

DEPARTMENT OF THE TREASURY - INTERNAL REVENUE SERVICE
ESTATE OF BERNICE PAUHI BISHOP, also known as,
KAMEHAMEHA SCHOOLS BISHOP ESTATE
CLOSING AGREEMENT ON FINAL DETERMINATION
COVERING SPECIFIC MATTERS

Under Section 7121 of the Internal Revenue Code ("IRC"), Estate of Bernice Pauahi Bishop, also known as, Kamehameha Schools Bishop Estate ("KSBE") (Taxpayer Identification Number 99-0073480), with its principal offices located at Kawaiaha'o Plaza, 567 South King Street, Suite 200, Honolulu, Hawai'i, 96813; Kamehameha Activities Association ("KAA") (Taxpayer Identification Number 51-0190227), with its principal offices located at Kawaiaha'o Plaza, 567 South King Street, Honolulu, Hawai'i, 96813; and KAA acting as successor to Pauahi Holdings Corporation, Inc. ("PHC") (Taxpayer Identification Number 99-0288052), with its principal offices located at 2201 Kalakaua Avenue, Suite A500, Honolulu, Hawai'i 96815, on behalf of itself and as agent of those members of the consolidated group set forth at Attachment 1 (the "Consolidated Group"), and the Commissioner of Internal Revenue make the following Closing Agreement:

WHEREAS, on February 2, 1939, the Internal Revenue Service ("IRS") determined that KSBE was a tax exempt organization under Section 101(6) of the Revenue Act of 1938 (predecessor to IRC Section 501(c)(3)), which was reconfirmed by the IRS in a letter dated November 28, 1952;

WHEREAS, on April 16, 1969, the IRS concluded that KSBE was a tax exempt educational organization under IRC Section 501(c)(3);

WHEREAS, on November 9, 1970, the IRS determined that KSBE was a public charity under IRC Sections 509(a)(1) and 170(b)(1)(A)(ii), which was reconfirmed by the IRS in a letter dated September 10, 1986;

WHEREAS, on April 14, 1976, KAA received a determination letter from the IRS that KAA was recognized as a tax exempt charitable organization described in IRC Section 501(c)(3). On September 16, 1998, KAA received notification that the IRS recognized KAA as a supporting organization for KSBE under IRC Section 509(a)(3);

WHEREAS, on May 31, 1991, PHC was formed as a wholly-owned taxable subsidiary of KSBE to hold the stock of the taxable subsidiaries comprising the Consolidated Group;

WHEREAS, the IRS has conducted an examination (the "Tax Audit") of KSBE, KAA, PHC, and selected members of the Consolidated Group for all or part of the taxable periods ended June 30, 1990 through June 30, 1996. See Attachment 2.

WHEREAS, as used in this Agreement the term "KSBE Organizations" refers to KSBE and its subsidiary and supporting organizations including without limitation, KAA, PHC, and members of the Consolidated Group, and the term "KSBE" refers to the Trust Estate;

WHEREAS, as used in this Agreement the term "Incumbent Trustees" means Marion Mae Lokelani Lindsey, Henry Haalilio Peters, Richard Sung Hong Wong, Gerard Aulama Jervis, and Oswald Kofoad Stender who until May 7, 1999, were the appointed trustees of KSBE;

WHEREAS, the term "Will" means the last will and testament of Princess Bernice Pauahi Bishop who died in Honolulu, Hawai'i, and whose Will and two codicils were admitted to probate in the Supreme Court of the Hawaiian Islands on December 2, 1884;

WHEREAS, on January 4, 1999, KSBE received a series of draft IRS Forms 5701, Notice of Proposed Adjustments, that were issued to members of the KSBE Organizations containing the IRS's preliminary findings and conclusions on a variety of issues identified by the IRS in the course of and as a result of the Tax Audit (hereinafter the issues raised in the draft Forms 5701 and any other issues arising out of the Tax Audit will be referred to as the "Audit Issues");

WHEREAS, the draft Forms 5701 proposed revocation of KSBE's tax exempt status retroactive to July 1, 1989, and also proposed a number of adjustments to the taxable income of KSBE;

WHEREAS, the IRS concluded that there was substantial evidence of private benefit and inurement of the net earnings of KSBE which benefited private individuals, including, but not limited to excessive compensation and perquisites paid to the Incumbent Trustees, sufficient to cause the IRS to revoke the exempt status of KSBE;

WHEREAS, the IRS concluded that there was substantial evidence of the operation of KSBE for a non-exempt purpose and, therefore, concluded that KSBE failed to engage in activities that primarily furthered KSBE's charitable purposes, sufficient to cause the IRS to revoke the exempt status of KSBE;

WHEREAS, the IRS also concluded that there was evidence of political campaign intervention by KSBE in violation of IRC Section 501(c)(3), which reflects a pattern of campaign intervention throughout the years examined by the IRS involving both Federal and state candidates for public office, including incumbents;

WHEREAS, the IRS concluded that unrelated business taxable income relating to credit enhancement revenue was not properly reported on KSBE's IRS Form 990-T during the taxable years 1992 through 1998;

WHEREAS, certain additional unrelated business taxable income was not properly reported on KSBE's IRS Form 990-T during the taxable years 1992 through 1996;

WHEREAS, certain amounts were omitted by KSBE on KSBE's IRS Forms 941 and 720 during the taxable years 1992 through 1996;

WHEREAS, under Haw.Rev.Stat. §554A-3(b) and under common law, the Incumbent Trustees have a duty not to exercise trust powers in a way to deprive KSBE of an otherwise available tax exemption, deduction, or credit for tax purposes;

WHEREAS, on January 21, 1999, the Master appointed by the Circuit Court of the First Circuit, State of Hawai'i ("Probate Court"), joined by KSBE's Tax Counsel and General Counsel, filed a report finding that the Incumbent Trustees of KSBE faced an apparent and actual conflict of interest in connection with the Tax Audit;

WHEREAS, on January 29, 1999, the Probate Court determined, after reviewing in camera the draft IRS Forms 5701, that the Audit Issues raised actual, apparent and potential conflicts of interest for the Incumbent Trustees and relieved the Incumbent Trustees of all trust powers to act for KSBE and the KSBE Organizations with respect to all issues involving or arising out of the IRS Audit;

WHEREAS, on February 16, 1999, the Probate Court appointed a panel of five Special Purpose Trustees, David Paul Coon, Francis Ahloy Keala, Ronald Dale Libkuman, Constance Hee Lau, and Robert Kalani Uichi Kihune ("Special Purpose or Interim Trustees"), "to exercise

the trust power with regard to the issues raised by the IRS Forms 5701 and the pending IRS audit." Throughout this Agreement the term "Special Purpose or Interim Trustees" shall refer to the above five named individuals and their successors;

WHEREAS, the IRS, the Attorney General of the State of Hawai'i ("AG") in the AG's capacity as *parens patriae*, and the Probate Court's Master ("Master") have raised concerns with respect to the structure and future operations of the KSBE Organizations, resulting from: (1) the Master's review of KSBE's 109th through 111th Annual Accounts; (2) a comprehensive financial and management audit conducted by Arthur Andersen LLP; (3) the activities giving rise to the proposed revocation of KSBE's tax exempt status as set forth in the draft IRS Forms 5701; (4) events and disclosures occurring after the issuance of the draft Forms 5701; (5) the controversy occurring at the Kamehameha Schools that led to the permanent removal of Trustee Marion Mae Lokelani Lindsey; and (6) reports of court appointed fact-finders, accrediting bodies and management consultants that have examined the governance of KSBE;

WHEREAS, the Interim Trustees have also raised governance concerns relating to the future operation and structure of KSBE Organizations;

WHEREAS, the IRS and the Interim Trustees have engaged in a special consolidated procedure in an attempt to resolve all of the Audit Issues, including the proposed revocation of the tax exempt status of KSBE;

WHEREAS, the IRS has advised KSBE and the Interim Trustees that it will initiate a process to revoke KSBE's tax exempt status unless the trust governance concerns raised by the IRS are satisfactorily addressed;

WHEREAS, in two letters to the Special Purpose Trustees from the IRS dated April 19, 1999, and May 4, 1999, the IRS advised the Special Purpose Trustees that one of the conditions necessary to enter into and finalize this Closing Agreement to preserve the tax exempt status of KSBE is the permanent removal of the Incumbent Trustees;

WHEREAS, in an order filed May 6, 1999, and in findings of fact and conclusions of law filed June 17, 1999, the Circuit Court, First Circuit, State of Hawai'i permanently removed Marion Mae Lokelani Lindsey as a Trustee of KSBE concluding by clear and convincing evidence and found in part that Ms. Lindsey (1) violated the Will; (2) breached her duties of loyalty by using trust property for her own purposes; (3) breached her duty of care; (4) mismanaged the Trust; (5) breached her duty to use her special skills; (6) failed to use sound discretion; and (7) engendered hostility with the beneficiaries. The Circuit Court also found the other Incumbent Trustees had taken no action to address the concerns raised regarding Ms. Lindsey's mismanagement of the Kamehameha Schools;

WHEREAS, on May 7, 1999, the Probate Court ordered the interim removal of four of the Incumbent Trustees and accepted the interim resignation of the fifth Incumbent Trustee and relieved all of the Incumbent Trustees of all power and authority to exercise any trust power related to KSBE and the KSBE Organizations;

WHEREAS, in its May 7, 1999 order removing the Incumbent Trustees the Court found that the Incumbent Trustees' failure or refusal to resign in the face of possible revocation of KSBE's tax exempt status constituted a breach of duty and that the Incumbent Trustees had knowingly violated an order of the Court requiring KSBE to adopt and implement a CEO form of governance;

WHEREAS, on May 7, 1999, the Probate Court appointed the Special Purpose Trustees as Interim Trustees of KSBE and vested the Special Purpose Trustees "with full and complete discretion, power, and authority to exercise all trust power with respect to KSBE and its subsidiaries and affiliated organizations in a manner consistent with the Will of Bernice Pauahi Bishop and the Codicils thereto and subject to such duties, responsibilities, and fiduciary obligations as are imposed by law and under the Will of Bernice Pauahi Bishop and the Codicils thereto;"

WHEREAS, the IRS has advised KSBE and the KSBE Organizations that absent an agreement on the Audit Issues, as described in Part A below, the IRS will continue the proceedings to revoke the tax exempt status of KSBE, which KSBE then would be permitted to contest through applicable administrative and judicial proceedings;

WHEREAS, the Interim Trustees have concluded that: (1) the activities described in the draft Forms 5701's including the conduct of the Incumbent Trustees have placed the tax exempt status of KSBE at risk; (2) there would be a significant risk that KSBE's tax exempt status could be lost if the revocation issues were litigated; and (3) settlement of the Audit Issues under the terms set forth in this Closing Agreement, including permanent removal or resignation of the Incumbent Trustees, is necessary and appropriate to preserve the tax exempt status of KSBE and is in the best interests of KSBE;

WHEREAS, the Interim Trustees agreed to seek all necessary orders from the Probate Court to implement the terms of the Closing Agreement including permanent removal of the Incumbent Trustees;

WHEREAS, the Interim Trustees filed a petition with the Probate Court on August 24, 1999, seeking the permanent removal of the Incumbent Trustees;

WHEREAS, the Probate Court, following an evidentiary hearing, granted the Interim Trustees' petition for permanent removal of all of the Incumbent Trustees;

WHEREAS, the IRS recognizes that KSBE does engage in significant educational activities that are of the type described in IRC Section 501(c)(3);

WHEREAS, an appropriate settlement of the Audit Issues, including preservation of KSBE's tax exempt status, will benefit KSBE and the charitable purposes of KSBE;

WHEREAS, by Order of the Hon. Kevin Chang, Judge, Probate Court 1st Circuit Court of Hawai'i, dated July 6, 1999, KAA and Ke Ali'i are subject to the same rules, regulations, and policies as those governing KSBE.

WHEREAS, by this same July 6, 1999, Order the Probate Court directed that the five KSBE Trustees be the sole directors of KAA and Ke Ali'i, and act solely in their capacities as Trustees of KSBE and not in their individual capacities. See Attachment 3.

WHEREAS, the Probate Court has continuing jurisdiction over KAA and Ke Ali'i and their assets in the same manner and to the same extent as its continuing jurisdiction over KSBE and its assets;

WHEREAS, the Interim Trustees and the KSBE Organizations have concluded that the interests of the KSBE Organizations will best be served by a resolution of the Audit Issues on the bases set forth in this Closing Agreement to avoid costly and time consuming litigation the outcome of which would be uncertain;

WHEREAS, the IRS also has concluded that it is in its best interests to resolve the Audit Issues on the bases set forth in this Closing Agreement, to ensure that KSBE will operate for educational and charitable purposes in compliance with IRC Section 501(c)(3), and as an educational organization described in IRC Section 170(b)(1)(A)(ii);

WHEREAS, KSBE has filed a supplemental appendix to its Form 1023 as a reaffirmation submission for continued status as an organization exempt from taxation under IRC Section 501(a) as described in IRC Section 501(c)(3), and for continued status as an educational organization described in IRC Section 170(b)(1)(A)(ii);

WHEREAS, the IRS found KSBE's reaffirmation submission to be acceptable and agreed to confirm KSBE's tax exempt status for all past periods and on a going forward basis subject to KSBE and the KSBE Organizations' compliance with this Closing Agreement;

WHEREAS, all of the Incumbent Trustees, namely Henry Haalilio Peters, Richard Sung Hong Wong, Marion Mae Lokelani Lindsey, Gerald Aulama Jarvis, and Oswald Kofoad Stender, have resigned or been removed as Trustees of KSBE by the Probate Court;

WHEREAS, the Incumbent Trustees have resigned or been removed from all positions obtained by virtue of their status as Trustees of KSBE, or by virtue of KSBE's ownership, investment, control, or voting power with respect to any entity or organization;

WHEREAS, the Interim Trustees have provided the Probate Court with their views regarding a new process for selecting the Trustees of KSBE that would include an independent committee (hereinafter referred to as the "Nominating Committee") representing a diversity of interests. See Attachment 4;

WHEREAS, this Closing Agreement does not cover any IRC Section 4958 excise tax liability or any issues pertaining to IRC Section 4958 for any disqualified persons or organization managers associated with KSBE;

WHEREAS, the parties' agreements to resolve the Audit issues relating to the IRS's proposed revocation of KSBE's tax exempt status are set forth in Part A below, the parties'

agreements to resolve the Audit Issues regarding the non-revocation tax issues are set forth in Part B below, and the general agreements of the parties are set forth in Part C below;

NOW, THEREFORE, IT IS HEREBY DETERMINED AND AGREED for Federal income tax purposes that:

Part A: Resolution of Audit Issues Relating to KSBE 's Exempt Status:

1. KSBE and the KSBE Organizations agree to the following:
 - A. In the event that any removal action of the Incumbent Trustees, namely Henry Haalilio Peters, Richard Sung Hong Wong, Marion Mae Lokelani Lindsey, Gerald Aulama Jarvis, and Oswald Kofoad Stender, is set aside on appeal or by collateral attack and one or more of the Incumbent Trustees is reinstated as trustee of KSBE, this Closing Agreement shall be null and void in which event the procedures specified in paragraph A.1.Y.4. of this Closing Agreement will apply.
 - B. To the extent the Incumbent Trustees continue to hold offices, directorships, memberships, consultative relationships, perquisites, or retain ex-officio status by virtue of their prior status as Trustees of KSBE, or by virtue of KSBE's ownership, investment, control, or voting power with respect to any entity or organization, or with respect to any position within the KSBE Organizations, the Interim Trustees or their successors will seek the resignation or removal of the Incumbent Trustees from such offices, directorships, memberships, consultative relationships, perquisites, or ex-officio status immediately upon discovery of said position;

- C. Any business meetings regarding KSBE Organizations' business between either the Interim Trustees or Top Executives and the Incumbent Trustees must be documented in writing by the current KSBE official in attendance at said meeting, detailing the purpose of the meeting, the substance of the matters discussed, and the persons who attended said meeting, for the term of this Closing Agreement. The term "Top Executive" is defined herein as an "Organization Manager" within the meaning of IRC Section 4958(f)(2). The Interim Trustee or Top Executive will notify the IRS and AG of the meeting within 30 days of said meeting. The documentation of any meetings shall be available to the IRS and the AG upon request, within 30 days of said request.
- D. KSBE agrees that the Trustees shall act as fiduciaries and exercise general oversight over the activities of the KSBE Organizations, but will not be involved in management of the day-to-day operations of the KSBE Organizations. The Trustees' primary focus is the furtherance of the educational purposes of KSBE, as set forth in Attachment 5.
- E. KSBE will follow the procedures established by the State of Hawai'i for suspension or removal of trustees in the event a trustee fails to fulfill his or her duties and responsibilities. KSBE agrees that in the event that a Trustee engages in one or more activities listed in Attachment 6, the other Trustees will initiate suspension or removal proceedings in accordance with Hawai'i law.

- F. The management structure of KSBE will initially be organized around a Chief Executive Officer. See Attachment 7 for current structure.
1. The Trustees will primarily establish the policies of KSBE and will exercise a fiduciary oversight role, consistent with the requirements of the Will, Probate Court orders regarding the administration of the Trust, and State of Hawai'i Trust law. The policies established by the Trustees will ensure that education is the primary focus of KSBE.
 2. The Chief Executive Officer will independently carry out the policy decisions of the Board of Trustees.
 3. KSBE agrees that the duties and responsibilities of the Chief Executive Officer are clearly defined and the individual(s) hired to fill this position will be person(s) with extensive experience in similar positions as enumerated in Attachment 8. The Trustees will perform annual performance reviews of the Chief Executive Officer. The CEO will review the performance of other Top Executives. These performance reviews will be made available to the Internal Auditor.
 4. The IRS agrees that if, as a result of the strategic planning process described in paragraph I, an alternative management structure is recommended, the alternative management structure may be implemented by KSBE, with notice to the AG and prior approval by the Probate Court. KSBE will provide the IRS with a

copy of any petition seeking the Probate Court's permission to effectuate such structural or management changes. KSBE will notify the IRS, in writing, of any such changes approved by the Probate Court within 30 days of issuance of the Court approval.

- G. KSBE agrees that the revised organizational structure of the KSBE Organizations referred to in paragraph F above, ensures that an adequate system of checks, balances, and affirmative disclosure requirements exists within the KSBE Organizations to provide safeguards against any abuse of power by the Trustees, individually or collectively, and any abuse of power by any Top Executives on the KSBE Organizations' staff, individually or collectively. Additionally, KSBE agrees to implement an adequate system of checks, balances, and affirmative disclosure requirements to provide safeguards against the mismanagement of Trust assets by the Trustees, or by any individuals or entities given access to said assets by the KSBE Organizations. The Trustees of KSBE in their capacity as Directors of any KSBE Organization will not actively participate in the day-to-day management or have effective management control over any of the KSBE Organizations. The KSBE Organizations agree to submit a report to the IRS and the AG within twelve months of the date of this Closing Agreement outlining the implementation of the above stated safeguards.

- H. KSBE agrees that its Trustees and Top Executives are subject to a new Conflict of Interest Policy (see Attachment 9) to ensure appropriate compliance with fiduciary standards. The required financial disclosure statements will be made available to the AG and to the Master.
- I. The KSBE Organizations have agreed to develop and implement a comprehensive educational and financial strategic plan, as ordered by the Probate Court on October 2, 1998, including investment policies. The strategic planning process will include an educational plan developed in conjunction with an investment plan, the principal focus of which is the furtherance of the educational mission of KSBE. The KSBE Organizations agree that this plan will be finalized and submitted to the IRS, to the AG and the Master no later than eighteen months from the date of this Closing Agreement. A copy of said plan shall also be filed by KSBE in the Probate Court.

- J. The Interim Trustees have adopted an initial Investment Policy. KSBE agrees that its Investment Policy will be regularly updated by the KSBE Organizations, as warranted, to ensure that the investment objectives and vehicles are consistent with the educational objectives of KSBE, and will be incorporated as supplemental schedules to the KSBE Organizations' financial statements. Investment performance reports will be prepared and submitted by KSBE to the Probate Court with KSBE's Annual Account. Such schedules will also be provided by KSBE to the IRS during the term of this Closing Agreement. A copy of said schedules shall be submitted by KSBE to the Probate Court, and to the Hawai'i Attorney General.
- K. KSBE and the KSBE Organizations have developed and agree to follow a spending policy that focuses on the educational purpose of KSBE, as set forth in Attachment 10. The IRS agrees that KSBE may increase spending to directly serve the educational needs of children consistent with the Will and Probate Court orders regarding the administration of the Trust. At least annually, KSBE will publicly solicit written comments from the Hawaiian community concerning the developmental and educational needs of native Hawaiian children.
- L. KSBE agrees that it will comply with the program approved by the Probate Court for setting Trustee compensation. See Attachment 11.

- M. KSBE agrees to follow the methodology for determining the compensation of the Chief Executive Officer, as set forth in Attachment 12.
- N. The KSBE Organizations will ensure that certified financial audits are prepared and filed annually with the Probate Court with the Annual Accounts of the KSBE Organizations. For the term of this Closing Agreement, these financial statements, including all supplemental schedules, will also be provided to the IRS, to the Hawai'i Attorney General, and made available to the general public upon request and by posting them on KSBE's Internet Web-site. These statements will be prepared in conformity with GAAP, unless otherwise approved in Court Orders and Stipulations by the Probate Court.

- O. An independent internal audit function has been reimplemented within KSBE, as described in Attachment 8. In addition to its other functions, the independent Internal Auditor including the Auditor's staff members (hereinafter "Internal Auditor") will monitor the KSBE Organizations' compliance with the terms of this Closing Agreement, all Court orders and stipulations relevant to this Agreement, and adherence to the Conflict of Interest Policy set forth in Attachment 9. The Internal Auditor will annually report the results of his/her monitoring of KSBE's compliance with this Closing Agreement, all Court orders and stipulations relevant to this Agreement, and adherence to the Conflict of Interest Policy to the IRS as "Special Filings" during the term of this Closing Agreement. The Special Filings will be signed by the Internal Auditor under the penalties of perjury. The Special Filings will also be submitted by KSBE to the Master, and the Attorney General of the State of Hawai'i.

1. The KSBE Organizations have established procedures to ensure that the Internal Auditor and any individuals within the KSBE Organizations providing information to the Internal Auditor will not be subject to intimidation, or detrimental or retaliatory actions as a result of their activities. Such protections will be announced and affirmed in a resolution of the Board of Trustees and communicated to all employees on an annual basis. The Internal Auditor or any other employee having knowledge that there has been a violation of this policy shall immediately report to the AG, the IRS and the Master any actions that violate this policy by KSBE, its Trustees, the KSBE Organizations, and their agents and employees.
2. The Internal Auditor will have immediate and unrestricted access to all records irrespective of their physical form and will be able to interview all employees of KSBE and the KSBE Organizations at the Auditor's request. The attorney/client privilege and/or other privileges will not be asserted by KSBE or the KSBE Organizations to prevent disclosure of any records to the Internal Auditor or access to any individuals by the Internal Auditor.

3. The Internal Auditor will be paid an annual salary set by the Board of Trustees, and may be removed or reassigned only for just cause by a majority of the Board of Trustees;
4. In the event the Internal Auditor finds that a trustee or Top Executive has failed to comply with the Conflict of Interest policy, the Internal Auditor will report any apparent conflicts to the Board of Trustees for appropriate action. The Board of Trustees will communicate in writing to the Internal Auditor the action or actions resulting from the Internal Auditor's report to the Board of Trustees, within 30 days of the action. The Internal Auditor will also include in the Special Filing provided for in Paragraph O, above, the actions taken by the Board of Trustees, if any, in response to the Internal Auditor's report to the Board of Trustees of an apparent or actual conflict of interest.

- P. KSBE has undertaken a review of existing contractual, consultative, employment, and professional service relationships in existence as of June 30, 1999 to ensure that the services provided under such contracts or through such relationships are necessary to the operation of the KSBE Organizations, that the prices and/or compensation paid for such services are reasonable and commensurate with services rendered, and that they are not in violation of any of the terms of this Closing Agreement. Retainer fees were subject to special scrutiny for propriety. KSBE shall report the results of this review to the IRS, the Master, and the AG within twelve months of the date of this Closing Agreement. A copy of said report shall also be filed with the Probate Court.
- Q. KSBE and the KSBE Organizations have reviewed all significant job classifications in existence as of June 30, 1999 to ensure that the job positions and compensation for such positions are appropriate for the accomplishment of KSBE's exempt purpose and that the individuals occupying such positions are qualified to perform the responsibilities of the position. KSBE shall report the results of this review to the IRS, the Master, and the AG within twelve months of the date of this Closing Agreement. A copy of said report shall also be filed with the Probate Court.
- R. KSBE and the KSBE Organizations agree to follow their standard procurement practices policy, attached as Attachment 13, to ensure that contracts for goods and services will be awarded on the basis of open and

competitive bidding, and that exceptions to competitive bidding will be specifically defined, as set forth in Attachment 13.

- S. KSBE and the KSBE Organizations will establish employment and contractual procedures ensuring, prospectively, that contractual and employment relationships are necessary and appropriate and that the prices and/or compensation paid for services are reasonable. A report of said procedures shall be submitted by KSBE to the IRS and the AG within twelve months of the date of this Closing Agreement. A copy of said report shall be filed by KSBE with the Probate Court.
- T. KSBE and the KSBE Organizations agree that they will follow the policy of not employing, reimbursing, or paying for the services of (including office expenses of), an elected or appointed member of the legislative, judicial, or executive branches of government, whether state, federal, or local. (This provision does not apply to non-compensated positions on advisory commissions or boards unless service on such a board or commission would violate KSBE's Conflict of Interest policy.) In no case shall KSBE or the KSBE Organizations employ such an individual, until a period of three years has passed since the individual's status as an appointee or elected official with the governmental entity has terminated, unless KSBE has received the express approval of the Probate Court. Notwithstanding the above, Robert Herkes, an incumbent legislator employed by KSBE may serve the remainder of his term in the Hawaii legislature which expires November, 2000, but will not thereafter serve in the legislature while employed by KSBE or the KSBE Organizations and will otherwise be subject to the foregoing paragraph.

- U. The KSBE Organizations have established procedures which will ensure the proper and complete documentation of all educational, investment and management decisions made by the Board of Trustees and by the Top Executives, and retention of said documentation. The Board of Trustees' minutes will contain documentation to indicate the Trustees present at the meeting and will contain a record of the matters voted on, in addition to the acceptance or rejection of the particular matter. Any staff reports presented prior to or during a meeting of the Board will be attached and filed with the appropriate minutes. Any Resolutions passed will be attached and filed with the appropriate minutes. In all instances in which these documents concern matters relating to the administration of the Trust, or a Trustee's fiduciary obligations or duties, or the Trustees' fiduciary responsibilities as Trustees, these documents will be readily available upon request for inspection and copying by IRS personnel, by the Hawai'i Attorney General's office, as *parens patriae*, or by the Probate Court, without assertion of privileges.
- V. The KSBE Organizations will not engage in any prohibited political intervention, as defined in the IRC Section 501(c)(3) and the implementing Regulations.
- W. KSBE agrees that within 6 months of the date of this Closing Agreement, KSBE will adopt a lobbying policy that will include requirements for documenting communications with state and federal legislators,

legislative offices and committees on matters relating to the financial, administrative, business, or educational affairs of KSBE or the KSBE Organizations. Documentation of any such communications will be made available to the Master, the AG, and the IRS.

- X. Any entity in which KSBE has or acquires an ownership interest of more than 50 percent, or any controlling interest in any organization, whether taxable or tax exempt, shall be considered a part of the KSBE Organizations for purposes of this Agreement. This includes any subsidiary or related organization organized under foreign law. Any passive investments, for example a passive investment in a limited partnership, will not be considered a part of the KSBE Organizations for purposes of this Closing Agreement, with the following exceptions:
1. Any compensation paid to Trustees or Top Executives by an entity that is involved in a passive investment of KSBE or the KSBE Organizations must be reported to the IRS and the AG in the annual Internal Auditor's Special Filing referenced in Paragraph O of this Closing Agreement;
 2. Any passive investments must be included in the FMV of the Trust Endowment for purposes of the annual Trust Spending Rate.
- Y. If the IRS believes there has been a material breach of any of the terms of this Closing Agreement, the following immediate actions will occur:

1. A Notice from the Internal Revenue Service will be mailed to KSBE and to the AG, informing KSBE that the IRS has become aware of an apparent material breach of the Closing Agreement. Any Notice under this paragraph shall contain an explanation of the alleged breach and a statement of the facts on which the allegation is based, and will provide KSBE with 30 days in which to respond, in writing, to the allegations;
2. Within 60 days of the date of KSBE's response, the IRS will afford KSBE the opportunity to have a conference with the IRS;
3. If the information presented at the conference does not satisfy the concerns of the Service, the Service shall so notify KSBE in writing and this agreement shall become null and void.
4. If this Closing Agreement becomes null and void for any reason, the IRS may issue a proposed revocation letter, proposing to revoke KSBE's tax exempt status. KSBE shall have full administrative rights to contest any proposed IRS revocation action and proposed tax adjustments under established IRS procedures and shall have any judicial remedies provided by law.

* * *

Part B: Settlement of Tax and UBIT Issues

1. KSBE agrees to a settlement of Nine Million Dollars for payment in lieu of Federal taxes or deficiencies thereof, additions to tax, and penalties for the tax years ended June 30, 1992, through June 30, 1996. KSBE agrees to a payment of \$4,992,500.89 for interest on the above stated settlement. This settlement includes the tax liability with respect to the "credit enhancements issue" through June 30, 1998. The "credit enhancements issue" relates to all fees paid or accrued during 1997 and 1998 under agreements similar in nature to those in issue in the Forms 5701 Issue No. B-IA and Issue No. B-IC, by which KSBE agreed to extend its creditworthiness to third parties, such arrangements including, but not limited to, note repurchase agreements, securing letters of credit, and otherwise providing guarantees of payment. This settlement amount has been paid in full.
2. The Commissioner agrees that the above stated amount shall satisfy the obligation of KSBE to the Commissioner for the tax years ended June 30, 1992, through June 30, 1996, and that no other amounts will be asserted as owed to the Commissioner by KSBE for those tax years. This amount includes an excise tax under IRC Section 4955 for political intervention during the taxable years 1992 through 1996.

3. KSBE agrees that for Federal tax purposes KSBE will not attempt to amortize, deduct, or otherwise try to recover from the Commissioner any of the Nine Million dollars settlement made pursuant to this Closing Agreement and that, except as provided below, none of the payment made pursuant to this Closing Agreement is amortizable, deductible, or otherwise recoverable on any Federal tax return. KSBE further agrees that KSBE will not receive any Federal tax benefit on account of the Nine Million Dollar settlement made pursuant to this Closing Agreement. Nothing in this paragraph is intended to preclude the deduction of \$4,992,500.89 as interest.
- c. Nothing in this Closing Agreement shall preclude or prohibit the Commissioner from examining KSBE or any member of the KSBE Organizations for taxable years ending June 30, 1997, or later, except that such examination shall not take place with respect to unrelated business taxable income issues relating to credit enhancements for the taxable years ending June 30, 1997 through June 30, 1998. In the event this Closing Agreement becomes null and void for any reason, the statute of limitations will be deemed to have been extended for three years from the date this agreement becomes null and void for all taxable years. KSBE agrees that Forms 872, Consents to Extend the Time to Assess Tax, with respect to liability for income tax for KSBE and tax exempt subsidiaries for the years included in the Tax Audit will be executed on the same date that this closing agreement is executed.

5. The KSBE Organizations and the IRS agree that the attorney- client privilege applies to communications with counsel for the purpose of receiving legal advice.
 - a. The KSBE Organizations agree that there will be no presumption of attorney-client privilege, or any other privilege, arising from the mere presence of an attorney in the KSBE Organizations' conduct of business for purposes of its subsequent dealings with the IRS.
 - b. The KSBE Organizations agree that the attorney-client privilege, or any other privilege, does not arise when counsel performs services other than providing legal advice.
 - c. The KSBE Organizations agree that the attorney-client privilege will not apply to facts, documents, materials, or information merely because such items are shared, circulated or coordinated with counsel and for which no legal opinion is requested.
6. Neither the IRS nor KSBE Organizations shall endeavor by litigation or other means to attack the validity of this Closing Agreement, absent fraud, malfeasance or misrepresentation of material fact.
7. This Closing Agreement does not cover any income tax, employment tax or excise tax liabilities of the non-tax exempt entities including corporations, partnerships, limited liability companies and limited liability partnerships of the KSBE Organizations.

Part C


1. The IRS agrees that in lieu of revocation, the IRS will accept KSBE's supplemental appendix to its Form 1023 as a reaffirmation submission requesting continued recognition as an organization exempt from taxation under IRC Section 501(a) as described in IRC Section 501(c)(3). The reaffirmation submission will be treated as part of KSBE's current exemption application for purposes of IRC Section 6104 and Section 301.6104(a)-1(d) of the Procedure and Administrative Regulations. The IRS agrees that it has reaffirmed KSBE's exempt status, as indicated by letter dated concurrently with the date the IRS has signed this Closing Agreement.
2. This Closing Agreement and Attachments will be made available to the public by KSBE in the KSBE Office located at Kawaiaha'o Plaza, 567 South King Street, Suite 200, Honolulu, Hawai'i, 96813, and on the KSBE Internet Web-site upon the signing of said Agreement.
3. KSBE agrees that it will file with the IRS all documents required by reason of this Closing Agreement by sending said documents to the Chief EP/EO, 300 North Los Angeles Street, Mail Stop 7000, Los Angeles, CA 90012-3335 or his/her successor, and a copy to the Director, Exempt Organization Division, 1111 Constitution Ave. N.W., Washington, D.C. 20224 or his successor.

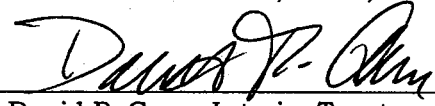
4. The term of this Closing Agreement shall be for five years after the signature date.
5. Nothing in this Closing Agreement is intended to amend, modify, or vacate any prior order of the Probate Court regarding the administration of the Trust.
6. This Closing Agreement does not affect the rights, duties or powers of the AG as *parens patriae* of charitable trusts in the State of Hawai'i, nor affect the common law duties of *parens patriae*.
7. This Closing Agreement is final and conclusive, except that:
 - a. The matter it relates to may be reopened in the event of fraud, malfeasance or misrepresentation of a material fact;
 - b. It is subject to the Code sections that expressly provide that effect be given to their provisions (including any stated exception for IRC Section 7122) notwithstanding any other law or rule of law; and
 - c. It is subject to any law enacted after this Closing Agreement is signed that applies to a taxable period ending after the date the Closing Agreement is signed.

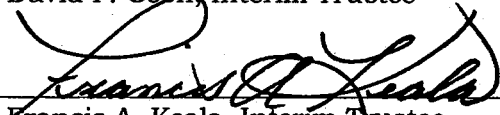
By signing, the parties certify that they have read and agreed to the terms of this document.

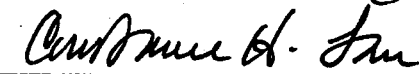
For and on behalf of:


Estate of Bernice Pauahi Bishop, also known as, Kamehameha Schools
Bishop Estate, Kamehameha Activities Association, KAA as successor to Pauahi
Holdings Corporation, Inc. and its Consolidated Group.

By  Date Signed 2/10/00
Robert K. U. Kihune, Chair, Interim Trustees

 Date Signed 2/10/00
David P. Coon, Interim Trustee

 Date Signed 2/10/00
Francis A. Keala, Interim Trustee

 Date Signed 2/10/00
Constance H. Lau, Interim Trustee

 Date Signed 2/10/00
Ronald D. Libkuman, Interim Trustee

Commissioner of Internal Revenue

By Steven J. Matt Date Signed 2/23/00

Title Director, Exempt Organizations

I have examined the reporting requirements to the Hawai'i Attorney General and agree that these reporting requirements are in the best interests of the Trust and the State of Hawai'i.

Attorney General
State of Hawai'i

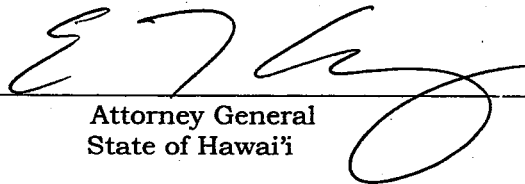
(Date)

Commissioner of Internal Revenue

By _____ Date Signed _____

Title _____

I have examined the reporting requirements to the Hawai'i Attorney General and agree that these reporting requirements are in the best interests of the Trust and the State of Hawai'i.



Attorney General
State of Hawai'i

MAR 16 2000

(Date)