LATE TESTIMONY

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February 18, 2009

Representative Angus McKelvey, Chair
Representative Isaac Choy, Vice-Chair
House Committee on Economic Revitalization
Business and Military Affairs
State Capitol
Honolulu, Hawaii 96813

Re: House Bill 1593, Re Real Property
Hearing Date: February 19, 2009, 9:30 a.m., Room #312

Dear Representatives McKelvey and Choy and Members of the Committee:

My name is Jay Fidell and I am general counsel of Citizens for Fair Valuation, Inc., a Hawaii non-profit corporation, which represents industrial and commercial ground lessees in Mapunapuna, Kalihi Kai and Sand Island.

The members of Citizens for Fair Valuation include various industrial and commercial ground lessees in these areas in which HRPT is the landlord. Many of these and other HRPT lessees in the area have gotten very high rent renegotiation proposals.

Although the HRPT lease form provides that the lease rent will be "fair and reasonable", the lease does not explain what "fair and reasonable" means. I do not believe that setting the rent at twice the rent or more is "fair and reasonable", particularly in view of the fact that these ground lessees are generally unable to afford to pay those increases and still operate their businesses and pay their employees.

If they cannot get a fair and reasonable rent from HRPT, they are at risk of losing their businesses and their improvements will revert to HRPT.

If they are charged higher rent, and in most cases it is double what they are paying now, they will have to raise their costs to their customers who buy their products and they in turn will have to increase their prices to the consumers that they serve. In this economy, people can't afford those higher prices and, so there will probably be less purchasing which will then affect their abilities to keep their workers employed.

This bill provides that the rent increase shall be "fair and reasonable" to both lessor and lessee and that the determination of the increase will depend on actual factors affecting to or relating to my property and not some imagined "highest and best use". Fair and reasonable rent will allow these lessees to continue to operate their business, pay their debts, service their customers and keep their employees working.

For these and other reasons, I urge you to pass this Bill. Thank you for allowing me to testify on this bill.

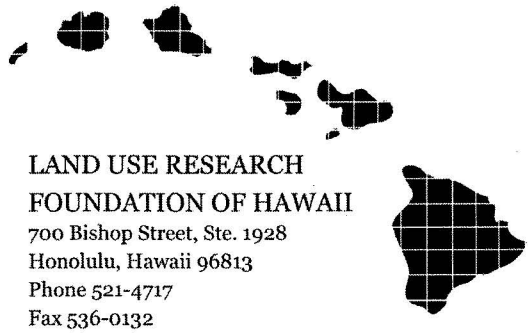
Very truly yours,

Jay M. Fidell

Jay M. Fidell
Of BENDET, FIDELL, SAKAI & LEE

JMF:dt

LATE TESTIMONY



LAND USE RESEARCH
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February 19, 2009

House Committee on Economic Revitalization, Business & Military Affairs
Hearing Date: February 19, 2009, at 9:30 AM in CR 312

Testimony in Opposition to HB 1593: Relating to Real Property
(Alteration of provisions in long-term
commercial and industrial ground leases and subleases)

Honorable Chair Angus L.K. McKelvey, Honorable Vice-Chair Isaac W. Choy
and Economic Revitalization, Business & Military Affairs,

My name is Dave 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, rational and equitable land use planning, legislation and regulations that encourage well-planned economic growth and development, while safeguarding Hawaii's significant natural and cultural resources and public health and safety.

LURF respectfully **opposes HB 1593,** which mandates certain changes in terms and conditions of existing commercial and industrial ground leases and subleases by mandating new terms and conditions for the renegotiation of rent with the lessor, and by giving the lessees the right to automatically pass on any rent increases to subtenants. LURF is **opposed to HB 1593**, based on the following:

- **HB 1593 violates the Contracts Clause (Article I, Section 10) of the United States Constitution ("U.S. Constitution").** HB 1593 is unconstitutional based on the following:
  - It alters major terms in existing long-term lease contracts and would substantially impair the contractual relationship of such leases;
  - The bill is not designed to promote a significant and legitimate public purpose;
  - The proposed law is not a reasonable and narrowly-drawn means of promoting a significant and legitimate public purpose; and
  - Prior legal opinions issued by the State of Hawaii's Department of the 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.

- **We understand that HB 1593 is based on complaints of a few lessees against one lessor**. It is bad public policy to enact a state-wide law to address a private dispute between a group of lessees and one lessor, and it is also bad policy to change the terms and conditions of contracts to favor one party to a contract.

- **Lessees should utilize arbitration or mediation instead of changing state law.** Instead of pursuing a new state-wide law to change existing lease and sublease contracts, the lessees should utilize the arbitration alternative which is available under their existing lease contracts, or through mediation offered by the lessor. If the lessees' definition of "fair and reasonable" annual rent is legally justified and prevails in arbitration or mediation, it would avoid the need for statewide legislation.

HB 1593. This proposed law, which would impact commercial and industrial leases and subleases on a statewide basis, is based on the erroneous premise that existing commercial and industrial leases (it cites the auto service center and small retailer in Mapunapuna area) "contain provisions that are so onerous as to force businesses to relocate to rural areas and away from urban centers." The bill further states that "Maintaining close geographic ties between small businesses and the communities they serve is a 'public purpose' that requires legislative support." Thus, the flawed purpose of this bill is to "stabilize Hawaii's economy by addressing some of the 'burdensome provisions of existing commercial and industrial leases' of certain lands within urban districts by clarifying provisions in long-term commercial and industrial leases..."

Although the purported purpose of HB 1593 refers to commercial and industrial leases in urban areas (only), it will apply to any lease of commercial or industrial leasehold property existing on July 1, 2009, or thereafter. , and would impose new mandatory terms and conditions which are favorable to the lessee, including, among other things,

- **Alters the existing lease contract terms and conditions between the lessor and lessee**, by mandating a new rent renegotiation process and criteria relating to the determination of "fair and reasonable annual rent;" and also
- **Alters the existing sublease contract terms and conditions between the lessee and its subtenants**, by legislatively mandating that the lessee has a new legal right to charge subtenants a pro-rata share of the renegotiated rent.

HB 1593 is an unconstitutional impairment of contract under the U.S. Constitution. The proposed bill would change the terms of existing leases, which have already been negotiated and agreed to by the lessor and lessee and would also change the terms and conditions of existing subleases. This bill is an brazen attempt to have the legislature change contractual remedies and obligations, to the detriment of all lessors and subtenants of commercial and industrial properties, and to the benefit of all lessees. The Hawaii State Department of the Attorney General (Attorney General) has opined that such legislation, which would change the terms and conditions of existing lease contract terms, is illegal. We believe that if challenged in court, the provisions of HB 1593, would fail to meet the legal test to determine whether a statute is constitutional under the Contracts Clause, as set forth in the 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 other bills which have attempted to alter existing 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."

Comparable legislation which altered lease terms to the benefit of lessees and to the detriment of lessors has been found to be unconstitutional by the Attorney General. 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 2008, HB 1075 proposed virtually identical alterations of existing lease contracts to favor the lessee, however, the Senate Economic Development and Tourism Committee (EDT) held the bill. EDT placed the contents of HB 1075 into HB 2040, SD2, however that bill was held in Conference Committee.
- In 2007, SB 1252 and SB 1619, proposed virtually identical alterations of existing lease contract to favor the lessee;
- In 2006, SB 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, SB 873 SD 1, .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 SB 873, SD 1, HD 2 violated the Contracts Clause (Article I, Section 10) of the U.S. Constitution as follows: "SB 873, as presently worded, will substantially impair existing leases without furthering any apparent public purpose... [It is] unlikely that SB 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 SB 873, SD 1, HD 1.
- In 2001, in response to HB 1131, HD 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 statue 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."

It is bad public policy to enact a state-wide law to address a private dispute between a group of lessees and one lessor, and it is also bad policy to change the terms and conditions of contracts to favor one party to a contract. This situation should not warrant a new state-wide law which changes the terms and conditions of existing leases and subleases of commercial and industrial properties. Prior to approving such legislation, this Committee should investigate the following issues:

- We have been informed by the proponents of this bill, that **the proposed new State law is meant to address the problems of a few lessees with one lessor,** relating to the lease renegotiation clause in its leases, and the lease renegotiations by one lessor with several of its lessees;
- Prior to enacting state-wide legislation, it is important to determine **just how many lessees are encountering the alleged problems which have given rise to this legislation?**
- Prior to enacting state-wide legislation, it is also important to **determine whether the proponents of the bill are small business or "master lessees," who hold a master lease and sublease to other businesses?**
- The proposed bill is yet **another brazen attempt to favor lessees** - it infringes on a lessor's ability to enter into and renegotiate a lease and it creates a new law which would allow lessees to automatically pass-on any increase in lease rent to subtenants.

Instead of pursuing a new state-wide law, the lessees should utilize the Arbitration alternative under their existing lease contracts or the Mediation offered by the lessor. If the lessees' definition of "fair and reasonable" annual rent prevails, it would avoid the need for statewide legislation. 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. If there is a dispute regarding the lease terms, usually either party may seek resolution through arbitration, mediation, or the courts.

- The proponents of this bill have admitted that the existing leases include an arbitration clause regarding any disputes, which could be used to resolve the existing issue regarding what is a "fair and reasonable" annual rent.
- The lessor who is the purported target of this legislation confirmed that they have resolved other lease renegotiations with most of their lessees, and have offered mediation to other lessees who wish to renegotiate their annual rent;
- The proponents also stated that appraisal experts assisted in drafting the proposed new definition of "fair and reasonable" annual rent, and that their experts were confident that the lessees would prevail in arbitration;
- The proponents cited the costs of mediation or arbitration as a reason they are pursuing statewide legislation, however, the lessees could all jointly contribute funding toward the first few mediations or arbitrations.
- Based on the confidence of the proponents and their experts - it would seem that if the lessees definition of "fair and reasonable" annual rent prevails in the first

couple of cases which go to mediation or arbitration, those results would arguably set a precedent for all of the other lease renegotiations - - so no further mediations or arbitrations would be necessary!

Conclusion. The intent and application of HB 1593 are unconstitutional, profoundly anti-business and bad public policy, and therefore we respectfully request that **HB 1593 should be held in this Committee**.

Thank you for the opportunity to express our **opposition to HB 1593**.

LATE TESTIMONY

PLYWOOD HAWAII, INC.

1062 Kikowaena Place
Honolulu, HI 96819

February 19, 2009

Representative Angus L.K. McKelvey, Chair
Representative Isaac W. Choy, Vice-Chair
House Committee on Economic Revitalization, Business, & Military Affairs
State Capitol

Honolulu, Hawaii 96813

Re: **HB 1593 Real Property – Testimony in Support**
Hearing Date: February 19, 2009, 9:30 a.m., Room #312

Dear Representatives McKelvey and Choy and Members of the Committee:

My name is Connie Smales and my husband and I are owners of Plywood Hawaii, Inc., a wholesale plywood and lumber distributor serving the construction industry. Our company has been in business since 1995 and we employ 12 people. I am writing in support of HB 1593.

This bill will clarify the language in our present leases and allow us to participate in a fair determination of our ground rent. We are seriously concerned about the recent efforts of HRPT to dramatically increase our cost of doing business by doubling or tripling the rent in Mapunapuna, Sand Island and Kalihi Kai areas. They are also attempting to alter the leases, which are subject to periodic rent renegotiation by adding an annual step-up of 3 to 4% in addition to the increase, despite the dramatic downturn in the economy.

In requesting such dramatic increases, HRPT, the largest industrial landholder in the State of Hawaii, is attempting to generate unreasonable rents and therefore puts in jeopardy the small and medium sized business of this area that are the lifeblood of the State's economy

As a small business owner, I share the concerns of other businesses in this area that we receive a fair interpretation of the provisions in our lease. Your passage of this legislation would provide an equal playing field for both lessor and lessee as we face renegotiation of our lease. The ability to pay a fair rent means that we can continue in business as well as continuing to employ the wonderful people who work for our company.

Thank you for your consideration of this legislation.

Sincerely,

Connie Smales
President

LATE TESTIMONY

TESTIMONY TO THE HOUSE COMMITTEE ON ECONOMIC REVITALIZATION, BUSINESS AND MILITARY AFFAIRS
THURSDAY, FEBRUARY 19, 2009, AT 9:30 A.M.
ROOM 312, STATE CAPITOL

RE: H.B. 1593, Relating to Real Property

Chair McKelvey, Vice Chair Choi, and Members of the Committee:

My name is Brad Leach, Vice President-Pacific Region, for Reit Management & Research LLC, the property manager for HRPT Properties Trust ("HRPT"). HRPT is a publicly traded Real Estate Investment Trust, or REIT, that by law, must return 90% of its income to shareholders each year in the form of distributions. HRPT's stock is approximately 60% held by institutions and 40% held by individuals. The Bank of Hawaii is an institutional shareholder of HRPT as are many individuals who hold their shares in mutual funds from companies like Vanguard and Fidelity. Through its affiliated companies, HRPT owns industrial zoned land in Mapunapuna, Sand Island, and Ewa, and leases many of its Hawaii properties pursuant to long-term leases.

HRPT respectfully, but strongly, opposes H.B. No. 1593 ("the Bill"). This Bill is unprecedented. The Bill is targeted at a single landowner—HRPT—and would effectively change the agreed upon terms of previously negotiated long-term commercial and industrial lease contracts, for the sole benefit of a small group of lessees. The proponents of this Bill include some of the largest companies in Hawaii and wealthy, Mainland, sandwich lease investors, who have enjoyed substantially below-market lease rents for the last decade. In testimony before the State Senate on a companion bill, SB 764, this Bill's proponents candidly admitted that they are pushing the Bill to use as leverage in lease rent renegotiations with HRPT, to use it (in the words of a State Senator) as a "club" against HRPT. HRPT respectfully submits that is not an appropriate use of the legislative process. HRPT urges the Bill be held in committee, for the following reasons:

1. There is no public need for this legislation— Since HRPT acquired the Mapunapuna properties in 2003, the type of rent re-set lease contract provisions targeted by the Bill have been triggered more than 50 times. HRPT and its tenants have successfully negotiated a mutually acceptable rent rate in more than 90 percent of these cases. The rent re-sets provide for shared risk between the lessor and lessee and are designed to re-align the rental rate to

market, whether the result is an increase OR a decrease to the rental rate. When the lessor and lessee cannot agree, the existing lease contracts and existing law in Hawaii establish a procedure whereby the land's fair market value and resulting lease rent are determined by neutral, qualified appraisers. This fair market value appraisal procedure for determining commercial and industrial lease rent rates has been followed here in Hawaii for many decades on all such leases. A 2003 State of Hawaii Legislative Reference Bureau study entitled "Real Property Leases" found that commercial and industrial lease rents are "probably right where they should be," and concluded: *"While it is clear that certain lessees are experiencing significant difficulty under their present leases, there is no indication at this time of a broad based compelling need for the Legislature to pass legislation to mandate the alteration of existing lease agreements."* Since then, there has been no new study or research of industrial or commercial lease rents that justifies legislation contradicting the clear conclusions of the 2003 LRB study, and certainly no study that justifies legislation directed at a single landowner such as HRPT.

In those few cases where the tenant and HRPT have not reached an agreement on new lease rent, HRPT has never declined a tenant's request for mediation which avoids the time and expense of arbitration otherwise required by the lease. HRPT also has entered into dozens of new leases. Demand has remained strong for HRPT's properties, and HRPT has tried to balance that demand with the needs of its existing tenants. In several cases HRPT has worked diligently with tenants to reach creative lease solutions that reflect the current market conditions but also provide a better "fit" for the tenant's evolving business needs.

Many of the proponents of the Bill are tenants whose lease rent was last re-set in the 1990s, when property values were far lower than they are today. Research data from Colliers Monroe Friedlander shows that industrial warehouse rents on Oahu have doubled between 1998 and 2008. Colliers' data also shows that estimated industrial land values in the Mapunapuna/Sand Island/Kalihi Kai area have doubled during the same period. Tenants who have had the benefit of a low, fixed rental rate for the last ten years will now have their rent re-set to reflect those increased values and current market rates. However, HRPT views each lease on its unique facts and circumstances, and has always carefully considered any reasonable tenant proposal.

2. The Bill will not fulfill its stated purpose, and will not help "small businesses" or Hawaii's economy—Although the Bill purports to help "small businesses," its

beneficiaries include some of the largest companies in the State. According to testimony submitted to the State Senate, the Bill's proponents include Servco Pacific Corp. and Grace Pacific Corp. Hawaii Business magazine lists Servco Pacific Corp. as the 13th largest business in Hawaii, and Grace Pacific Corp. as the 50th largest business. Furthermore, there is no evidence that targeting and penalizing one landowner, in one relatively small section of Oahu, will "stabilize Hawaii's economy," as the Bill claims. Finally, there is no evidence whatsoever that businesses in Mapunapuna are being "forced to relocate to rural areas and away from the urban centers," as the Bill alleges. Mapunapuna has always been and will remain a dynamic center for Oahu's industrial and commercial businesses, both large and small. Since acquiring the Mapunapuna properties in 2003, HRPT has worked hard to resolve some of the area's longstanding problems, including the tidal flooding that has plagued Mapunapuna for 25 years. This year, with HRPT's intervention and the City's assistance, the repeated tidal flooding will be stopped, for the benefit of Mapunapuna's businesses and customers alike.

3. The Bill is unconstitutional—While the Bill's proponents claim that this Bill merely "clarifies" HRPT's leases with its tenants, in fact the Bill seeks to re-define an existing term in existing leases. By the admission of the Bill's own proponents, in their testimony before the State Senate, the Bill seeks to change the lease rent redetermination process in existing leases for the sole benefit of lessees, to attempt to reduce their lease rent.

Three separate State Attorney General opinions—in 2000, 2001, and 2002—concluded that similar bills to rewrite the terms of commercial and industrial leases for the benefit of lessees were unconstitutional. As the 2002 Attorney General opinion stated: *"The bill does not appear to provide a reasonably and narrowly drawn means to accomplish a significant and legitimate public purpose."* Under the Contracts Clause of the Hawaii State Constitution, and a Hawaii Supreme Court case called Anthony v. Kualoa Ranch, Inc. 69 Haw. 112 (1987), a state law is invalid if it "operates as a substantial impairment of a contractual relationship." This Bill substantially impairs existing commercial and industrial lease contracts by regulating an area that was not previously subject to regulation; interferes with the expectations of the parties; and changes the agreed upon terms of affected lease contracts.

Furthermore, the Hawaii Supreme Court made clear in Anthony that a law which changes existing contract rights and remedies is also unconstitutional if it does not impose a "generally applicable rule of conduct designed to advance broad societal interests". This Bill

does not advance any "broad societal interests". Rather, the Bill seeks to benefit one small group of lessees, by attempting to reduce their renegotiated lease rents, to the detriment of one landowner, without any rational relation to the public purpose stated in the Bill.

This Bill is bad policy, and bad for business throughout the State of Hawaii. The Bill sets a terrible precedent, sending a message to all businesses that they cannot necessarily rely on enforcing mutually agreed contract terms in this State. I ask that the Committee hold this Bill, and I thank the Committee for the opportunity to express our opposition.

HB1242

LATE TESTIMONY

STATE OF NEW YORK
DEPARTMENT OF TAXATION AND FINANCE
W A HARRIMAN CAMPUS
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Max Birdsall
Director

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February 18, 2009

Angus McKelvey
Hawaii State Capitol
415 South Beretania Street, Room 427
Honolulu, HI 96813
FAX – (808) 586-6161

Dear Mr. McKelvey:

It is my understanding that the State of Hawaii is considering working with IBM and the IBM Tax Audit & Compliance Solution (TACS). The purpose of this letter is to let you know that the New York State Department of Taxation and Finance has been working with IBM over the past seven years in the use of TACS to address our tax gap. We have focused on audit selection, refund analysis, and most recently debt collection. Our work with IBM and TACS have resulted in significant returns to the State of New York.

In an article published in mid-2008 in the Weekly State Tax Report, we estimated our tax revenue savings at $600 million from the implementation of our CISS solution and the inclusion of TACS. We expect to see continued savings as our debt collection solution contributes to the savings.

We are supportive of the results IBM has helped us achieve on this project and would be willing to answer questions you might have about our innovative tax compliance work.

Sincerely,

Max Birdsall

Max Birdsall
Director of Information Technology Services