MEMORANDUM

State of Alaska

Department of Law

TO: The Honorable Michele Brown
Commissioner
Dept. of Environmental Conservation

DATE: June 5, 2000

FILE NO: 221-89-0818

TELEPHONE NO: (907) 269-5274

SUBJECT: Investment of Exxon Valdez Oil Spill Joint Trust Funds in a State Account

FROM: Craig Tillery
Assistant Attorney General
Environmental Section - Anchorage

The Exxon Valdez Oil Spill Trustee Council is evaluating whether to ask the Alaska Department of Revenue, Treasury Division, to hold and invest natural resource damage recoveries from the oil spill. As a part of that evaluation, you ask that we clarify the effect of having the joint trust fund money invested in a state account. Specifically, you ask if joint trust funds are deposited with the state in an agency fund:

1) Could the money be appropriated or expended by the state without the express authorization of the Trustee Council?
2) Could the state prevent the Trustee Council, upon the unanimous agreement of its members, from withdrawing all or part of the money from the account at any time?
3) Could the state use the joint trust fund monies as collateral without the express authorization of the Trustee Council?
4) Could the state direct the investment of the joint trust fund monies into particular investments or types of investments different from those desired by the Trustee Council?
5) Would the agency fund be a "state fund" as that term is used in AS 37.10.071 and, if so, how would the provisions of that statute be applied to the Trustee Council?
6) May the Trustee Council take into account social issues in making its investment decisions?

These issues will be addressed seriatim.

Introduction

The Memorandum of Agreement and Consent Decree in *United States v. Alaska*, A91-081 CV (August 28, 1991) ("MOA") provides that the United States and the State of Alaska ("the governments") shall establish a joint trust fund to receive, hold, disburse, and manage all natural resource damage recoveries obtained by the Governments under the Clean Water Act, arising out of the Exxon Valdez oil spill ("EVOS"). Under the MOA the joint trust fund is to be established in the Registry of the United States District Court for the District of Alaska "or as otherwise determined by stipulation of the Governments and order of the court." MOA at 10. Pursuant to a series of orders entered by the District Court for the District of Alaska, the joint trust fund monies are currently held in the Court Registry Investment System ("CRIS") in Houston, Texas. Monies held in the CRIS are limited to investments in Treasury securities and incur high fees.

At the time of the settlement the United States took the position that, under federal law, the joint trust funds must be held in either the United States Treasury or the federal court registry. Although the validity of this legal position was questioned by the State of Alaska, the federal trustees determined that based upon this legal advice they were unable to agree to invest the joint trust funds outside of these depositories in the absence of explicit federal statutory authority. Any decision on the investment of joint trust funds requires the unanimous agreement of the federal and state trustees. In 1999 Congress passed Public Law No. 106-113, the Consolidated Appropriations Act, 2000, which contains a provision (section 350 of H.R. 3423, which appears as an appendix to Public Law No. 106-113) allowing the EVOS joint trust funds to be deposited in a federal account within the Department of the Interior or in other accounts outside the United States Treasury ("outside accounts"). The purpose of this legislation was to allow the EVOS Trustee Council, which administers the joint trust funds, more latitude in its investment choices and the opportunity to reduce fees.

To carry out its responsibility with respect to its administration of the joint trust funds, the Trustee Council is currently evaluating whether to utilize the statutory authority provided by Congress in Public Law No. 106-113 to invest the funds outside the United States Treasury. Although the Trustee Council has not made a final decision on whether to deposit the monies in an outside account, it has received investment advice recommending that the money be deposited with the State of Alaska for investment by the Department of Revenue, Treasury Division. If deposited with the State of Alaska, the monies would be placed in an agency fund held by the Treasury Division. The Trustee Council wishes to be assured that if it deposits joint trust fund monies with the state, the money will remain under the control of the Trustee Council and not be subject to

expenditure or control by the State of Alaska except to the extent that an expenditure from the joint trust funds is authorized by the Trustee Council.

Nature of the Joint Trust Funds

To understand the effect of depositing the joint trust funds with the state for investment, it is important to first understand the nature of these monies. The natural resource damage recoveries in the Exxon Valdez litigation are to be used "jointly" by the governments for restoration purposes. MOA at sec. VI.A. The governments are to "establish standards and procedures governing joint use and administration of all such natural resource damage recoveries." *Id*. The provisions in the MOA do not differentiate between the money owed to either government for natural resource damages. Indeed, the District Court noted that it knew "of no means by which the natural resource damage recoveries could be divided between the federal and state trustees." *United States v. Exxon Corp.*, No. A91-0082-CV, Order of January 17, 1997 at 5 (D. Alaska). The court went on to state that a "significant feature of the federal/state consent decree was that there be no such allocation." *Id.* Thus the court described the money in the CRIS account as "held for the joint benefit of the United States and the State of Alaska" and concluded that "[b]oth the United States and the State of Alaska have undivided interests in the entire amount of the account." *Id.* at 6.

In an opinion relating to the application of the National Environmental Policy Act ("NEPA") to Exxon Valdez natural resource restoration, counsel for the United States Departments of Commerce, Agriculture, and the Interior reached a similar conclusion. *See* Application of NEPA to Exxon Valdez Natural Resource Restoration, U.S. Depts. of Commerce, Agriculture, and the Interior (November 30, 1993). The United States concluded that the "settlement fund administered by the Trustee Council is the jointly owned property of the State of Alaska and the United States." *Id*. at 4. Therefore it found that, for NEPA purposes, "each commitment of joint settlement funds constitutes in significant proportion, federal funding." *Id*.

During the approval process for the EVOS settlement, the State of Alaska took a similar position on the indivisible, joint nature of the recoveries. Attorney General Charlie Cole addressed the issue of whether the executive branch had the authority to negotiate and agree to a settlement of this nature. *See* 1999 Inf. Op. Att'y Gen. (Jan. 1; 221-89-0818). The opinion noted that in "framing that issue, it is critical to understand that the Trust Fund monies are not monies to be received by or belong to either the State or the Federal government." *Id*. at 4 (emphasis in original). Rather, "under the Settlement Agreement, those monies comprise a trust res, as to which neither government

has sole ownership or control . . . ." *Id.* Thus, there is a consensus among the governments and the court that the joint trust funds belong indivisibly to both governments and solely to neither. With this background we will turn to the specific questions which you have posed.

Appropriation or Expenditure of the Joint Trust Funds by the State

The legislature's appropriation power does not extend to monies that are not public revenues or assets of the state and can not be placed in the State Treasury. 1999 Inf. Op. Att'y Gen. at 5 (Jan. 1; 221-89-0818); *Thomas v. Bailey*, 595 P.2d 1, 4-9 (Alaska 1979). The EVOS joint trust fund monies are not assets belonging to the state, but rather are assets of a joint federal/state trust fund not subject to sole state ownership or control. 1999 Inf. Op. Att'y Gen. at 6 n.6 (Jan. 1; 221-89-0818). As such the monies are not subject to appropriation. The Alaska Legislature implicitly recognized this distinction with passage of legislation recognizing and governing the EVOS trust funds. In AS 37.14.405 the legislature specifically addresses those situations where appropriations of the trust funds are required. In enacting this bill the legislature recognized the existence of the trust but did not attempt to assert the right or ability to appropriate the trust funds generally. Rather, the legislature stated only that an appropriation was required prior to expenditure by a state agency of monies received from the trust by a state agency. AS 37.14.405. Thus, by their nature, the joint trust funds are not subject to appropriation.

Recent federal legislation clarified this status. As described above, Public Law No. 106-113 provides the authority for the joint trust funds to be invested in an outside account. That statute also makes it clear that joint trust funds deposited in an outside account, such as is contemplated here, must be transferred promptly from the account to the appropriate government upon the unanimous approval of the federal and state natural resource trustees for the Exxon Valdez oil spill ("Trustees") and the joint request of the governments. *Id.* The statute does not permit an appropriation of the joint trust funds by the state legislature.

Compliance by the state with the terms of Public Law No. 106-113 is a condition of acceptance of the deposit. Absent compliance with the terms of the federal law, authority to invest the money with the state does not exist. *Cf. Flick v. Liberty Mutual*, 2000 WL 155899 (9th Cir. (Cal.)). To the extent state law conflicts with a federal mandate, state law must yield. *Gade v. Nat'l Solid Wastes Management Assoc.,* 112 S. Ct. 2374, 2385, 2388 (1992) ("any state law, however clearly within a state's acknowledged power, which interferes with or is contrary to federal law, must yield");

Air Line Pilots Assoc. v. UAL Corp., et al., 874 F.2d 439, 445 (7th Cir. 1989) ("[i]f a federal and a state statute create inconsistent duties [or if the state statute would stand in the way of federal objectives], the state statute must of course give way; the supremacy clause requires no less"); *Nedd v. United Mine Workers of America*, 556 F.2d 190, 205 n. 30 (3rd Cir. 1977) (although fund exists as hybrid creature of both state and federal law and state law traditionally governs trusts, state law does not preempt federal law where both apply to a subject of federal legislation).

It is similarly clear that the state may not simply expend joint trust fund monies invested by the Treasury Division absent the agreement of the EVOS Trustee Council. The MOA specifically provides that all decisions relating to the expenditure of trust monies must be made by the unanimous agreement of the Trustees. More recently, Public Law No. 106-113 acknowledges the need for unanimous agreement for expenditure and provides for the transfer of funds only upon the joint request of the governments.

Authority of the State Regarding the Withdrawal of Funds

Public Law No. 106-113 states that joint trust funds deposited in an "outside account" such as the Treasury Division and approved for expenditure by the Trustees "shall be transferred promptly from the account to the appropriate government upon the joint request of the governments." As described above, state compliance with the requirements of Public Law No. 106-113 is a condition of acceptance of the deposit. To the extent state law conflicts with a federal mandate, state law must give way. Thus the state may not prevent the prompt withdrawal of all or part of joint trust fund money invested by the Treasury Division when the steps outlined above have been completed.

Use of Joint Trust Fund Monies by the State As Collateral

The state may not use joint trust fund monies as collateral except as expressly authorized by the EVOS Trustee Council. The joint trust fund is held jointly by the governments. The "trust" created by a recovery under the CWA is similar to a public or charitable trust and basic principles applicable to private trusts may be applied. *Cf. Lassen v. Arizona*, 385 U.S. 458 (1967); *Brooks v. Wright*, 971 P.2d 1025 (Alaska 1999) (applied basic principles of trust law to public land trusts); *see also State v. Weiss*, 706 P.2d 681, 683 n.3 (Alaska 1985). The use of trust funds for collateral by one holding the funds constitutes the use of trust monies for a benefit unrelated to the trust. Under basic trust principles, a person or entity acting as a joint owner or trustee may not use the res of the trust fund for his own benefit. *See In re Cornelius*, 520 P.2d 76, 85 (Alaska 1974);

Pino v. W.J. Budwine, 568 P.2d 586, 588 (N.Mex. 1977) (trustee breached duty of loyalty to trust by using beneficiaries' shares of stock to secure his personal loan at bank); *Tyler v. Citizens Home Bank of Greenfield*, 670 S.W.2d 964, 956 (1984) (co-trustees breach duty of loyalty to trust if they borrow money from a bank using trust corpus as security to pay a debt owed by them to the bank, for which the beneficiary was in no way liable).

In addition, the terms of the MOA and Public Law No. 106-113 prevent use by either government of the joint trust fund money for any purpose without the unanimous agreement of the Trustees and the joint request of the governments. This precludes the unilateral use of the funds as collateral.

Authority of the State to Direct Investment of the Joint Trust Funds Other Than As Determined by the Trustees

The terms of Public Law No. 106-113 make it clear that investments in an "outside account" are limited to those that "have been determined unanimously by the [Trustees] to have a high degree of reliability and security." This does not mean that the Trustees are required to approve each purchase and sale of a stock or bond, though they may if they wish. Rather, the Trustees are required to make a determination of the appropriate asset class allocation of investments with appropriate benchmarks. Those allocations must be adhered to by the investment managers for the outside account. Within the allocations, and subject to the specified benchmarks, the particular investments may be left to the discretion of the investment manager. Should the Trustees desire, they may determine that specific obligations, instruments, or securities shall or shall not be purchased. In that event the investment manager must carry out those instructions. The state may not direct the investments of the joint trust fund monies into particular investments or types of investments different from those desired by the Trustees. *See Gade v. Nat'l Solid Wastes Management Assoc.*, 112 S.Ct. 2374, 2385, 2388 (1992); *Air Line Pilots Assoc. v. UAL Corp., et al.*, 874 F.2d 439, 445 (7th Cir. 1989); *Nedd v. United Mine Workers of America*, 556 F.2d 190, 205 n. 30 (3rd Cir. 1977).

Application of AS 37.10.071 to Joint Trust Funds Invested by the State

Alaska Statute 37.10.071 describes certain powers and duties of the fiduciary of a state fund. Included in these powers and duties are a requirement to adhere to a standard of care in activities related to the monies in the state fund and provisions for liability for breach of duties assigned or delegated under certain statutes. The statute also provides, in

certain circumstances, for indemnification and defense for fiduciaries of a state fund and officers and employees of the state.

The provisions of AS 37.10.071 are applicable to "fiduciaries of a state fund." Initially we look to see whether the agency fund described in your request is a "state fund" as that term is used in AS 37.10.071. The phrase "fiduciary of a state fund" was added to this section in 1992 to replace the term "Commissioner of Revenue." *See*, 1992 SLA ch. 31, sec. 12. Although "state fund" is not defined in statute or opinion, the context of AS 37.10.071 makes it clear that the term encompasses accounts, including trust and custodial receipts, under the management or control of the state, though not necessarily subject to appropriation by the state. This is consistent with the approach taken by other states.

For example, in *Municipality of Metropolitan Seattle v. O'Brian*, 544 P.2d 729, 732 (Wash. 1976), the Washington Supreme Court noted that the Washington State Constitution, similar to article IX, section 13 in Alaska's Constitution, requires a legislative appropriation to disburse any funds from the state treasury. However, the Washington Supreme Court found:

> [F]or many years, there has stood the commonsense interpretation by this court that the treasurer may be made custodian of particular funds of a proprietary nature which are held for a specific purpose. Funds so held are distributable without specific legislative appropriation . . . . The mere fact that the state treasurer may be made the custodian of a particular fund and may be required to render certain services with respect to such fund does not of itself make the moneys so received and held by him State funds in the treasury.

Id. at 733-734. Alaska statutes make a similar distinction between state funds and funds in an account under state control. *See* AS 37.15.200. Thus there may be monies in an account under state control, a "state fund," that are not "state funds" subject to appropriation.

Alaska Statute 37.10.071 relates not to the expenditure of money, but rather to the mechanics of operating a fund. As such its terms are equally applicable to all funds managed or invested by the state, not just those accounts composed of money owned or subject to appropriation by the state. Under the question you pose, the joint trust fund monies would be placed in a state agency fund, managed and invested by the state and

owned indivisibly by the state and the United States, though not subject to appropriation by the state. This type of fund is a "state fund."

A "fiduciary of a state fund" is defined in AS 37.10.071(f) and includes in relevant part, "(3) the person or body provided by law to manage the investments for investments not subject to AS 14.25.180 or AS 37.10.070." The Trustees, by virtue of the requirement in federal law that they administer the joint trust funds and set the asset class allocations, would be fiduciaries of a state fund if the monies are invested through the state. To the extent that the Trustees delegate management responsibilities related to investment of the joint trust funds to state officers or employees, those individuals would also be fiduciaries of a state fund. With these principles in mind we turn to the application of AS 37.10.071 to the joint trust fund.

Alaska Statute 37.10.071(a) and (b) set out the duties and powers of fiduciaries of a state fund, including the power to delegate management functions. While these sections define the authority of state officers and employees who are delegated management responsibility, they do not define the authority of the Trustees. Rather the Trustees' investment authority is defined by federal law, including the MOA, Public Law No. 106-113, and orders of the District Court issued under authority of that law. Those federal laws define the duty of the Trustees as investing in "income-producing obligations and other instruments or securities that have been determined unanimously by the Federal and State natural resource trustees for the Exxon Valdez oil spill ("trustees") to have a high degree of reliability and security." Public Law No. 106-113. This language is taken from the investment guidelines for the Trans-Alaska Pipeline Liability Fund ("TAPLF"). *See* 43 C.F.R. § 29.11 ("monies accumulated in the Fund shall be prudently invested in the following types of income-producing obligations having a high degree of reliability and security . . . .") The TAPLF regulations interpret 43 U.S.C. § 1653(c)(6), which provides that excess funds shall be "invested prudently" in specific investments.[1] Thus it is clear that, at a minimum, the language in Public Law No. 106-113 requires investments to adhere to a prudent investor standard. For the reasons stated below, we believe that the language of that act, viewed in context, sets a slightly higher standard.

[1] Unlike the TAPLF, Public Law No. 106-113 does not restrict investments to income-producing securities approved by the Secretary of the Department of the Interior. Rather, money invested under the authority of Public Law No. 106-113 may be invested in income-producing obligations, securities, and other instruments. This broad range of options includes both domestic and international equities.

The language of Public Law No. 106-113 provides guidance to its intent. The statutory language does not simply adopt a standard such as the "prudent investor" rule. Rather, through the admonition that investments must be unanimously determined to be both secure and reliable it provides a specific focus on the protection and growth of the joint trust fund monies. This emphasis is consistent with the intent of the statute that earnings of the joint trust fund be used as an endowment to pay for stable long-term programs. *See* Resolution of the Exxon Valdez Oil Spill Trustee Council (March 1, 1999)(referenced in Public Law No. 106-113). For these reasons, we believe that the language used in Public Law No. 106-113 is intended to adopt the prudent investor rule but with an emphasis on the security and best interests of the joint trust fund. Similarly, AS 37.10.071(c) defines the duty for a fiduciary of a state fund as the "prudent investor rule" plus the added admonition to "exercise the fiduciary duty in the sole financial best interest of the fund entrusted to the fiduciary." We believe that these state and federal standards are synonymous. To the extent that the standard in AS 37.10.071 is different than that found in federal law, the language in the federal law controls.

Subsection (d) of AS 37.10.071 provides for liability in the case of a breach of a duty owed by the fiduciary or the fiduciary's designee under AS 37.10.071 and certain other listed statutes not applicable to the joint trust fund. Subsection (e) provides for defense and indemnification for a fiduciary of a state fund and for officers and employees of the state in certain circumstances against a claim of liability under subsection (d). Each of these subsections would be applicable to employees of the state who are delegated management responsibilities from the Trustees and to the state trustees. It is unclear whether the federal trustees are subject to liability under subsection (d), although it is likely that their liability is curtailed by a qualified federal immunity. *See Torossian v. Hayo*, 45 F. Supp.2d 63, 66 (D.D.C. 1999).

Assuming that the liability provisions of AS 37.10.071(d) are applicable, the question arises as to whom may a fiduciary of a state fund be liable. The statute does not specifically address this issue. By analogy to trust law, only beneficiaries of the fund could maintain a suit for redress of a breach of a duty. *See* Restatement 2d Trusts § 200 (1957). This approach is supported by language elsewhere in the statute. For example, subsection (c) of AS 37.10.071 describes a duty to "beneficiaries" to be treated with impartiality. Liability for a breach of that duty would logically be to the beneficiaries. However, in the context of a fund composed of natural resource damages accruing to the governments under the federal CWA, there is no beneficiary save perhaps the governments acting on behalf of the public. *Cf. Brooks v. Wright*, 971 P.2d 1025, 1033 (Alaska 1999) (the beneficiary of a trust may act as the trustee). Thus to the extent that

the Trustees and their designees are liable for a breach of a duty made applicable under AS 37.10.071, only the governments may seek redress for that breach.

The defense and indemnity provision of subsection (e) are applicable only to liability under subsection (d). To the extent that a "fiduciary of a state fund" is not liable under subsection (d) or is immune, then the protections of subsection (e) would not be applicable.

Consideration of Social Issues in Making Investment Decisions

The Council has asked if it may take the social implications of an investment into account. Under AS 37.10.071, the answer is no. Subsection (c) provides that in exercising its investment authority under this statute, the fiduciary of a state fund shall "apply the prudent investor rule and exercise the fiduciary duty in the *sole* financial best interest of the fund entrusted to the fiduciary." AS 37.10.071(c)(emphasis added). This language modifies the prudent investor rule in a manner that prevents a fiduciary of a state fund from considering anything other than the financial best interest of the fund. 1998 Inf. Op. Att'y Gen. 198, 206 (August 12; 663-98-0297). As discussed above, the standards contained in the language of Public Law No. 106-113 are the same. The emphasis placed by these statutes on investment of the joint trust funds in a manner that benefits the joint trust fund leads to the conclusion that the social implications of an investment may not be taken into account.

I trust that this response answers your concerns. If you have other questions on this matter, please contact us.

CJT:jmc