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Green Street Takes a Wrong Turn

Over the past few days, we have received inquiries regarding an article by Green Street Advisors last week (a) questioning the formation of REITs under Maryland law and (b) announcing that whether a Maryland REIT retains or renounces its power to opt in to the classified board provisions of Subtitle 8 of Title 3 of the Maryland General Corporation Law ("MGCL") will now represent 25% of the REIT's overall governance score.

For more than 50 years, Maryland has been the jurisdiction of choice for REIT formation. Today, it is estimated that approximately 80% of public REITs are formed under Maryland law. Among the many reasons is the absence of any franchise tax in Maryland, while in Delaware the franchise tax for a public company rapidly escalates to $180,000 per year. The MGCL also permits the charter of a corporation and the declaration of trust of a trust REIT to authorize the board alone to increase the number of authorized shares, a power that is critical for REITs, which require more frequent and efficient access to the capital markets than other public companies. In addition, the MGCL explicitly validates amendments to the restrictions on ownership and transfer of stock, even against holders who do not vote to approve the charter amendment, enhancing the enforceability of share ownership and transfer restrictions that are essential to maintaining a REIT's tax status.

Green Street's forthcoming allocation of 25% of its corporate governance points is wholly disproportionate to the full range of governance choices available to REITs. Indeed, it defies logic and economic rationality for Green Street to say that renouncing the mere choice of board classification, regardless of whether or how the board may exercise this option, is (a) more important than any factor other than the actual conduct of its directors and (b) *five times* more important than factors such as the presence of actual and serious conflicts of interest or any other takeover defense. We respect Green Street's research and analytics in the REIT market. However, we see this change in Green Street's corporate governance scoring methodology as evidencing a continuing pattern of efforts by corporate governance arbiters, without any skin in the game and citing no economic data to support their position, to intimidate REITs into adopting a single framework of corporate governance for all REITs and, more broadly, for all public companies.

Self-appointed corporate governance advisers like Green Street have their own business interests, were not elected by anyone and have no legal duties to the REIT or its stockholders. By contrast, the MGCL imposes legally enforceable obligations on each director, individually, to act in good faith, to act with a reasonable belief that his or her action is in the best interests of the corporation and to act with the care of an ordinarily prudent person in a like position under similar circumstances. There is no legal principle (although many short-term holders, shareholder activists and proxy advisers wish there were) that says that a board must passively submit to any proposal without taking reasonable measures to protect the corporate enterprise that the board, as the stockholders' elected representatives with more information than any single stockholder, is charged with overseeing.

Reasonable people can differ over the pros and cons of a classified board, especially in the context of a particular company at a particular time. It is hard to understand, however, why it would be a good idea for a board to effectively give up, for all time and in all circumstances, *even the choice* of classifying itself. We think that, as a general principle, more choices are better than fewer.

It is not clear whether Green Street is opposed to board classification after stockholder approval but in any event Green Street fails to recognize that (1) there is effectively a stockholder vote in an IPO and (2) even for existing REITs, a stockholder vote after the emergence of an inadequate bid for control will come too late to provide any protection against attempts to stampede stockholders into accepting low-ball offers or succumbing to the lure of unexamined promises of better performance than the current management. We advise that REITs and REIT boards consider very carefully whether it is in the best interests of the REIT for the board to deprive all future boards of the choice, authorized by the Maryland legislature over 16 years ago, of classifying itself under any and all circumstances.

We encourage you to review our prior publications regarding Subtitle 8: *Board Classification in Maryland: Evaluating Section 3-803 of the MGCL* and *"Getting Nothing for Something,"* James J. Hanks, Jr., REIT Zone Publications, September 3, 2014. We are available to discuss all of your corporate governance concerns, including the respective merits of Subtitle 8, classified boards and other matters.

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As always, please do not hesitate to call any of us if you have any questions or comments about any of the foregoing or any other matter of Maryland law.

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