THE SASKATCHEWAN WHEAT POOL TAKEOVER OF AGRICORE UNITED: A BUSINESS HISTORIAN’S PUZZLE

[Producers have] raised up a coöperative cult in America which cries down the Rochdale principles and exalts the new “coöperation American style,” along the lines of big business bargaining and ruthlessness. … Taking the essential facts of the market as he finds them, [the farmer] seeks merely to put himself in the most effective position with reference to it. (Nourse, 585, 586)

In June, 2007, Saskatchewan Wheat Pool (now Viterra) completed its takeover of Agricore United, thus ending about 100 years of farmer control of grain handling in western Canada. A year earlier, many would have thought such a move both impossible and undesirable. Why this improbable event occurred, and some of the puzzles it presents to the business historian, are the issues explored in this paper.

Introduction

In June of 2007, Saskatchewan Wheat Pool (SWP), a grain handling and marketing company that, in 2005, had converted from a cooperative into a Canada Business Corporation Act (CBCA) company, completed a takeover of Agricore United (AU), another western Canadian grain company which had been formed through two consecutive mergers: the first between Alberta Wheat Pool (AWP) and Manitoba Pool Elevators (MPE) to form Agricore, and the second between Agricore and United Grain Growers to form AU. What made this takeover of particular historical significance was that AU was the last remaining representative of just over 100 years of farmer control of the western grain handling industry – a history that had begun in earnest in 1906 with the formation of the Grain Growers Grain Company.¹

AU had a unique financial and governance structure – unique in the literal sense of one of a kind. This uniqueness lay in the fact that, while it was governed in part by the CBCA, it also operated under its own special legislation, the 1992 United Grain Growers Act, that retained some of the cooperative features from the company’s past. The first and most significant of these to this inquiry, was that both sections 6 and 9 of the Act very explicitly defined the company to consist of both shareholders and members. These sections respectively read as follows: “[t]he corporation continues to consist of members and shareholders,” and that “[t]he corporation is a combined membership and share capital corporation.” Secondly, the members essentially controlled the organisation, since they elected 12 out of 15 members of the board of directors. Although the company had preserved this governance structure from its cooperative past, it was also publicly traded, issuing what were called “limited voting shares” that gave shareholders the right to elect the other three board members. The Act’s preamble set out the rationale for these provisions, mandating it to be “desirable to maintain” the company’s “historic connection with the

¹ There were a number of country grain elevators that were cooperatively owned and operated locally, but the GGGC was the first attempt by farmers to organize cooperatively on a large scale.
farmers.” Arguably both the status of its customers as “members” (the status they enjoyed when UGG was a traditional cooperative) and members’ control of 12 director positions, formed the essence of that “historic connection.” The Act also specified that, where there was a conflict between it and the CBCA, the former would prevail.

At the same time, the legislation, in section 24, did conceive of the possibility of the end of this unique structure, specifying that, if 75% of the shareholders wished to convert the organisation to a CBCA company, they could “authorize the directors to apply for the continuance of the corporation under and in accordance with the governing Act” (i.e., the CBCA).

Almost all of the farmer directors of AU did not favour the takeover, and thought that there were sound reasons for retaining the company as an independent entity. Despite these sentiments, the board did not publicly articulate its desire to retain the company’s independence, but rather, set in process the usual procedure when an unsolicited bid is received, namely, to initiate an auction to realise a “change of control premium” in order to maximise shareholder returns. It is this dichotomy between the board’s position that it was in the interests of the corporation (and the grain industry) to remain independent, and the seeming haste with which they undertook to sell the company, that is the central inquiry of this paper. Why did the AU board not oppose the SWP bid, but instead, so quickly abandon their desire to retain AU’s independence?

The paper concludes that, ultimately, the rationale for the board’s actions remains a mystery, and that the historian is left with a series of unanswered questions as to why the process unfolded as it did.

The Subjects Covered and the Historical Methods Employed

The following section of this paper (Part III) examines the historical background to the formation of the four prairie grain cooperatives (UGG – whose story is the focus of this paper – and the three Pool organisations: AWP, MPE and SWP). This formative period stretches from 1906, when the company that was to become UGG was formed (Colquette, 1957), to the 1920s when the Pools came into existence (Fairbairn, 1984; Hamilton; 1957?; Nesbitt, 1962?). It then gives a brief history of the evolution of the grain industry from that formative period to about 1990. This section of the paper draws on both primary and secondary sources that deal with the period from 1906 to 1990.

The following section (Part IV) deals with the massive transformation of the industry that occurred between 1990 and early 2000s. This section draws primarily on a series of approximately 50 interviews that were conducted with senior managers and board members of all four of the cooperatives. Some of these interviewees are now retired, but were active during the last two decades when the industry underwent these changes. About a third of the interviewees were involved with AU when the takeover by SWP took place. The interview data is augmented by contemporary documentation from the period.

Part V of the paper deals with the SWP takeover itself. This section draws more heavily on the interviews that were conducted with those who were intimately involved in that event. A major section of this part also examines the process of the takeover and the actions of the AU board in the light of legal commentaries on the field of mergers and acquisitions (M and As). As will be seen, these legal commentaries paint a quite different picture of the duties of a target company’s board of directors during a takeover than the views held by the AU board. In a nutshell, this section questions the apparent belief of the board that its first duty was to the shareholders, and that the takeover could not have been resisted. The legal experts quoted seem to make a strong case that the board had the authority and the duty to act very differently than they did.
The paper’s last section summarises the results of this analysis and identifies a series of questions that are problematic for the business historian who attempts to answer the basic question addressed in the paper: why was SWP’s bid not opposed if the majority of the AU board thought the takeover was not in interests of the corporation or the grain industry?

The Historic Background

In 1906, the company that was eventually to become Agricore United began life as the Grain Growers Grain Company, which was the first large-scale attempt by western Canadian grain farmers to exercise cooperative control of the industry. The grain producers who formed the company conformed closely to Nourse’s description of “the new cooperators” who “took the market as they found it” and endeavoured “to put themselves in a favourable position with reference to it.” Farmers in 1906, in other words, were predominantly classic liberals and free traders and therefore saw their problems with markets in terms of their improper functioning (Fowke, 1957). In their view, the lack of effective competition among railways, grain companies and manufacturers allowed these parties to extract excessive profits from the value of the western wheat crop, leaving farmers with correspondingly lower returns. Part of the solution to this problem, they believed, was the creation of a farmer-controlled grain marketing company that could strike a better bargain with grain companies and railways and thereby extract a “fair” price from the marketplace for its farmer-members. Initially established as a commission agent to receive and sell grain shipped to it by farmers, the GGGC acquired its first country elevators in 1912, leasing 174 facilities that had been built by the Manitoba government. In 1917, the company expanded further through a merger with the Alberta Farmers Cooperative Elevator Company, at which time it changed its name to United Grain Growers. By 1917, therefore, the company had become a fully integrated grain handler and marketer, competing effectively with privately owned companies (Colquette, 1957).2

UGG, on the other hand, retained the classic liberal attitudes of the earlier critics. Mac Runciman, who headed the organisation from 1961 to 1981 thought of the company’s founders as people who were “getting themselves organized and trying to control their own destiny,” looked at his own

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2 Grain handling companies that were not cooperatively owned were commonly referred to as “the private trade” – a term which, for the most part accurately described their ownership. There were a few companies whose capital structure included publicly owned shares, but not many, and they disappeared over time. By 1970, virtually all the grain handling companies were either co-ops or privately held companies.
responsibility “primarily … as managing the business of United Grain Growers,” and summarised his own philosophy of cooperativism as supporting “the guy out there on the farm who puts his life and his bucks into farming [and who] should make the decisions [and] have an absolute controlling input into how his business is handled” (Earl, 2000, 84, 121, 141).

It is clear, then, that cooperativism embraces a wide spectrum of ideas about the marketplace, from the idealism of Ransom to the pragmatism of Runciman. Both the Pools and UGG, however, would have agreed with Nourse that the farmers sought to put themselves “in the most effective position with reference to” the market, even though they disagreed as to what that most effective position entailed. Moreover, they also agreed that it was not possible to attain that “effective position” without gaining some access to the levers of economic power, and that in turn demanded that they create their own companies in order, to quote Runciman again, to do “the things a farmer wished to have done to improve his lot, and the essential part of it was the marketing of grain because that improved his lot the most and the soonest” (id., 127).

This philosophical difference between the Pools and UGG persisted from the 1920s to the 1990s and led to some serious disagreements between them. In the mid 1920s, for example, when UGG President, Thomas Crerar suggested that UGG and MPE share the use of UGG’s elevators, MPE demurred in no uncertain terms:

We feel that the Pool system of marketing is so fundamentally different to the system represented by the U.G.G. that it is wholly impracticable to make the two systems operate as one in the running of elevators. We wish to operate the elevators as service machines, as a means to an end in better marketing, and not as profit-making concerns as they are operated by the ordinary grain companies (Scoop Shovel, Apr. 16, 1926, 7).

Similarly, in evidence given to the 1931 Stamp Royal Commission on futures trading, former UGG Vice President, Cecil Rice-Jones, responding to a parade of officials from the Pools and other farm organisations who had been critical of the futures market, said:

I feel the evidence given by some of the representatives of the farmers organisations and claimed to be the opinion so many farmers is hardly fair. My experience is, both as a farmer and official of the Farmers’ Grain Company, that the futures market is of a distinct benefit, both to a farmer in marketing his grain individually, and also to the trade and the whole general handling of the grain business (Evidence, 1931, 344).

In the 1970s, UGG president, Mac Runciman, led the criticism against the legislated grain rail rates, taking a stance on the issue that was markedly different from that of the Pools (Earl, 2000).

The Pools were enormously successful until 1929 when, in part because their hostility to the market led them to eschew the use of the Winnipeg Grain Exchange for risk protection, they very nearly went bankrupt and survived only through loans from the three prairie provincial governments (Wilson, C., 1980). UGG, it must be noted, which had no compunction about using the Exchange, survived without government help. Nevertheless, the experience of the early years of the Great Depression deepened farmers’ suspicions of the efficacy of free enterprise (as it did for many in free enterprise societies everywhere), and led many of them – particularly the leaders of the Pool organisations – to advocate strong state control of the industry. The idea of a 100 Per Cent Pool by Legislation (Hull, 1931) began to gain currency leading eventually to the creation of the Canadian Wheat Board (CWB) in 1935 – albeit without its current monopoly powers. These were added in 1943 as a result of wartime conditions and were retained after the war to implement a series of international wheat agreements (Morris, 1987; 2000).
The formative years of the cooperatives, therefore, were marked by an intense and widespread ideological debate. Did farmers’ problems with grain markets arise because of imperfect competition, or was free-enterprise capitalism a fundamentally flawed system? Should farmer-controlled enterprises operate within a laissez faire system, or should they look to cooperative enterprise replacing capitalism outright? Should the free market control grain handling and marketing, or should the system be brought under state regulation and control?

By the end of the Second World War, it appeared that these questions had been settled, and the industry had attained a relatively stable institutional configuration, although one that conformed most closely to the Pools’ vision of a highly centralised and regulated business, rather than a commercial one. Grain handling was dominated by the Pools and UGG which, ca. 1950, owned just under half of the country elevators (Canadian Grain Commission, 1950).³ The CWB had responsibility for marketing wheat, oats and barley, which accounted for over 90% of grain production. The industry was highly centralised and regulated, with most of the grain marketing, transportation and logistics functions managed by the CWB, freight rates legislated at 1898 levels (the Crow’s Nest Pass Rates), branch line abandonment virtually impossible under the Railway Act, and grain handling tariffs and licensing controlled by the Board of Grain Commissioners (Canada Grains Council, 1973). This situation led Vernon Fowke to conclude in his classic 1957 work, The National Policy and the Wheat Economy, that the farmers' views on grain marketing “rested on a belief - diametrically opposed to the free enterprise tenets underlying the national policy - that the open market or competitive system, the system of freely moving prices, ought not to govern the marketing of western grain” (Fowke, 1957, 191).

As events transpired, however, the post-war lull in the ideological battles proved to be only temporary. Underneath, the grain industry remained sharply divided, with the CWB, the Pools and most farm organisations supporting the status quo, and the private grain companies and the railways wanting a more commercial system. UGG retained its classical liberal outlook, thus occupying a kind of middle position between the protagonists, and falling into what Ian MacPherson called “the pragmatic” wing of the Canadian cooperative movement (MacPherson, 1979, 46). Generally, however, it tended to side with those who favoured a more commercial industry.

The ideological war was re-kindled in earnest within a decade or so after the war as a paradigm shift began to develop throughout the western world, characterised by a declining faith in the public sector, and an increasing acceptance of market-based solutions to economic problems (McBride, 2005, 8, 9). In Canada, the 1957 Macpherson Royal Commission (Canada, 1961) on transportation was an early indication of these evolving views. This Commission ultimately led to the passage of the 1967 National Transportation Act (NTA), the counterpart to the U.S. Staggers Act. This legislation set the Canadian transportation industry on the way to significant deregulation – a trend that was to have profound effects on the grain handling and transportation system.

From the late 1960s on, criticism of the highly regulated regime grew, with claims that the grain industry had stagnated under the heavy regulation and control. In 1973, a new farm organisation, the Palliser Wheat Growers Association (later the Western Canadian Wheat Growers Association) became a vigorous proponent of this view, and thus, a new constituency took shape that wanted to see a more market-oriented grain industry. There followed 20 years of often bitter debate, focussed primarily on transportation, which culminated in the end of tightly regulated grain freight rates in 1999 (Wilson, Barry, 1990, 181). This was accompanied by some changes in marketing, with domestic feed grains, barley exports to the U.S. (temporarily) and oats all being removed from CWB control.

³ In 1955/56, the four co-ops owned 48% of the country elevators. There were five companies larger than MPE (which was the smallest of the four co-ops) that collectively owned another 38%. None was as large as SWP. The remaining 14% were owned by about 40 smaller companies.
The critics were quite right that the long period of regulation had brought significant inefficiency. By 1970, the country elevators were old and outdated, too many in number, spread over a dispersed rail network, decreasingly capable of handling large modern trucks, and massively inefficient. Unlike other bulk commodities, grain continued to move predominantly in outdated boxcars until 1973 when, faced with a near-crisis in rail capacity, the federal government made the first of a series of hopper car purchases for grain movement (Canada Grains Council, 1973; Earl, 2000).

Between 1970 and 1990, therefore, the ongoing debate impeded progress towards modernising and consolidating the country elevator and branch line system, and by 1990, things had reached crisis proportions. The outdated system needed a huge injection of capital to modernise, while at the same time, grain companies’ financial returns had been impaired by the cost of the widely dispersed and inefficient elevator system (Touche Ross, 1984; Earl, 2007).

**The Transformation of the 1990s and Early 2000s**

Between 1990 and 2006, to use a now-common metaphor, the industry was driven by “a perfect storm” of circumstances, some that had their roots in the preceding decades and some that arose after 1990. All of the following factors were instrumental in shaping the events of this decade and a half, leading up to SWP’s bid for AU. This list emerged from, and was repeatedly confirmed by, the interviews conducted for this study.

- As observed above, the 20 year ideological debate had significantly delayed the desperately needed modernisation, and improvements that should have evolved over the preceding decades had to be done quickly, and at 1990 dollars instead of 1970 or 1980 dollars.

- Transport deregulation, although it did not initially apply with great force to western grain movement,4 was widely seen by interviewees as the most important driver of change during the 1990s. The grain industry had long foreseen that deregulation would end the Crow’s Nest Pass rate regime, and create incentives for massive changes in the way grain was handled and transported, and when that finally occurred in 1994, the effect was immediate and profound.

- At the same time, farm sizes increased, rural populations declined, and farming became more a business and less “a way of life.” Younger farmers, reflecting the post-war paradigm shift, were more comfortable than their forebears with free enterprise, and had less empathy with co-op philosophy. Neither the Pools nor UGG responded effectively to these changes. Moreover, the governance and policy-setting mechanisms of the companies did not change with the times, and so it was not only difficult to interest younger farmers in cooperative ideals, but also to engage them in what appeared to be outdated procedures.

- Farm populations were also aging, creating a looming “bubble” of member equity redemptions for all four of the large co-ops. Capital was needed, not only for reconstruction, but also to retire these obligations.

- Virtually all interviewees for this study also noted an inherent weakness of co-op boards. Except for three non-farmer members added to the UGG board in 1993, the directors of all four

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4 The greatest potential effect of the 1967 legislation was on branch line abandonment, but the effect of the legislation was forestalled by a series of studies, starting with the Hall Commission of 1977. (Canada, 1977). The proceedings of this Commission was one of the locales in which the bitter debates over transportation took place.
companies came from the farm community, all with the same skills and background. Moreover, director election procedures meant that directors ultimately gained their position from local support, and to some extent, were bound by local concerns. Less charitable observers spoke of the “parochial” outlook of board members who lacked the experience, knowledge and outlook required to direct large modern corporations. (See also Hoyt, 2003.)

- The need for the massive investment of the 1990s came on the heels of a long period of declining profitability. For the Pools, this was identified in a study done in the late 1980s (Touche Ross, 1988) and a longer time frame is explored in Earl (2007).

- Personalities also played a part. Prior to about 1990, the CEO positions of all four companies had generally been filled by internal appointments. Later, new incumbents entered these posts from a variety of backgrounds. The CEOs of AWP and SWP were both strong personalities with their own ideas for their companies and the industry, and they were widely reputed to have clashed. This clash was one of several factors preventing the Pools from merging, a step that was contemplated, and that might have led to preserving the three companies as a single cooperative.

Faced with the urgent need to modernise and re-build, and, after 1994, with the impact of changing freight rates, all four grain co-ops began a massive re-investment and renewal process, replacing old elevators with large “high throughput,” or “inland terminal” facilities, and reducing the number of country elevators from 1578 in 1990 to 336 in 20075 (Canadian Grain Commission, various years). Financing and managing this program involved, and induced, the following changes in the industry.

- In 1992, UGG petitioned the federal government for new legislation that would allow it to enter the equity market in order to finance its renewal program. The company continued to operate under this legislation until the takeover by SWP was completed. Its new shares were valued at $8 on their issuance, and rose to approximately $14 in 1997. By October 2006, they had declined to approximately $8 - 9 (UGG, various years; James Richardson, 2007).

- SWP followed a similar path to UGG in 1996, issuing public shares, but keeping a fully farmer-elected board. The shares had a value of $12 on issuance, and rose to almost $25 by 1998 (Fulton and Lang, 2006).

- MPE and AWP primarily financed their investments through debt.

- The balance sheets of all four companies deteriorated, and the financial results were worsened by near-record low crops in 2000 and 2001.

- MPE and AWP attempted to solve their financial problems by mounting a hostile takeover of UGG. To fend off the hostile bid, UGG sought a so-called “white knight,” Archer Daniels Midland (ADM), which then acquired about 40% of the company’s shares and occupied two of the non-farmer director positions.

- AWP and MPE then merged to form Agricore, a move that only partially addressed their financial difficulties. The merged company continued toward bankruptcy and was finally forced into a merger with UGG to form Agricore United. This diluted ADM’s ownership to about 25%.

5 As at December 28, 2007. Note that the privately owned companies, the major ones being James Richardson International, Cargill, Parrish and Heimbecker, and Paterson Grain, also built new facilities. These figures include elevators built by these companies as well.
• SWP made some major errors and almost went bankrupt, and by 2003, had abandoned farmer control and was governed by its debt holders. Its shares declined to $0.20 during this period (id.).

• To extricate itself from its financial problems, SWP implemented what it called “fresh start accounting” which involved writing down its assets, and consolidated its shares in a 20:1 ratio. In 2005, it became a CBCA corporation (Saskatchewan Wheat Pool, 2003, 2005).

• Over 2004 to 2006, SWP slowly improved its financial situation, and its shares rose to about $8. AU worked on reducing its debt load, and its share price, by September, 2006, was also about $8.

In just over a decade and a half, therefore, the long-delayed modernisation of grain handling and transportation was finally accomplished, but it was accompanied by massive changes in ownership and control in which the four large and seemingly successful co-ops were replaced with two publicly traded companies. Only one of these – AU – retained the farmer control which had long been seen by farmers as the key “to putting themselves in the most effective position with reference to the market.” This was the situation in November of 2006 when AU received an unsolicited offer to purchase all its shares.

The Takeover

What Happened

Throughout the 1990s and early 2000s, UGG, and subsequently AU, had arguably been the most effectively managed of the four companies. It had survived a very volatile period which included two disastrously small crops, and had ultimately taken over two of its rivals. Unlike SWP, it had retained its financial integrity and had retired much of the debt it had built up during the massive construction phase. Through the merger that created AU, it had attained a dominant market position in the industry and had become larger and financially stronger than SWP. It was SWP, however, that initiated the action to combine the two companies.

SWP’s opening offer was issued on November 28, 2006 (Agricore United, 2006, 3). The vast majority of interviewees from the company – both those who disapproved of the takeover and those who did not – agreed, as noted above, that the farmer members of the AU board strongly opposed the takeover, and felt that preservation of the company as an independent entity would have been beneficial for its members, for farmers in general and for the grain industry. Some directors also reported vigorous opposition from members who shared these views. Given the status of AU’s members under its legislation, the company might have tried to determine the depth and extent of this discontent. It did not, however, and in fact, the company’s members were never formally consulted on, nor given any say in, the takeover process. As is discussed below, this may have been considered a dereliction of their duty.

Notwithstanding the desire of the farmer members of the board, and despite the informally expressed objections of some members, the board almost immediately began the process that is commonly followed in mergers and acquisitions: to maximize shareholder value (Bainbridge, 1993, 1423). The initial bid was rejected, not on the grounds that it was not in the interests of the corporation, but that it was too low and therefore not in the interests of shareholders; by December 12, a “data room” had been opened and AU had “initiated contact with, and responded to inquiries from, a number of third parties” regarding “an alternate transaction,” and what eventually became an auction was set in motion (AU, 2006, 11).
The bidding process that ensued forms an interesting story in itself, particularly in the way that SWP financed its proposed purchase through “subscription receipts.” Suffice it to say here, however, that the end result was a bidding war between SWP and James Richardson International (JRI) that drove share prices above $20. Although the farmer board members’ first choice would have been to maintain the independent status of the company, their second was to sell the company to JRI. This preference was said to be justified on the basis of the recent actions of SWP, which, in the minds of at least the farmer-members of the AU board, raised concerns about the future of the company should it pass into SWP’s hands. However, in the end, SWP was able to offer a cash deal to shareholders that topped JRI’s last bid of $20.25 by 25 cents, and so the farmer members of the board again felt compelled to act against their own wishes, and in the interests of shareholders, and to recommend acceptance of the higher bid.

In the end, therefore, neither the wishes of the board, the interests of members, nor the provisions of the UGG Act determined the outcome. The takeover process satisfied only the shareholders who realised almost a three-fold increase in the value of the shares through the change of control premium generated by the auction.

The Putative Reasons for What Happened

Since the majority of the board did not favour the takeover, and since there was some indication that membership shared these views, why then did the board not resist the takeover? Why did they so quickly solicit other interests, a step that led, almost inevitably, to the sale of the company? Five explanations were advanced during the interviews.

1. That, under the principle of shareholder primacy, the rights and interests of shareholders trump the rights of all other stakeholders. Hence the rights and interests of other stakeholders (including the company’s members) could never prevail, no matter what.

2. That the shareholders were able to exercise more power than the other stakeholders and were in a position, through the threat of legal action, to force the board to complete the deal. In consequence, the interests of other stakeholders were, irrespective of the merits of such interests, subordinated to those of the shareholders.

3. If questioned about the legislative status of the company’s members, and whether they ought to have been consulted about the future of the company, most interviewees claimed that the rights and interests of both shareholders and members had been fully considered. However, most then immediately reiterated that the rights and interests of shareholders outweighed the rights and interests of other stakeholders anyway, or to argue that there was no way to measure the relative strength or merit of member rights versus shareholder rights.

4. It was also suggested that, over time, the percentage of the company’s shares that were actually owned by farmers had fallen, and that it was therefore reasonable to assume, given the provisions of section 24 regarding the possibility of converting the company to a CBCA corporation, that farmers had lost interest in retaining control.

5. That share price would have collapsed if the deal had been thwarted.

The business historian who seeks to understand the disappearance of AU might stop his or her inquiry at this point: it happened because the board, looking at all the above factors, decided that, notwithstanding their desire to retain the company, it was neither possible, nor consistent with their primary duty of care to shareholders, to do so. This was certainly the view that a number of interviewees advanced during the course of the research. However, this interpretation raises more questions than it
answers, some of which arise from a closer look at the way the above points were advanced, others
because some legal commentators, as discussed below, seem to take a different view of directorial
responsibility than the AU board did.

How the Explanations Were Framed by Interviewees

The first two of the above explanations for why the SWP bid was not resisted were by far the
most frequently, and the most immediately, cited by interviewees. In fact, the statements made by farmer
members of the AU board indicate that, overall, the board had fully accepted the principle of shareholder
primacy, and not only believed that their first and primary responsibility was to maximise returns to
shareholders, but that, if they either resisted the takeover, or acted in any way to reduce shareholder value,
then aggrieved shareholders would have, and could have, successfully prosecuted them in legal actions
that would have threatened them with loss of their farms.

If questioned on the matter of member rights, the third point – that the interests of members were
fully considered – would sometimes be cited. However, if pressed further as to precisely how member
rights weighed in the board’s decisions, no details were forthcoming. Questions like “how were members
considered?” or “was there a legal opinion on the relative rights of members and shareholders?” or “how
was the UGG Act taken into account?” did not get answered – or got answered with generalities: “I can
assure you that the rights of members were fully discussed and taken into account.” One interviewee
claimed that a written analysis of the legislation by the legal advisors had concluded that members’ rights
were subordinate to those of shareholders, but none of the others recalled such a document. Moreover,
the assurance that member rights were considered, was quite frequently followed by comments like “and
besides which, shareholders’ rights are paramount,” or “and besides which we would have been sued.”

The second part of objection 3 – that member concerns could not be measured in a way that
permitted effective comparison between the interests of members and the interests of shareholders – is
intuitively true. It is not easy to quantify the benefit to co-op members of the enhanced market power that
the organisation exercises on their behalf, or to compare that benefit with the dollar value of a change of
control premium to shareholders. That difficulty, however, does not absolve the board of the
responsibility of trying to do so. As legal expert Baxter said (see below), directors have both a right, and
sometimes a duty, to oppose takeover, “even though the response may not please all shareholders.” This
duty lies with the board, inter alia because they “are familiar with the corporation’s ‘non-investor
constituencies’ and the value of these constituencies to the corporation’s future success” (Baxter, 1988,
104, 99, 100, footnotes omitted). Elsewhere, he defines “intrinsic value” as the “value that may not be
reflected in the price at which the stock is trading,” and “non-investors” as “persons, organizations or
other entities who may or may not be shareholders … but whose function, service or support is of
significant value to the success of the corporation.” AU’s members conformed to this definition
precisely. He goes on: “shareholders have consented to the conferral upon directors of the duty and
power to manage the corporate enterprise [and] the power, and indeed the duty, to resolve the conflicting
interests that surface in a contest for corporate control” (id. p. 110).

The fourth explanation was more often cited by management than by the directors. While it was
true that the percentage of outstanding shares in the hands of farmers was declining, it is not clear that the
members were aware of section 24 of the Act or its implications. The fact that no effort was made to
solicit the members’ views on the takeover, or to mobilise member resistance, stands in contrast to the
company’s response to the 1997 attempt by MPE and AWP to take over UGG. At that time, the company
made a vigorous effort to mobilise the farm community to fight the takeover. The neglect of the
membership, both as to the board’s duty of care to members, and the potential to enable them to vote
against a step that they seemed to oppose, remains part of the puzzle as to why the takeover happened.
The last explanation – that share prices would have collapsed – was more frequently mentioned by management people than by directors. It is, however, a speculative claim. Shareholders were well aware of the governance structure of AU, and, by all accounts, had expressed their concerns that the company would always operate in the best interests of customer-members rather than the best interests of shareholders. Share prices were said to be depressed by about $2 because of these concerns over the governance structure. It is not clear why shareholders would have further discounted share value if the board had acted as they already feared it would, and had resisted the takeover because of a threat to the interests of members.

The importance of the duty to shareholders grew as the bidding process drove up share price, making it increasingly difficult to consider anyone but shareholders, and, accordingly, the rights of members seemed to vanish from the calculus. In the end, the board saw itself merely as an auctioneer, whose sole duty was to advise the shareholders that the offered price exceeded the value of the company as a stand-alone enterprise, and to recommend acceptance of the higher bid.

This assessment of the interviewee comments raises the first among a set of puzzling questions for the historian who seeks to understand why SWP’s bid was not resisted. More questions arise from a comparison of the AU board’s understanding of its role with the commentary of M and A legal experts.

Some Legal Views on Mergers and Acquisitions

Although the AU board was convinced that they were required to act in accordance with the principle of shareholder primacy, they seemed unaware that not all legal experts agree with this principle. To begin with, there is a lively normative debate on whether the principle of shareholder primacy ought to govern mergers and acquisitions, even in the case of “normal” CBCA companies (Bakan, 2004; Kelly, 2001; Green, 1993; Greenwood, 1996; Lee, 2005; Mintzberg et al., 2002; Smith, 1998). This paper, however, does not engage that normative debate. Rather, it compares the AU board’s understandings as outlined above with some legal commentaries on the role of a board of directors, as it actually is under Canadian law, during a takeover initiative and identifies a number of discrepancies between them. The following analysis examines five elements of the AU board’s understandings on the basis of commentaries by legal scholar, Michael St. Patrick Baxter, a publication from the legal firm of Stikeman Elliot, and a recent book by Christopher Nicholls which summarises the current state of M and A law for both students and practitioners of corporate law. Each of these three presents a summary of the rights and responsibilities of a target company’s board in the event of a takeover bid. Five questions about the AU board’s understandings are addressed as follows.

(i) Was the board’s prime responsibility to shareholders?

According to Stikeman, the Supreme Court of Canada case of Peoples Department Stores Inc. (Trustee of) v. Wise first of all affirmed that “fiduciary duty is owed to the corporation … rather than to its shareholders,” (Stikeman, 2008, 9) but went beyond this already established principle. While the Court’s findings in the case have been controversial (Lee, 2005), the judgement itself seems clear. It says: “the phrase the ‘best interests of the corporation’ should be read not simply as the ‘best interests of the shareholders’,” and that “[t]he interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders” (Peoples, 2004, paragraphs 42, 43). Baxter reached this same conclusion in 1988: “Canadian corporate law [rejects the view] that directors should only be concerned with profit-maximisation to the exclusion of” non-investor interests (Baxter, 1988, 103).

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6 It must be stressed that this paper is not intended, nor is the author qualified, to provide legal advice. Two of the references quoted most extensively (Baxter and Stikeman) were provided by a legal scholar at University of Manitoba who is a specialist in M and As.
None of these three authorities, therefore, supports the position that shareholder rights trump all others. All suggest that directors owe their duty to the corporation, not to shareholders, and given the status of members under the UGG Act, it is reasonable to infer that their arguments would have applied with greater force to AU.

(ii) Did the board have a right or responsibility to oppose the deal?

According to Baxter: “directors have a right, as well as a duty, to oppose takeovers which they believe … are not in the best interests of the corporation and its shareholders,” and they “are entitled [to this right] in the exercise of their business judgement” (Baxter, 1988, 98, 104). Stikeman says that directors need not “abandon a deliberately conceived corporate plan for a short term shareholder profit,” (Stikeman, 2008, 92), while Nicholls cites Teck v. Millar, (which he calls “an important part of the Canadian corporate law canon”) stating that directors may oppose “a takeover that they honestly believe is not in the corporation’s best interests” (Nicholls, 2007, 180), a position “based on the fundamental principles of directorial responsibility” (id., 183). Directors, he says, are “at times … positively obligated to resist potentially harmful bids,” and, in a footnote quotes First City Financial v. Genstar Corp et al.: “The right and indeed the obligation of directors to [act] in the interests of the company and its shareholders … in respect of a take-over bid, is perfectly clear and unchallenged” (id., 183, italics in original). Again it is worth stressing that “the company,” in AU’s case, included members. It noteworthy that, although Nicholls here seems to agree that directors can resist takeovers, he is generally very supportive of mergers and acquisition as positive business and economic developments.

If, as suggested above, the legislation’s “historic connection with farmers” included farmer control of the board, then arguably farmer control was also the core of AU’s “corporate policy and effectiveness.” It would appear, therefore, that the board had a duty to resist the bid.

(iii) Was AU obliged to seek other bidders?

Within a few weeks of the initial SWP bid, AU had invited other potential buyers to bid for the shares. This seems to be a clear indication that the board was persuaded, at an early point, that their own concern about members’ interests would carry little weight in the process. As Baxter says: “If the directors’ defensive tactic is to seek a suitor more to their liking than the unsolicited bidder, then it is doubtful whether concern for the non-investor interests is appropriate” (Baxter, 1988, 112).

Stikeman does provide a rationale for the board’s decision, pointing out that, under what is called the “Revlon duty,” directors become mere “auctioneers” whose duty is to maximise shareholder value. A few other interviewees also referred to the Revlon duty as an operative factor in the decision. The publication goes on, however, to say that the Revlon duty only applies “[w]here a sale or change of control is ‘inevitable’,” and so a takeover bid “does not necessarily require target directors to solicit higher third party bids” (Stikeman, 2008, 91 – 93). Although the “Revlon duty” is a U.S. concept which courts have not imposed in Canada, Nicholls argues that there are corresponding duties under Canadian law, but that the corresponding Canadian duties only apply when a company is “in play.” Precisely what “inevitable” and “in play” mean is therefore a critical question. Nicholls seems to reject the idea that an initial bid puts a company in play, an assumption, he says, that would go “well beyond … Revlon and its progeny” (Nicholls, 2007, 193). Moreover, “a company with a controlling shareholder cannot be said to be in play if there is some legal bar (such as a statutory provision) that makes it impossible for a single shareholder to obtain control.” He quotes the Airline Industry Revitalization Co. v. Air Canada ruling, which said that “Air Canada argues that it is protected from being a target of a takeover bid by an Act of Parliament which remains in full force and effect and which means that Air Canada is simply not “in
It seems reasonable to infer (1) that AU was not, in fact, “in play” by December, 12, 2006, (2) that it might have followed Air Canada in arguing that its legislation precluded it from being “in play”, and accordingly, (3) that, on either count, it was not obliged to explore “an alternate transaction,” at least as early as it did, and possibly not at all.

(iv) Was it AU’s sole responsibility, to advise shareholders whether the bid was fair and, if so, to recommend the sale to them?

According to Baxter, it often seems as if Canadian Securities regulation “places the target company permanently on the auction block,” but he goes on to argue that this position is not “appropriate” if directors honestly believe the corporation (which in AU’s case would have included members) would be “better served” “by the company remaining independent,” and that the position of Securities Administrators “is inconsistent with both the existing Canadian case law and the fundamental premise of corporate governance that the directors’ role is to manage the company” (Baxter, 1988, 100). Stikeman is even more direct: “[T]he Securities Acts allow boards of directors to decline to make a recommendation with respect to a take-over bid, provided that they state their reasons for doing so” (Stikeman, 2008, 90).

Again, the understanding of the AU board seems to have been incomplete.

(v) Would the board have been sued if they had resisted SWP?

It is very likely, in the litigious atmosphere of M and As, that some shareholders would have felt it their right to realise a change of control premium, and would have been inclined to sue if the takeover had been resisted. The question, therefore, is not whether the board would have been sued, but whether they could have successfully defended themselves in court. The following factors are relevant.

- Disgruntled shareholders may pursue what is called “an oppression remedy” if a board does not maximise shareholder value. However, said Stikeman: “In alleging oppression, a complainant must generally demonstrate that it had a ‘reasonable expectation’ that the interest in question would be protected” (Stikeman, 2008, 37). Evidently, AU shareholders did not have such expectations because, allegedly, they had continuously complained about their lack of control under AU’s governance system. They had, however, acquired their shares in full knowledge of that situation and were free to dispose of them if they did not like it.

- Legal action by shareholders would not result in altering a board’s decision. Stikeman points out that the “business judgment rule,” “is essentially a policy of judicial deference to board decisions that are reasonable, well thought-out and taken in good faith, whether or not in hindsight they turned out to be the best possible decisions” (Stikeman, 2008, 89). Another authority noted in 1993 that Canadian “courts have rarely held directors responsible for breaches of the corporate law duty of care” (Daniels and Hutton, 1993, 216).

It would appear, therefore, that litigant-shareholders would have been up against the issue of reasonable expectation, the competing rights of members under the AU legislation, and the courts “deference” to the board under the “business judgment rule.” In making their own case for a remedy, they would have had to show why, given their own repeatedly expressed concerns about AU’s governance, they suddenly had had a “reasonable expectation” that shareholder interests would completely eclipse the interests of members.
It seems reasonable to infer from these comments, therefore, that concern over legal action may have been exaggerated, and possible defences not fully considered.

**What Might Have Happened**

In order to understand the difficulty a business historian faces in determining why the AU board did not resist the bid it is necessary to see what action the board might have taken. Precisely how might they have reacted to the bid, on what basis might they have built their argument against the takeover, and what tools did they have at their disposal to fight against the takeover?

There are three widely accepted premises in the discourse on corporate takeovers: (1) that directors’ duties are more accurately defined as being to the corporation, not the shareholders; (2) at the same time, however, that the shareholders are the corporation, and therefore the interests of the two are identical; (3) that, even though shareholder supremacy is the accepted norm, the rights of other stakeholders – debtors, customers, employees, and society at large – must be given due consideration (Stikeman, 2008, 7 – 9). Arguably, however, because of the provisions of AU’s legislation, these premises did not apply to the company in the same way that they would have to a CBCA corporation. If directors are responsible to the corporation, then arguably, given the status of members in the legislation, the AU directors’ duty of care to members was of equivalent force to their duty of care to shareholders. The strength of this duty to members was further enhanced by the preamble to the Act which declared that the “historic connection with farmers” was a “desirable” feature to be maintained. The Act, therefore, seems to have provided both the grounds and the means for the board to resist the takeover.

When SWP launched its takeover offer, it is not difficult to conceive of a more strategic and defensive way that AU might have responded to the first bid than merely saying the price was too low. It might have stated that the board did not believe it to be in the interests of their members, grain producers generally, or the grain industry for the takeover to proceed; it might have cited the status of members under the UGG Act, making it clear that the board saw the “intrinsic value” (Baxter, 1988) of its members to the corporation; it might have actively mobilised its members to resist the takeover, as it did in 1997 when AWP and MPE launched their abortive effort to buy the company; it might have affirmed the board’s intention to give its members a voice in the decision; and it might even have gone so far as to issue the members with voting shares in sufficient numbers to outweigh the other shareholders’ votes, thus attempting to thwart SWP’s intention to invoke the provisions of Section 24 to convert the company to a CBCA corporation. AU apparently would have had a precedent to follow here in *Teck v. Millar* where a company did precisely this, placing shares in the hands of sympathetic shareholders after another company had acquired over 50% of its shares and intended to implement plans for the company with which the directors disagreed.

**In Summary**

The reasons advanced for the disinclination of the board to resist the SWP bid, therefore, do not appear to stand up to scrutiny. The reasons most frequently advanced – that shareholder rights triumph all others, and that the board would have been sued – are not in accordance with either the provisions of the UGG Act, nor the observations of legal experts. The allegation that member interests were considered was infrequently mentioned, and never accompanied with any details as to precisely how those interests were measured. The declining percentage of farmer ownership of shares was taken as evidence that the members were no longer interested in retaining control, even though it is not at all certain that lack of interest was the motivation for disposing of shares, or that the members were aware of section 24 and its implications for control of the company. Certainly, the members were never formally asked their opinion. The fifth and last reason – that share prices would have collapsed – is speculative and inconsistent with
what the company had already experienced. Investors were well aware of the governance structure and had already voiced their concerns, but purchased the shares notwithstanding their concerns.

This analysis, therefore, leaves the business historian with a number of unanswered questions as to why the SWP was not resisted by AU.

**The Historical Puzzles**

UGG’s pragmatic approach to cooperative control, embracing as it did Nourse’s acceptance of the market “as they found it,” served UGG and AU well through two of the most serious crises the industry had ever faced, namely the 1930s Depression, and the massive system renewal of the 1990s. It had remained viable, if not as prosperous as it might have liked, for 100 years, and, on completing the UGG-Agricore merger, had emerged as the dominant player in the grain handling industry. The vision which sustained it was well illustrated in the comments by Mac Runciman quoted earlier, and it was this vision that had motivated the company through its various incarnations as the GGGC, UGG and AU. It was also the vision embodied in the UGG Act both in its preamble and in the provisions which defined the corporation as consisting of both members and shareholders and which placed control of the company in the farmers’ hands. And as one sifts through the testimony of the farmer directors of the company, one sees that it was the potential loss of this vision that underlay their discomfort with the takeover.

At the same time, it must be admitted that there were numerous factors that militated against the retention of the company as an independent entity. Virtually all the interviewees for this study agreed that the various factors described earlier threatened the survival and viability of the big co-ops, AU included: the declining empathy, particularly among younger farmers, with cooperative ideals; the ineffective and tardy response of all four co-ops to these changing sentiments; the weakness of co-op boards; the tension between member control and shareholder interests; the weak financial performance, especially with the Pools, each of which went, or in the case of SWP, almost went, bankrupt; the challenges of renewal; the changes in transportation policy.

In the end, however, none of the things that “might have happened” to resist the takeover and to retain the independence of the company was done, and the historian is left with a number of puzzling questions. Why did the board so readily buy into the principle of shareholder primacy? Why did they not articulate the vision that had been well expressed by company representatives like Runciman for many years? Why did they move so quickly to solicit other interests when, as Baxter says: “If the directors’ defensive tactic is to seek a suitor more to their liking than the unsolicited bidder, then it is doubtful whether concern for the non-investor interests is appropriate” (Baxter, 1988, 112)? Why did they not reject the SWP bid on the grounds of its impact on its members and the grain industry? Why did the provisions of the UGG Act with respect to the status of members seem to play such a minimal role in the company’s calculus? Why were these provisions not seen as providing grounds for resisting the takeover? Why were interviewees so vague about the way the members’ interests were taken into account? Why were members not formally consulted? Why, after the experience of 1997, was not some effort expended to determine exactly how many shares were owned by members, and why were members not mobilised to increase their share ownership if they did not want the takeover to proceed?

It may be that the answers to these questions will never be known, and the historians of the western Canadian grain industry will forever wonder why an organisation which so many people thought was worth preserving was so easily surrendered to a hostile bid by a weaker company.
References

(In addition to the following, approximately 50 interviews, telephone conversations and meetings with directors and managers of the four now defunct co-ops, and other grain industry organisations, form the body of reference material from which the statements made in this paper are drawn.)

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