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MAY 10 1996 3:29
SUPERIOR COURT
CLERK OF COURT

IN THE SUPERIOR COURT
FOR THE
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

IN THE MATTER OF THE ESTATE OF) Civil Action No. 95-626
LARRY LEE HILLBLOM,)
Deceased.)
REMEDIAL ORDER

I. PROCEDURAL BACKGROUND

After providing all interested parties and the Attorney General from the State of California (collectively, "the parties") sufficient opportunities to be heard on the subject matter contained in the Report of the Special Master dated February 23, 1996 ("RSM"),¹ the Court rendered its final determination on the Report on May 10, 1996, adopting the findings of fact contained in the Report in their entirety,² and concluding that the Executor of the Estate of

¹ The parties filed objections and concurrences to the Report on March 15, 1996, reply memoranda on March 26, 1996 and presented oral arguments to the Court on April 2, 1996. May 10, 1996 Order Re: Report of the Special Master, § I (Procedural Background) ("May 10, 1996 Order").

² As stated in its May 10, 1996 Order, and in its June 6, 1996 Order, the Court adopted Sections I-III, pp. 1-74 in their entirety.

FOR PUBLICATION

1 Larry Lee Hillblom, Bank of Saipan ("the Bank" or "the Executor"), had engaged in eleven
2 breaches of its fiduciary duty.

3 Prior to imposing a remedy based on its May 10, 1996 Order, the Court solicited
4 proposed remedies from the parties, and each submitted their comments and authorities re:
5 remedies.³ The Court then conducted eight days of hearings to allow the Executor an
6 opportunity to show cause why it should not be removed.⁵ At the close of the hearings, the
7 Court ordered the parties to submit their closing arguments and proposed remedial orders in
8 writing.⁶

9
10 ³ The Court received the following submissions on May 24, 1996: Executor's Memorandum of
11 Points and Authorities Re May 10, 1996 "Order Re: Report of the Special Master;" Memorandum of
12 Charitable Trust in Opposition to Removal of Executor and in Support of Reinstatement of Executor;
13 Petitioner Kinney's Recommended Remedies Pursuant to the Court's Order of May 10, 1996; California
Attorney General's Comments Re: Remedial Order. On May 30, 1996, the Court received the
Comments of Special Administrator on Remedies or Conditions to be Issued Pursuant to the Court's
Order of May 10 and May 22, 1996.

14 ⁴ Evidentiary hearings on remedies were held on the following dates: May 31, 1996; June 6, 7, 11,
15 12, 13, 14 and 18, 1996 ("Evidentiary Hearing on Remedies") During the hearings, the Court received
16 the following supplemental briefs: Memorandum of Executor Re: Standard for Surcharge of Executor
17 dated June 7, 1996; Petitioner Kinney's Memorandum Re: Proper Measure of Damages dated June 7,
1996; California Attorney General's Brief on Measure of Damages in Surcharge Actions dated June 12,
1996; Hillblom Charitable Trust's Joinder With Attorney General's Brief on Measure of Damages in
Surcharge Actions dated June 13, 1996.

18 ⁵ The Court initially outlined the issues to be addressed at the Evidentiary Hearings on Remedies in
19 its May 23, 1996 Order Re: Clarification of Order dated May 10, 1996. These issues included: 1) good
20 faith on behalf of the Executor; and 2) safeguards now in place to prevent the recurrence of similar
21 breaches of trust in the future. After the Court heard testimony from the Executor's first witness, Mr.
22 Joseph Waechter, the Court expanded the issues to be addressed at the hearing to include surcharge, (*See*
23 June 7, 1996 Order) and offered the parties the opportunity to recall Mr. Waechter, if needed, to present
24 additional evidence on the issue.

25 ⁶ *See* June 18, 1996 Order Re: Closing of Evidentiary Hearings on Remedies. On June 28, 1996, the
26 Court received the following submissions: Executor's Closing Argument on Remedies and Proposed
27 Order Re: Reinstatement and Surcharge ("Executor's Closing Argument"); Charitable Trust's Post-
28 Hearing Memorandum on Remedies and Proposed Order After Remedial Hearing ("Charitable' Trust's
June 28, 1996 Post-Hearing Memo"); Petitioner Kinney's Post-Hearing Memorandum Concerning
Remedies ("Kinney's June 28, 1996 Post-Hearing Memo"); Final Argument of Petitioner Moncrieff On
Remedies for Executor's Breaches of Fiduciary Duty Established by the Court's orders of May 10 and
22, 1996 ("Moncrieff's Final Argument"); and California Attorney General's Post-Trial Brief Re:
Remedial Order and Surcharge ("CA AG June 28, 1996 Post-Trial Brief").

1 Having heard all the evidence presented and reviewed all submissions of the parties,
2 the Court now renders its decision.

3 4 II. FACTS

5 The Court incorporates the facts as fully stated in the Report of the Special Master
6 herein, and provides background information for the purpose of this Order as follows:
7

8 A. The Will

9 Mr. Hillblom nominated the Bank of Saipan ("the Bank") as Executor of his will to serve
10 without bond. Will of Larry Lee Hillblom, executed January 15, 1982, ¶ Seventh ("Will"). He
11 also named two alternate executors, to serve without bond in the event the Bank should fail
12 to qualify or cease to act as executor: 1) Jack Layne and 2) Roger Gridley. Will ¶ Seventh.
13 Mr. Hillblom made specific bequests of \$300,000 each to his two brothers, Terry Hillblom and
14 Grant Anderson. In addition, he directed that the Larry Lee Hillblom Charitable Trust be
15 created and gave the residue of his estate in trust to its trustees, Peter J. Donnici, L. Patrick
16 Lupo, Terry Hillblom, Grant Anderson and Stephen J. Schwartz. Will ¶ Fifth (2)(f). These
17 trustees are empowered to manage, invest and reinvest the *estate assets transferred to the*
18 *trust*, in their discretion, for a period of fifteen years. At the expiration of the fifteen years, the
19 trustees must distribute the principle of the trust fund, in accordance with the charitable
20 purposes identified in the trust instrument. Will ¶ Fifth (2)(b) and (e) (emphasis added).
21

22 B. Bank of Saipan

23 Initially incorporated as Commonwealth Savings and Loan Association, Inc. by Jack D.
24 Layne, Sid Blair, Dan Hart and Jack D. Russel, it was renamed Bank of Saipan in 1981. RSM,
25 Exhibit B-8. The four incorporators also comprised the original Board of Directors. *Id.* No
26 change in the original Board of Directors appears in Bank documents until 1991, when Larry
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1 Hillblom, Willie Tan, Matt S. Lonac, Benigno Fitial, Ed Calvo, Mike Dotts and Juan S. Torres
2 were listed as directors in the Bank's Annual Corporation Report. *Id.*, Exhibit B-9.

3 Mr. Hillblom owned ninety percent of the Bank's stock when he executed his will in
4 1982. Transcript of the Special Master Proceeding ("TR"), November 29, 1995 at 12. At the
5 time of his death, he, Calvo Enterprises, Inc., and Tan's Holding Corporation were the Bank's
6 largest shareholders, owning 85,931 (17%) of the Bank's shares each. RSM, Exhibit 16. The
7 Bank had seven directors: Benigno R. Fitial, Willie Tan, Michael W. Dotts, Eduardo A. Calvo,
8 Edward M. Calvo, Paul M. Calvo and Matt S. Lonac. *Id.*, Exhibit B-15. It did not have a trust
9 department. The Bank amended its by-laws to include specific fiduciary powers⁷ and hired Mr.
10 Joseph Waechter as Vice President in Charge of Trust and Fiduciary Affairs.

11

12 **C. DHL Corporation**

13 Larry Hillblom was the "H" of DHL. Started in 1969 from the back of his car in
14 California, the air express delivery company expanded and formed a subsidiary in Hong Kong
15 called DHL International. The two closely held DHL corporations still exist today as DHL
16 Corporation ("DHLC"), the domestic U.S. company, and DHL International, the international
17 company. Upon his death, Mr. Hillblom owned approximately 60% of DHLC and 22% of DHLI.
18 He was also a party to two Share Pledge Agreements (RSM Exhibit X-3 (DHLI) and RSM
19 Exhibit X-10 (DHLC)) and two Shareholders' Agreements (RSM Exhibit X-1(DHLC) and RSM
20 Exhibit X-2 (DHLI)).⁸

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22
23 ^{7/} The Bank's board of directors amended its by-laws on June 24, 1995. RSM at 42.

24 ^{8/} The DHLC Shareholders' Agreement dated July 9, 1990 ("DHLC Shareholders' Agreement") and
25 the DHLI Amended and Restated Amendment to Shareholders' Agreement dated August 18, 1992
26 ("DHLI Shareholders' Agreement") each contain a provision which gives a right of first refusal to the
27 corporation, to purchase a shareholders' stock in the corporation in the event of an "involuntary transfer"
28 of shares. If the corporation does not exercise its rights, then the right passes to the DHL shareholders.
Exhibit X-1 § 9.1(b); Exhibit X-10 § 14.2, respectively. Both Agreements define an "involuntary
transfer" to include transfers due to death.

1 DHLC filed a claim against the Estate, on behalf of itself and its shareholders,
2 requesting their rights under the DHLC Shareholders' Agreement be recognized by this Court.⁹
3 DHLC filed a separate claim against the Executor, now pending in a California federal court,¹⁰
4 to enforce the DHLC Shareholder Agreement. DHLI has likewise commenced two separate
5 actions on behalf of itself and its shareholders against the Estate. The first asks this Court to
6 recognize their rights under the DHLI Shareholders' Agreement. See Notice of Claim to
7 Enforce Rights to Purchase Shares of Stock in DHL International Limited and of Claim for Any
8 Contingent Liability, dated September 5, 1995. The second is a demand for arbitration before
9 the International Court of Arbitration in Paris, France, also seeking enforcement of the DHLI
10 Shareholders' Agreement.¹¹

11
12 **D. Peter J. Donnici, L. Patrick Lupo, Steven J. Schwartz**

13 Mr. Donnici has been legal counsel to DHLC and DHLI for approximately twenty years
14 and is currently a director of DHLI. RSM at 23-24. Mr. Lupo was general counsel to DHL for
15 eight years, has been part of DHLI's management for twelve years, and is currently Chairman
16 of the DHLI Board. RSM at 22-23. Mr. Schwartz is an international tax lawyer who advised
17 Mr. Hillblom on his personal legal affairs since approximately 1976 and helped to set up the
18 structure for DHLI. RSM at 25. Messrs. Donnici and Lupo are parties to the DHLC
19 Shareholders' Agreement. See DHLC Shareholders' Agreement. Messrs. Schwartz, Donnici
20 and Lupo have collectively filed a claim against the Estate for DHLI shares that they allegedly
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22 ⁹ DHLC withdrew its Notice of Claim and Request for Order Enforcing Rights to Purchase Shares
23 of Stock, filed in this Court on September 5, 1995, on July 23, 1996, stating that it is instead "proceeding
24 to enforce its rights under the DHLC Shareholders' Agreement in *DHL Corporation v. The Bank of
Saipan, as Executor of the Estate of Larry Lee Hillblom, et. al.*, Civil Action No. C 96-0582 CAL, in
the United States District Court, Northern District of California."

25 ¹⁰ See *supra*, note 9 (Civil Action No. C 96-0582 CAL).

26 ¹¹ See March 6, 1996 Memorandum of Special Administrator in Support of Petition for Instructions
27 to Enter All Necessary Confidentiality Agreements and/or Protective Orders in DHL Shareholders
Proceedings.

1 received from Mr. Hillblom in exchange for legal work performed for DHLI. See Notice of
2 Claim Re: Lien on 746 Shares of Stock in DHL International Limited, dated September 1,
3 1995. Mr. Donnici has filed a separate claim against the Estate for shares in Air Partners, a
4 limited partnership of which the Estate owns approximately 15%. See Notice of Claim Re:
5 Contractual Right And Lien On Air Partners Limited Partnership Interest, dated September 1,
6 1995. In addition, Mr. Donnici and Dennis Kerwin, together with Patrick M. Donnici and David
7 Jones, have collectively filed a claim against the Estate's interest in Air Partners. *Id.*

9 **E. The Carlsmith Firm**

10 Carlsmith, Ball, Wichman, Case and Ichiki ("the Carlsmith firm" or "Carlsmith") is
11 general counsel to the Bank. The firm initially became involved in this probate upon Mr.
12 Donnici's request¹² and was later retained by the Bank. Prior to opening probate, Carlsmith
13 incorporated Commonwealth Holding Corporation ("CHC"), an entity whose three shareholders
14 were Mr. Waechter (also the corporation's President), Mr. Donnici and Jose R. Lifoifoi. RSM,
15 Exhibit 7. The firm prepared a Subscription Agreement between CHC and the Bank, pursuant
16 to which the Bank would sell 199,275 of its treasury shares at \$17.50 per share to CHC for a
17 total price of \$3,487,312.50. *Id.*, Exhibit 8. It also reviewed loan agreements between DHL
18 and the Estate and issued an opinion letter concerning the same.¹³ Carlsmith first sought a
19 declaratory judgment establishing that Mr. Hillblom died on behalf of Mr. Donnici on May 21,
20 1995. The firm subsequently petitioned on behalf of the Executor for probate of the will and
21 the issuance of letters testamentary, and filed the Executor's First Petition for Letters of
22

23 ^{12/} Carlsmith drafted amendments to the Bank of Saipan's Articles and By-laws to provide specific
24 fiduciary powers to the bank to enable it to act as Executor and billed the law firm of Donnici, Kerwin
and Donnici for the work performed. RSM, Exhibit G-4.

25 ¹³ See Letter from David R. Nevitt to Mr. Cruikshanks, July 17, 1995 at 1. ("We are acting as counsel
26 for the Bank of Saipan, Inc. . . . We have reviewed . . . a draft of the proposed Loan Agreement and
27 Share Pledge Agreement received by facsimile transmission on July 12, 1995, together with the
amendments thereto received by facsimile transmission on July 14, 1995, and such laws, regulations and
rules of procedure as we have deemed necessary as a basis for the opinions hereinafter expressed.").

1 Instruction on July 14, 1995 ("Executor's First Petition for Instructions "). The Petition
2 requested permission for the Estate to borrow \$12 million from DHLI and \$3 million from DHLC
3 to "complete development in Vietnam by the Estate's holding company (Danao International
4 Holding Ltd. ("Danao"))¹⁴ and to solidify the Estate's position at Bank of Saipan." Executor's
5 First Petition for Instructions, ¶ 1(a). In addition, it requested "Court authorization to loan
6 \$3,700,000 to CHC for acquisition of Bank of Saipan shares to insure control of the Executor
7 to provide for orderly and efficient administration of the Estate and its assets." *Id.*, ¶ 1(c). The
8 Petition did not include information about the identity of CHC's directors, officers or
9 shareholders, nor did it indicate that CHC would purchase the Bank's treasury shares.
10 Although the Petition did state that the loan obligations to DHL and DHLC "will be secured by
11 the Estate's stock holdings in such companies," (*Id.* ¶ 1(a)) the Loan Agreements (and the
12 Share Pledge Agreements) were not submitted to the court until after they were executed by
13 the Estate. The Inventory and Declaration of Carlsmith ("the Inventory") was filed on
14 September 15, 1995.

16 **F. Breaches of Fiduciary Duty**

17 Several of the Executor's eleven breaches of fiduciary duty arise out of the sale of its
18 treasury shares to CHC. Before opening probate, the Bank agreed to sell all of its treasury
19 shares (199,275 shares, or 40% of the Bank's outstanding shares) to CHC (RSM, Exhibit 9),¹⁵
20 and executed the Subscription Agreement prepared by Carlsmith. RSM, Exhibit 8. The
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23 ^{14/} Danao is a holding company headquartered in Hong Kong, of which the Estate owns 90%.

24
25 ^{15/} Messrs. Calvo, Tan and Dotts all testified that they did not know who CHC was at the time they,
26 as bank directors, approved the sale of the Bank's treasury shares to CHC, but that they believed CHC
27 was an arm of the Estate. Messrs. Calvo, Dotts and Tan each testified at the Evidentiary Hearing on
28 Remedies on June 12, June 13 and June 14, 1996, respectively. Mr. Dotts also testified in the Special
Master Proceeding. *See* TR 11/17 at 79;

1 Executor also negotiated loans in the amount of \$12 million from DHLI and \$3 million from
2 DHLC to finance CHC's purchase of the shares.¹⁶

3 The Executor then admitted the will to probate and requested Court authorization, via
4 Petition for Instructions, to execute the DHL loans.¹⁷ The week after it received authorization,
5 the DHLI and DHLC loans were executed, as were Share Pledge Agreements. The Bank (Mr.
6 Waechter) then gave \$3.487 million to CHC.¹⁸ Mr. Waechter, in turn, (as CHC President)
7 issued a CHC check for \$3.487 million for the Bank's treasury shares.¹⁹ *Id.*, Exhibit 16. Soon
8 thereafter, the Bank held a special shareholder meeting and elected a new board of directors,
9 consisting of Ben Fitial, Ed Calvo, Willie Tan and Paul Calvo (remaining directors), Mr. Lifofoi,
10 Michael Grandinetti, Mr. Donnici, Dennis Kerwin and Mr. Waechter. RSM, Exhibit B-6. In filing
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12 ^{16/} The Executor authorized Mr. Donnici to negotiate the DHL loans on behalf of the Estate. *See* May
13 10, 1996 Order, Conclusion 2 ("The Executor improperly delegated the negotiation of the DHL loans
14 to Donnici, a member of the group of claimants, an attorney employed by DHL, and a director of DHLI.
15 He did so because of his trust in Donnici as a friend, despite the fact that Donnici had numerous conflicts
16 of interest in handling a transaction between the Estate and DHL. The Executor signed the DHLI loan
Agreement on July 18, and the DHLC Loan Agreement on July 25, both of which had been negotiated
by Donnici. The Agreements make the Estate a party to the earlier Shareholders' Agreements and grant
the DHL companies valuable purchase rights to the Estate's DHL stock, its most valuable asset."
RESTATEMENT (SECOND) TRUSTS § 170(q)).

17 ^{17/} The Bank Petitioned for probate on July 7, 1995 and filed its first Petition for Letters of Instruction
18 on July 14, 1995. *See supra* § II (D). By Order dated July 17, 1995, Mr. Hillblom's will was admitted
19 to probate, Letters Testamentary were issued and authorization for each of the requests in the Executor's
First Petition for Instructions was granted.

20 ^{18/} *See* May 10, 1996 Order, Conclusion 3 ("Waechter, as Executor, asked the Bank to send \$3.67
21 million from the 's account to CHC's bank account. Waechter was President of CHC. It is self-dealing
to arrange the loan of funds to a corporation in which the Executor is a principal officer."
RESTATEMENT (SECOND) OF TRUSTS §170(l)).

22 ^{19/} *See* May 10, 1996 Order, Conclusion 4 ("Waechter, as President of CHC, signed a \$3.487 million
23 check to the Bank to buy stock for CHC. CHC received 199, 275 Bank shares. This was done so that
24 Waechter, Donnici and Lifofoi could own 40% of the Bank, which employs Waechter as Executor.
Whether or not the stock was intended to be ultimately transferred to the Estate, it is improper for a
25 fiduciary to use Estate assets for its own purposes. This is self-dealing." RESTATEMENT (SECOND)
TRUSTS §170(b); §170(c); §170(d); §170(e); §170(h); §170(l); §170(r)); *See also* Conclusion 5 ("The
26 other half of the transaction was that the Bank, which serves as Executor, sold its stock to CHC when
its Board knew that the ultimate buyer of the stock would be the Estate. An Executor which sells its own
27 stock to an estate is engaged in self-dealing." RESTATEMENT (SECOND) OF TRUSTS §170(d); §170(e);
§170(i); §170(l); §170(m); §170(n); §170(r)).

1 the Inventory, the Executor did not include the 199,275 treasury shares purchased by CHC
2 as an asset of the Estate,^{20/} but instead listed a \$3.7 million loan from the Estate to CHC for
3 10 years at 10% when no such loan agreement existed.²¹ Also missing from the Inventory was
4 approximately \$6.8 million worth of DHL shares, all of which were the subject of claims filed
5 against the Estate by various DHL insiders.²²

6 Two additional breaches of duty arose from Mr. Waechter's advance of \$300,000 to
7 UMDA (an entity owned 45% by the Estate) without Court permission,²³ and from Mr.
8 Waechter's conversion of \$18.5 million of the Estate's equity in Danao into a loan.²⁴

9
10 ^{20/} At the August 5, 1995 special shareholder meeting, Mr. Waechter voted the 40% of Bank stock
11 purchased as CHC President. See May 10, 1996 Order, Conclusion 8 ("Waechter attended the Bank's
12 shareholders' meeting while Executor of the Estate, which owns 17% of the Bank's stock, and he
13 privately voted 40% of the Bank's stock as President of CHC. This was a conflict of interest.
14 RESTATEMENT (SECOND) OF TRUSTS § 170(r). He claims the CHC stock belonged to the Estate. If so,
he was using Estate assets for his own benefit. If not, he was using an asset that he received as a result
of an 'interest-free' loan from the Estate for his own use. Either way, the act constituted self-dealing.
Id. at § 170(l). He named Donnici, Dennis Kerwin, Lifofoi, Grandinetti and himself to the Bank's board
of directors. That gave him majority control of the Bank.").

15 ^{21/} See May 10, 1996 Order, Conclusion 10 ("The Inventory lists a \$3.7 million loan from the Estate
16 to CHC for 10 years at 10% when no such loan agreement existed. This false statement is the result of
17 a conflict of interest between Waechter's duties to the Estate and his duties to CHC." RESTATEMENT
(SECOND) OF TRUSTS §170(r)).

18 ^{22/} See May 10, 1996 Order, Conclusion 11 ("The Inventory filed by the Executor fails to list all of
19 the DHL shares claimed by DHL insiders. The 1,218 missing DHLI shares are worth about \$6.8 million.
20 The 1,118 missing DHLI class "A" shares would add another 11.5% to the listed Class "A" stock; and,
21 the missing 388,160 Class "B" shares would almost double the Estate's Class "B" stock. The listed
22 Class "A" and "B" shares together are valued at \$168 million. This act appears to have been the result
of the Executor prejudging the validity of these claims due to his conflict of interest between his loyalty
to the DHL group and his loyalty to the Estate. *Id.* at §170(q); 170(r)).

23 ^{23/} See May 10, 1996 Order, Conclusion 6 ("Waechter, as Executor, signed a \$300,000 Estate check
24 to UMDA while he was the Chairman of UMDA and on its payroll. Waechter could not have acted both
25 as UMDA chairman and as Executor in the same transaction without a conflict of interest. Recognizing
this error, Waechter rescinded the transaction. RESTATEMENT (SECOND) TRUSTS §170(l); §170(r)).

26 ^{24/} See May 10, 1996 Order, Conclusion 7 ("Waechter, while on the payroll at Danao International,
27 converted \$18.5 million in equity belonging to the Estate into a loan. Again, he was acting both as an
28 officer of Danao and as the Executor, which is a conflict of interest." RESTATEMENT (SECOND) TRUSTS

1
2 **G. Facts Not Contained in the Report of The Special Master**

3 **1. Unauthorized Issuance of a Power of Attorney**

4 On or about September 5, 1995, the Court became aware that the Executor had
5 executed a Power of Attorney on August 14, 1995, appointing Domingo L. Jhocson, Jr. as
6 attorney in fact for the Bank.²⁵ The Bank never filed or informed the Court that it executed the
7 Power of Attorney. It was only by happenstance that the Court came upon the document.
8 Concerned with the Executor's potential violation of Rule 10 of the Commonwealth Rules of
9 Probate Procedure,²⁶ the Court ordered the Executor to appear before the Court and give legal
10 justification as to why the Power of Attorney was executed without notice to the Court. See
11 September 5, 1995 Order to Show Cause. After hearing the Executor, the Court ordered that
12 the Power of Attorney be revoked. See September 8, 1996 Order.

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§170(r)).

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19 ²⁵ Mr. Jhocson was specifically authorized to "grant, bargain, sell, convey, sublease, assign or
20 contract for the lease, sale and conveyance of its interest in all real and personal property, located in the
Republic of the Phillipine Islands and owned by Larry L. Hillblom at the time of his death." See
September 5, 1995 Order to Show Cause.

21 ²⁶ Rule 10 states:

22 The executor must take into his possession all the estate of the decedent and collect all
23 debts due the decedent or to the estate. If the decedent was in business the executor *shall*
24 *petition the Court for instructions*. The executor shall pay debts of the decedent or the estate
25 *only after obtaining the Court's consent*. *No sale or other disposition of estate property will be*
26 *done without Court order*. The executor *shall safeguard the assets of the estate* and deposit all
27 cash in an interest bearing account if feasible.

28 The executor shall do such other acts as are necessary to carry out his fiduciary duties
subject to such instructions and orders as the Court may issue.

COM.R.PRO.10 (emphasis added).

1 **2. Amendments to the Probate Code**

2 By Order dated January 24, 1996, this Court determined that it is inconsistent with the
3 Executor's fiduciary duty of loyalty to use Estate funds to defend against the pretermitted heir
4 claims filed in this matter.²⁷ The Executor and the Charitable Trust jointly appealed that
5 Order.²⁸ The Court subsequently received a copy of a proposed Bill to amend the
6 Commonwealth Probate Code which, among other things, retroactively gives the Executor
7 standing to defend the Estate against any claim made by an alleged pretermitted child (or
8 omitted spouse) using Estate funds.²⁹ In light of the appeal and the potentially changing law,
9 the Court stayed all heirship proceedings pending the outcome of the Executor's and
10 Charitable Trust's appeal.³⁰ See February 21, 1996 Order Granting Stay Pending Appeal.

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15 ²⁷ Petitioner Kaelani Kinney filed her "Opposition of the Will to Probate and Motion for Hearing for
16 Determination of Paternity and Heirship and for Declaratory Judgment" on July 17, 1995. On November
17 17, 1995, Petitioner David Moncrieff filed his "Petition for Declaratory Judgment of Paternity and
18 Heirship." Petitioners are guardians for Junior Hillbloom and Jellian Cuartero, respectively, both of
19 whom claim that Mr. Hillblom was their natural father. In the event Petitioners Kinney and Moncrieff
20 prove paternity by clear and convincing evidence (*See* 8 CMC §2918(b)(2)), the statutory intestate
21 distribution scheme (8 CMC §2901 et. seq.) replaces Mr. Hillblom's will and the assets of his estate are
22 disposed of as if he died intestate.

23 ²⁸ *See* Appeal Nos. 96-007, filed February 9, 1996, and 96-009, filed February 15, 1996, respectively.

24 ²⁹ House Bill No. 10-147 passed first reading in the House of Representatives on February 16, 1996.
25 Without a hearing in the Senate, the Bill was signed into law on June 4, 1996. At the June 13, 1996
26 Evidentiary Hearing on Remedies, Mr. Lifofoi testified that he drafted the bill with the help of
27 Carlsmith attorney David Nevitt and introduced it to the legislature.

28 ³⁰ This Court partially lifted both the stay of the heirship proceedings and the Executor's suspension
29 for the limited purpose of allowing joint examination and testing of an alleged Hillblom mole, pursuant
30 to the terms of a November 17, 1995 Stipulation Re DNA Testing Protocol executed by the Executor
31 and Petitioner Kinney, to obtain DNA information for paternity testing. *See* May 13, 1996 Order
32 Partially Lifting Suspension and Stay and Clarifying Prior Order. Upon emergency request by the
33 Charitable Trust for an order granting a stay on all heirship proceedings and related discovery pending
34 decision on Appeal Nos. 96-007 and 96-009, the Supreme Court ordered this Court to take no further
35 action in the heirship proceedings. *See* May 20, 1996 Order Granting Emergency Motion to Stay All
36 Heirship Proceedings and Related Discovery Pending Appeal.

1 **3. The Lazard Transaction**

2 The Special Master issued his Report on February 23, 1996. Given the gravity and
3 complexity of the issues raised in the Report, the Court suspended the Executor (See
4 February 29, 1996 Order Suspending Executor) and appointed William I. Webster as
5 Temporary Special Administrator. See March 22, 1996 Order Appointing Special
6 Administrator. In its motion for reconsideration of the suspension, the Executor advised the
7 Court of several pending "matters of critical importance" that required attention.³¹ See
8 Memorandum of Points and Authorities in Support of Motion to Reconsider Order Suspending
9 Executor, dated March 6, 1996, p. 2. The most significant matter was the Executor's request
10 for authorization to execute a Deed of Subordination with Lazard Asia's Vietnam Investment
11 Fund, Vietnam Vest Limited ("Lazard") to secure financing for Danao to complete
12 development of projects started by Mr. Hillblom in Vietnam. The request was initially raised
13 in the Executor's December 22, 1995 Fourth Petition for Letters of Instruction.³² By Order
14 dated January 11, 1996, the Court conditionally approved the request, requiring the Executor
15 to present the finalized subordination agreement to the Court for review prior to execution.

16 The Executor filed a Deed of Subordination with the Court on February 8, 1996. Upon
17 review, the Court discovered that the Securities Purchase Agreement, referred to in the first
18 paragraph of the Deed of Subordination, was not submitted to the Court. Accordingly, the
19 Court ordered the Executor to produce a copy of the relevant Securities Purchase Agreement.
20 It was provided to the Court on February 23, 1996. Upon review of the Securities Purchase

21 ³¹ The same day the Report of the Special Master was issued, the Executor notified the Court of the
22 DHLC lawsuit pending in California (*See supra*, note 9) and that the Estate was required to file a
23 responsive pleading by March 11, 1996. On February 26, 1996, the Executor informed the Court of the
24 existence of Case No. SP PROC. 96-716, filed in the Republic of the Phillippines, captioned *In the*
25 *Matter of the Estate of Larry Lee Hillblom, Milagros Feliciano Petitioner*. The Court appointed counsel
26 to enter a special appearance on behalf of and to investigate these matters. *See* Order dated March 7,
27 1996.

28 ³² Specifically, the Executor requested "...authorization to subordinate the rights of the Estate under
the Loan Agreement and Security Agreement from Danao, dated August 1, 1995, to Lazard," explaining
that Danao urgently required additional financing to complete the Vietnam projects. *See generally*,
March 12, 1996 Order.

1 Agreement, the Court discovered that an Option Agreement, referred to in Article I of the
2 Agreement, was not submitted to the Court. Again, the Court Ordered the Executor to
3 produce a copy of the missing Option Agreement. Finally, at the close of the March 11, 1996
4 hearing on its motion for reconsideration of its suspension, the Executor presented the Court
5 with modified versions of both the Deed of Subordination and Securities Purchase Agreement,
6 giving the Court four days to render a decision on this "critical matter."³³

7 Simultaneous with the Executor's requests for reconsideration of its suspension and
8 for authorization to execute the Lazard transaction, the Deputy Attorney General of the State
9 of California ("California AG") asked to be declared an interested party in this matter,³⁴ and the
10 Charitable Trust requested that the Court stay its consideration of the Special Master's
11 Report.³⁵ The Court permitted the California AG to intervene in this matter (See May 3, 1996
12 Order Allowing Intervention), but denied the request for a stay and went on to settle the
13 Report.³⁶ See Procedural Background, § I above.

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15 ³³ By Order dated March 13, 1996, the Court granted the Executor's request for authorization to
16 execute the Deed of subordination, upon the condition that the Executor post a bond in the amount of
17 \$16 million. Upon the Special Administrator's recommendation (See Special Administrator's Report
18 on Lazard Loan, dated March 26, 1996) the Court removed the bond requirement. See March 27, 1996
19 Order. The negotiations with Lazard subsequently collapsed, and no Deed of Subordination was ever
20 executed.

21 ^{34/} Mr. Hillblom directed the trustees of the Charitable Trust created in his will to "show particular
22 attention to and benefit the research programs conducted by the University of California." Will ¶ Fifth
23 (2)(b). Based on the foregoing, and asserting that it is the Attorney General's duty to participate in court
24 proceedings to protect charitable gifts, the Attorney General sought permission to appear and defend
25 against the claims of Petitioners Kinney and Moncrieff. See generally, Attorney General's Statement
26 of Interest on Behalf of the Charitable Beneficiaries; Memorandum in Support Thereof; and General
27 Appearance, dated April 1, 1996.

28 ³⁵ The Charitable Trust argued that the Report's findings stemmed from the same interpretation of
the Executor's fiduciary duty on appeal before the Supreme Court and that the Court should therefore
await the outcome of the appeal before it acted on the Report. See generally, Charitable Trust's Motion
for Stay, dated March 8, 1996.

³⁶ On March 21, 1996, the Executor moved to recuse the Presiding Judge in this matter and his law
clerk for allegedly biased remarks made by the law clerk in a local bar. Citing *Corrugated Container*
v. Mead Corporation, 614 F.2d 958 (5th Cir. 1980) ("Clearly, a law clerk's views cannot be attributed
to the judge for whom the clerk works."), the Court denied the motion for recusal, but prohibited the law
clerk from any involvement in this matter.

III. ANALYSIS AND DISCUSSION

A. THE APPLICABLE LAW

1. REMOVAL

As the Probate Code is silent on removal of an executor (8 CMC §2101 et. seq.), the Court must look to the Restatement of Trusts, which sets forth the grounds for removal of a fiduciary.³⁷ Section 107, in particular, is entitled "Removal of Trustee" and indicates that the matter of removal "...is one for the exercise of reasonable discretion by the court." RESTATEMENT (SECOND) TRUSTS §107(a)(1957). See also BANC. PROB. PRAC. § 294; *In Re Estate of Livingston*, 502 P.2d 1247 (Wash. Ct. App. 1972)(The Court has very wide discretion as to the grounds upon which it may remove an executor, provided those grounds are valid and supported by the record). Comment (b) to §107 sets forth specific grounds for removal of a trustee, which include the following:

Lack of capacity to administer the trust (citation omitted); the commission of a serious breach of trust; refusal to give bond, if a bond is required; refusal to account; the commission of a crime, particularly one involving dishonesty; unfitness, whether due to old age, habitual drunkenness, want of ability or other cause; permanent or long-continued absence from the State; the showing of favoritism to one or more beneficiaries;³⁸ unreasonable or corrupt failure to cooperate with co-trustees. RESTATEMENT (SECOND) TRUSTS § 107(b) (1957).

³⁷ Where the Commonwealth Probate Code ("Probate Code") is silent, the Court must look to "the rules of common law, as expressed in the restatements of the law approved by the American Law Institute" 7 CMC §3401. The Restatement of Trusts is approved by the American Law Institute.

³⁸ Although this Court determined that the Executor showed favoritism to named will beneficiaries in breach of its fiduciary duty, the Court will not consider this a basis for removal since the Commonwealth law is presently unsettled on this issue. Appeal of the Court's January 24, 1996 Order is still pending before the Supreme Court. See *supra*, note 28. In addition, the effect of Public Law 10-147 as a law is not yet determined. Petitioner Kinney has filed an action in the United States District Court for the Commonwealth of the Northern Mariana Islands challenging the statute (*Kaelani Kinney as Guardian and Guardian Ad Litem For Junior Larry Hillbroom v. The Government of the Commonwealth of the Northern Mariana Islands; and the Honorable Froilan Tenorio, Individually and in His Capacity as Governor* (Civil Action No. 96-00029)). Petitioner Kinney has also asked this Court to declare the statute unconstitutional and inapplicable to this case (See Petitioner Kinney's Motion For Clarification of Discovery Rights and Finding that the Probate Code Amendments Do Not Apply to this Proceeding, dated June 5, 1996). Upon the Executor's emergency request, the Supreme Court stayed this Court from addressing the issue. See June 18, 1996 Order Denying Motion for Remand, and Order Granting Motion for Emergency Stay.

1
2 Courts will less readily remove a trustee named by the settlor than a trustee appointed by the
3 court or by a third person who is by the terms of the trust authorized to appoint a trustee. *Id.*
4 §107(f).

5 Although the comments to §107 do not explicitly state that the principles stated in the
6 section apply to all fiduciaries, such applicability is inferred. Because all fiduciaries owe the
7 same duty of loyalty to their beneficiaries,³⁹ all fiduciaries must be subject to the same
8 penalties for breach of that duty.⁴⁰ Removal is an equitable remedy applied in instances where
9 there has been a serious breach of trust. RESTATEMENT (SECOND) TRUSTS § 199(e) (1957).
10 Accordingly, the Court finds the RESTATEMENT (SECOND) TRUSTS §§ 107 and 199, applicable
11 to the removal of an executor.

12 13 2. SURCHARGE

14 When a trustee violates its duty of undivided loyalty, it is liable to the beneficiary for:
15 1) any profit it made through the breach; 2) any loss or depreciation in value of the trust estate
16 resulting from the breach and 3) any profit which would have accrued had there been no
17 breach. RESTATEMENT (THIRD) TRUSTS (PRUDENT INVESTOR RULE) §§ 205, 206 (1990).

18 In most jurisdictions, the fiduciary is strictly liable for breaches of the duty of loyalty.
19 Bogert §543 at 267, citing *Fulton Nat'l Bank v. Tate*, 363 F.2d 562 (5th Cir. 1966); *see also*,

20
21 ³⁹ See RESTATEMENT (SECOND) OF TRUSTS §170 (a)(1957) "The principle stated in this Section is
22 applicable not only to trustees but to other fiduciaries." See also G. Bogert, THE LAW OF TRUSTS AND
TRUSTEES (REV. 2D ED. 1993) § 543 at 251 ("Bogert").

23 ⁴⁰ Section 190 of the RESTATEMENT OF RESTITUTION supports this inference. It states the general
rule that:

24 Where a person in a fiduciary relation to another acquires property, and the
25 acquisition or retention of the property is in violation of his duty as fiduciary, he holds
it upon a constructive trust for the other.

26 Comment (a) to §190 provides that the same rule applies to all fiduciaries who violate their duties
27 ("The directors and officers of a corporation are also fiduciaries, as are receivers, and executors
and administrators.").

1 A.W. SCOTT & W.F.FRATCHER, THE LAW OF TRUSTS § 170 at 311 (4th ed. 1987) ("SCOTT").
2 That is, once it is shown that the fiduciary allowed itself to be placed in a position where its
3 interest *might* conflict with the interest of the beneficiary, the law presumes that the fiduciary
4 acted disloyally, and inquiry into matters of bad faith, unfair advantage gained, or harm to the
5 beneficiary are foreclosed. *Fulton, supra* at 571.⁴¹ The sole purpose and effect of the strict
6 liability rule is prophylactic in that it punishes the fiduciary for allowing itself to be placed in a
7 position of conflicting interests in order to discourage such conduct in the future. See
8 *Magruder v. Drury*, 35 S.Ct. 77 (1914).

9 The Restatement suggests a more lenient rule as to liability and damages in conflict
10 cases, authorizing courts of equity, in absence of a statute, to excuse the trustee in whole or
11 in part from liability where it has acted honestly and reasonably and ought fairly to be
12 excused.⁴² RESTATEMENT (SECOND) TRUSTS §205 (1957), comment (g). In certain situations,
13 in addition to establishing a breach of the duty of loyalty, a claimant may also be required to
14 prove loss to the trust and a causal connection between the breach and the loss. *Id.*,
15 Comment (f); See also *Jefferson Nat. Bank of Miami Beach v. Central Nat. Bank in Chicago*,
16 700 F.2d 1143 (7th Cir. 1983)(bank held liable for damages proximately caused by its conflict
17 of interest). The Court finds that the RESTATEMENT (THIRD) TRUSTS (PRUDENT INVESTOR
18 RULE)§§ 205 & 206 (1990) is the applicable standard for surcharge of an executor.

22 ⁴¹ The strict liability rule is most notably applied in situations where the trustee makes a mistake of
23 law and interprets the trust instrument as authorizing him to do acts which the court determines he is not
24 authorized by the instrument to do. RESTATEMENT (SECOND) TRUSTS §201(b) (1957). In such case,
the trustee "is not protected from liability merely because he acts in good faith, nor is he protected
merely because he relies upon the advice of counsel (citations omitted)".

25 ⁴² The distinction between actions at law and those at equity is based on the nature rather than the
26 form of the proceeding. *Allard v. Pacific Nat. Bank*, 663 P.2d 104 (Wash. Sup. Ct. 1983). This
27 proceeding is equitable in nature, as the Court is applying equitable remedies to the Executor's breaches
of fiduciary duty, as stated in its May 10, 1996 Order. See RESTATEMENT (SECOND) TRUSTS §199
(1957).

1 **B. THE EXECUTOR'S BREACHES OF DUTY**

2 **1. THE CHC TRANSACTION**

3 Six of the Executor's eleven breaches of fiduciary duty arise out of the Bank's sale of
4 its treasury shares to CHC. The Court assesses the measurable damages to the Estate as
5 the result of these breaches and the available remedies as follows:

6 **a. The Transfer of \$3.487 million to CHC and the Purchase of 199,275 Bank**
7 **shares**

8 A trustee who uses trust property for his own benefit may be required to pay the value
9 of its use. See BOGERT § 543(J), citing *Mont C.C* 172-34-105(1), 72-34-508; S.D. Codif. L. 55-
10 2-2. "Without the aid of a statute, the courts apply this rule to loans of trust funds which are
11 indirectly for the benefit of the trustee, as in the case of a corporation, the stock of which is
12 controlled by the trustee." *Id.* at 355, citing *Cornet v. Cornet*, 190 S.W. 333 (Mo. Sup. Ct.
13 1916) (trustee half owner of borrowing corporation); SCOTT §170.10 at 347.

14 \$3.487 million of funds were transferred to CHC on July 21, 1995. The 199,274 shares
15 of Bank stock that were purchased with those funds were not transferred to the Estate until
16 November 30, 1995. The daily interest that accrued on the loan, calculated at a rate of 10%
17 per annum, was \$955.34. The loan was outstanding for 132 days, making the total amount
18 of interest on the loan \$126,105.21. Accordingly, the Executor must re-pay the Estate
19 \$126,105.21 for the use of the \$3.487 million.

20
21 **b. The Bank's Sale of Treasury Shares to the Estate**

22 Most state statutes expressly prohibit the purchase by a corporate trustee of its own
23 shares as a trust investment. BOGERT §543(G) at 331; SCOTT §170.15 at 370. Likewise, the
24 retention by a corporate trustee of its own stock in a trust being administered by it seems to
25 involve a conflict of interest and a breach of the duty of loyalty. BOGERT at 332; SCOTT at 371.
26 Absent statutory authority, the corporate trustee may retain its own stock in the trust account
27 where there is express authority in the trust instrument. BOGERT at 333, citing *Matter of*

1 *Roche's Will*, 182 N.E. 82 (N.Y. Ct. App. 1932); SCOTT at 372-73. A general grant of
2 discretionary authority in the trust instrument to invest or retain securities has also been held
3 to give a corporate trustee authority to retain its own stock. BOGERT at 334, citing *In Re*
4 *Heidenreich's Will*, 378 N.Y.S. 2d 982 (N.Y. Sur. Ct. 1986).

5 Mr. Hillblom did not expressly authorize retention of the Bank's stock in his will. He did
6 grant the Bank absolute discretion to "... invest and reinvest any surplus moneys in [its] hands
7 in any kind of property, including ... stocks, ... mutual funds, or common trust funds,
8 including funds administered by the Executor." Will ¶ Seventh(a) (emphasis added). In
9 addition, since Mr. Hillblom owned ninety percent of the Bank at the time he executed his will,
10 he knew that the Bank's acceptance of the Executor position would expose it to a conflict of
11 interest. The Court finds that the will contemplates this conflict, at least in so far as the
12 retention of the Bank shares owned by the Estate at the date of Mr. Hillblom's death is
13 concerned. See e.g. *In Re Thomas*, 311 A. 2d 112 (Del. Sup. Ct. 1973); *Goldman v. Rubin*,
14 441 A.2d 713 (Md. Ct. App. 1982).

15 As for the purchase of additional shares after Mr. Hillblom's death, the Court finds no
16 such implied exemption from the duty of loyalty in the terms of the will. However, the Special
17 Administrator has advised the Court that the purchase of Bank shares has proven to be
18 beneficial to the Estate and should not be unwound. The Estate paid \$3,487,000 for the
19 199,275 shares. Mr. Webster has indicated that the shares may have substantially more value
20 than the purchase price, in terms of the majority interest they create for the , the dividends
21 they produce,⁴³ and their future sale value, and suggests that the Estate retain the shares.
22 See Declaration of William I. Webster, dated May 30, 1996. Given this recommendation by
23 the Special Administrator, the Court finds that no measurable damage has resulted from the
24 Estate's purchase of the Bank's treasury shares. The Court further finds that the retention of
25 the Bank shares is in the best interest of the Estate.

26 ⁴³ The Estate has received approximately \$79,000 in dividend payments from the Bank. Charitable
27 Trust's June 28 Post-Hearing Memo at 27.

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c. Mr. Waechter's Voting of the CHC Shares

A trustee's voting of shares in a corporation held in trust for his own benefit rather than for the benefit of the beneficiaries involves a conflict of interest. BOGERT §543 (N) at 371. However, the conflict will not result in a penalty if the trustee's conduct was fair and the trust did not suffer actual damage as the result of the conduct. *Id.* at 375.

Mr. Waechter voted the CHC stock to make himself, Mr. Lifofoi, Mr. Grandinetti, Mr. Donnici, and Mr. Kerwin Bank directors. As the Executor's representative, he was obligated to secure directors and officers who would advance the welfare of the Estate to the maximum possible extent. He owed this same duty to CHC, since he was also its President. In voting his co-shareholders in CHC, Messrs. Lifofoi and Donnici, onto the Bank's Board, Mr. Waechter subordinated the Estate's interest to CHC's interest. More egregious, however, is the fact that Mr. Waechter's votes placed a will beneficiary and claimants to the Estate in a position of control over the Executor.

Messrs. Kerwin and Donnici resigned from the 's board on November 12, 1995, after three months of service. RSM at 46. They were replaced by Mr. Jesus Villagomez and Mr. Victor Hocog, neither of whom are parties to a DHL shareholder agreement or have filed claims against the Estate. *Id.* Since the danger created by Mr. Waechter's voting has ostensibly been removed, the Court finds that no measurable damage resulted from Mr. Waechter's voting of the shares.

d. The Omission of the 199,275 Bank Shares From the Inventory

Although the 199,275 Bank shares were purportedly purchased on behalf of the Estate in July, they were not listed on the Inventory filed in September. The Executor, the Charitable Trust and the Attorney General all assert that the Executor relied on counsel to file the Inventory. In addition, each asserts that because an inventory is a listing of assets at the date of death, and the Bank shares were purchased after Mr. Hillblom died, counsel had no legal

1 obligation to list the shares on the Inventory. Executor's Closing Argument, p. 27-28;
2 Charitable Trust's June 28, 1996 Memo, p. 13; CA AG Post-Trial Brief, p. 8.

3 This argument is without authority and contradicts the often repeated representation
4 that the treasury shares were purchased on behalf of the Estate. See Executor's Closing
5 Argument, pp. 17-20; Charitable Trust's Post-Hearing Memo, p. 24; CA AG Post-Trial Brief,
6 p. 4. If the shares were purchased for the Estate in July, they were a known asset of the
7 Estate and should have been included in the Inventory filed in September. This argument is
8 also inconsistent with the spirit of open administration of estates contemplated by COM. R.PRO.
9 10. See *supra* n. 26. Nonetheless, the Court finds that no measurable damage resulted from
10 the Executor's misreporting.

11 12 **e. The Misreporting of a CHC Loan on the Inventory**

13 Despite the fact that the Executor asked and relied on Carlsmith to draft the appropriate
14 documents, the transfer of \$3.487 million of Estate funds to CHC was never memorialized in
15 the form of a written loan. Yet, the loan was listed as an asset on the Inventory. Executor's
16 Closing Argument, p.28; Charitable Trust's June 28, 1996 Post-Hearing Memo, p. 13; CA AG's
17 Post-Trial Brief, p.9. ("Once again, however, we find the Carlsmith firm in the vortex of this
18 failing and since it was that firm that created this CHC/BOS arrangement and counseled the
19 Executor through each of the steps thereof . . .").

20 Other than the loss to the Estate resulting from the interest-free loan, calculated in §III
21 (B)(1)(a) above, the Court finds no measurable damage to the Estate resulting from the
22 misreporting.

23 24 **2. THE DHL-RELATED TRANSACTIONS**

25 Three of the eleven breaches of fiduciary duty enumerated in the Court's May 10, 1996
26 Order involved transactions related to the DHL shares. Those breaches include: participating
27 in the plan to purchase control of the Bank (Conclusion 1); delegating negotiation of the DHL
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1 loans to Mr. Donnici (Conclusion 2); and omitting shares claimed by DHL insiders from the
2 Inventory (Conclusion 11).

3 During the Evidentiary Hearings on Remedies, the Court reserved judgment on the
4 issues related to the DHL stock and loan agreements pending the outcome of the DHLC
5 litigation in California and the DHLI arbitration in France. Without knowing the outcomes of
6 these proceedings, the Court cannot measure what damage, if any, has resulted from the
7 negotiation and procurement of the loans⁴⁴ as part of the plan to purchase control of the
8 Executor, or from the omission of certain DHL shares from the Inventory. The Court therefore
9 makes no finding as to whether the Estate incurred any actual damage as the result of these
10 transactions, but reserves the right to impose further surcharge amounts upon resolution of
11 the litigations.

12 13 **3. OTHER BREACHES**

14 The Court assesses the measurable damage to the Estate as a result of the two
15 remaining breaches of fiduciary duty as follows:

16 **a. The Unauthorized UMDA Loan**

17 Without Court approval, Mr. Waechter advanced \$300,000 to UMDA on July 24, 1995.
18 The funds were transferred back to the Estate on August 16, 1996. As the result of the
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⁴⁴ The Special Master concluded that the Estate's execution of the DHL loan agreements granted the
23 corporations and their shareholders additional rights to purchase the corporations' stock that they were
24 otherwise not entitled to. RSM at 161. Both the DHLC and DHLI Shareholders' Agreements provide
25 that if the corporations' shares transfer by operation of law, an involuntary transfer occurs. RSM Exhibit
26 X-1, §9.1(a)(v); Exhibit X-2, §14.2(a)(v). The involuntary transfer triggers the corporations' and the
27 shareholders' right to purchase the stock. *See supra*, note 8. By executing the Loan Agreements with
28 DHL, the Estate became bound by the DHL Shareholders' Agreements. RSM, Exhibit 34 (DHLI Loan
Agreement), § 9.1.3, Exhibit 35 § 9.1.3 (DHLC Loan Agreement). Thus, the corporations and their
shareholders are given an option to purchase the Estate's DHL shares, in the event that they are
transferred to a pretermitted heir.

1 unauthorized transfer, the Estate lost use of the funds for 23 days. Calculated at a rate of
2 10% per annum, the interest that accrued in that 23 day period amounts to \$1,890.41.⁴⁵

3 The Charitable Trust and Attorney General assert that because the Estate indirectly
4 owns 45% of UMDA, Mr. Waechter effectively advanced the \$300,000 to the Estate, and the
5 Estate only lost use of 55% of the \$300,000 advance. Charitable Trust's Post-Hearing Memo,
6 p.12; CA AG Post-Trial Brief, p. 7. The entire advance to UMDA was unauthorized.
7 Accordingly, the Executor must pay 100% for the unauthorized use of the funds. See § III
8 B(1)(a), *supra*.

9
10 **b. The Conversion of Equity to Debt**

11 Mr. Waechter's employment with the Bank began on July 1, 1995. Upon his request,
12 and pursuant to an agreement dated August 1, 1995, the Estate's investment in Danao was
13 converted into \$18.5 million of debt and \$54,913,000 of equity. Mr. Waechter was not a
14 Danao Board member at the time of the conversion, but he was still receiving a salary from
15 Danao, as part of his contractual severance package.

16 Although advances to Danao in the form of equity have the potential for greater gain,
17 advances in the form of a loan are more secure. Declaration of William I. Webster, dated May
18 30, 1996. Loans have preferential return positions (i.e. ahead of equity) and also have
19 preference over the claims of shareholders in the event of liquidation. *Id.* Accordingly, the
20 Special Administrator has advised the Court that the equity to debt conversion is prudent,
21 should not be reversed and caused no measurable damage to the Estate as the result of the
22 conversion. *Id.*

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⁴⁵ $\$300,000/365 \times 23 \text{ days} = \$1,890.41.$

1 **C. ADDITIONAL CONSIDERATIONS**

2 **1. The Grant of Discretion in the Will**

3 The Charitable Trust asserts that absent a showing that the Executor acted in bad faith
4 and was influenced by improper motive, the Court lacks jurisdiction to control its exercise of
5 the broad discretionary powers granted by the will. Charitable Trust's June 28, 1996 Post-
6 Hearing Memorandum, p.7, citing *In Re Buchar's Estate*, 74 A. 237 (Pa. Sup. Ct. 1909); *In re*
7 *Kelner's Estate*, 66 N.Y.S. 2d 727, 729 (N.Y. Sur. Ct. 1946).

8 This argument underscores a fundamental misunderstanding of fiduciary obligations
9 as every grant of discretion, regardless of breadth, must be exercised in a manner and subject
10 to the obligations and duties of fiduciaries. RESTATEMENT (SECOND) TRUSTS §186 (f) (1957).
11 "The discretion of a trustee is but a legal one, and, whenever the law determines that a proper
12 case has arisen in which the trustee's discretion should have been exercised, in a particular
13 way, he will be constrained to act in accordance therewith (citations omitted)." *In Re Buchar's*
14 *Estate, supra*, at 237.

15 By accepting the position of Executor, the Bank also accepted the responsibility to carry
16 out the attendant fiduciary obligations, as enumerated in the RESTATEMENT (SECOND) OF
17 TRUSTS §170. The broad grant of discretionary powers contained in Mr. Hillblom's will (See
18 Will, ¶ Seventh), by nature, cannot absolve the Executor from liability for breach of those
19 fiduciary duties. See, e.g. *In re Durston's Will*, 74 NE. 2d 310 (N.Y. Ct. App 1947) ("Although
20 a power is conferred upon the trustee, he cannot properly exercise the power under such
21 circumstances or to such extent or in such manner as will involve a violation of any of his
22 duties to the beneficiary."); *In re Gabel's Will*, 64 N.W.2d 853 (Wis. Sup. Ct. 1954) (Duty of
23 loyalty not reduced by settlor's grant of wide discretionary powers to trustee). Accordingly, the
24 Court must insure that the Executor exercises its discretion in accordance with its fiduciary
25 duties.

1 reviewed the documents referenced in its opinion letter dated July 17, 1995, and the actions
2 and knowledge of Carlsmith, the Bank's agent, are imputed to the Bank. *Williams v.*
3 *Continental Life & Acc. Co.*, 593 P.2d 708, 710 (Idaho Sup. Ct. 1979). The Court therefore
4 finds that any consent given by the beneficiaries was invalid, since the Executor did not
5 disclose a material fact concerning the assisting beneficiaries' interest in the transactions.
6

7 **3. Attorney Fees**

8 **a. The Executor's Fees**

9 The Executor asserts that it is entitled to recover costs and attorney fees incurred in its
10 defense of the Special Master Proceedings. Executor's Closing Argument, p. 12-14. A trial
11 court may allow and properly charge attorney fees to an estate for litigation that is necessary
12 to the administration of the estate. *Allard v. Pacific Nat. Bank*, *supra* n. 37, at 111 (citations
13 omitted). The Court, in its discretion, must consider the result of the litigation, particularly
14 whether the litigation and the participation of the party seeking attorney fees caused a benefit
15 to the trust. BOGERT § 871; *Estate of Baird*, 287 P.2d 372 (Cal. Dist. Ct. App. 1955). Although
16 a trustee who unsuccessfully defends against breaches of fiduciary duties does not cause a
17 benefit to the trust, it is not automatically precluded from reimbursement of attorney fees.
18 *Wilmington Trust Co. v. Coulter*, 208 A.2d 677 (De. Ch. 1965). The Court must also consider
19 the nature of the breach. *Id.*

20 As a defense to its breaches of duty, the Executor argues that it acted in good faith at
21 all times and upon the advice of counsel. It also asserts that this is complex, as this Court
22 has confirmed,⁴⁷ and that many of its actions were taken during the hectic and unsettling early
23 stages of administration which, with the benefit of hindsight, could have been done differently.
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26 ⁴⁷ See September 28, 1996 Order ("... all of the parties, as well as the Court itself, are in unfamiliar
27 territory in dealing with an estate so large, business affairs so complex, and properties so numerous as
28 the present matter.").

1 Executor's Closing Argument, pp.2-3.⁴⁸ Yet, these facts must be evaluated in light of other
2 factors as well. First, the Bank is a professional executor being paid a substantial commission
3 for its services. Second, 7 CMC §3401 clearly refers the Executor to the Restatement of
4 Trusts for definition of its fiduciary obligations. Third, both the Restatement and COM.R.PRO.
5 10 instruct the Executor, when in doubt about its duties, to apply to the Court for instruction.
6 When judged with more than mere hindsight, the Court finds that the Executor's breaches of
7 fiduciary duty were not the natural result of Mr. Hillblom's untimely death.

8 As an additional defense, the Executor and the Charitable Trust assert that all of the
9 conflicts now complained of existed during Mr. Hillblom's lifetime or were contemplated by his
10 will. Executor's Closing Argument, p. 4; Charitable Trust's June 28, 1996 Post-Trial Memo,
11 p. 5-6. To the contrary, the Court finds that Mr. Hillblom deliberately attempted to avoid these
12 conflicts by excluding his business associates from participation in the administration of the
13 Estate and limiting their involvement to a time after the Estate is closed. During Mr. Hillblom's
14 lifetime, no party to a DHL shareholder agreement ever served as a Bank director. His chosen
15 Executor and DHL business associates were therefore carefully separated.⁴⁹ The two were
16 commingled for the first and only time after Mr. Hillblom died, when Mr. Waechter voted
17 Messrs. Donnici and Kerwin onto the Bank's board of directors. By allowing the will
18 beneficiaries to participate in and control the administration of the estate, the Bank
19 transformed the interest of the beneficiaries into self-interest, impairing its ability to administer
20 the Estate in a disinterested manner. And, it did this upon the advice of counsel.

21
22 ⁴⁸ Executor asserts its conduct should be reviewed in the context of the circumstances existing at the
23 time the actions were taken, citing *Estate of Baldwin*, 442 A.2d 529 (Sup. Ct. Me. 1982); *Vaught v.*
Struble, 139 P.2d 456 (Sup. Ct. Ida. 1943); *In Re Stewart*, 28 P.2d 642 (Sup. Ct. Ore. 1934); *Young v.*
Phillips, 93 S.W.2d 634 (Sup. Ct. Tenn. 1936).

24 ⁴⁹ Neither the Bank of Saipan (including the members of its board of directors), Mr. Lane, nor Mr.
25 Gridley are parties to any DHLC or DHLI Shareholders' Agreement, and none have filed claims against
26 the Estate. The Bank does have a possible lien against Estate assets. Saipan Cattle Co. claims that in
27 March 1995 Mr. Hillblom or an agent guaranteed its \$2,443,652.00 loan from the Bank. The claim was
28 submitted to arbitration before Robert A. Hefner, but subsequently withdrawn on June 6, 1996 because
the Bank has not acted to enforce the alleged guarantee on the loan. See Special Administrator's Report
on Arbitration Between Estate and UMDA, dated July 15, 1996.

1 Although the Court does not find bad faith on the part of the Executor, it cannot
2 overlook the fact that the Bank has encumbered the DHL stock in such a way that may prevent
3 it from being transferred to a pretermitted heir.⁵⁰ The Court finds that the Executor's breaches
4 of fiduciary duty, under the circumstances outlined above, are sufficient to require denial of
5 its request for attorney fees.

6
7 **b. Petitioner Kinney's Fees**

8 Petitioner Kinney asks that the Executor be ordered to pay her legal fees and costs in
9 connection with the Special Master Proceeding. Kinney's June 28, 1996 Post-Hearing Memo,
10 p. 30. Courts assess opposing counsel's fees against a trustee individually, only when his
11 conduct has been of a gross or inexcusable nature. *Wilmington Trust Co. v. Coulter, supra*.
12 The Court finds that the Executor performed its actions upon reliance of counsel. In light of
13 this fact, and the fact that the measurable loss to the Estate as the result of these actions is
14 relatively small at this time, the Court will not hold the Executor individually liable for Petitioner
15 Kinney's attorney fees.

16 Petitioner Kinney alternatively requests reimbursement for her legal fees from the
17 Estate. Kinney's June 28, 1996 Post-Hearing Memo, p. 31, citing *In Re Estate of Swanson*,
18 340 P.2d 695 (Cal. Dist. Ct. App. 1959); *In Re Estate of Bullock*, 284 P.2d 960 (Cal. 1955).⁵¹
19 While they are concededly allowable, the ultimate result of granting Kinney's costs is a
20 depletion of estate assets. Petitioner Kinney has not yet proven paternity by clear and
21 convincing evidence. Nonetheless, the Court has granted Petitioner Kinney financial
22 assistance from the Estate, in the form of travel expenses to Belgium, to prove her allegations
23 with regard to the Special Master Proceedings. The Court, in its discretion, finds that
24

25
26 ⁵⁰ See *supra*, note 45.

27 ⁵¹ Petitioner Moncrieff makes no request for an award of attorney fees from the Estate.

1 Petitioner's attorney fees are part of the burden of pursuing and proving her claims and denies
2 her request for costs and fees.

4 **4. Carlsmith**

5 Petitioner Kinney proposes that Carlsmith be removed as counsel to the Executor.
6 Kinney's June 28, 1996 Post-Hearing Memo, p. 20. The California AG recommends that the
7 Court surcharge Carlsmith instead of the Executor for the measurable loss to the Estate
8 resulting from the Executor's breaches of fiduciary duty. CA AG Post-Trial Brief, p.10 ("... we
9 recommend that a proper order for surcharge be entered surcharging not the Executor (except
10 for the UMDA loan), but its counsel, the Carlsmith firm, for some of the costs incurred by the
11 Executor on advice of its counsel."). A trial court has the inherent power to protect the integrity
12 of its proceedings and wide discretion to supervise members of the bar appearing before it.
13 *City of Maple Heights v. Redi Car Wash*, 554 N.E.2d 929 (Ohio Ct. App. 1988), citing *Royal*
14 *Indemnity Co. v. J.C. Penney Co.*, 501 N.E.2d 617 (Ohio Sup. Ct. 1986). This includes the
15 authority to disqualify attorneys in cases of truly egregious misconduct which is likely to infect
16 future proceedings.⁵² *Id.*

17 The record demonstrates that Carlsmith has engaged in a pattern of misrepresentation
18 concerning the existence of documents and information about the administration of this Estate
19 which has diminished the integrity of this proceeding. The surreptitious issuance of the Power
20 of Attorney to Mr. Jhocson, the omission of material facts concerning the CHC transaction, the
21 intentional misreporting of assets on the Inventory, and the withholding of documents

24 ⁵² A trial court retains the "authority and duty to see to the ethical conduct of attorneys in proceedings
25 before it . . . [and][u]pon proper grounds it can disqualify an attorney." *Royal Indem. Co., supra*, citing
26 *Hahn v. Boeing Co.*, 621 P.2d 1263 (Wash. Sup. Ct. 1980). This does not conflict with the Superior
27 Court's jurisdiction over disciplinary proceedings. CNMI Disciplinary Rule 1 ("Nothing herein
28 contained shall be construed to deny any Court of the Commonwealth such powers as are necessary for
that Court to maintain control over proceedings conducted before it, such as the power of contempt.").

1 concerning the Lazard transaction, all fly in the face of COM.R. PRO. 10 and the guidance to
2 executors contained therein.

3 The Court sees a strong likelihood that this conduct will continue to infect future
4 proceedings since Carlsmith, on behalf of the Executor and in spite of the established record
5 in this matter, does not acknowledge a single act of wrongdoing or conflict of interest on the
6 part of the Executor or its representative Mr. Waechter.⁵³ Instead, Carlsmith condones each
7 of the actions taken by the Executor to date as necessary to perpetuate Mr. Hillblom's
8 "business style" and to carry out the terms of his will. Executor's Closing Argument at 3.
9 Unfortunately, Mr. Hillblom's "style," i.e. his flair for high risk and aggressive investment, is
10 wholly inconsistent with the parameters of prudent investment that bind a fiduciary. Perhaps
11 more unfortunate is the reality that Carlsmith either does not understand or refuses to accept
12 this fact.

13 Accordingly, the Court finds that Carlsmith's demonstrated disregard for COM.R.PRO.
14 10 and the principles of fiduciary law amounts to egregious conduct sufficient to warrant its
15 disqualification from further participation in this probate. See *Royal Indem. Co., supra*.

16

17 **5. Fitness**

18 In determining what action to take against the Executor, the Court is influenced by the
19 desire to grant relief which will act as a deterrent to the commission of similar breaches of
20 fiduciary duty by the Bank and by other executors in the future. BOGERT § 543(V) at 441. The
21 Bank has instituted its own safeguards to prevent future breaches of duty, which include
22 separating Bank operations and Trust Department operations and the creation of a two-
23 member (Ben Fitial and Paul Calvo) Estate Oversight Committee. RSM at 46. The Bank's

24
25 ^{53/} See Executor's Closing Argument, p.2 ("Although the Executor has taken exception to the Special
26 Master's Report, the Court's 'adoption of the Report' in its Order of May 10, 1996 requires the Executor
27 to *assume for the purpose of this memorandum* that the breaches set forth in the Court's Order have
28 occurred. In any event, it is the position of the Executor as will be set forth herein that the *assumed*
(emphasis added)).

1 directors have also retained independent counsel to advise them of their fiduciary
2 obligations.⁵⁴

3 Yet, the facts remain that this Estate is complex and the Bank lacks the much needed
4 expertise to manage it efficiently and in accordance with its fiduciary obligations. Prior to
5 accepting the position of Executor, the Bank had no fiduciary experience. It relied on
6 Carlsmith to establish and provide counsel to its Trust Department, and hired Mr. Waechter
7 to act as Vice President and to take charge of its affairs. As the result, the Bank committed
8 eleven breaches of its fiduciary duties. In addition, it failed to comply with several disclosure
9 requirements with respect to the CHC transaction, the changes in its Board membership, the
10 establishment of its Trust Department and the changes to its by-laws.⁵⁵

11 The Court addressed Carlsmith's role in this probate in § III(C)(4) above. Mr. Waechter
12 is a smart businessman, is particularly knowledgeable about Mr. Hillblom's businesses, and,
13 from the standpoint of the named will beneficiaries, is loyal to Mr. Hillblom and can be relied
14 upon. RSM at 121. He has been almost exclusively employed by Hillblom entities, in a variety
15 of capacities, since 1973 and is therefore well acquainted with Mr. Hillblom's "business style."⁵⁶
16 His understanding of fiduciary obligations, on the other hand, is noticeably limited. These
17 same qualifications that made Mr. Waechter the ideal Executor in the eyes of the named
18 beneficiaries make him uniquely unqualified to maintain his position of control over the

22 ⁵⁴ Mr. Calvo testified at the June 13, 1996 Evidentiary Hearing on Remedies that Ed Calvo, Jr. and
23 Rodney Jacobs were retained as counsel to the Board.

24 ⁵⁵ The CNMI Director of Banking, Mr. Oscar Camacho, testified at the June 14, 1996 Evidentiary
25 Hearing on Remedies.

26 ⁵⁶ Mr. Waechter worked for: DHL (60% owned by the Estate) from 1973-1987; UMDA (45%
27 owned by the Estate) from 1990-1994; and Danao International Holding Corp. (90% owned by the
28 Estate) from 1994 until he became Vice President of the Bank's Trust Department. Mr. Waechter spent
two years (1987-1989) working for a private investment firm.

1 Estate's administration. In fact, Mr. Waechter, in all candor, recognized his own limitations by
2 stating that his loyalty to Larry Hillblom prevents him from being a neutral Executor.⁵⁷

3 Since he was appointed Special Administrator, Mr. Webster has demonstrated his
4 ability to professionally manage this Estate, almost without objection.⁵⁸ He possesses the
5 business acumen and financial expertise that the Bank greatly needs at this point. See
6 attachments to March 22, 1996 Order Appointing Administrator. In addition, after five months
7 of service to this Estate, Mr. Webster is very knowledgeable about Mr. Hillblom's business
8 affairs.⁵⁹ In light of the above, the Court will require the Bank to: 1) retain Mr. Webster to
9 administer this Estate for a minimum one year period, and 2) restrict Mr. Waechter's duties
10 as Trust Department Vice President to matters not including administration of this Estate. The
11 Court will also require the Executor to retain White, Pierce, Mailman & Nutting for a minimum
12 one year period. The law firm has effectively advised Mr. Webster of his fiduciary obligations
13 and has assisted him to efficiently administer this Estate during the Executor's suspension.

14 *See supra*, note 59.

21 ^{57/} Mr. Waechter testified at the June 6 and 7, 1996 Evidentiary Hearings on Remedies.

22 ^{58/} See Petition SA-1 for Letters of Instruction, dated April 10, 1996; Petition SA-2 for Letters of
23 Instruction, dated April 18, 1996; Petition SA-3 for Letters of Instruction, dated April 19, 1996;
24 Petition SA-4 for Letters of Instructions, dated May 24, 1996; Petition SA-5 for Letters of Instruction
25 and Report on Vietnam Investment, dated June 7, 1996; Petition SA-6 for Letters of Instructions,
Activity Report, and Report on Certain Claims, dated June 21, 1996; Petition SA-7 for Instructions and
Activity Report, dated July 19, 1996.

26 ^{59/} Petitioners Kinney and Moncrieff both recommend that the Court provide a future role for Mr.
27 Webster in the administration of this Estate. Kinney's June 28, 1996 Post-Hearing Memo, p. 30;
Moncrieff's Final Argument, p. 26.

1 **IV. CONCLUSION**

2 After weighing all of the facts and circumstances surrounding the Executor's breaches
3 of fiduciary duty, and, giving due regard to fact that Mr. Hillblom appointed the Bank Executor
4 of his Estate, the Court finds that the Executor need not be removed at this juncture if
5 measures designed to hold it to the performance of its duty are implemented.⁶⁰ Accordingly,

6 **IT IS HEREBY ORDERED, ADJUDGED AND DECREED THAT THE EXECUTOR**
7 **SHALL, UPON COMPLIANCE WITH THE FOLLOWING CONDITIONS, BE REINSTATED**
8 **WITH FULL POWERS:^{61/}**

9 1. The Executor shall comply with the CNMI Banking Commissioner's requests
10 for information concerning its Board of Directors and ownership within 15 days from the date
11 of this Order;

12 2. The Executor shall, within 30 days from the date of this Order, re-pay the sum
13 of \$127,995.62 to the Estate as surcharges, representing the measurable loss to the Estate
14 resulting from the interest free loan to CHC and the unauthorized loan to UMDA;

15 3. The Executor shall, on or before August 30, 1996, retain William I. Webster
16 to manage this Estate on behalf of its Trust Department for a minimum period of one year;

17 4. The Executor shall restrict Mr. Waechter's authority as Trust Department
18 Vice President to matters not including the administration of this Estate;

19 5. The Executor shall, on or before August 30, 1996, retain White, Pierce,
20 Mailman & Nutting to serve as counsel to Mr. Webster for a minimum period of one year; and
21
22
23

24 ⁶⁰ The power to remove includes the power to impose the terms upon which removal will be refused.
25 *Carrier v. Carrier, et. al.*, 123 N.E. 135, 138 (N.Y.Ct. App. 1919)("[A trustee] is not aggrieved because
a privilege which might have been withheld altogether is burdened with conditions.").

26 ^{61/} The Court has taken considerable time to study and evaluate the issues presented herein and
27 therefore advises the parties that no reconsideration or stay of execution of this Order will be entertained.
Any perceived errors should be brought to the attention of the Commonwealth Supreme Court on appeal.

