Real Property and Financial Services Section
Hawaii State Bar Association

KA NU HOU

"The News"

April 1997

FROM THE CHAIR

A plethora of bills dealing with issues relating to real property are currently in various stages of hearings, cross–overs and the like as you read this letter. Unfortunately, the volume together with the fluidity of the legislative process has made it very difficult for us to provide the summary which we hoped would be useful to you. We can report that the sponsors of SB 8 regulating traditional Hawaiian gathering rights withdrew the bill, and HB 1920, which deals with such rights in a somewhat different fashion, was, as of this writing, still alive. Also, S.B. 986, "A bill for an act relating to nonconsensual common law issues," amending HRS 507D, is designed to permit property owners to clear "frivolous" clouds on their titles in an expedited manner.

Continuing with our practice of highlighting a case of particular interest each quarter, you will find in this issue an edited report of Hi Kai Investment, Ltd. v. Aloha Futons Beds & Waterbeds, Inc., decided by the Hawaii Supreme Court this past December. A unanimous court permits a landlord who exercises his option to retake possession of his premises through summary possession, to sue a defaulting tenant for damages for breach of contract as measured by future lost rent. This result could effectively dissuade a landlord from mitigating his damages as the court stated that the defaulting tenant was liable for all unaccrued future rents, without mentioning that such rents should be discounted to present value. The U.S. Supreme Court has heard oral argument on Suitum v. Tahoe Regional Planning Agency (ripeness and transfer of development rights in a regulatory taking action) and was reportedly sympathetic toward the property owner who apparently attended the proceedings in a wheelchair. The Court generally issues opinions dealing with property and land use late in the term, and we will report the results in the newsletter following the decision.

Aside from our usual update programs on litigation and legislation and our annual meeting program based upon our revised multi–volume real property handbook, we are organizing a land use seminar with HICLE, following the format of the annual meeting program several years ago. The seminar will likely take place in October, and we hope to attract as our keynote speaker a federal circuit judge who has been handing down a number of high–profile takings decisions lately. Details will follow in our next newsletter.

Lastly, welcome to our newest board members, Robert Rowland (representing Maui), Jon Pang and Jan Kobayashi. Jan has returned to the Board as its elected secretary.

With Aloha,

David L. Callies,
Chair Real Property and
Financial Services Section

LIMITED LIABILITY COMPANIES

By David Johnson, Esq. and Maria Lowder, CPA

Overview. It is very likely that the limited liability company ("LLC") will replace the general partnership, limited partnership, joint venture, sole proprietorship, and S corporation as the business entity of the future, especially for small and medium sized businesses. The LLC offers single taxation under partnership tax law (or on the individual tax return of a sole member LLC), the flexibility in management structure and allocation of financial benefits of a partnership, the limited liability protection of a corporation protecting all owners, and freedom from the investor restrictions of an S corporation.

For real estate related businesses, an LLC offers particular tax advantages over an S corporation. Although the federal tax treatments of S corporations and LLCs are similar, they are not identical. Unlike an S corporation, an LLC is subject to partnership tax law which generally does not recognize gain to the LLC on a distribution of appreciated property to its owners. Also unlike an S corporation, an LLC which is subject to partnership tax law, has the ability to increase its members' basis by buying real property subject to non–recourse debt, or making non–recourse borrowings against the LLC's appreciated real estate. This results in an LLC having more flexibility than an S corporation to

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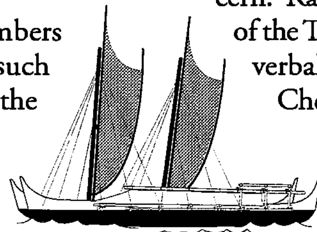
distribute funds to its members which, at least to the extent such distributions do not exceed the members' basis, probably will not be taxed in the year of the distribution.



A regular or C corporation may still be more desirable than an LLC for a few types of businesses, mainly those which: a) need to raise large sums from many owners for major projects; or b) intend to reinvest all profits for the foreseeable future, and want presently lower corporate tax rates on those profits, although eventual dividends and distributions will probably be double taxed; or c) provide owner–employees with various types of tax favored benefits which can only be provided by corporations.

Federal Check the Box Tax Regulation. If you ever puzzled over the four characteristics test which the Internal Revenue Code ("IRS") used to apply in determining whether an entity should be taxed as a corporation or a partnership, you can forget that arcane knowledge. IRS Reg. §301.7701–1, effective January 1, 1997, nicknamed "Check the Box Regulations" provides that unless one elects otherwise by filing form 8832, domestic partnerships and LLCs with two or more members will be taxed as partnerships; one member LLCs will be taxed similar to a sole proprietorship on the member's tax return. There will be no double taxation unless it is specifically chosen. The rules for foreign entities doing business in the U.S. are more complex, but still retain considerable flexibility and choice.

Hawaii Tax Law. Neither the Hawaii Revised Statutes nor the Hawaii Department of Taxation ("Tax Department") has yet addressed LLC tax treatment in writing. This causes some concern. Ray Kamikawa, the Director of the Tax Department, has stated verbally that Hawaii will follow Check the Box Regulations as to income taxes, but will not follow it for general excise taxes. He views general excise taxes as a business entity tax, thus the LLC with human beings as members will be taxed at the LLC level only; the human members will not be separately taxed. There seems to be some uncertainty as to whether entity members of LLCs will be taxed a second time on their distributions from the LLC.

There will probably be a conveyance tax on members conveying real estate into an LLC, as there is on partners conveying real estate into a partnership. There should not be conveyance tax on the conversion from a partnership or limited partnership to an LLC, or from a merger of another entity into an LLC, since under HRS §§ 428–903 & 428–906, such actions automatically vest the property in the LLC, and any filing in the Bureau of Conveyances or Land Court system is only to confirm and clarify what has legally already occurred.

LLC Structure. An LLC can be structured as a member–managed LLC or a manager– managed LLC, roughly parallel to a general partnership and a limited partnership. In a member–managed LLC, the members are the decision makers, although the LLC documents can allocate responsibilities to some degree. In a manager–managed LLC, most decisions are made by the manager(s) who need not be members, but restrictions can be placed on the managers' authority. Basically, a member of a manager–managed LLC has lower duties to the LLC than a member of a member–managed LLC, or than a manager (HRS §428–409).

The formation documents of an LLC are the Articles of Organization and the Operating Agreement. The Articles of Organization, for which the Department of Commerce and Consumer Affairs ("DCCA") has a non–mandatory printed form, are filed with the DCCA and serve a similar purpose to Articles of Incorporation. They create the entity's existence, and put third parties on notice of its limited liability. If the LLC intends to restrict or enlarge the authority of managers or members to act for the LLC, those special provisions should probably be included in the Articles, so that third parties arguably have constructive notice of them. The Hawaii statute specifically provides that any member of a member–managed LLC or any manager of a manager–managed LLC may sign and deliver conveyances of real estate; this often should be restricted in the Articles of Organization.

The Operating Agreement is like a combination of Bylaws and Shareholders' Agreement. It is not publicly filed. It deals with the inner workings of the LLC — management, financial contributions, tax allocations and distributions, members' voluntary or involuntary dissociation (leaving), transfers of membership interests, percentages of votes needed for various decisions, etc. The flexibility of the Operating Agreement is fairly broad, but is specifically limited in various degrees as to certain subjects listed in HRS §428–103, being: access to information; duty of loyalty; duty of care; duty of good faith and fair dealing; expulsion of a member; windup; or attempts to affect the rights of third parties.

As in general partnership and limited partnership agreements, Operating Agreements may include numerous and complex provisions concerning tax issues. This is a matter of the attorney's style and the client's sophistication. It is our view that such agreements should be completely understood by the lawyers who draft them and the accountants who review them, and to the maximum extent possible understandable by the parties whose interests they govern. We are currently analyzing which tax provisions are necessary or highly desirable to include in Operating Agreements.

Hawaii LLC Statute. Hawaii is the last state to authorize domestic LLCs and the registration of foreign LLCs. The statute became effective April 1, 1997. It is modeled, with some variations, on the new Uniform Limited Liability Company Act. The official comments to that Act were not adopted by Hawaii. The statute has some problems. It was written under the old federal tax code laws, and so contains a provision restricting LLCs to two or more persons. and contains provisions generally helpful to an attorney in meeting the old IRS four corporate characteristics test. These prior aids are now unneeded restrictions in view of the Check the Box Regulations. (Note: On March 31, 1997, the Governor's office confirmed that the one–member LLC bill passed by the current Legislature has just been signed into law. It is immediately effective. Because of the publication deadline, this article could not be revised to explore the one–member LLC in greater detail, but it is a major benefit.)

HRS § 428–111 excludes certain businesses from the use of LLCs. Generally, these excluded businesses are law, accountancy, many types of licensed health care, banking, trust and insurance companies. The exclusions are specified by a list of HRS chapter numbers, giving rise to some confusion. For example, dentistry is regulated by HRS Chapter 448 , and is excluded from LLC usage. This does not mean that activities regulated by Chapters 448E (electricians and plumbers) or 448H (elevator mechanics) are denied LLC usage. Chapters 448E and 448H are entirely separate chapters, and are not listed as excluded from LLC usage.

The statute has mandatory and default provisions as to issues usually covered by the Operating Agreement. Default provisions are those that can be varied by the Operating Agreement. Unfortunately, the statute is not very clear as to which provisions are mandatory, and which are default provisions, the only guidance being HRS § 428–103. The interpretation of that section is still a topic of debate, but a suggested interpretation is that the Operating Agreement can change any aspect of the rights, obligations and dealings among the members, managers and company ("Internal Matters"), except as specified in § 428–103. But the Operating Agreement cannot change legal rights and obligations of those parties vis a vis the State or third parties. Thus, as to Internal Matters, except where compliance with a specified statute is mandated by HRS § 428–103, the Chapter 428 sections are default provisions which Operating Agreement provisions will override.

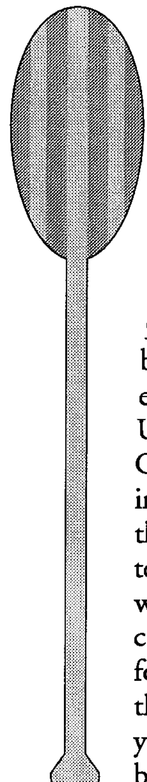
Some items must be addressed in the Operating Agreement. Sections 428–405 and 428– 806 of the Hawaii Revised Statutes provide that all distributions must be in equal shares (presumably per person). That would be odd, unless the partners contributed equally or intended that result. Probably allocations should be based on contributions or agreed upon percentages. Section 428–404 has a list of decisions requiring the consent of all members. This 100% agreement standard will be awkward when there are several members. Some limitations on the duty of loyalty and non–competition statutory provisions should be made, though here it is not clear how far one can go without violating HRS § 428–103. Issues concerning financial settlements and installment payouts with dissociating members should be considered carefully. A current list of the contributions of each member, and their agreed upon valuation, should be kept, probably as a continually updated amendment to the Operating Agreement.

Securities Laws. Whether an LLC membership is a security depends on the form of the LLC. Membership interests in a member–managed LLC, at least if all members have the right and power to actively participate in business decision making, are not likely to be securities. Membership interests in manager–managed LLCs may very well be securities. The analysis is based on securities decisions concerning general partnerships (similar to member–managed LLCs) and limited partnerships (similar to manager–managed LLCs). Typical restrictions on transfers of corporate stock should also be placed in the Operating Agreement and membership certificates of LLCs, particularly those which are manager–managed.

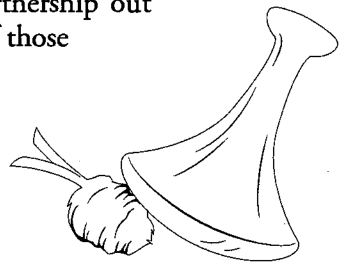
Borrowing. There are probably no reasons why a lender should treat a borrowing LLC any differently than it would treat a corporation. Sinceall members have limited liability, the

lender may want guarantees. A lender giving a loan secured by a LLC membership interest has much the same rights as a lender secured by a limited partner's interest. Such memberships are personal property, and security interests in them are probably governed by Article 9 and perhaps Article 8 of the Uniform Commercial Code. Generally, the financial interests may be pledged, but the management rights and powers do not automatically follow.

Conversion to LLCs of Existing Entities. To convert a general partnership (or joint venture) or limited partnership to an LLC is easy (a Hawaii filing form is available), and usually tax free. Assuming the one-member LLC is approved by the current Hawaii legislature and governor, the same should be true of converting a sole proprietorship into an LLC. To convert an S corporation to an LLC may involve tax problems, especially if the S corporation has appreciated property, such as real estate. It is probably not advisable to convert a C corporation, or an S corporation which was converted from a C corporation less than ten years ago, unless the conversion is very carefully studied as to its tax results. While the post conversion LLC will enjoy single tax benefits, the conversion is a liquidation of the corporation, and may carry with it a heavy tax load.



People should consider the benefits of conversion to an LLC from a joint venture, limited partnership or general partnership even where all human beings are presently shielded from personal liability by the use of corporations in these partnerships. In a partnership of three corporations, it is true that all human stockholders have limited liability, but it is also true that if the partnership gets in trouble, each of those partners may end up paying the entire liability of the partnership out of its corporate assets. If those three corporations formed an LLC, none of the assets of the corporate members would generally be at risk; only the assets of the LLC.



Foreign LLCs. The Hawaii LLC statute requires foreign LLCs to apply for a certificate of authority (a State form is available) if they are "transacting business" in Hawaii, and excludes certain types of actions from that term. HRS § 428–1001 provides that the internal affairs of a foreign LLC will be governed by the state law of its creation, but its business activities are governed by Hawaii law. This may create some minimal opportunity for forum shopping, especially if one member LLCs are not approved in the current legislative session, but would not permit a foreign LLC law firm (one of the excluded businesses under the Hawaii statute) to practice in this state.

Members from Foreign Countries. Members of LLCs can be citizens or business entities of foreign countries residing outside the U.S. However, the Clark Boardman Callahan LLC treatise, provides only in its real estate related LLC forms that a transferee of a membership interest from an existing member must warrant that the transferee is a U.S. citizen and resident. There is no footnote indicating the reason for this requirement. While this is beyond the writers' expertise, it may be based on the FIRPTA requirements of §1445 and §897 of the Internal Revenue Code ("IRC") and accompanying regulations. There, the transfer of an interest in a business entity holding a U.S. real property interest is generally subject to a withholding tax. Further, the business entity may have to issue a statement as to whether its ownership of real property in the U.S. exceeds 50% of the total fair market value of its property. There may also be concerns about withholding taxes on distributions to foreign persons or business entities under §1441 and §1442 of the IRC. Since the LLC itself is formed in Hawaii, no similar taxation problem exists on the sale of U.S. real property by a Hawaii LLC owned by members who are citizens and residents of foreign countries, nor does the HARPTA statute presently reach the sale of ownership interests in business entities.

Because of the very strong tax motivations in forming or converting to LLC, it is the authors' recommendation that the necessary documents be prepared by both a lawyer and an accountant, both of whom understand the client's business, and the tax goals of its members. Please feel free to contact Dave Johnson at 524–1212 or Maria Lowder at 532–9200 if you any questions or would like further information about limited liability companies.

(David Johnson is a shareholder and director of Paul, Johnson, Park & Niles where his practice focuses on business counselling and transactions. Maria Lowder has been a certified public accountant since 1974. Her tax services include tax planning and tax preparation for corporations, partnerships, trusts, estates and individuals.)

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HI KAI INVESTMENT, LTD.
and
MARSHALL REALTY, LTD.
(Plaintiffs-Appellants)
v.
ALOHA FUTONS BEDS & WATERBEDS, INC. (Defendants)
and
HONOLULU BOOK SHOPS, LTD.
(Cross–Claim Plaintiff–Appellant)
v.
ALOHA FUTONS BEDS & WATERBEDS, INC..
(Cross-Claim Defendant-Appellee)
84 Hawai'i 75 (1996)

(Selected portions of Hawaii Supreme Court Justice Mario R. Ramil's December 18, 1996 opinion have been edited and reprinted.)

This appeal raises the issue whether Hawai'i Revised Statutes ("HRS") Chapter 666 precludes a landlord, who exercises his option to regain possession of his premises under the statute, from bringing a common law action for damages for breach of contract, as measured by future lost rent. For the reasons discussed below, we hold that it does not.

* * * * *

I. BACKGROUND

Honolulu Book Shops, Ltd. ("HBS") entered into a ten-year lease with Kacor Investments Corp. ("Kacor") in 1986. In 1991, Kacor sold the property to HI Kai Investment Ltd. and Marshall Realty, Ltd. (collectively "Landlords"). HBS subsequently assigned its leasehold interest to Aloha Futons in September 1992. When Aloha Futons failed to pay the rent as agreed, Landlords filed a complaint for summary possession on April 2, 1993, under HRS Chapter 666 (1993). Landlords sought: (1) possession of the premises; (2) $15,063.32 in past rent through March 31, 1993; and (3) other damages resulting from the default, including interest, costs, future rent, and attorneys' fees.

The district court granted writs of possession against HBS and Aloha Futons (collectively "Tenants"). The court also awarded Landlords damages for the arrearage accrued through the dates on which the writs were issued, but denied them an award of damages based on future rents for the unexpired lease term accruing after the writs were issued. Specifically, the court stated: "So, the Court finds the arguments advanced by the Defendant for termination of the Lease as of the date of possession, that as of the date possession is recovered, to be more in line with the case law and the public policy of the State of [Hawai'i]." The court held, as a matter of law, that HRS § 666-13 (1993) "cuts off the landlord's right to damages as of the date of the issuance of a Writ of Possession."

Landlords moved for (1) leave to amend the Complaint to conform to trial testimony concerning their right to damages equivalent to future rent, less mitigation, and (2) to amend the judgment to reflect the increased damages sought in the motion to amend the Complaint. The district court denied both motions. Landlords subsequently appealed.

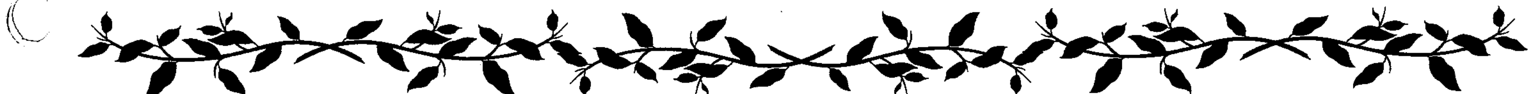
On May 5, 1993, HBS filed a cross-claim against Aloha Futons for damages resulting from Aloha Futons's breach of the lease. The district court entered a default judgment against Aloha Futons on October 5, 1993, in the amount of $26,069.75, which included fees and costs incurred by HBS. HBS then moved to alter or amend the judgment against Aloha Futons, but the district court denied the motion. Subsequently, HBS filed a cross-appeal to preserve its indemnification rights against Aloha Futons, in the event that HBS were ultimately liable for an amount greater than that awarded by the default judgment against Aloha Futons.

On appeal, Landlords argue that the district court erred (1) when it denied Landlords full damages for Tenants's breach of the lease, as measured by lost rents for the unexpired lease term, subject to mitigation, and (2) when it denied Landlords recovery of accelerated rent which "was due and had accrued under the [l]ease contract prior to the entry of the judgment for possession."

* * * * *

III. DISCUSSION

Landlords assert that (1) the lease provisions allow them to recover damages, as measured by future rent, and (2) HRS Chapter 666, Hawai'i's summary possession statute, does not preclude them from suing for both possession and damages. We review these arguments in light of: (1) the language, policies, and legislative history of HRS Chapter 666; (2) relevant case law of this and other jurisdictions; and (3) our previous holding that "statutes abrogating common law rights must be strictly construed[.]" Fonseca v. Pacific Construction, 54 Haw. 578, 585, 513 P.2d 156, 160 (1973); see also Burns Int'l Security Services, Inc. v. Dept. of Transportation, 66 Haw. 607, 611, 671 P.2d 446, 449 (1983) ("[w]here it does not appear there was a legislative purpose in superseding the com-



damages); Holly Farm Foods, Inc. v. Kuykendall, 114 N.C.App. 412, 442 S.E.2d 94, 96 (1994) (breaching tenant is liable not for rent but for damages flowing from breach of contract); Schneiker, 732 P.2d at 608 (landlord can maintain an action for contract damages caused by tenant's breach); Benderson v. Poss, 142 A.D.2d 937, 530 N.Y.S.2d 362, 363 (N.Y.App.Div. 1988) ("what survives after the termination of a lease is not liability for rents, but liability for damages").

Furthermore, a basic precept of contract law is that a party who sustains a loss by the breach of another is entitled to compensation that will "actually or as precisely as possible compensate the injured party." Amfac v. Waikiki Beachcomber Inv. Co., 74 Haw. 85, 128, 839 P.2d 10, 32, reconsideration denied, 74 Haw. 650, 843 P.2d 144 (1992) (citing Ferreira v. Honolulu Star-Bulletin, Ltd., 44 Haw. 567, 573-74, 356 P.2d 651, 655, reh'g denied, 44 Haw. 581, 357 P.2d 112 (1960)). Despite this rule, Tenants argue that damages should not be awarded in this case because they are speculative and uncertain. We disagree.

Under the lease, future unpaid rent less mitigation is the measure of damages to be used in the event of a breach by Tenants. Other jurisdictions agree with this formula. For example, Rokalor held that

> [u]npaid [future] rent, while not recoverable as such, may be used by the court in computing the losses suffered by the plaintiff by reason of the defendant's breach of contract of lease. The plaintiff would be entitled to recover the damages which would naturally follow from such a breach.... We conclude that ... in an action for breach of a lease, the amount of rent agreed to by the parties is a proper measure of damages.... Rokalor, 558 A.2d at 268-9.

This " 'court cannot rewrite the contract of the parties,' " Fortune v. Wong, 68 Haw. 1, 11, 702 P.2d 299, 306 (1985) (citations omitted); see also Sentinel Ins. Co., Ltd. v. First Ins. Co. of Hawai'i, Ltd., 76 Hawai'i 277, 300, 875 P.2d 894, 917 (1994); First Ins. Co. of Hawai'i, Ltd. v. Lawrence, 77 Hawai'i 2, 16, 881 P.2d 489, 503, reconsideration denied, 77 Hawai'i 373, 884 P.2d 1149 (1994), but must "construe and enforce [it,] not make or alter [it]." Strouss v. Simmons, 66 Haw. 32, 40, 657 P.2d 1004, 1010 (1982). Pursuant to § 18.3 of the lease, both HBS and Aloha Futons could have reasonably foreseen that they would be liable for rental of the premises for the entire term of the lease, subject to the proceeds of any subsequent reletting. Both HBS and Aloha Futons were aware, or should have been aware, that (1) the length of the lease term was ten years; (2) failure to pay the rent would constitute a "default" that would allow Landlords to terminate the lease; and (3) termination of the lease before expiration of the ten-year term would result in their liability for rent payments for the remainder of the lease term, as provided in § 18.3 of the lease. Had either Aloha Futons or HBS continued to pay the rent agreed under the lease, Landlord would have collected the rental value of the premises for the entire lease term. In doing so, Landlords would have realized the benefit of the bargain. Accordingly, we reject Tenants' contention that damages based upon future unaccrued rent were speculative, unforeseeable, or penalties. This result protects Landlords' expectancy interest and places them in the same position they would have been in had the contract been fully performed by Tenants.

C. HBS' Cross-Claim Against Aloha Futons.

Because we hold that Landlords are entitled to damages that include amounts based upon the unpaid rent for the balance of the lease term accruing after the district court issued the writs of possession, we vacate the default judgment in HBS' cross-claim against Aloha Futons and remand this portion of the case to allow the district court to reconsider the amount Aloha Futons must indemnify HBS.

IV. CONCLUSION

Accordingly, we vacate (1) the district court's October 11, 1993 judgment against Aloha Futons and HBS, and (2) the district court's October 5, 1993 default judgment in HBS' cross-claim against Aloha Futons. We remand this case to the district court for a determination of damages measured by lost future rent, less mitigation and credits, and any other interest, fees and costs to which Landlords may be entitled.

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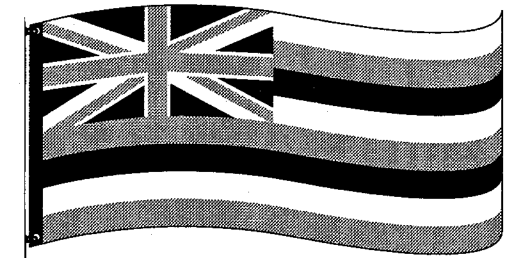
PERFECT TITLE COMPANY AND OTHER IMPERFECT LIENS

By John Jubinsky, Esq.

There is now occurring a serious abuse of Hawaii's recording system. Documents are being recorded at the Bureau of Conveyances ("Bureau") which have created, and are increasingly continuing to create, substantial damage and disruption to land titles and legitimate property interests. Those documents have a variety of forms: some purport to be issued by or on behalf of the Kingdom of Hawaii; some are entitled "Common Law Liens"; some are filed by those who claim only gold and silver can be used as legal tender; some are called nonstandard financing statements; but the most prolific and currently disruptive are those being filed by, or under the direction of, the Perfect Title Company. All of the documents have one thing in common: they are spurious and are utterly lacking of legal merit.

PERFECT TITLE COMPANY

Perfect Title Company pur–ports to be a general partnership comprised of Donald A. Lewis ("Lewis") and David Keanu Sai ("Sai"). It was formed in November 1995 and its stated purpose was "the business of researching, manufacturing and selling land title reports". (In July 1996, the purposes were amended to add "escrow services, appraisal services and land survey services.") A companion general partnership called the "Hawaiian Kingdom Trust Company" also was formed by Lewis and Sai in January 1996. It was to be "in the business of administrating, investigating, determining and the issuing of land titles, whether in fee, or for life, or for years, in such manner as Hawaiian law prescribes". Both partnerships were to be effective as of December 10, 1995, the 150th anniversary of the establishment of the Land Commission. Since Lewis and Sai do not recognize the legitimacy or authority of the State of Hawaii, their partnership documents are not filed with the Department of Commerce and Consumer Affairs.

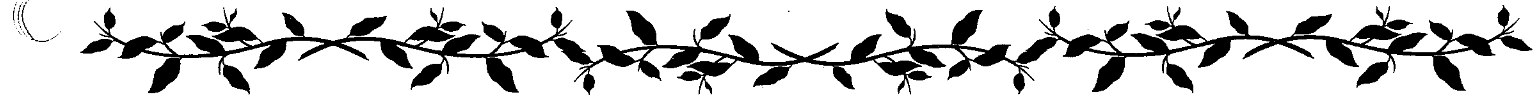


The Hawaiian Kingdom Trust Company purports to derive its authority from a series of about ten deeds in which individuals conveyed to the Hawaiian Kingdom Trust Company "all of their undivided right, title and interests as native Hawaiian subjects and tenants duly recognized by Hawaiian law". There is no meaningful explanation of these words. Presumably, they derive from the original rights of native tenants. It is upon this flimsy and essentially meaningless foundation that the entire house of cards of Perfect Title Company, Hawaiian Kingdom Trust Company and Sai, as Regent, is built. Not surprisingly, the first grantors of such rights were Lewis and Sai.

In February 1996, Hawaiian Kingdom Trust Company promulgated a resolution which appointed Perfect Title Company as its agent to investigate and confirm or reject all claims to land in Hawaii arising after December 10, 1845. It also published a sort of quiet title action notifying all persons claiming to own fee simple title in Hawaii to file with the Perfect Title Company evidence in support of their claims before February 14, 1996, and "in default of so doing that they will thereafter be forever barred of all rights to recover the same".

In March 1996, the Trustees of the Hawaiian Kingdom Trust Company appointed Sai as Regent to act on behalf of the Hawaiian government during the absence of a monarch. (It is unknown who the Trustees are but it is assumed by the author that they are Lewis and Sai.) The Hawaiian Kingdom Trust Company thereupon apparently dissolved and its functions are being performed by Sai as Regent. It should be noted that on August 1, 1996, a separate and different group called the "Kingdom of Hawaii" issued its cease and desist order to Lewis and Sai, and, among other things, stated that Lewis and Sai "have used the Kingdom of Hawaii and the laws thereof to mislead and defraud the People and obtain money, funds, property and the like, and cause injury to many innocent and naive parties".

In furtherance of its self proclaimed quiet title action and threat of divestiture of title, Perfect Title has aggressively solicited people to file their claims for investigation with Perfect Title Company. Each applicant agrees to pay an investigation fee of $10 per year from 1845 to the present; approximately $1,500. As of this date, about 250 notices or investigations have issued and undoubtedly more are in progress. At $1,500 each that amounts to approximately $375,000 in fees in just a little over one year.



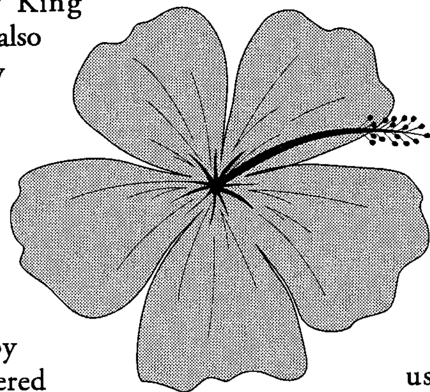
Although Lewis and Sai do not recognize the legitimacy of the State of Hawaii, their documents are filed in the Bureau. Sai, by proclamation as Regent for the Hawaiian Kingdom in abeyance, "reopened" the Bureau for the filing of their documents. They otherwise contend that the Bureau has been closed since January 17, 1893 and all filings therein after that date are invalid.

In the typical case, Perfect Title files in the Bureau a "Notice of Pending Investigation Upon a Claim to Fee Simple". This presumably is its equivalent of a lis pendens or Notice of Pendency of Action and merely recites that a claim has been submitted for investigation by Perfect Title in accordance with its quiet title action. Usually, within a month or two thereafter, Perfect Title files a "Notice of Investigation Upon a Claim to Fee Simple". This Notice consists of a brief and partial abstract of title starting with Kamehameha III's title in 1845.

The invariable conclusion of each Investigation is that the title is "void and without merit". That conclusion is predicated on a variety of theories. The most common theory is that anyone who derived title either from anyone who participated, directly or indirectly, in the 1893 overthrow or had their title either adjudicated or recognized by any governmental entity subsequent to January 17, 1893, including the committee of safety, the provisional government, Republic of Hawaii, Territory of Hawaii or State of Hawaii, was in some manner guilty of the crime of treason. Such acts of treason gave rise to the forfeiture of one's property. On that basis, Perfect Title concludes that the lands of the Damon Estate and Kaneohe Ranch, to name only two, are subject to forfeiture and thus the title of the present owners to any lands derived from them are "void and without merit". Perfect Title also concluded in May 1996 that the State's ownership of its lands, as well as its sovereignty over the Hawaiian Islands, was void. That conclusion was similarly predicated upon the treasonous acts of the committee of safety and the declaration that all acts subsequent to the overthrow of 1893 were void.

Additionally, all conveyances of Bishop Estate lands after 1893 are void because the Bishop Estate Trustees were appointed by courts which had no legal authority or legitimacy.

Perfect Title concludes that the only valid laws of the Hawaiian Islands are those of the Hawaiian Kingdom. According, all conveyances and titles subsequent to 1893 are void. In some instances Perfect Title goes farther and concludes that acts subsequent to the constitution of King Kalakaua in 1887 are also void since the validity of that constitution is not recognized.



Having created a situation where all titles are void, Lewis and Sai created a methodology whereby titles could be rendered valid. A person whose title has been determined to be void may apply to the Regent for a deed. In order to be eligible for such a deed, one must be a native Hawaiian subject willing to conform to Hawaiian Kingdom law. Depending on how the title was determined to be void, the applicant can receive a warranty deed from the Regent conveying the fee simple title or a life estate. It is not clear whether the applicant must pay for the deed, but the conveyance tax appears to be only $1.00. These deeds are being used by some owners to support their position that they continue to own property which they have already lost in foreclosure actions.

LEGISLATION

In 1996, Act 24, now Chapter 507D, Hawaii Revised Statutes, was enacted. The impetus for the Act was the filing of liens against property owned by governmental officials. Those "nonconsensual common law liens" are essentially rambling and incomprehensible documents and
are similar to filings occurring in Texas, Oregon, Arizona and other states. In addition to the liens against governmental officials, there were similar liens filed against non–government employees' properties. Many of those were filed by individuals who believe that only silver or gold is legal tender. In the typical situation, an individual would appear at a public auction and bid gold or silver. The property would be sold at significantly higher prices either to the mortgagee or some third party in the usual public auction fashion. The losing bidder would then file a "nonconsensual common law lien" against the property contending that the auction and the subsequent conveyance to the purchaser were invalid because the property was not purchased with legal tender. The losing bidder's position is that the lienor was the rightful owner of the property having made the highest lawful bid.

Recognizing that these nonconsensual common law liens were not only clouding titles by expunging them from the public records was time consuming and expensive, Act 24 was passed. This Act not only provides for a more expeditious method to both expunge those liens but it allows the imposition of sanctions, including damages, from the lienors.

Under the statute, a nonconsensual common law lien is a lien that (1) is not provided for by a specific statute; (2) does not depend upon the consent of the owner of property affected for its existence; and (3) is not a court–imposed equitable or constructive lien. Any person whose real or personal property is subject to a recorded claim of such a nonconsensual common law lien may file a petition to the Circuit Court to contest the validity of the instrument and to seek its expungement as well as other sanctions, including injunctive relief and damages. A somewhat expedited procedure is provided for, but some of the requirements are not clear.

If the Court finds a purported lien is invalid, it can order the Registrar of the Land Court or the Bureau to expunge the instrument creating it and order the lien claimant to pay actual damages, the cost of the suit and reasonable attorneys' fees. Additionally, the Court may award actual damage or $5,000, whichever is greater. The statute does not preclude any person from seeking any other common law, statutory or other equitable remedy.

If any person is deemed to have submitted a frivolous instrument for recordation more than two times in a calendar year, the Court may also order that the Registrar be directed not to record during the next five years any further instrument submitted by that person without leave of the Court.

There is currently pending before the legislature amendments to Chapter 507D the effect of which would be to somewhat broaden its reach and clarify its procedures and applicability. As of this writing, the amendments have passed both the House and Senate Judiciary Committees although in slightly different forms and a conference committee will be required to reconcile the differences. It is hoped that those differences will be reconciled and that the amendments will be enacted and become effective upon approval by the Governor.

There has been at least one judgment against Perfect Title and Sai, in his capacity as Regent, under Chapter 507D. In that case, Perfect Title Company caused its Notice of Investigation to be recorded in the Bureau and concluded that since the source title was a land patent which issued after 1893, it was void. Sai, as Regent, thereupon issued his royal patent to the property in favor of one of the defendants.

The plaintiffs were co–owners of the property and represented by the Native Hawaiian Legal Corporation. The plaintiffs filed their Petition in the Third Circuit Court to expunge the filings by Perfect Title Company and Sai as being nonconsensual common law liens under Chapter 507D. Notwithstanding Lewis' appearance at the hearing on the Petition, Judge Ibarra concluded that the Notice of Investigation, Royal Patent and other instruments recorded by the defendants, including Perfect Title Company and Sai, were without basis in law or fact and were frivolous. He thereupon ordered that they be expunged and strickened from the Bureau and entered judgment against Perfect Title Company, Sai, in his capacity as Regent, and the other defendants in the amount of $3,990 as attorneys' fees plus costs plus statutory damages of $5,000.

CONCLUSION

The filings by Perfect Title Company and Sai, the purported Regent of the Hawaiian Kingdom, are predicated on the false and erroneous precept that the only valid laws of Hawaii are the compiled laws of 1884 and the Session Laws of 1884 and 1886. Pursuant to that Hawaiian Kingdom law, the perpetrators of treasonous acts were subject to having their property forfeited. Further, the overthrow of 1893 was illegal and thus all titles and conveyances subsequent to 1893 are "void and without merit".

An unfortunate result of this is that numerous persons, have paid and are continuing to pay, Perfect Title Company approximately $1,500 each to have investigative reports made on their property, the conclusion of which has been preordained to result in a finding that their title is void. In addition to being charged for such a meaningless document, some recipients are being induced to not pay their real property taxes, their mortgages or their lease rents. Those failures or refusals to pay have led to and will continue to lead to the loss of their properties. Hopefully, the courts promptly will issue judgments and orders finding that the filings of the Perfect Title Company and Lewis and Sai are frivolous and will invoke Chapter 507D to grant monetary and injunctive relief, in addition to prohibiting these parties from filing any future documents in the Bureau for five years.

(John Jubinsky is a sole practitioner concentrating his real estate practice in the area of title matters. He has practiced since 1959 and has been general counsel to Title Guaranty for over 25 years.)

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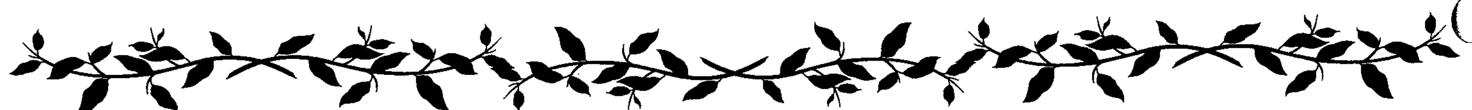

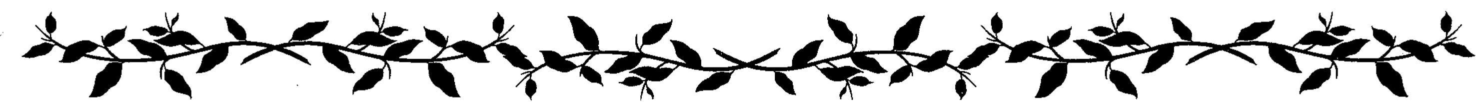

MEET THE NEWEST BOARD MEMBERS

Jan A. Kobayashi rejoins the Board as Secretary after a 2–year absence. Jan graduated from Hastings College of Law in 1986 and concentrates her practice in the area of acquisitions, development, leasing management and dispositions. She also practices in the area of commercial credit and secured transactions. Jan is of counsel with Oshima Chun Fong & Chung.

Jon M.H. Pang was recently elected to join the Board as a Director. He is a partner with Dwyer Imanaka Schraff Kudo Meyer & Fujimoto practicing in the area of development and finance. He handles major resort, commercial, industrial, affordable and residential developments as well as financing, banking and regulatory compliance. Jon graduated from the University of San Francisco School of Law in 1985.

Robert E. Rowland was recently appointed to the Board as its Maui representative. Bob graduated from Boalt Hall School of Law in 1972 and is the managing partner of Mancini, Rowland & Welch in Kahului, Maui. His real estate practice is in the area of foreclosure, real estate documentation and conveyancing, condominium documentation and law and real estate development. He represents over 50 condominium or property owner associations.

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DID YOU KNOW THAT...

The Federal Trade Commission amended its pre–merger notification rules last year to exempt several categories of real property acquisitions from the reporting requirements of the Hart–Scott–Rodino Antitrust Improvements Act. The exemption relating to the sale of property sold in the ordinary course of the seller's business is still in effect. The new categories include:

• NEW FACILITIES that have not yet produced income and were either built by the seller or held by the seller solely for sale. This exemption specifically addresses the turnkey facility that is capable of immediately beginning operations with a minimal infusion of additional capital investment.

• USED FACILITIES that a lessee acquires from the lessor, however the lessee must have had sole and continuous possession and use of the facility since it was built. To qualify, the lessor must have held title to the facility for financing purposes in the ordinary course of its business.

• UNPRODUCTIVE REAL PROPERTY including raw land and property containing buildings and other improvements, as long as the property did not generate in excess of $5 million in revenue during the three years preceding the acquisition. This exemption applies to wilderness and rural land transactions and urban properties that have ceased operation.

• OFFICE AND RESIDENTIAL PROPERTY including common areas such as parking and recreational facilities.

• HOTEL AND MOTELS including related improvements such as golf courses and restaurants. This exemption does not apply to acquisitions of ski resorts or hotels and motels that include gambling casinos.

• RECREATIONAL LAND used primarily as a golf course, swimming club or tennis facility. This exemption does not apply to multipurpose arenas, stadiums, racetracks or amusement parks.

• AGRICULTURAL PROPERTY that primarily generates revenue from the production of crops, fruits, vegetables, livestock, poultry, milk and eggs.

• RENTAL RETAIL SPACE AND WAREHOUSES including shopping centers, strip malls and stand–alone buildings. This exemption does not apply if the space or warehouse is acquired in connection with an on–going business conducted on the real property.

• INVESTMENT RENTAL PROPERTIES held solely for rental or investment purposes and rented only to entities unrelated to the purchaser, except to the extent that a related entity rents the property for the sole purpose of managing the operation of the investment.

For further information regarding these new exemptions, please refer to the Federal Trade Commission pre–merger notification rules in 16 C.F.R. §§ 802.2 and 802.5.

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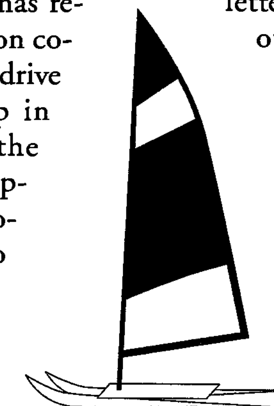
WHAT HAS YOUR BOARD BEEN UP TO?

The Board of Directors of the Real Property and Financial Services Section holds its monthly meetings at the HSBA offices on the third Friday of each month. Members of the Section are welcome to attend. The following is a brief summary of Board minutes.

January Meeting:

• At the previous meetings, Marvin Dang reported that the Hawaii Financial Services association is proposing legislation in the 1997 session to revise Hawaii Revised Statutes Section 667-5 regarding Power of Sale and Foreclosures. David Callies indicated that the Board members could, individually, if they desire, submit testimony, but that the Board, in conformance with the Board's policy would not take a position on the legislation.

• Charlie Key is the local chairman of the American Bar Association ("ABA") membership committee. He has requested that our Section cosponsor a membership drive to boost membership in the Section and in the ABA. The Board approved a motion authorizing David Callies to sign a letter encouraging our members to join the ABA and the ABA Real Property and Probate Section.



• David Callies determined that there are four (4) continuing activities of the Board: (a) the annual meeting program/seminar; (b) legislative updates; (c) continuing legal education; and (d) membership. It was decided that one Board member would oversee each of these activities and would coordinate the same with an executive committee member. Deb Chun and Jan Kobayashi agreed to work on the annual meeting program and the legislative update seminar. William Deeley agreed to work with Tom Rosenberg on continuing legal education and Danton Wong agreed to work with Sheila Sakashita on membership.

• Mark Hazlett indicated that in a two week period, he became aware of three separate instances of possible cases of unauthorized practice of law. In one instance, a Texas firm sent out a newsletter to its clients with an erroneous summary of the PASH case. There was a discussion as to whether that constituted the unauthorized practice of law. It was decided that David Callies should raise the issue with the Hawaii State Bar Association ("HSBA") at their Section chair meeting. The Board recommended that the HSBA look into the issue.

February Meetings:

• David Callies is organizing a land use conference in the fall. Federal Court Judge Shelton J. Plager has agreed to be the keynote speaker.

• Tom Rosenberg met with Carla Poirier to discuss the Section's relationship with HICLE. Tom Rosenberg and Carla Poirier will meet again to formulate written guidelines for HICLE seminars.

• Coralie Matayoshi informed the Board that there continues to be discussion regarding requiring mandatory CLE, especially a course on civility for new admittees and for referrals from the Office of Disciplinary Counsel. The arguments for mandatory CLE include raising the level of professional practice in the State and the opportunity for HICLE and HSBA to raise money by sponsoring the seminars. Some of the arguments against mandatory CLE include the possibility that many companies, including those that are not very reputable, would enter the CLE market.

• The Section discussed at length a consumer bill currently in the legislature to offer certification in specialty areas. HSBA is testifying in support of the bill but HSBA is suggesting that the testing be done by a totally independent organization. Board members presented arguments why certification in real property should be rejected.

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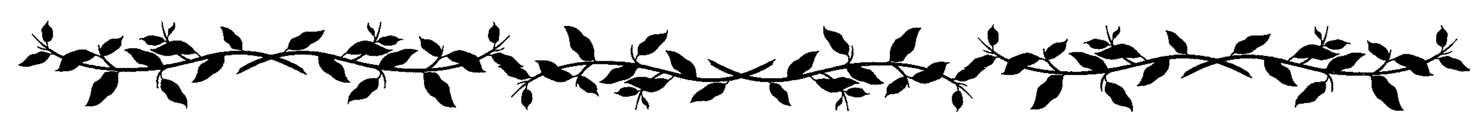

Real Property and Financial Services Section
Hawaii State Bar Association
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REAL PROPERTY AND FINANCIAL SERVICES SECTION HAWAII STATE BAR ASSOCIATION BOARD OF DIRECTORS -1997

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CALENDAR OF EVENTS

Date	Event
May 16	Board of Directors' Meeting 12:00 HSBA Office
May 30	Hawaii Water Law Japanese Cultural Center 7:30–4:30
June 20	Deadline to submit articles for July newsletter
July 11	Legislative Update Ala Moana Hotel Hibiscus Ballroom 11:00 lunch 11:30–1:30 seminar
July 18	Board of Directors' Meeting 12:00 HSBA Office
Aug 15	Board of Directors' Meeting 12:00 HSBA Office
Sept 22	Deadline to submit articles for October newsletter
Nov 7	Litigation Update Ala Moana Hotel Hibiscus Ballroom 11:00 lunch 11:30–1:30 seminar
Dec 9–10	HSBA Annual Convention Sheraton Waikiki

(For further information regarding seminars, please call HICLE at 956-6551)