This 3DAdvisors Report Covers:	
✓	**Insider Trading**: Insider Trading Behavior
	Accounting: Quality of Earnings Issues
✓	**Governance:** Corporate Governance Issues

CEO Change Forces Focus on Governance Behavior
Starwood Hotels & Resorts Worldwide, Inc. (NYSE:HOT)

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Contact: Bob Gabele (954) 779-3974 or bgabele@3DAdvisors.com

Starwood Hotels & Resorts Worldwide, Inc. is a hotel and leisure company. The Company's status as a hotel and leisure company resulted from the 1998 acquisition of Westin Hotels & Resorts Worldwide, Inc. (Westin) and certain of its affiliates (the Westin Merger) and the acquisition of ITT Corporation (the ITT Merger), renamed Sheraton Holding Corporation (Sheraton Holding) and the acquisition of Vistana Inc. (renamed Starwood Vacation Ownership, Inc. (SVO)) in October 1999. The Company conducts its hotel and leisure business both directly and through its subsidiaries. Starwood's brand names include St. Regis, The Luxury Collection, Sheraton, Westin, W and Four Points by Sheraton. Through these brands, the Company is well represented in major markets worldwide. Its operations are grouped into two business segments, hotels and vacation ownership operations.

Summary of 3DAdvisors Findings for HOT

- **Governance:** Is this management shake-up déjà vu all over again?
- **Insider Trading:** Selling by key insiders just before Sternlicht announcement
- **Governance:** Sternlicht benefits from long list of related party transactions
- **Governance:** Obfuscated disclosure related to employee loans
- **Governance:** Board independence could camouflage certain loyalties

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Discussion of 3DAdvisors Findings

Governance: Is this management shake-up déjà vu all over again?

Just yesterday (October 30), and on the same day it announced third quarter results, Starwood also announced that Chairman and CEO Barry Sternlicht (42) will be stepping down as CEO. His stated reason for the move is to spend more time with his family. We were deeply involved in researching Starwood at the time of the announcement and feel that there is more going than the announcement seems to imply. In fact, the move did not at all surprise us. Based on certain insider and governance behaviors we have been monitoring, we expect to see additional changes.

One reason we were not necessarily surprised is that this isn't the first time that Sternlicht has attempted to step down as CEO of the Company. He had set out to do the same back in April of 1998 when Sternlicht hired, with much fanfare, his old Harvard buddy, Richard Nanula, from Disney, to be Starwood's CEO. Sternlicht's comments at the time mirrored those of todays: "…we need a world class executive to help organize, integrate and manage our global operations. Richard Nanula is one of the most able and respected senior executives in Corporate America today".

The hiring of Nanula in 1998, and sidestepping internal candidates, started a long period of unprecedented management uncertainty at the Company. Within one year of the Nanula hiring, the former Disney executive had resigned. A flurry of senior executive appointments were announced at the same time, only to find the appointee's resigning a short time later: Jim Gallagher, named V.P. Public Relations in May of 1998, resigned in January of 2000; Mark Rozells, named Treasurer in May of 1998, was out of the picture by May of 2000. Thomas Jason, named General Counsel in August of 1998, resigned in November of 2000. The November 1999 resignations of Jurgen Bartells, CEO of the company's Hotel Group, Fred Kleisner, president of the company's North American operations, and Nanula, dropped Starwood shares 15% on the news. Like Nanula, Kleisner had been on board for only four months before calling it quits. It would be two years before the executive structure at Starwood would stabilize.

Out of this chaos, one member of the Starwood senior executive staff emerged. Robert Cotter, who had remained loyal through all the gyrations, worked his way up through the organization and was finally promoted to the COO position in February of 2000. With his appointment and with Sternlicht once-again firmly in place as Chairman and CEO, the revolving doors of Starwood management finally appeared to stop.

Another little-known fact about Starwood's structure during that time was that none other than Dennis Kozlowski (of Tyco fame) had been appointed to the Starwood board in April of 1999. He, like so many of the others at the time, did not wait one full year before leaving. Though the Company never announced his departure date, suffice it to say that he did not remain on the board long enough to serve on any board committees that we are aware of. One wonders why a high-powered individual like Kozlowski would leave so quickly and so quietly, long before he began experiencing the problems at Tyco that have made him so dubiously famous.

<u>Insider Trading: Selling by key insiders just before Sternlicht announcement</u>

With Sternlicht once again attempting to name an outside successor as CEO, and snubbing the long-loyal Cotter in the process, we wonder if a similar churning of the management ranks, similar to what we saw back in 1998-1999, may be in the offing. As if in anticipation of Sternlicht's announcement to find an outside CEO, four key senior members of Sternlicht's management team had filed 10b5-1 trading programs to sell shares and had begun selling at record levels:

- **Ronald Brown (48) –** CFO. Brown filed a 10b5-1 trading program in June of 2003. He then sold 107,500 shares, in September, at prices near the current $35 range. These trades, his largest in the past five years and first since

November 2000 (30,000 shares) depleted his actionable holdings (common shares plus exercisable options) by 20%.

- **Kenneth Siegel (47)** - Chief Counsel. One month after Brown, Siegel filed a 10b5-1 trading program on July 7, 2003. On October 9th, he sold 21,875 shares at $37.25 each. Siegel, who had not sold a share prior to this, dropped his actionable holdings by 43%.

- **Robert Cotter (51) -** COO. The month following Siegel's 10b5-1 program filing, was Cotter's turn to do so as his was filed on August 6th. Cotter then sold 120,766 shares in the $35 range, which were his first sales since November of 2001. The sales dropped his actionable holdings by 13%.

- **Steve Hankin** - President of Starwood Technology & Revenue Systems (S.T.A.R.S.) and Chief Marketing Officer. Hankin has been with the Company since 1999 and, prior to this, has never sold a share. His 10b5-1 trading program was filed on September 8th. He followed up with a 4,000-share sale on October 8 for $37 each.

<u>Governance: Sternlicht benefits from long list of related-party transactions</u>

Make no mistake about it, Sternlicht has much to protect with regards to his personal dealings with the Company. Could it be that his long list of Related Party transactions are worth more to him than his $2.2 million compensation package?

Sternlicht, in addition to being Chairman and CEO of Starwood Hotels, is also Chairman and CEO of Starwood Capital Group L.L.C. Starwood Capital is not affiliated with Starwood Hotels. Starwood Capital, however, owns a 50% voting interest in the Westin hotels acquired by Starwood Hotels in 1997.

- **Health Clubs:** Starwood Capital, controlled by Sternlicht, is the General Partner of a Limited Partnership, which owns 45% in "an entity" that manages 40 health clubs, including one health club and spa owned by Starwood Hotels.

- **Troon Golf:** Troon is a golf course management company managing over 120 high-end golf courses. Sternlicht owns 12% of Troon. In 2002, Starwood Hotels entered into an agreement with Troon where Troon will manage all golf courses in the U.S. and Canada that are owned by Starwood. In the deal, Starwood has also agreed to, on a best-efforts basis, use reasonable efforts to have Troon manage golf courses at resorts that Starwood does not own, but manages. In 2002, Starwood paid Troon $2.7 million under the agreement.

- **Sheraton Tamarron Resort:** Sternlicht owns a 38% interest in the common area of this resort, which Starwood had managed until 2001. There continue to be outstanding receivables totaling $314,000 (due to Starwood) as of F/Y 2002 resulting from the termination of the management agreement. These receivables, according to Starwood, "are expected to be paid in connection with any settlement of the Innisbrook matter." (Discussed below.)

- **Innisbrook Resort:** Sternlicht holds a 38% interest in the entity that owns the common area facilities at this resort. Starwood had the management contract for the resort. Under the management agreement, Starwood was obligated to loan up to $12.5 million to the resort owner in the event certain performance levels were not achieved. The resort operations did not generate sufficient cash flow to service the debt and now, the owners and Starwood are in discussions regarding the terms and timing of the payments owed. In dispute are $7 million in loans by Starwood and $5 million in deferred management fees owed by the resort owners.

  What seems clear to us, with regards to the Sheraton Tamarron and Innisbrook Resorts, is that since Sternlicht has an interest in both deals he may be calling the shots to the extent of saying that both deals have to be settled at the same time and neither will be settled without the other. In fact they seem to be saying that those receivables in the Tamarron deal are not going to be paid until and unless the Innisbrook deal gets settled. Given the way his tentacles reach into these related party matters, he probably has enough power and influence to call the shots on whether any settlement is acceptable in both deals. To us, this clearly flies in the face of Company implications that deals such as these are arms length and that Sternlicht does not participate in the negotiations concerning such deals.

  Indeed, a similar conflict of interest reared its head back in 1997 when Starwood bought the Westin properties, which were 50% controlled by Starwood Capital L.L.C., when one observer noted that, "Officially, Sternlicht recused himself from the Westin negotiations, though he concedes he oversaw the transaction from behind the scenes."

  Yet another conflict of this nature occurred back in 1995 when Starwood Hotels initially negotiated the purchase of the Sheraton Hotels from ITT. At that time, Starwood Capital LLC, which is controlled by Sternlicht, received a $22 million fee for advising Starwood Hotels on the ITT deal. This obvious conflict of interest in a related party transaction is behavior that always gets our attention.

- **Westin Savannah Harbor Resort and Spa:** In July of 2002, Starwood Hotels acquired 49% interest in this property. An additional 2% of the property (enough to swing the controlling interest in Starwood's favor) is owned by Troon Golf, where Sternlicht owns a 12% interest.

- **Aircraft Leases:** Starwood Hotels has been leasing aircraft from an affiliate of the Sternlicht-controlled Starwood Capital L.L.C. (Star Flight L.L.C.). In 2002, Starwood Hotels had paid Star Flight L.L.C. $2 million under the deal. In 2001, the total paid was $1.7 million.

Governance: Obfuscated disclosure related to employee loans

Starwood Hotels has made a series of loans to certain executives in conjunction with purchases of their own homes. As of December 31, 2002, 36 loans totaling $11 million were outstanding. In the 2003 Proxy (covering F/Y 2002), the Company goes on to state various details of the loans. Dropped in the recent disclosure, however, is a small phrase, which had been included in the prior year's proxy: These loans were non-interest-bearing. We note this not as a material item, but as evidence that the Company is not beyond the obfuscation of certain detail when the chance arises.

Governance: Board independence could camouflage certain loyalties

Formally, the independence of Starwood Hotel's board structure cannot be argued. Governance Metrics International (GMI) ranks eight of the ten-member board as independent, according to GMI standards. The tenure of the board however, with six members having served on the board prior to 1999 and three since 2001 (not counting Sternlicht), it becomes clear that this is essentially the same board that has allowed Sternlicht to have his way with Company dealings that inure to his benefit. So even in the presence of independence, the board has clearly done little to change executive behavior consisting of extensive related party dealings the likes of which were more common in the pre-Enron era.