FOCUS ON REITs

CRITICISM OF REITs GOES TOO FAR – SELLING OUT OR MERGING ISN'T ALWAYS BEST FOR SHAREHOLDERS

by Adam O. Emmerich & Robin Panovka

One of the latest fashions in the popular REIT press is to bash indiscriminately the management and directors of REITs that seek to remain independent or explore alternatives in the face of a potential merger or other strategic transaction. A recent REIT M&A transaction, for example, drew comments from one analyst to the effect that "it is very rare to be associated with a REIT management team that holds its responsibilities to shareholders in such high regard" and, in similar vein, a statement from a different commentator that "doing the right thing for [REIT] shareholders shouldn't be noteworthy, but it is." Similarly, REITs' adoption of shareholder rights plans (so-called "poison pills"), common in the rest of corporate America, has prompted some REIT commentators to argue that the credibility of the REIT industry is being damaged by the adoption of "unnecessary" and "anti-shareholder" measures.

These attacks go too far. They are based on a flawed perception that any resistance to a sale of the company is not in the best interests of shareholders. In reality, the ability to resist and negotiate can often be advantageous to the shareholders, and a sale – even at a seemingly attractive price – can mean a less favorable result for shareholders than pursuing the REIT's long-term strategic objectives.

An analysis of the impact of rights plans is instructive. Rights plans protect against takeover abuses, give companies and their shareholders and boards of directors breathing room in which to make decisions on potential takeovers, and strengthen the ability of the board of directors of a target to fulfill its fiduciary duties. Studies have shown, over and over again, that "poison pills … are reliably associated with higher takeover premiums for selling shareholders, both unconditionally and conditional on a successful takeover … Antitakeover measures increase the bargaining position of target firms, but they do not prevent many transactions."[1] As a result, rights plans have become a familiar part of the landscape in corporate America, having been adopted by over 2,300 public companies, including at least 45 percent of the Fortune 500 Companies. But despite the empirical evidence, in the eyes of some popular REIT commentators, rights plans are still too often viewed as tools to entrench management and make REITs takeover proof, at the cost of shareholders.

One of the myths that has contributed to the perception that REITs that adopt rights plans are taking excessive anti-shareholder action is the notion that REITs are "bullet proof" by virtue of their built-in 9.8 percent (or lower) share ownership limitations. REITs, the argument goes, are inherently well-fortified, and the adoption of rights plans on top of their ownership limits makes them far more difficult to take over than non-REIT public companies. The argument is fundamentally flawed – as we have long argued, REITs with rights plans are no more "takeover proof" than other public companies with rights plans. In reality, REITs' share ownership limitations are largely untested as anti-takeover defenses and may be inherently vulnerable because

of their grounding in the tax code. Moreover, the consequences of violating a typical share ownership limitation are less draconian than the consequences of violating rights plans and they therefore have a weaker deterrent effect.

Excessive skepticism as to the motives of REIT executives is unfair and can force a "short term" mentality on executives that is ultimately harmful to shareholders and to the REIT industry. Certainly, there are bad apples in the REIT industry, as there are in other industries, but it is a mistake to extrapolate too quickly and to condemn the entire industry for taking actions which are in fact in the interests of shareholders and are entirely consistent with mainstream corporate governance practices outside the REIT area.$_{REI25}$

NOTES

Copyright © 2001, Adam O. Emmerich and Robin Panovka. All rights reserved.

1. "Poison or placebo? Evidence on the deterrence and wealth effects of modern anti-takeover measures." Robert Comment and G. William Schwert, *Journal of Financial Economics*, Vol.39 (1995), pp.3-43.

ABOUT OUR FEATURED COLUMNISTS

Adam O. Emmerich *and* **Robin Panovka** *are partners of Wachtell, Lipton, Rosen & Katz in New York, where they specialize in REIT and real estate mergers and acquisitions and other strategic real estate transactions.*