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March 13, 2008

The Honorable Carol Fukunaga, Chair  
The Honorable Will Espero, Vice Chair, and Members  
Senate Committee on Economic Development and Taxation  
Hawaii State Capitol, Room 224  
Honolulu, HI 96813

**Subject: H.B. No. 1075 H.D. 1, Relating to Real Property  
(Lease alterations to favor long-term lessees)**

Dear Chair Fukunaga, Vice-Chair Espero, and Committee Members:

My name is David Arakawa, and I am the Executive Director of the Land Use Research Foundation of Hawaii (LURF), a private, non-profit research and trade association whose members include major Hawaii landowners, developers and a utility company. One of LURF's missions is to advocate for reasonable and rational land use planning, legislation and regulations affecting common problems in Hawaii.

LURF appreciates the opportunity to provide our testimony **in opposition to H.B. No. 1075 H.D. 1**. LURF is opposed to this bill because it **violates the Contracts Clause (Article I, Section 10) of the United States Constitution ("U.S. Constitution")**. It is unconstitutional because (1) it alters major terms in existing long-term lease contracts and would substantially impair the contractual relationship of such leases; (2) the proposed bill is not designed to promote a significant and legitimate public purpose; and (3) the proposed law is not a reasonable and narrowly-drawn means of promoting a significant and legitimate public purpose. Moreover, prior legal opinions issued by the State of Hawaii's Department of the Attorney General ("Attorney General") have repeatedly cautioned that analogous legislation, which altered existing contract rights to the detriment of lessors and to the benefit of lessees, would violate the Contracts Clause of the U.S. Constitution.

**H.B. No. 1075 H.D. 1**. The alleged purpose of this bill is to alter certain lease conditions in existing long-term leases of commercial and industrial properties and to provide a tax benefit for lessors who sell the leasehold interest and all improvements to lessees. The proposed H.B. No. 1075 H.D. 1 would change certain terms of the original lease agreement between parties to the detriment of the lessor and to the benefit of the lessee by, among other things:

- 1) Altering the existing contract rights of lessors to withhold approvals for the assignment, transfer, or encumbrance of leasehold property;

- 2) Altering the existing contract terms which would require lessees to make substantial new improvements to infrastructure or structures, by changing the contract requirement to making reasonable maintenance and repair work to satisfy laws, ordinances and code requirements...;
- 3) Altering the contract terms which require the reversion of any improvements on the leasehold property at the termination of the lease; and
- 4) Altering the contract terms which provide for the calculations of periodic step-ups in lease rent.

**Background of similar and comparable unconstitutional legislation which altered lease terms to the benefit of lessees and to the detriment of lessors.**

Over the past several years, legislation has been introduced with the recurring theme of legislatively altering the terms and conditions of existing leases to the benefit of lessees and to the detriment of lessors:

- In 2007, S.B. No. 1252 and S.B. No. 1619, proposed virtually identical alterations of existing lease contract to favor the lessee;
- In 2006, S.B. No. 2043, would have imposed a surcharge tax on the value of improvements to real property subject to reversion in a lease of commercial or industrial property;
- In 2000, S.B. 873 S.D. 1 H.D. 2 also attempted to alter existing lease contract terms to the detriment of lessors and to the benefit of lessees by proposing to alter existing lease terms to require a lessor to purchase a lessee's improvements at the expiration of the lease term. The Department of Attorney General opined that S.B. 873 S.D. 1 H.D. 2 violated the Contracts Clause (Article I, Section 10) of the U.S. Constitution as follows: "S.B. No. 873, as presently worded, will substantially impair existing leases without furthering any apparent public purpose... [It is] unlikely that S.B. 873 will be found to be a 'reasonable and narrowly-drawn means of promoting... [a] significant and legitimate public purpose.'" Governor Cayetano relied on the Attorney General's opinion, and vetoed S.B. No. 873, S.D. 1, H.D. 1.
- In 2001, in response to H.B. No. 1131, H.D. 1, yet another bill which proposed to alter existing lease contracts to favor lessees, the Attorney General again reaffirmed its opinion that the proposed bill violated the Contracts Clause of the U.S. Constitution.
- In 1987, in the Hawaii Supreme Court case of Anthony v. Kualoa Ranch, 69 Haw. 112, 736 P.2d 55 (1987). The Court ruled that a statute requiring a lessor to purchase a lessee's improvements at the expiration of the lease term violated the Contracts Clause. The Court observed that: "This statute, as applied to leases already in effect, purely and simply, is an attempt by the legislature to change contractual remedies and obligations, to the detriment of all lessors and to the benefit of all lessees, without relation to the purposes of the leasehold conversion act; without the limitations as to leaseholds subject thereto contained in the conversion provisions; not in the exercise of the eminent domain power; but simply for the purpose of doing equity, as the legislature saw it. If there is any meaning at all to the contract clause, it prohibits the application of HRS §516-70 to leases existing at the time of the 1975 amendment. Accordingly, that section, as applied to leases existing at the time of the adoption of the 1975 amendment, is declared unconstitutional."

**H.B. No. 1075 H.D. 1 is an unconstitutional impairment of contract under the U.S. Constitution.** We believe that the provisions of H.B. No. 1075 H.D. 1, if challenged in court, would fail to meet the test to determine whether a statute is constitutional under the Contracts Clause, as set out in the more recent Hawaii Supreme Court case of Applications of Herrick & Irish, 82 Haw. 329, 922 P.2d 942 (1996) and quoted by the Attorney General in its prior opinions relating to proposed laws which alter lease terms to benefit lessees:

In deciding whether a state law has violated the federal constitutional prohibition against impairments of contracts, U.S. Const., art I, § 10, cl.1, we must assay the following three criteria: 1) whether the state law operated as a substantial impairment of a contractual relationship; 2) whether the state law was designed to promote a significant and legitimate public purpose; and 3) whether the state law was a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose.

**It is bad public policy to use legislation to alter the terms and conditions of contracts to favor one party to a contract, or to attempt to address private disputes.** The proposed H.B. 1075 H.D. 1 is yet another attempt to infringe on a lessor's ability to enter into and negotiate a lease. Under the law, a lease is a contract between two parties entered into at their own free will; the terms and conditions of the lease are agreed to in their entirety when the lease is executed; the lessee and lessor may seek amendments or modifications to the lease terms and conditions as long as both parties agree; and if there is a dispute, either party may seek resolution through the courts.

**Conclusion.** The intent and application of H.B. No. 1075 H.D. 1 are unconstitutional, profoundly anti-business and bad public policy, and therefore the bill should be held.

Thank you for the opportunity to express our opposition to H.B. 1075 H.D. 1.

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Senator Carol Fukunaga  
Twenty-Fourth State Legislature  
Regular Session of 2008  
State of Hawaii

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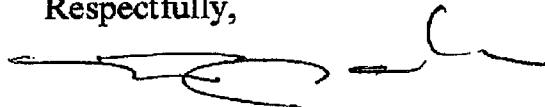
Via Fax: (808) 586-6899

Madame,

I am a small landowner and will be severely, negatively impacted by the passage of HB 1075 which relates to Real Property. I would like to make an appointment to come in and talk to you about some concerns I have about this bill. I will contact your office to secure an appointment however at this time, I respectfully request that you defer this bill.

Thank you for your prompt attention to this matter.

Respectfully,



Nohea M. Santimer