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1 meet the necessary expenses of the mental health program of the state.
2 In making annual appropriations from the mental health trust income
3 account, the legislature shall consider the recommendations of the
4 Alaska Mental Health Board established under AS 47.30.661, including
5 recommendations regarding capital improvements. After the necessary
6 expenses of the state's mental health program have been funded, the
7 legislature may make appropriations from the mental health trust
8 income account for other public purposes.
9 * Sec. 4. AS 38.05 is amended by adding a new section to article 11 to
10 read:
11 Sec. 38.05.800. RECONSTITUTION AND ADMINISTRATION OF MENTAL
12 HEALTH LAND TRUST. (a) The commissioner of natural resources, under
13 procedures approved by the interim mental health trust commission,
14 shall determine the fair market value, as of the effective date of
15 this section, of all land selected by and patented to the state under
16 the Alaska Mental Health Enabling Act. The commissioner shall report
17 the determination of that value to the board established under AS 47.-
18 30.661.
19 (b) The commissioner of natural resources, with the approval of
20 the interim mental health trust commission, shall identify land within
21 legislative designations that is equal in value to all land selected
22 by and patented to the state under sec. 202 of the Alaska Mental
23 Health Enabling Act that is not in legislative designations.
24 (c) All land selected by and patented to the state under the
25 Alaska Mental Health Enabling Act that is within legislative desig-
26 nations, together with all land identified by the commissioner under
27 (b) of this section, constitutes the corpus of the mental health land
28 trust.
29 (d) Upon reconstitution of the trust under this subsection, land

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

commissioner of health and social services, or the commissioner's designee, and not fewer than nine nor more than 12 other members, appointed by the governor, with due regard for population and balanced geographic representation of the state.

(b) At least one-third of the members shall be consumers of mental health services, or parents or guardians of consumers.

(c) At least one-third of the members shall be either public or private providers of mental health services.

(d) The remaining members shall be representatives of the public at large.

Sec. 47.30.663. TERM OF OFFICE. (a) Board members serve staggered terms of three years.

(b) A vacancy occurring in the membership of the board shall be filled by appointment of the governor for the unexpired portion of the vacated term.

(c) Members may be removed only for cause, including, but not limited to, poor attendance or lack of contribution to the board's work.

Sec. 47.30.664. OFFICERS AND STAFF. (a) The board, by a majority of its membership, shall annually elect a chair and other officers it considers necessary from among its membership.

(b) The board will have a paid staff provided by the Department of Health and Social Services, including, but not limited to, an executive director who shall be selected by the board from candidates provided by the department. The executive director is in the partially exempt service and may hire additional employees in the classified service of the state. The executive director and the staff of the board shall be directly responsible to the board in the performance of their duties.

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Sec. 47.30.665. BYLAWS. The board, on approval of a majority of its membership and consistent with state law, shall adopt and amend bylaws governing its composition, proceedings, and other activities consistent with state law and including, but not limited to, provisions concerning a quorum to transact board business and other aspects of procedure, frequency and location of meetings, and establishment, functions, and membership of committees.

Sec. 47.30.666. POWERS, DUTIES, AND RESPONSIBILITIES OF THE BOARD. The board shall

(1) measure the extent of the mental health need and, as necessary, conduct independent studies, evaluate the statewide mental health information system, and review the current mental health program of the state;

(2) provide a public forum for discussion of issues regarding current and potential services to persons served by the mental health program of the state;

(3) determine the needs, including those currently unmet, of the persons to be served by the mental health program of the state;

(4) 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, from the Department of Revenue regarding allocations to the mental health income account, and from other departments regarding the current and projected revenue for the support of the mental health program of the state;

(5) subject to disclosure restrictions imposed by state or federal confidentiality or privacy laws, have access to information in the possession of state agencies;

(6) in conjunction with the Department of Health and Social Services, prepare and annually update a long-term comprehensive state

mental health plan, to include the projected need and the services, facilities, and resources for the mental health program of the state to meet that need;

(7) in conjunction with the Department of Health and Social Services, develop, prepare, adopt, and periodically review and revise as necessary an annual state implementation plan to meet the needs of persons served by the mental health program of the state;

(8) in conjunction with the Department of Health and Social Services, and before developing the annual state implementation plan, evaluate the effectiveness of the prior year's implementation plan and evaluate program performance and recommend improvements, set priorities, and establish criteria to utilize in funding allocations;

(9) report at least annually to the legislature, governor, and commissioner of health and social services, and meet with appropriate legislative committees, concerning the board's activities, including its evaluation of the effectiveness of the prior year's implementation plan, and its recommendations to meet the necessary operating and capital expenses of the mental health program of the state;

(10) serve as an advocate before the executive and legislative branches of government and the public on behalf of those served by the mental health program of the state;

(11) discourage duplication of services and promote efficient and coordinated use of federal, state, and private resources in the provision of mental health services; and

(12) review applicable statutes, regulations, and policies and recommend appropriate changes.

Sec. 47.30.669. DEFINITION. In AS 47.30.661 - 47.30.669, "board" means the Alaska Mental Health Board established in

AS 47.30.661.

* Sec. 7. Section 1(b), ch. 132, SLA 1986, is amended to read:

(b) The commission established under (a) of this section consists of three [FIVE] members, including the commissioner of natural resources, or the commissioner's designee [AND THE COMMISSIONER OF HEALTH AND SOCIAL SERVICES, OR THEIR DESIGNEES], and two [THREE] members and two [THREE] alternates [APPOINTED BY THE GOVERNOR] as follows:

(1) a member and an alternate representing the plaintiffs who were [,] appointed by the governor from a list of three names submitted to the governor by the plaintiffs in Weiss v. State, 4 FA 82-2208 Civil;

(2) a member and an alternate representing the intervenors who were [,] appointed by the governor from a list of three names submitted to the governor by the intervenors in Weiss v. State, 4 FA 82-2208 Civil [; AND

(3) A MEMBER AND AN ALTERNATE REPRESENTING THE GOVERNOR'S MENTAL HEALTH ADVISORY COUNCIL, APPOINTED BY THE GOVERNOR FROM A LIST OF THREE NAMES SUBMITTED TO THE GOVERNOR BY THE GOVERNOR'S MENTAL HEALTH ADVISORY COUNCIL].

* Sec. 8. Section 1(c), ch. 132, SLA 1986, is amended to read:

(c) The members of the commission shall elect a presiding officer. A majority of the commission constitutes a quorum. The affirmative vote of two [THREE] members is required to take official action. A vacancy does not impair the power of the remaining members to exercise the powers of the commission.

* Sec. 9. Section 2, ch. 132, SLA 1986, is repealed and reenacted to read:

Sec. 2. RESPONSIBILITIES OF THE COMMISSIONER OF NATURAL RE-

SOURCES AND THE COMMISSION. (a) The commission shall review 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 land 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.

(b) The commission shall review the identification by the commissioner of natural resources under AS 38.05.800 of 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 designations.

(c) In the exercise of the commission's responsibilities under this section, the commission and its staff may review the records of the Department of Natural Resources that are made confidential by law or regulation. An individual who acquires information made confidential by law or regulation in the performance of functions authorized by this Act and discloses it without proper authority violates AS 11.56.860.

(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. 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.

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(e) The commissioner of natural resources may transfer trust land to the federal government under AS 38.05.035(b)(9) without approval of the commission. The commissioner of natural resources shall advise the commission of an intention to transfer trust land to the federal government and, after the transfer, shall make every effort to acquire replacement land to fulfill the state's remaining entitlement based on a prioritization, approved by the commission, of existing valid mental health selections.

* Sec. 10. Section 6, ch. 132, SLA 1986, is repealed and reenacted to read:

Sec. 6. This Act is repealed on the certification of the commissioner of natural resources that the mental health land trust has been reconstituted under AS 38.05.800 to

(1) the Alaska Mental Health Board established under AS 47.30.66 ;

(2) the lieutenant governor; and

(3) the revisor of statutes.

* Sec. 11. TRANSITIONAL PROVISIONS. Beginning with fiscal year 1989 and continuing until the commissioner of natural resources certifies to the commissioner of revenue that the mental health land trust has been reconstituted under AS 38.05.800, as enacted in sec. 4 of this Act, the commissioner of revenue shall annually allocate from the general fund of the state to the mental health trust income account in the general fund an amount equal to five percent of the unrestricted revenue of the state for the fiscal year.

* Sec. 12. Notwithstanding AS 47.30.663(a), as added by sec. 6 of this Act, of the initial appointees to the Alaska Mental Health Board appointed under AS 47.30.662, as added by sec. 6 of this Act, one-third shall serve for one year terms, one-third shall serve for two year terms, and one-third

for three year terms.

* Sec. 13. AS 37.14.010, 37.14.020, 37.14.030, 37.14.040, 37.14.050; AS 47.30.605; and sec. 3, ch. 132, SLA 1986, are repealed.

* Sec. 14. Sections 7 - 10 of this Act take effect July 1, 1987.

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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.

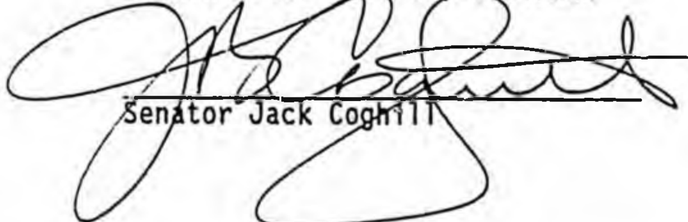
The Committee is authorized to meet during and between sessions of the Legislature, and terminates upon convening of the First Session of the Seventeenth Legislature. The Committee conducted two public hearings during the past interim and met individually with many of the participants in this issue. 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,

Senator Pat Pourchot, Chairman



Senator Jack Coghill

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/AYI/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 meaing 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 statutorily 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.

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(907) 586-3537

January 23, 1990

HAND DELIVERED

Senator Jack Coghill
Senate
Capitol Building, Room 30
P. O. Box V
Juneau, Alaska 99811

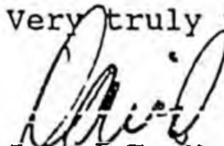
Re: Mental Health Trust Land Settlement

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
406 G STREET, SUITE 206
ANCHORAGE, ALASKA 99501
(907) 274-7686
TELECOPIER (907) 274-9493

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 1981).

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.
>
> 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 17? 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 in The Law of Trusts and Trustees, Revised Second Edition[9]., 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.
>
> 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.
>
> (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."
>
> (2) He may have knowl[illegible] [illegible]oming to him or his agent through the senses [illegible] or hearing, which shows that the property in [illegible] 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 statutes treat him as having notice, whether or not he is 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.

* * *

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.

* * *

> 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.
>
> * * *
>
> 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.
>
> * * *
>
> 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."
>
> * * *
>
> 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.
>
> * * *
>
> [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.
>
> * * *
>
> 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.
>
> * * *
>
> [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 suit, for tracing as to all property identified and a 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.
>
> * * *
>
> 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.
>
> * * *
>
> [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.

---

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.
>
> * * *
>
> 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.
>
> * * *
>
> 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 trustee's own, the entire commingled fund is subject 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.
>
> 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 fund, and by the appointment of a receiver, or in some 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.

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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.

----

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 formally 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

----

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.

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

RECEIVED APR 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 Economic 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).

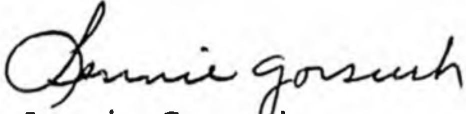
3. Remove the requirement in AS 38.05.800(a) that the commission approve the procedures to be used to value the original grant and the replacement lands.

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
Commissioner

INTERIM MENTAL HEALTH TRUST COMMISSION

DRAFT FINAL REPORT

(December 20, 1989)

on

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

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),

CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

02–576(2/77)

INTERIM MENTAL HEALTH TRUST COMMISSION

DRAFT FINAL REPORT

(December 20, 1989)

on

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

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.

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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 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. The other public member of the Commission, Dr. Lidia Selkregg, is a professional geologist and planner. Dr. Selkregg has served on the Anchorage Assembly and its Planning and Zoning Commission. She is also a Professor Emeritus at the University of Alaska and developed its planning curriculum. 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;" Koester, May 9, 1989, "Fair Market Value.") 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 the 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 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 in-

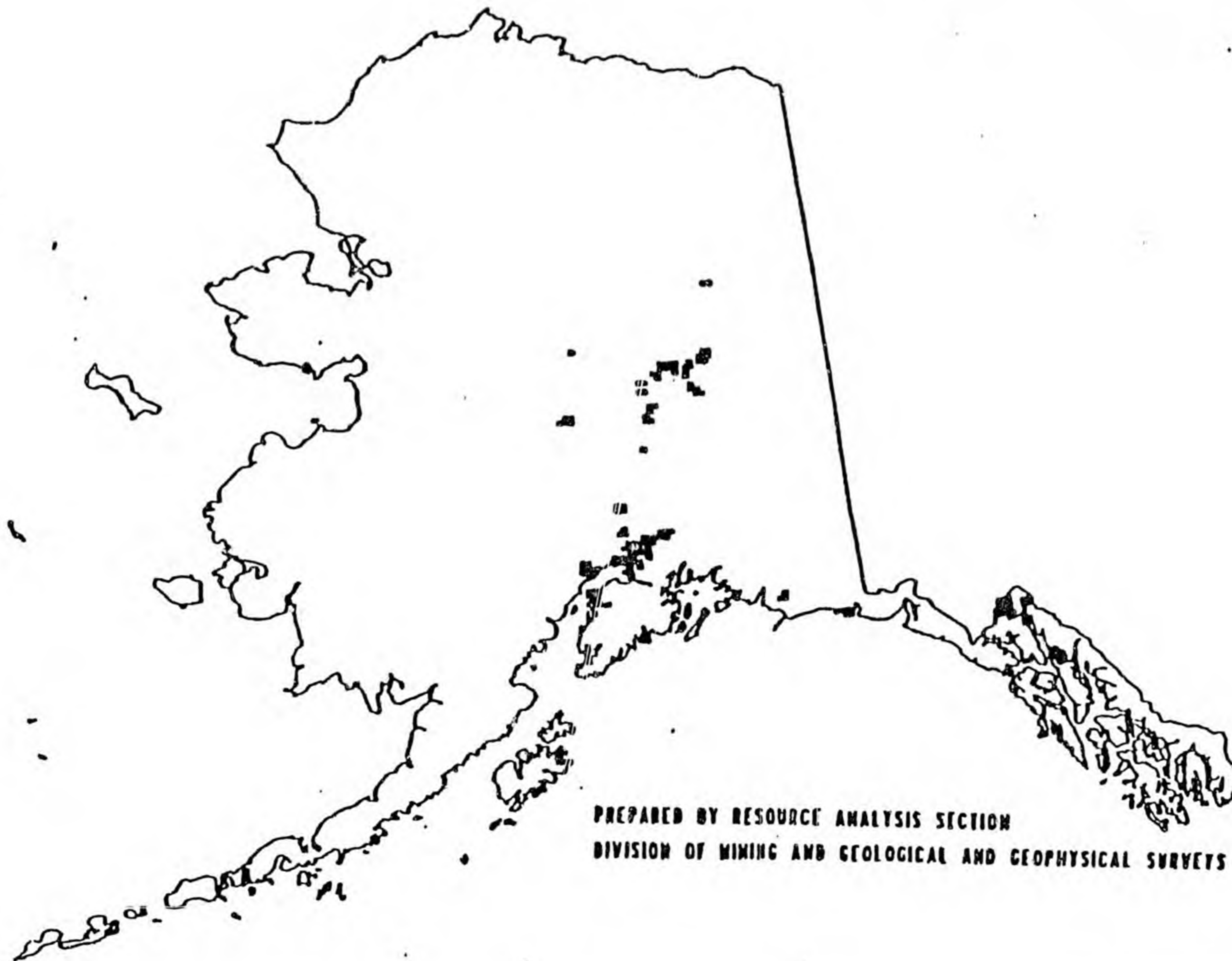
tent, the land selections made by the Territory and State of Alaska between 1956 and 1965 were based upon <u>income analysis</u>. Selections were anticipated to be suitable for development and targeted lands surrounding the principal urban centers and known commercially valuable natural resource lands 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 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. <u>ESTABLISHING PROCEDURES</u>

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 <u>most appropriate</u> 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 from the beneficiaries. Where it was not possible to arrive at a value in-house, this task would be contracted to a consultant.

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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.

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

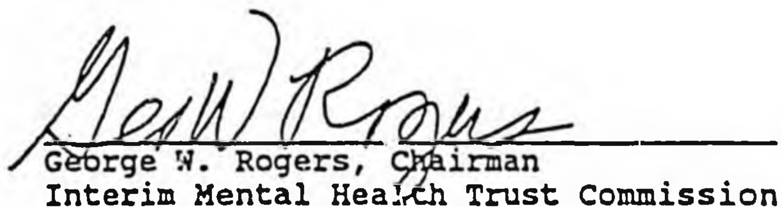
and the necessity of arriving at procedures for determining the fair market value of the oil and gas resources of mental health trust lands, the Commission hereby approves as its procedures, the methodology, data, assumptions and judgments utilized in the "Hydrocarbon Potential of Mental Health Grant (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 Selkregg	Commissioner Swope	

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 ____).

In 1986 the State used a similar approach to value some 55,000 acres of Mental Health Trust Lands that had been approved 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 796% 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 ________ parcels of which 7,000 were Mental Health Trust Lands and ________ 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

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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.

number of Questioned Values focused on consideration of site 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 review appraiser in attendance to consider the review appraiser's presentation of information developed regarding large parcels. 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. In addition, three very important large parcel sales occurred in late 1988 -- early 1989. 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.