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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.

# ACTIVITIES AND COSTS
for the
ESTIMATION OF MARKET VALUE OF MINERAL RESOURCES
of
ALASKA MENTAL HEALTH TRUST LANDS

Prepared
by

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Submitted to

Alaskan Department of Natural Resources
Division of Land and Water Management
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INTRODUCTION

This report describes the activities required to produce a credible estimate of the market value of mineral resources of the lands of the Alaska Mental Health Trust and the costs of these activities. Basically, evaluation of these lands requires first the probabilistic estimation of mineral endowment (number of deposits and their features) and second, the estimation of the economic value of the mineral endowment so as to produce a probability distribution of market value. Details on information, method, activities and their costs are provided in the sections that follow.

MINERAL ENDOWMENT ESTIMATION

Perspective

A credible estimate of market value of Alaska's Mental Health Lands (MHL) for their potential mineral resources must rest upon a credible estimate of the number of undiscovered mineral deposits that occur in said lands and characteristics of the deposits, e.g., ore tonnage and average grade, depth to deposit. Inasmuch as potential deposits are not visible, their number and characteristics can only be inferred from indirect information, e.g., observed geological features and characteristics of deposits of the same type and geologic environment but in other well explored, analogous regions. Because of incomplete geological information on the region being evaluated, number of deposits is an uncertain quantity and is appropriately described by a probability distribution. Similarly, since potential deposits cannot generally be seen, their characteristics, e.g., size, grade, morphology, and depth of cover are unknown and should be described probabilistically. Estimation of the number of deposits occurring in a region and their characteristics is generally referred to as mineral endowment estimation.

This probabilistic description of undiscovered mineral endowment (inventory of undiscovered deposits), which is the foundation for mineral resource appraisal or for the description of the market value of potential mineral resources, was not made by the ADGGS nor by Metz, Delong, and Associates (MDA). Consequently, the first, most fundamental, and most important task in the estimation of fair market value of MHL is to describe probabilistically the mineral endowment of these lands.

## Appraisal Methodology

Time considerations preclude the generation of quantified geology, geochemistry, geophysics, structure, alteration, and mineralogy and comprehensive synthesis of information in such data sets for the objective quantitative estimation of mineral endowment, as described in Harris and Pan (19 ). Instead, the estimation of mineral endowment must rely upon the subjective integration by well qualified geologists of geoinformation and resource information with geoscience. Experience has shown that at best this is a very difficult task and requires support by relevant data and an appraisal methodology. When not supported by controls (analogue areas, genetic models, deposit models, etc.) estimates of an uncertain event even by experts may exhibit strong biases, both motivational and cognitive. While an appraisal methodology cannot totally remove these, it can mitigate to some degree the magnitude of biases, and it provides a "track" of data and reasoning that lead to the mineral endowment estimates. Consequently, it is important that a methodology be identified and consistently administered. In that regard, at least one individual who is highly experienced in mineral resource estimation should oversee and manage the mineral endowment estimation process. An even better appraisal would result if the appraisal process were monitored by two experts, one whose expertise is in Alaskan geology and mineral deposits, and one whose expertise is appraisal methodology. Together, these individuals could provide assistance to the geologists who estimate the mineral endowment, and they could lend credence to appraisal estimates as being unbiased and made by good procedures.

Necessity for Reexamination of Geology

A natural inclination is to consider the endowment estimation as an add-on to the product of the ADGGS effort, which produced rankings: the first ranks MHL from 5 to 1 by their favorability for mineral deposits; the second ranks MHL from 5 to 1 by the amount and quality of information available. Moreover, for favorability rankings of 3, 4, or 5, the mineral deposit types to which the geologic environment is permissive were identified. An initial perception may be that the same ADGGS geologists who made the rankings could also provide subjective probabilities for number of deposits simply as an extra, independent effort, based upon consideration of the favorability rankings only. In other words, the geologists would convert the favorabilities to probabilities for number of deposits. Unfortunately, such an approach is strongly discouraged, because it does not recognize the need of the geologist to consider geology, spatial dimensions of the parcel, and deposit features explicitly and critically vis-a-vis geology in the estimation of the probability distribution for number of deposits. Clearly, probabilistic estimation of number of deposits is far more difficult than favorability ranking because it requires the relating of geology to magnitude of mineral endowment and probability. Examination and analysis of the geology for that purpose requires information about mineral deposit densities and methodological support for elicitation of subjective probabilities. Both of these are major tasks not undertaken in the previous effort by ADGGS.

Basically, the point to be made in the foregoing is that much of the geologic analysis by ADGGS personnel will have to be redone for the estimation of mineral endowment. This effort will be more extensive than it would normally be, because the various data sets, e.g., geochemistry, geophysics, lithology, etc., were not compiled at constant scale to new maps nor to composites. Due to shortage of time and resources, the data sets were assembled from various sources and utilized in their original forms to perform the favorability rankings, after which the data were returned to their sources. Since compilations and composites to constant scale were not made, the geologic analysis for endowment estimation would have to repeat this initial data and information acquisition.

## Study of Analogue Areas

A well designed and executed estimation of mineral endowment differs from favorability ranking in another very important regard, the use of analogue areas. When the objective of the geological analysis is mineral endowment estimation, the study of analogue areas is nearly as important as is the geological analysis of the MHL themselves.

An analogue area is a well explored area having a geologic environment similar to the region or land parcel under appraisal. Ideally, several analogue areas would be identified and studied for each specific geologic environment or deposit type, e.g., volcanogenic massive sulfides or epithermal gold, etc. Besides providing information on geologic particulars, these areas support the geologic estimation of mineral endowment by providing information on deposit density and on how that density varies in response to geologic differences. Such information is of great value to the geologist in estimating probabilities for numbers of deposits indicated by the geology of a MHL parcel. Of course, wise use of deposit density information requires that the criteria used to delineate permissive or favorable areas are compatible with criteria used to delineate the analogue area; consequently, geology of the analogue areas also must be carefully reviewed and compared with that of MHL land parcels to assure uniformity.

## Important Information From Other Work

### Mineral Endowment Appraisals.

One of the first tasks in preparation for estimation of mineral endowment of MHL is the review and use, where relevant, of resource appraisals made by other institutions or agencies of parts of Alaska. Probabilistic estimates of the mineral endowment of much of the MHL have been made at one time or another by U.S. agencies. Generally, the tracts or favorable areas appraised in previous studies are much larger than the parcels of MHL; consequently, few of these estimates could be used directly. But, they provide information that represents considerable effort for the explicit purpose of mineral endowment estimation. Such information is available at a very small cost and should be considered and evaluated as a starting point in the mineral endowment estimation of MHL.

AMRAP. In 1974, the U.S. Congress mandated the U.S. Geological Survey to appraise the "mineral resource potential" (mineral endowment) of the d-2 lands of Alaska as support for approaching land classification decisions in December of 1978. Geologic, gravity, and aeromagnetic maps were compiled at a 1:1,000,000 scale for all of Alaska and geochemical data were assembled for local areas. Deposit models were compiled for several types of deposits, and favorable areas were delineated for these deposit types throughout all of Alaska except the North Slope, Aleutian Islands, islands of the Bering Sea, and Southeastern Alaska. Using expert judgment, numbers of deposits for specified probabilities were estimated for each deposit type and favorable area. These estimates are available in various USGS Open File Reports. A brief description of the study is reported by D. A. Singer and A. T. Ovenshine in "Assessing Metallic Resources in Alaska," American Scientist, v. 67, no. 5, 1979, pp. 582-589. Besides this work done at the 1:1,000,000 scale, mineral endowment of a few regions, e.g., Nabesna Quadrangle by Richter, et al (1975), was completed at the 1:250,000 scale. It is my understanding that the boundaries of the favorable areas delineated in the AMRAP mineral endowment appraisal have been digitized and processed to a GIS file and that a map of these areas can be obtained from the ERDAS Center at Sioux Falls , South Dakota, by contacting Ray Arndt, Program Manager, National Mapping Division, U.S.G.S.

Other Mineral Endowment Appraisals. In addition to the AMRAP appraisal, more recent appraisals by the USGS include Chugatch National Forest, Open File; some Southeastern Alaska regions, Open File; and Seward Peninsula tin (D. Menzie) forthcoming in Economic Geology. Finally, a mineral endowment appraisal of the Tongas Forest is currently under way by the U.S.G.S.

Analogues and Deposit Densities.

A common reference for mineral endowment appraisal and resource evaluation is USGS Bulletin 1693, entitled "Mineral Deposit Models," edited by D. P. Cox and D. A. Singer, which gives descriptions of geologic environments and size and grade distributions for many deposit types. Additional deposit models as well as new developments in resource appraisal methods are forthcoming in a new USGS Bulletin to be published sometime this year. Information on this work could be obtained from Jim Bliss of the Tucson Field Office of the USGS, 210 E. 7th St., Tucson, AZ 85705.

As indicated in an earlier discussion, one of the most difficult tasks of the geologist in estimating mineral endowment is the associating of number of deposits with the geology of a region. Accordingly, statistical information on deposit density of analogue regions is extremely important support for this task and should be made available whenever possible. In that regard, work completed or in progress on deposit density by the USGS could be highly beneficial to the estimation of mineral endowment of MHL. Studies of deposit densities have been completed or are in progress on the following: Cyprus massive sulfides, gold placers, mercury, bedded barite, podiform chromite, and gold veins. For further information, contact Jim Bliss, USGS Tucson Field, Office, Tucson, AZ.

## Logistics of Endowment Estimation

### Kinds of Expertise.

A credible estimation of undiscovered mineral endowment brings together three kinds of expertise: geoscience of mineral resource formation, specific knowledge of the geology of the region and of the land parcel, and estimation methodology. Seldom is any one individual truly expert in all three kinds of knowledge, particularly when the endowments of several deposit types must be estimated. Consequently, a credible endowment estimation entails "engineering" the contributions from multiple sources so as to produce the desired probabilistic estimates of endowments of the land parcels in specific metals.

Having recently completed the favorability ranking of the MHL and having first-hand knowledge of the geology of some areas, geologists of the ADGGS are especially well qualified in the second expertise, knowledge of the regional and local geology. Moreover, some of them are well qualified in the first expertise, at least for certain deposit types. While not highly experienced in expertise three, estimation methodology, some of them have had some experience in that regard.

There is little doubt that there is no other group of geologists having as much collective experience in mineral endowment estimation using subjective probability as the geologists of the U.S. Geological Survey, Office of Mineral Resource Analysis, under the direction of Dr. Glenn Allcott. These geologists include prominent names in mineral endowment estimation, e.g., David Menzie, Don Singer, Norm Page, Greg McKelvey, Jim Bliss, to name a few. These and other

USGS geologists also are highly knowledgeable of the geoscience of resource formation, at least for some deposit types. Some USGS geologists undoubtedly have expert knowledge of the regional and local geology.

The Estimators.

Since estimates of market value of MHL could influence future land tenure decisions by the State of Alaska or the bases for royalty assessments, the possibility for conflict of interest of geologists employed in the mining industry of Alaska preempts their performing of the endowment estimation itself, even though they may be very excellent sources of geologic and mineral resources information. Exclusion of this body of expertise leaves two groups of geologists who by virtue of their knowledge and experience could produce credible estimates of mineral endowment of the MHL: the U.S. Geological Survey and the ADGGS geologists. Even for one of these, the ADGGS, someone or some institution seeking to discredit or taint an estimate by ADGGS may suggest conflict of interest because they are employed by the State of Alaska, one of the principals in previous litigation. While in concept, such conflict of interest may be possible, I found no evidence for it. Quite to the contrary, the personnel of ADGGS seem to be possessed mainly of professional concerns regarding geoinformation, methodology, and the scientific basis for endowment estimates. If the illusion of conflict of interest should be considered an issue, it could be mitigated by either (1) contracting the estimation task and responsibility with someone or some institution other than ADGGS with the understanding that the ADGGS personnel would perform the estimation under his supervision, or (2) contracting directly with the

ADGGS with the requirement that the ADGGS obtain the services of two highly qualified and prominent experts to monitor and supervise the estimation; one of these should be an expert in appraisal methodology, and the other should be an expert in mineral deposits and the geology of their formation.

Alternatively, the mineral endowment estimation could be contracted directly with the U.S. Geological Survey. Clearly, such a plan would remove the issue, or illusion thereof, of vested interest. I have checked informally with personnel of the U.S. Geological Survey and found that such a plan in its broadest generality is feasible. However, I cannot comment upon the terms (budget and time) required of the U.S. Geological Survey to perform the estimation. DNR would need to explore this directly with Dr. Glenn H. Allcott, Chief, Office of Mineral Resouces, U.S. Geological Survey, 12201 Sunrise Valley Drive, MS 917, Reston, VA 22092.

If there were no special contracting considerations, e.g., an Alaskan contractor, other than the engineering of an impartial, highly credible endowment estimation, there would be considerable merit to contracting the work with the Center for Mineral Resources Science (CMRS) currently being created at the University of Arizona. The purpose of the CMRS is to coordinate interaction of geologists, mineral resource specialists, and mineral economists of the University with those of the Tucson Field Office of the USGS specifically for the estimation of mineral endowment and the economic analysis of mineral resources. Prominent USGS mineral resource assessment specialists at Tucson include Norm Page, Jim Bliss, and Greg McKelvey. Participation of personnel of ADGGS, USGS, and the University of Arizona could be very effectively coordinated through CMRS for the estimation of MHL mineral endowment. Moreover, the CMRS could also perform the other tasks required to convert the mineral endowment distributions to market value distributions through the expertise of the mineral economics faculty, who are members of the CMRS. Such a plan would increase both the level of expertise brought to bear upon the endowment estimation and maximize, given the time constraint, information availability. Of course, costs of implementing such a plan would, everything else being equal, increase simply because of the involvement of more individuals and institutions and because of the increased management task.

## Complications Due to Scattered and Small Land Parcels

Some of the MHL land parcels are very small and widely scattered as compared to the tracts of land for which endowment estimates are usually performed. Being both small and widely scattered compounds endowment estimation scientifically and increases considerably the effort required. Metallogenetic processes that are reflected in the geological information customarily available to and used by geologists to estimate mineral endowments of unexplored areas have natural scales, some of which are regional. Analogue regions, as well as regions of geologic experience with regard to endowment estimation, are usually larger than these small parcels. Moreover, larger regions generally have more varied geology and provide robustness to endowment estimates. For all of these reasons, a geologist is reluctant to estimate mineral endowment of a small land parcel. While there is no way to remove totally these conceptual and logistical issues, they can be mitigated to some degree by aggregating land parcels in a given region when they exhibit geology of a like geologic environment and deposit type. When this cannot be done, it may be useful for the geologist to select the best matching analogue and to evaluate the analogue area as though it possessed the geology of the parcel and then to use a programmed mathematical procedure to compute from the adjusted analogue distribution the probability distribution for number of deposits that is consistent with the size of the parcel. This could serve directly as the desired probability distribution or it could be taken as a first approximation, one that could be modified by the geologist. Of course, such an approach relies even more heavily upon analogue areas and the availability of a computer algorithm to support the estimation process. Moreover, complications may arise when the geology of a small land parcel is consistent with more than one possible analogue. These could be treated by either compiling a composite analogue or by estimating endowment separately for each analogue and requiring the geologist to provide numerical expressions of the similarity of the parcel to each analogue. Either procedure requires both data and computational support.

Cost of Endowment Estimation

Estimation of costs for the mineral endowment estimation of MHL requires fixing some parameters. Accordingly, for the purpose of cost estimation, I have made the assumption that the ADGGS would perform the endowment estimation via budget appropriation by the State of Alaska. Table 1 itemizes costs by major activity. Most of these costs were estimated jointly with personnel of the ADGGS, drawing upon costs of activities in the previously completed favorability ranking project.

TABLE 1

ESTIMATION OF COSTS FOR ENDOWMENT ESTIMATION*

| Activity | Estimated Cost |
|---|---|
| Acquisition of basic geodata and information[1] | $ 20,000 |
| Preparation of analogues and supportive information | 35,000 |
| Information enhancement | 20,000 |
| Preparation of map overlays (personnel and materials) | 14,000 |
| Analysis of MHL geology and of analogues in preparation for endowment estimation | 50,000 |
| Estimation of subjective probabilities for endowment by deposit type and geologic environment | 25,000 |
| Experts serving as monitors and consultants | 21,000 |
| Special support required because of small land parcels | 15,000 |
| TOTAL | $200,000 |

*Based upon direct costs for ADGGS and supplementary assistance.

[1]This includes the re-creation of the data base used in the favorability study and the acquisition of information on previous mineral endowment estimations and on previous, relevant analogue studies.

Moreover, these costs were made for a minimum acceptable effort to produce a credible endowment estimation, without the generation of additional geoscience information. To these base activity costs made jointly with ADGGS, I have added some additional ones, such as experts serving as monitors and consultants, and special support required because of small land parcels; these were described in previous sections and do not require additional comment. One cost item not yet described is information enhancement. Although no new geodata will be generated by primary surveys, there may be a need for the enhancement of selected geodata used in the previous favorability ranking so as to better support the estimation of number of deposits. The cost of $20,000 is to permit enhancement on a very limited scale, leaving the specification of data and kind of enhancement to be made by the ADGGS working in conjunction with the consulting experts.

A cost of $25,000 allowed for the estimation of subjective probabilities for endowment is to include some pre-estimation experimentation with and calibration of estimation methodology, with direction from the experts on methodology, e.g., use of analogue areas, and the preferred procedure for estimating probabilities.

A sizeable cost has been allocated to the preparation of analogues and supporting information because of their importance in supporting the endowment estimation process. Even so, this activity is viewed as incremental to the work already done, as described in previous sections, on deposit density studies and deposit models. This additional effort is required because for some deposit types, density studies are not available. Moreover, a geologist never has enough analogue information when he attempts to consider the effects of geologic differences between land parcel and analogue on number of deposits. Typically, given the importance of good analogues, too little effort is given to preparation and study of analogues.

Experience may show that any one of the estimated costs may vary considerably from actual costs, but overall I believe these differences will offset each other so that overall, a cost of $200,000 for direct costs of all activities leading to a credible estimate of mineral endowment of MHL will not vary much from actual costs (see Table 1).

## MINING AND MILLING COSTS

### Perspective

One of the most glaring deficiencies of the analysis by Metz and Dixon of the market value of the MHL is the failure to consider explicitly costs of mining and milling by deposit type. No matter how comprehensive the geological estimation of metal endowment is, it will not result in a credible estimate of market value unless the major costs incurred in the production of a marketable commodity are credibly estimated and are integrated with relevant recoveries and revenues for the computation of net present value. Inasmuch as production costs and recoveries vary by deposit type, they must be described by deposit type.

Operating and capital costs of mining and milling are affected by a host of factors, such as kind of host rock, rock fracturing, deposit tonnage and average grade, mineralogy, spatial distribution of mineralization, depth to deposit, surface and subsurface water conditions, terrain, climate, etc. However, since the market value of MHL derives from deposits not yet known, most of the factors affecting costs are not known either. Thus, the approach to cost analysis is to describe how costs on average vary with the major determinants of costs, such as deposit type, deposit size, grade, depth, and mineralogy when the deposits are in Alaska.

The task of re-estimating market value of MHL could benefit greatly from mineral resource studies performed in the past few years by the U.S. Bureau of Mines (BOM). Some objectives of these studies are similar to those of the MHL. Accordingly, the BOM describes the major costs incurred in translating an in-ground, postulated resource into a marketable commodity.

The approach taken by BOM was to use its extensive, computerized costing system, known as CES, to create simplified descriptions of capital and operating costs for mining, processing, and local infrastructure. These cost relations, with adjustments for inflation and cost differentials by region, could be used in the economic analysis of market value of MHL. Estimated cost relations developed by BOM that are relevant to the analysis of MHL are described below.

## Previous Work

### Tonopah.

A 1988 Open File Report (OFR 31-38) of the U.S. Bureau of Mines, authored by T. Gunther, B. White, R. Gillette, and R. Adams, describes the economic evaluation of selected undiscovered precious metal deposits in the Tonopah Quadrangle of Nevada. The appendix to this report, entitled Engineering Cost Analysis of the Potential Mineral Supply of the Tonopah Quadrangle, Nevada, contains mining and milling cost relations for the deposit types listed in Table 2. Clearly, these cost relations are for precious metal deposits in Nevada in January 1986 dollars. As such they do not apply to deposits in Alaska. Best practice would require that these relations be re-estimated for deposits in the various regions of Alaska; however, Alaskan costs could be approximated by adjusting the Nevada equations for inflation and for cost differentials for Alaska relative to Nevada using adjustment factors estimated by the U.S. BOM.

TABLE 2

MINE AND MILL MODELS FOR DIFFERENT DEPOSIT TYPES

| Deposit Type | Proposed Mining Method | | Proposed Milling Method |
|---|---|---|---|
| | Surface | Underground | |
| Carbonate-hosted (Carlin-type) | Open Pit | Room-and-Pillar | Heap leaching or Carbon-in-pulp[1] |
| Comstock/Sado Epithermal | $NA_p$ | Room-and-Pillar | Heap leaching or Merril-Crowe[1] |
| Hot Springs | Open Pit | Room-and-Pillar | Flotation |
| Polymetallic Replacement | Open Pit | Room-and-Pillar | Flotation |
| Polymetallic Vein | $NA_p$ | Cut-and-Fill | Flotation |

$NA_p$ - Not applicable

[1]The mill method used depends on the ore grade.

Source: U.S. Bureau of Mines OFR 31-38.

Juneau Mining District.

In March, 1989, an Open File Report, entitled Mine and Mill Models for the Juneau Mining District, by Thomas W. Cram, was completed by the Western Field Operations Center of the U.S. Bureau of Mines. This report describes cost relations by deposit type, mine type, and process, as indicated in Table 3. Clearly, these cost models are highly relevant to the evaluation of MHL in the Juneau area. Especially noteworthy is the fact that some of these same deposit types are among those having the greatest potential in the MHL lands in general; consequently, this study is of considerable value to an effort to re-estimate the market value of MHL. With adjustments for regional cost differentials in Alaska, these cost relations could be used for the same deposit types occurring elsewhere in Alaska. These regional cost differentials can be approximated using adjustment factors estimated by the U.S. Bureau of Mines.

White Mountains-North Steese Areas.

A report entitled The Potential Supply of Minerals from the White Mountains National Recreation Area and part of the North Steese National Conservation Area, Alaska, February, 1989, was prepared by the Division of Policy Analysis, U.S. Bureau of Mines, for the Fairbanks Alaska District Office of the Bureau of Land Management. This report describes the estimation of mineral endowment and the economic analysis of estimated mineral endowment for the estimation of potential mineral supply. Although the objective of that study is potential supply, not market value per se, the estimation of potential supply requires the same cost analysis of endowment as does the estimation of market value; consequently, the cost relations developed for that study are of potential use in the evaluation of

TABLE 3

GEOLOGIC MODELS AND CORRESPONDING MINE AND MILL TECHNIQUES

| U.S.G.S. Bull. 1693[1] | | Mine | Mill |
|---|---|---|---|
| p. 49 | Alaska PGE | Open Pit<br>1,000-10,000 mt/d | Flotation, 1 product<br>Gravity, 1 product |
| p. 86 | Cu Skarn | Open Pit<br>1,000-10,000 mt/d | Flotation, 1 product |
| p. 120 | Mo Porphyry-low F | Open Pit<br>1,000-10,000 mt/d<br>Sublevel longhole<br>500-5,000 mt/d | Flotation, 1 product |
| p. 125 | Polymetallic Vein | Overhand Stopes<br>100-500 mt/d | Flotation, 2 products |
| p. 189 | Kuroko Massive Sulfide | Open Pit<br>1,000-10,000 mt/d<br>Cut-and-fill<br>400-4,000 mt/d | Flotation, 2 products |
| p. 211 | Sedimentary Exhalative | Open Pit<br>1,000-10,000 mt/d | Flotation, 2 products |
| p. 239 | Vein Gold | Sublevel longhole<br>500-5,000 mt/d<br>Overhand stope<br>100-500 mt/d | Flotation, 1 product |
| p. 261 | Placer Gold | Placer 20-250 LCY/h | |

[1]Source: Cram, U.S. Bureau of Mines, 1989.

MHL. The appendix of the report on that study (Appendix A--Potential Supply Methodology) contains a detailed description of procedures and relations, including the deposit models and cost relations, as shown in Table 4. Most of these same deposit types are among those identified in the MHL; consequently, these mine-mill cost relations could be used in the re-evaluation of MHL by making adjustments for regional cost differentials based upon U.S. Bureau of Mines cost studies.

## Implications to Analysis and Costs

Restricting attention to those cost relations developed explicitly for areas in Alaska reveals that 12 cost models for 12 deposit types have been estimated which, with adjustments for regional capital and operating cost differentials, could be used in the re-evaluation of MHL. In view of the 29 deposit types recognized in the ADGGS favorability study, there remain about 17 deposit types for which cost relations have not been estimated. If cost analysis were to be performed separately for each of the remaining 17 deposit types, the cost would be approximately $100,000; this estimate is based upon the costs of previous work of about $6000/deposit type (Tom Gunther, U.S. BOM, personal communication, 1989).

Costs for estimating additional mine and mill cost relations probably can be reduced considerably below $100,000 by taking advantage of commonalities among deposit types, especially for capital and operating costs of mining. Examination of the foregoing cost analysis reveals that cost relations in Alaska have been estimated for seven different mining methods:

TABLE 4

DEPOSIT TYPES AND ASSOCIATED MINE AND MILL METHODS[1]

| Deposit Type | Recovered Commodities | Mine Methods | Mill Methods |
|---|---|---|---|
| Alkalic-associated gold | Au | Open Pit<br>VCR | Heap leaching<br>CIP process |
| Gold Placer | Au | Placer | Placer |
| Gold Vein | Au, Ag | Open-Pit<br>Cut-and-fill<br>VCR | Heap leaching<br>CIP process |
| Polymetallic Vein | Pb, Zn, Ag | Open Pit<br>Cut-and-fill | Polymetallic flotation |
| Sediment-hosted Pb-Zn | Pb, Zn, Ag | Open Pit<br>Room-and-Pillar | Pb, Zn flotation |
| Tin greisen | Sn, Ta, Ag | Open-Pit<br>Cut-and-fill<br>VCR | Sn flotation<br>gravity |
| Tungsten skarn | W, Au | Open-Pit<br>Shrinkage stope<br>VCR | W flotation<br>W gravity |
| Uranium | U, REO | Open-Pit<br>VCR | REO flotation |

[1]Source: Division of Policy Analysis, U.S. Bureau of Mines, 1989.

Open pit

Overhand stopes

Sublevel longhole

Cut and fill

Placer

Shrinkage stope

Room and pillar

Mining costs for a deposit type are a function directly of deposit size or indirectly via output rate or mine life, one of which is related to deposit size. Since mining costs are described in terms of dollars per ton of ore, mining costs at this level of abstraction are not sensitive to deposit type mineralogy, or grade of mineralization, as long as the mine type is appropriate for the morphology, size, and depth of the deposit. Since mining cost relations estimated for a deposit type are parameterized either directly or indirectly on deposit size and depth or stripping ratio, as long as the morphology is consistent with the mining method, mining cost relations estimated for one deposit type may be used for a different one by making adjustments for regional cost differentials. Thus, with the aid of mining engineering experitse, some of the mining cost models developed for specific commodities could be used for other commodities with minor adjustments.

Commonalities among milling costs of different deposit types are much rarer than they are for mining, but when one deposit type yields an ore similar to that for which mining and milling costs have been estimated, the milling cost relation may be useful with only minor modification. Less likely, but still possible, is the use of mill cost relations estimated on one deposit type when the ores differ but are concentrated by a common technology, e.g., jigging. In some cases, the previously estimated mill cost relation may be useful with only minor modification.

Finally, if the re-analysis of the geology of MHL for endowment estimation produces no surpr  es in the identification of favorable areas and their deposit types, there are several deposit types for which the amount of MHL involved is very small, so small that investment in the estimation of cost models is not justified by the contribution of that (those) land parcel(s) to market value of MHL. In other cases, when the size and grade and location of known suppliers to the world market are compared to the sizes and grades indicated by the deposit models of the deposit type identified by MHL, some deposit types a priori will not contribute to market value given current expectations for demand and cost differentials for Alaska. Accordingly, cost models for such deposit types need not be estimated.

Taking into account the foregoing considerations, a cost of $40,000 is estimated for the development of new cost models for mining and milling and/or the modification of existing models for use in the re-estimattion of value of MHL. If possible, this work should be coordinated through Burt Gosling, Supervisor Physical Scientist, Western Field Operations Center, U.S. Bureau of Mines, Spokane, Washington. Since Gosling supervised the work cited in the foregoing studies, e.g., Juneau and White Mountain-North Steese area, it would be logical to enlist his expertise in the MHL evaluation.

## Long Term Trends in Metal Prices

The indisputable finiteness of the earth and its mineral resources often leads physical scientists and engineers to predict rising future prices as mineral resources are depleted. The appeal of this view is strengthened further by the fact that a mineral deposit is a very rare geologic event and that depletion of the earth's crust in low cost, easy-to-find mineral deposits will inevitably cause prices to increase across time as man is forced to find and exploit lower quality mineral resources. Moreover, the pure theory of exhaustible resources also predicts that net price, meaning rent, will rise across time at the rate of interest. However, historical evidence indicates that mineral prices have not behaved this way; Barnett and Morse showed in their seminal work Scarcity and Growth and later in Scarcity Revisited, that in real terms (adjusted for inflation), metal costs and metal prices have decreased across time from the late 1800s to the 1970s. In essence, technical change in exploration, mining, processing, smelting, and refining when combined with increased efficiency of metal use, substitution, and scrap recycle combine to give declining metal prices. These studies and others, e.g., Cranstone's demonstration of constant discovery costs and Malenbaum's "life cycle" in intensity of metal use, indicate that the value of MHL should be predicated on the continuation of the trend to declining unit costs and real prices of metals. Of course, there will be periods of price increases for one or more specific metals because of market imperfections, speculation, or trade interruptions, just as there have been in the past, but these are expected ultimately to adjust and to continue the long term trends to decline. The market value of MHL should not be based upon expectations for higher future metal prices.

Market Inpacts

Even if trends in real prices can be identified and credibly projected, if the supply of a metal from MHL were large enough, new supply would cause a decrease, at least for a few years, of metal price below the long term trend in price. In concept, this impact could cause a serious price adjustment, particularly in local markets. However, most metals today are traded in world markets; consequently, price response to potential supply from MHL may be minor except for markets with stagnating demand and for large supply increments. Consequently, potential impacts of new supply from MHL are expected a priori to be nil for some commodities, small for others, and significant for a few, at least for a few years.

Approach to Analysis

A rigorous econometric modeling of world markets for all mineral commodities that could be produced from the identified deposit types would cost several hundreds of thousands of dollars. Such an in-depth and extensive analysis is not justified in thi ase. First of all, for a number of commodities, price respo ost of little or no consequence in terms of its effect on market value of MHL. This arises when the deposits are small enough that their production would have little effect on world markets or when the deposits are not likely to be economic given a priori evidence about their features, about costs, and about expected future prices. For example, podiform chromite deposits are small and high cost even when located in more favorable economic circumstances, e.g., those of the lower 48 states. Such deposits located in Alaska probably are not likely to be economic given the significantly higher costs in Alaska and given expected long-term prices. Moreover, even if they were to be economic, such deposits are small, and the amount of MHL having such potential also is small; consequently, nothing is lost if market response for chromite deposits of MHL is ignored, and expected long-term price is used for the computation of market value.

As another example, consider price response to copper production from MHL. Certainly, bringing on to the market of a world class porphyry copper deposit in MHL would impact copper price, at least for a few years. But, the probability for the occurrence of a world class copper prophyry in MHL is very small. Moreover, Cu porphyries tend to be smaller and lower in grade the further north they occur, and in Alaska annual operating costs and capital costs are approximately twice those of the southwestern U.S. Finally, the amount of MHL lands having potential for Cu porphyries is not large. On the other hand, copper production from Cu skarn deposits and from massive sulfides may be economic either as a main product with other by-products or as a by-product. But, such production is not likely to be a major supply factor, given the magnitude of the copper market. Consequently, ignoring price response to potential copper supply from MHL and the use of long term Cu price for the computation of market value probably is acceptable.

It is expected that similar analysis of MHL deposit types, economics of supply, and markets would reduce the number of metal markets for which market response is important to at most a few. One approach would be to contract for econometric modeling of these few markets, but even this would be costly if done comprehensively.

An alternative to formal econometric modeling of markets is an eclectic approach of demand and price projections and an analysis of resource depletion and capacity constraints on supply to estimate the timing of MHL supply as that supply on the margin that is allowed by projected consumption requirements. This approach avoids the need to determine price using demand and supply price elasticities. Instead, projected long-term price is used to determine revenue and projected <u>consumption is used to govern the timing of incremental supply from MHL</u>. In other words, only when projected consumption exceeds supply capacity can new supply from MHL be generated, given the assumption that the new supply will come from MHL if such is economic at projected long-term price.

As stated, the eclectic approach requires the long-term projection of consumption and price. While this has been done by various methods, some recent work at the University of Arizona has shown that the intensity of use models stated as either translogue consumption models in which consumption is a function of GNP (GDP) or learning models of consumption and GNP generally produce better forecasts than direct trend projection. Of course, use of such models requires projected GNP. These projections are periodically made by the World Bank or IMF. So as to take advantage of individual specific growth patterns, consumptions should be projected separately for the major consuming nations. The analysis of supply of a metal would begin by documenting reserves, current capacity, by-product capacity, recently shut-in capacity that could be reactiviated, and future new capacity that is currently under development. These provide a measure of the magnitude of supply at long run expected price. Year by year projected consumption and supply capacity would be compared. When projected consumption exceeds supply capacity significantly, supply is incremented by new production from a simulated discovery on MHL lands. Clearly, this is simplistic because in the real world new supplies could

## INFRASTRUCTURE AND TRANSPORTATION COSTS

Costs considered here are in addition to mine site infrastructure costs, which are estimated by the U. S. BOM cost relations for mining and milling. The additional costs include the capital costs of access roads, costs of over-land transporting of concentrate to either a smelter or to a water-way transportation linkage, and the cost of transporting by water to smelter. Transportation costs are an especially important element in the evaluation of MHL because the land parcels are so widely scattered. Fortunately, much of this work has already been completed in the evaluation of forest lands by the Division of Forestry. According to Rick McMann, the Division of Forestry prepared worksheets for land parcels having forest resources; these worksheets provide estimates of the length of access road, construction costs, and haulage costs for primary and secondary roads. Thus, for those land parcels having forests, much of the cost analysis required for economic analysis of minerals has already been completed. For such land parcels, the only costs remaining to be estimated and considered in evaluation are those for transportation from parcel to smelter. According to McMann, there is high conformity of the lands with mineral potential favorability rankings of four and five with those lands having forest resources. Accordingly, McMann expressed the sentiment that since infrastructure costs were accounted for in the evaluation of forest resources, to also consider them in the evaluation for mineral resources would be double counting. For those land parcels for which both forest and mineral resources can be exploited, that perception is accurate. But, for those parcels for which only one of these kinds of resources can be exploited, infrastructure costs should be considered separately in both evaluations, and the value ascribed to the parcel should be the greater of the two evaluations.

Land parcels having no forest resources would need an estimation of infrastructure and transportation costs; for the sake of uniformity these should be estimated using the same procedures and bases employed by McMann for forest resources.

Because of the work already completed by the Division of Forestry, the effort required to treat explicitly infrastructure and transportation costs is not great, being that it is incremental. It is estimated that approximately $10,000 should be allocated to this effort.

EXPLORATION MODELING

Exploration models vary greatly in structure and in complexity, depending upon the intended use of the model. Accordingly, for a pre-exploration analysis of target objective, budget, and risk, an exploration model may be highly structured by stage and activity and focus upon a detailed analysis of risk and its economic consequences (see Harris, 1989). On the other hand, for the analysis of potential supply, which is a stock analysis, exploration models generally are quite simplistic as they are designed to describe generally exploration outcomes in terms of effort, and the ordering of discoveries by selected features, e.g., size and grade, so as to permit an approximation of the optimum exploration expenditure and the outcomes that such would yield, given the estimated endowment of the region.

Two feasible approaches to exploration modeling that should be examined for the evaluation of MHL are (1) the adaptation of EADS, an exploration model developed for the U.S. Bureau of Mines' potential supply system (PSACM), and (2) the use of exploration experts to construct exploration models explicitly for Alaska.

EADS is an acronym for Exploration and Discovery Simulation, a computer simulation model of exploration developed by ICF, Inc., 1987, to interface with ROCKVAL and to generate discoveries from the estimated mineral endowment. The simulation program merits examination particularly because it was designed for the potential supply analysis computer system, PSACM, and because that system could be used in the evaluation of MHL, thereby avoiding the expense of constructing computer simulation programs especially for the evaluation of MHL. However, to my knowledge, the BOM has not yet used EADS; consequently, some research and development would be involved in (1) the integration of EADS with other components of PSACM, and (2) parameterizing EADS for the various deposit types and for Alaskan conditions. I cannot provide informed comments about the magnitude of this effort. I did acquire copies of the ICF reports, but the reports are quite brief and time did not permit creating the program from the listings and experimentation with the program. Moreover, although I requested copies of the PSACM system a few weeks ago, I have not yet received them. Consequently, while this approach seems feasible, its implemention is somewhat uncertain. Nevertheless, it should be investigated early in the re-evaluation of MHL.

An alternative to EADS is to identify one or more experts for each of the important deposit types and to elicit from them a description of exploration so structured that it provides information by deposit type on probability of discovery of deposits by deposit tonnage, ore grade, and depth and kind of cover (alluvium, ice, sedimentary rocks, etc.) as both density of deposits and intensity of search effort vary. This approach, which has been used before (CRA, 1978; Harris et al, 1981; Harris, 1989), permits models to be highly relevant to Alaskan conditions. Of course, after the relevant responses have been obtained from the expert explorationists, they must be processed and used to construct a computer model of the exploration process. Moreover, it must interact with the endowment model so that the amount expended on exploration is consistent with exploration economics. In other words, the system must be programmed to allocate exploration economically - see Harris, 1989, for further information on this approach.

Individuals or firms thought by personnel of the ADGGS to be highly qualified by their exploration expertise in Alaska include, but are not limited to the following: Cominco, Inc. (Anchorage); C. C. Hawley (Anchorage), Watts, Griffith & McHewitt (Anchorage), Don Stevens (Anchorage), Nuerco Exploration (Vancouver, Washington), Ed Chipps (Minden or Gardnerville, Nevada), On-Line Exploration Services, Inc. (Anchorage), and Ernie Wolf and Doug Coulp (Fairbanks). A separate model would need to be constructed for each important deposit type. The costs of constructing exploration models for the important deposit types is estimated to be approximately $30,000. This cost includes the costs of an expert as a consultant for two days for each deposit type, the cost of travel, the cost of processing responses and the construction of a computer program to integrate the processed responses into a computerized exploration submodel. As with other components of the evaluation of MHL, such analysis would not be performed on all 29 deposit types identified in the favorability analysis by ADGGS, because the contribution of some of these to market value on *a priori* grounds can be judged to be negligible; consequently, estimating and programming exploration models for them would not be cost effective.

in Appendix A—Potential Mineral Supply Analysis Methodology, of the report entitled The Potential Supply of Minerals from the White Mountains National Recreation Area and Part of the North Steese National Conservation Area, Alaska, written by the Division of Policy Analysis, Bureau of Mines, Washington, D.C., February, 1989. Although this system was designed to interface with ROCKVAL, it could be modified to accept a different probabilistic description of endowment. Moreover, the system would need to be modified to include the simulation of discoveries and the optimum allocation of effort using the exploration models.

Costs for systems design, modification, and of programming are very vague in advance of knowledge of the exploration modeling and without having the program to examine. As stated elsewhere in this report, I did request a copy of the computer program but have not yet received it. With great uncertainty, I suggest that $30,000 be allocated to the constructing of necessary subprograms, modification of PSACM, and the processing of the data for MHL to produce a probability distribution for estimated market value.

SUMMARY

The direct costs of estimating the market value of lands of the Alaska Mental Health Trust and replacement lands is estimated to be about $350,000. Of this cost, $200,000 is allocated to the estimation of the mineral endowment of said lands, and $150,000 is allocated to the estimation of the market value of the mineral endowment. The breakdown of the $200,000 and of the $150,000 is as follows:

Estimation of Mineral Endowment

| | |
|---|---|
| Acquisition of basic geodata and information | $ 20,000 |
| Preparation of analogues and supportive information | 35,000 |
| Information enhancement | 20,000 |
| Preparation of map overlays (personnel and materials) | 14,000 |
| Analysis of MHL geology and of analogues in preparation for endowment estimation | 50,000 |
| Estimation of subjective probabilities for endowment by deposit type and geologic environment | 25,000 |
| Experts serving as monitors and consultants | 21,000 |
| Special support required because of small land parcels | 15,000 |
| TOTAL | $200,000 |

Estimation of Market Value of Endowment

| | |
|---|---|
| Estimation of mine, mill, and on site infrastructure cost relations | $ 40,000 |
| Estimation of infrastructure and transportation costs | 10,000 |
| Exploration modelling | 30,000 |
| Market analysis | 40,000 |
| Computer systems and processing | 30,000 |
| TOTAL | $150,000 |

In both cases (endowment estimation and economic analysis), individual costs may err considerably, but overall, the estimate of total cost is thought to be quite robust.

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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

David T. Walker
Counsel for the Class

DTW:ndp

Enclosure

Law offices of
JAMES B. GOTTSTEIN
[illegible] STREET, SUITE [illegible]
ANCHORAGE, ALASKA [illegible]
[illegible]

James B. Gottstein
Lawrence V. Albert

MEMORANDUM

FROM: JAMES B. GOTTSTEIN
TO: INTERESTED PARTIES
DATE: January 19, 1990
RE: LEGAL ANALYSIS OF STATUS OF MENTAL HEALTH TRUST LANDS AND RELATED ISSUES

Summary and Purpose

The Commissioner of the Department of Natural Resources is expected to announce on January 24, 1990 that she does not intend to follow the procedures to determine the fair market value of one million acres of Mental Health Trust Lands which the Interim Mental Health Trust Commission (Commission) approved pursuant to Chapter 48 SLA 1987 (Chapter 48). If this expected action occurs, the Plaintiffs in the Mental Health Trust Lands lawsuit, Weiss v. State, 4FA-82-2208 Civ., will be forced to challenge title to approximately 750,000 acres of Mental Health Trust Lands and take other actions, as necessary steps to protect their rights against the continuing breach of the trust by the State of Alaska in properly discharging its fiduciary responsibilities in managing the trust.

The land categories are:

| | |
|---|---|
| 370,000 | acres designated as state parks, refuges, etc.; |
| 40,000 | acres to Municipalities; |
| 40,000 | acres to Native corporations[1]; |
| 45,000 | acres to individuals; |
| 3,000 | acres to the University of Alaska; and |
| 280,000 | acres in less than total conveyances. |
| 778,000 | |

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1. It does not appear this would include a large portion of the Beluga Coal Field conveyed to Cook Inlet Region Inc., as a result of its exchange under the Alaska Native Claims Settlement Act.

The purposes of this memorandum are to outline the relevant facts and legal authority for such actions.

## I. FACTUAL BACKGROUND

In 1956, the Congress, in order to correct a longstanding problem in providing an adequate mental health program in Alaska, granted Alaska, in trust, one million acres of land to generate income "first for the necessary expenses of the mental health program of Alaska". Unfortunately, after selecting the best lands available, Alaska never administered the trust properly. This included transferring Mental Health Trust Lands to third parties without adequate compensation. Starting in the mid-Seventies, the State began to recognize this was illegal, and at the same time there was a tremendous clamor for land by municipalities and other interested parties (without paying for it, of course).[2] In 1978[3] the legislature purported to abolish the trust by "redesignating" Mental Health Trust Lands as General Grant Lands.[4] While a theoretical compensatory monetary fund was established, Mental Health Trust Lands were never valued to determine the proper compensation, and more importantly, **not a single penny was ever paid into this account.** Immediately after the "redesignation", municipalities, Native corporations and individuals began to receive large amounts of the best Mental Health Trust Lands without paying fair value for them.

A lawsuit was brought in 1982 by the Alaska Mental Health Association, through Steve Cowper[5], naming Vern Weiss and Karl Hilliker as representatives of people needing mental health services, the beneficiaries of the Mental Health Lands Trust, to declare the legislative action in abolishing the trust invalid. The Supreme Court, in 1985, did just that and ordered "the trust be reconstituted to match as nearly as possible the holdings which comprised the trust when the 1978 law became effective." State v. Weiss., 706 P.2d 681 (Alaska 1985). However, the state

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2.This was the period of the "Beirne Initiative" where residents were to be allowed to stake "undesignated" state land for private ownership.

3.In the same package of legislation providing land to residents enacted as a response to the "Beirne Initiative".

4.Chapters 181 and 182 SLA 1978.

5.Governor Cowper has apparently been advised by the Attorney General's Office that as former attorney for the plaintiffs it is inappropriate or improper for him to take an active role in resolving the lawsuit. This has left a policy vacuum.

desired to avoid reversing previous actions it had taken on Mental Health Trust Lands, and the plaintiffs in the lawsuit were challenging conveyances of trust lands to third parties (for the reasons set forth below). An alternative method of reconstituting the trust was agreed on between the plaintiffs and the state. This approach was enacted as Chapter 48 SLA 1987 (Chapter 48).

Among other things, Chapter 48 provided that Mental Health Trust Lands be valued and an equal value of lands in legislative designations (state parks, refuges, critical habitats, and the like) be constituted as a replacement trust, with 8% of the value being deposited every year into the Mental Health Trust Income Account. Under Section 4 of Chapter 48, the value is to be determined by the Commissioner of the Department of Natural Resources under procedures approved by the Interim Mental Health Trust Commission (Commission). On November 7, 1989, after more than two years of a tremendous amount of work, the Commission approved its final procedures for determining the value of Mental Health Trust Lands. At this time, all indications are that the Commissioner is intending to refuse to follow these procedures. If the Commissioner fails to follow the approved valuation procedures the proposed settlement of the litigation will be nullified and the plaintiffs will be forced to challenge the legal status of the hundreds of thousands of acres of Mental Health Trust Lands described above and take other steps to protect their rights.

## II. APPLICABLE LAW

A. General Considerations. In the Weiss decision (this case), supra., the Alaska Supreme Court confirmed that "basic trust law principles" apply to the administration of the Mental Health Lands Trust. In doing so, at footnote 3, the court cites the United States Supreme Court case of Lassen v. Arizona, 385 U.S. 458, 87 S. Ct. 584, 17 L.Ed.2d 515 (1967), and its own previous decision in State v. University of Alaska, 624 P.2d 807 (Alaska . ).

76 American Jurisprudence, 2d, Trusts, Section 315 describes generally the trustee's duties as follows[6]:

> A trustee must act in good faith in the administration of the trust, and this requirement means that he must act honestly and with finest and undivided loyalty to the trust, not merely with that standard of honor required of men dealing at arm's length in the workaday world, but with a punctilio of honor the most sensitive. He must act with such high good faith in the

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6.References to footnotes are generally omitted throughout this memorandum.

> exercise of decisions in the administration of the trust, and in the investigation and determination of facts as a basis for his judgment and decisions. He must avoid all situations and relations tending in the least to interfere with the discharge of his duties, or in which honesty may be a strain on him. Any exceptions in his conduct to the high standard of honor governing him renders him fully liable for all ensuing damages to the trust estate. Courts of equity have been uncompromising in their hostility to any laxness on the part of a trustee and inquire in proper cases into his administration of the trust to determine his honesty and loyalty. The liberality with respect to a trustee of provisions in a trust instrument or declaration in no way diminishes the trustee's duty to act in utmost good faith.

Section 316, Trusts, 76 American Jurisprudence, 2d., describes how a trustee must act exclusively in the trust's interests:

> A trustee in his administration of the trust is under the duty of acting exclusively and solely in the interest of the trust estate or the beneficiaries within the terms of the trust, and is not to act in his own interest or in the interest of a third person. He must act for and not against the trust estate or the beneficiary. In general, any act of the trustee in hostility to the interest of the trust estate is a breach of trust. He may not without breach of duty take part in any transaction concerning the trust, where he has an interest in such transaction adverse to that of the beneficiary.
>
> A trustee is under a duty to refrain from situations wherein his own interests are brought into conflict with those of the trust, irrespective of good or bad faith on his part. He must not do anything tending to interfere with his exercise of a wholly disinterested and independent judgment.

In conformance with the above described standard of conduct by a trustee, one of the basic principles of trust law is that the trustee must keep trust property separate from his individual property. Section 179 Restatement of the Law of Trust, 2d.

Similarly, a trustee may not engage in self-dealing with trust property.

> A trustee is not permitted to place himself in a position where it would be for his own benefit to violate his duty to the beneficiaries, and it is a well established general rule that a trustee should not engage in self-dealing * * *.

* * *

> The prohibition against self-dealing or mingling of funds by a trustee does not depend upon any question of fraud, but is made absolute to avoid the possibility of fraud and to avoid the temptation of self-interest.

76 American Jurisprudence, 2d., Section 319. This is not a new principle. In the 1823 United States Supreme Court case of Wormley v. Wormley, 8 Wheaton 421, 5 L.Ed 651 (1823), Justice Story wrote:

> No rule is better settled than that a trustee cannot become a purchaser of the trust estate. He cannot be at once vendor and vendee. He cannot represent in himself two opposite and conflicting interests. As vendor he must always desire to sell as high, and as purchaser to buy as low, as possible; and the law has wisely prohibited any person from assuming such dangerous and incompatible characters.

In the case of the Mental Health Lands Trust, the dishonest and unscrupulous actions of the state[7] in the administration of the trust[8] makes a mockery of the just enunciated standards of conduct. The following is a description of the remedies appro

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7.While the state, as a whole, has acted abominably with respect to the trust, the state is composed of many different parts, and with some notable exceptions it is hard to cast particular individuals as culpable. The 1978 legislature, for example, can say it intended to compensate the trust and no bad faith was involved. From 1978 until the lawsuit, DNR can say it was just following state law. The 1987 Legislature can say it acted in good faith in enacting Chapter 48 and expected the Commissioner of DNR to follow the procedures approved by the Commission. On the other hand, the administration's budgeting process clearly does not properly allocate trust funds "first to the necessary expenses of the mental health program", and the Legislature certainly has not corrected this in its appropriations. Similarly, DNR has not been at all concerned with making sure the trust is fairly compensated.

8.The barest outline of facts given here does not even scratch the surface of the repeated, deliberate and determined efforts of the state to avoid its trust responsibilities and convert trust property to its own use without compensation to the beneficiaries of the trust, who, after all, are among the most defenseless in the population.

priate for this breach of trust, including the rights of the beneficiaries to pursue trust property into the hands of third parties, and hold third parties accountable to the trust in the event of their participation in the breach of trust.

B. Only Purchasers For Value Without Notice Have Valid Title to Mental Health Trust Lands.

1. General Requirements.

Only bona fide purchasers -- that is people who have paid value for trust property and are without notice, either actual or imputed of the trust or the breach of trust have valid title to Mental Health Trust Lands. The reason for this rule is that as between the clearly innocent beneficiary and a third party who has obtained trust property, the beneficiary should not suffer the loss, unless the third party can prove he was innocent as well. In proving his innocence, the law charges the third party with knowledge of certain facts and with the duty to make an inquiry into other facts where he should have been wary. Bogert 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:

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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 knowledge, coming to him or his agent through the senses of sight or hearing, which shows that the property in question is being transferred to him subject to an equity. In this case he may be said to be a "purchaser with actual notice."

(3) He may have notice of an equity, <u>imputed to him through recording or other statutes</u>, in which case he is usually called a purchaser "with constructive notice." For purposes of public policy the tatutes treat him as having notice, whether or not he .s actually conscious of the existence of the equity.

(4) He may have knowledge of facts about the ownership of the property, either actually acquired by himself or his agent, or imputed to them under statutes, which, while not sufficiently strong to lead an ordinarily prudent man to a positive belief that the property is subject to an equity, is of sufficient force to compel an ordinarily careful man to inquire further regarding a possible equity. If such is the case, the purchaser is charged by the court with notice of the facts regarding the equity which a reasonable inquiry would have revealed. A purchaser of this type is one "put upon inquiry," and if the inquiry ought to have led to notice of the equity he is treated by the court as if he had had actual notice of it.

(5) A purchaser may become a purchaser with notice because of a combination of the factors of actual notice, constructive notice, and notice acquired from facts putting on inquiry. Thus he may have information from each of the three types of sources, no one of which, standing alone, would make him a purchaser with notice of an attached equity, but which, in combined effect, give him the requisite knowledge to make him a mala fide purchaser.

(Emphasis added)

Section 892 states:

**If the proof shows that the purchaser was conscious of the existence of any equity against the property, there is no doubt that he cannot get the benefit of the bona fide purchaser rule.**

Section 893 of Bogert "Constructive Notice under Recording Acts", states:

From the time of filing for record, all purchaser of the property involved, and in many cases creditors are charged with knowledge of the existence and contents of the document in question. It is clear that these statutes are frequently of importance in giving to a purchaser from a trustee or other holder of property subject to an equity notice of the existence and terms of the trust. This notice is generally called "constructive". It exists no matter what may be the purchaser's actual knowledge. Thus one purchasing land

> is charged with notice of the terms of the recorded deed to his grantor and with the terms of all prior recorded deeds in the chain of title. If the grantor or a predecessor of the grantor is described in the deed by which he acquired title as a trustee, with or without details of the trust, the purchaser is deemed to know of the existence of such a trust and of such details as to names of beneficiaries, purposes of the trust, powers of the trustee, etc., as are given in the recorded instrument. Such facts thus treated as being known to the purchaser may give him constructive notice that he will take the property subject to an equity in favor of the beneficiary, or they may merely **put him on inquiry** as to whether he will get title free of the trust or not.
>
> * * *
>
> 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 gran e 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 it, for tracing as to all property identified and money judgment as to the balance.

D The State should be Enjoined[12] from Further Transfers of Mental Health Trust Lands and Possibly All State Lands; Receipts from All State Lands Are Subject to Impoundment; Traceable Trust Property in the Hands of Third Parties is Subject to the Trust's Claims.

Section 861 of Bogert states:

> The court may order the trustee or his successor in interest to perform the trust as a whole, or to take some particular step in trust administration.
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> * * *
>
> The court may in its discretion require the defaulting trustee to restore to the trust fund or deliver to the beneficiary particular property other than money, by way of restitution in kind.
>
> * * *
>
> [T]he beneficiary may claim part of a trust fund under a constructive trust theory and recover money damages for conversion or misappropriation of the other part.

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12. Under Civil Rule 65(c) a bond will normally be required to obtain an injunction in order to cover any costs which may be incurred if the injunction later turns out to have been wrongfully issued. There are numerous cases, however, which hold that such a bond is not necessary (or may be posted in a nominal amount) if the party seeking it is a public interest litigant, or is indigent. The beneficiaries of the Mental Health Lands Trust qualify under both criteria. See People of State of Cal. ex rel. Van De Kamp v. Tahoe Regional Planning Agency, 766 F.2d 1319 (9th Cir. 1985); Natural Resources Defense Counsel v. Morton, 337 F.Supp. 167 (D.C.D.C. 1971); West Virginia Highlands Conservancy v. Island Creek Coal Co., 441 F.2d 232 (4th Cir. 1971); Environmental Defense Fund, Inc., v. Corps of Engineers, 331 F.Supp. 925 (D.C.D.C.. 1971); Orantes-Hernandez v. Smith, 541 F.Supp. 351 (D.C. Cal. 1982); Bartels v. Biernat, 405 F.Supp. 1012, 1019 (D.C. Wis. 1975); Bass v. Richardson, 338 F.Supp. 478 (D.C.N.Y. 1971); Denny v. Health & Social Services Bd., 285 F.Supp 526, 527 (D.C. Wis 1968).

Section 862 of Bogert states:

> For a breach of trust the trustee may be directed by chancery to make a payment of damages to the beneficiary out of the trustee's own funds.

Section 865 of Bogert states:

> [I]f the trustee who has defaulted has in his hands the trust res or its substitute, the right of the beneficiary to hold the trustee to personal liability may in some cases be supplemented by a lien upon the res or its substitute.
>
> * * *
>
> 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 ustee's own, the entire commingled fund is subjec to the trust.

In Blair v. Trafco Products, Inc., 369 N.W.2d 900 (Mich. App. 1985) the court said:

> [W]here mingling of trust funds with other funds occurs, the cestui que trust has a lien upon the entire fund, and the law presumes that the trust fund was not paid out so long as an amount equal to the trust fund remained.

F. Appointment of A Receiver on Mental Health Trust Lands and Replacement of the State as Trustee.

Restatement of Trusts 2d., Section 107 (a) states a trustee can be removed by a proper court. Relevant comments to that section state:

> a. **Removal by Court.** A court may remove a trustee if his continuing to act as trustee would be detrimental to the interests of the beneficiary. The matter is one for the exercise of a reasonable discretion by the court.
>
> b. **Grounds for Removal.** The following are, among others, grounds for removal of a trustee: * * * the commission of a serious breach of trust

Section 108 of the Restatement of Trusts 2d., states if a trustee has been removed the court can appoint a new trustee.

Section 199(e) of the Restatement of Trusts 2d., states the beneficiaries can maintain a suit to remove the trustee. Section 519 of Bogert states, "When in the course of the administration of a trust it becomes apparent that the trustee cannot in fairness to the beneficiaries be allowed to continue in the exercise of his powers, he may be removed."

Bogert states at section 867:

> Sometimes a court can be induced to appoint a receiver for the trust property in order to protect the trust and conserve its assets, pending its decision on an application for the removal of a trustee or for other relief. The rule regarding receivers has been stated by a Georgia court: "Besides it is an established rule of the Court of Chancery, that when a trust fund is in

danger of being wasted or misapplied, it will interfere on the application of those interested in the d, and by the appointment of a receiver, or in sc other mode, secure the fund from loss."

A New York court has said: "it is said that the appointing of a receiver rests in discretion. This proposition does not teach much. A receiver is proper, if the fund is in danger; and this principle reconciles the cases found in the books.

## III. APPLICATION OF THE LAW TO THE FACTS HERE

### A. Notice Through Public Records.

There is a very strong argument that everyone is charged with notice of the trust and later the breach thereof because of the following.

(a) Deed. The Patents (deeds) to the state indicate that the grant is pursuant to the Alaska Mental Health Enabling Act.

(b) Provisions of the Alaska Mental Health Enabling Act. The Alaska Mental Health Enabling Act is a public law and all persons taking Mental Health Trust Lands should be either charged with constructive notice of the trust requirements or put on inquiry.

(c) The 1978 Trust Abolishment. The purported redesignation of Mental Health Trust Lands by the legislature in 1978 and the failure to compensate the trust one penny was a matter of public record and persons taking Mental Health Trust Lands should be either charged with constructive notice thereof or put on inquiry.

The legal result of being charged with notice is that one can not be a bona fide purchaser. Thus, under this analysis no third party can have good title to Mental Health Trust Lands, no matter how far removed down in the chain of title.[13] Even if the court does not conclude everyone is charged with notice, under the specifics of many cases, third party conveyees do not have good title.

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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.

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14. That the lands have to be managed to produce maximum income does not mean that the trustee may sacrifice long-term income for immediate income.

15. The 40,000 acre figure does not include lands lost by the state in its lawsuit with Tyonek Native Corporation over conflicting selection rights under the Alaska Mental Health Enabling Act and the Alaska Native Claims Settlement Act Tyonek Native Corp. v. Secretary of the Interior, 836 F.2d 1237 (9th. Cir. 1988), nor the Beluga Coal Field lands exchanged to Cook Inlet in its exchange.

4. Individuals.

(a) Constructive Notice. As indicated above, title to all Mental Health Trust Lands is in dispute, even if 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

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16. Whether individually or as a member of one or more defendant classes.

17. Trustees for Alaska v. State Department of Natural Resources, 736 P.2d 324 (Alaska 1988). In this case, the Alaska Supreme Court ruled that the state's practice of granting rights to extract minerals, although denominated a "lease" was not truly a lease because no rents or royalties were due and that this violated Section 6(i) of the Statehood Act which requires a lease of mineral resources.

leases are invalid.[18] Of course, the operators of these mineral properties are accountable for royalties due to the trust for the minerals that have been removed and arguably for minimum ɔyalty and/or rental payments.

(b) Oil & Gas Leases. It strains credulity to bel ⁄e that oil companies did not actually know of the trust status of the lands because a detailed assessment of land status and title is normally done by any prudent potential oil and gas lessee.[19]

(c) Public and Charitable Uses. As described above, trust property given for a charitable purpose, where payment of value and lack of notice is not present normally must be returned to the trust.

There are many other types of transactions and circumstances that will no doubt be revealed. The foregoing, rather than intended to be exhaustive, is to illustrate the general principles involved and how they should be applied in particular circumstances.

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18. As recently as May of 1989, the United States Supreme Court held that a flat rate royalty for mineral lands was an invalid method of leasing mineral trust lands and the statute authorizing it invalid as applied to Arizona's School Trust Lands. Asarco v. Kadish, 490 US ___, 104 L.Ed 696, 109 S.Ct. ___ (1989). This would appear to invalidate the state's current leasing program with respect to its application to Mental Health Trust Lands (However, no new mineral leases have been issued on Mental Health Trust Lands since the Alaska Supreme Court's decision in this case in October of 1985). Interestingly, at footnote 3, the United States Supreme Court specifically acknowledged the difficulty of determining fair market value of minerals, but reaffirmed its previous pronouncements that "whatever the difficulties may be in making such appraisals with complete accuracy, it does not defeat the existence of a "market value" in mineral rights, and it does not suffice as a reason to depart from the ordinary requirements that the law imposes on such transactions.

19. The same is true for mineral properties, but to a lesser extent where the lessee is a "mom and pop" operation which is much more prevalent in mining, particularly placer.

**ALASKA MENTAL HEALTH BOARD INTERIM REPORT ON CHAPTER 48 REVISIONS (6.6.4)**

**January 1990**

## INTRODUCTION

In 1987, when the Alaska State Legislature adopted revisions to Alaska law which reconstituted the Mental Health Lands Trust and created the Alaska Mental Health Board, it was with the hope that these changes would resolve the issues raised in the Weiss v. State lawsuit. All parties to the suit felt that a workable compromise was better than the continuation of litigation, and they expected that the Legislative changes set forth in Chapter 48 would form the basis of a settlement.

The plaintiffs in the Weiss suit expected that these legislative changes would ensure that the monies set aside for the Alaska Mental Health Trust would be used first and foremost to meet the needs of the mentally ill. They contemplated that these needs would be determined by the Alaska Mental Health Board and that upon identification the Legislature would appropriate funds to meet those needs. It was their expectation that only after the basic needs of the trust beneficiaries were met would the Legislature take advantage of the statutory provisions that allowed excess revenues from the trust to be used for general expenses of the State.

The legislative changes have not worked. First, the Greene decision identified a group of beneficiaries not contemplated by the original Weiss litigants. Not only were considerable questions raised about the proper way to identify who beneficiaries of the Trust were, but also considerable confusion was created about the role of the Alaska Mental Health Board. The Board has been forced to function in two conflicting roles at once. As the statutorily mandated body charged with responsibility to identify needs of Trust beneficiaries, it has had to act as a neutral arbiter of claims to the Trust's funds from all of the beneficiaries, including those identified in the Greene decision. At the same time, as the body charged with representing the mentally ill, the Board has been required to be an advocate on behalf of a specific population that competes with other trust beneficiaries for the Mental Health Trust Funds.

Second, and perhaps more important, there has been insufficient appropriation of Trust funds to meet the needs of the Trust beneficiaries. Over the last three years, the Alaska Mental Health Board has identified needs far in excess of those being presently met. Each year, the Board has made modest recommendations, not sufficient even to meet identified needs, but at least sufficient to begin to redress some of the severe shortcomings of Alaska's Mental Health Program. Even these minimal recommendations have not been accepted. More money has been transferred from the Mental Health Trust Lands income account into the general fund than was spent on the entire Mental Health Program. The Weiss litigants, have concluded -- reasonably in the estimate of most members of the Alaska Mental Health Board -- that the reconstitution of the Mental Health Trust has resulted in no real change in the way in which Trust revenues are spent. An additional concern, which may become more important over the years, is that the Department of Natural Resources (DNR), which has a broad range of responsibilities for the management of State lands, has full authorization over the management of Mental Health Trust lands as well. There is no agency or group with a particular mandate to represent the beneficiaries of the Trust who can review the management decisions of the DNR to make sure that, over the years, management decisions which are a based solely on the best interests of the Trust are made and that the value of trust lands are not eroded over time.

The Alaska Mental Health Board, has recognized the serious nature of these problems for some time. Beginning in July of 1988 the Board facilitated a series of meetings with affected groups to discuss the proper way to define the beneficiaries of the Trust. After this Greene group issued its report the Board adopted "A Policy Report Pertinent to the Greene Decision", a report discussing the implications of the Greene decision. In April of this year, the Board passed a resolution calling for public hearings to examine the role of the Board in light of the Greene decision. The Board delegated to its Legislative Committee the task of gathering information that might lead to proposed changes to Chapter 48. The Committee has held public hearings and devoted two work sessions to the subject. The purpose of this report is to outline the conclusions and recommendations of the committee.

## BACKGROUND

None of these issues is new. The Legislature reviewed the proper role of a mental health board and the proper mechanism for funding programs from the Trust in-depth in 1986 when originally attempting to reach a settlement of the Weiss litigation. At that time, the Joint Special Committee on Mental Health Trust Land suggested three possible alternatives. The first alternative was a "secured revenue stream". Under this proposal, eight percent of all State unrestricted general fund revenues would be dedicated to the mental health program, secured by a pledge of State assets which could be executed upon in the event that the Legislature failed to appropriate sufficient funds to meet the necessary expenses of the mental health program.[1]

The second alternative was reconstitution of the Mental Health Land Trust and the creation of a Mental Health Trust Corporation which would be responsible for managing the assets of the Trust. The unencumbered Trust land would be re-transferred, and a cash settlement of lands encumbered or patented would be made. This alternative was less desirable, because of the difficulty and expense inherent in identifying, transferring, and then subsequently managing the Trust lands.

Finally, the Legislature recognized the alternative of permitting the court-ordered reconstitution of the Trust to take place under court supervision.

In supporting the secured income stream alternative, the Joint Committee recognized the inherent difficulty with that solution. There was no way to guarantee that the Legislature would necessarily appropriate sufficient funds each year to meet the needs of the Mental Health program.

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[1] *See report to the Legislature of the Joint Special Committee on Mental Health Trust Land, January, 1987, pg. 14, this was the preferred alternative*

> "Earmarking" Trust land income in the general fund and appropriating an amount equal to the income is permissible, but it does not insure that income will go toward funding mental health programs. Since one Legislature cannot bind future Legislatures, enactment of a law stating that income will be spent on mental health programs is subject to the will of each Legislature and dependent on annual appropriation of funds.[2]

The Joint Committee recommended a Statement of Legislative Intent as a means of guiding future legislatures as to the appropriate levels of funding.

At the same time, the joint Committee recognized that present funding levels were inadequate.

> State appropriations for mental health programs have grown from slightly less than $1.2 million in 1959 to slightly more than $23.4 million in 1986. However, when an inflation factor is applied, actual State spending on mental health has declined over the last few years.
>
> The draft Mental Health Plan, released in August 1986, estimates the cost of developing a comprehensive mental health system at $106.9 million in annual operating costs, an increase over FY87 operating expenditures of approximately $82.1 million. It also identifies a need for $102.1 million in one-time capital costs.
>
> . . .
>
> [I]n the Committee's view, the draft clearly demonstrates that Alaska's current level of mental health funding is

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2 *Id.* pg 8-9

> insufficient to serve our mentally ill population. It should be noted that the Alaska Alliance for the Mentally Ill has testified that the draft falls short of the goals of an adequate program.
>
> The Committee's view is supported by testimony received from the National Conference of State Legislatures (NCSL). Their review of Alaska's mental health program led to several recommendations, primarily that our programs be expanded.[3]

The Interim Mental Health Trust Commission reached a similar conclusion, ultimately suggesting that a revenue-stream option be adopted by the Legislature.[4] The Interim Mental Health Trust Commission also recognized the necessity of binding the Legislature in a constitutionally accepted manner so that future legislatures would be required to use the revenues generated to meet the needs of the mental health program:

> Furthermore, the enabling legislation should be very clear that the Legislature intends to fully fund an adequate mental health program in perpetuity. To satisfy the court-ordered reconstitution, such an arrangement would have to include collateral -- an identifiable, quantifiable entity -- which could be redeemed by the Trust in the event that the promised revenue stream failed to materialize or was somehow diverted. . . . While falling short of binding the hands of future legislatures, such a surety bond would make them always cognizant of the revenue stream legislation's original intent.[5]

These recommendations were the genesis of the present Chapter 48.

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3 *Id. at pg. 19-21*

4 *Report to the Legislature by the Interim Mental Health Trust Commission, February 1987, at pg 199*

5 *id at pg., 19-21.*

As enacted, Chapter 48 did not include any provisions for enforcement. Over the last three funding cycles, funding for the mental health program has continued to be inadequate. In FY88, the Alaska Mental Health Board, recognizing the need for a phasing in of increased funding for mental health programs, recommended increased program funding of $15,322,400 over the Governor's proposed operating budget. Despite the fact that even this recommendation was far below the minimum necessary to fund an adequate program for the State and meet the goals of the Comprehensive Mental Health Plan, only $8,868,900 in additional operating funds was appropriated. Similarly, FY89 recommendations of the Alaska Mental Health Board were $15,791,800 in additional operating funds over the prior year's base budget. Only $5,026,000 more than the base, was appropriated while $47,072,733.93 was transferred from the Mental Health Trust income account into the general fund.[6] The result has been that mental health services throughout the state have failed to keep pace with rising demand. Similarly, the Board's recommendations to meet long standing capital improvement requirements have been rejected. The needs identified in the State Comprehensive Mental Health Plan are being funded at a fraction of the amount necessary to meet the Plan's goals.

In 1978, when the Legislature re-designated Trust lands as general grant lands, the Legislature failed to ever make the necessary appropriations to compensate for the loss, and the Mental Health Trust was never funded. This was the reason for the Weiss suit in the first place. It is the perception of many members of the Alaska Mental Health Board, as well as of the Weiss litigants, that a variation of this situation continues to exist under the Chapter 48 revisions. Mental Health Trust funds are used for general fund purposes with little regard to the requirement that the Mental Health Trust account be spent first to meet the needs of the mental health program.

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6 *Letter from Milt Barker, Department of Revenue, December 1, 1989*

## PROPOSED RESOLUTIONS

The AMHB, IMHTC, relevant advocacy groups, and litigants generally agree that changes to the present structure must be made. The Legislative Committee has received a broad spectrum of recommendations. These range from recommendations that nothing be done or that the status of the Alaska Mental Health Board be diminished, to proposals that the entire way in which the State approaches funding and operation of mental health programs be modified. Some examples of proposed ways of resolving the conflicts raised by the present Chapter 48 follow.

**PROPOSAL A** Status quo with a Re-definition of the Alaska Mental Health Board's Responsibilities

The Legislative Committee received several suggestions to the effect that little change should be made to the present system. In response to our request for information, the Department of Natural Resources indicated that:

> The only change the Commission anticipates at this point is a proposal to alter the five-year reappraisal requirement. We have indicated support for an indexing system which would automatically adjust the value of the trust lands. As yet, however, there has been no uniform agreement concerning the adjustment methodology.[7]

Under this approach, there would be no changes to the present procedure for determining how Trust revenues are spent. The provisions of Chapter 48 requiring that eight percent of the land value be place in the Mental Health Trust income account would remain in effect and the Legislature would continue to appropriate on the basis of its perception of the needs of

7 *Letter, Rod Swope, Commissioner Designate to the Interim Mental Health Trust Commission, to Nelson G. Page, September 6, 1989.*

the mental health program of the State, with unexpended revenue going to the general fund.

The Division of Mental Health and Developmental Disabilities also prefers a limited approach.

> I would like to have the presently constituted Mental Health Board able to give its entire attention and effort to the hospital and community mental health services administered by the Division.
>
> The Governor's Council for the Handicapped and Gifted, the Older Alaskans' Commission, and the SOADA Board are already serving planning, advisory, evaluative and advocacy functions for the other Mental Health Trust beneficiaries, and there is no other board to provide these functions for the "mentally ill who may require hospitalization" nor for the other recipients of traditional mental health services.[8]

Thus, the Mental Health Board would be divested of its present responsibility for oversight and budget recommendations regarding all trust beneficiaries. Although this would eliminate the confusion which has resulted from the Greene decision, relieving the Board from its dual, and often conflicting role of being an advocate for one group while being an umbrella organization representing all groups, it would leave no entity with responsibility for trust oversight and would tend to perpetuate a fragmented and uncoordinated approach to the delivery of mental health services.

In the Committee's view, limited modifications to the Alaska Mental Health Board's role and structure do not change the problems with the

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8 *Letter, Todd R. Risley, Director, Division of Mental Health and Developmental Disabilities, to Nelson G. Page, October 16, 1989.*

present system. Rather than strengthening the level of commitment the Legislature must make to using Mental Health Trust funds for mental health programs, this approach would decrease what, in the view of many, is an already inadequate incentive on the part of the Legislature to spend Trust funds appropriately. At present, despite the conflicting nature of its role, the Alaska Mental Health Board does serve as a guardian and watchdog over the Trust and the uses for which Trust revenues are spent. There is no other group which has either the legislative mandate or the responsibility to act as an umbrella speaking on behalf of all beneficiaries of the Trust. Although a re-definition of the Alaska Mental Health Board's responsibilities would end the ambiguity in the Board's role, it would also end the Board's ability to protect and defend the Trust leaving nothing in its place. For these reasons, it is the view of the Committee that an independent board of trustees whose responsibility is to the Trust, and not just to the individual constituent groups, must exist. The Committee has been struck by the unanimous nature of the consensus among all affected groups on that principle, even if the details remain to be worked out.

**PROPOSAL B** Creation of a Separate Trustee Without Operating Authority

A more extensive modification of Chapter 48 would be to create a separate board of trustees with responsibility for the Trust. Such a separate board of trustees would not have responsibility for advocacy on behalf of any one group of beneficiaries to the Trust. At a minimum, the Board would be given responsibility for oversight of the way in which the Department of Natural Resources manages Trust land, would have responsibility for ensuring that the value of the Trust lands was maintained over time, and would have responsibility for defining who are the beneficiaries of the Trust and what services can properly be funded from the Trust. The Alaska Mental Health Board would remain the advisory and planning board advocating on behalf of the "traditional" mental health programs, similar to the Governor's Council for the Handicapped and Gifted, the Older Alaskans' Commission, and the Advisory Board on Alcoholism and Drug Abuse. At the same time, however, the independent Trustee Board would take over the responsibility for protecting and advocating on behalf of the Trust itself.

Although the exact scope and nature of the independent Board of Trustees remains to be determined, at a minimum, the Board would be a separate entity with separate legal status akin to the Alaska Power Authority, the Alaska Public Utilities Commission, or the Permanent Fund Board. As such, it would have the capacity to sue and be sued and to hire its own counsel to provide independent legal representation. At a minimum, the Board of Trustees would be charged with the responsibility to :

1. Oversee and approve land management decisions of the Department of Natural Resources, as they affect the Mental Health Trust lands, and to negotiate with the State when it became necessary to revalue State land. Under the present Chapter 48, such re-valuation is to take place every five years;

2. Invest and oversee any designated funds, such as funds appropriated for capital improvements;

3. Determine annually the extent to which the needs of the beneficiaries of the Mental Health Trust have been met, based on the goals and objectives of the Alaska State Comprehensive Mental Health Plan, and to certify annually the extent to which the needs have been met or not met;

4. To review and approve expenditures from the Trust to ensure that the expenditures are properly charged to the Trust.

This independent Board of Trustees would have the power to promulgate regulations to implement its authority, the power to hire and fire its employees, and the power to set employees salaries, as a necessary element of its independence.

Under this proposal, the language of Chapter 48 would be amended to prohibit the expenditure of funds held in the Mental Health Trust revenue account without either (1) approval of the Board of Trustees, or (2) in the event that the Board of Trustees does not approve, a specific finding from the Legislature that the expenditure is necessary and appropriate to meet the needs of the Mental Health program of the State of Alaska. In addition, Chapter 48 would be amended to provide that no reappropriation to the general fund from the Mental Health Trust revenue account could take place unless (1) the trustees had certified that the necessary expenses of the Health program had been met for the previous year, or (2) in the event that the trustees did not so certify, the Legislature had made a specific finding to that effect.

For this structure to work, the members of the Board of Trustees would have to act with a clear fiduciary responsibility for the Mental Health Trust and the beneficiaries of that Trust. It would be essential that members of the Board of Trustees consist of individuals who could fairly, impartially and knowledgeably review and evaluate the needs of the Trust and of the beneficiaries of the Trust. Ideally, this Board of Trustees would take over the present responsibility of the Alaska Mental Health Board to ensure that the plans of the various entities and agencies responsible for the mental health program are integrated and comprehensive.

**PROPOSAL C** <u>Separate Trust with Operating Authority</u>

Most proposals for modification of Chapter 48, however expansive, do not change the underlying way in which mental health services are provided in the State of Alaska. The services are delivered through the Department of Health and Social Services and funding levels are determined by the legislative process. Recent actions in other parts of the United States have focused attention upon the feasibility of creating a public authority or corporations into which the assets or income of the Alaska Mental Health Trust would be transferred. This public authority would be empowered and authorized to do those things set forth in Proposal B. In addition it would act as an operating authority, providing mental health services for the State of Alaska. The general outlines of the program and the goals of the program would be set by the Legislature, and additional funding, as necessary, would be available through appropriations through the

Legislature or, in the case of capital expenditures, through a bonding power given to the public authority. The primary responsibility for the payment for and delivery of mental health services would be with this "Mental Health Authority".

Similar broad and sweeping changes to the method for delivering mental health services have been enacted in the states of Washington and Wisconsin. In those states, the legislature contracts through a separate authority with regional mental health entities to provide mental health services on a local level. The overriding advantage of this system is that it provides incentives for greater local responsiveness to meet individual needs and creates a system which de-emphasizes institutionalization and in which dollars more closely follow patient needs.

## RECOMMENDATIONS

It has become obvious to the Legislative Committee that additional work needs to be done. There is a clear consensus that Chapter 48 needs to be amended, and that the Amendments need to include the creation of an independent Board of Trustees which can, at a minimum oversee the actions of the State in funding and administering the Mental Health program and the Mental Health Trust lands. It is important to remember that the Weiss lawsuit is still pending. Unless and until the Weiss litigants are satisfied that a reasonable structure has been created, there is always the possibility that a court-ordered restructuring of the Trust will be required, which all parties presently still agree is an undesirable outcome.

Realistically, it is unlikely that the necessary study and review of these issues can be completed in time for any action to be taken by this legislative session. The Legislative Committee recommends, therefore, that work be done with an eye toward creating well thought-out and comprehensive changes during the 1990/91 legislative session. In the meantime, the Board, the Legislature, and the Executive Branch, should work toward reaching a consensus on the necessary changes. Specifically, the Committee recommends the following:

### A. Approve the Recommendations of the Interim Mental Health Trust Lands Commission.

The Legislative Committee is not prepared to recommend changing some basic aspects of Chapter 48. Specifically, the "dedicated revenue stream" approach to funding has much to recommend it. The alternative, a re-transferring of Mental Health Trust lands to create a trust corpus, has the same problems and difficulties as always: it will be difficult to do, very expensive, and may result in a situation in which Mental Health Trust dollars go to managing the Trust lands, and not toward benefitting the beneficiaries of the Trust. After 2-1/2 years of study and deliberation, the Interim Mental Health Trust Lands Commission has issued its recommendations regarding the value of Mental Health Trust lands.

These important recommendations are the result of careful analysis and reasoned decision-making. They are essential to making the "dedicated revenue stream" approach successful. At a minimum the Legislature should act this session to adopt procedures approved November 7,1989 by the IMHTC. Thus, the Committee's first recommendation is that the Legislature should resolve the long-standing issue of Mental Health Trust lands valuation by accepting the procedures adopted by the recommendation of the Interim Mental Health Trust Commission during this legislative session.

## B. PREPARE COMPREHENSIVE PROPOSALS FOR THE 1991 LEGISLATIVE SESSION

The Committee recommends that no specific changes in Chapter 48 be made during this legislative session so that a more comprehensive approach to an overhaul of Chapter 48 and of the Alaska Mental Health program can be undertaken during the following legislative session. The changes outlined in this report provide only a summary of possible options and do not purport to be a comprehensive view of the possible ways in which a separate Board of Trustees could function. Alaska is not the only state that has been faced with these issues over the last few years. There is a wealth of information and knowledge which can and should be evaluated for precedent to determine the best way to structure mental health services delivery for the State of Alaska. The Legislative Committee recommends, therefore, that the Legislature appropriate sufficient funds for the purpose of conducting a study which will lead to comprehensive recommendations for enactment of legislation during the 1990/91 session.

## C. AUGMENT THE BOARD'S COMMITTEE STRUCTURE ON AN INTERIM BASIS

Finally, the Legislative Committee recognizes that if no changes are made to Chapter 48 and to the structure of the Alaska Mental Health Board at the present time, the built-in conflict between the Alaska Mental Health Board's role as an advocate for the traditional Mental Health program and its role as a neutral arbiter of claims to the Trust's funds will continue, at least on an interim basis. The Legislative Committee wishes to emphasize its belief that the Alaska Mental Health Board, on the whole, has done an excellent job of attempting to juggle these conflicting responsibilities. However, those beneficiaries of the Trust who are not presently required by statute to be represented on the Alaska Mental Health Board must be made to feel that their interests are being given full and fair consideration by the Board when it acts in its capacity as planning and oversight body for the Mental Health Trust as a whole. This issue was recognized by Governor Cowper in a letter which he sent to the Board February 17, 1989, in which he requested that the Board itself make recommendations as to any changes that should be implemented in its membership and structure.

The Legislative Committee believes that, for the time being, no formal changes need to be made to the structure and membership of the Board. Instead, in order to ensure that the interests of all of the beneficiaries are represented on an interim basis, and, as importantly, in order to ensure that these beneficiaries <u>perceive</u> that their interests are adequately represented, the Legislative Committee recommends that the Board take the step of augmenting its Committee structure by adding to each of its committees voting members from one or more of the affected beneficiary groups. This augmentation would be on an interim basis until final recommendations can be made as to changes in the Board's structure and in Chapter 48. This recommendation can be implemented by the Board itself, and does not require any legislative changes. The Board has already had experience with this arrangement. Its Budget Committee has been an augmented committee for the last year, and the Legislative Committee itself welcomed and benefitted substantially from the participation of several interested parties. Thus, the Legislative Committee recommends Board Committees be expanded by the Executive Committee in accordance with established Board procedures to provide reasonable representation of beneficiary groups. The Committee further recommends that the committee expansions include coordination with the three affected boards and coalition attorneys representing plaintiffs in the litigation.

## CONCLUSION

The challenge that is faced by the Board, the State, and the Weiss litigants is to find a way to make a permanent, binding commitment that adequate funding for the State's mental health program will be provided in the future. It is disheartening that the problems which led to the present dissatisfaction with Chapter 48 as a proposed resolution to the Weiss litigation are in many respects the same problems which existed and led to the Weiss lawsuit in the first place. Without a commitment to an enforceable and workable arrangement for funding the mental health programs, the Weiss litigants have no incentive to abandon their original demand that the Trust be reconstituted in its entirety. The State has at the present time an opportunity to look carefully at the way in which mental health services should be funded and delivered in the State of Alaska. The Legislative Committee recommends that steps be taken so that the mental health program and the Mental Health Trust can be structured in a manner that is forward looking and takes into consideration the needs of the State of Alaska over the next several decades.

Interim Report 6.6.4

Related to SB493

March 20, 1990

Mrs. Lennie Gorsuch
Commissioner of Natural Resources
State of Alaska
Willoughby Center, 5th Floor
Juneau, Alaska 99801

Dear Commissioner Gorsuch:

With this letter I am transmitting the Interim Mental Health Trust Commission's response to Rod Swope's Minority Report. I wanted to get this response to you earlier, but I was hospitalized resulting in the delay.

I suggest we meet, at the earliest possible time, to discuss where the Commission should go from this juncture. We have yet to finalize the reevaluation and the replacement lands.

If you agree with the minority report, and are unable to follow the Commission's procedures, then there may be reason for us not to proceed with the rest of our task. We do need to discuss these options.

A process for reevaluation was suggested to the Commission by David Walker and Jim Gottstein. Tom Koester was to review this suggestion and give the Commission his recommendation. It would be helpful to have his response.

Sincerely,

KJ Metcalf

for

Dr. George Rogers
Chairman
Interim Mental Health
Commission

INTERIM MENTAL HEALTH TRUST COMMISSION (IMHTC)
RESPONSE TO
MINORITY RECOMMENDATION TO THE COMMISSIONER OF NATURAL RESOURCES

March 20, 1990

George Rogers, Ph.D.
Chair

Lidia Selkregg, Ph.D.
Commissioner

K.J. Metcalf
Alternate

Dennis Scholl, Ph.D.
Alternate

## Introduction:

The Commission members and alternates have reviewed the "Minority Recommendation to the Commissioner of Natural Resources" (Minority Report) submitted February 1, 1990 by Rod Swope, the Commission member serving as the Designee for the Commissioner, Department of Natural Resources (DNR). The review of the Minority Report by the Commission majority produced no basis for modification or revision of the "Interim Mental Health Trust Commission Draft Final Report" (Commission Report) of December 20, 1989. The Commission Report stands as the final report on the "Approved Procedures for Determining the Fair Market Value of Alaska's Mental Health Trust Lands." The public members of the Commission and their alternates re-affirm their recommendations.

## General Nature and Character of the Minority Report:

The nature of the Minority Report was a significant disappointment to the other members of the Commission. While failing to substantiate DNR's findings and conclusions, the Minority Report attempted to discredit the Commission's work by portraying the public members as unprofessional, not acting in the public interest and in fact acting illegally. These are serious personal allegations that require a personal response.

The Minority Report opens on the first page by asserting that the Commission exceeded its authority and adopted,

> *"...valuation procedures urged by the attorneys for the plaintiffs and intervenors in the Weiss case, procedures designed to maximize value and not to produce fair market value as required by Chapter 48."*

The Minority Report is laced with similar implications of professional misconduct by the public members of the Commission. Designee Swope portrays himself as the lone champion of reason and legality, and by implication, and sometimes directly, portrays the public members as being the reverse. On page 6, for example, Swope claims

> "*I strived toward achieving consensus and a common resolution*...[On the other hand] *it became apparent that the majority of the IMHTC was dissatisfied with the results of the initially approved procedures and began amending them to produce higher values.*"

It is extremely unfortunate that the Minority Report personally attacked two professionally respected, long time Alaskans who have dedicated their lives to public service, by implying they would put their professional and personal reputations on the line for the benefit of an interest group.

The public members of the Commission volunteered over three years of their time without compensation to develop a legitimate process for arriving at the "fair market value" of the original Mental Health Trust. The process is legitimate and the Commission Report accurately documents the effort.

Another tactic used at the outset of the Minority Report has nothing to do with the Commission recommendations as such, but is designed to create an attitude in the mind of the reader that would be antagonistic to the Commission and favorable to the Minority Report. At the top of the second page the Minority Report introduces a half truth to portray the dire consequences to the State budget of following the Commission's recommendations.

> *"The importance of the value determination used to determine fair market value cannot be overstated because of the dramatic effect they will have on the overall state budget. Under the valuation procedures adopted by the majority of the IMHTC...this would result in more than $178 million in otherwise unrestricted state general funds being restricted in the Mental Health Trust Income Account."*

The omitted half of the whole truth is that the restriction to the Mental Health Trust Income Account is only a temporary accounting transaction required by Chapter 48 in an attempt to comply with the 1956 Congressional Alaska Mental Health Enabling Act which created the Trust. After payment from the account of only the necessary expenses (not the unnecessary expenses) of the Mental Health Program, the balance of the income is transferred to the General Fund for other public purposes. The value of the land corpus (whether it be high or low) does not determine the Mental Health Program budget as Designee Swope states. The Program budget is determined by Legislative appropriation after consideration of the recommendations of the Alaska Mental Health Board. In short, the effect of the valuation procedure upon the overall State budget is neutral, not "dramatic" as alleged.

The public member majority of the Commission do not feel resolution of the issue is served by trying to alarm Alaskans, rightfully concerned with fiscal solvency of the State, by painting a fiscal horror story not supported by facts. They further believe that the tactic was used to justify DNR's own fanatical efforts throughout the process to drive down the estimated value of the original Trust Lands.

The personal attacks in the Minority Report are distressing and had to be addressed. But, to belabor this does not serve the purpose of resolving the complex Mental Health Lands Trust issue. The technical questions raised in the Minority Report are more appropriate to address.

## Technical Questions Raised by the Minority Report:

The Minority Report fails to address directly the Commission Report. Instead, Designee Swope's dissent is based upon two charges, (1) that the Commission exceeded its statutory authority, and (2) that the Commission adopted "procedures designed to maximize value and not to produce fair market value."

> Minority Report Finding 1: "The IMHTC exceeded its statutory authority by proposing and adopting its own valuation procedures instead of reviewing and approving procedures proposed by the Commissioner."

The long and arduous task of developing a procedure for identifying fair market value was undertaken by the Commission in an atmosphere of cooperation and trust. We, the public members, assumed all parties were working toward a solution. This enormous task was made difficult by shortages of data, time, and funds and by the limited expertise of DNR staff. The Commission Report adequately details the process. The Commission followed the advice and counsel of the Attorney General's office in developing the fair market value procedures. It therefore came as a shock to find DNR and/or the Attorney General's office, in the Minority Report, creating a new interpretation of the Commission task in an apparent attempt to invalidate our years of effort. It is all too apparent this new interpretation evolved because DNR disagreed with the Commission's approved procedures. This unfortunate "eleventh hour" tactic suggests the Commission's assumption of trust and good faith was ill-founded.

Chapter 48, SLA 1987 revised and replaced certain sections of Chapter 132, SLA 1986 which created the Commission to oversee interim management of the Trust lands and work with the Legislature in establishing a statutory basis for resolving the Trust land issues. The Commission membership was reduced from five (5) to three (3) -- the Commissioner of DNR and two public members -- and its mission redefined in terms of the negotiated settlement framework. The reduced Commission assumed sections of Chapter 132 not replaced or revised were still in effect and for more than two years continued operations much as it had in its original form without question or challenges.

Throughout this period the Commissioner of DNR participated continuously (through various designees) and the Attorney General was represented by Tom Koester. It came as a surprise, therefore, to be informed three months after the Commission submitted its final approved procedures and two months after forwarding its draft final report that the Commission had "exceeded its statutory authority."

The Minority Report further alleges,

> *"By proposing and adopting valuation procedures over the department's objections, the IMHTC has ignored the legislative requirement that, in effect, there be consensus as to the valuation procedures to be employed. ... In my opinion, the failure of the IMHTC to reach consensus on valuation procedures makes it impossible for the Commissioner to comply with Chapter 48."*

Consensus was not a "legislative requirement". Chapter 132, SLA 1986 provided that motions could be adopted by majority vote and, in fact, many of the "action items" treated by the present Commission were resolved by a two yea vote (the other member voting nay or abstaining). The actions resulting in the final approved procedures and the Commission Report were carried out, at the suggestion of Designee Swope, as a means of bringing the whole issue of valuation to a close. He also stated, and it was agreed, there might also be a minority report.

In the Minority Report Designee Swope also charges the Commission improperly changed the originally approved procedures and he implies this was a frequent practice aimed at producing a value substantially greater than fair market value. In fact, the originally "accepted and approved" procedures were observed to the very end of the Commission deliberations adjusted only when required by lack of funds or data. This is more fully discussed in the final section of this reply (page 10, below).

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

The bulk of the Minority Report attempts to discredit the Commission's fair market procedures. After careful review of the Minority Report, the Commission determined there is no reason to alter its conclusions. The Commission Report sets forth the final approved procedures in detail. Rather than repeat that substantial information, a summary response is given to key challenges in the Minority Report.

Given the limitations of budget, time, data and staff the final approved procedures are appropriate, legal and lead to a mid-range value, not a high value. This is summarized in the text of the resolution adopted November 7, 1989 (see Appendix A in the Commission Report of December 20, 1989).

The largest differences between DNR's preferred values and the values arrived at by the Commission's final approved procedures are in the surface estate and the mineral resources. Further clarification on surface estate valuation and procedure for valuing mineral resources follows.

### Surface Estate Valuation Procedures

Because of time and financial constraints the Commission could not use "best practices" (i.e. appraisals). Instead, three geo-panels of appraisers were selected to give opinions of value for parcels in their regions. At best the process was highly judgmental and subjective, but in addition only an estimated seven to ten minutes was spent on each parcel and data was limited to that provided by DNR or brought to the meetings by the appraisers. Because of inevitable differences of opinion between appraisers and the probability of error due to time and data limitations, the approved procedures provided for a review and discussion of questioned values. In the event the review step did not resolve differences, the Commission could utilize a mediator to recommend resolution.

The review stage was never completed and the mediation stage never reached.

Although problems arose in connection with the operations of the geo-panels, it was with the initiation of the review stage of the approved procedures that the surface estate valuation process began to break down. Through various tactics the DNR staff attempted to thwart the proper implementation of this stage of the surface valuation with the justification that the approved procedure might result in increases in values. After several bitterly fought meetings, the process was allowed to continue with modifications. The Minority Report chose to ignore the review aspects of the approved procedures and wrongfully portrays the role of the review appraisers as something added later at the insistence of attorneys for the plaintiff and intervener.

The Southeast geo-panel was provided a random sampling of the questioned surface estate values. On the basis of the geo-panel's accepted adjustments the initial geo-panel value for

Southeast parcels was increased by 30%. However, of the 387 sample parcels reviewed more than half (207) were recommended for further mediation, a step of the originally approved procedures that never came to fruition.

The Southcentral geo-panel was called into review session, but DNR staff neglected to invite the review appraiser. Although an apology was made to the Commission, the end result was the reviewer could only be present for a few hours of one morning. At that time he did present comparable sales for large parcels which the geo-panel did not know existed. Once provided this useful large parcel information, the Southcentral geo-panel recommended five of six large parcels re-examined be increased in value by 68%. If the southcentral review had been possible, as provided by the approved procedures, there was a high probability other similar adjustments would have been made.

A review of the Northern geo-panel was never even initiated. At this point the Commission was informed by the DNR staff that funds had been exhausted.

In the course of carrying out the approved procedures it became apparent the opinion of value approach was seriously flawed. The State's appraiser provided the geo-panels during their deliberations with interpretation of the valuation instructions for application to actual cases. The review step disclosed the State's interpretations as not totally unbiased. During the geo-panels' deliberations the State appraiser reported to the Commission problems between members of the Southeast panel in coming to agreement. Additionally, the members of the Southcentral geo-panel submitted a memorandum to the Commission designed to protect their professional reputations. The memo stated the product of the abbreviated valuation process was "not even 'preliminary opinions of value' as commonly understood in the appraisal profession" and listed other limitations such as time and funding and the manner in which the State had parcelized the land for appraisal(see Commission Report, Appendix B, page B4).

The unfinished process of carrying out the approved procedures left the Commission with a wide range of surface estate values -- the adjusted values of the geo-panels advocated by DNR and the values presented by the review appraisers advocated by the plaintiffs. The Commission chose a procedure leading to a mid-level value between these extremes.

## Procedures for Valuing Mineral Resources -- A Question of Most Appropriate Methodology

The National Appraisers Association Standards for determining fair market value recognized three general approaches: market (comparable sales), income (capitalization of income stream from the property) and replacement cost. From the beginning the public member majority of the Commission have insisted the methodology most appropriate to the type of estate being valued would be employed and the various Commissioners of DNR and designees understood this requirement. On September 29, 1987, for example, the then Commissioner of DNR directed the Division of Geological and Geophysical Surveys (DGGS) to "assess the quantity and quality of known and potential hard rock minerals...followed by a resource valuation." This value was to "be determined by an independent entity, likely retained under contract to the department."

In April 1988 DGGS maps reflecting mineral potentials and favorability of mineral occurrence on Trust Land were presented to the Commission. In preparing for the next phase, the Commission was informed

> *"assuming it proves impossible to complete an in-house mineral valuation (for whatever reason), we will be prepared to proceed with contract solicitation to complete the work."*

The Commission assumed it had approved procedures that included mineral valuation by outside consultants using the income approach. This is the point at which DNR decided to depart from the previously approved procedures and to use instead the comparable sales approach. The comparable sales approach was considered totally inappropriate by the public members as well as the State's own professional consultant, (Dr. Harris). Using the wrong approach, DNR first set the mineral value at zero and later at $16 million. In commenting on the Commission's rejection of this value, the Minority Report author agrees, "The initial value determined--$16 million--admittedly seemed quite low." (see Minority Report, page 16).

To bring these mineral valuation procedures to a conclusion, therefore, the plaintiffs and interveners entered into a contract with independent consultants as provided in the originally approved procedures. The Minority Report asserts wrongfully that the consultants used "a procedure not previously recommended by the Commissioner or formally discussed or approved by the Commission." This statement is an outrageous distortion of the truth. From the very beginning the Commission has distinguished between procedures and the methodology selected to implement the procedures and also has always held the most appropriate methodology would be used in implementing the procedures. This was formally reiterated by the Commission and agreed upon by all members at the July 12, 1989 meeting. "Fair market value for purposes of Chapter 48 means utilization of the best information and methodology available." (see Commission Report, page 5, emphasis added).

Designee Swope and the DNR staff, however, have overlooked this Commission direction. Instead, at the September 5, 1989 meeting the lead DNR staff member emotionally exclaimed

> *"we have been faithful to the market approach because that is what the Legislature required."*

(Commission Report, page 5). We have searched the statute in vain for any such requirement! Stonewalled by DNR staff the Commission was left with two mineral values ranging from the unacceptable "comparable sales" value of $16 million and the $1.5 billion value arrived at by employing an appropriate "income" methodology.

DNR staff have consistently insisted on or returned inappropriately to reliance upon only one methodology -- comparable sales -- and have gone to the extreme of insisting this and nothing else results in fair market value. This entrenchment is clearly because their valuation experience has been primarily in "condemnation litigation" (the Minority Report at least twice, pages 10 and 27, admits these are the DNR standards). This is the methodology DNR has always used and they are most comfortable with. But, the present transaction is not a condemnation valuation and comparable sales are totally inappropriate to determining fair market value of a mineral endowment.

This view of limitations of DNR experience and capability was shared by DNR's own expert consultant, Professor Harris, who also provided possible explanation for DNR's very narrow interpretation. Dr. Harris diplomatically worded an evaluation of the technical expertise of the DNR staff (see Harris, September 1989, pages 8-9). Of the types of expertise required for the mineral estate valuation estimates attempted, he found the DNR staff qualified "as to certain types of deposits...especially well qualified as to regional knowledge...[but] not highly experienced in estimation methodology." He also noted the possibility of bias or at least the "appearance of conflict of interest," due to the State being defendant in litigation.

In his conclusion as to the requirements for a process following "best practices," Harris reiterated his evaluation of the in-house expertise by stating the DGGS work on mineral endowment would have to be redone. He recommended this work and the estimation of value not be done in-house. Instead, the mineral endowment should be done by contract with the U.S. Geological Survey (he confirmed USGS could and were willing to do the work) and the valuation work should be done