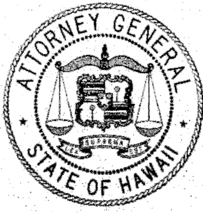

TESTIMONY OF THE DEPARTMENT OF THE ATTORNEY GENERAL TWENTY-SIXTH LEGISLATURE, 2012

ON THE FOLLOWING MEASURE:
S.B. NO. 2456, RELATING TO LEASES.

BEFORE THE:

SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION

DATE: Thursday, February 9, 2012 **TIME:** 9:00 a.m.

LOCATION: State Capitol, Room 229

TESTIFIER(S): David M. Louie, Attorney General, or
Linda L. Chow, Deputy Attorney General, or
William J. Wynhoff, Deputy Attorney General

Chair Baker and Members of the Committee:

The Department of the Attorney General (the "Department") appreciates the intent of this bill to assist local small businesses but must oppose it.

Purpose

The purpose of the bill is to alter the contractual relationship between lessors and lessees of commercial and industrial property. The bill gives lessees the option to extend otherwise expired leases for at least 35 years. The lease rent for the new term is to be set by a formula stated in the bill. If the lessor and lessee cannot agree on lease terms, then the lessee is given the right to purchase the property at a formula set by the bill. If the lessee neither renews the lease nor buys the property, then a "one hundred percent windfall surcharge tax" is levied on the lessor.

In addition, section 3 of the bill appears to broaden existing section 519-1, Hawaii Revised Statutes (HRS), so that it also covers State-owned land.

Discussion

As written, it is not clear whether the bill is intended to apply only to new leases that are entered into after passage or whether it applies to all leases that expire after passage. Generally speaking a retroactive law is one that takes away or impairs vested rights acquired under existing laws or attaches a new obligation, imposes a new duty, or attaches a new disability with respect to transactions or considerations already concluded. Employees Retirement Sys. v. Chang, 42 Haw. 532, 535 (1958). Retroactive laws are not favored and all laws will be construed as

prospective unless retrospective application is clearly intended and expressly declared, or is necessarily implied from the language used. See, section 1-3, HRS (no law has any retrospective operation unless otherwise expressed or obviously intended); Clark v. Cassidy, 64 Haw. 74 (1981). This principle is particularly applicable where the statute or amendment involves substantive, as opposed to procedural, rights. Clark, 64 Haw. at 77; Dash v. Wayne, 700 F. Supp. 1056 (D. Haw. 1988).

If the bill is passed and challenged, a court considering it would construe the statute to avoid the constitutional problem if at all possible. Matsuda v. Wada, 128 F. Supp. 2d 659, 665 (D. Haw. 2000). Such a construction would also favor its application only to new leases.

In any event, rather than leaving the issue open to interpretation, we recommend clarifying the intent of the bill. If it applies only to new leases that are entered into after passage, it may not have any practical effect for decades. If it applies to all existing leases that expire after passage, it is likely unconstitutional for reasons we now address.

First the bill proposes to alter the contractual relationship between lessors and lessees in favor of lessees. The Contract Clause of the United States Constitution, article I, section 10, clause 1, provides that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts."

Although the wording of the Contract Clause is facially absolute, there are circumstances in which the State may constitutionally affect existing contractual rights. The more drastic the change, the more closely a court will examine it.

If there is a substantial impairment, the State must have a significant and legitimate public purpose behind the regulation such as the remedying of a broad and general social or economic problem. Once the legitimate public purpose is identified, a court would consider whether the change to the contract is "based upon reasonable conditions" and is reasonably designed to promote the purpose.

The bill substantially alters existing contracts by forcing lessors to extend the terms of existing leases and regulating the lease rents they may charge. The articulated purpose for doing so is that otherwise "thousands of businesses" could be looking for properties to rent in an environment of "artificially created, speculative land values that do not reflect actual fair market values."

Hawai‘i land values are undoubtedly high compared to some other states. However, it would be difficult or impossible to support the proposition that these values are artificial or due to speculation instead of scarcity and desirability. Moreover, case law indicates that a court would likely find the measure provides a windfall to lessees, rather than effectively addresses the perceived problem. Richardson v. City and County of Honolulu, 124 F.3d 1150, 1165–66 (9th Cir. 1997); Chevron U.S.A., Inc. v. Cayetano, 198 F. Supp. 2d 1182, 1192 (D. Haw. 2002). These cases were overruled on other grounds in Lingle v. Chevron U.S.A. Inc., 544 U.S. 528 (2005), but their discussion of economic issues remains pertinent.

It is noteworthy that United States District Judge Susan Mollway found a recent, less pervasive law affecting leases unconstitutional in violation of the Contract Clause. HRPT Properties Trust v. Lingle, 715 F. Supp. 2d 1115 (D. Haw. 2010). See also Anthony v. Kualoa Ranch, Inc., 69 Haw. 112, 736 P.2d 55 (1987) (law that required lessors to pay, at the sole option of the lessees, for improvements built upon the leased premises in order to get the leased premises back, substantially impaired the contractual rights of the parties and was unconstitutional).

Second, we believe the bill also runs afoul of the Fifth Amendment to the United States Constitution. That amendment provides that private property can be taken only for a public purpose upon paying just compensation. The provision requiring lessors to rent their property for an additional thirty-five years is likely a taking. The provision requiring lessors to sell the property to tenants is certainly a taking. Requiring the transfer from one private owner to another (whether by lease or sale) probably does not satisfy the public purpose requirement under the circumstances. Restricting the price to be paid violates the constitutional requirement of just compensation.

Finally, the third section of the bill closely tracks existing chapter 519, HRS, except that the definition of lessor and lessee also includes the State (page 5, lines 13-15). We note that this definition is not consistent with later wording that restricts the bill to “the lease of private lands” (page 6, lines 5-6).

As a result of these several constitutional concerns, we respectfully ask the Committee to hold this bill.

QUEEN EMMA LAND COMPANY

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February 8, 2012

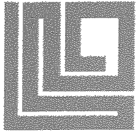
Senator Rosalyn H. Baker, Chair
Senator Brian T. Taniguchi, Vice Chair and
Members of the Senate Committee on Commerce and
Consumer Protection
State Capitol, Room 229
Honolulu, Hawaii 96813

RE: Senate Bill No. 2456 - Relating to Leases

My name is Eric Martinson and I am the President of Queen Emma Land Company (QEL), a non-profit entity whose mission is to fulfill the intent of Queen Emma and King Kamehameha IV to provide in perpetuity quality health care services to improve the well-being of Native Hawaiians and all of the people of Hawaii, primarily through The Queen's Medical Center, a sister company under The Queen's Health Systems. QEL accomplishes its mission by managing and enhancing the income-generating potential of the lands left by Queen Emma, who along with her Husband King Kamehameha IV had strong commitments to the health care needs of the people of Hawaii. The income from QEL is solely dedicated to supporting and improving healthcare services offered primarily through The Queen's Medical Center, but also through a number of other health care entities and programs throughout the state.

As an owner and lessor of commercial, industrial and residential real property, **QEL strongly opposes this bill**. Bills of similar language and intent have been heard previously in the state legislature and have repeatedly been identified as violating the Contracts Clause of the U.S. Constitution by mandating changes to existing leases for the benefit of only one party, the lessee. For any existing lease, the parties at that time of the agreement settled on mutually acceptable terms and conditions benefiting and balancing the goals and objectives of the parties over the term of the agreement. Mandating changes at the end of the term of the lease destroys pre-existing contractual expectations and obligations that the parties originally entered into. The extension of an existing agreement should be treated like a new agreement with both parties negotiating new terms and conditions mutually beneficial to each. Mandating term, rate of return and valuation with the further threat of forced fee sale, all to the benefit of the lessee, does not provide the basis for an equitable agreement.

Thank you for the opportunity to strongly oppose SB 2456.



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February 6, 2012

Senator Rosalyn H. Baker, Chair; Senator Brian T. Taniguchi, Vice Chair
and Members of the Senate Committee on Commerce and Consumer Protection

RE: OPPOSITION TO S.B. 2456 RELATING TO LEASES

HEARING: THURSDAY, FEBRUARY 9, 2012 @ 9:00 AM in CR 229

Dear Chair Baker, Vice Chair Taniguchi, and Committee Members:

Loyalty Development Company, Ltd. hereby submits its written testimony in opposition to S.B. 2456 Relating to Leases. Among other things, the bill would rewrite existing commercial and industrial leases by requiring lessors to offer lessees the option to renew their leases for not less than thirty-five years, with rent during the renewal period capped at a rate of return of not more than five per cent, and with the land value based upon the tax-assessed valuation from 1985, adjusted by the increase in the consumer price index. Further, if the lessor and lessee are unable to agree on the terms of a lease renewal, then the bill would give the lessee the option to purchase fee simple title to the property based upon the aforesaid land value. And where an existing lease of private lands (i.e., not restricted to commercial or industrial leases) provides for renegotiated rent based upon the fair market value of the land, or the value of the land as determined by its highest and best use, or similar words, then "[a]ny disputes over value shall be settled by the procedure selected by the lessee and not by arbitration under chapter 658A." The bill would also require, in lease renegotiations, that a rent based on fair market value shall apply even if the value is lower than the existing rent and the lease prohibits the lowering of the rent upon renegotiation.

As stakeholders, we believe the bill unfairly mandates one-sided changes to existing lease contracts to favor lessees only, without any significant and legitimate public purpose. Commercial and industrial ground leases are lengthy and complex contracts covering many subjects over a long period of time. They were freely negotiated by both lessors and lessees, at arm's length. Over the life of a lease, some provisions may tend to favor the lessor, while at other times the lessee may be favored. For the legislature to intervene now to make substantial and material changes in the provisions of existing lease contracts to favor one business party over another -- for example, by giving lessees the right to renew their leases for 35 years with the rent capped or alternatively to purchase fee simple title to the property, and by providing that disputes over land value are to be settled by any procedure selected by the lessee and not by arbitration as set forth in the lease -- is an unfair and arbitrary infringement of existing contracts.

We share the concern of other small and large landowners and lessors that S.B. 2456 raises serious public policy, legal, and constitutional issues. The bill will infringe on Article I, Section 10 of the United States Constitution, which says: "No State shall . . . pass any . . . Law impairing the obligation of Contracts." In the recent past, the federal courts and the Hawaii Supreme Court

have struck down Hawaii laws that made material changes in existing leases to the detriment of one party and the advantage of the other. *HRPT Properties Trust v. Lingle,* 715 F. Supp.2d 1115 (D. Hawaii 2010); *Anthony v. Kualoa Ranch, Inc.,* 69 Hawaii Reports 112 (1987).

We respectfully urge you to hold this bill. Thank you for this opportunity to express our views on this important issue.

Very truly yours,

LOYALTY DEVELOPMENT COMPANY, LTD.

Catherine Luke
Its Vice President

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GCA of Hawaii
GENERAL CONTRACTORS ASSOCIATION OF HAWAII
Quality People. Quality Projects.

February 9, 2012

TO: THE HONORABLE SENATOR ROSALYN H. BAKER, CHAIR, BRIAN TANIGUCHI, VICE CHAIR AND MEMBERS OF THE HOUSE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION

SUBJECT: **OPPOSITION TO S.B. 2456 RELATING TO LEASES.** Requires lessors of commercial and industrial property to afford lessees the option of renewing their leases.

HEARING

DATE: Thursday, February 9, 2012
TIME: 9:00 a.m.
PLACE: Conference Room 229

Dear Chair Baker, Vice Chair Taniguchi and Members of the Committee:

The General Contractors Association (GCA) is an organization comprised of over six hundred (600) general contractors, subcontractors, and construction related firms. The GCA was established in 1932 and is celebrating its 80th anniversary this year; GCA remains the largest construction association in the State of Hawaii. GCA is in **opposition** to S.B. 2456, Relating to Leases.

The bill proposes to require lessors of commercial and industrial property to afford lessees the option of renewing their leases. The bill also requires in leasehold negotiations, that a rent based on fair market value shall apply even if that value is lower than the existing rent and the contract between the parties bars the lowering of rent upon renegotiation.

The GCA believes that this bill is unconstitutional and would strip lessors of their right to determine specific terms in a lease agreed to between the parties.

We believe that this bill is unfair as it seeks to alter the terms of a negotiated lease term and seeks to legislatively impose new terms on the lessor not originally contemplated by either party to the lease.

The bill does not serve any significant legitimate public purpose requiring legislative action and should not be passed.

We recommend that the bill be held by this committee.

Thank you for the opportunity to present our views on this bill.