

Governance at Lodging REITs: 2017 proxy season roundup

- The vast majority of listed lodging REITs incorporated in Maryland now opt out of provisions of Maryland's Unsolicited Takeovers Act (MUTA)
- Roughly half now also allow shareholders to amend bylaws
- REITs not allowing shareholders to amend bylaws have seen support for directors on corporate governance and nominating committees sink by about 25% in 2017
- While most REITs have been responsive to shareholder calls for governance improvements, a small number have taken steps to limit shareholder participation

1. Maryland Unsolicited Takeover Act (MUTA) Opt-Outs

Most Maryland-incorporated listed lodging REITs now opt out of at least one provision of MUTA – the provision allowing boards to adopt multi-year, staggered terms for directors without shareholder approval. Many also opt out of provisions allowing boards to unilaterally adopt supermajority voting thresholds, and a 50% threshold for calling a special meeting. Some of these REITs opt out of all MUTA provisions. Except as indicated (*), these REITs also require shareholder approval before becoming subject to these statutes again.

REIT	MGCL § 3-803	MGCL § 3-804			MGCL § 3-805
	Directors - Staggered multi-year terms	(a) Supermajority threshold for director removal	(b) Directors set size of board	(c) Vacancy appointments - by vote of remaining board members only	Majority of outstanding shares to call Special Meeting
AHP	x	x	x	x	x
AHT*	x	x	x	x	x
CHSP	x	x	x	x	x
CLDT*	x*				
DRH	x				
FCH	x	x			x
HST	x				
INN	x	x	x		x
LHO	x				
PEB	x				
RLJ	x	x	x	x	x
SHO	x				
STAR	x	x	x	x	x
XHR	x	x	x	pending vote	x

* doesn't require shareholder approval before opting in again

Lodging REITs, incorporated in MD, not opting out of any provisions of MUTA: HPT, HT, SOHO

2. Shareholders' right to amend bylaws

In Delaware, where approximately 60% of U.S. companies and trusts are incorporated, the right of shareholders to amend bylaws is expressly protected by statute. Maryland is one of a handful of states allowing company charters or bylaws to strip that right from shareholders.

By way of statute or governing documents, over half of listed lodging REITs now allow shareholders to submit binding shareholder proposals, without setting additional ownership and holding requirements beyond those set by SEC Rule 14-a8.

Which listed lodging REITs allow shareholders to amend company bylaws?

Shareholders have right to amend bylaws that is protected by statute	Shareholders have unrestricted right to amend bylaws (MD)	Shareholders have no right to amend bylaws (MD)	Shareholders' right to amend bylaws is restricted (MD)
APLE (VA)	AHT	AHP	PEB
RHP (DE)	CHSP	CLDT	
PK (DE)	DRH	HT	
ESH (DE)	FCH	HPT	
	HST	LHO	
	RLJ	SOHO	
	SHO	XHR	
	CDOR		

3. Shareholder support for certain directors drops at lodging REITs that prohibit shareholders from amending bylaws

Last fall, leading proxy advisor Institutional Shareholder Services (ISS) adopted a policy recommending shareholders vote against directors serving on a company's nominating and governance committee when the company limits shareholders' right to amend bylaws, either through an "outright prohibition on the submission of binding shareholder proposals, or share ownership requirements or time holding requirements in excess of SEC Rule 14a-8."

This was the first proxy season the new policy was applied in ISS voting recommendations. On average, at lodging REITs not permitting shareholders to amend bylaws, shareholder support for incumbent directors serving on the nominating and governance committees averaged 66%. Support for incumbent members of the nominating and governance committee dropped by an average of 25% from the previous uncontested election. By way of contract, Ernst & Young estimate that in 2016, only 4% of directors received less than 80% of votes cast (in 2017, as of 5/31/17, that number was 3.8%).

	Average support for members of Nominating & Corporate Governance committee		
REIT	2017	Prior election	Average difference from 2016 to 2017
AHP	79.4%	99.4%	-20.0%
CLDT	65.9%	98.4%	-32.5%
HPT	19.8%	56.6%	-36.8%
LHO	72.0%	98.6%	-25.5%
XHR	80.9%	97.6%	-16.7%
PEB	80.1%	99.6%	-19.4%
Average	66.35%	91.53%	-25.2%

Notes: Percentages express (votes for)/(votes for + votes against). Prior election refers to votes cast for incumbent members of that year's N&CG committee in the immediately preceding uncontested election. In AHP's case this means the 2015 election, due to a contested election in 2016; because HPT's board is staggered, this means 2014. Table excludes Hersha Hospitality Trust, with a staggered board structure, which had no member of the nominating and governance committee up for election this year, and Sotherly Hotels, where a proposal to allow shareholders to amend the bylaws was on the ballot. Pebblebrook does not entirely limit shareholders from initiating bylaw amendments, but restricts all shareholders except for those holding 3% of company stock for 3 years from submitting binding proposals.

4. Some REITs move to limit shareholder participation

While most lodging REITs have been responsive to shareholder calls for governance improvements, a small number have taken steps that would limit shareholder input and participation.

Pebblebrook Lodging Trust (PEB) recently adopted provisions that allow only shareholders who have held 3% of company stock for 3 years to submit binding proposals for shareholders' consideration, according to the company. With a market cap of over \$2.2 billion (6/29/17), the new bylaw requires shareholders to hold roughly \$66 million for three years to even propose amending a company bylaw.

Hospitality Properties Trust (HPT's) bylaws were amended in 2015 to provide that shareholders must have owned at least 1% of outstanding shares (over \$47 million as of 6/9/17) for 3 years to nominate a director or propose other business – far in excess of SEC Rule 14a-8 thresholds. Further, new bylaws exclude nominees receiving certain forms of compensation during their candidacy which, according to ISS, “could deter legitimate efforts to seek board representation via a proxy contest.”