Real Property and Financial Services Section
Hawaii State Bar Association

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"The News"

April 1999

FROM THE CHAIR

Now that the taxman has come and gone, we can focus our attention on less stressful but otherwise important matters.

This issue features an article by Jerry Guben that was given as a speech to the Real Property and Financial Services Section last November, regarding the City and County of Honolulu's condominium conversion ordinance and its place in the history of Hawaiian land reform. The speech was entitled "Hawaii's Triple Revolution In Land Ownership" and describes the 1967 Land Reform Act covering single family homes, the 1975 rent renegotiation law, the 1991 condominium conversion and lease rent ordinances, and the proposed leasehold conversion ordinance for commercial property.

I hope to see everyone at our upcoming Section-sponsored seminars. Deb Chun will chair the annual Legislative Update seminar on July 15. In October, Bill Deeley will chair the annual Real Property Litigation Update seminar. And in December, at the Bar Convention, our Section will hold a very important seminar on opinion letters. Several members of our Section have formed an opinion letter committee, the goal of which is to develop a prototype opinion for real estate closings. The committee will present its results at the Bar Convention seminar and also hopes to publish them in a law journal or law review. Details on all seminars can be found in the Calendar of Events in this and future issues.

Nancy Grekin has posted on our web site at http://www.hsba.org/section/rpfs/index.html, pending legislation which may be of interest to our members on topics ranging from condominiums to foreclosures.

Unfortunately, the proposed real property and financial services supplement to the Pacific Business News that was planned for June of 1999, has been cancelled. PBN requested that either the HSBA or our Section sell ads as a condition to publication of the supplement. Since this was not part of the original agreement with PBN, we decided against publishing the supplement. Alternatives for publishing the articles that our members have worked so hard on are being discussed, including publishing the articles in this newsletter or posting them at our web site.

I would like to thank departing director Colleen Wong for her time and effort, and to welcome to the Board her replacement, Ken Marcus.

Yours sincerely,

Randy Brooks, Chair
Brooks Tom Miller & Porter
737 Bishop Street, Suite 2700
Honolulu, Hawaii 96813
Tel: (808) 526-3011
Fax: (808) 526-0121, 523-1171
E-Mail: BTMP @ Aloha.Net

HAWAII'S TRIPLE REVOLUTION IN LAND OWNERSHIP[1]

by Jerrold K. Guben

On October 5, 1998, the United States Supreme Court denied certiorari in Trustees of the Bernice Bishop Estate/Kamehameha Schools v. City and County of Honolulu[2] concluding almost seven years of litigation over the City and County of Honolulu's Ordinance 91-95, the "condominium conversion" law. The Supreme Court's denial of certiorari ended the federal phase of the landowner's challenge to the City and County of Honolulu's equivalent of the State of Hawaii's Land Reform Act, codified as Chapter 516 of the Hawaii Revised Statutes.

The denial of certiorari in the Bishop Estate case signaled the end of Hawaii's second revolution in land ownership, the conversion of leasehold land under condominiums and cooperatives to individual ownership, which followed the first revolution in 1984, with the Supreme Court's validation of Hawaii's

[1] This paper was given as an oral presentation to the Real Property and Financial Services Section of the Hawaii State Bar Association on November 20, 1998. The author was one of the attorneys for Hawaii Leaseholders Equity Coalition, the HALE Coalition, an intervenor in Richardson II.

[2] ___U.S.___, 119 S.Ct. 275 (1998).

single-family residential leasehold conversion law in Hawaii Housing Authority v. Midkiff, 467 U.S. 229, 104 S.Ct. 2321, 81 L.Ed.2d 186 (1984). The third revolution, which is in its initial phase, is the legislative effort to convert commercial leasehold property to individual ownership. This movement will gain momentum in the coming years as commercial long-term lessees find it more and more difficult to meet the escalating ground lease rents during periods of rent renegotiation.

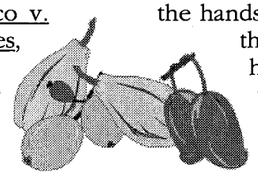
I. HISTORICAL BACKGROUND OF LEASEHOLD LAND IN AMERICA

In the Nineteenth Century, there were several states, all with colonial backgrounds, which had large tracts of land owned by one or more families, which were rented out to hundreds of tenants on long-term leaseholds. While these "feudal-like" arrangements may have been satisfactory in the colonial era, after independence, many of these farmer-tenants wanted to own the land they lived and worked on.

Probably the most famous "tenant revolution" was New York's widespread anti-rent movement in the 1840's which resulted in the promulgation of the New York state constitution of 1846. See D.M. Ellis, Landlord and Farmers in the Hudson-Mohawk Region, 1790-1850 (1946). The constitutionality of New York's abolition of leasehold land and conversion to fee was later upheld in DePeyster v. Michael, 6 N.Y. 467 (1852).

In Maryland, in Stewart v. Gortner, 70 Md. 242, 16 A. 644 (1889), the court upheld a City of Baltimore ordinance allowing renters to purchase the fee interests of their landlords. However, in Pennsylvania, in the case of In re Palarets' Appeal, 67 Pa. 479, 5 Am.Rep. 450 (1871), the court struck down a statute which required owners to sell their fee interests to their lessees.

One of the few Twentieth Century precedents addressing the conversion of large tracts of land to individual ownership was the Commonwealth of Puerto Rico's land reform act which broke up the large commercial sugar plantations and transferred title to smaller farmers. People of Puerto Rico v. Eastern Sugar Associates, 156 F.2d 316 (1st Cir. 1946), cert. denied 329 U.S. 772, 67 S.Ct. 190, 91 L.Ed. 664 (1946).



With these major legal precedents as background, in 1967, the Hawaii Legislature enacted the Land Reform Act, as codified in Chapter 516 of the Hawaii Revised Statutes, and eight years later, a companion measure which limited the amount of the increase in single-family residential rent renegotiations to four percent of the owners' basis. Haw. Rev. Stat. § 519-2(a)(2) (Michie 1993).

II. THE CONSTITUTIONAL HISTORY OF HAWAII'S LAND REFORM ACT

A. THE LAND REFORM ACT - CHAPTER 516, HAW. REV. STAT.

The 1967 Land Reform Act established a procedure whereby a tract would be designated for condemnation by the State of Hawaii ("State") and the condemned fee sold to the incumbent lessees, who leased the land from the ground lessor and owned the improvements, a single-family residence.[3] According to the legislative history, the purpose of the Land Reform Act was to break-up Hawaii's oligopolistic land ownership, transfer the fee interest to the lessees and thereby create an active market in land. The theory behind the legislation was that by breaking up Hawaii's land oligopoly and transferring the land to the individual lessees, who owned the improvements, a true market in land would finally be created in Hawaii. With the land in the hands of many owners, rather than concentrated in the hands of a few large charitable or proprietary trusts and estates, a market for single-family residences would be created and the market effect would reduce the prices of single-family residences in Hawaii.

The first case involving a constitutional challenge to the Land Reform Act was filed by the Trustees of the Estate of Bernice Pauahi Bishop ("Bishop Estate"). Midkiff v. Tom, 483 F.Supp. 62 (D. Haw. 1979). United States District Court Judge, the Honorable Samuel P. King, a jurist well-familiar with Hawaii's unique history, upheld the statute over a constitutional challenge by the Bishop Estate.[4]

[3] 1967 Haw. Sess. Laws 307. The legislative history is set forth in the Sen. Conf. Comm. Rep. No. 827, in 1967 H. J., at 797.

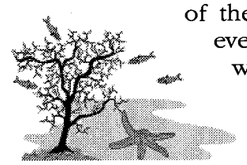
[4] Judge King wrote on the legislature purpose of the Land Reform Act:

"Hawaii, as discussed earlier, has an uncommon system of landholding. A substantial part of all residential land is held by a few interests and leased to a large number of residential lessees. Plaintiffs, Trustees of the Bishop Estate, hold a significant portion of the residential land on Oahu. Section 516-83 of the Hawaii Revised Statutes is entitled "Legislative findings and declaration of necessity; purpose" and in it the Legislature sets forth numerous economic and non-economic rationales for Chapter 516. Plaintiffs argue that they can demonstrate that all the economic justifications for the statute are incorrect, and that the Legislature was wrong in enacting the statute. Yet, in order to uphold the constitutionality of Chapter 516, this Court believes all it need do is look at the broadest possible rationale for the statute that of redistributing residential land and changing the pattern of residential ownership in Hawaii. I believe this purpose is within reach of the police power, and hence the takings authorized by the statute are for a public purpose. All that the Court need rely on in the way of evidence to support this conclusion is the system of landholding in Hawaii and the concentration of land in a few large landholders. At the preliminary injunction hearing, there was testimony and documentary evidence concerning the way land is held in Hawaii. The Court believes that given this system of landholding, the Legislature had the right, pursuant to its police power, to conclude that the general welfare of the people of Hawaii was served by condemning the land of large landholder-lessors and allowing the lessees to purchase that land from the State. The Legislature had the right to conclude that Hawaii's system of landholding was injurious to the social and economic health of the community."

483 F.Supp. at 67-68.

The Bishop Estate appealed to the Ninth Circuit Court of Appeals where in a 3 to 0 decision, the court reversed Judge King's ruling and invalidated the statute. The Ninth Circuit found, inter alia, that the statute violated the "public use" requirements of the Fifth Amendment, which requires a finding of a "public use" even for compensated takings. The court held that since the statute transferred the property from one private owner, the Bishop Estate, to another private owner, the lessees, it failed to satisfy the "public use" requirement of the Fifth Amendment, even though the State did the actual condemnation, held the land for a very short period after purchasing it from the land owner and then sold the fee to the lessee-home owners. Midkiff v. Tom, 702 F.2d 788 (9th Cir. 1983).[5]

This time, the State of Hawaii and the lessees appealed and filed a petition for a writ of certiorari in the United States Supreme Court. In one of the leading eminent domain cases in recent years, the Supreme Court, by an 8 to 0 vote, with Justice Thurgood Marshall recusing himself because of family connections on the Big Island, reversed the Ninth Circuit and upheld the constitutionality of the Land Reform Act. Hawaii Housing Authority v. Midkiff, 467 U.S. 229, 104 S.Ct. 2321, 81 L.Ed.2d 186 (1984).



In writing for a unanimous Court, Justice Sandra Day O'Connor held that in reviewing the legislative purposes of a statute, great deference was to be given to the legislative statement, and as long as there was a "reasonable or rational relationship" between the statute and the legislature's stated purpose, a court should accord great deference to the stated legislative purpose and enactment. The Court refused to "strictly scrutinize" the Hawaii Legislature's finding that the breaking up of the land oligopoly was necessary to create a market in land, which would result in lower residential home prices. The breaking up of the land oligopoly, the creation of a market in land, and the expected reduction in home prices was a sufficient public purpose to satisfy the "public use" requirement of the Fifth Amendment, even where private land was taken from one private party and given to another private party, with fair and just compensation paid to the fee owners.

For purposes of the federal constitution, the Midkiff case resolved the major issues, including the satisfaction of the "public use" requirement. However, the landowners had reserved their state constitutional claims and after the Midkiff case was decided, the landowners challenged the statute in a case that reached the State Supreme Court in Hawaii Housing Authority v. Lyman, 68 Haw. 55, 704 P.2d 888 (1985), and resolved the remaining state constitutional issues in favor of the lessees.

The Lyman and Midkiff cases addressed the constitutional issues, and for several more years Chapter 516 cases came to the State Supreme Court in order to interpret the application or implementation of the Land Reform Act. See Uffman v. Housing Finance & Development Corporation, 70 Haw. 64, 760 P.2d 1115 (1988); and Note, Midkiff v. Tom: The Constitutionality of Hawaii's Land Reform Act, 6 U. Haw. L. Rev. 561 (1984).

[5] The Ninth Circuit panel characterized the Land Reform Act as a simple taking of private property from Party A and giving it to another private party, Party B, without satisfying the "public use" requirement of the Fifth Amendment. In the language of Circuit Judge Alan Alarcon, the Land Reform Act, was simply the taking of private property of A and giving it to B solely for B's private use and benefit. 702 F.2d at 793.

After these early cases, the remaining single-family residential tracts were designated for conversion and the proceedings involved the valuation of the fee interest and the compensation to be paid to the landowner, rather than the constitutionality of the statute. The remaining Chapter 516 cases became a "battle of appraisers," to determine the just compensation that the landowner was to receive from the lessees.

B. RENT CONTROL FOR SINGLE-FAMILY RESIDENCES - §519-2(A)(2), HAW. REV. STAT.

Eight years after the Land Reform Act was enacted, the Hawaii Legislature enacted Section 519-2(a)(2) of the Hawaii Revised Statutes, which limited the increase in renegotiated ground rent for single-family residences to an amount derived by multiplying the "owner's basis" in the land by four percent.[6] Interestingly enough, this renegotiated rent control or limitation statute was constitutionally challenged almost immediately in 1978. In Midkiff v. Amemiya, Civil No. 47103, reported at 1978-1 Hawaii Law Reporter 78-59 (1978), in a lengthy opinion, then Circuit Judge Herman Lum upheld the constitutionality of the rent control statute. The circuit court decision upholding Section 519-2 was never appealed.[7]

Section 519-2(a)(2) was designed to protect the homeowners who did not want or could not afford to purchase the fee, by limiting the amount of the renegotiated rent that the landlord could charge the lessee. By 1975, at least with respect to single-family residences, the State provided a framework procedure whereby homeowners and lessees could purchase their fee or, if they wanted to renegotiate the rent, Section 519-2(a)(2) would limit the renegotiated rent increase to four percent of the owner's basis in the land.

In Hawaii, there was a large percentage of the population who lived in condominiums. The needs of this constituency were not met during the First Revolution and the organization of the condominium owners initiated the Second Revolution in Hawaii's land ownership regime.

III. THE SECOND REVOLUTION: LEASE FEE CONVERSIONS FOR CONDOMINIUMS AND COOPERATIVES — REVISED ORDINANCES OF HONOLULU, CHAPTER 38

While the Land Reform Act was being challenged and enforced, the Hawaii Legislature turned its attention to leasehold conversions for the State's condominium projects. Prior to 1991, there were over twenty bills introduced in the State Legislature providing for the condemnation of the fee interest and the sale of the fee to the condominium apartment owners. None of these statewide measures was successful and eventually the issue of condominium conversion and renegotiated rent control or limitation became a City and County of Honolulu ("City") issue.

A. CITY AND COUNTY OF HONOLULU ORDINANCE 90-95: RENT CONTROL IN CONDOMINIUMS

In 1990, the City Council enacted Ordinance 90-95 which provided a formula for the rent renegotiations of long-term condominium leases, many of which were coming up for re-opening after an initial rent period of 25 years. Ordinance 90-95 provided a formula whereby the renegotiated ground lease rent was tied to a long term CPI "rent factor" based on the first year's rent and provided for an increase during the year of reopening.

Unlike the State's Land Reform Act, Ordinance 90-95 was intended to create affordable housing for the existing condominium apartment owners and not designed to breakup the oligopolistic land ownership patterns in the Oahu condominium market, although later judicial opinions recognized that there was a concentration of land ownership in the Hawaii condominium market. While land ownership under Honolulu's condominiums was concentrated,[8] the purpose of Ordinance 90-95 was not, like Chapter 516, intended to break up a land oligopoly and create a market in condominium apartments, but to prevent the ground lessors from increasing the rent beyond the means of the existing apartment owners.

One fatal defect in the 1990 legislation was that Ordinance 90-95 did not make a distinction between owner-occupants and absentee-owners who rented out their apartments to residents. The rent renegotiation formula applied both to owner-occupants, who comprised only 37% of residential leasehold condominium owners, and to absentee-owners, who could rent the apartments to resident non-owner occupants and "transfer" the rent premium to their tenants and appropriate the rent control premium for themselves. Overall, sublessees of the absentee condominium owners were not protected and the absentee-owners, notwithstanding Ordinance 90-95, could charge their tenants whatever the market would bear without reference to the limitations of Ordinance 90-95.

Bishop Estate challenged Ordinance 90-95 and United States District Court Judge David A. Ezra declared Ordinance 90-95 unconstitutional. Trustees of the Estate of Bernice P. Bishop/Kamehameha Schools v. City and County of Honolulu, 759 F.Supp. 1477 (D. Haw. 1991) [hereinafter "Richardson I"]. Judge Ezra found that Ordinance 90-95 could not be upheld because it was "over-inclusive," insofar as its purpose was to create affordable housing for Honolulu residents, yet the renegotiated rent cap applied to owner-occupied apartments as well as to units owned by absentee-owners, who could lease to Oahu residents, and the ordinance had no mechanism whereby the absentee condominium owners could be bound by the renegotiation formula incorporated in Ordinance 90-95.[9] Since the ordinance restricted the renegotiated rents for units owned by the absentee-owners, yet were occupied by residents, the tenants of absentee-owners were not protected by Ordinance 90-95. Hence, the ordinance could not accomplish its objective of creating affordable housing for actual Oahu residents.

In short, by allowing absentee-owners to be included in the protective ambit of the rent control ordinance, without requiring the absentee-owners to pass on to their tenants the benefits of the renegotiated rent control ordinance, the actual Honolulu residents, who rented condominium units from absentee-owners, were not assured that their renegotiated rents would be similarly controlled and Ordinance 90-95 would not accomplish its purpose of creating affordable housing for Honolulu residents. The Richardson I court, however, did not invalidate the formula used to calculate the renegotiated rent and Judge Ezra was careful to provide guidelines for future legislation. Richardson I, 759 F.Supp. at 1496, n.39 ("The court notes that a properly crafted ordinance may well pass constitutional muster.")

B. ORDINANCES 91-95 AND 91-96: THE SECOND ROUND OF CONDOMINIUM LEGISLATION

Soon after Ordinance 90-95 was invalidated, the City Council enacted Ordinances 91-95 and 91-96 in December of 1991, which were designed to address the constitutional defects and concerns raised by Judge Ezra in Richardson I. The provisions of Ordinance 91-95 were similar in nature to the State's Land Reform Act for single-family residences, providing a procedure whereby the owner-occupants of condominium units could purchase their fee interests from the ground lessor/owner.

The legislative purpose of Ordinance 91-95 was to create "affordable" housing and prevent the owner-occupants from being charged renegotiated rents that evidenced increases of up to 1000% or 8000% over the previous rent.[10] Again, the legislative purpose of Ordinance 91-95 was not to break up concentrated land ownership of condominium projects or create a market for condominium units, although there was such a concentration, but to require the ground lessors who refused to sell the fee to the apartment owners, to transfer the fee interest. Small Landowners, 832 F.Supp. at 1410. As an alternative to leasing from a ground lessor, Ordinance 91-95 allowed qualified projects and

[6] See 1975 Haw. Sess. Laws 185. The legislative history is set forth in Sen. Conf. Comm. Rep. No. 501, in 1975 H. J., at 1193.

[7] In Wong v. Brundage, S.P. No. 98-0135, Circuit Judge Kevin Chang declared Section 519-2 unconstitutional. The case may ultimately be appealed to the State Supreme Court, giving Section 519-2 its first appellate challenge, almost 25 years after its enactment.

[8] See Richardson v. City & County of Honolulu, 124 F.3d 1150, 1159 (9th Cir. 1997).

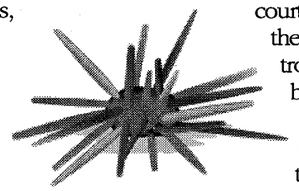
[9] Judge Ezra also found that Ordinance 90-95 failed to take into account the individual characteristics or market value of any particular piece of property in determining the maximum allowable renegotiated rent. Richardson I, 759 F.Supp. at 1494.

[10] See Small Landowners of Hawaii v. City and County of Honolulu, 832 F.Supp. 1404, 1410, n.4 (D. Haw. 1992) [hereinafter "Small Landowners"].

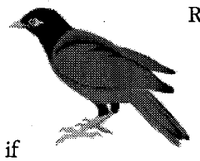
owner-occupants to purchase the fee interests from a ground lessor who was reluctant or refused to sell the fee interest to its tenants.

Ordinance 91-96 was much like Ordinance 90-95, insofar as it was a rent control ordinance, which gave the condominium owners the opportunity to renegotiate their ground lease rent according to a predetermined formula. Unlike Ordinance 90-95, the rent control provisions of Ordinance 91-96 were limited to owner-occupants of condominium units and absentee unit owners could not take advantage of the rent control formula during the renegotiation of their ground lease rent.

On the day that Ordinances 91-95 and 91-96 became law, December 19, 1991, the Bishop Estate filed suit against the City seeking a declaration that both ordinances were unconstitutional on their face. In attacking the ordinances, the Bishop Estate raised both federal and state constitutional claims, including violations of the landowners' due process and equal protection rights. Judge Ezra upheld the constitutionality of Ordinance 91-95, authorizing the condemnation of the ground lessors' interest, the transfer of the fee interest to the City and the re-transfer of the City's interest to the actual owner-occupants.



The District Court, however, invalidated Ordinance 91-96 as being a regulatory taking of the landowners' interest without compensation. Trustees of the Estate of Bernice P. Bishop/Kamehameha Schools v. City and County of Honolulu, 802 F.Supp. 326 (D. Haw. 1992) [hereinafter "Richardson II"]. As to Ordinance 91-96, Judge Ezra noted that despite its limitation to owner-occupants, thereby remedying the defects of Ordinance 90-95 invalidated in Richardson I, Ordinance 91-96 effected a "regulatory taking" from the landowners because it did not compensate the landowners for the "rent control premium," which the existing unit owners could appropriate for themselves if they transferred a rent-controlled unit to a new purchaser. This "rent control premium" was taken from the ground lessor and appropriated by an incumbent owner when he or she sold the unit to a new owner-occupant, without compensating the landowners for the premium. Richardson II, 802 F.Supp at 337-38 (discussion of "ground lease premium").



According to the Richardson II court, when the City enacted the condominium rent control ordinance, it created a benefit or "property right" for the lessee, who had the right to renegotiate the rent based on a fixed formula. The incumbent owner-occupant could then sell the apartment to a new owner-occupant and exact a premium, the rent control premium, based on the value to the tenant of purchasing a rent controlled apartment at below market rates. Since the ground lessee would be able to appropriate this "ground lease premium," without compensation to the ground lessor, Ordinance 91-96 effected a regulatory taking of the landowners property without compensation.[11]

[11] Bishop Estate argued that Ordinance 91-96 constituted a regulatory taking because it allowed the lessee to monetize a below-market renegotiated lease rent at the expense of the lessor. If an owner-occupant, living in a rent controlled unit, transferred his leasehold interest in a residential condominium unit to another owner-occupant, the renegotiated lease rent is assigned to the new owner-occupant. This allowed the "selling" owner-occupant with a below-market rate renegotiated lease rent to sell his or her condominium for a premium for the below-market rate renegotiated ground lease rent. This transferred the ground lease premium from the ground lessor to the owner-occupant without compensation.

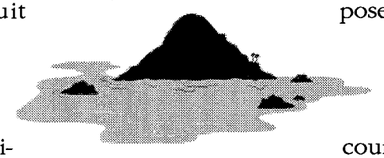
Although Judge Ezra upheld Ordinance 91-95 against the Bishop Estate's state and federal constitution challenges, it certified a question to the State Supreme Court to determine if the State had preempted the area of leasehold conversion as (1) evidenced by the state-wide Land Reform Act for single-family residences, and (2) the almost two dozen unsuccessful attempts to enact a statewide condominium leasehold conversion statute. The Hawaii Supreme Court ruled that the City's ordinance was not preempted by the State, even though the State had enacted a single-family residential conversion statute applicable statewide and despite several unsuccessful attempts by the Hawaii Legislature to enact similar legislation. Richardson v. City and County of Honolulu, 76 Haw. 46, 868 P.2d 1193 (1994). The State Supreme Court, therefore, referred Richardson II back to the U.S. District Court for the entry of final judgment. Both parties appealed Judge Ezra's decision[12] to the Ninth Circuit.

[12] After the filing of Richardson II, the Small Landowners first moved to intervene in Richardson II, and when that was unsuccessful, the group filed their own complaint seeking to invalidate Ordinance 91-95.

The Small Landowners case was referred to the late District Court Judge Harold F. Fong, who ruled that Ordinance 91-95, as it applied to the Small Landowners, was constitutional. Small Landowners of Oahu v. City and County of Honolulu, 832 F.Supp. 1404 (D. Haw. 1994).

For purposes of the appeal to the Ninth Circuit, all parties agreed to consolidate the Richardson II and the Small Landowners cases.

The parties briefed and argued the appeal on November 2, 1995, and the Ninth Circuit's opinion was issued on September 8, 1997, almost two years after the oral argument. Trustees of the Estate of Bernice Pauahi Bishop v. City and County of Honolulu, 124 F.3d 1150 (9th Cir. 1997). The Ninth Circuit affirmed the District Court rulings on Ordinance 91-95, the leasehold conversion ordinance, by a 2 to 1 vote, with Circuit Judge O'Scannlain dissenting.



One of the reasons that the constitutionality of Ordinance 91-95, the conversion ordinance, became problematic was the several Supreme Court land use decisions rendered after the Midkiff case. These three cases, Nollan v. California Coastal Commission, 483 U.S. 825, 107 S.Ct. 3141, 97 L.Ed.2d 677 (1987), Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 112 S.Ct. 2886, 120 L.Ed.2d 798 (1992), and Dolan v. City of Tigard, 512 U.S. 374, 114 S.Ct. 2309, 129 L.Ed.2d 304 (1994), all seemed to limit the deference that federal courts had to give to local government and agencies in reviewing takings cases. This trilogy, the Bishop Estate argued, shifted the burden to the government to show a compelling need when condemning land and required a "strict scrutiny," not a "reasonable relationship" standard, in reviewing the relationship between the legislative purpose or objective and the results.

In Midkiff, the Supreme Court required a court to give the greatest deference to the legislative fact-finding and statutory purpose, and so long as there was a rational basis for the legislation, the reviewing court was to allow the legislation to stand. In the land use trilogy, the Supreme Court required that the legislative purpose be reviewed under a stricter standard and ruled that courts need not show the same deference to the legislative findings and purposes that the Midkiff "rational relationship" standard established.

However, as the Chief Judge Procter Hug's majority opinion in Richardson II pointed out, the trilogy of land use cases invalidated regulatory takings where the landowner was given no compensation, whereas the Honolulu condominium conversion ordinance provided for full or just compensation to the ground lessors. Richardson II, 124 F.3d at 1161-62. The Richardson II majority held that where the legislation, on its face, provided for full or just compensation to the limits of the Fifth Amendment, the "strict scrutiny" test of the land use trilogy involving regulatory takings without compensation was not required in the context of compensated takings.

The Ninth Circuit panel unanimously went on to uphold the District Court's invalidation of Ordinance 91-96 on the ground that while the ostensible purpose of the ordinance was to provide affordable housing to Oahu residents, that objective could not be accomplished because the present owner-occupants who sold their units to a "second-generation" of owner-occupants could charge a premium for the benefit of living in a rent-controlled condominium. Since there was no control on the resale price of a rent-controlled condominium unit by the incumbent owner-occupant to a purchasing owner-occupant, the price of housing on Oahu would ultimately remain the same. The ordinance thus effected a "regulatory taking" as to the ground lessors because its stated public purpose could not be achieved. 124 F.3d at 1165-66.[13]

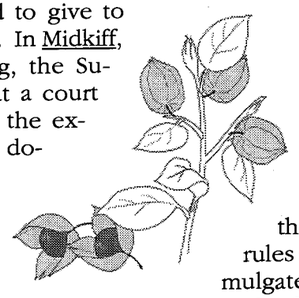
[13] Chief Judge Hug wrote, in striking down Ordinance 91-96:

"Land use regulations do influence the value of property, but to be constitutional, they must do so in a manner that substantially furthers a legitimate government interest. Ordinance 91-96 does not do this. It regulates the use of the lessors' property interests in a manner that does not substantially further the goal of creating affordable housing. The absence of a mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium, means that the Ordinance will not substantially further its goal of creating affordable owner-occupied housing in Honolulu. Incumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in rent controlled condominium. The price of housing ultimately will remain the same. The Ordinance thus effects a regulatory taking. See Id. (regulation must substantially advance a legitimate state interest). ((("Traditional land-use regulation (short of

Since Ordinance 91-96 did not accomplish its objective of creating affordable housing because the incumbent owner-occupants who transferred a unit subject to the rent control ordinance could charge a premium for the rent controlled unit, it created a regulatory taking because nothing was paid to the ground lessor for the rent premium which the selling owner-occupant could exact from a purchasing owner-occupant.

After the adverse ruling on their constitutional challenge to Ordinance 91-95, the Bishop Estate and Small Landowners filed a petition for a writ of certiorari to challenge the constitutionality of Ordinance 91-95.[14] While certiorari petitions are rarely granted, 1 in 20, the Bishop Estate's petition for a review of Ordinance 91-95 had a real chance of success.

First, since the Midkiff case, the land use trilogy of Nollan, Lucas and Dolan may have shifted the nature of the review or deference that a court had to give to the legislative purpose. In Midkiff, a compensated taking, the Supreme Court held that a court could only invalidate the exercise of the eminent domain power under the "rational relationship" review. After Midkiff, the Supreme Court had apparently tightened its standard of review, at least for uncompensated regulatory takings and the dissent in Richardson II wanted to extend the "strict scrutiny" review applied to uncompensated takings to compensated takings.



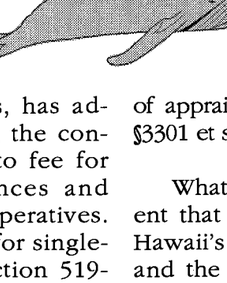
Second, the Supreme Court had already granted certiorari to a California land use case, City of Monterey v. Del Monte Dunes at Monterey, Ltd., 95 F.3d 1422 (9th Cir. 1996), cert. granted ____ U.S. ____, 118 S.Ct. 1359, 140 L.Ed.2d 509 (1998), which again raised regulatory takings issues. Ordinance 91-95 could have been a companion case to Del Monte Dunes at Monterey and the Court in the context of both cases could have revisited Midkiff in the context of a compensated taking.

The challenge to Ordinance 91-95 was not resolved by the Supreme Court's denial of certiorari in October of 1998. Even before certiorari was denied on October 5, 1998, the Bishop Estate and the Small Landowners filed State court lawsuits to invalidate the ordinance as applied. In Wong v. City and County of Honolulu, Civil No. 98-0782-02, filed on February 18, 1998, the Bishop Estate challenged the constitutionality of the enforcement of the rules and regulations promulgated pursuant to Chapter 38 of the Revised Ordinances of Honolulu ("ROH"). The Small Landowners filed suit on May 5, 1998 alleging that the implementation of the City's regulations and the designation of condominium projects eligible for conversion was faulty. Small Landowners of Oahu v. City and County of Honolulu, Civil No. 98-2590-06 (First Circuit, State of Hawaii).

The final resolution of the pending State law challenges to Ordinance 91-95 may be years away, after a trial on the merits and the expected appeals. Like the Land Reform Act, it appears that the condominium conversion ordinance will generate years of litigation.

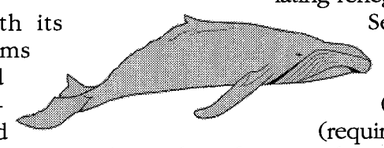
IV. THIRD REVOLUTION: CONVERSION OF COMMERCIAL LEASEHOLD PROPERTY

The State and City have attacked the leasehold problem for single-family residences under Chapter 516 and condominiums under Chapter 38, ROH (Ordinance 91-95). In April of 1998, City Councilman Andy Mirikitani introduced a bill which would apply the leasehold conversion procedure to commercial property, and as recently as February of 1999, a bill was introduced in the State House of Representatives to enact a form of the Maryland land conversion law for commercial properties.



While the successful conversion statutes and ordinances have involved single-family residences and residential condominiums and cooperatives, there are a few cases dealing with commercial and business property. The Poletown case, Poletown Neighborhood Council v. City of Detroit, 410 Mich. 616, 304 N.W.2d 455 (1981), is an indication of the extent to which private property can be taken for avowedly commercial operations. (Land taken from private owners to build General Motors plant in depressed economic area.) Other instances have developed where the legislature has been able to condemn commercial property.

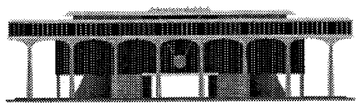
Hawaii, with its unique problems of leasehold land for residential and commercial properties, has addressed, to this point, the conversion of leasehold to fee for single-family residences and condominium and cooperatives. As to the rent control for single-family residences, Section 519-2(a)(2) of the Hawaii Revised Statutes was upheld in 1978, but its constitutionality was questioned in 1998.



As to the City's rent control ordinance for condominium projects, all courts, including the Supreme Court, have recognized the validity of rent control ordinances provided they comply with the standards set down in Pennell v. City of San Jose, 485 U.S. 1, 108 S.Ct. 849, 99 L.Ed.2d 1 (1988). However, it will be up to the City Council to draft a renegotiated rent control ordinance which will pass constitutional muster and still provide protection to the condominium apartment owners.

Lastly, in the Third Revolution in Hawaii's land ownership law, both City Councilman Mirikitani's proposed ordinance and the State bill show an active interest in enacting a commercial leasehold conversion law. As to commercial tenants who face rent renegotiations, many commercial lessees expect that the uniform appraisal standards law passed in the 1998 legislative session will provide some relief from escalating renegotiated rents. 1998 Sess. Law. 180, now codified as Haw. Rev. Stat. § 466K-1 (Michie Supp. 1998) (requiring implementation of appraisal standards in 12 U.S.C. §3301 et seq.).

Whatever happens, it is apparent that the Third Revolution in Hawaii's Land Ownership Regime, and the fight for leasehold conversion and rent control, in the commercial sphere, will continue for years to come.



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 the minutes of the January, February and March meetings.

JANUARY MEETING

- **SEMINARS.** Due to the anticipated revision to Chapter 514A, the board felt that we might wish to postpone the seminar about condominiums for the time being. Similarly, in light of a pending Supreme Court appeal, the seminar on covenants and servitudes will be held over until next year. Jon Pang recommended a seminar on the topic of opinion letters for borrowers and lenders. Everyone agreed that it would likely be of great interest and could be scheduled as the Section's contribution to the HSBA annual meeting at year-end. Mitch Imanaka suggested the formation of a task force to draw up a new standard form of opinion letter. Chair Randy Brooks then asked if anyone present had (a) a burning desire, (b) a scintilla of interest, or (c) any likelihood of attending such a task force meeting. Everyone interested in working on the task force was urged to contact the Chair. The Section will be conducting its annual legislative update seminar in July and litigation up-

that which totally destroys the economic value of property) does not violate [the principle that one should not be forced to bear a burden which belongs to the public as a whole] because there is a cause-and-effect relationship between the property use restricted by the regulation and the social evil that the regulation seeks to remedy.")) (Scalia J., concurring). We accordingly hold that Ordinance 91-96 violates the Fifth Amendment to the Constitution of the United States."

124 F.3d at 1165-66 (internal citations omitted).

[14] The City filed a conditional cross-petition for certiorari under Rule 12.5 Rules of the United States Supreme Court on Ordinance 91-96. When the Bishop Estate's petition for a writ of certiorari was denied on October 5, 1998, the City's conditional cross-petition was automatically denied.

date seminar in October. The Section will also be publishing its own separate tab in the Pacific Business News in June 1999. Nancy Grekin is Chair of the HSBA/ CLE Committee of the HSBA. Anyone scheduling a proposed seminar is requested to provide her with preferred dates as soon as possible.

• **Treasurer's Report.** Treasurer Stanley Kuriyama reported that as of January 14, 1999, the Section had $3,369.67 in its treasury. This amount does not reflect the 1999 annual Section dues not yet collected. The treasurer's report was approved as submitted.

• **Old Business.** In connection with the PBN tab, Sheila Sakashita reported that she had 19 offers of articles. The four editors will be working with the writers to produce draft documents by the first deadline of February 26, 1999.

• **New Business.** Chair Randy Brooks reported on a decision entered by Judge Raffetto in the Second Circuit, which affected HRS Chapter 514C and bulk purchases by homeowner's associations of leased fee interests in condominium projects. The court prohibited an AOAO from assessing an individual leasehold unit owner any expense that related to the purchase by the AOAO of the leased fee interest in the land. The decision is on appeal. Secretary Trudy Burns Stone reported on the initiative of the DLNR to implement its coastal erosion management plan (COEMAP) by way of a statute that would provide for funding mechanisms to support a beach restoration fund. The draft statute poses constitutional questions.

FEBRUARY MEETING

• **April Newsletter.** Vice-Chair Jon Pang was able to obtain the assistance of Jerry Guben to do an article in the April Section newsletter regarding condemnation statutes and the new City ordinance.

• **Seminars.** In a discussion of potential seminars for 1999, Vice-Chair Jon Pang agreed to be the pro tem chair of the task force working on updating a standard form opinion letter along the lines of the ABA accord. The board discussed whether or not to focus just on the lender/ borrower, buyer/seller opinion letters or also to include auditor's letters at this time. It was agreed to leave this decision to the task force.

• **Treasurer's Report.** Passed. Congratulations to Stan are in order for his promotion to executive vice-president of A&B Hawaii.

• **Old Business.** Secretary Trudy Stone reported that the DLNR has modified language in its recent bill amending Chapter 171 to clarify that the bill only affects "public" as opposed to "privately held property." Chair Randy Brooks spoke further on the recent condominium decision from Judge Raffetto and stated that Senate Bill 285 was introduced, which modifies Chapter 514C to clarify how lessors and homeowners associations can negotiate lease to fee conversions.

• **New Business.**

• Chair Randy Brooks announced that Sheila Sakashita had been informed by PBN that the Section supplement had been pulled because of lack of advertising for the Family Law supplement (which precedes the Real Property Section's supplement). All writers were instructed to stop work on their various articles. It was the decision of the editors that they would not request the various article writers to take up their tasks again until PBN had committed to the supplement.

• Mark Hazlett suggested greater use of e-mail. Nancy Grekin reminded everyone about the various hot links on the Section website.

• Chair Randy Brooks reported that Steve Torkildson was the winner of his newsletter quiz about the Beatles.

• David Callies reported that Wayne Hyatt has just published a new book with Susan French Smith on Community Associations Law. Professor Callies also reported that the ALI is taking a look at the restatement of law on the issue of joint ownership. If anyone is interested, please let him know. He also reported that at the ABA Convention in Atlanta, the real property section would be hosting a session on takings and looking at the recent Del Monte Dunes case, which is expected to have been decided by the Supreme Court by then. He reminded us that he will be in England on sabbatical until July. Finally, Professor Callies recommended that the board think about having a student liaison from the UH Law School as a permanent non-voting member of the Board of Directors of the Section.

• Mark Hazlett discussed the forthcoming revised Article 9 of the UCC, which has been introduced and is anticipated to be enacted everywhere with an effective date in mid-2001.

• Professor Callies also discussed the proposed revised land use ordinance which would hopefully shorten the permitting process, which is under consideration at this time.

• There seem to be a great many condominium bills being introduced in the legislature this year. The consensus was that we should have plenty of fodder for the legislative update seminar in July.

MARCH MEETING

• **Seminars.** Chair Randy Brooks reviewed a memo from Coralie Matayoshi, Executive Director HSBA, regarding the bankruptcy workshop to be held Thursday, April 29th, which requested a volunteer from the Section to attend and participate in the break-out session. Bill Deeley very generously offered to attend.

• **New Business.** Chair Randy Brooks took the agenda out of order and requested that Morris Atta from the Real Estate Commission speak to Calvin Kimura's request for support from the Section for a condominium recodification bill before Senator Rod Tam's Government and Housing Committee. The bill is at risk of failing because it calls for additional funding. Chair Randy Brooks, with the approval of the board, agreed to write a letter of support for the bill on behalf of the Section. Chair Brooks will make specific reference to the fact that the Section is a voluntary section of the HSBA and that he is speaking only on behalf of the Section.

• **Seminars (Continued).** Nancy Grekin said that the Section could hold its seminar at the December '99 HSBA Convention either as multiple small seminars or as one day-long seminar. It was the consensus of the board that the proposed seminar on updating the standard form opinion letter was likely to take all day. Therefore, the board should recommend to Coralie Matayoshi that the offer from David Miller, President of AIA, to co-sponsor a seminar with that group be held next year.

• **Treasurer's Report.** As of February 28, 1999, the Section had a balance of $11,244.47. Chair Brooks also reported that there had been some problem with HSBA staff sending reminder notices to Section members who had already paid their dues (increased from $15 to $25 for 1999). The snafu was subsequently corrected.

• **Old Business.**

• Sheila Sakashita reported on the situation with Pacific Business News. She said that there had been no meeting with PBN at Coralie's request. PBN was requesting that either the HSBA or the Section sell ads for PBN as a condition to publication of the Real Property supplement. The consensus of the board was that the Section does not want to have to be obligated to sell ads and that we had never agreed to do so as part of our initial agreement with PBN. Rick Kiefer suggested asking Vice-Chair Pang to follow-up with all prospective PBN supplement writers to see if any of them want to redo their articles from a general audience readership to an attorneys' audience. They could possibly be included in an upcoming Section newsletter. In the alternative, Nancy Grekin suggested posting the articles on the Section website.

• Trudy Burns Stone reported on the very positive meeting she had with her clients and other members of the Lanikai Community Association and Tim Johns, the new director of DLNR, and his staff members, Dean Uchida and Sam Loomis, about proposed beachfront legislation.

• Mark Hazlett reported on Senate Bill 568 (A Bill for an Act Relating to Historic Preservation), which calls for, among other things, automatic forfeiture of real property for knowingly taking or destroying any heiau or the contents thereof.

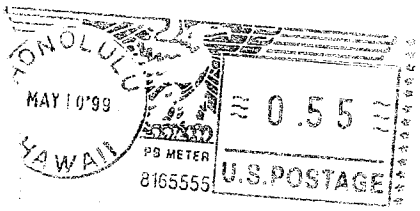
• Chair Randy Brooks reported on further work with the legislature regarding the various condominium bills.

• Max Graham reported on Senate Bill 1276, which resurrected the ban on condominiums in agriculturally zoned land.

MEET THE NEWEST BOARD MEMBER

Kenneth B. Marcus is a Brooklyn (NY) boy who attended the Wharton School of Economics at the University of Pennsylvania, and then New York University Law School. He graduated from NYU in 1975, practicing real estate law in New York City until the end of 1989 when he came to Honolulu to join McCorriston Miho Miller Mukai. His practice has included shopping center development and leasing, office building development and leasing, and hotel purchases and sales, financing and management agreements. Ken wrote the chapter on Hotel Management Contracts for the Hawaii Real Estate Manual, and is a member of the International Society of Hospitality Consultants.

Real Property and Financial Services Section
Hawaii State Bar Association
c/o Dwyer Imanaka Schraff Kudo Meyer & Fujimoto
1800 Pioneer Plaza
900 Fort Street Mall
Honolulu, HI 96813



William E. Atwater III
Carlsmith Ball Wichman
P.O. Box 656
Honolulu, HI 96809

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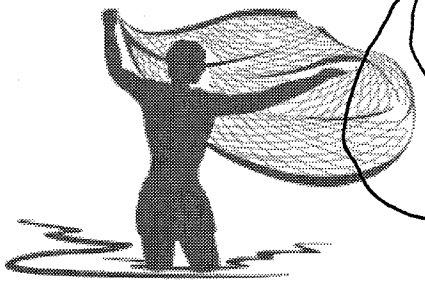

CALENDAR OF EVENTS

March 16
~~April 16~~ Board of Directors' Meeting
Pacific Tower 22nd Floor ~~1136 Union Mall, Penthouse 1~~
12:00 Noon

~~May 21~~ Board of Directors' Meeting
April 20 ~~1136 Union Mall, Penthouse 1~~
12:00 Noon

~~June~~ 18 Board of Directors' Meeting
May ~~1136 Union Mall, Penthouse 1~~
12:00 Noon

~~July 15~~ Legislative Update
June ~~Hawaiian Electric~~
Training Center
~~Pacific Tower, 8th Floor~~
11:00 a.m. - 2:00 p.m.