Governance at Maple Leaf Foods

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Being subjected to a lesson in governance by a hedge fund, as the Maple Leaf Foods Corporation has to endure, is somewhat akin to being lectured on abstinence and modesty by the residents of the Mustang Ranch bordello in Nevada.

Hedge funds, more appropriately called "speculative funds" in most cases, have resisted all efforts of regulators to shed some light on their murky operations; by the standards imposed on public corporations, their governance ranges from poor to non-existent; investors, who risk their money on their adventures, get to sit, not on a board of directors, but merely on "advisory committees".

Whenever a private equity/hedge fund decides to become listed on a stock exchange, as Blackstone and KKR have done, they grab on a loophole, becoming *publicly listed limited partnerships*, which shields them from most governance obligations imposed on other corporations, including the requirement of a board made up of a majority of independent directors!

Hedge funds demand egregious fees for questionable performances (see Dickey, I.D. and G. Yu (2010); Ibbotson, R.G. *et al.* (2010)). Their general partners make unconscionable amounts of money, yet cast a critical eye on executive compensation.

[1] The opinions expressed here are strictly those of the author

They are driven by short-term imperatives to maximize quickly their take. Here are what studies show about their usual demands and intentions (see Bratton, 2006; Brav et al., 2007):

Selling the company, going private (33% to 36% of cases)
Unbundling – selling "under-performing" divisions, assets, etc. (18% to 32% of cases)
Disgorging cash – special dividends, share buy-back, debt restructuring (20% to 36% of cases)
Changing governance, strategy and/or management (30% to 45% of cases)
Pursue growth strategies (1% to 2% of cases)

Perhaps, the Canadian hedge fund West Face Capital is a refreshing exception.

Be that as it may, this hedge fund "requisitions" a special meeting of the shareholders of Maple Leaf Foods Inc. to vote on five, non-binding, resolutions. In essence, these resolutions call into question the board's independence and the quality of its governance. Remarkably, West Face Capital pushes for a definition of independence, which is in part conventional (and the board of Maple Leaf Foods would declare its compliance) and in part excessive; for instance:

> *a director shall be considered independent where, in addition to meeting the independence requirements under applicable securities and corporate laws:...*
> *(vii) he or she does not currently share, or has not in the past five (5) years shared, interlocking board relationships with other directors or officers of the Corporation, including, without limitation, with respect to boards of private companies, charitable organizations or academic institutions;*

Presumably, the ideal candidate for board membership, according to this hedge fund, does not play golf, is not a member of any club, has few friends in the world of business, enjoys playing solitaire and computer chess, and presently does not sit on the board of any corporation or any charitable organization.

Any interaction with other board members outside the confines of board meetings at Maple Leaf will spoil their independence, contaminate their judgment!

Even within the ranks of governance zealots, the notion of independence is undergoing a much needed revision. For instance, a Commission set up by the New York Stock Exchange recently included the following principle in its recommendations:

> ***Principle 7***
>
> *While independence and objectivity are necessary attributes of board members, companies must also strike the right balance between the appointment of independent and non-independent directors to ensure that there is an appropriate range and mix of expertise, diversity and knowledge on the board.*
> (The NYSE Commission on Corporate Governance, September 2001)

Indeed, the **independence of board members** is a concept with little interest when formally measurable; it is relevant when it refers to **independence of mind and judgment**, qualities that are not observable by outsiders.

But what is really going on here?

Are we witnessing a classic instance of a management and a board coming under attack for proposing a long-term strategy that impatient funds do not like and want abandoned? The management and the board of the company have decided to invest over the next three years some $700 millions in a modernization program to reduce costs and make the company more competitive. For management and the board, these investments are essential and value-creating for shareholders.

This most strategic decision has been reviewed and discussed at six board meetings and twenty corporate executive meetings; some thirty external consultants were hired to assess the project; some 5,000 hours were spent on the project by senior executives and 10,000 pages of analysis were produced (Presentation to investors, November 28th, 2010).

But the hedge fund people, running numbers in their Toronto offices, know better. They do know indeed that this program of strategic investments will only bring results some five years down the road, an eternity in some investment circles.

The Ontario Teachers' Pension Plan (OTPP), a putative long-term investor, sold part of its stake in Maple Leaf Foods to West Face Capital and is bailing out of the rest of its stake through a private placement. Their agreement with the McCain family meant that they jointly exercised control of the corporation with 60% of the votes. But no such agreement is forever. Teachers seem to be signalling their lack of confidence in the strategic investment program proposed by Maple Leaf Foods; or is it a lack of patience? Are-they piggy-backing on the moves of West Face Capital?

From West Face Capital's perspective, would it not be preferable to sell Maple Leaf Foods to one of the American companies now on the prowl for growth through acquisitions and thus pocket the quick 30-40% premium that would come from a takeover? Is their action calling for improvement of the board's independence just a first step in that direction?

Whatever is their game plan, this case provides a telling example of the clash between short-term investors and corporate long-term strategy. Perhaps, the McCain family will now regret not having adopted a dual class of shares to retain control and the freedom to carry out the strategy and investment program that they deem to be in the long-term interest of the company. Now, they are engaged in a dog-fight with uncertain outcome.