SB 764 SD2

LATE TESTIMONY

KAMEHAMEHA SCHOOLS

Testimony to the House Committee on

Economic Revitalization, Business & Military Affairs

By Paul A. Quintiliani

Vice President of Endowment, Kamehameha Schools

Hearing Date: Tuesday, March 17, 2009

7:30 a.m., Conference Room 312

RE: Senate Bill No. 764 SD2 Relating to Real Property

Kamehameha Schools submits the following comments regarding S.B. No. 764 SD2 (the "*Bill*"). The Bill sets out to clarify provisions contained in long-term commercial and industrial ground leases.

As a lessor of residential, commercial and industrial real property, Kamehameha Schools **objects** to this Bill because, as written, it would likely hurt both lessors and lessees and could negatively impact our communities.

We oppose this Bill for the following reasons: (1) it may potentially de-stabilize the lessor-lessee relationship, (2) it fails to acknowledge that many landowners (including nonprofits and local families) are also struggling during these challenging economic times, (3) it fails to recognize that in certain circumstances bargained for rent increases, even in this market, may be legitimately justified, and (4) its subject matter may be more appropriately addressed by the courts and not the legislature.

Thank you for this opportunity to express our objection to this Bill.

567 South King Street • Honolulu, Hawai'i 96813-3036• Phone 808-523-6200

Founded and Endowed by the Legacy of Princess Bernice Pauahi Bishop

SB 764 SD2
LATE TESTIMONY

THE QUEEN'S MEDICAL CENTER

1301 Punchbowl Street • Honolulu, Hawaii 96813 • Phone (808) 538-9011 • FAX: (808) 547-4646 • www.queens.org

Representative Angus McKelvey, Chair
House Committee on Economic Revitalization, Business, & Military Affairs

Tuesday, March 17, 2009; 7:30 AM
State Capitol, Conference Room 312

Re: SB 764 SD2 – RELATING TO REAL PROPERTY

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

My name is Mark Yamakawa, Executive Vice President and Chief Operating Officer of The Queen's Health Systems, testifying in **opposition to Senate Bill 764 SD2**, which imposes terms on commercial and industrial leases.

The Queen's Health Systems (Queen's) is the parent company of Queen Emma Land Company. Established in 1979, Queen Emma Land Company is the non-profit organization which supports The Queen's Medical Center, Molokai General Hospital, and its affiliates in providing quality health care in Hawaii. The company accomplishes this by managing and enhancing the income-generating potential of the lands left by Queen Emma in 1885.

Any initiative that could curtail Queen's ability to get the most out of real estate income would impact our ability to support our health care mission. In FY 2007, Queen's contributed to the well-being of the State by giving back to the community more than $40 million, including costs associated with healthcare services, education, and uncompensated care. Real estate income supports the Queen Emma Clinics, the State's only designated trauma center, Native Hawaiian health programs, and the continuing education and training of health care workers.

According to the Healthcare Association of Hawaii, local hospitals incurred $141 million in uncollected payments last year resulting from bad debt and charity care. At a time when the health care industry is very fragile, this legislation could negatively impact Queen's ability to subsidize health programs that benefit the neediest in our community.

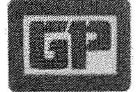
The Queen's Health Systems respectfully opposes Senate Bill 764 SD2 as it is contrary to the mission that our organization has supported for the last 150 years. Thank you for the opportunity to comment.

SB 764

LATE TESTIMONY

Grace Pacific
CORPORATION
P.O. Box 78 / Honolulu, Hawaii 96810

Administrative Office (808) 674-8383 fax (808) 674-1040
Paving Office (808) 845-3991 fax (808) 842-3206
Quarry Office (808) 672-3545 fax (808) 672-3998



March 16, 2009

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

TESTIMONY IN SUPPORT OF SB 764

DATE: Tuesday, March 17, 2009
TIME: 7:30 AM
PLACE: Room 312

Dear Representatives McKelvey and Choy and Members of the Committee:

I support SB 764, as written, and urge you to act on this important bill to help local businesses survive this recession. My name is Robert Creps and I am the Senior Vice President of Administration for Grace Pacific Corporation. Grace Pacific holds 5 ground leases in the Sand Island and Mapunapuna area, totaling five acres.

HRPT, landowner under the ground leases, is attempting to keep transaction data out of the public domain, denying tenants the ability to negotiate a fair market rent. Open access to current market data levels the playing field and insures pricing that is based upon the free flow of information. The Damon Estate made fair and reasonable rent escalations a central element of their business philosophy for more than 30 years. HRPT has made it clear that they intend to use their monopoly-like holdings to restrain the free trade of negotiation to their exclusive benefit, irrespective of the harm it does to Hawaii's economy.

Passage of this bill will require the mainland landowner to negotiate terms based on what is happening here in Hawaii, rather than trying to make up for losses on the mainland. We want rents that are fair and reasonable for both sides and reflect true market rents, not speculative land sales.

I urge you to please pass SB 764 as it is written. Thank you.

OB 764

LATE TESTIMONY

INTECH *inc.*

98-736 Moanalua Loop, Suite B
Aiea, HI 96701

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

TESTIMONY IN SUPPORT OF SB 764
DATE: Tuesday, March 17, 2009
TIME: 7:30 AM
PLACE: Room 312

Dear Representatives McKelvey and Choy and Members of the Committee:

I support SB 764, as written, and urge you to act on this important bill to help local businesses survive this recession. My name is Bernie Boltz and I live in Aina Haina. I have a long term master lease for a property located in the Kalihi Kai area. There are four small businesses employing over 20 people who sublease the space. An increase in ground rent will be a straight pass through but these businesses can not afford huge rent and property tax increases. They will simply close up shop.

Rent is one of the largest expenses we face. Up to now, the rents charged by the Damon Estate were "fair and reasonable," which is what the lease specifies. The new owner, mainland based HRPT, is demanding rents that are double or triple the current amount plus, they want 4% per year escalations. In addition, they are demanding that I sign a confidentially agreement before they will even start to negotiate. Based on how Damon did it for over 30 years, this is not fair and reasonable.

Passage of this bill will require the mainland landowner to negotiate terms based on what is happening here in Hawaii, rather than trying to make up for losses on the mainland. We want rents that are fair and reasonable for both sides and reflect true market rents, not speculative land sales. I urge you to please SB 764 as it is written. Thank you.

Bernard A. Boltz
Intech Inc.
151 Puuhale St
Honolulu, Hawaii 96819
808 330 2421
zbolt@hawaii.rr.com

www.intechhawaii.net
Phone 808-848-7753
Fax 808-848-0730

SB 764

March 17, 2009

LATE TESTIMONY

Rep. Angus L.K. McKelvey, Chair
Rep. Isaac W. Choy, Vice-Chair
Committee on Economic Revitalization, Business, & Military Affairs
State Capitol
Honolulu, Hawaii 96813

Re: SB 764 Re Real Property
Hearing Date: March 17, 2009, 7:30am, Room#312

Dear Representatives McKelvey and Choy and Members of the Committee:

My name is Jason Ideta and I support SB764 as written. I vote in the Kaneohe District and I am a lessee in the Mapunapuna area. My company is a small locally owned wholesale business that distributes auto parts directly to mechanics and other auto parts distributors on Oahu and the outer islands. We own an 18,000 square foot warehouse on 35,000 square foot property with a ground lease originally from the Damon Estate. We have 40 full-time and 2 part-time employees who have worked very hard to build the business over the last 23 years.

In front of the House Committee on Economic Revitalization, Business & Military Affairs, HRPT's lawyer stated to the committee that the Department of Hawaiian Homelands had a ground lease available for $8 per square foot. That statement was more than disingenuous. It was a deliberate lie to the committee. I spoke with the person who handles DHHL commercial leases and the person who won the bid. Lease rates on those properties were determined by a bidding situation. The minimum opening bid was $5.36 for 25 years, with no increases for the first 10 years. Only two of the current tenants showed up with just one taking the minimum. The other tenant did not bid at all.

When traditional lease contracts include a formula to calculate rents based on land value, the end result could favor the lessor or the lessee depending on the prevailing market conditions. I believe the original drafters of our leases, specifically did not include these formulas in order to hedge their positions. The Damon Estate was "fair and reasonable" with its tenants during its tenure by increasing rents during the good times and decreasing rent increases during the bad times. Even when the increases were already in the contract, they deferred then waived the scheduled increases on their own volition. This is how the contract was meant to be exercised. Currently, if the dispute goes to arbitration, "traditional" valuation standards will be applied. The Damon Estate contracts were purposely meant to be non-traditional.

In HRPT's written testimony, they have stated that this bill interferes with the expectations of the parties and changes the agreed upon terms of the affected lease contracts. The fact is that HRPT has chosen to ignore the expectations and agreed upon terms that the lease rents be "fair and reasonable" by trying to impose rents that are 50 to 90% above market rents. HRPT states that

the lease is "designed to re-align the rental rate to market, whether the result is an increase OR a decrease to the rental rate." In the latest Colliers Monroe Friedlander 3rd quarter 2008 Industrial Market Briefing, market indicators show a decrease in industrial rental rates for 2009. Yet, HRPT insists that they are being fair by asking for annual increases and rates that are clearly above market. They claim to have "worked diligently with tenants to reach creative lease solutions that reflect the current market conditions," but the unprecedented support for Citizens for Fair Valuation by small businesses proves otherwise. None of us would be here in this room today if HRPT lived up to its part of the contract.

Also in HRPT's written testimony is a statement that the proponents of this bill are large, wealthy, Mainland investors. There is nothing large, wealthy, or mainland about my company and nothing could be further from the truth about the vast majority of the businesses in Mapunapuna who could use your support.

Does this bill act as a substantial impairment of a contractual relationship? I believe it does not. The main focus of this bill does not try of re-define the term "fair and reasonable." Apparently not all, but most reasonable people already know what it means to be fair. Instead, it provides an avenue for both parties to live up to the spirit of the contract.

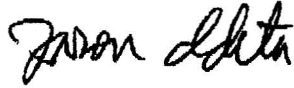
Is it a reasonable and narrowly-drawn means of promoting a significant and legitimate public purpose? I believe it is. This bill focuses on one style of contract from one landlord. In economic times like this, there are only a few things more important to the people of Hawaii than having the legislature support the local economy. The last thing we need is to have an east coast investment company trying to cover their bad investments on the mainland by unfairly raising rents and putting a bunch of small local companies out of business.

With the local credit markets frozen, it would be mistake for any business to abandon their initial investment in infrastructure because they would not be able to get funding for the cost to relocate and start over. Secondly, we would still be responsible to pay HRPT the rest of the rent for the remaining 15-25 years left on our leases. HRPT would probably hold us to it because no one else will sign a lease with them for the rates they are asking. HRPT knows this and is taking advantage of the situation. Lastly, being centrally located is very important in providing timely delivery to our customers which makes moving westward unfeasible. If our rents double, we will be forced to increase prices and cut costs by decreasing our work force to stay in business. Our customers will then pass on the increased costs to their customers. The cost to maintain and repair vehicles in Hawaii will increase. Most local businesses cannot raise prices and decrease service at the same time and remain competitive.

When HRPT bought the properties at the end of 2003 from the Damon Estate, they were generating a rental income of around 7%. Today, with the stock market down more than 50%, the real estate investment trust market down 50-70%, and the economy in the worst shape since I can remember, HRPT expects to increase their return by more than double?

By passing this bill as written through your committee, you will send a message to the people of Hawaii that you care about the local economy and the plight of small business. I respectfully ask for your support on this bill and thank you for the opportunity to testify.

Sincerely,



Jason Ideta
Pacific Jobbers Warehouse, Inc.

LATE TESTIMONY

Testimony on S.B. 764, SD2
Relating to Technology
House Committee on Economic Revitalization, Business, & Military Affairs
Keali`i Lopez, President and CEO of ʻŌlelo Community Television
Tuesday, March 17, 2009

Chair McKelvey, Vice-Chair Choy and members of the House Economic Revitalization, Business, & Military Affairs Committees. Thank you for the opportunity to provide written comments on S.B. 764 S.D.2. ʻŌlelo supports this Bill. We are a local non-profit organization located in Mapunapuna. The building that we own is located on a parcel of land that we lease. We have 26 years remaining on our lease and could soon see our lease rent increase substantially when we renegotiate terms later this month.

A substantial increase in lease rent, coupled with major increases in our other operating expenses would place us in a very precarious financial position. In this respect, we are no different from a small business that operates on a very slim margin. However, we are unable pass these increases on to our customers.

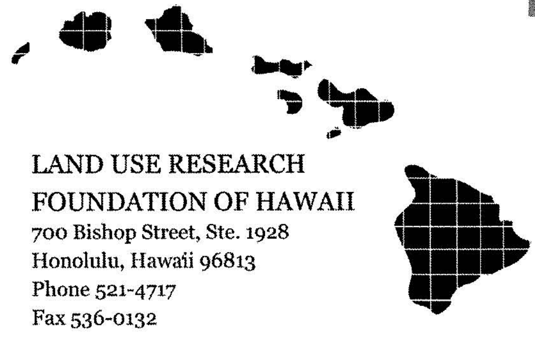
We understand that lessors have rights, to include the expectation of a reasonable return on their investments, but clearly there is a need for safeguards to ensure that lessees are not subject to unreasonable increases that drastically curtail services or force them out of business.

We are members of the Citizens for Fair Valuation, a non-profit organization committed to ensuring fair valuation of the commercial and industrial ground leases in the Sand Island, Mapunapuna and Kalihi Kai areas. We believe that fair interpretation of leases is crucial to the health of non-profit organizations and small businesses that all of us rely upon.

Because of this, we ask that you support that the term of "fair and reasonable" in commercial ground leases that are renegotiated have these equity provisions. In summary, I ask for your support of SB764. Mahalo.

Revised SB 764 SD2

LATE TESTIMONY



LAND USE RESEARCH
FOUNDATION OF HAWAII
700 Bishop Street, Ste. 1928
Honolulu, Hawaii 96813
Phone 521-4717
Fax 536-0132

Via Capitol Website

March 17, 2009

House Committee on Economic Revitalization, Business & Military Affairs
Hearing Date: Tuesday, March 17, 2009, at 7:30 a.m. in CR 312

Testimony in Opposition to SB 764 SD2: Relating to Real Property (Alteration of provisions in long-term commercial and industrial ground leases)

Honorable Chair Angus L.K. McKelvey and Honorable Vice-Chair Isaac W. Choy and Members of the Committee on 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 understands that this measure was proposed by lessees who are having trouble negotiating their leases with one lessor - HRPT. We and hope that further negotiations, arbitration and mediation can resolve such differences and result in renegotiated leases which can be accepted by both parties. Nonetheless, LURF respectfully **opposes SB 764, SD2,** which:

- targets a single landowner – HRPT;
- changes the previously negotiated and agreed-upon terms of existing commercial and industrial ground leases by mandating new terms and conditions for the renegotiation of rent with the lessor, which are for the sole benefit of a small group of lessees; and
- changes existing commercial and industrial subleases by giving the master ground lessees of properties owned by HRPT the statutory right to automatically pass on any pro rata rent increases to sublessees, if not otherwise specified in the sublease, and denies the subtenants an opportunity to negotiate a fair and reasonable rent with the master lessees of HRPT's properties.

LURF's objections to SB 764, SD2, can be summarized as follows:

- **"If you put lipstick on a pig, it's still a pig."** SB 764, SD2 is an unconstitutional violation of the Contracts clause of the United States Constitution. In an effort to try to save the bill from being held unconstitutional, it appears that certain legislators have changed the purpose and intent section of the bill from "Geographic proximity" to "Economic viability." However, an unconstitutional law cannot be "fixed" by merely changing the "purpose and intent" section of the bill.

- **"SB 764, SD2 is a "special law," which violates Article XI, section 5 of the Hawaii Constitution**. SB 764 is "special legislation," which is prohibited by the Hawaii constitution, because it applies to one particular lease renegotiation provision in the leases of just one particular lessor - HRPT, discriminates against one particular lessor - HRPT, and operates in favor of certain lessees, by granting them a special or exclusive privilege. The proponents of this bill have admitted that this legislation is aimed at only one lessor – HRPT; and there is no testimony or evidence regarding any other lessors in the state who utilize the lease renegotiation language which is the subject of this bill.

- **"It is also not good public policy to pass a state-wide 'special law' because of a dispute between one lessor and a few lessees."** How many state-wide lessees are affected? Does a dispute with one lessor warrant a new state-wide law purporting to save Hawaii's economy?

- **"It is unfair and unconstitutional to change the terms of existing contracts to favor one party**." The Attorney General has issued prior opinions finding that such alterations in the terms of existing leases are unconstitutional.

- **"What is good for the goose, should be good for the gander" "You can't have it both ways!"** – Why does the proposed bill provide that negotiations between lessors and lessees must use a new definition of "fair and reasonable annual rent," but at the same time the bill also denies subtenants the opportunity to negotiate a fair and reasonable rent, by mandating that "sublessees shall be charged their pro rata share of the renegotiated lease," of not otherwise specified in the sublease.

- **"There is no need for this legislation – current lessees are going through the renegotiation process as provided in the existing contracts."** The record shows that HRPT has successfully renegotiated a mutually acceptable rent rate in 90% of the leases up for renegotiation.

- **"Don't legislate, just arbitrate."** Instead of creating a new law that alters existing contracts, the disgruntled lessors should just use the rights and remedies in the contract – arbitration, or inexpensive mediation, which has been offered by the lessor.

- **"Cut the Shibai." "The buck stops here."** Given the legal problems with this bill, we respectfully request that this Committee **hold this bill**.

- The measure is a "special law" which is intended to interfere with the ongoing lease negotiations for existing lease contracts with one lessor.
- The "amended" intent and purpose is a "pretext" (alleged reason, ploy, ruse, red herring, bogus), which states: ".....it is important to support local employers and small businesses in these difficult economic times.....there is a need to alleviate the economic consequences of allowing unfair and unreasonable rent increases for these properties until the local economy improves."
- If that alleged purpose of supporting small businesses were true, shouldn't the legislature be trying to help all of the existing business leases in the state? Instead, this bill is meant to affect the lease negotiations with only one lessor.
- If the alleged purpose is to truly help lessees "until the local economy improves" - - **Where are the sunset dates or sunset provisions in the bill?**

SB 764, SD2. The key provisions of SB 764, SD2, are described as follows:

- **Amendments by the Senate Committee on Commerce and Consumer Protection (CPN).** The CPN amended this measure to an SD1 version, by:
  (1) Amending section one to "accurately reflect the purpose and intent of this measure" – in truth, the CPN Committee **"tried to put lipstick on a pig,"** by changing the original unconstitutional purpose and intent to another pretextual purpose and intent which is also unconstitutional;
  (2) Removing the provision relating to the assignment, transfer, or encumbrance of leasehold property;
  (3) Removing the provision limiting the improvements to structures on leasehold property that may be required of lessees; and
  (4) Making technical, nonsubstantive changes for the purpose of clarity and accuracy in the language of this measure.

- **Key provisions of SH 764, SD2: Changes to contract terms of existing leases and existing subleases.** The proposed SB 764, SD2 applies to any commercial or industrial lease, and would mandate changes favorable to the lessee and detrimental to the lessor and sublessee, with respect to certain terms and conditions of the original lease and sublease agreement between parties, including, among other things:

  - Creates new terms and conditions in existing lease contract terms which provide for the calculations of renegotiation of "fair and reasonable annual rent" – - the new law would replace the existing contract terms with a new definitions and legal requirements for determination of lease rent. Requires that all leases existing or entered into on after July 1, 2009, that includes a renegotiation clause that renegotiates rent on a "fair and reasonable annual rent" be construed to mean that a fair and reasonable rent is a requirement and that such a determination take into account the uses, intensity, subsurface and surface characteristics, and neighborhood of the leased site on the renegotiation date; and

- Creates new terms and conditions in existing sublease contract terms, by providing that, unless otherwise specified in the sublease, sublessees shall be charged their pro rata share of the renegotiated lease.

- **Amendments by the Senate Committee on Judiciary and Government Operations (JGO).** JGO amended this measure to the current SD2 version by changing the effective date to July 1, 2050, to encourage further discussions on this matter. SSCR 782

LURF's OBJECTIONS TO SB 764, SD2. We believe that the current version of SB 764 SD2 will result in the legislature changing the terms in existing leases and subleases for the clear benefit of lessees and to the detriment of lessors and sublessees. LURF is **opposed to SB 764 SD2,** based on the following:

- **"Putting lipstick on a pig."** Any judge or appellate court will review this legislation and ask – "Why did the bill start out with a 'geographic proximity' purpose and intent, then in a SD2, the purpose and intent changes radically to 'economic viability' – while the key lease renegotiation provisions remain identical?"

- **Senate Bill 764 SD2 violates the Contracts Clause (Article I, Section 10) of the United States Constitution ("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 a 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 this measure, 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."

  - **This Bill substantially impairs the contractual relationship between the lessor and lessee.** The bill changes the original negotiated agreement between the lessor and lessee by mandating a new definition for renegotiation of

the lease, which is favorable to the lessee and objectionable to the lessor. The bill impairs the contractual relationship by, among other things:

- Altering the process for determining the amount of rent to be paid by a lessee, which is an essential terms of the lease contract;
- Seeking solely to reduce the amount of rent which lessees would be obligated to pay based on the renegotiation provisions in the existing contracts;
- Mandating a new process and definitions for renegotiation of rent, which is contrary to the methods and interpretations previously followed by appraisers in prior rental renegotiations under the existing contracts;
- Regulating an area of commerce – commercial and industrial leasing – that was not previously regulated by the state;

- The proposed law is **not designed to promote a significant and legitimate public purpose.**
  - First, there is **no significant statewide problem** to be addressed by this measure. The written testimony in support of this measure proves that it is based on **a dispute between one lessor and several lessees.**
  - Second, the bill **does not "advance broad societal interests,"** as it operates to the benefit of a few lessees and to the detriment of one lessor – HRPT;
  - Third, there is **no legitimate public purpose. The purpose stated in SD2 – "economic viability" - is a pretext, ploy, ruse and red herring.** It is very important to note that the key provisions in the original SB 764 and the SD2 are identical. However, the "purpose" has changed radically – from "Geographic proximity" to "Economic viability." It appears that the CPN Committee attempted to "fix" the purpose and intent language in a SD2, by changing it completely.
    - **Old purpose: "Geographic proximity."** The original public purpose of SB 764 was to change lease provisions which were "burdensome" and "so onerous as to force these businesses to relocate to rural areas away from the urban centers...Thus maintaining close geographic ties between small businesses and the communities they serve is a public purpose that requires legislative support."
    - **Amended purpose in SB 764 SD2: "Economic viability."** Now, however, to justify the exact same changes in lease renegotiation definitions, the "amended purpose" in SD2 is that "it is in the public interest that its citizens remain employed, that businesses continue to operate and pay wages and taxes, and that financial failures be reduced."
  - Finally, there are **no facts or proof that the new law will succeed in achieving the stated purpose of the bill, or that it will avoid the problems described in the section 1 of the bill.** According to HRPT, close to fifty businesses have renegotiated their lease rent pursuant to the existing contractual terms, and there is not evidence that any of those business have suffered the problems which are listed in the bill (home foreclosures, bankruptcy filings, financial failures, more unemployment, and business closures), as a result of the new lease rent.

- The proposed law is **not a reasonable and narrowly-drawn means of promoting a significant and legitimate public purpose**. The proposed bill is an attempt to resolve a dispute between one lessor and a few lessees in favor of the lessees, however, it is unreasonably broad – as it is a state-wide law, which changes the rent renegotiation terms of existing leases and also broadly changes all existing subleases, by adding new terms, providing that, unless not allowed under the lease, sublessees shall be automatically charged their pro rata share of the renegotiated lease.

➢ **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 later 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 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."

- **It is bad public policy to enact a state-wide law to address a private dispute between one lessor and a group of lessees, and it is also bad policy to change the terms and conditions of existing contracts to favor one party to a contract.** The testimony submitted by proponents proves that SB 764 SD2 is based on complaints of a few lessees against **one lessor**. 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 their leases;
  - 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 state-wide legislation?**
  - Prior to enacting state-wide legislation, it is also important to **determine whether the proponents of the bill are small businesses 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 give master lessees the new legal right to automatically pass-on any increase in lease rent to subtenants, unless otherwise specified in the lease.

- **"No need to Legislate – just Arbitrate." "It could just take one!"** Instead of pursuing a new state-wide law to change existing lease contracts, the lessees should utilize the Arbitration alternative which is available under their existing lease contracts, or through Mediation offered by the lessor. One major lessee, or a group of similarly situated lessees could share the costs on one arbitration or mediation. 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.

  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 arbitration or mediations, which could set the standard and criteria for all future lease renegotiations.**
- 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 SB 764 SD2 are unconstitutional, profoundly anti-business and bad public policy, and therefore we respectfully request that **SB 764, SD2 be held in this Committee.**

Thank you for the opportunity to express our **opposition to SB 764, SD2.**