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**Supplement to the Report to
Congressional Requesters**

July 1989

**U.S. TRUST
TERRITORY**

**Issues Associated With
Palau's Transition to
Self-Government**



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**National Security and
International Affairs Division**

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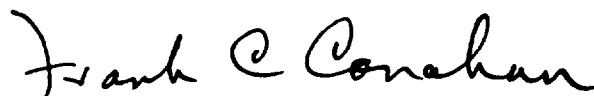
The Honorable Morris K. Udall
Chairman, Committee on Interior
and Insular Affairs
House of Representatives

The Honorable George Miller
Chairman, Subcommittee on Water, Power,
and Offshore Energy Resources
Committee on Interior and Insular Affairs
House of Representatives

The Honorable Ron de Lugo
Chairman, Subcommittee on Insular
and International Affairs
Committee on Interior and Insular Affairs
House of Representatives

This is the supplement to our report on issues associated with Palau's transition to self-government (GAO/NSIAD-89-182, July 1989), providing detailed information on (1) major contracts and agreements entered into by Palau for infrastructure and services, (2) Palauan law enforcement capabilities and U.S. law enforcement assistance, (3) issues related to Palau's 1987 Compact of Free Association referenda, and (4) potential problems regarding U.S. military use and operating rights in Palau following compact implementation. This supplement contains the information and analyses upon which our report conclusions and recommendations are based. Recommendations concerning the issues addressed in this supplement are included in our overview report.

As noted in our overview report, we plan to distribute this supplement to members of Congress and executive agencies having an interest in this matter, the government of Palau, and other interested parties who specifically request copies.



Frank C. Conahan
Assistant Comptroller General

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Abbreviations

DEA	Drug Enforcement Administration
DOD	Department of Defense
FBI	Federal Bureau of Investigation
OEK	Olbiil Era Kelulau
OMB	Office of Management and Budget
TIA	Territorial and International Affairs
PNCC	Palau National Communications Corporation
TTPI	Trust Territory of the Pacific Islands

Analysis of Contracts and Agreements

During President Salii's administration, Palau's national and state governments and government-owned corporations entered into some major contracts and agreements for services, development bonds, and capital improvements. We reviewed 17 contracts and found that in some cases Palauan officials finalized contracts without (1) conducting independent feasibility studies, (2) obtaining legislative authorization and appropriation of funds, and (3) making reasonable efforts to obtain competition. Also, some of these projects and agreements were not included in Palau's national economic development plan and some contracts may have violated provisions of Palauan law. Although several of these ill-advised contracts and agreements were canceled or allowed to expire following President Salii's death, some still may result in obligations which the government of Palau eventually will be forced to pay. Moreover, they illustrate serious internal control problems which, if allowed to continue, could adversely affect Palau's ability to manage Compact of Free Association funds wisely, including at least \$46 million¹ for capital improvements.

Secretarial Orders 3039 and 3119 authorized Interior to monitor Palau's efforts to negotiate contracts and agreements and to advise and assist it in addressing any potential problems. Under Order 3039, the High Commissioner had the right to audit, and, after audit, could require compliance with proper accounting principles and audit recommendations. The Department of the Interior currently has this authority under Order 3119. For 3 of the 17 contracts, Interior officials closely monitored Palau's actions and (1) advised about potential problems, (2) initiated audits or investigations, or (3) notified other U.S. agencies about potential problems. However, for the remaining 14 contracts, Interior officials—consistent with their policy of delegating authority for most government functions to Palau—did not closely monitor Palau's actions and/or did not advise and assist Palauan officials in avoiding or resolving problems.

Our review of these 17 contracts and agreements focused on (1) documenting their terms and the circumstances surrounding their negotiation and approval, (2) reviewing whether Palau adhered to Palauan laws and regulations and complied with U.S. grant requirements, (3) determining whether Palau followed sound acquisition practices, and (4) documenting actions taken by officials at Interior, State, the Trust Territory

¹The compact states that the United States will provide Palau with \$36 million for capital improvements and that this amount will be partially adjusted for inflation since 1981, once the compact takes effect. We estimate that Palau will receive about \$46 million, including the inflation adjustment, if the compact is implemented in 1989.

of the Pacific Islands (TTPI) government, and the Federal Bureau of Investigation (FBI). We reviewed the following projects, contracts, and agreements.

- Two contracts for upgrading Palau's telephone system.
- A national government contract to build a 22-mile road on Babelthuap island.
- Palau National Development Banking Corporation's bond issue underwritten by Matthews and Wright.
- A national government contract for managing Palau's power plant.
- Four state government contracts for road and sewer systems.
- Two national government contracts to (1) develop plans to construct and lease back a national capital and (2) to produce and sell commemorative coins.
- Two contracts to procure oil and borrow funds to be repaid through fuel surcharges.
- National government expenditures to lease and renovate a house for President Salii.
- Three national government contracts and agreements for a new international airport.

The House Committee on Interior and Insular Affairs specifically requested us to review 15 of these contracts because some Palauan legislators had expressed concerns about potential problems, such as failure to use competitive bidding and violations of Palauan law, and some Palauan citizens had filed lawsuits involving several contracts. A Palauan official provided us with copies of two contracts with Pacific Ventures, Inc., and we decided to review these contracts also. Our analyses of these 17 contracts are based on documentation maintained by Palau's executive branch and U.S. agencies and discussions with Palauan and U. S. officials and corporation representatives. For the most part, government of Palau files on these contracts and agreements were incomplete and many of the principal Palauan officials involved in negotiating these contracts and agreements were not available to meet with us. Except for one contract for a telephone system design study, which was funded mostly by a technical assistance grant from the Department of the Interior, we could not determine whether expenditures for these contracts were made with U.S. funds or local revenues. U.S. revenues account for over 60 percent of Palau's total revenues. However, U.S. funds for general operating expenses, which totaled about \$15.5 million in fiscal year 1988, are deposited in Palau's general fund and are commingled with local revenues, thus losing their identity as U.S. funds.

Orion Telecommunications, Ltd.

In June 1986, President Lazarus Salii awarded Orion Telecommunications, Ltd., a \$65,000 contract to develop an initial design and installation plan to replace Palau's telephone system. The contract was funded mostly by a technical assistance grant from the Department of the Interior. In accepting the grant, Palau agreed to certify that it would comply with then applicable Office of Management and Budget (OMB) Circular A-102, which required that all procurements, whether by sealed bid or by negotiation and without regard to dollar value, be conducted in a manner that provides maximum open and free competition.³ In November 1986, the Palau National Communications Corporation (PNCC), a government-owned corporation with authority over Palau's telephone system, signed a follow-on agreement with Orion to install and manage a new telephone system. We identified the following problems with these two contracts.

- PNCC did not conduct an independent feasibility study because President Salii, without PNCC's knowledge and using Interior funds, awarded Orion a noncompetitive contract to develop a plan to upgrade Palau's telephone system. After approving the follow-on installation agreement, PNCC board members concluded that the cellular phone system recommended and scheduled to be installed by Orion was not in Palau's best interest.
- PNCC board members told us they were pressured by President Salii and an adviser to approve a noncompetitive joint venture telecommunications installation agreement. Although the Palau Supreme Court ruled that the lack of competitive bidding did not violate Palauan law, the failure to solicit bids was not in Palau's best interest because Palau lacked assurance that it had received a fair and competitive price.
- Interior (1) did not ensure that in awarding the initial contract, paid mostly with Interior funds, Palau adhered to OMB Circular A-102 requirements for competition and (2) was not aware of problems resulting from these two contracts.

Initial Contract With Orion

On June 2, 1986, Interior and Palau finalized a technical assistance memorandum of understanding for the preparation of a communications action plan. Interior agreed to give Palau \$45,000 toward the cost of the study. President Salii signed an agreement with Orion a few days later to prepare an initial telephone system design plan at a cost of \$65,000.

³This circular was superseded in March 1988 and no longer contains the free and open competition requirement. The requirement was included in a common rule on Uniform Administrative Requirements For Grants and Cooperative Agreements to States and Local Governments. This rule has been adopted by many federal agencies, including the Department of the Interior.

Although PNCC has authority for Palau's telephone system, PNCC board members stated that they were unaware of this contract until after it was signed. President Salii's decision to award Orion this contract appears to have caused PNCC to abort its efforts to conduct a thorough independent study of its telephone needs. In September 1985, PNCC submitted a preliminary application for a loan from the Rural Electrification Administration to upgrade its system. PNCC's attorney stated that PNCC was considering hiring a firm to make an area coverage survey and design as required under Rural Electrification Administration procedures. He stated that PNCC also had talked with Hawaiian Telephone and that the contract with Orion interrupted these efforts.

From our discussions with Palauan officials, it appears that President Salii awarded the initial contract to Orion without competition. In our opinion, lack of competition for this contract appears to have violated Palau's memorandum of understanding with Interior which required Palau to certify that it would comply with all applicable federal laws, regulations, and requirements involving the application, acceptance, and use of federal funds in projects in accordance with OMB Circular A-102.

Follow-On Installation Contract

PNCC did not solicit competitive bids before signing the joint venture agreement with Orion for installation of the system. The agreement stated that Orion would finance or arrange financing for the new system. On November 10, 1986, PNCC board members were called to President Salii's office and presented with a proposed joint venture agreement with Orion to install a cellular phone system in Palau. On November 12, PNCC's board chairman signed the agreement with the board's approval. Board minutes signed by the members show that the board was under pressure from the Office of the President to sign the agreement.

In 1987, two Palauan citizens filed a class action suit alleging that the Orion installation contract was void because the government of Palau failed to undertake competitive bidding procedures as required by Palauan law. On November 4, 1987, the Trial Division of the Palau Supreme Court ruled that the lack of competitive bidding did not render the contract void because (1) Palauan law does not require PNCC to use

competitive bidding and (2) the bidding requirements of Palauan law³ apply only to contracts financed by funds made available or appropriated by the Olbiil Era Kelulau (OEK). The Orion contract was to be funded by private financing arranged by Orion. The court also noted that a provision in Palauan law (15 PNC 315(n)) describing PNCC's functions exempts Palau from liability for PNCC's debts and obligations. The plaintiffs appealed this decision in December 1987; however, as of November 1988, the Appellate Division of the Palau Supreme Court had not rendered a decision. Despite the trial division's ruling, PNCC has decided to use competitive procedures in the future and is developing internal policy guidelines requiring competition.

The suit also alleged that because Orion failed to obtain a foreign investors' business permit, the contract was null and void. The trial division ruled that, although Orion readily admitted that it was in violation of the law for failing to obtain a permit, this does not render the contract void because the statute does not expressly render legally void business done in violation of the statute. The court also noted that the violation could be addressed by possible prosecution and criminal sanctions. The current Attorney General stated that he had not pursued this matter, because he was out of the country at the time the ruling was made and his staff did not bring it to his attention. He stated that he would request guidance from Palau's new President on whether to prosecute Orion.

PNCC Seeking Termination of Agreement

After approving the joint venture agreement with Orion, PNCC board members visited several locations outside Palau that had cellular phone systems and concluded that the cellular system Orion was scheduled to install was not in Palau's best interest. Therefore, on March 30, 1988, PNCC formally notified Orion that it wanted to terminate the joint venture agreement and asked Orion to detail costs incurred to date. On April 18, Orion responded that it wanted PNCC to pay about \$1.1 million, including foregone profits, to terminate the agreement. On August 4, PNCC sent a letter objecting to Orion's figure and on October 4, Orion filed suit against PNCC on numerous grounds including breach of contract. As of November 1988, the suit was pending.

³40 PNC 402 and 403 establish competitive bidding requirements and procedures for projects for the construction, repair, or rebuilding of any building or structure and any purchase of goods, commodities, or materials, including related services, except those goods, commodities, or materials purchased through the National Procurement System, which require an expenditure of more than \$5,000 and which are financed in whole or in part by funds made available or appropriated by the OEK. We were told that Palau has not established a National Procurement System.

Interior's Role

Interior's files contain a copy of Palau's initial contract with Orion, but Interior officials were not aware that Palau's actions may not have complied with OMB Circular A-102 requirements for competition and therefore may have violated its memorandum of understanding with Interior. Moreover, although Interior permitted Palau to expend \$45,000 under the grant, a September 1988 Interior report lists the project status as "unknown" and indicates that Palau did not submit required narrative reports. Although Interior took steps in September 1988 to require Palau to provide the missing reports, these actions were too late to enable Interior to help Palau identify problems early enough so that they could be corrected easily.

We found no evidence that Interior officials monitored Palau's continued involvement with Orion or advised Palau on how to address problems that arose under the joint venture agreement. Interior's Deputy Assistant Secretary for Territorial and International Affairs (TIA) said he was aware that Palau had a contract with Orion but that Interior did not know much about it and did not have a file on it. He also said that Interior did not provide Palau with advice on which technology—Orion's or Hawaiian Telephone's—was more appropriate.

House Committee on Interior and Insular Affairs staff asked us to determine whether any former Interior officials are involved with Orion and whether such involvement violates U.S. laws or regulations. We identified two former Interior officials who currently are shareholders in Orion; however, their involvement with the firm does not appear to have violated U.S. laws or Interior regulations governing former officials' conduct. One of these individuals resigned as director of Interior's technical assistance program in April 1987. Records provided by Orion indicate that he was not a stockholder of the firm when the contract was signed. The other individual resigned from Interior prior to Orion's involvement with Palau.

Babelthuap Road Contract

In August 1987, Palau's President awarded a competitive contract for the construction of a 22-mile road on Babelthuap Island at a cost of at least \$26 million. We believe that issuance of this contract was premature because the United States, under the terms of the compact and a related subsidiary agreement, already was obligated to build a road in the same area at no cost to Palau. We also identified the following problems with this contract, which was terminated by the government of Palau in September 1988.

- According to an Interior consultant, Palau instructed an engineer hired to prepare the bid documents to incorporate unusual terms in the bid documents, such as requiring that the project be financed entirely by the contractor; this stopped four of the six contractors who had shown interest in the project from submitting bids and resulted in an expensive contract.
- Palau's President signed the contract without obtaining OEK authorization and appropriation of funds. Because the contract could have required payment with Palauan funds, it may have violated a Palauan law which requires certification that funds are available before entering into final contracts.
- Although competitive bidding was used, allegations exist that the contractor may have been pre-selected and that Palau's attempt to solicit bids was superficial at best. We did not investigate these allegations because Interior's Inspector General was conducting a detailed review of this project concurrent with our review.

Compact Terms

Section 212(a) of the compact signed in 1986 obligates the United States to provide a road system for the people of Palau in accordance with mutually acceptable specifications. The road is to be built before the sixth anniversary of the effective date of the compact. In a subsidiary agreement, the United States agreed to build a 53-mile road along a mutually acceptable route on Babelthuap island. The United States intended to solicit bids for project implementation and to supervise construction through the Navy Officer in Charge of Construction in Guam.

Contract Events

On May 1, 1987, the President of Palau published an invitation for sealed bids for constructing a 22-mile road system on Babelthuap island along a route which differed somewhat from that envisioned by the United States. Bidders were asked to submit offers for several alternate sets of specifications. The contract was awarded on August 10, 1987, to the team of Calista Construction International, an Alaskan firm, and Keangnam Enterprises, Ltd., a Korean firm, which submitted bids ranging between about \$25.9 million to \$29.6 million, based on the alternate sets of specifications.

Calista and Keangnam agreed to finance the project and to receive final payment in one of two ways: (1) the contractor would be paid by the United States if the United States agreed to accept the 22-mile road project as part of its obligation to build a 53-mile road system or (2) if the United States did not agree to pay the contractor but the compact was

ratified, the President of Palau agreed to introduce and “vigorously support” legislation for OEK appropriations to pay the contractor with capital improvement or other compact funds.

In September 1988, Palau’s Attorney General sent the contractor a notice of termination based on failure to comply with various contract provisions, including commencing work within the time agreed and posting a bank guarantee for an amount equal to 10 percent of the contract’s value. On September 15, Keangnam Enterprises sent a letter to Palau’s Attorney General objecting to unilateral termination of the agreement without reasonable grounds. In November 1988, Palau’s Attorney General told us that the contractors might sue Palau for terminating the contract but that even if Palau lost the suit and had to pay the contractors \$1 million or so to terminate the agreement, Palau would be better off because the agreement did not adequately protect Palau’s interests.

OEK Not Involved

Palau’s constitution specifically grants authority to regulate the ownership, exploration, and exploitation of natural resources to the OEK. Moreover, a Palauan law (40 PNC 401(b)) forbids the entry into any contract which obligates public funds from any source without certification of the availability of funds.

The President of Palau’s Senate told us that the OEK was not asked to authorize or appropriate funds for the Babelthuap road project and that President Salii did not inform them of his plans for the project or notify the OEK that he intended to solicit bids. A letter from the Senate President to President Salii, dated October 2, 1987, indicates that the Senate learned that the President had signed an agreement for the road when it was reported by the Pacific Daily News, a major independent source of news for Micronesian islands. A letter written by the Senate President in November 1987 indicates that, despite repeated requests to President Salii for information on the project, the Pacific Daily News continued to be the only source of information.

Potential Noncompliance With Statutory Requirements

Because the contract could have required payment with Palauan funds, it may have violated a Palauan law which requires certification that funds are available before awarding contracts. The Attorney General’s September 1988 letter to the contractor terminating the agreement stated that “the agreement is not in compliance with statutory provisions otherwise voiding contracts entered into purporting to obligate

funds without certification of availability of such funds.” Also, the President’s signing the contract without legislative approval appears to conflict with the specific constitutional grant to the legislature to regulate the ownership, exploration, and exploitation of natural resources.

Study Finds Unusual Bidding Procedures and Contract Terms

A 1988 study of the Babelthup road project by an engineering consultant hired by Interior found that the bid documents and terms of the proposed contract included several unusual features. For example, Palau instructed the engineering firm hired to prepare the bid documents that the project should be “fast track,” meaning that design and construction should occur concurrently. Also, Palau required that the project be financed entirely by the contractor. The report also suggested that, because the resulting agreement required that Calista and Keangnam advance funds for the engineer’s fees and did not clearly define the engineer’s authority in representing Palau in matters with Calista and Keangnam, the engineer might have difficulty in enforcing his decisions and properly protecting Palau’s interest.

In addition, the bid documents stated that if the contractor did not receive compact funds either directly from the United States or through Palau, the contractor would not be paid for the project. Interior’s consultant concluded that (1) this clause deterred four of the six contractors who had shown interest in the project and had purchased bid documents, and (2) the short time provided for preparing bids, coupled with the lack of survey drawings and other drawings, may have caused contractors to include large contingency sums in their bids.

Interior’s consultant also concluded that unusual features used in the bidding procedure and incorporated in the construction contract led to “an extremely expensive road.” The winning bid submitted by Calista and Keangnam would have cost Palau \$1.2 million per mile compared to \$600,000 to \$800,000 per mile for recently completed Palauan road projects managed by the Navy Officer in Charge of Construction and funded by Interior. For this and other reasons, the consultant recommended that the contract be terminated.

Allegations of Bidding Irregularities

Certain individuals with knowledge of the Babelthup road project have alleged that there may have been an unduly close and unethical relationship between the contractor and Palauan officials to the extent that there was a pre-conceived idea that Calista and Keangnam would be awarded the project even before invitations to bid were announced. For

example, a former Palau Assistant Attorney General told us he believes the firms that received the contract were pre-selected and that efforts to obtain competition were superficial at best.

An April 15, 1987, cable from Calista's vice president to a prominent Palauan official prior to Palau's advertising for bids stated that Calista officials "...have no plans to return until bid document prepared and we return to bid road project. I know we have many other business to conduct but our return must not be seen by [Officer in Charge of Construction] as influence on engineers or Palau Govt." An April 29, 1988, cable from Palau's former Attorney General to Calista's vice president stated that "I will be in Honolulu from about the 18th to the 22nd. We have many things we need to discuss in some detail concerning this bid, and do not think we should do it over the phone. Understand your concern about travel to Palau at this time. How do you feel about Hawaii?" We did not investigate these allegations because Interior's Inspector General was reviewing this project concurrent with our review. In May 1989, the Inspector General reported that Palau effectively limited competition to ensure that the joint venture of Calista and Keangnam would be the successful bidder.

U.S. Agencies' Actions

In May 1987, TTPI officials advised Palau executive branch officials not to sign the contract and in mid-1988 Interior officials initiated (1) a detailed study of the contracting process by an engineering consultant familiar with Palau and (2) an Interior Inspector General audit. In May 1987, the High Commissioner and Director, TTPI Office of Capital Improvement Program, recommended that Palauan officials not open bids on June 2, 1987, as scheduled and that they inform bidders that the government of Palau had decided to re-evaluate its intention to proceed. These officials cautioned that Palau was opening itself up for liability problems by advertising a project when there was absolutely no funding available. President Saliu proceeded with the bid opening and signed a contract in August 1987 despite Interior's advice.

After Palau signed the contract with Calista and Keangnam, the State Department learned that President Saliu planned to ask the Department of State to substitute the 22-mile road system for all or part of the road system promised by the United States under the compact. In January 1988, a Department of State official told us that the Department had not rejected the idea of "cashing out" the U.S. obligation to build a road but that the United States would have to determine that Palau had followed appropriate contracting procedures and obtained a reasonably priced

contract. After consulting with State officials, Interior asked an engineering consultant to review the road project. Interior's Deputy Assistant Secretary for TIA also requested the Inspector General to review the project. The audit, which was completed in May 1989, identified numerous problems with the procurement process and other matters.

Matthews and Wright Bond Issue

On August 28, 1986, the Palau National Development Banking Corporation issued bonds totaling over \$398 million which were supposed to finance capital improvement projects in Palau. We found that (1) bank board members were asked to approve the bond issue on short notice and apparently did not understand it fully, (2) the bond issue was not mentioned or envisioned by Palau's 1987-91 economic development plan, and (3) \$398 million in bonds appears to have exceeded Palau's needs and would have been difficult to repay. In December 1987, an official and a consultant of Matthews and Wright, the bond underwriters, were indicted by a federal grand jury in Guam on various counts of fraud in connection with Palau's bond issue and bond issues in Guam and the Northern Mariana Islands. Although Palau canceled the bonds in September 1987, thereby avoiding any financial liability, the U.S. Attorney for Guam stated that Palau's involvement with Matthews and Wright may have damaged its credit rating and future ability to issue bonds.

Change in Tax Laws Precipitated Rash of Bonds

Bond underwriters generally charge underwriting fees equivalent to about 5 percent of the bonds' value up front, so that municipalities receive 95 percent of the bonds' face value. Prior to a U.S. tax law change in 1986, municipalities could invest bond proceeds in interest bearing accounts for up to 3 years. This practice, called arbitrage, would produce interest earnings that were sufficient to pay the underwriter's fees.

However, as a result of changes made by section 624 of the Tax Reform Act of 1984 and section 1301 of the Tax Reform Act of 1986, interest on municipal bonds generally is not tax exempt unless the municipalities rebate to the United States certain arbitrage profits earned from investing in tax-exempt bond proceeds. Municipalities can no longer use the arbitrage to recoup underwriting fees. The effective date for the 1986 tax law change was August 31, 1986. According to an Internal Revenue Service official, a rash of municipal bond issuances for questionable projects occurred just prior to this date. FBI officials said they suspect that Matthews and Wright underwrote questionable bond issues worth

over \$2 billion in the United States, Guam, the Northern Marianas, and Palau.

From our review of records and discussions with Palauan and U.S. officials, we found that Matthews and Wright officials met with President Salii in New York in May 1986 and arranged for the Palau National Development Banking Corporation to issue over \$398 million in bonds to finance capital improvement projects. Although President Salii stated in a letter to Interior that Ambassador Fred Zeder, former U.S. Ambassador for Micronesian Status Negotiations, had introduced Matthews and Wright to him, Zeder denied in writing that he had any role in the introduction. The U.S. Attorney for Guam believes that one of President Salii's advisors introduced Matthews and Wright to Salii.

On August 28, 1986, Palau issued \$398 million in bonds to finance various capital improvement projects. An official of Matthews and Wright purchased the bonds by writing two checks totaling \$398 million drawn on the New American Federal Credit Union. The checks were passed to the Pittsburgh National Bank, which, according to bond documents, was to act as trustee. The Pittsburgh National Bank endorsed the checks over to the Commercial Bank of the Americas, an offshore bank allegedly located in the Northern Mariana Islands, in return for a one-year investment agreement paying 5-percent interest on the funds. The Commercial Bank of the Americas then used the checks to purchase the bonds from Matthews and Wright. The Commercial Bank of the Americas was to hold the bonds until Matthews and Wright re-marketed them to individual investors and then hold the bond proceeds until the Pittsburgh National Bank redeemed its investment agreement. Matthews and Wright would retain 5 percent of the re-marketing proceeds as its fee.

According to a letter from Interior's Assistant Secretary for TIA to the former Director of the Executive Office for U.S. Attorneys, the Commercial Bank of the Americas was not licensed to do business in the Northern Mariana Islands as of January 1987 and it was controlled by a Matthews and Wright consultant. The mailing address for the Commercial Bank of the Americas, as stated on the investment agreement, was in care of the New American Federal Credit Union in Jersey City, New Jersey. A Securities and Exchange Commission official said the credit union was founded and directed by an official of Matthews and Wright. Endorsing the check to the Commercial Bank of the Americas and then having the Commercial Bank of the Americas use the check to purchase the bonds from Matthews and Wright placed the check back in Matthews and Wright's possession. This ensured that the check would not

be cashed. The indictment filed in December 1987 alleges that an official and a consultant of Matthews and Wright took certain actions to falsely make it appear that \$398 million in bonds had been issued and sold on or by December 31, 1985 or August 31, 1986, to conceal the fact that the bonds were subject to certain provisions of the Tax Reform Act of 1986. It also states that further actions included a series of bogus paper transactions to make it appear that the Palauan bonds had been sold to the Commercial Bank of the Americas when in fact the individuals knew there was no substance, or real money, behind the transaction.

According to officials familiar with municipal bonds, tax-exempt status is critical to marketing such bonds and a bond counsel opinion regarding the tax status of the bonds is normally a part of the bond documentation. The Palau bond documents contain a letter from Palauan officials to Matthews and Wright and the bond counsel stating that Palau understood that the tax-exempt status of the bonds had not been determined as of the date of issue. The letter also stated that Palau planned to seek a decision from U.S. officials on the tax-exempt status.

Bank Board Members Did Not Understand Transaction

Members of the Board of Directors of the Palau National Development Bank told us that they were not aware of the bond issue until 2 days before it was signed. Palau's Attorney General and one of President Salii's advisors presented the bond papers to the board on August 26, 1986. Board members said that they never understood the transaction fully and were reluctant to sign a resolution authorizing the Bank's chairman to sign the bond papers. However, they eventually went along after the Bank's President decided to support the project.

Shortly after the bonds were issued, board members began reading in newspapers about allegations of wrongdoing by Matthews and Wright. Board members also realized that a housing project that was supposed to have been financed by the bond proceeds was not feasible and would not meet Palau's needs due to its location and high cost. The Board approved a resolution terminating the bond issue on September 28, 1987, about 2 months before an official and a consultant of Matthews and Wright were indicted. The Bank incurred no liability for the bonds because the checks for the \$398 million were never cashed and the Pittsburgh National Bank agreed to seek its fees for serving as trustee from Matthews and Wright.

Bank's Bond Issuing
Authority Unclear

On March 11, 1987, a group of Palauan citizens filed a lawsuit against the Palau National Development Banking Corporation and President Salii alleging, among other things, that the Bank exceeded its \$100-million authority by issuing bonds which totaled over \$398 million. Palau Public Law 1-27, which created the Palau National Development Banking Corporation, limits the Bank's outstanding obligations, including bonds, to \$100 million. The Bank's attorney stated in a letter to the Bank's accountant that the issue of whether the Bank exceeded its authority was unclear because the statute is ambiguous. The Palau Supreme Court did not rule on this issue because the case was dismissed by the court at the request of the parties.

Bonds Appear to Have
Exceeded Needs

Palau's First National Development Plan for 1987-91 is its official plan for economic development and capital improvements. During this period, Palau planned to undertake development projects estimated to cost \$94.74 million. Most of these projects were to be funded with compact funds or foreign assistance grants from the United States and other donor nations. The plan, which includes a section concerning the National Development Bank of Palau, does not mention or include plans for a bond issue.

Although the bond issue collapsed in September 1987, it could have adversely affected Palau's ability to carry out its economic development plan. In January 1987, Interior's Assistant Secretary for TIA wrote to the Department of Justice that bonds issued by Palau and other U.S. territories in the Pacific completely exceeded the "requirements of these islands. The ability to repay the bonds is, therefore, questionable." We did not find evidence that economic analyses were made before the bonds were issued to determine whether projects would generate sufficient revenue to pay off the bonds in 30 years.

Consistent with Interior's views, the indictment against an official and a consultant of Matthews and Wright, filed on December 10, 1987, charged that these officials inflated the bond issue to obtain fees and payments, specifically that they willfully and knowingly misrepresented that there was a need for issuing approximately \$400 million in bonds for undefined speculative purposes. In November 1988, the U.S. Attorney for Guam told us that the trial of these individuals is scheduled to occur in 1989.

U.S. Agencies' Actions

After learning about the bond issue in September 1987, the Assistant Secretary of Interior for TIA cautioned President Salii and notified U.S. government agencies of his concerns shortly afterward. Documentation we reviewed indicates that Interior shared information with federal agencies and cautioned Palau about potential problems throughout most of 1987. Specifically, after Palau requested Interior to support tax-exempt status for the bonds, Interior officials repeatedly requested bond documents from Palau and from Matthews and Wright. Upon receiving some of the documents after a long delay, Interior's Assistant Secretary for TIA found no justification for a tax exemption and urged Palau's President "to insist on a hard analysis of the economic viability of any projects and how they were to provide the financial return necessary to repay principal and interest on the bonds."

FBI officials told us that they did not make an independent investigation of Palau's bond issue because their authority to make such investigations in Palau is not clear. To their knowledge, no U.S. agency attempted to discourage the FBI from investigating the Palau bond issue. The FBI investigated Matthews and Wright transactions in Guam and Saipan, where their authority is clear.

The U.S. Attorney for Guam told us that because the Palau bond transaction used mail and wire services that passed through Guam, where the U.S. Attorney has jurisdiction, he is using Matthews and Wright activities in Palau as a basis for prosecuting an official and a consultant of the firm. A press release issued by the Department of Justice on December 10, 1987, indicates that the FBI and Interior's Inspector General provided support to a year-long federal grand jury investigation directed by the U.S. Attorney for Guam in obtaining information about bond issues in Guam, Saipan, and Palau. Thus, although the FBI did not initiate a comprehensive, independent investigation of the Palau bond issue, it assisted the U.S. Attorney for Guam in obtaining documentation on the bond issue. This is consistent with information provided by Palau National Development Bank board members, who told us that FBI officials took documentation on the bonds from their files.

U.S. officials told us that they were not aware of any bribes being paid to Palauan officials in connection with the bond issue. The U.S. Attorney for Guam stated that federal investigators attempted to determine if an American who served as an advisor to President Salii received a payoff in connection with the Palau bond issue, but no evidence of a payoff was found. Nonetheless, U.S. officials said they suspect that paying bribes was consistent with Matthews and Wright's method of operation. The

indictment filed on December 10, 1987, against an official and a consultant of the firm charged them with conspiracy to bribe and with bribing a former governor of Guam to get his support for a \$300-million Guam housing bond issued in 1985.

Power Plant Management Contract

On August 4, 1986, the government of Palau entered into a 5-year contract with Gorones International Construction Corporation to operate and maintain Palau's power plant. The contract, under which Palau was to pay Gorones \$550,000 during the first year, was not competitively bid. This did not violate Palau's competitive bidding law, however, which, according to a Palau Supreme Court decision, does not apply to service contracts. Nonetheless, we believe that Palau would have had greater assurance that the price it negotiated was reasonable if it had used competitive bidding. Palauan officials, including the Attorney General and House and Senate legal counsels agree that the law probably should be amended to require competition for large service contracts.

We also found that a Palauan legislator, although listed as an officer and stockholder of the firm, played no role in approving the contract and his financial interest in the firm does not appear to violate Palauan law.

No Formal Bids Were Solicited

Palauan officials stated that Palau did not solicit bids to manage the power plant but informally held discussions with several firms. We requested documentation on the process used to select a firm, but Palauan officials said no documentation was available. According to two Palauan officials, four to six firms made verbal offers. Gorones was selected because its offer was the lowest.

In 1987, two Palauan taxpayers sued the government of Palau, its President, and Gorones, alleging that the contract was not competitively bid and that this violated Palau's competitive bidding law (40 PNC 402). On December 8, 1987, the Trial Division of Palau's Supreme Court dismissed the action, stating that Palau's bidding law did not apply because the contract was a service contract.

Several Palauan officials, including Palau's current Attorney General and Senate legal counsel, believe that major service contracts such as this one should be subject to some form of competition and that Palau's bidding law should be changed to require competition for service contracts. Requiring competition for such contracts could help to ensure that Palau obtains the most cost effective services.

Palauan Delegate Listed as Stockholder and Officer

Gorones was incorporated in Palau on August 9, 1985, and was granted a 15-year business permit that year, according to a Gorones official. According to Palauan and Gorones officials, Gorones is affiliated with a family owned corporation named Aboitiz, which owns and operates a power plant in the Philippines similar to Palau's plant. According to a Gorones official, the firm had no other business contracts in Palau as of November 1988.

We could not determine the total amount of stock issued by Gorones or the amount issued to shareholders, because information in the firm's articles of incorporation and annual reports was not consistent.⁴ However, it appears from Gorones annual reports that two Palauans, one of them a member of the House of Delegates, may each hold at least 10 percent of the total capital stock of the corporation. The delegate is listed as vice president of the firm. In July 1987, speaking before the House Subcommittee on Insular and International Affairs, this delegate suggested that neither he nor his family members had a financial interest in the firm. However, in July 1988, in hearings before the same Subcommittee, he stated that he had invested \$20,000 in the firm and had received about \$12,000 in income from the firm thus far.

Neither the Palau Attorney General nor the House or Senate legal counsels were aware of any Palauan law prohibiting legislators from holding office and concurrently having a financial interest in a firm doing business with the government of Palau. In fact, these officials told us that it is common for legislators to own firms that do business with the government. In general, officials we spoke to do not perceive a problem with this practice, since contracting for routine services, such as operation of the power plant, is an executive branch function in which the legislature has no role. In the case of Gorones, it appears that the legislature did not play a role in approving the contract.

Interior's Role

Interior's Deputy Assistant Secretary for TIA told us that Interior has no information on the Gorones contract.

State Road Contracts

The Republic of Palau is divided into 16 states, each with a local government funded largely by the national government. In fiscal year 1987, the

⁴After attempting to resolve apparent discrepancies through discussions with Palauan and Gorones representatives in Palau, we wrote to Gorones' president in the Philippines, but received no response.

national government made block grants totaling about \$1.1 million to the 16 state governments.

During our fieldwork, we learned that four state governments had awarded contracts to Japanese companies to construct road or road and water systems at a total cost of at least \$25 million. According to a government official, the state governments do not have funds to pay for these contracts. Moreover, the roads were not included in Palau's 1987-91 economic development plan. Although both Presidents Remeliik and Salii signed letters of guarantee in conjunction with these projects, the national government's obligation to pay for these roads is unclear. Nevertheless, as a practical matter, it appears that the national government may have to find funds to pay for these state government roads in view of the states' lack of funds. This may preclude the national government from funding other high-priority projects identified in its national development plan.

Melekeok State Road and Water System Agreements

In 1984, Kawasho Corporation, a Japanese firm, contracted with the state government of Melekeok to build a 2.5-mile road and water distribution system for a price stated in Japanese yen. The contractor received assurance from the national government that it would be paid for its work. In July and August 1984, President Remeliik signed two letters in which the national government guaranteed, "unconditionally and irrevocably, as a primary obliger and not as a surety merely," payment of the unpaid principal and accrued interest on the contract.

In a memorandum dated January 27, 1986, Palau's Attorney General advised President Salii that, because the earlier guarantee could be construed as a contract, he believed President Remeliik had likely exceeded his authority by obligating government funds without obtaining the mandatory certification that funds were available and that the contract was probably void.

On January 31, 1986, President Salii signed another letter of guarantee for the same project. Although this agreement contained some of the same language as those signed by President Remeliik, it also stated that the "guarantee is conditioned and limited to the amount of funds from all sources appropriated by law to and for the account of the State of Melekeok which have not been disbursed as of this date."

The original contract price, including interest, was about one billion Japanese yen, or about \$4.52 million at the average 1984 dollar to yen

exchange rate. Additional work added \$441,196 to the price. The state government agreed to pay both amounts in installments beginning in September 1984 and continuing through December 1988. The installments were subject to fluctuations in the dollar to yen exchange rate. As of December 1987, the state had paid only about \$222,000. The contractor has completed the project and stated that his firm will wait until the national government receives compact funds to determine what actions to take next.

Other State Government Contracts

Between April and August 1986, President Salii signed letters of guarantee for the contractors of three other state government projects costing a total of about \$17.8 million. These letters do not appear to obligate national government funds to pay the contractors. They state that the national government guarantees that capital improvement funds from all sources which are to be paid to the respective state governments, including compact and local revenue funds, that had not been disbursed to the respective state governments as of the date of the guarantees would be paid directly to the contractors, if the state legislatures authorized such payments and legally assigned the funds to the contractor. During our second visit to Palau in November 1988, officials stated that they were not aware of any additional road contracts signed by states since our 1987 visit.

Contracts Not Included in National Development Plan

Several of the contracts specify that capital improvement funds, including the compact's capital improvement grant, may be used to repay the contractors. The United States will provide a one-time capital improvement grant upon compact implementation equal to \$36 million, which will be adjusted for inflation since 1981. If the compact is implemented in 1989, we estimate that Palau will receive at least \$46 million, including the inflation adjustment. The compact states that this grant, among other compact grants, shall be expended in accordance with an official national development plan promulgated by the government of Palau and concurred in by the United States prior to compact implementation.

We reviewed Palau's national development plan for 1987-91, which has been approved by the United States and will be updated to adjust for the delay in compact implementation, and found no mention that allocations would be made to state governments on the basis of existing contractual arrangements. According to the plan, less than \$26 million of the capital improvement grant has been scheduled to be expended within the first 5 years. Disbursements after the first 2 years may be

larger than scheduled to account for allotments to state governments, which by that time are expected to have individual development plans. The schedule of disbursements is \$4.4 million in the first year, \$3.7 million in the second year, and \$6.6 million in the fifth year. It is clear that the increases in planned disbursements will not be sufficient to liquidate the \$25 million owed to the contractors of the four state government projects.

One Palauan official expressed concern that the lack of funds to liquidate pre-compact debts and contractual commitments will cause Palau to divert compact funds designated for specific purposes, such as capital improvement, to debt service or liquidation without regard to development needs.

Interior's Role

Although Interior officials were aware that some states had signed road and sewer contracts, they were unable to provide us with specifics, such as how many states had entered into contracts and what the roads would cost. Interior officials stated that the lack of monitoring of these contracts was consistent with the Interior position that contracting authority had been delegated to Palau when its first constitutional government was installed in 1981.

Our review of Interior's files disclosed evidence of some Interior involvement in one of the four state road contracts after it was signed. However, this involvement appears to have occurred because Palau requested the High Commissioner to permit Interior capital improvement funds to be used to pay for a portion of the state of Melekeok's road project. It appears that Interior did not caution Palau about potential problems with the contract before receiving a letter from Palau after the contract was signed requesting U.S. funds to help pay for the project. On October 30, 1985, Interior denied Palau's request to use capital improvement funds to help pay for the project because the project was not competitively bid and capital improvement funds provided to Palau were subject to the free and open competition requirement of OMB Circular A-102. The High Commissioner's letter to President Salii states "I am sure you can see the risks inherent in a state contracting for substantial work to be done when there is no present funding available and when the source of funding is a mere expectancy." Interior's files contained no evidence that Interior monitored or provided cautionary advice to Palau with regard to the other three state road contracts.

The U.S. official comments on Palau's national development plan, transmitted to the U.S. Congress in December 1987, did not mention the state road projects' potential impediment to Palau's ability to achieve the plan's goals.

Contracts With Pacific Ventures

In October 1987, President Salii entered into two contracts with Pacific Ventures, Inc., whose incorporators included a former special assistant to the President and an Assistant Attorney General of Palau. One contract gave Pacific Ventures, Inc., the right to develop and prepare a plan for construction and leaseback of the national capital and the other designated the firm as Palau's exclusive agent for the production, promotion, and sales of coins and commemoratives. The President may have exceeded his authority by entering into the first contract, since Palau's Capital Relocation Commission was established by law to plan the relocation of Palau's capital and Commission members reportedly were not aware of the contract with Pacific Ventures, Inc. Also, the President did not seek OEK authorization to issue coins or commemoratives before entering into the contract for the production of coins. There is no evidence that competition was solicited for either contract.

These former officials' actions, although raising conflict-of-interest issues from a U.S. perspective, do not appear to have violated Palauan laws governing government officials' conduct. Palau does not have a criminal conflict-of-interest law. Its civil laws governing public employees contain broad conflict prohibitions, which generally prohibit salary supplementation for government work and limit outside employment when it would raise conflict problems. These laws, however, do not contain specific penalties for violation. Moreover, they exempt numerous classes of public employees, including officials appointed by the President with Senate consent, elected officials, persons appointed by the President or Vice President as chiefs of staff, special advisors and assistants, and certain contract employees. Palau does not have any statutes that establish bans on former government employees' activities.

Contract Terms

We were unable to obtain much information about these two contracts because President Salii was unwilling to discuss them with us during our December 1987 visit and other government officials said they were not aware of them. However, we obtained documents showing that Pacific Ventures, Inc., was incorporated on September 11, 1987, and entered into two agreements with the President of Palau on October 16, 1987.

In accordance with the first agreement, Pacific Ventures was given the “exclusive right to organize, develop and prepare a plan for the construction and leaseback of the national capital of the Republic of Palau.” The exclusive right was valid for one year, during which time Pacific Ventures was supposed to prepare a “proposal for such a construction and leaseback and upon future negotiations and agreement the parties shall execute a binding contract for the same.” The contract did not explain the relationship between the construction plan to be developed by Pacific Ventures and plans developed by Palau’s Capital Relocation Commission. The Commission was set up by the government of Palau in 1984 to plan the relocation of Palau’s capital from its present location to the state of Melekeok. On December 5, 1986, the Commission signed a contract with Architects Hawaii, Ltd., for planning, architectural, and engineering services for the project.

In November 1988, Palau’s Attorney General told us that the government of Palau had allowed the agreement with Pacific Ventures, Inc., to expire after one year. To his knowledge, no work was performed under the contract. He said that the Capital Relocation Commission did not approve the contract.

On October 16, 1987, the President signed a second agreement with Pacific Ventures appointing the firm “to be the Government’s sole and exclusive worldwide agent for the production, promotion, and sales of all legal tender coins, all other coins, commemeratives (sic), bullion, issues, medals and related items of the Republic of Palau,” including all coins commemorating the compact. On October 4, 1988, Palau’s Attorney General sent Pacific Ventures, Inc., a notice rescinding this agreement, which states that one of the bases for the rescission was

“Conflict of interest, or the appearance of such, if not undue influence, by virtue of the fact at the time of execution of this agreement, Michael Mirando, President, a director and subscribing shareholder of Pacific Ventures Inc., was an employee of the National Government of the Republic of Palau, Office of the President, and indeed, special legal assistant to the President....agreement is void as a matter of law as beyond the contracting authority of the President, the National Congress not then, or yet, having by law created or designated a national currency.”

Conflict-Of-Interest Issues
Regarding Firm's
President

Our review of government of Palau personnel records indicates that the president of Pacific Ventures, Inc. was on retainer as a consultant to President Salii when these two contracts were awarded and had resigned as a special assistant to President Salii and advisor to the Capitol Relocation Commission on August 21, 1987.

On September 30, 1987, the president of Pacific Ventures signed a consulting agreement wherein the Office of the President agreed to retain his services for one year on matters and issues relating to the compact. The agreement stated that he would have "an unencumbered right to work, secure and service clients, do business, act as a lawyer, make investments and do any other lawful business in Palau without hindrance or conflict of interest being at issue including providing his services to persons doing business with the Republic of Palau." While on retainer, he was to receive free housing and utilities, automobile transportation, \$250 per month, and government transportation and per diem when travel outside Palau was required.

Based on our review of Palauan laws regarding government officials' conduct, it does not appear that the conduct of the president of Pacific Ventures violated Palauan law. Nevertheless, the award of the national capital contract to Pacific Ventures, Inc., while he was serving concurrently as its president and as a consultant to President Salii and had been an advisor to the Capital Relocation Committee several months before the contract was signed raises conflict-of-interest problems.

Assistant Attorney
General Involved

Both contracts with Pacific Ventures, Inc., were "approved as to form" by an Assistant Attorney General of Palau, who was an incorporator of Pacific Ventures, Inc., and, at the time the contracts were signed, a member of its Board of Directors. He resigned from the Board on December 3, 1987. In mid-1988, he resigned from his position as Assistant Attorney General and is no longer a government employee.

Although we do not know this individual's financial interest in Pacific Ventures, his public involvement as an Assistant Attorney General in a matter involving an entity on which he served as a board member raises a conflict-of-interest concern. Moreover, it created a situation in which he could have used his position to benefit financially. It is possible that this conduct might have violated a Palauan civil conflict-of-interest statute broadly prohibiting activity incompatible with his position as a government employee. Nevertheless, it appears that this individual is exempt from coverage as a contract employee and, in any event, the

statute does not provide for penalties. This conduct would not appear to violate any Palauan criminal statute.

Interior's Role

Interior officials stated that they knew nothing about contracts between the government of Palau and Pacific Ventures, Inc., and were therefore not aware of any potential conflicts of interest.

Oil Company Supply Agreements and Loans

In November 1986, Palau entered into two 5-year contracts with Mobil Oil Micronesia, Inc., and Shell Company, Ltd., to supply Palau with fuel. The agreements granted both companies the right to supply a minimum of 750,000 gallons of oil per year. The contracts specified base prices for oil products and included formulas for adjusting the base prices in accordance with changes in mean Singapore cargo prices for these products. Each agreement contains a provision entitled "Security and Repayment" by which the oil companies each agreed to pay Palau \$1 million as "security for performance of obligations." The contracts state that the security deposits and 10-percent interest, or the maximum interest permitted by law if less than 10 percent, are to be repaid over the 5-year contract term by fuel add-on payments which shall be added to the price of the minimum annual quantities Palau is required to purchase each year.

We found no evidence that competitive bidding was used to award these contracts although Palauan law requires competitive bidding for goods exceeding \$5,000. Also, President Salii may have violated a provision in Palauan law that requires the President to inform the legislature of loan negotiations with private entities. Palauan officials, including the Attorney General and House and Senate legal counsels, agree that the security deposits discussed in the contracts were actually loans. Moreover, one of the two contracts did not include a certification as to the availability of funds as required by law.

Competitive Bidding Not Used

Palauan law (40 PNC 402) requires competitive bidding for procurement of construction, repair, or rebuilding projects; goods, commodities, and materials; and related services over \$5,000. The oil supply contracts with Mobil and Shell appear to have been subject to competitive bidding since the value of each exceeded \$5,000 and oil products appear to fall within the definition of "goods, commodities, and materials." However, we found no evidence that Palau used competitive bidding.

A former Palauan official told us that competitive bidding was not used because Palau was experiencing cash flow problems and severely needed funds to meet payroll costs. When Mobil and Shell offered to loan funds to Palau by providing security deposits in exchange for exclusive rights to supply oil, Palauan officials had not identified other alternatives for resolving their financial problems and accepted the offer. Both firms originally wanted to be the exclusive supplier, but a compromise was reached whereby each company agreed to supply half of Palau's oil needs. Because other oil companies probably would have been unwilling to agree to such an unusual arrangement, competitive bidding was not considered, according to one official.

President Did Not Notify Legislature of Loan

Palauan officials agree that the security deposits discussed in the contracts with Mobil and Shell were actually loans. Proceeds from both loans were deposited in Palau's general fund and the loans are being repaid through fuel surcharges of \$.343 per gallon for the first 750,000 gallons of oil purchased each year from both companies. Documents provided by Palau's Director of the National Treasury indicate that as of November 15, 1988, Palau had repaid \$297,235 to Mobil and \$537,132 to Shell.

Palauan law (40 PNC 504) authorizes the President, on behalf of the Republic of Palau, to borrow up to \$35 million from private persons without legislative approval. Palau's Senate legal counsel agreed that President Salii appears to have had authority to borrow funds from Mobil and Shell, but stated that Salii may have violated a provision in the law that requires the OEK to be informed of loans prior to their execution. Several legislators told us that the OEK was not aware of the loan agreements with Mobil and Shell until after they were signed.

Palauan officials informed us that proceeds from the loans were used to meet payroll expenses. Senate and House legal counsels stated that if the security deposit proceeds were not reflected in Palau's budget and were not appropriated, the executive branch's expenditure of these funds may have been illegal. However, Palau's Attorney General believes that the expenditure probably was legal if the proceeds were used for payroll expenses included in the budget and appropriated by the legislature.

Availability of Funds Not Certified

Palauan law (40 PNC 401) requires the Director of Program, Budget, and Management to certify that funds are available before contracts are executed. The Mobil contract included a certification of funds availability but the Shell contract did not. The Minister of Administration stated that this was an unintentional oversight and that funds were actually available to comply with the contract's minimum purchase requirements. Palau's Attorney General and the Senate legal counsel agreed that if funds were available and an oversight occurred, the lack of certification would not warrant further concern or action. According to the House legal counsel, certification of funds availability is implied when bills are approved for payment.

Interior's Role

Interior officials had no information about Palau's contracts with Mobil and Shell. Therefore, they were unaware that the contracts potentially violated provisions of Palauan law requiring competitive bidding, prior certification of funds availability, and legislative notification of loan negotiations.

Lease and Renovations to House Occupied by President Salii

In November 1985, the Republic of Palau began leasing from a Palauan citizen a house occupied by President Lazarus Salii from November 1985 until his death in August 1988. The government of Palau initially spent over \$90,000 renovating the property. In January 1987, President Salii contributed \$20,000 toward the cost of these renovations. According to a Department of Public Works official, the renovations consisted primarily of changing the interior layout and extending the front of the house and were not for security purposes.

We were unable to answer many questions about the lease and renovations because documentation was insufficient. However, documentation we reviewed raised numerous questions about the propriety of government expenditures to lease and renovate this house. We believe these matters are serious enough to warrant further investigation by Palau's public auditor. Also, Palau's housing policy, although recently amended, does not adequately describe (1) the type of housing that Palau's President and other officials are entitled to and (2) the extent to which government funds may be used to renovate property leased by the government.

Questions Remain About Who Owns Property

An April 10, 1986, memorandum from Palau's Assistant Attorney General indicates that, although the government began paying rent on the house in November 1985, government officials may not have signed the lease until April 1986. The 2-year lease⁵ between a Palauan citizen and the Republic of Palau describes a parcel of real property, together with existing improvements, which the lessor claimed to own in fee simple. Rent was established at \$750 per month. In June 1986, the lease was amended to extend the term through November 1, 1990 with a one-year option to extend the lease through November 1, 1991.

In February 1987, a Palauan taxpayer filed suit against President Sali and Palau's former Attorney General, alleging that President Sali, without budgetary authorization and appropriation, illegally expended public funds to renovate and improve his property. These allegations were not resolved by the court because the suit was amicably settled and the case dismissed on October 5, 1987, without costs in favor or against either party.

We obtained documentation that raises questions about ownership of the house. Specifically, in 1974 Lazarus Sali signed a 20-year land lease for the parcel of land identified in the lease between the government and the Palauan citizen. The lease was for land that was owned by the TPI and is now owned by the State of Koror. Files in the Koror State land records office show that Lazarus Sali paid the land lease until November 1985, when the government of Palau began renting the house and land from a Palauan citizen. The records indicate that no lease payments for the land have been made since that date.

In December 1987, the lessor told us that she purchased the house on this parcel of land from Lazarus Sali in 1982 for \$35,000. She said that she lost the bill of sale and does not have a title to the property. Palau's Attorney General told us that recording sales is common practice in Palau. Moreover, Palau's Supreme Court Chief Justice stated that it would be very unusual for no record of a house sale to exist in government records. Our review of records maintained by the Clerk of the Court and the Palau Bureau of Lands and Surveys disclosed no record of sale or title.

Although the lessor signed a lease addendum on June 17, 1986, President Sali and the lessor's husband signed a letter to the Koror State government on March 6, 1986, stating that, by agreement between the

⁵The lease also included an option to extend the lease for one additional year.

lessor, her husband, and Lazarus Salii, the building was being sold back to President Salii and a partial payment had already been made. The letter asked that the building permit for the renovations of the house be issued under Salii's name because of the impending sale. The permit, issued in March 1986, shows Lazarus Salii as owner.

If Salii owned the house at any time during the lease period, the lessor's acceptance of rent payments for a house she no longer owned would have been improper and potentially fraudulent.

Issues Surrounding Renovations

Records provided by Palau's Department of Public Works indicate that renovations cost over \$90,000. The Director of Public Works said his department paid for the work with appropriated funds and that it purchased materials through its regular supply channels. Department records indicate that Palau paid over \$71,000, or almost 80 percent of the project's cost, to one local business for materials and labor. President Salii contributed \$20,000 toward the cost of these renovations.

The Senate and House legal counsels believe that the Department of Public Work's expenditure of funds for the renovations is questionable, even if appropriated funds were used. However, they did not cite a specific law that such actions potentially violated. Palau's Attorney General believes the expenditure of funds was legal, assuming appropriated funds were used.

Housing Guidelines Inadequate

Palau's housing policy does not provide specific guidance on what type of housing the President and other government officials are entitled to and the extent to which government funds can be used to pay for renovations to private property leased for these officials. An executive order dated January 17, 1983, provides a monthly living quarters allowance for government employees whose contracts include housing but does not state that the President is entitled to housing. A new executive order, effective October 1, 1988, states that official residences for Palau's President and Vice President will be provided rent-free as a matter of policy, but it does not include guidelines on the type of housing to be provided or the extent to which government funds may be used for renovating leased property.

Irrespective of who owns the house, it appears that the government of Palau probably will not receive any permanent benefit from approximately \$70,000 spent on renovations, since it does not own the house. In

view of Palau's limited resources, we believe the government of Palau should consider whether \$70,000 is a reasonable sum to spend for improvements that will revert to a private owner upon expiration of the government's lease. Palauan officials could avoid similar problems in the future by developing housing regulations that include specific standards on the scope of permissible renovations to leased property.

Interior's Role

Interior officials had no information on the lease agreement or expenditure of funds to renovate the house occupied by President Sali.

International Airport Contracts

In 1986 and 1987, the government of Palau entered into three agreements involving plans to construct a new international airport. One contract involved an airport feasibility study while the other two were related to construction and engineering services. The feasibility study contract, which may have obligated Palau to pay \$1.2 million to a Japanese firm, did not include a certification of funds availability as required by law. Moreover, although Palau's constitution grants the OEK authority to regulate the ownership, exploration, and exploitation of Palau's natural resources, the executive branch did not obtain legislative authorization for the construction agreement. To the extent that this agreement provided for use or transformation of Palau's natural resources, entering into it without legislative approval could have violated this provision.

Contract for Feasibility Study

On November 4, 1986, President Sali signed a contract with C. Itoh and Company, Ltd., whereby C. Itoh and its subcontractor, Japan Airport Consultants, agreed to make an airport feasibility study at a cost of \$1.2 million. The contract stated that Palau would pay for the study through a loan or other funds from the National Development Bank of Palau and that this would be the only method of payment. However, the President also signed a letter of confirmation stating that the government "shall not be relieved of our payment obligation by reason of impossibility of our finance arrangement from the National Development Bank of Palau."

According to the Bank's attorney, the National Development Bank of Palau does not have sufficient assets to provide a \$1.2-million loan and it is doubtful that this type of project would have met the bank's criteria for loaning funds. The lawyer was not aware of any effort by President

Salii or other executive branch officials to obtain the bank's approval of a loan to pay for the feasibility study.

On August 27, 1987, C. Itoh submitted the feasibility study. It examined several alternative sites for constructing a new airport and improving the existing one and recommended that a new airport be built in the center of Babelthup on land belonging to three states. According to one former Palauan official involved in negotiations with C. Itoh, the firm hoped to obtain a follow-on contract to build the airport and therefore did not insist on being paid for the feasibility study immediately after its completion. However, President Salii signed a broad agreement with another firm in late 1987 and, although C. Itoh was awarded a follow-on contract for engineering services, the company's officials became upset when the project collapsed in 1988. Palau was supposed to pay C. Itoh for the study on February 23, 1988. On July 20, 1988, C. Itoh sent a cable to President Salii requesting that Palau pay \$1.2 million owed for the feasibility study without further delay.

As of November 1988, Palau had not paid C. Itoh for the study. Palau's Attorney General stated that Palau may be obligated to pay all or part of this amount because C. Itoh completed the study and therefore may be entitled to compensation even though certain aspects of the contract appear to have been illegal. The Attorney General stated that he planned to study this matter further and discuss it with Palau's President.

Our review of this contract disclosed that it did not include a certification of funds availability. Palau's Attorney General agreed that the contract did not comply with Palauan law in this regard.

Follow-On Contracts

On October 23, 1987, Palau entered into an agreement with CIC International, Ltd., a U.S. firm, and Howa Company, Ltd., a Japanese firm, to construct a new international airport and an agreement with Japan Airport Consultants to prepare surveys, designs, and bid documents and supervise airport construction. Palau agreed to pay Japan Airport Consultants \$4.46 million for its services and expenses according to a schedule included in the agreement. In consideration for a nominal sum of \$10, CIC (1) was granted the right, with the approval of the government of Palau and Howa Company, Ltd., to select the owners and operators of hotels to be built to attract increased tourism traffic to Palau, (2) agreed to assume the costs of constructing and managing the airport in exchange for 84 percent of the airport revenues until it recouped its

costs, and (3) agreed that, if it recouped its costs plus a sum equal to 10 percent of any profits derived up to the point of repayment, it would transfer ownership of the airport to Palau for \$10 and would have the right to manage the airport for the remainder of a 25-year period for 14 percent of airport operating profits.

Palau's Attorney General told us that he had a number of concerns about the legality of the agreement, especially the provisions which appeared to grant tourism development rights. However, when he raised these concerns, a special assistant to President Salii told him that he "would be history" if he did not sign it. On October 9, 1987, the Attorney General wrote a memo to President Salii outlining his concerns about the agreement's legality, but shortly thereafter he went off-island to receive medical treatment, and an Assistant Attorney General signed the agreement during his absence.

The Attorney General's October 9, 1987, memo stated that construction pursuant to this contract would have to be competitively bid unless an OEK waiver was obtained. However, Palauan officials told us that this agreement was awarded noncompetitively.

On September 22, 1988, Palau's Attorney General sent CIC and Howa a notice of cancellation of agreement, citing CIC's failure to advance funds to defray the cost of a consultant to undertake architectural engineering, designs, and specifications. The president of CIC objected to the termination notice, stating that his firm had spent considerable funds on items, such as architectural and engineering services. The Attorney General disputed this claim and, as of November 1988, Palau had not sent or received any further correspondence. According to an Attorney General memorandum dated October 21, 1988, the follow-on contract with Japan Airport Consultants for engineering services died of its own weight when CIC failed to make the first payment to that firm. Palau's Attorney General believes this contract was legal, since CIC, not the government of Palau, was supposed to pay for Japan Airport Consultants' services.

Interior's Role

Interior officials hired a consultant to complete a study identifying deficiencies in Palau's existing airport runway and became aware of agreements signed by President Salii to plan and construct a new airport after the agreements were signed. We found no evidence that Interior analyzed the agreements or expressed concerns to Palauan officials about potential problems with these contracts.

others in custody. Although the Palau constitution mandates that accused prisoners must be separated from convicted criminals and separated according to age and sex, current space limitations and the configuration of the facility do not permit these separations. Offenders are occasionally housed in the hospital because of medical conditions, including psychiatric problems, or because of the need to separate the sexes, thereby putting a strain on the hospital staff.

According to the Minister of Justice, Palauan court action was taken in 1983 to declare the prison unfit because of overcrowding and unsanitary conditions, and the prison was still under court review in 1987. The Minister emphasized that the prison continues to deteriorate despite some renovations and repairs. In October 1988, TTPI approved a \$100,000 capital improvement grant for renovating the prison, and a May 1989 compact subsidiary agreement between the United States and Palau provides for an additional \$800,000 to improve the prison facility.

The Attorney General, Bureau of Legal Affairs, is responsible for prosecuting criminal and civil cases; rendering legal services to executive branch agencies; and drafting and reviewing government contracts, corporate documents, and legislation. Within the Bureau, the Division of Immigration and Customs is responsible for enforcing immigration and naturalization laws; processing passports and visas; and inspecting passengers, aircraft, and vessels arriving or departing Palau. However, this Division had no customs officers as of November 1988. Instead, tax and revenue officials and agricultural inspectors made baggage checks. They were not trained to search for narcotics and did not have authority to make arrests. Also, police officers present at Palau's airport for incoming flights did not have authority to open and inspect personal belongings of passengers and cargo without search warrants or probable cause, according to Palau's Public Safety Director.

The Director expressed the opinion that staffing the Customs Division with appropriately trained personnel would help to deter illegal imports, notably drugs and firearms. Palau law enforcement officials said that the customs positions are authorized but have never been funded. According to a subsidiary agreement which was signed on May 26, 1989, and will become effective upon compact implementation, (1) the United States will provide Palau with up to \$400,000 annually for 5 years for narcotics enforcement treatment programs, and (2) Palau will employ customs officers who will be trained and equipped to detect narcotics.

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Also, the public defender position has not been filled since 1983. The public defender is responsible for providing criminal defense to all needy persons who cannot afford the services of a private attorney.

Criminal Investigations

Opponents of the Compact of Free Association alleged that Palauan law enforcement officials have not conducted adequate investigations of the 1985 assassination of President Remeliik and crimes allegedly directed at them. We were specifically asked to review the assassination investigation and the functioning of Palau's law enforcement system with respect to alleged compact related violence. We reviewed investigations of the assassination and four violent acts that occurred shortly before a Palau Supreme Court hearing scheduled to consider the constitutionality of the compact implementation process

1. the September 6, 1987, shooting at the private residence of the Speaker of Palau's House of Delegates.
2. the September 7, 1987, murder of an anti-compact activist's father.
3. the September 7, 1987, explosion of a firebomb in the front yard of one of the women participating in the anti-compact lawsuit.
4. the September 7, 1987, arson at a local club.

We found that public safety officials demonstrated a basic understanding of investigative techniques. They visited the scenes of the crimes, interviewed witnesses, and collected evidence in all five cases. But FBI and/or Interior officials provided assistance in three of the cases. These three investigations involved murder or firearms, were politically sensitive, posed the potential for creating conflict between police procedures and cultural norms, and required more advanced investigative techniques. As discussed in Chapter 5 of our overview report, FBI and Interior officials believe that Palau law enforcement officials rely on U.S. assistance in these more complex cases.

Assassination of President Remeliik

In 1986, three individuals were convicted of the 1985 assassination of President Remeliik. The convictions were based on the testimony of witnesses, police identification of one suspect for a curfew violation¹ on the night of the assassination, and FBI ballistics analyses. The trial court's conviction was overturned by the Palau Supreme Court Appellate Division in July 1987, based on a finding that the evidence was insufficient to sustain the conviction. The three convicted men were released.

Our review showed that Palau officials followed reasonable procedures in identifying suspects, collecting evidence, and obtaining witnesses' testimony with U.S. assistance. In this case, they were assisted by the TTPI government and the FBI. The FBI did not take a lead role in the investigation, but it assigned two investigators to serve as advisors and it provided laboratory analyses and polygraph examinations. Subsequently, congressional concern was expressed regarding the FBI's role in this investigation and the fact that the accused were not afforded trial by jury. The American Civil Liberties Union also questioned the trial proceedings and the reliability and substance of the evidence used as the basis for conviction. However, Palau's Attorney General believes the investigation was adequate.

After the conviction was overturned, the government petitioned the TTPI High Court to review the case. On April 14, 1988, the Chief Justice, TTPI High Court, dismissed Palau's petition for writ of certiorari² on the grounds that the TTPI lacks jurisdiction to review the case. During our November 1988 visit, Palau's Attorney General said that he had not received any new evidence reliable enough to warrant action, so the assassination remains unsolved.³

Shooting at Residence of House Speaker

On October 29, 1987, three government employees were arrested and charged with attempted murder, aggravated assault, weapons violation, and other violations in connection with shots fired on September 6,

¹According to Palauan officials, Koror, the location of Palau's current capital, imposes a 12 midnight to 6 a.m. curfew. Since Koror state does not have its own police force, Palau's national police enforce the curfew.

²A writ of certiorari is a writ issued by a superior court to an inferior court of record requiring the certification and return of the record and proceedings so that the record may be reviewed and corrected in matters of law.

³Since our visit, the Australian Broadcasting Company aired two segments of its program, Background Briefing, which purportedly contained new information on the assassination. We did not conduct an investigation into the assassination and therefore have no information on the veracity of the information.

1987, at the House Speaker's residence from a moving vehicle. According to a court affidavit filed by a Palauan public safety official, an officer had stopped the three suspects driving a red sedan without a license plate a few minutes prior to the shooting. A witness to the shooting said the shots originated from a similar vehicle.

During the investigation, Interior's Law Enforcement Coordinator provided investigatory advice and assistance. The Coordinator said that public safety officers relied on his assistance to ensure that the necessary arrest paperwork and proper procedures were followed. The FBI provided ballistics analyses for both the drive-by shooting and the murder of an anti-compact activist's father the next day; however the results did not link the two crimes. During the trial, Palau's Attorney General subpoenaed FBI agents to testify but they did not do so because the FBI questioned the need for testimony on the test results, according to an FBI official.

It has been alleged that Palau law enforcement officers were reluctant to interview one of the three suspects, who was a special assistant to President Salii and that President Salii interceded on his behalf. In an October 22, 1987, letter to Interior, President Salii defended his assistant, explaining that the suspect was talking to two police officers across town at the time of the shooting. However, according to the Coordinator, the President instructed him to bring the suspects to justice, regardless of their identities.

In early February 1988, the Palau Supreme Court Trial Division found the three men guilty on three counts: (1) unlawful use and possession of a firearm, (2) unlawful use and possession of ammunition, and (3) riot. On February 26, 1988, they were sentenced to serve 15 years on the first count and received lesser sentences on the other counts. The three appealed their convictions on the same day and were out on bail pending appeal as of June 1989. An attorney for one of the men told us that he is using the FBI's failure to testify as one of two bases for appeal.

Murder of Anti-Compact Activist's Father

Bureau of Public Safety officials have not yet solved the murder of a compact opponent's father. The murder occurred during an unscheduled power outage on September 7, 1987, the weekend prior to a court hearing scheduled to determine the constitutionality of the compact approval process. This investigation is politically sensitive, because it appears to be compact related and it required extensive questioning of government workers furloughed due to Palau's financial crisis. At the

time of our 1988 visit to Palau, no public safety officers were assigned to the case. While working on the drive-by shooting investigation, Interior's Law Enforcement Coordinator helped public safety officers find an eyewitness to the murder, interviewed the son of the victim, reviewed evidence, and suggested additional individuals for questioning.

Both Palau and Interior officials requested investigatory assistance from the FBI. The FBI provided ballistics analyses and searched for fingerprints on a recovered shell casing, but it did not provide investigative assistance due to uncertainty over the type and level of assistance the FBI can provide to Palau.

Palau's public safety officers have taken some action, according to both Palau's Attorney General and Interior's Law Enforcement Coordinator, but are not pursuing this investigation aggressively enough. A witness to the investigation at the scene of the crime said that criminal investigators took measurements of the law office where the shooting occurred and drew sketches on the morning following the shooting. Records we reviewed indicate that 71 individuals were interviewed between September 1987 and April 1988, including neighbors and furloughed workers. According to the Public Safety Director, two officers investigated the case full time until he was forced to reassign them due to funding and manpower shortages caused, in part, by the need to provide 24-hour security for two of the Presidential candidates until after the November 3, 1988, election. In a memo to the Minister of Justice, the Attorney General described the investigation as "half-hearted" and lacking coordination and direction. We found that as of November 1988, public safety officials had not yet questioned the prime suspects, although the Attorney General asked them in writing to do so.

Attempted Arson and Explosion

Palau's Attorney General stated that Palau law enforcement officials had not identified any suspects in the September 7, 1987 attempted arson that occurred at a local club or the explosion in a field near the home of one of the women plaintiffs in a lawsuit challenging the constitutionality of the most recent compact approval process. Palauan law enforcement officials visited the scene of both crimes that evening and prepared reports on the incidents. The Attorney General stated that in the absence of eyewitnesses to these crimes, officials can do little to investigate them.

Drug Enforcement

Although the magnitude of Palau's drug problem is small compared with that in more densely populated parts of the world and known centers for drug trafficking, the presence of even a small quantity of illegal drugs can have a negative impact on Palau due to its small, closely knit culture. Palau has created a narcotics task force, but officers are hindered by a lack of resources and experience.

Extent of Palau's Drug Problem

Officials' views on the seriousness and magnitude of Palau's drug problem varied. Although the DEA Administrator estimated in an October 1987 letter that there were over 400 heroin addicts in Palau and that it was a transshipment point for heroin smuggled from Southeast Asia to the United States, DEA officials we interviewed in 1988 maintained that the amount of heroin transshipped through Palau is small relative to the overall U.S. drug problem and DEA and Palau officials stated that 400 addicts is too high an estimate.

Heroin is not produced in Palau, but marijuana is grown there and is readily available. DEA officials could not estimate the volume of marijuana exported from Palau. The likelihood of drug transshipment through Palau to the United States is limited by the lack of direct flights to the United States, according to DEA agents. Although commercial flights link Palau to Guam, Manila and Yap, there are no direct flights from Palau to Hawaii or the U.S. mainland. Baggage and cargo must pass through inspections in Guam. Statistics provided by a Guam Customs official indicate that seizures of both marijuana and heroin coming from Palau significantly decreased from 1987 to 1988. In fiscal year 1987, Guam Customs made 39 seizures totaling 448 pounds of marijuana and 3 seizures totaling 7 ounces of heroin. In fiscal year 1988, Guam Customs made 16 seizures totaling 103 pounds of marijuana, with only 5 pounds seized from January through September 1988. No heroin was seized in fiscal year 1988.

Heroin use in Palau fluctuates depending on availability, according to Palau's Attorney General. A World Health Organization consultant reported in September 1987 that more than 100 people in Palau use heroin on a semi-regular basis. According to a DEA field agent, Palau's public safety and public health officials estimated that there were 100 to 150 heroin addicts in Palau in November 1987. One year later, the same officials told us the availability of heroin had decreased in 1988 and estimated that there were 40 to 60 heroin addicts in Palau. Officials based their revised estimates on the number of addicts seeking treatment for withdrawal, the decreased number of burglaries associated

with drug use, less traffic at known distribution sites, and information provided by regular sources.

Palau's Public Health Director documented a total of 63 individuals treated for heroin abuse by the public health facility from 1974 to 1988; 50 of these cases were first treated in 1987 and only 3 in 1988 as of November. No new cases had been treated since February 1988.

In November 1988, U.S. and Palau officials said they believed that heroin traffickers had temporarily halted activity or were bypassing Palau. These officials offered varying reasons for this change, including increased scrutiny by federal agencies during compact implementation discussions and efforts by Palau's recently formed narcotics task force. The Assistant U.S. Attorney for Guam said that in order to continue to restrict the presence of heroin in Palau, law enforcement officials must maintain constant pressure on traffickers.

Palauan Efforts to Address the Drug Problem

In March 1987, Palau created a special four-man narcotics task force and subsequently added two undercover officers. Palau's Public Safety Director believes that the actions of the task force contributed to the recent reduced availability of heroin. However, although task force officers have been actively pursuing cases, their effectiveness is constrained by lack of resources, inexperienced officers, and cultural factors. For example, elements from Palau's traditional culture, such as clan chiefs, are still a factor in Palauan society. If a chief were involved in an illegal activity, a public safety officer may be reluctant to enforce the law. Also, because of Palau's small size and closely knit family structure, public safety officers may be faced with arresting a family member or friend for a narcotics violation. The DEA agent in Guam said the undercover officers had very little training and no public safety experience. Also, Palau has not hired trained customs officers who could be posted at the airport and restrict the flow of drugs into Palau.

According to informal records, the task force initiated 37 investigations during 1987 and 1988; 18 cases involved very small quantities of heroin. All but 2 of the 19 marijuana cases involved very small quantities of plants or pre-rolled cigarettes.

Of the 37 investigations, 22 are still pending. Palau's Attorney General requires evidence from two buys before he will prosecute a case, and the Public Safety Director said that heroin is now so scarce in Palau that it is difficult to arrange a buy.

We found incomplete and sometimes conflicting documentation on the status of the remaining 15 cases. From available documentation in November 1988, it appeared that only 2 cases had resulted in convictions, and one was scheduled for trial. Four cases were pending trial until drug test results are completed in Guam because Palau does not have a drug testing lab. Test results can be delayed for 3 to 4 months and cases have been dismissed without prejudice pending receipt of lab results. Finally, we found numerous discrepancies between the Bureau of Public Safety and Attorney General records in the remaining 8 cases, including 2 that were lost in the referral process. Three cases remained with or were returned to the task force due to insufficient or poorly controlled evidence. Interior's Law Enforcement Coordinator said that inadequate documentation and poor collection and preservation of evidence jeopardize task force arrests.

The Interior funded Public Safety Advisor is aware of the recordkeeping problems resulting in lost cases and contradictions between departments and has proposed an automated system linking the Bureau of Public Safety with the Attorney General and judiciary. The Bureau, with the assistance of the Public Safety Advisor, submitted a technical assistance grant proposal to Interior in September 1988 for funding to purchase computer hardware and software to improve recordkeeping systems.

In July 1988, public safety officers conducted a marijuana eradication raid on the islands of Peleliu and Ngerchong. The Public Safety Director estimated that more than \$3 million worth of marijuana was seized.

In April 1988, 10 Palau agencies sponsored a drug free awareness forum. Representatives from a cross-section of organizations, including the Bureaus of Public Safety and Education and the Ministry of Social Services, met to discuss local strategies to control the use of alcohol and drugs.

U.S. Agencies' Roles

The Micronesian Public Safety Academy, funded in part by Interior, provides training in narcotics and controlled substances for new public safety recruits. The DEA regularly participates in this training. Interior also allocated \$125,000 in technical assistance funds for an anti-drug program for Palau and the freely associated states. This program included a 3-week training course for public safety officers, a public education component, and funds if needed for DEA participation.

The Anti-Drug Abuse Act of 1988 authorizes \$500,000 annually for grants to Palau to be spent in accordance with a plan approved by the Secretary of the Interior in consultation with the Attorney General and the Secretaries of Education, State, and Health and Human Services. As previously mentioned, in the May 1989 subsidiary agreement, the United States agreed to provide Palau with up to \$400,000 annually for 5 years for drug enforcement and treatment programs.

DEA's Guam field office is responsible for Palau. According to DEA officials, over the past 5 years, the number of DEA agents assigned to Guam has decreased from about five to one. This decrease is based on arrest statistics and other information about the seriousness of the drug problem in the area. DEA officials said they investigate only those drug cases that involve transshipment and reach beyond Palau. The DEA agent in Guam told us that he is unable to do any undercover work in Palau because he works alone and is highly visible. He can, however, request help from the DEA in Los Angeles and Honolulu. The U.S. Attorney for Guam expressed the view that the DEA presence in the area is inadequate because working without any back-up increases the danger to the DEA agent, and although the quantity of illegal drugs in Micronesia may be small compared to larger cities, the relative impact is equally serious due to its small population.

The DEA assisted Palau in a marijuana eradication effort in 1983. On July 11, 1989, DEA agents from Guam and Honolulu, with assistance from other U.S. and Guam law enforcement agencies, arrested 13 persons in Palau on charges related to heroin and marijuana transshipment and distribution, according to the DEA agent in Guam. Among those arrested were the three men who were convicted in 1986 of the assassination of Palau's first President and whose convictions were overturned in 1987. Also, two of those arrested are former Palau legislators.

FBI agents in Guam have not worked drug cases on their own or with the Guam DEA agent on matters related to Palau due to uncertainty about the nature and type of assistance the FBI can provide there, according to FBI and DEA agents. According to FBI headquarters, FBI policy is to pursue only those investigations involving major drug organizations.

Arms Trafficking and Possession

U.S. and Palau officials have found no evidence of firearms transshipment through Palau. Possession of firearms is generally prohibited by Palau's constitution and code, but criminal acts involving firearms indicate that guns and ammunition are present in Palau.

Palau's constitution and national code establish penalties for firearms violations. Article XIII, section 12 of the constitution states that no persons except armed forces personnel and law enforcement officers acting in an official capacity shall have the right to possess firearms unless authorized by legislation that is approved in a nationwide election by a majority of voters. It also directs the OEK to enact legislation requiring mandatory minimum imprisonment of 15 years for firearms violations. In accordance with the constitution, Palau's National Code (17 PNC 3306) forbids the importation, manufacture, possession, and use of firearms and requires a fine of not more than \$5,000 and a mandatory sentence of not less than 15 years. However a November 13, 1984, Palau Supreme Court decision declared the 15-year mandatory sentence for firearms possession in conflict with the trusteeship agreement.

Reported crimes involving firearms and data on individuals charged with possession or use of firearms demonstrate that firearms are available to Palauans. Although the records in the Bureau of Public Safety and Attorney General's office were incomplete or inconsistent in recording procedures, it appears that in 1987 the Bureau of Public Safety received 40 reports of criminal acts involving the possession and use or importation of ammunition and firearms. In 1988, 10 such crimes were reported from January through September.

Records at the Attorney General's office for 1987 and 1988 list three individuals convicted of possession of firearms or ammunition and one of ammunition importation. All four offenders were sentenced to 5 years in prison, the sentences were suspended, and they were then fined. The records show five additional pending cases involving ammunition or firearm possession. As of November 1988, three individuals were in prison for murder, manslaughter, or attempted murder with a firearm.

The plan of action developed by Palau's Public Safety Advisor calls for the disposition of weapons collected under Palau's National Firearms Control Act either by destruction or sale to an authorized buyer. This act mandated that all persons surrender their firearms to the President or his representative. According to the Public Safety Director, 300 firearms were surrendered.

Palau has no major arms trafficking problems, according to the Public Safety Director. Most seizures involve small caliber firearms and small amounts of ammunition. In the Director's July and August 1987 monthly reports, he expressed concern over increased imports of illegal firearms

and ammunition, although the quantity remained small. He believes firearms are brought into Palau from Guam.

Palau's Attorney General is authorized to permit the import and possession of firearms, according to a former Palau Attorney General. We reviewed one instance in which this former Attorney General exercised this authority. On January 15, 1987, an Australian citizen applied for a foreign business permit to operate a commercial air charter company in Palau. According to the application, the company's aircraft could also be used for emergency transportation to the more remote islands. The aircraft under discussion could travel over 3,000 miles without refueling, according to the Foreign Investment Board Chairman.

On January 16, 1987, this former Attorney General, acting in an official capacity at the time, authorized the Australian citizen to import a .50-caliber machinegun, ammunition, and up to 12 rockets. According to this official, the weapons were to be used to arm a Palauan marine patrol vessel used to patrol Palau's borders and to interdict foreign vessels fishing illegally in Palauan waters.

The Foreign Investment Board approved the business permit request on March 19, 1987, and President Salii signed the permit on March 31. There were allegations that President Salii vouched for the character of the permit applicant. According to the Board chairman, the President did not try to influence the Board's decisions. However, while reviewing the permit application, the Board asked the applicant to attend a meeting to discuss his proposal. The Attorney General attended instead and spoke on behalf of the applicant.

In late April 1987, the Australian citizen was arrested in the Philippines for gun running and drug trafficking and was subsequently deported. According to the former Attorney General, the individual did not return to Palau and did not deliver the weapons.

There were also allegations that Palau approved the business permit after the State Department notified Palau officials that the individual was alleged to be involved in illegal activities. However, according to a State Department official, State notified Palau's Attorney General on June 24, 1987, well after the application had been approved and after the applicant was arrested and deported from the Philippines. The application expired 120 days from approval due to a lack of business activity.

Counterfeiting Activity

Palau's small private sector economy probably could not support large-scale counterfeiting activity, according to Palau's Attorney General. Because of the small population, almost anyone passing \$50 and \$100 bills would attract attention. The Secret Service has a record of 37 counterfeit notes passed in Palau during 1987 and 1988. Secret Service field agents said this level of counterfeiting activity is insignificant compared with that in other areas. Also, by analyzing design defects and circular numbers, agents know that most notes originated in the Philippines and none were made in Palau.

The Secret Service and Palau law enforcement officials have worked together cooperatively on counterfeiting cases. Although Secret Service and Palau law enforcement officials agree that the Secret Service does not have authority to conduct investigations in Palau, the Secret Service has provided Palau with technical assistance, such as laboratory analyses and expert testimony.

Of the 37 counterfeit notes circulated in Palau, 16 were surrendered by the Bank of Hawaii, primarily during March 1987, according to Secret Service records. These notes, mostly in \$100 denominations, were passed by Palauans in daily transactions with the bank and have not resulted in investigations or open cases. Palau's law enforcement officials have investigated 3 cases involving the remaining 21 notes.

In the first case, Secret Service records indicate that 16 \$100 notes were passed in Palau in March 1987. Approximately 12 notes were used by two unidentified Filipinos to buy food and drink at a hotel in Palau. A Palauan senator reportedly joined the two Filipinos for part of the evening. The Public Safety Director said he has no concrete evidence that the senator knew of the counterfeit notes, and the notes were not detected until after the Filipinos left the Hotel. It is not clear where the remaining notes were passed.

Following the March discovery of the counterfeit notes, a Palau legislator requested assistance through Interior and Treasury, alleging that officials at very high levels of government were involved in the counterfeiting activity. Treasury referred the request to Secret Service agents in Hawaii. In the request to Interior, the legislator also alleged that the judgement of the Palau Attorney General at that time might have been clouded because his Philippine domestic helper was accused of smuggling counterfeit notes into Palau. Despite these allegations, Interior advised the FBI of the request and forwarded it directly to the Attorney General. During our 1988 fieldwork in Palau, we found indications that

the former Attorney General's domestic helper was accused of counterfeit activities during a personal dispute with another Philippine woman. But we found no evidence that she was charged with counterfeiting and did find documentation that the Attorney General gave his Assistant Attorney General full responsibility for the case. According to Secret Service officials, Philippine authorities made arrests and recovered the plates and negatives used to produce these notes.

In June 1987, a Palauan employed by an anti-compact governor was charged with placing counterfeit notes among funds distributed for compact referendum education expenses. On June 10, 1987, the employee was sent to pick up \$1,000 from the office of the Minister of State, according to information provided by Palau's Attorney General. The Minister of State was distributing funds to state governments to be used for compact education for an upcoming referendum. Four \$100 notes were found to be counterfeit. The defendant was convicted in September 1987 and subsequently appealed based on new evidence provided by two men. In the principal statement, one man swore that an employee of the Minister of State, who was now dead, conspired to frame the defendant by placing counterfeit money into the envelope in an attempt to embarrass the anti-compact governor. In January 1988, the Trial Division of Palau's Supreme Court vacated its finding of guilt and released the defendant. Palau's Attorney General appealed this decision because the order was vacated without first granting a new trial. The appeal was still pending as of November 1988.

The Secret Service learned of this case from a June 11, 1987, telegram to the Secretary of Treasury from concerned legislators and citizens in Palau who feared that, as a result of counterfeit notes found among compact education funds, the referendum could have become tainted by fraud and illegality. Treasury alerted Secret Service agents in Hawaii. An official in the Hawaii office requested clarification of the applicability of the U.S. criminal code in Palau from Palau's Attorney General. The Assistant Attorney General replied that the U.S. code "has no application in Palau." However, at the request of Palau's law enforcement officials, the Secret Service provided forensics examinations and expert testimony. This is consistent with the technical assistance the Secret Service provides to foreign countries.

In October 1988, Palau public safety officers arrested a Philippine woman vacationing in Palau for passing a \$20 counterfeit note. It was reported that she also possessed 11 other counterfeit notes of varying denominations. The woman claimed that she received the notes from a

Part II
Law Enforcement Issues

friend in the Philippines. Law enforcement officials eventually permitted her to return to the Philippines.

Issues Concerning Approval Process for the Compact of Free Association

Before the Compact of Free Association can take effect, Palauans must approve it according to requirements in their constitution. The constitution contains an anti-nuclear clause which can be waived only with the approval of 75 percent of Palau's voters. The compact allows the United States nuclear transit rights and five previous compact referenda did not achieve the required 75-percent approval; therefore in 1987, Palau's legislature authorized a referendum to change the constitutional requirement, paving the way for a referendum to approve the compact. Palauan voters approved both referenda in August 1987. However in 1988, Palau's Supreme Court ruled that the referendum to amend the constitution was null and void; as a result, Palau's voters have not yet approved the compact.

During this attempt to implement the compact, opponents (1) questioned the legality of the constitutional amendment, (2) alleged that intimidation and violence influenced the legislative and judicial process, and (3) claimed that Palau's executive branch used coercive and improper actions to promote compact implementation. Several anti-compact legislators told us they experienced anonymous threats and property damage and that these acts influenced their votes on the bill to authorize the constitutional amendment. Also, actions by the furloughed government workers and anonymous threats and intimidation appear to have been significant factors leading to the withdrawal of a lawsuit challenging the constitutionality of the August 1987 compact approval process. The lawsuit was subsequently refiled, resulting in a Palau Supreme Court decision that nullified the compact approval process.

Palau experienced a cash shortfall in 1987 and cost reductions were needed. As a result, the government reduced services and furloughed workers. Following compact-related violence, the executive branch offered to accompany plaintiffs to a September 8, 1987, court hearing and arrested three suspects in connection with shots fired at the House Speaker's residence. However, some actions taken by Palau's executive branch favored compact proponents. For example, we found that the distribution of some compact education and referenda funds favored compact supporters; Palau's President provided pro-compact furloughed workers with funds and permitted them to use government vehicles without providing similar support to compact opponents; and executive branch officials pressured government employees to support compact implementation by issuing notices instructing them to campaign for the compact and by permitting the furloughed workers committee to attach pro-compact notices to government paychecks.

Partly because of the political sensitivities associated with U.S. intervention, Interior and State officials did not interfere with Palau's attempted compact approval process. Based on their policy of promoting Palau's self-government, officials from these agencies agreed that Palau's legislature and judiciary should function without U.S. intervention. Also, based on this policy, Interior treated executive branch actions as local concerns and acts of violence and intimidation as violations of Palauan law that should be addressed by Palau's law enforcement system.

Efforts to Implement the Compact

Due to an anti-nuclear clause in Palau's constitution, at least 75 percent of Palauan voters must approve the Compact of Free Association before it can be implemented. Prior to August 1987, Palauans voted to implement the compact five times, and although a majority voted to implement the compact each time, none of the referenda achieved the required 75-percent vote. (See table III.1.)

Table III.1: Results of Palau Compact Approval Referenda

Date of Referendum	Registered Voters	Votes Cast	Votes in Favor	Votes Against	Percent in Favor
Feb. 10, 1983 ^a	8,338	7,246	4,452	2,715	61
July 4, 1984 ^a	9,063	6,458	4,290	2,103	66
Feb. 21, 1986	9,905	7,067	5,079	1,957	72
Dec. 2, 1986	10,760	8,824	5,789	2,986	66
June 30, 1987	10,851	8,263	5,574	2,673	68

Source: Government of Palau and U.N. reports.

^aReferendum included votes on two or more propositions for Palau's future political status.

Opposition to the compact has been based on several reasons, including concerns about the level of funding guaranteed under the compact, the compact's nuclear transit provisions, and U.S. rights to use Palauan land for defense purposes.

Palau's constitution prohibits the use, testing, storage, or disposal of nuclear, chemical, or biological weapons within Palau's territorial jurisdiction unless approved by 75 percent of votes cast in a popular referendum. Section 324 of the compact contains a similar prohibition but also gives the United States the right to operate nuclear-capable or propelled vessels and aircraft within the jurisdiction of Palau without either confirming or denying the presence of nuclear weapons. In 1986, the Palau

Supreme Court ruled in effect that Palau could not enter into the compact without first obtaining 75 percent voter approval of the U.S. right to transit nuclear weapons through Palau.

Procedures for Constitutional Amendments

Shortly after the unsuccessful December 1986 compact referendum, Palau's President established a task force for resolving Palau's political status problem. On January 30, 1987, the task force recommended holding a fifth referendum and, in the event it failed, amending Palau's constitution to reduce the compact approval requirement from 75 to 50 percent.

Palau's constitution includes two articles concerning amendments. Article XIV specifies that an amendment may be introduced by a constitutional convention, by popular initiative, or by legislative action and must be (1) put to voters in a regular general election and (2) approved by a majority of voters and in no less than three-fourths of the states. In order for Palau's legislature to introduce an amendment, both legislative houses must approve a resolution by no less than three-fourths of their membership.

Article XV contains provisions dealing with Palau's transition from trust territory to freely associated state. Section 11 of article XV describes requirements for constitutional amendments intended to resolve inconsistencies between the constitution and the compact. Amendments under this section must be approved by the same popular vote as those under article XIV. However, section 11 is silent about the procedural requirements for introducing an amendment and the timing of referenda.

Based on the advice of an outside attorney hired by the Palau executive branch, pro-compact legislators determined that (1) article XV could be used to amend the constitution immediately, and (2) a bill would be a reasonable mechanism to authorize a constitutional amendment referendum, since article XV of the constitution is silent on procedural requirements.

Financial Pressures at Time of Referenda

Palau executive branch officials viewed compact implementation as critically important for financial reasons, in addition to providing Palau with greater independence. Without compact funds, the President anticipated a potential cash shortfall of approximately \$5 million during fiscal year 1987. To alleviate cash-flow problems, the President reduced

public services in early 1987 and requested executive branch employees to accept a deferral of payment of 20 percent of their salaries until funds became available.

Following the fifth compact referendum's defeat on June 30, 1987, the executive branch furloughed over 900 of more than 1,350 employees from July 8 until October 1, 1987. On July 7, about 500 furloughed workers marched to the Palauan legislature and began a continuous demonstration that lasted until September 30, 1987. According to Palauan officials, an average of 150 to 200 workers were present throughout the demonstration. The workers demanded that the legislators either obtain funds to end the furlough or support legislation authorizing referenda to amend the constitution and approve the compact.

A Bill to Amend the Constitution

Palau's legislature, the OEK, has two houses, a Senate and a House of Delegates. On July 15, 1987, a delegate introduced a bill authorizing a referendum to amend the constitution and approve the compact. The House passed the bill by a vote of 11 to 0 with 5 delegates absent and referred it to the Senate. Based on advice from the Palau executive branch legal counsel, the Senate amended the House bill to provide for two referenda—one on the constitutional amendment and one on the compact. The Senate approved the amended House bill on July 19 by a roll call vote of 11 to 0 with three senators absent. The amended bill proposed a constitutional amendment that would suspend the anti-nuclear provisions of the constitution insofar as they would apply to the compact. In effect, this reduced the compact approval requirement from 75 percent to a simple majority.

The same day, the House of Delegates approved the amended Senate bill by a roll call vote of 9 to 2, with 5 delegates absent. Six delegates voted for the bill and two voted against. The votes of three delegates who abstained twice were counted as affirmative votes according to House rules of procedure. The President signed the bill, RPPL 2-30, into law in a ceremony that day on the National Congress grounds.

The Voting Process

The two referenda were held in August 1987. On August 4, 1987, 73 percent of 7,733 voters approved the amendment to suspend the constitution's nuclear provisions, thereby reducing the voter approval requirement for the pending compact referendum from 75 percent to a simple majority. After a sixth compact referendum resulted in 73-percent voter

approval, President Saliu certified approval of the compact as being in accordance with Palau's constitution on August 29, 1987.

Compact opponents we talked with raised no concerns about the polling procedures used in the August 1987 referendum. We reviewed visiting U.N. mission reports to the U.N. Trusteeship Council on this sixth referendum as well as referenda held in December 1986 and June 1987. U.N. representatives identified some minor problems but concluded that voting results in these referenda accurately reflected the population's freely expressed wishes. U.N. observers concluded that, despite some political tension, the compact referendum held in Palau in August 1987 was carried out fairly and in accordance with Palauan law. Voters were able to cast their votes in secret and U.N. mission members reported that they saw no evidence of malpractice or attempts to improperly influence voters. They also noted that Palauan election practices promoted maximum participation by permitting voters to vote at any polling place they chose.

Legislative Process

In 1987, the Senate had a pro-compact majority, with 8 of 14 members supporting the implementation of the compact signed by the U.S. administration and President Saliu while he served as Palau's ambassador to the political status negotiations. In contrast, the House of Delegates had an anti-compact majority—11 of 16 members opposed implementation of this compact.

Some anti-compact legislators questioned the legitimacy of the compact approval process and RPPL 2-30 on both constitutional and political grounds, and they told us they were intimidated into supporting RPPL 2-30 and voting against their consciences by furloughed workers' actions and by anonymous threats and acts of violence. To some extent, it appears that furloughed workers' demonstrations and letters were legitimate vehicles for exercising constitutional rights to assemble and petition elected officials. However, several anti-compact legislators also told us they experienced threats and property damage.

Opposing Legislators' Views

We met with five delegates and three senators¹ who opposed the compact signed by President Saliu because they believed that (1) overall compact funding was insufficient, (2) the Saliu administration had committed a significant amount of compact funds for projects in which the legislature had no role, and (3) the compact did not require the United States to provide fair market compensation for land if it chooses to exercise its military land use rights under the compact. These legislators said they could support a compact that included more generous benefits to address these concerns.

In December 1987, prior to the Palau Supreme Court's ruling that nullified the August 1987 referendum to amend the constitution, these opposing legislators told us that they questioned the legitimacy of the compact approval process and RPPL 2-30. They said that they believed the August 1987 referenda to amend the constitution and vote on the compact were unconstitutional because the constitutional amendment should have been (1) authorized through a legislative resolution rather than a bill and (2) voted on in the next regular general election in November 1988. These legislators also stated that RPPL 2-30 was invalid because the bill was approved by less than three-fourths of the members of each house.

These legislators also stated that they received threatening letters and telephone calls and that some legislators suffered property damage to their cars and houses. Also, one legislator stated that the executive branch put pressure on him by withholding government services and resources from his constituency.

According to anti-compact legislators, the following events occurred before the enactment of RPPL 2-30.

- The Vice Speaker of the House of Delegates stated that a pro-compact legislator and approximately 30 furloughed workers came to his house, insisted that he accompany them to the OEK, and pressured him into voting for RPPL 2-30.
- One legislator stated that another anti-compact legislator's house was burned down by compact supporters. The legislator who owned the house acknowledged that his home was burned down but refused to speculate on who was responsible. He stated that he was injured in the

¹We scheduled separate meetings with pro-compact and anti-compact legislators in December 1987 which all legislators were invited to attend.

fire and did not vote on the bill because he was receiving medical attention abroad for his injuries.

- One legislator stated that someone tried to burn his house in June 1987, but no damage occurred and someone threw a rock into his house later in the summer.
- Three legislators stated that anti-compact legislators, including themselves, received threatening anonymous telephone calls.
- Some legislators received letters from a group of furloughed workers which contained insults and demanded their resignation. We obtained copies of some of these letters.
- One legislator alleged that furloughed workers threatened him with physical violence.
- One legislator stated that someone slashed the tires of his car while it was parked in the OEK parking lot.

The legislators stated that intimidation continued after the bill's approval. Some furloughed workers remained on the OEK grounds until September 30, 1987. A legislator alleged that the workers continued to pressure legislators and were frequently disorderly. Shots were fired at the House Speaker's residence in the early hours of September 6, 1987. In February 1988, the Palau Supreme Court Trial Division found three government employees guilty of (1) unlawful use and possession of a firearm, (2) unlawful use and possession of ammunition, and (3) riot in connection with this crime.

Also, one delegate stated that he regularly received threatening telephone calls and in October 1987 was forced to pay \$2,000 to the furloughed workers because they demanded money and he was afraid of what would happen if he did not pay.

Some anti-compact legislators argued that local law enforcement officials did not aggressively investigate actions directed against individual legislators and did not provide adequate protection. They also noted that the police did nothing to stop furloughed workers from demonstrating at the OEK during the midnight to 6:00 a.m. curfew.

Compact Proponents' Views

Four legislators we met with stated that, in authorizing the August 1987 constitutional amendment referendum, the legislature and the President used an appropriate means to respond to the will of the majority that had supported compact implementation in five prior referenda. They also stated that legislators, although subjected to some pressure, were free to vote their conscience and that the furloughed workers had the

right to present their demands to the OEK through letters, meetings, and peaceful demonstrations. Senate leaders did not ask the workers to leave the OEK grounds and allowed them to use Senate facilities at night and in bad weather.

Executive branch officials also stated that they investigated actions directed against legislators and provided protection when appropriate. In the most serious case of violence against a legislator, the shooting at the House Speaker's residence, the police arrested three government employees who were tried and convicted in February 1988. Upon request from Palau, Interior provided investigative assistance in this case. According to the Vice President, the executive branch did not comply with the Speaker's request that he be permitted to carry firearms after the shooting because the constitution forbids it.² The government provided police protection to the Speaker and his family on a continuous basis from December 1987 to November 1988, after the Chairman, U.S. House Subcommittee on Asian and Pacific Affairs, questioned President Salii about compact-related violence and specifically referred to the need for protection for the Speaker in a public hearing.

Suits Challenging the Approval Process

Two similar lawsuits, Merep v. Salii and Ngirmang v. Salii, challenged the constitutionality of the August 1987 compact approval process. The first law suit was settled in August 1987; the second was withdrawn in September 1987. However, on April 5, 1988, the second lawsuit was reinstated as Fritz v. Salii due to a change in persons bringing the suit. Based on this suit, the Trial Division of the Palau Supreme Court ruled on April 22, 1988, that RPPL 2-30 was not properly enacted and therefore the attendant referendum intending to amend the constitution was null and void. In August 1988, the appeals court upheld this decision. Because the attempt to amend the constitution was unsuccessful, the 73-percent voter approval obtained in the August 1987 compact referendum was not sufficient to approve the compact.

The circumstances surrounding the two lawsuits differed significantly. Plaintiffs voluntarily withdrew the first lawsuit after the Ibedul, one of

²Article XIII, section 12, of Palau's constitution states that "no persons except armed forces personnel lawfully in Palau and law enforcement officers acting in an official capacity shall have the right to possess firearms or ammunition unless authorized by legislation which is approved in a nationwide referendum by a majority of the votes cast on the issue."

the paramount traditional leaders in Palau³, signed a memorandum of understanding with the President. In the second lawsuit, pressure from compact supporters and acts of violence, including the murder of the father of an anti-compact activist who assisted the women plaintiffs, appear to have caused at least 12 of the 38 plaintiffs to sign a stipulation of dismissal.

Merep V. Salii

On July 29, 1987, three plaintiffs in Merep v. Salii filed a complaint asking the Palau Supreme Court to enjoin executive branch officials from calling or holding the August 1987 constitutional amendment and compact referenda. The complaint, as subsequently amended on July 30 and August 5, argued that the constitutional amendment process was not conducted according to the procedures stipulated in articles XV and XIV of Palau's constitution and therefore the compact ratification referendum was not legal.

The substantive issues of the case were scheduled to be heard on September 8; however, the lawsuit was settled on August 28 by a stipulation of dismissal between the parties after the Ibedul signed a memorandum of understanding with President Salii. The stipulation does not contain any independent findings by the court but incorporates the memorandum by reference. This memorandum states that the Ibedul would cause the lawsuit to be dismissed and in return (1) the Palauan government would not use power of eminent domain to obtain land for U.S. use contrary to the constitution, (2) land provided pursuant to the compact would be taken with just compensation and the consent of owners, and (3) the President would designate the Council of Chiefs⁴ as responsible for considering U.S. requests for land.

Chief Justice's Role

On August 25, 1987, the Palau Supreme Court Chief Justice issued an order of assignment removing himself from the Merep case and assigning an Associate Justice for further proceedings. The Chief Justice stated in his order that, because he had received written communications and public statements questioning his motives in rulings in the case and alleging that his close relationship with compact opponents endangered such rulings, he reluctantly concluded that public confidence in

³There are two paramount chiefs in Palau: the Ibedul, who reigns over the southwestern part of the archipelago, and the Reklai, who dominates the northeast. Traditional politics have been focused upon maintaining the balance of power between these two chiefs.

⁴Article VIII, section 6, of Palau's constitution states that "A Council of Chiefs composed of a traditional chief from each of the states shall advise the President on matters concerning traditional laws, customs and their relationship to this Constitution and the laws of Palau."

the integrity and impartiality of the judiciary could be maintained only by assigning the case to another judge. During our visit to Palau, the Chief Justice informed us that he had experienced significant pressure but that his action was motivated by a desire to maintain the court's integrity and not by intimidation, as some compact opponents have alleged. He stated that although he received threats, he did not request police protection.

In January 1988, a three-member mission visited Palau on behalf of the International Commission of Jurists and the American Association for the International Commission of Jurists. The mission's report, issued in April 1988, noted that the Chief Justice, after issuing an order enjoining the tabulation of votes, had received letters from legislators and furloughed workers which threatened him with removal and accused him of unethical conduct. Shortly thereafter, he vacated the order and disqualified himself from hearing the case. The mission concluded that "In these circumstances, the appearance of the independence of the judiciary was damaged." Moreover, these actions by legislators and furloughed workers represented "a gross interference with the independence of the Judiciary."

Ngirmang V. Salii

On August 31, 1987, 38 female plaintiffs filed Ngirmang v. Salii. This complaint, similar to Merep, contested the constitutionality of the compact approval process. Between September 1 and 8, several motions were filed.

- On September 1, the defendants, representing the government of Palau, filed a motion to dismiss the lawsuit, stating that the issues raised in Ngirmang had already been decided on their merits in Merep and asking for an expedited hearing no later than September 4.
- On September 3, eight plaintiffs filed a motion to dismiss the case on the basis that no useful purpose would be served by pursuing it in view of the memorandum of understanding between the President and the Ibedul.
- On September 4, the two lead plaintiffs, Gabriela Ngirmang and Rafaela Sumang, representing the remaining plaintiffs, submitted a letter to the Clerk of the Court requesting a postponement of the September 8 hearing because they had not been able to secure legal counsel in Palau and needed time to bring a lawyer from the United States.
- On September 8, seven plaintiffs added their signatures to the September 3 motion to dismiss.

- On September 8, one of the two lead plaintiffs, accompanied by a police escort, filed a second request asking the court to postpone the hearing scheduled for that day. In this request, the plaintiffs stated that (1) they needed a 2-week postponement for their attorneys to come from the United States and (2) they were afraid to attend the hearing because the father of an anti-compact activist had been shot the previous night.

On September 8, the plaintiffs did not appear at the hearing. However, the two lead plaintiffs met with government officials and agreed to file a stipulation for dismissal. This stipulation, prepared by the Palau Attorney General's office, states that the case was dismissed on its merits on the basis of the Merep case and the memorandum of understanding between the Ibedul and President Sali. This dismissal was signed in English and Palauan by 22 plaintiffs. A lead plaintiff stated that she collected most of the remaining plaintiffs' signatures on September 8 and finished on the morning of September 9. She stated that the government provided a police vehicle with a driver who remained in the vehicle when she went into plaintiffs' homes to obtain signatures.

On September 9, the Associate Justice held a hearing to dismiss the case. The defendants, the two lead plaintiffs, and a group of about 50 people, including furloughed workers, were present during this hearing. In a memorandum, the judge included a provision to allow the plaintiffs to reopen the suit, since it appeared that they had been intimidated.

Reasons for Dismissal

According to a September 9, 1987, memorandum from Palau's Attorney General to the President, the plaintiffs agreed to withdraw the lawsuit in the interests of national harmony and in acceptance of the agreement between the Ibedul and the President. However, 12 plaintiffs told us that they were afraid to pursue the lawsuit after experiencing considerable pressure and learning of violence.

We met with 12 plaintiffs, including the 2 lead plaintiffs, who stated that the Ibedul pressured them to withdraw the lawsuit on several occasions because it violated his memorandum of understanding with the President. The women said that they believed the memorandum was contrary to their interests and would not be found legally binding once the compact took effect and therefore the agreement did not resolve their concerns over how Palauan land rights would be protected under the compact. In addition, they said that they felt intimidated by the furloughed workers' actions and by rumors of impending violence against them. In sworn affidavits, the plaintiffs provided examples of incidents causing their intimidation.

- Some women were frightened by a group of men who drove a bus decorated in black with signs reading Black September and Rest in Peace. On the morning of the scheduled court hearing, the men drove this van past a plaintiff's home several times.
- Several women were told by friends and relatives among the furloughed workers or other compact supporters that they were in danger.
- One plaintiff said that the furloughed workers surrounded her home with eight vehicles, including a bus, while three men came to her door and told her to withdraw her name from the suit. Her children were frightened and ran to hide.
- A furloughed worker and special assistant to the President broadcast a radio and a television message on September 7, 1987 appealing for support for the compact and sanctioning violence against those who opposed the compact.

None of the plaintiffs were physically attacked or harmed and none experienced serious property damage. However, according to the plaintiffs, acts of violence that occurred during unscheduled power outages on the weekend preceding the court hearing, including the fatal shooting of the father of an anti-compact activist who helped the plaintiffs prepare their complaint; the shots fired at the House Speaker's residence; and an explosion in a field near a plaintiff's home; heightened their fears and contributed to their refusal to appear in court.

According to several plaintiffs, the Minister of Justice offered to provide a police escort to enable them to attend the September 8 hearing but they rejected this offer because they (1) lacked confidence in the government's ability to protect them, (2) believed that government officials supported the furloughed workers' efforts to pressure them into withdrawing the lawsuit, and (3) were afraid that their appearance would cause the furloughed workers to become violent.

The 12 women acknowledged signing a stipulation of dismissal on September 8, 1987, but 11 of them told us they did not read the stipulation and, at the time, they thought they were signing a request to postpone the case until the atmosphere became calm and they could find a lawyer. In affidavits, several women stated that the policeman assigned to accompany the lead plaintiff in gathering signatures hurried them into signing the document. All 12 women stated that pressure from the furloughed workers and concerns about violence precluded them from continuing the lawsuit.

Fritz V. Salii

In January 1988, President Salii wrote a letter to one of the lead plaintiffs offering police protection to any Palauan citizen who wished to refile. On March 31, 1988, plaintiffs from the Ngirmang lawsuit filed a motion to set aside their previous withdrawal of their complaint. By order of April 5, 1988, the court granted the motion. Because there were changes in the persons bringing the action, the suit was reinstated as Fritz v. Salii. On April 22, 1988, the Palau Supreme Court held that RPPL 2-30 was not properly enacted and that the referendum to amend the constitution was void. The court found that RPPL 2-30 was subject to the procedures set forth in section 1(c) of article XIV of Palau's constitution which provides for proposal of a constitutional amendment by a resolution adopted by not less than three-fourths of the members of each house of the Palauan legislature. The adoption of RPPL 2-30 did not follow these procedures. This decision was upheld in August 1988 by the Appellate Division of the Palau Supreme Court.

Palau Executive Branch Actions

Compact opponents alleged that Palau executive branch officials (1) furloughed workers and cut services to gain support for compact approval rather than because of financial problems, (2) favored compact proponents, and (3) coerced anti-compact employees into supporting the compact.

We found that Palau was experiencing a cash shortfall in 1987 and cost reductions were needed. We also found that there were limited controls on the distribution of compact education and referenda funds and that executive branch officials favored compact supporters in the distribution of some of these funds. In addition, we found that the executive branch officials permitted furloughed workers campaigning for compact implementation to use government funds and property but did not provide similar opportunities to compact opponents and pressured government workers to support the compact by actions such as issuing notices instructing employees to campaign for the compact and permitting the furloughed workers' committee to attach pro-compact notices to government paychecks.

Cost Reduction Measures

Palau's President stated that cost reduction measures taken during fiscal year 1987 were necessary and unavoidable due to a cash shortfall and the government's inability to obtain additional revenues from Interior. Interior Inspector General officials and Palau's auditors agreed that

cost reduction measures were needed. According to President Salii, payroll was a logical target for reducing expenditures, since salaries and benefits account for more than half of Palau's expenditures.

In early 1987, the executive branch projected that revenues would be insufficient to meet anticipated expenditures and took several measures, including a 20-percent reduction in expenditures for all nonessential government services. Compact opponents were particularly critical of the government's decision to reduce hospital patient meals. Beginning on April 6, 1987, families of patients were requested to deliver three meals a day to the hospital at specified times.

In addition, the executive branch delayed a portion of government payroll costs by asking government employees to work 40 hours a week, receive pay for only 32 hours, and postpone receipt of pay for the remaining 8 hours until funds were available. We estimate, on the basis of an unaudited Palauan statement of fiscal year 1987 payroll expenditures, that the 20-percent salary postponement helped the government reduce disbursements by about \$120,770 per biweekly pay period, or a total of about \$1.4 million for 6 months, thus somewhat alleviating its cash-flow problems. This measure represented a deferral of costs—not a savings—since the government was obligated to reimburse employees for credit hours.

The Furlough

On July 3, 1987, 3 days after the fifth compact referendum was defeated, the executive branch notified over 900 of more than 1,300 executive branch employees that they would be furloughed from July 8 until October 1987. During the furlough, many government services, including some services funded by U.S. grants, were suspended. For example, schools remained closed until October 1, 1987. Moreover, federally funded services to the elderly were reduced because program employees were furloughed. We obtained the following information on the government's financial condition during the furlough.

- In July 1987, the government purchased a \$500,000 certificate of deposit. Officials stated this action was taken to set aside funds for an emergency.
- Executive branch officials requested additional funds from Interior several months before the furlough, cautioning that temporary layoffs might be necessary if funds were not provided. The additional funds were not provided and Interior officials said that Palau had been

advised as early as 1984 to reduce personnel costs and to eliminate over-spending. Interior officials decided that U.S. funding should be held constant even if workers were furloughed.

- The Bank of Hawaii would not loan Palau funds before implementation of the compact; however, Palau obtained a \$918,000 loan from the Bank of Guam on September 8, 1987.
- Beginning with the first pay period in July 1987 during which the furlough took effect, the government began reimbursing employees for credit hours earned from January through June 30. A Palau official stated this decision was made to minimize the hardship of government employees on furlough. According to an unaudited financial worksheet, employees were reimbursed over \$1.2 million for these credit hours during the furlough. These funds could have been used to keep some additional employees in pay status or to bring some or all employees back to work before October 1, 1987. According to one official, the executive branch decided not to bring some workers back to work before others because that could have been viewed as unfair or could have led to further unrest.

Government Employees Paid With Federal Grant Funds

The salaries for about 190, or 20 percent, of furloughed employees were fully funded by U.S. federal program grants. Some other U.S.-funded employees were not furloughed, apparently because (1) their programs receive funds directly from U.S. federal agencies rather than through Palau's executive branch and (2) program directors or boards decided not to honor the President's request that all nonessential employees be placed on furlough for morale purposes. For example, employees of Palau's aging program, which receives funds through the executive branch, were furloughed and, according to the local Program Director, the funds that would have been used for salaries were used to purchase additional food for the elderly. In contrast, employees of Palau's Head Start Program, which receives funds directly from the U.S. Department of Health and Human Services, were not furloughed.

According to the Minister of Administration, Palau could not keep U.S.-funded employees working because federal agencies provide reimbursement only after Palau provides documentation of expenditures. However, we found that at least one federal program permitted Palau to draw funds prior to expenditures. Moreover, according to Palau's Minister of Administration, Palau did not ask U.S. agencies to waive the reimbursement procedure so that employees could keep working.

According to Interior, the July furlough of employees whose salaries were paid by U.S. program funds was consistent with Interior policy. Palau is free to hire its own employees and make decisions on how to administer the funds.

Compact Education

Neither Interior nor the Republic of Palau established strict requirements for using or accounting for compact education and referenda funds. We found that the lack of adequate criteria created a situation in which disbursements of these funds to individuals, including state governors and legislators, were not subject to adequate control. We also found that the executive branch provided some pro-compact legislators with funds but that legislators opposed to the compact did not receive any funds.

According to data obtained from Palau's Minister of Administration, appropriated funding for compact education and referenda expenses totaled \$1.7 million for the six referenda held between 1983 and 1987. Interior provided \$700,000 of this total, including \$150,000 for the June 30, 1987, referendum, according to an Interior official. In addition to these amounts, we found that the Palau executive branch spent \$217,045 in fiscal year 1987 from two additional compact-related subsidiary accounts controlled by President Salii. Of this amount, \$50,000 had been appropriated by the OEK; we could not determine whether the remaining funds had been appropriated.

We found no problems with fiscal year 1987 compact education expenditures for salaries, foodstuffs, printing, supplies, advertising, and travel to Palau, Guam, Saipan, Hawaii, and other locations.⁵ The expenditures we reviewed were adequately supported by invoices and travel vouchers. However, little or no documentation existed for checks written to state governors, executive branch officials, legislators, and other individuals. For example, the President of Palau's Senate received \$10,000 in June 1987 and \$7,000 in August 1987 to use for compact education but there is no documentation on how these funds were used. The Senate President told us that he used some money and distributed the remainder to senators and other individuals who supported the compact; he did not provide funds to anti-compact senators. He gave us copies of 19 canceled checks to various individuals; funds reportedly were used for barbecues and other activities to promote compact support.

⁵Palauans living outside Palau were permitted to vote in compact referenda and compact education was conducted in areas outside Palau, such as Guam, Saipan, and Hawaii.

With regard to the House of Delegates, our limited review of compact education expenditures disclosed that one pro-compact delegate received \$1,000. The Speaker of the House of Delegates, who was an opponent of the Salii-negotiated compact in 1987, told us that the executive branch did not provide him with compact education funds.

Palau public laws, such as RPPL 2-30, authorizing compact referenda required that compact education be conducted in an impartial manner so that voters could make an informed choice about Palau's future. Compact opponents and supporters expressed conflicting views on the extent of compliance with this requirement. In December 1986, a U.N. visiting mission received several complaints alleging that compact education had been conducted in a biased manner. However, in June 1987, U.N. observers concluded that the education program had been conducted fairly and that voters had a good understanding of the compact.

Support for Furloughed Workers

President Salii stated that the government did not provide furloughed workers with funds or food to support their demonstration. However, a government subsidiary ledger showed that the chairman of the furloughed workers committee had received checks totaling over \$10,000 during August and September 1987 from a compact-related account administered by the President's office. Government records did not contain documentation on how these funds were used.

In December 1987, former President Salii stated that he permitted furloughed workers to use government vehicles, including cars, trucks, and a bus, from July through September 1987 because some workers volunteered to protect government buildings while on furlough. He acknowledged that workers also used these vehicles for personal use and parked them in front of the OEK.

We identified one instance in which property purchased with U.S. grant funds appears to have been used by furloughed workers. Specifically, the Director of one Palauan social service program stated that the Minister of Social Services permitted furloughed workers to use U.S.-funded program vehicles. After the furlough, the vehicles were reportedly returned damaged.

Policies Toward
Government Employees

Compact opponents alleged that Palau's executive branch unfairly pressured government employees to support the compact and took actions that caused employees who opposed the compact to fear reprisal. Specifically, allegations were made that the executive branch

- instructed government employees to campaign for the compact,
- permitted the furloughed workers' committee to distribute notices to government employees through government channels, and
- used the personnel system to reward and penalize government employees in accordance with their positions on the compact.

We found that some government actions favored government employees who supported the compact and may have conflicted with Palau's Public Service System Rules and Regulations. For example, notices sent to government employees through official government channels can be viewed as placing pressure on them to support the compact. We also identified two instances in which actions taken with regard to specific employees may have involved reprisal.

Before the December 1986 referendum, the Minister of Social Services issued two controversial memos that addressed the government employees' role in campaigning for the compact. On November 7, 1986, the Minister authorized administrative leave for teachers appointed to serve on state compact committees. On November 17, 1986, the Minister issued a memorandum stating:

"Since the approval of the Compact of Free Association with the United States of America is the top priority program of the Executive Branch of our National Government, it is expected of all personnel to vigorously campaign for the Compact...Any personnel under your supervision who chooses to campaign otherwise shall be reported to me at once...It is no longer tolerable for civil service employees to oppose the system while remaining in it..."

After a member of the legislature criticized this document on television, the Minister of State wrote to all government employees that (1) although the government urged employees to vote for the compact, all government employees had the right to vote as they wished, (2) government employees who wished to campaign for the compact during work hours could do so if management approved, (3) the government could allow the use of government property to support the compact, (4) government employees could not campaign against the compact during work hours but could do so after work, and (5) the government would not take reprisals against anti-compact employees.

In August 1987, executive branch officials permitted the furloughed workers committee to attach a notice to the August 7 paycheck of government employees requesting them to participate in the furloughed workers' demonstration at the OEK and stating "Your failure to comply may consequently result in an adverse action against you." Furloughed workers committee representatives acknowledged sending the memo.

These government officials' actions favored government employees who supported the compact and therefore appear to have conflicted with the intent of Palau's Public Service System Rules and Regulations. These regulations, adopted in 1984, prohibit public service employees from using their official influence to affect the results of an election or to coerce any person regarding any politically related activity. Public service employees also are not to be obligated to render service to any political activity.

We noted one transfer involving a teacher who opposed the compact. Although his salary did not change, he told us that he contested the transfer because his new position was with a federally funded program that he claimed was scheduled to be terminated upon compact implementation. However, government officials did not reinstate him to his former position.

In addition, a public health official told us that when the furlough was announced, he submitted a list of less-essential employees to the President but key public health employees were furloughed instead. The doctor was told by others that these employees opposed the compact.

Access to the Media

Palauan news sources include an executive branch newsletter, a government-owned radio station, and a commercial television station. Although Palau has no independent newspapers, those published in Guam and other locations provide significant coverage of Palauan events. Our review disclosed the following information:

- Palau's executive branch determines the content of its newsletter and does not provide space for articles submitted by other branches of government or private citizens, according to the Speaker of the House of Delegates. However, Palau has no restrictions precluding other private and public organizations from publishing newsletters.
- Foreign newspapers were readily available during our visit. Allegations were made that circulation of foreign newspapers in Palau is restricted

when they contain articles that criticize executive branch policy. Documentation on whether this occurred during the compact approval process was unavailable.

- Palauan officials stated that all branches of government and private citizens are required to pay fees for political announcements on commercial television. Neither compact supporters nor opponents voiced complaints about access to commercial television.

We heard conflicting views about the extent to which legislators were permitted access to the government-owned radio station during 1987, but no documentation was available to resolve these conflicting claims. The House of Delegates' Speaker alleged that radio station officials often changed announcements, interfered with their transmission, or refused to broadcast them. He also stated that the House of Delegates' Public Information Officer's residence was burned in July 1987 after a House of Delegates anti-compact announcement was broadcast. The House reportedly continued to submit announcements for several more weeks but subsequently stopped because none were aired.

According to a radio station official, the House of Delegates and the Senate are each allowed up to 30 minutes per day without charge for public service announcements. The radio station's guidelines require that announcements be submitted in advance and permit the station to edit them and reject those which contain false or misleading information. The official acknowledged a dispute between the radio station manager and the Speaker but attributed the problem to a long-standing personal and political rivalry.

U.S. Actions

The trusteeship agreement obligates the United States to promote Palau's self-government and at the same time fulfill other responsibilities, such as protecting the rights and fundamental freedoms of all elements of the population without discrimination. In 1979, the Secretary of the Interior issued Secretarial Order 3039 which delegated responsibility to the Micronesian governments for administering most government functions, which in effect included maintaining law and order. Palau assumed this responsibility in 1981 when its constitution took effect. Secretarial Order 3119 superseded this order in July 1987. Although Secretarial Orders 3039 and 3119 delegated significant authority to the emerging governments, they also permitted the Secretary of the Interior to exercise broad authority to take actions needed to carry out U.S. responsibilities under the trusteeship agreement. The State Department also plays a role in determining U.S. policy and

actions toward Palau. The Secretary of State is responsible for interpreting the rights and obligations of the United States arising out of the trusteeship agreement.

In our opinion, Interior's responsibilities in administering Palau have not been clearly defined during Palau's transition to self-government since 1981. With regard to events surrounding Palau's 1987 compact-related referenda, including alleged intimidation and violence, it appears that decisions on how the United States should respond to violence and alleged intimidation involved weighing the somewhat conflicting trusteeship goals of promoting self-government and protecting individual rights.

We found that Interior, in consultation with State, adopted a policy that the United States should not intercede in violence and alleged intimidation associated with Palau's compact approval process. With regard to reported violence, such as the bullets fired at the House Speaker's residence and the murder of the father of an anti-compact activist, Interior officials provided investigative assistance at Palau's request but did not conduct any independent investigations. In addition to providing investigative assistance on the case involving the House Speaker, Interior officials provided Palau with a \$50,000 grant to hire a full-time public safety advisor. Interior officials acknowledge that they have authority to conduct independent investigations under the trusteeship agreement but stated that using this authority would have meant a significant departure from the Department's policy of permitting Palau to exercise authority in law enforcement matters. Thus, they chose to provide technical assistance instead.

On September 10, 1987, the Director of Interior's Office of Transition in Saipan met with the judge who presided over the dismissal of Ngirmang v. Salii and reported the results of this meeting to TIA officials in Washington. According to the report, the judge stated that he believed intimidation through the use and threat of violence was the only reason the plaintiffs withdrew their case. The judge recommended that an independent third party review what transpired with regard to the compact certification process so that the United States, if appropriate, could support the process that Palau went through. The report recognized that Palauan leaders might perceive such a review as interference with Palau's internal affairs. However, it stated that accepting the certification without question would probably lead to questions by congressional committees and the United Nations.

On November 30, 1987, after Ngirmang v. Salii was withdrawn, the President of the United States accepted President Salii's August 1987 certification that Palau had approved the compact in accordance with its constitution. State Department officials did not conduct an investigation to determine whether the plaintiffs were intimidated into withdrawing the suit. Interior officials said that both the alleged intimidation of the plaintiffs in the Ngirmang v. Salii suit and the questions regarding the legality and constitutionality of RPPL 2-30 and the referendum were local matters to be resolved by Palau government officials and jurists. State Department officials stated that they recognize Palau's right to interpret its own constitution.

As a result of Interior's policy of non-interference, Palau officials independently chose cost saving-measures and decided to furlough government employees. Interior did not reprogram funds to prevent the furlough because Interior officials had previously warned Palau of the consequences of overspending. Interior did not investigate allegations that the executive branch (1) provided financial support and property to furloughed workers who demonstrated for the compact's approval, (2) pressured government employees to campaign for the compact, and (3) used the personnel system to reward and penalize government employees according to their position on the compact.

Except for a 1983 Interior Inspector General audit of \$300,000 in compact funds, Interior did not audit Palau's use of subsequent compact education and referenda funds. Therefore, Interior officials were unaware that (1) some expenditures were not adequately supported by documentation and (2) some funds from compact subsidiary accounts were used to pay furloughed workers.

Current Status of the Compact

On November 30, 1987, after the Ngirmang v. Salii lawsuit was withdrawn, the President of the United States certified to Congress that Palau had approved the compact in accordance with its constitution and in a manner that creates no impediment to the exercise of U.S. rights and he submitted legislation to authorize compact implementation.

In response to the President's certification, the House Committee on Foreign Affairs and the Senate Committee on Energy and Natural Resources approved legislation to implement the compact. However, the House Committee on Interior and Insular Affairs did not support the legislation due to concerns about the legitimacy of Palau's compact approval process and other matters, and, it introduced a bill that went beyond the

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Issues Concerning Approval Process for the
Compact of Free Association

other Committees' positions. For example, the bill would have required Palau to maintain an independent office of special prosecutor for 15 years after the effective date of the compact and would have provided additional funding. Although the three Committees reached agreement during the closing days of the 100th congressional session, Congress adjourned before voting on the compromise. In March 1989, Interior Committee members introduced House Joint Resolution 175, which is intended to reflect the compromise. The House approved the resolution on June 27, 1989; as of June 30, 1989, the Senate had not acted.

Palau's President has changed twice since Palau's Supreme Court struck down the constitutional amendment. On August 20, 1988, President Lazarus Salii committed suicide and Vice President Thomas Remengesau served as President for the remainder of Salii's term. On November 3, 1988, Palauans elected a new President, Ngiratkel Etpison. As of June 1, 1989, Palau had not yet scheduled another vote on the compact.

Issues Concerning U.S. Military Use and Operating Rights in Palau

To determine whether problems exist concerning Palau's ability to fulfill compact requirements to make land available to the United States for military purposes upon request, we reviewed documents on Palauan land ownership and U.S. defense rights and responsibilities, including (1) the subsidiary agreement to the compact regarding U.S. military use and operating rights, (2) relevant Palau Supreme Court decisions, and (3) a 1987 agreement between President Saliu and the Ibedul. We also discussed these issues with State, Department of Defense (DOD), and Palauan officials.

Although over half of Palau's voters have supported implementation of the compact, including its military use provisions, some Palauan officials have concerns about U.S. military rights to use Palauan land and would like to see the compact and/or its subsidiary agreement on U.S. military use changed to ensure that (1) owners receive fair compensation for land and (2) a more reasonable timeframe is established for Palau to respond to U.S. requests for land. In the absence of changes, some officials fear that Palau may be unable to carry out its defense obligations in a manner consistent with its constitution.

DOD and State Department officials believe the provisions of the compact adequately protect U.S. and Palauan interests and provide sufficient flexibility for these issues to be addressed on a case-by-case basis as problems arise.

Background on U.S. Military Use and Operating Rights

The Compact of Free Association recognizes that Palau is a self-governing state but gives full authority and responsibility for its security and defense to the United States for a period of 50 years. Once the compact takes effect, Palau must refrain from actions that are incompatible with U.S. defense responsibilities and must close its territory to other nations' military forces unless the United States agrees to their entry. The United States may conduct activities and operations within Palau's lands, water, and airspace necessary for the exercise of its authority and responsibilities. However, a U.S. law¹ approving the compact states that, in recognition of the scarcity and special importance of land in Palau, the United States will request the minimum area necessary to accomplish its security and defense purposes.

¹On November, 14, 1986, Public Law 99-658 was enacted. It approved the terms of the Compact of Free Association between the United States and the Government of Palau.

The United States may not use, test, store, or dispose of nuclear, toxic chemical, gas, or biological weapons intended for use in warfare. However, it may operate nuclear capable or nuclear-propelled vessels and aircraft within Palau without either confirming or denying the presence or absence of such weapons.

A subsidiary agreement to the compact sets forth additional information on U.S. military use and operating rights in Palau. This agreement states that the United States may specify defense sites in Palau and designate them as (1) exclusive use areas, (2) joint-use areas, or (3) non-exclusive use areas for which the United States anticipates a need for intermittent use. The agreement also states that the government of Palau must make available defense sites requested by the United States or alternate sites acceptable to it within 60 days of the original request. The government of Palau is responsible for paying any rent, use charges, or other consideration to persons with interest in land used by the United States. Upon compact implementation, the United States will provide a grant of \$5.5 million to assist Palau in carrying out its obligations to make designated sites available.

The agreement further states that the United States can request exclusive use of (1) about 65 acres of land adjoining Palau's existing airfield in Airai state, (2) about 40 acres of submerged and adjacent land in Malakal harbor, and (3) an area or areas for base and logistic support activities.

Potential joint use areas include (1) the existing airport in Airai state, with the right to extend the runway, and (2) all anchorages in Malakal harbor and adjacent waters, with the right to make improvements. The United States also may request non-exclusive use of an area for training and maneuvers, and exclusive or non-exclusive use of an airfield in the state of Angaur or of another airfield.

DOD Plans

DOD officials stated that U.S. military objectives in negotiating the compact included (1) foreclosing other nations' access to Palau, (2) ensuring U.S. rights to conduct military operations and training, (3) obtaining the right to station forces in Palau if needed, and (4) ensuring the right to acquire facilities in Palau if needed. These officials believe the compact achieves these goals.

DOD has no specific plans to exercise its military land use options in Palau following compact implementation, according to DOD officials, but

they expect that DOD's peacetime use of Palau will probably include limited training and port visits. DOD officials stated that Palau also plays a role in DOD's contingency plans. If the United States were to lose access to existing base facilities in Japan, Korea, or the Philippines, Palau would be considered a possible site for relocating certain functions but would play a relatively minor role because of its rugged terrain, limited infrastructure, and shortage of labor.

Palauan Concerns About Military Use Provisions

Over half of the Palauan voters have supported compact implementation in six referenda held between 1983 and 1987. However, these results have been insufficient to implement the compact because the Palau Supreme Court ruled in effect in September 1986 that Palau's constitution required 75-percent voter approval of U.S. nuclear transit rights included in the compact. Most recently, 68 and 73 percent of Palauan voters supported the compact in referenda held in June and August 1987.

Although there are other reasons why some Palauans oppose the compact, concerns about U.S. rights to use Palauan land for military purposes are a factor, according to Palauan officials including the Speaker of the House of Delegates and the Senate President. A small percentage of Palauans oppose any agreement which would enable the United States to use land in Palau for military purposes; for example, some of Palau's older women believe that U.S. rights to use Palauan land would lead to a further deterioration of traditional Palauan society and culture.

Other Palauans, however, have identified specific concerns that they believe should be addressed by modifying the compact; for example, some legislators who are opposed to the compact stated they would support it if changes were made to its defense and economic provisions. These legislators believe the United States should be required to (1) provide fair market compensation to Palauan citizens whose land may be needed to meet U.S. defense requirements and (2) give Palau more time to respond to U.S. requests for land.

Palau May Have Difficulty Complying With 60-Day Requirement

Palau's Attorney General and Supreme Court Chief Justice also believe that the 60-day requirement in a compact subsidiary agreement to make sites available to the United States could be difficult for Palau to comply with, because most public land is controlled by the state governments and numerous land claims by private citizens have not been adjudicated.

Palauan land may be owned by individuals, tenants in common, clans, lineages, and government entities. However, clans and lineages are not very clearly defined groups. Also, foreign occupying powers claimed much of Palau's land over the past century without compensating private landowners. In many cases, records do not exist to demonstrate original ownership. Thus, it is common for more than one individual, clan, or lineage to claim ownership of the same parcel of land.

Most Public Land Controlled by States

In 1974, the Secretary of the Interior issued Secretarial Order 2969 authorizing the transfer of public lands held by the TTPI government to legal entities within each Micronesian district, which were to (1) hold title to public lands in trust for the people and (2) establish adjudicatory bodies to settle claims to title or rights to land. The Palau District Public Lands Authority was established for this purpose, and in 1979 the TTPI government transferred its right, title, and interest in a significant amount of land to this Authority. Rather than keep ownership of public lands at the national level, the Palau Public Lands Authority conveyed most land to the state governments.

Information provided by Palau's Land Claims Hearing Office shows that 68 percent of all land in Palau is public land and 32 percent is privately owned. DOD officials told us that much of the land the United States has identified as possible defense sites—such as Airai airfield and Malakal harbor—is public land. However, according to Palau's Attorney General the national government currently owns very little land; for example, Koror State owns and has title to most of the land on which national government office buildings are located. When the national government needs additional land for government facilities, it must negotiate with the Ibedul.

If the United States were to request the use of public land, the national government probably would have to negotiate an agreement with one or more state governments. Most Palauan officials we interviewed—including the President, Attorney General, Speaker of the House, and Senate President—believe that 60 days would not be sufficient time for the national government to reach agreement with states on the terms and conditions of U.S. use.

Private Land Claims Not Yet Adjudicated

Unresolved claims to land by private individuals and clans could further complicate Palau's ability to respond to U.S. requests for land within 60 days, according to Palauan officials. In 1987, Palau enacted a law, known as the Palau Lands Registration Act, whose purpose is to

“accomplish within eight years of the enactment of this Act the registration of all lands within the Republic of Palau, and to determine the ownership of lands and provide for the return to the original owners or their heirs or assigns, land which became public lands as a result of the acquisition by the previous occupying powers or their nationals through force, coercion, fraud or without just compensation or adequate consideration.”

The law established a new Palau Land Claims Hearing Office under the administration of the National Judiciary to carry out the act.

January 1, 1989, was the deadline for citizens to submit claims for public lands. Determinations of ownership by the Land Claims Hearing Office must be made prior to January 1, 1991. These decisions may be appealed to the Trial Division of the Supreme Court and then to the Court’s Appellate Division. Thus, final adjudication of these claims could take several years.

According to Palau’s Supreme Court Chief Justice and Attorney General, the requirement that Palau provide the United States with land within 60 days could create major problems in situations in which land is privately owned or private claims are pending. If the United States requested land that was privately owned, the national government would have to negotiate with private owners for the use or purchase of the land. Owners are likely to insist upon adequate compensation and 60 days may not be enough time for the government to reach agreements. Moreover, if the United States made a request for land whose ownership was in the process of being adjudicated by the Land Claims Hearing Office or the Supreme Court, Palau would have even more difficulty complying with the 60-day requirement. According to Palau’s Supreme Court Chief Justice, adjudication of individual cases is likely to take 1 to 2 years.

Palau Supreme Court Finds Defense Provisions Troubling

In 1986, several plaintiffs, including the Ibedul, filed a suit against President Lazarus Salii² alleging that the Compact of Free Association was not properly ratified pursuant to Palau’s constitution because only 72 percent of Palauan voters supported compact implementation in the February 1986 national referendum. In July 1986, the Trial Division of the Palau Supreme Court issued an oral ruling partially in favor of the plaintiffs and in August the decision was appealed. In September 1986, the Appellate Division of the Palau Supreme Court in effect ruled that

²Yutaka Gibbons, Gabriela Ngirmang, James Orak, and Rikrik Spis v Lazarus Salii, Political Education Committee, and Republic of Palau

the compact had not been ratified in accordance with Palau's constitution because it required 75-percent voter approval due to the compact's nuclear transit provisions.

The court also addressed problems that could occur if the United States exercised its right to use Palauan land for military purposes following compact implementation. The court rejected the plaintiff's contention that compact provisions regarding U.S. military use are unconstitutional and concluded the matter was not yet ready for decision. Although the court recognized the problem, it stated that the government of Palau could possibly carry out its obligations to make designated land sites available to the United States without violating constitutional provisions which preclude the government from using its powers of eminent domain on behalf of a foreign entity.

However, the court also stated that the defense site provisions of the compact "are profoundly troubling and surely raise the specter of future constitutional crisis." The court went on to say that U.S. defense site provisions under the compact may eventually place the government of Palau in the position of either violating Palau's constitution or breaching the compact. Specifically, Palau's constitution vests in the national government "power to take property for public use upon payment of just compensation" but goes on to say that this power shall not be used for the benefit of a foreign entity. The compact subsidiary agreement on military use requires that Palau make sites designated by the United States available within 60 days—a timeframe which the court accepted as being "extraordinarily tight." The court stated that it seems highly likely, if not inevitable, that Palau will be faced with the necessity of paying exorbitant prices in order to coax reluctant owners to part with their land. Moreover, "the difficulties could be compounded, if not rendered insuperable, by disputes as to ownership of the designated land."

Agreement Between President Salii and the Ibedul

Palauan concerns about U.S. military rights under the compact were also a factor in the dismissal of a lawsuit filed in July 1987 and dismissed in August 1987. On July 29, 1987, three plaintiffs in Merep v. Salii filed a complaint asking the Palau Supreme Court to enjoin the executive branch from calling or holding referenda held in August 1987 to amend Palau's constitution and approve the compact. The court refused to enjoin the referenda and the complaint, as subsequently amended, contested the propriety of a Palauan law which authorized an August 1987 referendum on the constitutional amendment. On August 28, 1987, the lawsuit was settled by a stipulation of dismissal

between the parties after the Ibedul signed a memorandum of understanding with President Sali. This memorandum stated that the Ibedul would cause the lawsuit to be dismissed and, in return, (1) the Palauan government would not use its power of eminent domain to obtain land for U.S. use contrary to the constitution, (2) land provided pursuant to the compact would be taken with just compensation and the consent of owners, and (3) the President would designate a Council of Chiefs with responsibility for considering U.S. requests for land.

According to some Palauans, it is not clear what impact, if any, this agreement between a former President and one of Palau's paramount traditional leaders will have on Palau's ability to comply with U.S. requests for land in a manner consistent with Palau's constitution. Some Palauans who have concerns about the land issue do not believe this agreement will resolve problems with the provisions or bind future Presidents. In the absence of a Palau Supreme Court decision on this issue, the impact of this agreement is uncertain.

U.S. Officials' Views

DOD officials stated that DOD has no plans to establish military facilities in Palau once the compact takes effect and therefore problems identified by some Palauans are not likely to occur. However, they acknowledged that if the United States exercises its option to establish facilities, state ownership of public lands and unresolved land claims by private individuals and clans could complicate Palau's making land available to the United States. For example, DOD officials in Guam and Hawaii stated that complex land-ownership arrangements and confusion about who owns land could make it difficult for the government of Palau to respond to U.S. requests for land in 60 days. They believe the compact provides an adequate framework for addressing this issue on a case-by-case basis as problems arise.

The Director of State's Office of Freely Associated State Affairs said that the State Department does not view the defense provisions of the compact and related subsidiary agreement as potentially incompatible with Palau's constitution because U.S. rights under the compact are restricted to using land during the period the compact is in effect; the United States cannot own or obtain a permanent interest in land. If the United States made a request to use land that is owned by Palau's state governments or private citizens, the government of Palau in all likelihood would negotiate with private landowners or states for temporary use of the land and would not need to use its eminent domain authority. He also noted that the United States currently has no plans to exercise

its military land use options under the compact and, judging from history, this is not likely to change. The United States has never established military facilities in Palau during the trusteeship—even during the Vietnam war.

Furthermore, the State Department does not view the 60-day requirement and compensation issue as problems because even if the United States requested land, U.S. policy would require taking reasonable actions in exercising compact land use options. The 60-day timeframe could be extended on a case-by-case basis by mutual agreement. Moreover, although the Department believes that economic assistance included in Title 2 of the compact provides adequate and fair compensation to Palau for U.S. military land use options, the United States, if it deemed appropriate, could provide Palau with additional funds to assist it in meeting its obligations to make land available.

According to State officials, the administration believes the compact and subsidiary agreement are adequate but, to comply with an agreement reached with congressional committees in October 1988, it developed a new subsidiary agreement to the compact that includes language to address Palauan concerns about the military land use provisions. The new agreement, which was signed by U.S. and Palauan officials on May 26, 1989, explicitly recognizes that Palau may request U.S. financial assistance in addition to amounts provided in the compact and that the two governments shall enter into appropriate agreements for this purpose subject to approval in accordance with their respective constitutional processes. It also recognizes that the government of Palau may request extensions of the 60-day time limit and the United States will consider such requests.