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REPORT ON THE HORMEL FOUNDATION

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## REPORT ON THE HORMEL FOUNDATION

This report summarizes the investigation made by Attorney General Hubert H. Humphrey, III into certain allegations that the Hormel Foundation ("Foundation") and its directors are abusing the power entrusted to it by George A. and Jay C. Hormel. More specifically, the allegations charge that the directors have failed to vote the stock of Geo. A. Hormel & Company ("Hormel Company" or "Company") as its founders intended, that is, to protect the interests of the people of the City of Austin and Mower County. As a result of this alleged failure, or perhaps even incidental to it, the complainants charge that the presence of Hormel Company officials on the Foundation's Board of Directors is a conflict of interest that has substantially affected the ability of the Foundation to carry out its functions and has ultimately led to a general decline in the population and economic well-being of Austin and Mower County. The Attorney General's investigation finds these charges to be unfounded and concludes that no legal action against the Foundation is warranted.

The Foundation has voting control of approximately 46% of the Hormel Company's stock equity. Even though the Foundation directors may exercise this voting power so as to affect policy and guide the Company's affairs, management decisions of the Company rest essentially with the Company's board of directors. It is the Company which bears the responsibility for such management decisions as whether and where to expand and the resolution of labor disputes.

The purpose of the Foundation is not to manage the Hormel Company for the benefit of its employees, but to manage the stock holdings for charitable purposes, so that maximum benefit will inure to the Foundation's beneficiaries, which are the eight local charitable organizations identified in the Foundation's Restated Articles of Incorporation and, ultimately, persons in the City of Austin and Mower County. In voting the Company stock, the directors of the Foundation have the duty to exercise proper care for the benefit of these beneficiaries. The investigation by this office revealed that the directors did not abuse their discretion in carrying out their fiduciary duties.

This conclusion is reached despite the close connection between the management of the Hormel Company and the Foundation. At present, three retired officers of the Hormel Company plus its current chief executive officer are on the board of the Foundation, which is comprised of seven elected and eight appointed members. It is apparent that this representation on the board is one reason for the number of complaints received by this office. However, as discussed more fully below, the relationship between the Foundation and the Company is not illegal. Although not illegal, this relationship presents at least an appearance of impropriety. This report, therefore, recommends that the directors work toward greater independence from the Company's influence, particularly in areas concerning the exercise of the Foundation's voting power.

This investigation was conducted under the authority of Minn. Stat. § 501.78 (1984), which provides that the Attorney General may conduct investigations to assure that charitable trusts are in compliance with Minnesota law and to determine whether property held for charitable purposes is properly administered. The investigation included a thorough review of hundreds of pages of documents which were subpoenaed from the Foundation and from the Hormel Company. In addition, interviews of a number of directors and other interested parties were conducted.

#### FACTS

The Hormel Foundation is a non-profit corporation which was established in December 1941 for religious, charitable, scientific, literary or educational purposes. The Articles of Incorporation granted the Foundation the authority to acquire property and "to maintain, use and operate the same in such a manner as to promote and foster its [the Foundation's] corporate objects and purposes as well as those of the gifts which it shall receive." The articles further provided that the directors' chief financial interests should lie within the City of Austin or vicinity and that a majority of the directors should be residents of Mower County. The original directors (members) were S.D. Catherwood, H.H. Corey, R.P. Crane, Park Dougherty and M.F. Dugan. All resided in Austin. Three were directly associated with the Hormel Company.

The assets of the Foundation then and now consist primarily of shares of stock in Hormel, Inc., a holding company which was later merged with Geo. A. Hormel & Company, a Delaware corporation. These shares were given to the Foundation primarily by George A. Hormel, the Hormel Company's founder, and his son, Jay C. Hormel ("donors"). The Foundation also has stock interests in other corporations.

The Foundation is also the trustee for numerous so-called "family trusts." These trusts provide for the financial needs of a particular person or persons for a period of time with either a vested or contingent interest thereafter to the Foundation. In 1968, the Minnesota Supreme Court upheld the Foundation's appointment as trustee for these trusts in In Re Trust Created By Hormel, 282 Minn. 197, 163 N.W.2d 844 (1968).

The family trusts, like the Foundation itself, have substantial assets in the Company. In 1975, the Foundation sought court approval to purchase additional Hormel Company stock for a group of family trusts. The court allowed the purchase, stating that a dominant reason for the creation of the trust was to give the Foundation controlling interest in the Hormel Company and to provide for the maintenance and continuation of the controlling stock interest. See In the Matter of Fourteen Hormel Trusts Above-Captioned, Nos. 22649-22650, 22652-22653, 22658-22667, (County Court, Probate Division, Mower County, Minn., Nov. 17, 1975).

Currently, the Foundation has voting control of approximately 46% of the Hormel Company's stock equity.

In July 1980, the articles of the Foundation were substantially amended to permit the Foundation to qualify as a public foundation pursuant to Section 509(a)(3) of the Internal Revenue Code. One reason for the change was to prevent potential tax liability if the Foundation remained a private foundation.

Pursuant to the 1980 Restated Articles of Incorporation, the purpose of the Foundation is to benefit and assist in carrying out the purposes of "qualified" organizations. These qualifying organizations are specifically identified in the restated articles. New or additional organizations may be added or substituted by vote of at least a majority of the directors. Each qualified organization is a public charity.

Also, pursuant to the Restated Articles and the bylaws, there are currently fifteen (15) members of the Board of Directors who are both appointed and elected. The appointed members constitute a majority of eight (8); each is appointed to the position by a "qualified" organization. Every appointed member fully participates in the grant-making process for all organizations, including the one it represents. Each is also a full voting member of the Foundation board and participates accordingly.

There are seven elected members of the board. Those members choose directors to fill vacant elected board positions. At present, the elected members include an attorney, a businessman, a retired bank executive, three retired officers of the Company, and the current chief executive officer of the Company. Each of these directors resides in or around Austin. The Company treasurer is the Foundation's assistant secretary. He is not a member of the board of directors.

The Foundation currently has the power "to acquire and receive funds and property . . . and to own, hold, manage, administer, and to make gifts, grants and contributions only to Qualified Organizations." Restated Articles of Incorporation, Article II. The bylaws provide that the Foundation may continue to serve as trustee of the trusts "in order to assure, as nearly as possible, that this corporation will, after the expiration of the present interests in such trusts, have sufficient assets available to it to enable the continuance and expansion of its present tax-exempt purposes."

The Foundation meets on a regular basis, usually in the corporate boardroom of the Company headquarters. Secretarial and other ministerial services are provided by the Company to the Foundation. Generally, the Foundation pays the Company for services received. For instance, for the fiscal year ending November 30, 1985, the Foundation paid \$20,727 for services.

Foundation directors have consistently voted the stock in the Company in the manner recommended by the Company's management. They have approved stock splits and voted at annual stockholders' meetings in support of management decisions. The directors have no policy for obtaining information concerning the Company's business management. Many, perhaps all, of the directors individually are shareholders of Hormel Company stock. Whether through their personal holdings or as directors for the Foundation, they receive copies of the Company's annual report.

In recent years the Foundation provided grants of approximately \$950,000 per year to the qualified organizations represented on its board. In addition, the Foundation provided grants of approximately \$100,000 as trustee for the Geo. A. Hormel Testamentary Trust to other charitable organizations primarily located in and around Austin. In regard to all grants, the Foundation board has adopted specific procedures concerning the request and use of the money.

Besides Hormel Company stock, the Foundation's assets include other securities and investments. These assets are managed by the directors rather than a corporate trustee. The rate of return on the investments is higher than the rate of return of Foundations of similar size in the State of Minnesota. Similarly, the Foundation's operating expenses are lower than those of comparable Foundations.



DISCUSSIONA. THE HORMEL FOUNDATION IS A CHARITABLE TRUST.

Our analysis of the facts begins with the premise that the Hormel Foundation holds the stock in the Hormel Company in trust for charitable purposes. The Foundation was essentially funded with gifts made before death or by will from George and Jay Hormel. The gift instruments that were used as the instrumentality of transfer set forth the details of the transfer. These details include, primarily, the name of the donor and donee (the Foundation) and the charitable use to which the stock should be dedicated. In Minnesota, a gift to a charitable organization such as the Hormel Foundation for charitable purposes constitutes a charitable trust.

[W]e hold, in line with many courts, that a devise or bequest, although in form an outright gift, yet when made to an institution whose sole reason for existence and whose entire activity is charitable, is in purpose and practical effect a charitable trust.

In re Peterson's Estate, 202 Minn. 31, 36, 277 N.W. 529, 532 (1938); see also In re Quinlan's Estate, 233 Minn. 35, 45 N.W.2d 807 (1951). In fact, "No special language is needed to express an intent to create a charitable trust." In re Quinlan's Estate, id. at 42, 45 N.W.2d at 811.

Since most of the stock held or managed by the Hormel Foundation is the result of gifts or bequests to the Foundation, the standards imposed on the Foundation and its directors are those applicable to charitable trusts.<sup>1/</sup>

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<sup>1/</sup> There is legal precedent in Minnesota for using a different standard of care for directors of a charitable corporation than would be used for trustees. Ray v. Homewood Hospital, 223 Minn. 440, 27 N.W.2d 409 (1947). This report, however, has held directors to the higher standard required for trustees.

B. THE FOUNDATION'S PURPOSE AND CHARITABLE BENEFICIARIES.

The purpose of a non-profit corporation is set forth in its articles of incorporation, articles which may be amended under procedures prescribed by law. Minn. Stat. §§ 317.08 and 317.27 (1984 and Supp. 1985). In 1980 the Foundation adopted Restated Articles of Incorporation of The Hormel Foundation, which dedicated the assets of the Foundation "for the benefit of, and to assist in performing the functions and in carrying out the purposes of, 'Qualified Organizations.'" Certificate of Restated Articles of Incorporation of the Hormel Foundation, Article II, adopted by resolution on July 28, 1980. These "qualified" organizations are tax exempt organizations organized and operated exclusively for charitable, educational, literary, religious or scientific purposes. They include the City of Austin, United Way of Austin, Inc., Salvation Army of Austin, St. Olaf Hospital Association, Young Men's Christian Association, Cedar Valley Rehabilitation Workshop, Inc., University of Minnesota, and Austin Community Scholarship Committee. All of these organizations, with the partial exception of the University of Minnesota, are located in or around Austin, Minnesota.

The funds directed to the University of Minnesota are for the Hormel Institute which is located in Austin. The restated articles provide that other qualified organizations may be added to or substituted for the designated ones.

Since these "qualified" organizations are public charities organized for various charitable purposes, the restated articles do not substantially vary the terms of the original articles of incorporation. Even though the funds in the original articles did not necessarily go to a "qualified organization," they were designated "for exclusively public purposes" or for "religious, charitable, scientific, literary or educational purposes."

The restated articles are in accord with George and Jay Hormel's original intent in donating the company stock. As already noted, the Foundation holds the stock in trust. The use to which the stock should be put is determined by the donors' intention as expressed in the donating instrument. Tufford v. Northwestern National Bank, 275 Minn. 66, 145 N.W.2d 59 (1966). Here, the primary donating instrument consists of a series of nearly identical gift instruments executed over a period of years by George and/or Jay Hormel. The majority of the documents describe the charitable use of the Company's stock as follows:

I hereby give, grant and convey unto The Hormel Foundation, its successors and assigns, the [Hormel stock] . . . . for the purpose of establishing, organizing, promoting and engaging exclusively in the business of or for religious, charitable, scientific, literary or educational purposes within the State of Minnesota with its principal place of business and

use and administration to be within Mower County, Minnesota.

Gift Instruments, December 1941 to 1949, by Jay C. Hormel, Donor, to the Hormel Foundation, Donee. Later gift instruments and wills of both Jay and George Hormel contain language similar to the above. These instruments reveal the intention that the Foundation use the stock for general charitable purposes within Minnesota and principally within Mower County. Since the organizations identified in the restated articles are organized for general charitable purposes and are located within and serve the community of Austin and Mower County, the Foundation is operating in a manner consistent with the intentions of the donors.

By reference to Austin and Mower County in the governing instruments, it appears that the intent is that the ultimate beneficiaries of the assets be persons or entities in that locale. This view is consistent with that of the Foundation which has interpreted the documents as requiring that the beneficiaries be limited to those residing in Austin or the surrounding area. This is especially evident in the choice of qualified organizations which are the recipients of the Foundation's grants.

C. THE FOUNDATION DIRECTORS' FIDUCIARY DUTIES.

As a trustee, each director of the Foundation must use that care and skill which a person of ordinary prudence would exercise in dealing with his or her own property. Restatement

(Second) of Trusts, § 379, comment a; In re Comstock's Will, 219 Minn. 325, 17 N.W.2d 656 (1945). Since the Foundation, as a shareholder, has the right to vote for the election of the Hormel Company's board of directors,<sup>2/</sup> the task of voting the stock requires the exercise of proper care. The care required in voting the shares of stock in this matter is even greater than might be required if the directors were trustees of a small number of shares:

Where the trustee holds as trustee such a large proportion of the shares of a corporation that he is in control or substantially in control of the corporation, his responsibility with respect to the voting of the shares is heavier than it is where he holds only a small fraction of the shares.

Restatement (Second) of Trusts, § 193, comment a.

It is important to remember that in electing the Company's board of directors, the Foundation must exercise its vote for the benefit of the Foundation's beneficiaries. Management decisions of the Company rests with the Company's board of directors, not with the Foundation. See infra section D p.15; Del. Code Ann. tit. 8, § 141(a) (1983); see also Aronson v. Lewis, 473 A.2d 805 (Del. Supr. 1984).

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<sup>2/</sup> In Delaware, stockholders have the right to participate in an annual meeting of company stockholders and to vote for the election of the board of directors for the company. Del. Code Ann. tit. 8, § 211 (1983).

Here, the facts reveal that once a year the directors of the Foundation meet as a group to determine how to vote the shares. In the past, they have supported the candidates recommended by Company management. Three directors of the Foundation have been chosen to cast the Foundation's vote at the Company's annual stockholders' meeting.

Each director apparently reaches a decision on how to vote primarily by independent reflection and investigation, which is based upon information received at Foundation board meetings and elsewhere. From time to time, Company officers who are Foundation board members discuss a point of general interest with the Foundation board. The directors apparently feel free to discuss their views during these occasions. It is clear that the directors are aware of the financial success of the Company. The directors' familiarity with the Company's operation and financial standing supports the position that each uses proper care in voting the stock. Since courts will not control the voting of trustees absent an abuse of discretion, no legal action is proper in the present situation. Restatement (Second) of Trusts, § 193, comment a. See also In re Trust Created by Hormel, 282 Minn. 197, 163 N.W.2d 844 (1968) (cannot remove a trustee except for an abuse or violation of duty).

However, there is considerable concern in the Austin community that the directors of the Foundation are not exercising independent judgment when it comes to voting the stock. This concern is based primarily upon the close ties between the Hormel Company and the Foundation.<sup>3/</sup>

It is important to note that these ties are not illegal. Courts do not, without other reason, prohibit a corporate officer from sitting on the board of a charitable organization which the corporation funded. See generally Chapin v. Benwood Foundation, Inc., 402 A.2d 1205 (Del. Ch. 1979); Stone v. Baldwin, 348 Ill. App. 225, 109 N.E.2d 244 (1952). Further, even if the Company's officers indirectly benefit from their participation on the board, this is permissible, since the donors authorized that kind of participation. See In re Anneke's Trust, 229 Minn. 60, 38 N.W.2d 177 (1949). Three of the original five directors of the Foundation were also employed by the Company.

While these ties are not illegal, they can result in an appearance of impropriety and could interfere with the independent judgment each director must make. Our investigation acknowledges the public's concern that the directors are not exercising

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<sup>3/</sup> A review of the facts set forth in the earlier part of this report demonstrates these ties clearly. For instance, the Foundation meets in the Company's headquarters. The Company provides secretarial and ministerial services. Furthermore, several directors currently or in the past have been principal officers of the Company.

independent judgment. Consequently, even though no improper conduct has been substantiated, we believe the Foundation should take steps to alleviate potential problems.

For instance, one source of information concerning the Company's financial affairs has traditionally been the officers of the Company who are also members of the Foundation's board. While it is appropriate to obtain information about the Company from all sources, including the Company, there should be sufficient balance from those sources to permit each director to independently exercise his duties. "The law confines the business management of a [charitable] corporation to its directors, and they are vested with a fiduciary responsibility to administer its affairs." Ray v. Homewood Hospital, 223 Minn. 440, 444, 27 N.W.2d 409, 411 (1947).

Based on this rationale, this office recommends that the directors rely less heavily on the Company's officers in determining how to vote the stock. Steps that might be appropriate include more formalized discussion and analysis of the Company's annual reports or the hiring of an outside expert to obtain an independent analysis of the Company's operations and finances. Which, if any, of these is appropriate would depend on the circumstances of the situation. See In re Butler's Trust, 223 Minn. 196, 26 N.W.2d 204 (1947), cert. denied, 332 U.S. 759 (1947).



D. MANAGEMENT OF THE HORMEL COMPANY

Delaware law<sup>4/</sup> mandates that the business of every corporation be managed by the corporation's board of directors:

The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.

Del. Code Ann. tit. 8, § 141(a) (1983); see also Aronson v. Lewis, 473 A.2d 805 (Del. Supr. 1984). But Delaware law also recognizes that stockholders have the right to participate in an annual meeting and to vote for the election of the corporation's board of directors. Del. Code Ann. tit. 8, § 211 (1983). Consequently, majority shareholders do have the power to affect policy and guide the activities of the corporation. 18A Am. Jur.2d Corporations § 762.

In 1948, Jay Hormel recognized this right of a stockholder in a speech at an annual stockholder's meeting. Mr. Hormel acknowledged that the Foundation must vote the stock in keeping with its charitable purpose. He stated that the Foundation would eventually hold a large ownership in the Company and could be counted on to "so vote its stock in the Company as to make sure that control will never be exercised in a way which fails to keep the best interests of Austin and the surrounding community as its prime purpose." In the same speech, he also said:

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<sup>4/</sup> Since Geo. A. Hormel & Co. is a Delaware corporation, Delaware law is applicable to its operations.

In managing the stock which it holds, the Foundation has the responsibility for spending the money which comes from dividends from that ownership. It is the policy of the Foundation to believe that charities should be personal affairs. The Foundation, being an impersonal trusteeship for the benefit of the whole community, undertakes to spend its income in ways which will produce basic contributions to the welfare of the community as a whole.

(Emphasis added.)

In essence, Mr. Hormel was advising the stockholders that the Foundation's responsibility is to spend the money it earns from dividends for the benefit of the entire community. Its duty is to vote the stock so as to assure that the entire community benefits from the profits earned. In other words, the Foundation is to vote its stock in order to preserve the soundness of the Company as a business entity, so that the Foundation will continue to receive sufficient funds to carry out its charitable purpose. A similar interpretation may be made of other comments made from time to time by Jay Hormel or other persons associated with the Foundation.

This interpretation of Jay Hormel's comments is bolstered by the way in which the Foundation has operated in the past. Even in its early days, the Foundation exercised no management control over the Company. Jay Hormel, who was never a director of the Foundation, apparently made numerous management decisions without consultation with the Foundation, including the decision to expand the Company outside of Austin. R. DOUGHERTY, IN QUEST OF QUALITY, (1966).

SUMMARY

The directors of the Foundation have the fiduciary obligation to use proper care in voting the shares of stock held in Geo. A. Hormel & Company. This fiduciary duty has not been abused. However, in order to avoid an appearance of impropriety and to assure the use of independent judgment, this report recommends that the directors work towards greater independence from the Company's influence in determining how to vote the stock. In this regard, it may be appropriate for the directors to meet and discuss in greater depth the Company's financial standing or to obtain independent analysis of the Company's standing.

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