REAL ESTATE FINANCE

Volume 22, Number 2
August 2005

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REITs: Battle of the Boundaries

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Ms. Habbart recently moderated and coordinated a program on real estate investment trusts, entitled "REITS: Battle of the Boundaries." Panelists included Carol Miller of CNL Financial Group, Inc., a Florida-based company that has both listed REITS and a number of non-listed REITS; Norbert Seifert, the former general counsel of a listed REIT from its initial IPO to its ultimate merger; Randall Parks, a partner with Hunton and Williams who practices law out of Virginia; and Sharon Kroupa, a partner with the Maryland office of Venable. Excerpts of that program, full audiotapes of which are available at *www.teachem.net/aba,* follow.

Ellisa Habbart: Carol will give a description and the benefits of a REIT. Then we will give you some general information on the various alternatives available when you consider a REIT and some of the regulatory issues that apply. Norbert will ask questions he experienced with his company's REIT. Our goal is to present to you the real-life situation between counselor and the management so you are prepared to address your clients' concerns. Carol, please begin by putting this in a bit of context for us.

Carol Miller: What I hope to do is give you in layman's terms the way I present REITS to the general public. I work with people who are like my mother, who is 83. I have to be able to explain it so she can understand it as well as talking to major institutions, pension consultants, endowments, foundation, so a very broad range of people.

How many of you are familiar with Monopoly? What is the goal in Monopoly? You get a lot of property, and how do you make the most money? Buying hotels and homes, right? That's how you get your ultimate rents which provide you the income that you're looking for.

When I am asked: what is a REIT, I typically respond by saying, do you understand a mutual fund? Basically, in a mutual fund you give a company money, they give you stock, they take your money and they go out and buy stock in companies that make widgets. In a REIT, you give us money, we give you stock, we invest your money in real estate to provide an income stream with some tax deferral. There are two types of REIT that we deal with primarily. We deal with publicly traded REITS, those that are on the New York Stock Exchange. The major focus of our business, however, is to put together privately held REITS, grow them to be

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of institutional size, and, when the time is appropriate, take those REITS from Main Street to Wall Street. Our focus has been to always watch where the baby boomers are and to be at the point of sale. We want to be where the money changes hand, where that business is reliant on that real estate for its total success. So as an example, assume you own stock in Toys R Us. In order for them to grow the value of that stock, they have to sell more toys. How do they sell more toys? By having more stores. If that facility does not do well, if it can't sell enough toys, it doesn't need its warehouses, and it doesn't need its manufacturing facilities. So if you believe in equities, you have to believe in real estate and if you believe there are good companies out there why not be the landlord to those companies? What we do is raise money to be able to provide income streams. About 50 percent of all the money that we raised is in the pension/profit sharing arena from an individual's pension plans all the way up to CALPERS, they all have invested a substantial amount of money with us. Now, I'm going to talk primarily about the private REIT because I have much more contact with an investor. When you sell a listed REIT you have absolutely no idea who bought it.

Everything we do is on a triple net basis, which means that we pay absolutely no expenses. Everything is passed on through to the tenant. Consequently, our gross income is our net income and by law, a REIT must pay out 90 percent of its taxable income to the investors. So there's a very predictable cash flow.

THE REIT STRUCTURE

Audience Question: Why use the REIT structure as distinct from other forms of investment vehicles, such as a partnership, etc.?

Carol Miller: We did partnerships initially. There are a couple of reasons. One is that you have a bad name with partnerships. People are very uncomfortable with them, and they also have a very limited exit strategy. With a REIT, there is more liquidity. You have a defined exit strategy and we're able to give the investors the best of both worlds. Our REITs have between five and ten years by prospectus to either list or liquidate the portfolio. It gives me the opportunity to research the market and see which one will give the best return to the investors. They will either be listing or they will be liquidating. In addition to that, you do not have double taxation, and are able to pass through depreciation. Investors also get tax-deferred income, they do not have the double taxation and it gives them a lot more flexibility.

QUALIFYING AS A REIT

Sharon Kroupa: The task has fallen to me to identify the eight characteristics that need to be satisfied for any entity to qualify as a REIT. It has to be taxable as a corporation and has to be managed by a Board of Directors or Board of Trustees. It has to have fully transferable shares with a minimum of 100 shareholders. No more than 50 percent of its shares can be held by five or fewer individuals in the last half of any taxable year. It must satisfy certain asset and income tests. No more than 20 percent of its assets can consist of stock held in taxable REIT subsidiaries. Most importantly, 90 percent of taxable income must be distributed each year.

These characteristics limit the form that a REIT can take in terms of entity choices. When Congress first enacted the provisions of the code in 1960, REITs had to be formed as trusts. Some states, such as Maryland, enacted legislation that provided for statutory trust vehicles, allowing entities to take advantage of the benefits afforded by electing REIT status. Other states have adopted general business trust statutes. In 1976, Congress extended these benefits to corporations and today we have over 178 publicly traded REITs, 73 percent of which are corporations and 27 percent of which are either statutory REIT specific trusts or general business trusts.

EQUITY CAPITAL

Norbert Seifert: Let me discuss what I would be concerned about and would need to understand if I were considering raising equity capital in a REIT today. I'd be considering the three jurisdictions that we have represented here today [Maryland, Delaware, and Virginia] because they are the leading jurisdictions for the formation of REITs in today's legal environment. I would need to understand certain things about Maryland, Delaware, and Virginia so that I could advise members of senior management on which jurisdiction would be best and why. I'm going to address my conversation with the members of our panel and at the end I'll allow the representatives of each jurisdiction to give me a statement as to why I should consider forming our entity in their jurisdiction.

My first concern is one of investor familiarity. I need equity capital for our vehicle at the lowest cost. If I can't raise the equity capital, there is no REIT. If I have a hiccup right at the outset because the investors are going to gag over one or the other jurisdiction, I need to know that immediately. So let me start off by asking how favorably will your jurisdiction be viewed by investors and thus by the underwriters? Is there a market perception of differences between the different jurisdictions that will affect the pricing of my REIT when I go to market? I am not talking about general issues of corporate friendliness, but the investor familiarity and comfort with the jurisdictions.

Sharon Kroupa: Over 60 percent of those publicly traded REITs are formed in the state of Maryland, which has 40 years of history and legislation with respect to

REITs. Underwriters have a comfort level in this history and when it comes to the next IPO, we believe that the greatest comfort level is in Maryland.

Randall Parks: Let me just comment on Virginia. I cannot say that Sharon is not right with respect to market perception. Underwriters and investors are herd animals. They are afraid they will get picked on by the critical analyst. It is very easy for an underwriter to tell his lawyers: pick the jurisdiction that is going to keep me safe. Maryland has got a lead on many of the other jurisdictions simply because so many REITs are already formed there. I would go to the Commonwealth of Virginia and look at its new REIT statute.

Ellisa Habbart: With respect to Delaware, there is a common perception and credibility when one deals with Delaware. There was a recent US Chamber Commerce of Study done that ranked Delaware number one with respect to its court systems and use for business operations. I would say that should be very comforting in making your decision, and second, I would note that every major mutual fund in the 1990s had to face the same issue went through the analysis, and determined that a move to Delaware was appropriate.

COSTS OF FORMATION AND OPERATION

Norbert Seifert: Let me go to the costs of formation and operation. One thing that is always of concern to management is bottom line dollars. Of course, the way you get the bottom line dollars is by minimizing costs. Are there any significant capital costs that I might encounter if I were to form our entity in your jurisdiction? What are the costs of ongoing operations? What might I encounter in the way of annual fees, franchise taxes, costs to run the business, and amending corporate documents, if I have to raise additional capital? I am talking about costs that will impact what my CFO cares about, which is earnings per share.

Ellisa Habbart: The REIT industry is heavily regulated. For a listed REIT, there are exchange rules one must follow. If it is a non-listed REIT, NASAA guidelines come into play and, of course, there are Internal Revenue regulations that need to be complied with. All of the costs come into play because of this overlay of these regulatory agencies and the filings you have to make with them in the review process. You still need to be cognizant of the state that you choose because many times interpreting those regulations and implementing them will fall on interpretations of state law. The choice of jurisdiction, however, certainly at least in Delaware adds no additional costs.

Sharon Kroupa: We don't have any franchise tax in Maryland.

Randall Parks: Nominal cost in Virginia.

Ellisa Habbart: When I say Delaware, I am saying a business trust that has no annual fees, no franchise taxes. There has been much written comparing the Maryland corporation to the Delaware corporation where, yes, in fact, there would be a franchise tax that could be substantial; but that is not applicable when using the business trust structure.

Randall Parks: The business trust, just as a general matter, is an unincorporated business entity. It's not a corporation, a partnership, or limited liability company, it's simply an unincorporated entity. Now what the statutes have done is to take what used to be a creature of common law, and if you are familiar with the securitization structures many of those are done through common law trust, codified the law of the trust.

Ellisa Habbart: I would add one additional distinguishing factor—we have an absolute statement to the effect that the statutory trust is a creature of contract. For one, there are no rules placed on how you must design your business trust. The first place to look for interpretation of rights and how things must be managed is the agreement itself. It is based on contract law principles rather than the statutory authority that exists for a corporation.

Norbert Seifert: I have heard about the Delaware franchise taxes; so, with the business trust, there is nothing to worry about?

Ellisa Habbart: That is correct.

DESIGNING CAPITAL STRUCTURE

Norbert Seifert: Are there limits on how we can design our REIT's capital structure in your jurisdiction and what are the differences in the jurisdictions? How will those differences, if there are any, impact the way our REIT functions? I'm thinking about things like increasing our authorized share, creating different series, creating different classes of share, changing and paying the amount of our dividend—those sorts of things—ease of maintenance, accounting costs, and so on.

Sharon Kroupa: I think my colleagues will probably tell you much the same in the context of the business trust, but our statute does permit the governing documents of a REIT to include a provision allowing the board of directors or trustees to increase or decrease the authorized shares without stockholder approval, and also if the governing documents so permit, to create new classes of shares without stockholder approval. We also have specific statutes that allow REITs to issue up to 100 shares to satisfy the REIT requirements without consideration, and as to dividends, we do have dividend limitation, but I think it is one that would be observed in any context and that is

that you would not be permitted to pay dividends to the extent that it would render your company insolvent.

Norbert Seifert: In terms of having different series, classes of stock, whatever we wanted to do we have carte blanche?

Sharon Kroupa: There's a filing. Administratively, you create a new series of stock. You would file articles of supplementary with our state, but that does not require any stockholder approval, and the same with the increase to your authorized capital.

Randall Parks: The Virginia statute was based largely on Delaware. We try to take the best of what everybody else has and roll it up into the better mousetrap, but the Virginia statute and the Delaware statute are very much the same in that you are allowed to set the capital structure and limitations on the capital structure in what is called your governing document, your trust instrument, and you can do that without limit. So you can authorize an unlimited amount of shares to be issued—shareholders are not required to vote on additional issuances. It is the boards' prerogative to determine the capital structure of the corporation.

Ellisa Habbart: While it's just an incidental item in Delaware, no filing is required with the state when you create and designate new classes of capital.

Randall Parks: As a matter of fact, there's only a one page filing in both states to organize the entity and thereafter, if you like, you can keep your corporate governance under cover. Nothing needs to be filed with the state.

TRANSFER RESTRICTIONS

Norbert Seifert: I do not run afoul of the REIT tax laws. I am going to need a provision in my corporate documents that restricts transfers to the extent that I need to restrict them, so I do not run afoul of the 50 Rule. Is there any problem with putting those kinds of restrictions in the documents in any of the jurisdictions?

Ellisa Habbart: No.

Randall Parks: No.

Carol Miller: Why would my investor care about any of this?

Ellisa Habbart: Well, it is important which jurisdiction you are in. The more experienced and sophisticated the court, the more predictability that is provided by a body of law in a given jurisdiction. It provides management with a certain level of certainty and predictability in its decision-making, which restrains somewhat outside legal costs that may need to be incurred and also, that same predictability and reliability reduces litigation costs.

A LISTED REIT

Norbert Seifert: Let me ask a question that deals with a REIT that's going to be listed. Listed REITs, of course, trade publicly by definition. We can assign a market value to their stock by taking the number of shares outstanding in the price and that gives us their market capitalization value. If that value should become lower than what we think the fair market value is, some outside person, let's call him a raider, might think that there's an opportunity which could disrupt the ongoing operations, could impact shareholders in an adverse way, and could have adverse impacts on the senior management team. In considering each jurisdiction, how do we react to that possibility?

Sharon Kroupa: There is a benefit to continuity of management and continuity of business purpose, and the real underlying purpose of these anti-takeover provisions is to protect the company's shareholders from a raider who may seek to come in and take advantage. That's really the goal of these provisions when they are implemented. In Maryland, we have a broad array of anti-takeover devices. A company may choose whether or not it wishes to be subject to these different provisions. We have a business combination act with a five-year moratorium on transactions with so-called interested stockholders and a supermajority vote thereafter. What that protects against are so-called squeeze-out mergers after there has been a tender offer. We have a control share acquisition statute that would affect the voting rights of anyone who acquired over a certain percentage of stock. In the case of Maryland, that figure is low—it's 10 percent. This forces someone to come to the board and strike a deal. We have the unsolicited takeover provision in Subtitle VIII of the Maryland General Corporation Law which allows a company to opt into any or all of several provisions regardless of what the governing documents of the company may provide including establishing a staggered board, a 2/3 vote for removal, power to fill vacancies for the remainder of the term, majority requirements for special meetings, and so forth. Additionally, the Maryland statutes specifically validate stockholder rights, plans or so-called poison pills, as well as the 180-day slow hand provision which would prohibit future directors from voting on matter for a period of up to 180 days. Also, directors and trustees of a Maryland corporation can just say, "No" to an acquisition proposed without violating their duties as directors and trustees.

Norbert Seifert: Let me ask the other jurisdictions whether their jurisdictions are any different in terms of protecting against that kind of a situation?

Randall Parks: The response to the question is a little bit different. What you have in Maryland is a statute that looks and acts a lot like corporate statutes and so you have control share acquisition; you have business combination; you have poison pill validator statutes—all

the things that you get along with the model business corporation act. In contrast, under the statutes in Virginia and Delaware, you have a blank slate. You can write whatever you like. You can certainly have a poison pill. That's simply a contract in any case and you can issue all the securities that are necessary to back up a pill. You can do that in Delaware and in Virginia under the trust statute. You can also generate your own, and we have actually tried to do this in the corporate arena before, but you can certainly do it in the governing document. There is no question whether it is going to be enforced or not because in Delaware, for example, you have a court system that is going to enforce your contract.

Ellisa Habbart: Yes, I would note that when the mutual funds moved and they were going from the corporate to the Delaware business trust structure, the way in which we approached it was what do you like and dislike under your current governing document? Let's begin crafting there. Keep what you like. Let's reconsider what you don't like and then let's see what the law has been in Delaware in the corporate structure to see if we are addressing all the possibilities that might arise, so that we have the answers in our agreement rather than in court cases that apply to a different type of structure. That approach was quite successful.

Norbert Seifert: What if we decide for whatever reason that we don't want to include these provisions at the time that we go to market, but later on it becomes apparent to us that we should have? How difficult is it going to be later on to put these kinds of protections into place?

Ellisa Habbart: Depends what your amendment procedure is in your agreement.

Norbert Seifert: So, it's totally governed by our documents. We don't have to worry about any state law jurisdictional issues that would impede our ability to do that.

Ellisa Habbart: I'm assuming that management has noticed that there's something missing in the agreement and wants to put in those provisions rather than having a situation in which you are the target. If you are in the former as I've described, you can propose an amendment to your investors for their approval unless, perhaps in this agreement, you have granted authority to management to design and adopt these without approval. If you are the target and you have not provided for that situation, you're then opening yourself up to the possibility the court could look to case law on that topic area even if it is with respect to a different entity. The court may turn to that for guidance and then you're within that entire case law. But I would hope that everybody going into it—it is such a basic issue that I don't think you would allow your client and you would stress to any general counsel that they want to think about this in advance.

Norbert Seifert: Well, we want to think about it but it's a tension between marketing to our investors and protecting management, and so you want to be at the right point on that spectrum between those two objectives.

Sharon Kroupa: I think that it is an important distinction—the ability to opt out of certain statutory provisions can be effective in Maryland without amendment to the charter or a declaration of trust because most times you are affecting these through board resolutions. You consult the business combination act or an amendment to the bylaws or a controlled share act.

CORPORATE GOVERNANCE

Norbert Seifert: Let me ask a related question about investor rights and initiatives and how they might impact our corporate governance. What, if any, rights do we have to give our investors in your respective jurisdictions? Let me tell you a list of concerns: inspection rights, voting rights, appraisal rights, rights to call meetings, rights to drive proposals, and investor ability to take control away from management where it's just a small group of renegade investors and really management is doing what it's supposed to be doing.

Ellisa Habbart: The simple answer is that it depends on what you write in your agreement. There are no restrictions on what you can or cannot put in the design of your agreement, and all of that, of course, ultimately can be affected by how you write your amendment provision. Perhaps if you wanted to seek certain changes, does management have the right to do that without going to investors? That's all negotiated. There's nothing in the statute that requires you to go one-way or another. There is one provision in the business trust that imposes a blight on shareholders and that provision is that if you are going to do a merger, unless you have provided otherwise in your agreement, unanimity is required, which is a very difficult standard to meet and effect a merger, so that is something you have to draft against so that it doesn't apply otherwise. Blank slate, craft your deal.

MANAGEMENT DUTIES

Norbert Seifert: Another thought that I'm concerned about, and perhaps senior management as well, are the duties that management owes to the business entity. In Virginia, what is the duty of care, duty of loyalty, and the standard of business judgment?

Randall Parks: This is where we think Virginia has got the best statute backed by some excellent positions that have run all the way up to the Supreme Court. In Virginia, we have imported the statutory standard of conduct from the Virginia Stock Corporation. It's a very simple statute,

and a very simple standard. It does not contain any references to reasonableness; there is no concept of a reasonable man. What it does say is that a fiduciary has got to act in good faith, business judgment as to the best interest of the trust. We have cases that came out of a take-over battle involving Tyson Foods several years ago. The upshot of those decisions, that went up to the fourth circuit and then was denied in the Supreme Court, was that what this all boils down to is a process-based standard. There is no second guessing; there's no Unocal; there's no heightened scrutiny, there's no trying to reconcile the thousand of cases that have come out of Delaware since 1983 on these issues. You simply look at whether the Board ran a good process and you stop if they do. Some of the case law has indicated that even the inquiry into what the Board did when it was considering these actions can only go to elements of process. For example, it might be very interesting to know what the investment banker told you, it might be very interesting for the judge to see that but he's not going to let it into evidence because its irrelevant. If you hired the banker and he presented and you listened to him, that's all you get to know. For managers, I would think that would be quite compelling because the manager's nightmare is that he votes "aye" on a matter and there's somebody looking over his shoulder a year and a half later saying "No, you should have voted 'nay' and here are the reasons why."

Ellisa Habbart: In Delaware, you start with the premises that you are a fiduciary and we all know that a fiduciary has to act properly. It has to respect doing anything that's in conflict with its investors. The old line fiduciary cases in the common trust area, however, would not make sense in a business operation. For example, there may be a perfectly good reason why management may actually want to purchase assets from the REIT for another operation. Now, as a fiduciary you could reduce your dealing on both sides there. Our statute says you can modify the fiduciary duties it would otherwise apply. Thus, you give management a layer of protection so that they can take actions that are responsive to business demands, and yet not feel that they're running against or violating the otherwise applicable fiduciary duties. We have an example where the fiduciary is a fiduciary for a number of different funds and an opportunity arises that could be good for any one of them. How does the fiduciary make the decision which fund gets it and not violate its fiduciary duty? You put into your agreement systems to address that and, again, since your agreement should control and if it's a provision that can be sold to the investor, that will give lots of guidance and level of security and predictability for management.

THE MARYLAND CASE

Norbert Seifert: Sharon, how would the situation be handled in Maryland?

Sharon Kroupa: We have a statutory standard of conduct for directors. We have a three part standard. We do have the reasonable man, but also good faith and so forth. In Maryland, there is a presumption that directors have satisfied their duties and we reject the heightened scrutiny in the case of change of control situation. Unocal is not good law in Maryland.

We also have safe harbor provisions for interested director transactions. Ellisa was mentioning there are times when it may be beneficial for the REIT to do business with affiliated parties. We have a safe harbor that if you satisfy, this transaction would be deemed void or voidable. You also mentioned when you asked the question about ways to limit liability, and I would note that we also have the ability in Maryland to put a provision in our governing document that limits liability of both director trustees and officers for money damages except in very limited circumstances, such as an actual receipt of an improper benefit or an act of indeliberate dishonesty.

Norbert Seifert: Are there any compelling differences in litigation process that might impact a newly formed REIT? If there is a dispute what jurisdiction do I want to be in?

Ellisa Habbart: In the Delaware Court of Chancery we have no jury so you're not educating a lay person. There are no punitive damages that may be imposed. You also have a judge who has had a lot of experience in reviewing, analyzing, and rendering decisions with respect to business entities.

Norbert Seifert: Sharon, how about in Maryland?

Sharon Kroupa: We have 40 years of legislative concern for REITs, specifically, and we believe that our courts, our attorneys, and our legislators would continue to approach REITs with the same concern that we have in the legislative process. We understand the importance of being the haven for REITs, and I cannot imagine that courts would undertake to make our jurisdiction less favorable.

THE VIRGINIA SITUATION

Norbert Seifert: Virginia doesn't have the history of the statute, Randall. What can you tell me about litigation issues that I might confront in Virginia?

Randall Parks: Well, there are a couple of things that make Virginia an attractive jurisdiction. First of all, there are no state law class actions. Assuming you're going to be in federal court, the Commonwealth of Virginia is the rocket docket. You can get in and out of federal court in Virginia in about six months, which is a very good thing, when you start to think about how many hours can be

invested in manpower and lawyer's fees. In the survey that was mentioned, Delaware was number one, Virginia was number two.

THE FINAL PITCH

Norbert Seifert: Is there anything else about your respective jurisdictions that I should consider before making a recommendation to a senior management team?

Sharon Kroupa: In summary, I would emphasize that over 60 percent of all publicly traded RETIs, are in Maryland. I think in the ease of moving through your process is something to be considered. I would also note that a lot of what I hear in the context of the business trust is the ability to import the best of all protections and limitations on liability, standards for duties and so forth. In many cases they tout the ability to bring in from other jurisdictions statutes that may be more favorable than those that may apply to the analogous corporate statutes in their own jurisdictions, but I have to question that as an uncertainty because we don't know.

Ellisa Habbart: I would begin with the concept that, again, I stress there is certainty. The business trust is a creature of contract meaning that the terms of your agreement will control. The Delaware courts have respected that in the other alternative entities that are based exactly in the same fashion as based upon contractual provisions. Second, I would say that for the listed entities that have used Delaware business trust, there is a huge market in asset securitizations that are done through business trusts very successfully. For the mutual fund industry, absolutely there is a given comfort level when you can say 60 percent do it this way. The mutual funds, the Vanguards, the Franklin Funds, the Delaware Funds, the Federated Funds, and the list continues; they had to fight the same battle saying, "we are better off in Delaware." They went through that exercise and it has proven, without exception if you surveyed them, they have seen this as a progressive benefit to them.

My final point would be that I like the idea of no jury trials. I like the idea that that is not a necessary part of litigation and thus you have increased the reliability and predictability and reduced your costs.

Randall Parks: Norbert, I think when you go to your investors, two things that you know about them are, they want to make money and, probably 9 out of 10 of them hate lawyers, and they don't want to pay lawyers a dime more than they have to.

The Virginia Business Trust Act is the antidote to lawyers. We tried to draft a very simple statute that has very simple standards, which are not subject to a lot of second-guessing and interpretation. Every major takeover now, in Delaware, is litigated within an inch of its life. What we've tried to do in Virginia is draft a statute that's so clear that there can't be any question in the judge's mind when he goes to look at that statute as to what was intended by the draftsman.

DELAWARE LAW

Audience Question: Does anything you say really matter because in the end the court applies Delaware corporate law? Let's suppose that the lawyers weren't smart enough or management didn't want to include provisions for what happens if somebody wants to buy 40 or 50 percent of their stock. It could even be a friendly transaction. There is nothing specifically in the governing documents and now someone comes along and wants to buy 40 or 50 percent of your stock and the questions start being raised: Is this a change of control? If it is a change of control what do I have to do, what's my standard of duty, what does the Board have to do? Do I have to shop the company? It could even be a Maryland REIT and the answer that I generally get back from most people in Maryland and most people in Virginia is, we don't have any case law on this or we think that our courts would apply Delaware law, and it is Delaware corporate law that they would apply. I'd be very interested in what your experience is because does any of it really matter if I end up applying Delaware corporate law anyway and then maybe the question is, which courts would I want to apply Delaware corporate law?

Sharon Kroupa: We find ourselves doing a combination of what you mentioned. First, obviously you have looked to, in the case of Maryland REITs, we look to Maryland case law. If there isn't any case law on point, we would look to Delaware case law. If you have the issue of whether it is a change of control, you look to Delaware case law and try to make that determination. Perhaps you are able to conclude that this would be a change of control situation, but the difference is you go back and apply the Maryland standards as to duties of directors in a change of control situation. You would not import your Delaware duties or business judgment rule in that instance. The local jurisdiction still matters because even though you've made that threshold determination, then you are coming back to address the director duties.

Ellisa Habbart: Why would you want Delaware law analyzed by any court but Delaware? I would much rather the situation be analyzed by those same judges that rendered those decisions in the Delaware corporate arena. I would like to be in the position to have that done without having to worry about juries and punitive damages.

CHOICE OF LAW

Audience Question: If it's all a matter of contract,

then what's to keep me from forming my business trust in Delaware? My properties are located in Virginia and my financers are located in Maryland and my financer wants to litigate in her home state's court providing in formative documents that Maryland law controls. Can we just write choice of law clause in the contract to make it easier?

Ellisa Habbart: Good question. No, if you are a Delaware entity you are electing for Delaware to control. I would venture that you could not simply adopt that another state's law. The statute does not permit you to select another jurisdiction for exclusivity.

Sharon Kroupa: The entities that we've been talking about in Maryland are creatures of statute, so Maryland law would apply.

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