LATE TESTIMONY

LAND USE RESEARCH
FOUNDATION OF HAWAII
1100 Alakea Street, 4th Floor
Honolulu, Hawaii 96813
(808) 521-4717
www.lurf.org

February 10, 2011

Representative Angus McKelvey, Chair and Representative Isaac Choy, Vice Chair
Committee on Economic Revitalization and Business

Opposition to HB 844, Relating to Real Property. (Mandates conditions applicable to commercial and industrial leases where the lessor owns 50,000 square feet or more of commercial or industrial leasehold property in the State.)

Thursday, February 10, 2011 at 8:00 a.m. in CR 312

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 **strongly opposes HB 844,** which proposes to mandate changes to the provisions of, and add conditions to certain existing long-term commercial and industrial leases where the lease provisions have already been negotiated and agreed upon by the parties to the lease contract.

HB 844. The bill is based on the erroneous premise that inequities exist in the relationship of fee simple owners of commercial and industrial properties (lessors) and the holders of long-term leasehold interests in those properties (lessees). The purpose of this bill is to implement changes in the certain terms and conditions governing existing long-term leases of commercial and industrial properties, to the benefit of lessees and to the detriment of lessors; and to provide a tax benefit for the lessors who sell the leasehold interest and all improvements thereon to those lessees.

LURF's Position. LURF **strongly opposes** this bill based on the following:

- **HB 844 violates the Contracts Clause (Article I, Section 10) of the United States Constitution ("U.S. Constitution").**

  HB 844 is unconstitutional because it alters major terms and provisions in existing long-term lease contracts and would substantially impair the contractual relationships underlying such leases. The proposed bill would change the terms and provisions of existing leases, which have already been negotiated and agreed to by the parties to the

agreement, and is an attempt to have the legislature change contractual remedies and obligations, to the detriment of all lessors and to the benefit of all lessees.

- Prior legal opinions issued by the State of Hawaii 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.

  The Hawaii State Department of the Attorney General has in fact opined that legislation such as HB 844, which would change the terms and conditions of existing lease contract terms, is violative of the Contracts Clause and therefore, illegal. LURF likewise believes that if challenged in court, the provisions of HB 844 would fail to meet the test of constitutionality under the Contracts Clause, as set forth in the Hawaii Supreme Court case, *Applications of Herrick & Irish*, 82 Haw. 329, 922 P.2d 942 (1996) (cited by the State Attorney General in its prior opinions relating to proposed laws which alter lease terms to benefit lessees), as 1) the bill operates as a substantial impairment of a contractual relationship; 2) the proposed state law is NOT designed to promote a significant and legitimate public purpose; and 3) the proposed state law is NOT a reasonable and narrowly-drawn means of promoting the significant and legitimate public purpose.

- HB 844 contradicts the ruling of U.S. District Judge Susan Oki Mollway in *HRPT Properties Trust, et al., v. Linda Lingle, in her capacity as Governor of the State of Hawaii*, Civil No. 09-0375 (U.S. District Court, D. Hawaii), a federal lawsuit in which Plaintiff lessor challenged the constitutionality of Act 189 of the 2009 legislature, and was successful.

  The court in the HRPT case found that Act 189, which similarly sought to amend the terms of long-term leases to the detriment of the lessor and to the benefit of lessees, violated the Contract Clause and Equal Protection Clause of the U.S. Constitution.

  HB 844 applies only to commercial or industrial leases where the lessor is the owner of fifty thousand square feet or more of commercial or industrial leasehold property in the State, and would mandate changes favorable to the lessee with respect to certain terms and conditions contained in the original lease agreement between parties. These changes include, among other things:

  - **Changes in the existing contract rights of lessor to withhold approvals for the assignment, transfer, or encumbrance of leasehold property**. The bill proposes to change the existing lease provisions relating to assignment/transfer to provide that "the approval of the lessor shall not be unreasonably withheld;"

  - **Changes to the existing contract provisions relating to the responsibilities and obligations of lessee, which require the lessee to make major and substantial improvements to the leasehold property, or to any infrastructure supporting the leasehold**

property. The changes proposed by HB 844 would reduce the existing responsibilities and obligations of the lessee by providing that "the lessee shall not be required to make substantial new improvements to infrastructure or structures" and shall instead be required to perform "only reasonable maintenance and repair work to satisfy federal, state, and county laws, ordinances, and code requirements to ensure the public's health, safety and welfare."

- **Changes to existing contract provisions relating to the condition of any improvements on the leasehold property upon reversion at the termination of the lease.** The changes proposed in HB 844 would allow the improvements to "be returned subject to reasonable wear and tear that may have resulted from the use of the improvements over the full term of the lease;"

- **Changes to the existing contract terms which provide for the calculations of periodic increases or step-ups in lease rent.** The new law would replace the existing contract terms with a new requirement for determination of lease rent. Increases in lease rent shall be determined, in part, "on a determination of the financial feasibility of the rent increase in relation to the current use of the leasehold property;"

  As indicated above, similar to the HRPT case, the impairment of lessors' rights under HB 844 is **substantial** as it deprives lessors of important rights; defeats the expectations of the parties; alters financial terms; and destroys contractual expectations.

➢ **SB 844 is yet another attempt in a long line of unsuccessful past attempts to introduce comparable Hawaii legislation which unconstitutionally alters the terms and provisions of existing leases to the benefit of lessees and to the detriment of lessors.**

Over the past several years, recurring attempts have been made to legislatively alter the terms and conditions of existing leases to the benefit of lessees and to the detriment of lessors, but said efforts have all been **unsuccessful**:

- In 2009, SB 770, which proposed virtually identical alterations of existing lease contracts to favor the lessee, was introduced, however, the members of the Senate Committee on Commerce and Consumer Protection unanimously voted to hold the bill in Committee. By operation of the legislative rules, SB 770 was carried over to the 2010 Regular Session, however, was **never set for hearing** in 2010.

Prior to 2009 and 2010, a number of other attempts to introduce almost identical or strikingly similar legislation were also made **unsuccessfully, having been declared unconstitutional**:

- 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 this 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, the Hawaii Supreme Court in Anthony v. Kualoa Ranch, 69 Haw. 112, 736 P.2d 55 (1987), 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 in the Anthony case 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."

➢ **HB 844 is <u>bad public policy.</u>**

The bill undermines the integrity of contracts and agreements entered into openly and willingly between private parties. Moreover, it allows the State to unfairly alter the terms and conditions of agreements to favor one party to a contract over the other, thereby creating uncertainty as to the ability of any individual or business organization to legally enforce contractual terms and agreements.

<u>Conclusion</u>. For the reasons set forth above, LURF believes that the intent and application of HB 844 are unconstitutional and profoundly anti-business, and should therefore **be held in this Committee**.

Thank you for the opportunity to express our **<u>strong opposition</u> to HB 844**.

From: mailinglist@capitol.hawaii.gov
Sent: Wednesday, February 09, 2011 9:04 PM
To: ERBtestimony
Cc: jwmccully54@gmail.com
Subject: LATE TESTIMONY - Testimony for HB844 on 2/10/2011 8:00:00 AM

Testimony for ERB 2/10/2011 8:00:00 AM HB844

Conference room: 312
Testifier position: support
Testifier will be present: No
Submitted by: James McCully
Organization: Individual
Address:
Phone:
E-mail: jwmccully54@gmail.com
Submitted on: 2/9/2011

Comments:
Aloha,

Please support HB 844

Mahalo,

Jim McCully