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Lessons for Cooperatives in Transition: The Case of Western Canada's United Grain Growers and Agricore United

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This paper explores the takeover of Agricore United (AU) by Saskatchewan Wheat Pool, now known as Viterra. AU's predecessor, United Grain Growers, was a "pure" cooperative that had issued limited voting shares, but was legally defined as consisting of members and shareholders. The paper argues that members should have been consulted about the transaction. The paper draws six lessons that formerly "pure" cooperatives like AU, should observe to prevent being absorbed by a publicly held firm. It argues that hybrid organizations like AU can successfully resist a takeover bid if properly prepared.

Introduction

United Grain Growers (UGG) was formed in 1906 as the Grain Growers Grain Company (GGGC), but altered its name in 1917 after a merger with the Alberta Farmers Cooperative Elevator Company (AFCEC). It operated as UGG until 2001, when it merged with Agricore, which had been formed by a merger between Alberta Wheat Pool (AWP) and Manitoba Pool Elevators (MPE), and became known as Agricore United (AU). In November 2006, it was subject to a hostile and ultimately successful takeover bid from the Saskatchewan Wheat Pool (SWP), which, by this time, had converted from a cooperative to a shareholder-controlled Canada Business Corporation Act (CBCA) company. The takeover was completed in June 2007. The story of AU is therefore inseparably connected to the story of the three pool organizations. Between 1997 and 2007, all four companies, after a century of farmer control of grain handling, disappeared. This article focuses on the forces that came into play in the last six months of AU's existence, and which, in the end, were responsible for its demise. The material in this article is based on approximately 50 interviews and conversations with grain industry directors and management, public documents issued by the four companies, and archival material lodged in the University of Manitoba Archives and Special Collections.

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Background

The History

When the GGGC was formed, farmers were predominantly classic liberals and free traders who felt that they suffered from a lack of effective competition among railways, grain companies, and manufacturers. During the 1920s, however, they developed a more radical critique of laissez faire—a critique which became the philosophical basis on which the three provincial wheat pools were founded in 1923 and 1924 (Earl 1992). While UGG retained the classic liberal attitudes of earlier critics, the Pools' generally negative view of the private sector led them to favor centralization and regulation of grain handling, marketing, and transportation.

The Pools were enormously successful until 1929, when, in part because of their reluctance to use the Winnipeg Grain Exchange for risk protection, they nearly went bankrupt and survived only through loans from the three prairie provincial governments.

The Great Depression called free enterprise into question throughout most of the world, including Western Canada, where the concept of a "100 Per Cent Pool by Legislation" (Hull 1931) led 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).

By the end of the Second World War, therefore, the industry had attained the institutional configuration and ideological divisions that persisted until the early 1990s. Grain handling was dominated by the Pools and UGG, which by 1950 owned 48 percent of the country elevators. (There were five companies larger than MPE, the smallest of the four co-ops, that collectively owned another 38 percent. None was as large as SWP. The remaining 14 percent were owned by about 40 smaller companies (Canadian Grain Commission 1955/56).) The CWB had responsibility for marketing wheat, oats, and barley, which accounted for over 90 percent of grain production. The industry was highly centralized and regulated, with most of the grain marketing, transportation, and logistics functions managed by the CWB. Freight rates were legislated at 1899 levels (the Crow's Nest Pass Rates), branch line abandonment was virtually impossible under the Railway Act, and grain handling tariffs and licensing were controlled by the Board of Grain Commissioners (Canada Grains Council 1973). As discussed below, this heavy centralization and regulation had profound effects on the grain handling and transportation system, and was a major factor leading to the disappearance of the co-ops.

Ideologically, the grain industry was sharply divided, with the CWB, the Pools, and most farm organizations supporting the status quo, and the private grain compa-

nies and the railways wanting a more commercial system. UGG occupied a middle ground between these two. By the 1960s, however, a paradigm shift had begun to develop throughout the western world, characterized by a declining faith in the public sector and an increasing acceptance of market-based solutions to economic problems (McBride 2005). In Canada, the 1967 National Transportation Act (NTA), counterpart to the American 1980 Staggers Rail Act, was a key development in the resulting trend to deregulation. Regrettably for some, and happily for others, the Act retained legislated rates for grain movement.

From the late 1960s on, criticism of the highly regulated regime grew, with claims that the grain industry had stagnated under heavy regulation and control. In 1973, a new farm organization, 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 a more market-oriented handling, transportation, and marketing system to emerge. There followed twenty years of often bitter debate, focused primarily on transportation, which culminated in the end of tightly regulated grain freight rates in 1994. This debate was accompanied by some changes in marketing, with domestic feed grains, barley exports to the U.S. (temporarily), and oats all removed from CWB control.

Critics of the status quo were correct in their claim 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, and decreasingly capable of handling large modern trucks. Grain moved predominantly in 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 (Earl 2000).

Between 1970 and 1990, progress towards modernizing and consolidating the country elevator and branch line system was slow, but by 1990 modernization could no longer be delayed. The outdated system needed a huge injection of capital to modernize, but the grain companies' financial returns were impaired by the cost of the widely dispersed and inefficient elevator system (Earl 2007).

The Conversion and Demise

The following major events occurred between 1990 and 2007:

1. Faced with a near crisis with their country elevator systems, all four grain co-ops began a massive re-investment and renewal process, replacing old elevators with large "high throughput," or "inland terminal" facilities, thereby reducing the number of country elevators from 1578 in 1990 to 336 by the end of 2007 (Canadian Grain Commission 2008).

2. UGG entered the equity market, issuing public shares in 1993. Three non-farmer directors were added to its 15 member board, while the other 12 continued to be farmer-elected. The company then operated under new federal legislation, the 1992 United Grain Growers Act.

3. SWP followed UGG by issuing public shares in 1996, but kept a fully farmer-elected board.

4. MPE and AWP primarily financed their investments through debt.

5. All four companies' balance sheets deteriorated, and the financial results were worsened by poor crops in 2000 and 2001 (Earl 2007).

6. MPE and AWP almost went bankrupt and, following a failed takeover attempt of UGG in 1997, merged to form Agricore in 1998. To fend off the hostile bid, UGG sought a so-called "white knight," Archer Daniels Midland (ADM), which then acquired about 40 percent of the company and occupied two of the non-farmer director positions.

7. Agricore itself continued toward bankruptcy, and in 2001 was finally forced into a merger with UGG to form Agricore United. This diluted ADM's ownership to about 25 percent. AU continued to operate under the 1992 UGG legislation.

8. SWP made some major errors and almost went bankrupt. By 2003, it had abandoned farmer control and was largely controlled by its debt holders. In 2005, it became a CBCA corporation (Fulton & Lang 2006).

9. From 2004 to 2006, SWP slowly improved its financial situation, and its shares rose from about C$2 to about C$6. AU worked on reducing its debt load, and its share price remained largely unchanged (approximately C$7).

10. On 7 November 2006, SWP mounted a hostile takeover of AU. AU rejected SWP's first bid on grounds that it was too low, and by 12 December had begun to explore whether other parties might be interested.

11. A rival offer by James Richardson International (JRI) led to a bidding war that ended with SWP acquiring all outstanding shares at a price of C$20.50.[1]

In just over a decade and a half, therefore, the long-delayed modernization of grain handling and transportation was finally accomplished, but it was accompanied by a near revolution in ownership and control. During this period, most of the country elevators extant in 1990 were replaced by a network of inland terminals,

while the four large and seemingly successful co-ops had been replaced with one publicly traded company.

The story of UGG and AU over these years breaks into two parts. The first—which stretched from 1992 to 2006 and included conversion to a publicly traded, but farmer-controlled, company and the merger with Agricore—was largely a success. The second, from November 2006 to June 2007, which encompassed its takeover by SWP, was arguably a failure.

The Operative Factors

The following description of the operative factors underlying these changes emerged from, and was repeatedly confirmed in, the interviews conducted for this study.

- The first factor was the 20-year, ideologically driven debate over transportation policy as described above. This delayed the modernization that was so urgently needed, and improvements that should have evolved over the preceding decades were done quickly. Because capital had not been set aside over previous decades, new monies had to be raised, and the consequent concentration of investment weakened the balance sheets of all four companies.

- 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 paradigm shift alluded to above, were more comfortable than their forebears with free enterprise, and had less empathy for a co-op philosophy. Neither the Pools nor UGG responded effectively to these changes. The governance and policy activities 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.[2]

- Farm populations were also aging, creating a looming "bubble" of member equity redemptions for all four companies. 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 members of the UGG board, the directors of all four companies came from the farm community, and all with the same skills and background. Moreover, the director election process 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 weakened balance sheets resulting from 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 conducted in the late 1980s (Touche Ross 1988; see Earl 2007 for an examination of a longer time frame).

- AU failed to address properly the implications of its conversion for the relative rights and responsibilities of shareholders and members. In the end, the company acted as if it were fully governed by the CBCA, and hence members, notwithstanding their status in the UGG Act (see below), had no say in the takeover. This was arguably the most important factor contributing to AU's final demise. (See Hansmann 1999 for a discussion of the way that the interests of shareholders and other stakeholders can conflict.)

- Personalities also played a part. Prior to about 1990, the CEOs of all four companies had generally been promoted internally. Later, new incumbents entered these positions 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 might have led to preserving the three companies as a single cooperative (see Fulton and Larson 2009).

- Within UGG, the new CEO appointed a number of new senior managers whose commitment to, and empathy with, farmer control was less than that of the farmer directors. Interviewees from the company identified tension between the board and management as a significant factor in the way that events unfolded. The AU board did not act as decisively or as proactively as they should have to address this issue.

- A number of interviewees also identified the company's relations with investors as a critical issue, some claiming that a co-op style of governance was a "hard sell" with investors, and others suspecting that management had never properly presented the benefits of member control to the investment community. Fulton and Larson (2009) point out, for example, that a membership structure with farmer control tends to create a core customer base that is committed to the company, and that customer commitment is a key factor in commercial success. These were important points to make with shareholders.[3]

Some of these factors were controllable, and AU's fate might have been different had the board of directors managed the company—and responded to the SWP bid—differently than they did. A close analysis of events from November 2006 to June

2007 yields lessons for other similar organizations that might consider entry into the equity market but are concerned about finding themselves the target of hostile takeovers that could threaten the member control that is one of the essential features of cooperative enterprise.

Conceptual Framework

The primary issue before the AU board when the SWP bid was received was the relative rights of shareholders and members. While most interviewees from the company (directors and management) claimed that the members' rights were considered, they provided few details as to precisely how this was done. Overall, the board apparently believed that their ultimate responsibility was to maximize returns to shareholders. The importance of the board's duty to shareholders grew as the bidding process drove up share price, ultimately making it impossible to resist the takeover. The rights of members eventually vanished from the calculus and 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 highest bid. Moreover, the board believed that they would have faced legal action from aggrieved shareholders had they either resisted the takeover or acted to reduce shareholder value.

There is a lively debate as to whether the principle of shareholder primacy should govern mergers and acquisitions (Bakan 2004; Greenwood 1996; Kelly 2001; Lee 2005; Mintzberg, Simons, & Basu 2002). This article, however, does not engage that normative debate. Rather, it compares the AU board's understandings as outlined above with a several legal commentaries on the role of a board of directors during a takeover initiative, and identifies a number of discrepancies between them.[4]

The Canada Business Corporation Act requires that directors of a corporation, in exercising their "duty of care," to "act honestly and in good faith with a view to the best interests of the corporation" (p. 122). Legal authorities confirm that the directors' duties are to the corporation, not to any one stakeholder. Stikeman (2008), for example, writes: "The fundamental duty of a director of officer is to the corporation he or she serves" (p. 5). At the same time, the "shareholder primacy norm" means that the interests of shareholders and the interests of the corporation are normally identical. According to Bakan (2004), serving the interests of the corporation "generally means to maximize the wealth of shareholders." In an accompanying footnote, Bakan quotes Dr. Janis Sarra, director of the National Centre for Business Law at Simon Fraser University: "In North America, the best interests of the corporation have been defined as the best interests of shareholders" (p. 37). Legal scholar Gordon Smith (1998) has traced the evolution of the "shareholder primacy

norm" and goes so far as to say that, from the early nineteenth century onward, it was assumed that "shareholders collectively became the corporation" (p. 297).

In AU's case, however, this identity between shareholders and the corporation seems to have been challenged by the provisions of the special legislation under which the company operated. In the first place, sections 6 and 9 of the UGG Act explicitly defined AU's members as part of the corporation. These sections read, respectively, as follows: "The corporation continues to consist of members and shareholders," and "The corporation is a combined membership and share capital corporation." Moreover, the Act's preamble mandated that "it is desirable to maintain" the company's "historic connection with the farmers." Arguably, farmer control of the organization was part of that "historic connection." The Act also specified that where there was a conflict between it and the CBCA, the former would prevail.

By all accounts, the farmer members of the AU board were not happy with the outcome of the takeover process, 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 also reported vigorous opposition from members who shared these views. Although this dissatisfaction represents a prima facie case that the members thought it was in their interests to preserve the company, they were never consulted about the takeover. According to some interviewees, the takeover process offered no way of measuring the relative value of farmer control and shareholder returns.

The conclusions drawn at the end of this article turn on this distinction between AU and a "normal" CBCA company. If the AU board, in its collective view, did not fully understand its position and its duties, then it follows that: (1) the principle of shareholder primacy might have been tempered by the rights of members; (2) members might have been given a voice, and a way might have been found to weigh shareholder and member interest; (3) the threat of legal action might have been overrated; and (4) in the end, the takeover bid might have been successfully resisted and the company retained as an independent, farmer-controlled enterprise.

An Analysis of the Takeover

The following analysis examines five elements of the AU board's understandings on the basis of Baxter (1988), Stikeman (2008), and Nicholls (2007).[5] Each of these three sources is a summary of the rights and responsibilities of a target company's board in the event of a takeover bid from, respectively, an academic, professional, and pedagogical perspective.

Was the board's primary responsibility to shareholders?

The Supreme Court of Canada 2004 case of *Peoples Department Stores Inc (Trustee of) v. Wise* provides one of the most recent rulings on the issue of shareholder primacy. According to Stikeman (2008), it showed, as discussed above, that "fiduciary duty is owed to the corporation. . . rather than to its shareholders" (p. 9). However, the Peoples judgement is controversial and went beyond this already established principle (Lee 2005). The judgement says, the "phrase the 'best interests of the corporation' should be read not simply as the 'best interests of the shareholders'," and "[t]he interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders" (*Peoples Department Stores Inc. (Trustee of) v. Wise* 2004, paragraphs 42, 43). Baxter (1988) reached this same conclusion in 1988: "Canadian corporate law [rejects the view] that directors should only be concerned with profit-maximization to the exclusion of" non-investor interests (p. 103).

Nicholls does not address the question of shareholder primacy directly, but he does state, unequivocally, where the directors' duties lie. "A corporation's directors and officers must, at all times, discharge their duty to act 'honestly and in good faith with a view to the best interests of the corporation.' This very language is found in many Canadian law statutes, and the essential principle existed in common law as well" (p. 175).

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 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.

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

According to Baxter (1988), "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" (pp. 98, 104). Stikeman (2008) says that directors need not "abandon a deliberately conceived corporate plan for a short term shareholder profit" (p. 92), while Nicholls (2007) cites *Teck Corporation Ltd. v. Millar* (1972) (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." This position is based on what he calls "the fundamental principles of directorial responsibility." Directors, he says, are "at times. . . positively obligated to resist potentially harmful bids," and in a footnote he quotes *First City Financial v. Genstar Corp et al.* (1981): "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" (pp. 180, 183; emphasis in original).

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

Was AU obliged to seek other bidders?

Stikeman (2008) says that, under what is called the "Revlon duty," directors are mere "auctioneers" whose duty is to maximize shareholder value. The publication also points out, however, 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" (pp. 187; 91–93). Although the "Revlon duty" is an American concept that Canadian courts have not imposed, Nicholls (2007) argues that there are corresponding duties under Canadian law, but that these 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" (p. 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* (1999) ruling, which stated 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 play'" (p. 192). The kind of arguments advanced by Stikeman and Nicholls did not, apparently, influence AU since, within a little over a month, it had "initiated contact with. . . a number of third parties [regarding] an alternate transaction" (Agricore United 2006, p. 11).

It seems reasonable to infer that: (1) AU was not, in fact, "in play" in December 2006; (2) it might have followed Air Canada in arguing that its legislation precluded it from being "in play;" and, accordingly, (3) on either count, it was not obliged to explore "an alternate transaction," at least as early as it did, and possibly not at all.

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

Although Baxter (1988) suggests that Canadian Securities regulation "places the target company permanently on the auction block," he argues that this position is not "appropriate" if directors honestly believe that the corporation (which, in AU's case, would have included members) would be "better served" "by the

company remaining independent." He further states 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" (p. 100). Stikeman (2008) is even more direct: "The 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" (p. 90).

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

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

The following factors are relevant:

- Disgruntled shareholders may pursue what is called "an oppression remedy" if a board does not maximize shareholder value. However, according to Stikeman (2008), "In alleging oppression, a complainant must generally demonstrate that it had a 'reasonable expectation' that the interest in question would be protected" (p. 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. The "business judgment rule," Stikeman (2008) argues, "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" (p. 89). Another authority noted in 1993 that Canadian "courts have rarely held directors responsible for breaches of the corporate law duty of care" (Daniels & Hutton 1993, p. 216).

The question, therefore, is not whether disgruntled shareholders might have sued, but whether AU could have successfully defended itself against legal action. It would appear 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 case for a remedy, they also would have had to show why, given their own repeatedly expressed concerns about AU's governance, they suddenly 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.

Conclusions

Lessons for Co-ops in Transition

AU's choice to issue public shares placed it one step away from "Investor Owned Firms" in Chaddad and Cook's (2002) seven-stage typology of ownership rights models. This position allowed the company to access badly needed capital, and in comparison with AWP and MPE, which faced the same need, this seemed to be a sound policy. It did not, however, allow it to survive the SWP takeover bid despite: (1) the desires of farmer-directors and members; (2) the interpretation of mergers and acquisitions law outlined by Baxter (1988), Stikeman (2008), and Nicholls; and (3) the provisions of the UGG Act, which seemed to provide a basis on which to mount a defence. The experience of UGG and AU provides a number of lessons for organizations like the Western Canadian grain co-ops that need to access capital and see equity markets as the obvious source.

1. Governance procedures must be regularly reviewed and must reflect the values and lifestyles of the membership.

UGG and AU failed to do this, with the result that the governance process (local committees, delegates, annual meetings, and director elections) becoming no longer compatible with lifestyles of modern farming.

2. On entering the equity market, the relative rights and obligations of members and shareholders must be clearly defined, and directors must have clear guidelines for resolving conflicts between the two groups.

In AU's case, even though members were a legislated part of the company, it seems from the collective responses of interviewees that precisely what rights this provision conveyed in the event of a takeover bid were never clearly defined.

3. Senior management must be fully committed to the board's vision for the company, and particularly to the core policies of corporate governance.

In AU's case, the tension between board and management was longstanding and severe.

4. Management and board must actively "sell" the vision of member control of the corporation to the investment community.

There remains considerable doubt, in the minds of at least some senior former AU people as to whether the benefits of the governance structure were convincingly represented to investors.

5. A regular "SWOT" analysis of the environment is essential, including a careful assessment of who potential buyers of the firm might be and their financial capability of completing a purchase.

AU significantly underestimated the danger of a takeover, believing that there was no company interested or capable of executing such an action.

The foregoing five points all represent steps that must be taken long before any threat of a takeover appears, but they also constitute an essential foundation for resisting a takeover bid should it arise. The most important lesson that comes from the AU experience, however, is this:

6. The company should ensure that it has a "game plan" to deal with a hostile takeover bid — one that focuses on member control as the fundamental component of the company's "corporate policy and effectiveness" and includes defensive mechanisms designed to defeat any hostile takeover.

What AU Might Have Done

In AU's case, the literature reviewed for this study suggests that their game plan might have entailed responding to the initial bid with the following points:

> We do not believe an acquisition of AU shares by SWP is in the interests of this corporation. We believe that our "corporate strategy and effectiveness" is inextricably linked to the continuation of member-control of AU.
>
> We cite the provisions of our legislation as the fundamental basis for our rejection of the SWP bid, which clearly mandates that "it is desirable to continue our historic connection with farmers," which we construe to mean preserving the essential features of our governance system. That historic connection would be severed if this bid were to succeed.
>
> We further maintain that our legislation makes our members more than merely "stakeholders" (like customers, debtors, employees, society at large) and, indeed, gives our members an equal voice with shareholders in deciding the future of this company.
>
> We recognize that if 75 percent of shareholders wish, they "may, by resolution, authorize the directors to apply for the continuance of the corporation. . . under" the CBCA (UGG Act, s. 24(1)). However, we believe that such a step is not in the interests of the corporation and our "intrinsic value" (see Baxter 1988, pp. 99–100) is much higher than indicated by the current price of our shares, and would be destroyed by the success of this takeover.
>
> We cannot, therefore, prevent SWP from continuing to purchase our shares and acquire 75 percent of same from existing shareholders. If, however, they continue to do so, it is our intention to solicit and weigh the opin-

> ions of our members regarding the takeover, and will consider following the procedures discussed in *Teck Corporation Ltd. v. Millar* (1972; see Nicholls 2007, pp. 179, 180) and issue a second class of shares ("member shares") to our members to provide them with a formal vote on the issue of converting to a CBCA company.

This statement would have been issued as a directors' circular, and would have been much longer than this, explaining why the Act read as it did, and would have built a case around the "corporate strategy and effectiveness" that the company was pursuing.

If AU had taken the foregoing steps, both over the decade or so prior to its demise and when the SWP bid was first made in November, 2006, it might have survived as an independent entity "meeting farmers' business needs."[6]

Can Hybrids Succeed?

What can be inferred from the UGG/AU experience as to the future of "hybrid" organizations that seek to access equity capital while retaining member control? Do they represent a viable alternative for a co-op whose capital needs cannot be effectively met by the traditional means open to co-ops of debt and member equity? Or does AU's experience suggest that hybrids cannot survive in today's world?

On the con side, it may be that a cooperative governance structure is no longer needed. The large agricultural cooperatives were born under very different circumstances than those that prevail today, notably the massive informational imbalances of the first quarter of the twentieth century when farmers did not know the price of their grain until they arrived at their local elevator by horse and wagon. These circumstances led to the perception, and perhaps the reality, of abuses by private grain companies to which farmer-owned grain companies seemed an appropriate answer. Since these circumstances no longer exist, perhaps the need for farmer control has likewise disappeared.

Over against this argument, however, lies the discomfort of AU's farmer board members with the takeover, and the support they received from members. It stretches the imagination to attribute this discomfort to century-old abuses, particularly in the case of UGG, which was only partly motivated by the early twentieth-century abuses of market power and very early had accommodated itself to the open market. UGG occupied what Ian MacPherson (1979) called the "pragmatic" wing of the co-op movement (p. 46), whose underlying philosophy was summed up in 1922 by Edwin Nourse (1922) as "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"(pp. 585–586). Former UGG President Mac Runciman

implicitly agreed, summarizing his own view of cooperativism as doing "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," and 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, pp. 127, 141). Arguably, unless the directors' dissatisfaction is attributed to "agency theory" (and some interviewees among management were quick to do so), then it was the loss of this vision, which continues to have contemporary relevance, that caused the directors and at least some members to wish for the preservation of the company.

It might also be argued that member governance is unnecessary because of antitrust legislation. This factor is mentioned by Hansmann (1999, p. 401) and was cited by a number of interviewees—although not by company directors—as a reason why it was not necessary to preserve AU in order to protect its members against market abuse.

However, this proposition ignores the fact that engaging legal or quasi-legal processes of this nature takes a level of resources and organization that is not readily available to all potentially aggrieved parties, not to mention the fact that the outcome of such initiatives is always uncertain.[7] In the transportation area, legal remedies against abuses of market power are available to shippers through the Canada Transportation Act, and these were utilized by the Canadian Wheat Board in 1997 to charge the railways with violating their "level of service" commitments to the grain industry. This case illustrated the immense effort that is required to utilize legal remedies to alleged abuses of market power. If farmers by themselves lack the organization and resources to initiate an action with antitrust regulatory bodies, who would do so on their behalf? A shareholder-controlled company is highly unlikely to initiate action on behalf of its customers, whereas a member-controlled organization, whose directors are both responsible and accessible to members, would have both the resources and motivation to do so.

Does the actual disappearance of both AU and SWP point to the non-viability of a hybrid structure? It would seem not. For both companies, there were factors unique to the Western Canadian grain industry that bulked large in their demise, including the destructive effects of the long period of ideological disputation that delayed the needed reinvestment and two years of almost record poor crops that reduced their revenues while that reinvestment was underway. In AU's case, neither the tension between management and board over farmer control, nor the apparent lack of preparedness for a takeover bid in the belief that there was no imminent threat, nor the board's apparent lack of awareness of opposing legal views on the principle of shareholder supremacy, were attributable to its hybrid status. Moreover,

SWP's success in taking over AU was enabled by world financial markets that were awash in liquidity, and was not particularly aided by AU's hybrid nature.

There are, of course, a number of factors, some discussed in this article, that militate against the continued existence and success of cooperative style organizations, whether they are traditional co-ops or hybrids: the weakness of member dominated boards; society's increasing comfort with the marketplace and the corresponding decline in empathy for co-op ideals; and the increasing propensity to see farming as a business rather than a way of life. Hansmann (1999) also notes the potential conflict of interest that exists between shareholders who want maximum returns and members who are contributors to those returns. As noted earlier, UGG and AU felt these tensions and received negative feedback from shareholders on their governance structure. Arguably, too, farming in Western Canada no longer has the heavy dependence on wheat production that it did in the 1920s. Today, canola, and to a lesser extent so-called "specialty crops" like lentils, peas, and beans, all of which trade through the open market, has increased farmers' comfort with the market and reduced the perception that cooperative enterprise is a necessary defence against market power. (See also Hansmann 1999 regarding the negative impact of "heterogeneity" on co-op organizations.)

Despite these factors, both SWP and AU achieved some significant success. AU's aim, in 1993, was to raise much needed capital, both for re-investment in its outdated country elevator system and to redeem its looming member equity obligations. Both these goals were met, and on balance it did better than its cooperative competitors, absorbing two of them and emerging larger and stronger than the third (the one that, a decade earlier, had been the largest and healthiest of the four). SWP, immediately following its share issue in 1996, was also seen by shareholders as a valuable investment, advancing their value from C$12 on issuance to almost C$25 by 1998 (Fulton & Lang, 2006). The subsequent fall was not initially attributable to its hybrid status, but to some questionable investments and the two near-crop failures that impaired its financial viability.

The evidence from AU as to the viability of hybrid organizations is therefore mixed, but what is certain is that, with the factors that militate against the success of cooperative style organizations today, if a co-op wishes to access equity markets for capital, it must have a clear game plan in mind, and AU's experience does provide some guidelines as to what such a game plan must include.

Notes

1. Note that SWP had made an overture to AU in 2005. After the AWP/MPE hostile bid in 1997, and the 2005 approach by SWP, AU arguably might have begun to prepare for a new takeover bid from a third party. However, the interviewees said that they did not think

anyone would be interested or equipped to try, particularly SWP, which, circa 2005, was by far the weaker company. Note, too, that SWP's ability to raise capital for the purchase was aided by a financial market that was highly, if self-delusionally, awash with liquidity. AU's unpreparedness and the high levels of liquidity in world financial markets could be added to the list of "operative factors" discussed below.

2. A personal note may be illustrative. When I first worked for UGG in the mid-1970s as a young man from Eastern Canada, and attended my first of the company's annual meetings, I felt as if I had stepped back about 30 years or more in time. My reaction was similar to my first visit to a country elevator some years earlier when I felt that I had stepped into a living museum (see Earl 2000, p. 177).

3. Another personal anecdote illustrates this point. Around the time that UGG issued its first public shares (1993), the company hired a team of marketing consultants to examine a number of company practices. I was working for UGG at the time, and one of the consultants said that most companies "would kill" to have customer advisory groups like UGG's local member committees (called "local boards" in the company's lexicon). Despite this advice, many in management were not favorably disposed to the local board structure and viewed it as a relic of the past. See the previous bulleted point.

4. It must be stressed that this article is not intended, nor is the author qualified, to provide legal advice.

5. Discussions with legal experts suggest that this analysis, and the conclusions that follow, look only at corporate law, not securities law. The duty of securities administrators in Canada is to protect target company shareholders, and their policies tend to favour takeovers (Condon, Amand, & Sarra 2005). However, these same discussions suggest, and a review of standard works confirms (Condon, Amand, & Sarra 2005; Gillen 1998), that nothing therein negates either a board's duty to consider the best interests of the corporation or its discretion to recommend rejection of, or not to make a recommendation on, a bid if they believe that it is not in the corporation's interest.

6. "Meeting Farmers' Business Needs" was UGG's, and subsequently AU's, corporate slogan.

7. Charles Dickens' comment that "the law is a ass" (usually slightly misquoted as "the law is an ass") is well known. Rather less well known is his humorous observation in *The Old Curiosity Shop* (1841): "Lawyers are shy of meddling with the Law on their own account, knowing it to be an edged tool of uncertain application, very expensive in the working, and rather remarkable for its properties of close shaving, than for its always shaving the right person."

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In addition to the below, approximately 50 interviews, telephone conversations, and meetings with directors and managers of the four now defunct co-ops and other grain industry

organizations form the body of reference material from which the statements made in this paper are drawn.

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