissioner of Revenue annually must allocate to the mental health trust income account under AS 37.14.011(c) until revaluation takes place equals $45,176,058. or $45.18 per acre per year; this compares very favorable to the national average of $8.97 per acre per year returned for trust lands in other states.

At first blush, this figure might appear unfair to the state. After all, it is more than five times the national average, and exceeds even Washington which, at $45.68 per acre (as a consequence of its prime and easily accessible timber resources), has the highest average in the nation. At the same time, it must be remembered that, following the exchange contemplated by Chapter 48, all of the newly reconstituted mental health trust will consist of land within legislatively designated areas which the state will continue to administer for legislatively designated purposes. In other words, unlike the case in most states, the state here will be using every acre of the newly constituted mental health trust for its own purposes. It therefore is only fair that the state compensate the trust for that use. One consequence of this is that, unlike the case in other states, every acre of the mental health trust will be productive in terms of generating revenue. That has the effect of raising the per acre earnings of the entire trust, a result which I believe is not inappropriate.

I recognize that many in the mental health community will find fault with the approach I have recommended and its result. I did my best, as a Commission member, to be cooperative and strive toward achieving consensus. Unfortunately, it was simply not possible to reach agreement on all of the difficult issues that required decisions. It should not go unnoticed that the IMHTC was able to reach agreement on many issues. I believe the facts and information presented in this report support my recommended approach and the resultant values. While further litigation may be inevitable as a consequence of my recommendation, I cannot

accede to the values determined under the procedures adopted by the IMHTC majority since they significantly overstate the value of the original one million acre mental health trust land grant as of September 7, 1987. Accordingly, for the reasons stated, I dissent from the report filed by the IMHTC majority.

February 1, 1990
Date

Rod Swope, Designee
Interim Mental Health Trust
Commission

INTERIM MENTAL HEALTH TRUST COMMISSION (IMHTC)
RESPONSE TO
MINORITY RECOMMENDATION TO THE COMMISSIONER OF NATURAL RESOURCES

March 20, 1990

George Rogers, Ph.D.
Chair

Lidia Selkregg, Ph.D.
Commissioner

K.J. Metcalf
Alternate

Dennis Scholl, Ph.D.
Alternate

APPENDIX E

Introduction:

The Commission members and alternates have reviewed the "Minority Recommendation to the Commissioner of Natural Resources" (Minority Report) submitted February 1, 1990 by Rod Swope, the Commission member serving as the Designee for the Commissioner, Department of Natural Resources (DNR). The review of the Minority Report by the Commission majority produced no basis for modification or revision of the "Interim Mental Health Trust Commission Draft Final Report" (Commission Report) of December 20, 1989. The Commission Report stands as the final report on the "Approved Procedures for Determining the Fair Market Value of Alaska's Mental Health Trust Lands." The public members of the Commission and their alternates re-affirm their recommendations.

General Nature and Character of the Minority Report:

The nature of the Minority Report was a significant disappointment to the other members of the Commission. While failing to substantiate DNR's findings and conclusions, the Minority Report attempted to discredit the Commission's work by portraying the public members as unprofessional, not acting in the public interest and in fact acting illegally. These are serious personal allegations that require a personal response.

The Minority Report opens on the first page by asserting that the Commission exceeded its authority and adopted,

> *"...valuation procedures urged by the attorneys for the plaintiffs and intervenors in the Weiss case, procedures designed to maximize value and not to produce fair market value as required by Chapter 48."*

The Minority Report is laced with similar implications of professional misconduct by the public members of the Commission. Designee Swope portrays himself as the lone champion of reason and legality, and by implication, and sometimes directly, portrays the public members as being the reverse. On page 6, for example, Swope claims

> *"I strived toward achieving consensus and a common resolution...*[On the other hand] *it became apparent that the majority of the IMHTC was dissatisfied with the results of the initially approved procedures and began amending them to produce higher values."*

It is extremely unfortunate that the Minority Report personally attacked two professionally respected, long time Alaskans who have dedicated their lives to public service, by

implying they would put their professional and personal reputations on the line for the benefit of an interest group.

The public members of the Commission volunteered over three years of their time without compensation to develop a legitimate process for arriving at the "fair market value" of the original Mental Health Trust. The process is legitimate and the Commission Report accurately documents the effort.

Another tactic used at the outset of the Minority Report has nothing to do with the Commission recommendations as such, but is designed to create an attitude in the mind of the reader that would be antagonistic to the Commission and favorable to the Minority Report. At the top of the second page the Minority Report introduces a half truth to portray the dire consequences to the State budget of following the Commission's recommendations.

> *"The importance of the value determination used to determine fair market value cannot be overstated because of the dramatic effect they will have on the overall state budget. Under the valuation procedures adopted by the majority of the IMHTC...this would result in more than $178 million in otherwise unrestricted state general funds being restricted in the Mental Health Trust Income Account."*

The omitted half of the whole truth is that the restriction to the Mental Health Trust Income Account is only a temporary accounting transaction required by Chapter 48 in an attempt to comply with the 1956 Congressional Alaska Mental Health Enabling Act which created the Trust. After payment from the account of only the necessary expenses (not the unnecessary expenses) of the Mental Health Program, the balance of the income is transferred to the General Fund for other public purposes. The value of the land corpus (whether it be high or low) does not determine the Mental Health Program budget as Designee Swope states. The Program budget is determined by Legislative appropriation after consideration of the recommendations of the Alaska Mental Health Board. In short, the effect of the valuation procedure upon the overall State budget is neutral, not "dramatic" as alleged.

The public member majority of the Commission do not feel resolution of the issue is served by trying to alarm Alaskans, rightfully concerned with fiscal solvency of the State, by painting a fiscal horror story not supported by facts. They further believe that the tactic was used to justify DNR's own fanatical efforts throughout the process to drive down the estimated value of the original Trust Lands.

The personal attacks in the Minority Report are distressing and had to be addressed. But, to belabor this does not serve the purpose of resolving the complex Mental Health Lands Trust issue. The technical questions raised in the Minority Report are more appropriate to address.

Technical Questions Raised by the Minority Report:

The Minority Report fails to address directly the Commission Report. Instead, Designee Swope's dissent is based upon two charges, (1) that the Commission exceeded its statutory authority, and (2) that the Commission adopted "procedures designed to maximize value and not to produce fair market value."

> Minority Report Finding 1: "**The IMHTC exceeded its statutory authority by proposing and adopting its own valuation procedures instead of reviewing and approving procedures proposed by the Commissioner**."

The long and arduous task of developing a procedure for identifying fair market value was undertaken by the Commission in an atmosphere of cooperation and trust. We, the public members, assumed all parties were working toward a solution. This enormous task was made difficult by shortages of data, time, and funds and by the limited expertise of DNR staff. The Commission Report adequately details the process. The Commission followed the advice and counsel of the Attorney General's office in developing the fair market value procedures. It therefore came as a shock to find DNR and/or the Attorney General's office, in the Minority Report, creating a new interpretation of the Commission task in an apparent attempt to invalidate our years of effort. It is all too apparent this new interpretation evolved because DNR disagreed with the Commission's approved procedures. This unfortunate "eleventh hour" tactic suggests the Commission's assumption of trust and good faith was ill-founded.

Chapter 48, SLA 1987 revised and replaced certain sections of Chapter 132, SLA 1986 which created the Commission to oversee interim management of the Trust lands and work with the Legislature in establishing a statutory basis for resolving the Trust land issues. The Commission membership was reduced from five (5) to three (3) -- the Commissioner of DNR and two public members -- and its mission redefined in terms of the negotiated settlement framework. The reduced Commission assumed sections of Chapter 132 not replaced or revised were still in effect and for more than two years continued operations much as it had in its original form without question or challenges.

Throughout this period the Commissioner of DNR participated continuously (through various designees) and the Attorney General was represented by Tom Koester. It came as a surprise, therefore, to be informed three months after the Commission submitted its final approved procedures and two months after forwarding its draft final report that the Commission had "exceeded its statutory authority."

The Minority Report further alleges,

> *"By proposing and adopting valuation procedures over the department's objections, the IMHTC has ignored the legislative requirement that, in effect, there be consensus as to the valuation procedures to be employed. ... In my opinion, the failure of the IMHTC to reach consensus on valuation procedures makes it impossible for the Commissioner to comply with Chapter 48."*

Consensus was not a "legislative requirement". Chapter 132, SLA 1986 provided that motions could be adopted by majority vote and, in fact, many of the "action items" treated by the present Commission were resolved by a two yea vote (the other member voting nay or abstaining). The actions resulting in the final approved procedures and the Commission Report were carried out, at the suggestion of Designee Swope, as a means of bringing the whole issue of valuation to a close. He also stated, and it was agreed, there might also be a minority report.

In the Minority Report Designee Swope also charges the Commission improperly changed the originally approved procedures and he implies this was a frequent practice aimed at producing a value substantially greater than fair market value. In fact, the originally "accepted and approved" procedures were observed to the very end of the Commission deliberations adjusted only when required by lack of funds or data. This is more fully discussed in the final section of this reply (page 10, below).

> Minority Report Finding 2: "**The procedures proposed and adopted by the IMHTC in the majority report do not produce fair market value, as required by Chapter 48; instead they produce a value substantially greater than fair market value.**"

The bulk of the Minority Report attempts to discredit the Commission's fair market procedures. After careful review of the Minority Report, the Commission determined there is no reason to alter its conclusions. The Commission Report sets forth the final approved procedures in detail. Rather than

repeat that substantial information, a summary response is given to key challenges in the Minority Report.

Given the limitations of budget, time, data and staff the final approved procedures are appropriate, legal and lead to a mid-range value, not a high value. This is summarized in the text of the resolution adopted November 7, 1989 (see Appendix A in the Commission Report of December 20, 1989).

The largest differences between DNR's preferred values and the values arrived at by the Commission's final approved procedures are in the surface estate and the mineral resources. Further clarification on surface estate valuation and procedure for valuing mineral resources follows.

Surface Estate Valuation Procedures

Because of time and financial constraints the Commission could not use "best practices" (i.e. appraisals). Instead, three geo-panels of appraisers were selected to give opinions of value for parcels in their regions. At best the process was highly judgmental and subjective, but in addition only an estimated seven to ten minutes was spent on each parcel and data was limited to that provided by DNR or brought to the meetings by the appraisers. Because of inevitable differences of opinion between appraisers and the probability of error due to time and data limitations, the approved procedures provided for a review and discussion of questioned values. In the event the review step did not resolve differences, the Commission could utilize a mediator to recommend resolution.

The review stage was never completed and the mediation stage never reached.

Although problems arose in connection with the operations of the geo-panels, it was with the initiation of the review stage of the approved procedures that the surface estate valuation process began to break down. Through various tactics the DNR staff attempted to thwart the proper implementation of this stage of the surface valuation with the justification that the approved procedure might result in increases in values. After several bitterly fought meetings, the process was allowed to continue with modifications. The Minority Report chose to ignore the review aspects of the approved procedures and wrongfully portrays the role of the review appraisers as something added later at the insistence of attorneys for the plaintiff and intervener.

The Southeast geo-panel was provided a random sampling of the questioned surface estate values. On the basis of the geo-panel's accepted adjustments the initial geo-panel value for

Southeast parcels was increased by 30%. However, of the 387 sample parcels reviewed more than half (207) were recommended for further mediation, a step of the originally approved procedures that never came to fruition.

The Southcentral geo-panel was called into review session, but DNR staff neglected to invite the review appraiser. Although an apology was made to the Commission, the end result was the reviewer could only be present for a few hours of one morning. At that time he did present comparable sales for large parcels which the geo-panel did not know existed. Once provided this useful large parcel information, the Southcentral geo-panel recommended five of six large parcels re-examined be increased in value by 68%. If the southcentral review had been possible, as provided by the approved procedures, there was a high probability other similar adjustments would have been made.

A review of the Northern geo-panel was never even initiated. At this point the Commission was informed by the DNR staff that funds had been exhausted.

In the course of carrying out the approved procedures it became apparent the opinion of value approach was seriously flawed. The State's appraiser provided the geo-panels during their deliberations with interpretation of the valuation instructions for application to actual cases. The review step disclosed the State's interpretations as not totally unbiased. During the geo-panels' deliberations the State appraiser reported to the Commission problems between members of the Southeast panel in coming to agreement. Additionally, the members of the Southcentral geo-panel submitted a memorandum to the Commission designed to protect their professional reputations. The memo stated the product of the abbreviated valuation process was "not even 'preliminary opinions of value' as commonly understood in the appraisal profession" and listed other limitations such as time and funding and the manner in which the State had parcelized the land for appraisal(see Commission Report, Appendix B, page B4).

The unfinished process of carrying out the approved procedures left the Commission with a wide range of surface estate values -- the adjusted values of the geo-panels advocated by DNR and the values presented by the review appraisers advocated by the plaintiffs. The Commission chose a procedure leading to a mid-level value between these extremes.

Procedures for Valuing Mineral Resources -- A Question of Most Appropriate Methodology

The National Appraisers Association Standards for determining fair market value recognized three general approaches: market (comparable sales), income (capitalization of income stream from the property) and replacement cost. From the beginning the public member majority of the Commission have insisted the methodology most appropriate to the type of estate being valued would be employed and the various Commissioners of DNR and designees understood this requirement. On September 29, 1987, for example, the then Commissioner of DNR directed the Division of Geological and Geophysical Surveys (DGGS) to "assess the quantity and quality of known and potential hard rock minerals...followed by a resource valuation." This value was to "be determined by an independent entity, likely retained under contract to the department."

In April 1988 DGGS maps reflecting mineral potentials and favorability of mineral occurrence on Trust Land were presented to the Commission. In preparing for the next phase, the Commission was informed

> *"assuming it proves impossible to complete an in-house mineral valuation (for whatever reason), we will be prepared to proceed with contract solicitation to complete the work."*

The Commission assumed it had approved procedures that included mineral valuation by outside consultants using the income approach. This is the point at which DNR decided to depart from the previously approved procedures and to use instead the comparable sales approach. The comparable sales approach was considered totally inappropriate by the public members as well as the State's own professional consultant, (Dr. Harris). Using the wrong approach, DNR first set the mineral value at zero and later at $16 million. In commenting on the Commission's rejection of this value, the Minority Report author agrees, "The initial value determined--$16 million--admittedly seemed quite low." (see Minority Report, page 16).

To bring these mineral valuation procedures to a conclusion, therefore, the plaintiffs and interveners entered into a contract with independent consultants as provided in the originally approved procedures. The Minority Report asserts wrongfully that the consultants used "a procedure not previously recommended by the Commissioner or formally discussed or approved by the Commission." This statement is an outrageous distortion of the truth. From the very beginning the Commission has distinguished between procedures and the methodology selected to implement the procedures and also has always held the most appropriate methodology would

be used in implementing the procedures. This was formally reiterated by the Commission and agreed upon by all members at the July 12, 1989 meeting. "Fair market value for purposes of Chapter 48 means utilization of the best information and methodology available." (see Commission Report, page 5, emphasis added).

Designee Swope and the DNR staff, however, have overlooked this Commission direction. Instead, at the September 5, 1989 meeting the lead DNR staff member emotionally exclaimed

> *"we have been faithful to the market approach because that is what the Legislature required."*

(Commission Report, page 5). We have searched the statute in vain for any such requirement! Stonewalled by DNR staff the Commission was left with two mineral values ranging from the unacceptable "comparable sales" value of $16 million and the $1.5 billion value arrived at by employing an appropriate "income" methodology.

DNR staff have consistently insisted on or returned inappropriately to reliance upon only one methodology -- comparable sales -- and have gone to the extreme of insisting this and nothing else results in fair market value. This entrenchment is clearly because their valuation experience has been primarily in "condemnation litigation" (the Minority Report at least twice, pages 10 and 27, admits these are the DNR standards). This is the methodology DNR has always used and they are most comfortable with. But, the present transaction is not a condemnation valuation and comparable sales are totally inappropriate to determining fair market value of a mineral endowment.

This view of limitations of DNR experience and capability was shared by DNR's own expert consultant, Professor Harris, who also provided possible explanation for DNR's very narrow interpretation. Dr. Harris diplomatically worded an evaluation of the technical expertise of the DNR staff (see Harris, September 1989, pages 8-9). Of the types of expertise required for the mineral estate valuation estimates attempted, he found the DNR staff qualified "as to certain types of deposits...especially well qualified as to regional knowledge...[but] not highly experienced in estimation methodology." He also noted the possibility of bias or at least the "appearance of conflict of interest," due to the State being defendant in litigation.

In his conclusion as to the requirements for a process following "best practices," Harris reiterated his evaluation of the in-house expertise by stating the DGGS work on mineral endowment would have to be redone. He recommended this work and the estimation of value not be done in-house. Instead,

the mineral endowment should be done by contract with the U.S. Geological Survey (he confirmed USGS could and were willing to do the work) and the valuation work should be done by independent economic consultants such as the Center for Mineral Resource Science in Arizona (Ibid. page 10). Ironically, these recommendations by DNR's mineral valuation expert consultant coincide with the recommendations of the Commission Chairman made in a memo over two years previously, June 19, 1987.

In Search of a Resolution:

The task of valuation was far more complex, controversial and time consuming than anyone had contemplated beforehand. The public Commission members entered the effort, more than three years ago, with the belief that fair resolution of the Trust valuation was in the best interests of Alaska. To not resolve the issue and continue the legal battle could be disastrous to the well-being of all Alaskans, not just the primary beneficiaries of the trust. The Commission believed at the outset that it had the latitude to craft a resolution that could be recommended to the Legislature. This goal was pursued until mid-1989 when it became apparent DNR and the public members of the Commission could not achieve accord on the methodology to be used in implementing the approved procedures.

Only at this point did the Commission contemplate amending the originally approved procedures. At its May 16, 1989 meeting the Commission discussed (but did not adopt) a draft report submitted by the three lawyers in the case which noted "Continuing with the Commission's currently approved valuation procedures no longer appears possible" and also recommending amended procedures. These would attempt to narrow the range of values calculated by use of the two sets of methodology and the Commissioner of DNR would determine a value within the narrowed ranges.

No progress was made toward narrowing the range and a team composed of the three lawyers in the Weiss case and a DNR staff member explored the possibility of using negotiation to arrive at an acceptable value for purposes of settlement. The defendants made a token increase (mineral value from $16 to $73 million) and the plaintiffs decreased their value by $200 million. At the October 1989 Commission meeting the team announced an impasse leaving a difference of more than $1.5 billion.

At this point Designee Swope agreed that a resolution setting forth procedures should be placed before the Commission for a vote. This was done on November 7th, 1989. The public members and their alternates stand firm on their final approved recommendations. We followed the law. We recognize a divergence of opinion exists. We see it as unfortunate complete consensus was not achieved. However, complete consensus may never be reached. We feel it is essential to complete the task of reconstituting the Trust and removing the threat of continued litigation and resulting disruption.

We urge the Commissioner of the Department of Natural Resources to use the Commission procedures in establishing a fair market value for the Mental Health Trust.

ALASKA MENTAL HEALTH BOARD

STEVE COWPER, GOVERNOR
STATE OF ALASKA

ST. ANN'S CENTER
419 6th STREET, SUITE 124
JUNEAU, ALASKA 99801
907-465-3071

March 26, 1990

Senate Resources Committee
P.O. Box "V"
Juneau, AK 99811

Honorable Senators,

The Alaska Mental Health Board(AMHB) has reviewed SB493, "An Act relating to the reconstitution and administration of the mental health trust." At its meeting in February the AMHB took action in support of the intent of SB493 including that:

(1) the Legislature recognize the trust value of $2,243,000,000 established under procedures approved by the Interim Mental Health Trust Commission,

(2) land and resources in legislatively designated areas be identified as security for the trust corpus, and

(3) revaluation procedures be established which effectively continue to reflect the value of the original trust lands over time.

In actions related to the AMHB discussion of SB493, the Board re-affirmed its prior action supporting appointment of an independent trustee for the mental health trust and urging the appointment of an interim trustee pending final resolution of issues in the Weiss v. State litigation.

On behalf of the Alaska Mental Health Board I convey their support for the intent of SB493.

Sincerely,

Dennis M. Scholl, Ph.D.
Executive Director

cc.
AMHB

Official Business

COMMITTEE: SENATE RESOURCES

DATE: 4/20/90

Subject of meeting: SB 493 Mental Health Trust

SIGN-IN

PLEASE PRINT!

NAME	ADDRESS (MAILING) & (ZIP)	PHONE	REPRESENTING	DO YOU WANT TO TESTIFY?
David V. Shoemaker	215 Fidalgo St., Suite 102, Kenai, AK 99611	(907) 283-7501	Central Peninsula Counseling Service	
BOB IRVINE	230 E. PAULSON STE 68 WASILLA	376-2411	MAT SU COMMUNITY COUNSELING	
DIANA BRINKMAN	" " "	"	" "	
~~Dianne Lyles~~	~~3601 C St, Anch, Ak 99503~~	~~762-2384~~	~~ADAP~~	
David Walker	326 4th St. Juneau	586-3537	Beneficiary	Yes?
Dennis Schwall	326 4th St #1110 Juneau	99801	AMHB & self	Yes