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The Hershey Trust: Managing Conflicts of Interest in Corporate Governance

As Layla Dylan[i] settled into her seat for the flight home, the complexity of her position was top of mind. Being one of 11 members[1] of the board of directors for the Hershey Company, she had just received a presentation from snack food company Mondelez regarding a takeover bid. Under a traditional governance structure, her primary concerns would be ensuring that the business case for the acquisition made sense and the shareholders she represented would achieve a worthwhile return on the deal. She certainly had to do this as a member of the board, but her responsibilities did not end there. Dylan was also a member of the board of the Hershey Trust Company, a trust that oversaw the funding of the Milton Hershey School and that had a responsibility to provide for the school in perpetuity.[2] A large portion of the trust's funding was represented by its stake in the Hershey Company,[3] making her deliberation on Mondelez's offer even more complicated and multifaceted. Under normal circumstances, this shared relationship worked in concert – if the company was doing well, then the trust's funds were doing well. So, making the best decision for the Hershey Company matched the best decision for the Hershey Trust Company. However, in this instance, Dylan had to judge the impact of liquidating the billions of dollars in shares that the trust held and what it could mean for the school's long-term future. Beyond money, both institutions had a rich history of community investment and values-based outreach, indicating that they were motivated by several factors beyond pure monetary valuations.[4, 5]

On the surface, Dylan knew that the strategy behind the deal made sense. Despite only being spun off from Kraft Foods in 2012,[6] Mondelez had proven itself as a highly successful company. Based in Illinois, it owned many of the world's most famous snack food brands including Oreo, Chips Ahoy, Cadbury, Ritz, and Triscuits.[7] Behind the strength of these brands and a growing snack market Mondelez held a leadership position in nearly every category in which it competed, driving revenues to nearly $30 billion.[8] If there was any weakness in its portfolio, it was that the company made the majority of its money outside of the United States – a fact which made an acquisition of the extremely U.S.-centric Hershey's a very attractive proposition.[9] Similarly, Hershey could benefit from the international exposure of Mondelez, because 85% of

i Layla Dylan is a pseudonym. This character is not meant to represent any specific individual, and instead is a tool to build context and promote course discussion and learning.

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its business was conducted in North America.[10] Yet, Dylan was not completely convinced that this was the best long-term move for the company, the trust, and the community that was built around them.

As she listened to the flight attendant's pre-flight presentation, she wondered: was it possible to make a decision that reflected the mission, values, and goals of both the company and the trust? If not, to which position did she owe loyalty? How would the local community react to this deal, especially considering both the trust and company had been pillars in Hershey, Pennsylvania for more than 100 years? What metrics were key to making her decision and how would her vote impact the relationship between these interconnected organizations? The plane's acceleration stirred Dylan from her reflective thoughts. She had one week to formulate her decision, and she truly wondered if she could make the "right decision."

The Hershey Company History

When he was 14 years old, Milton Hershey began apprenticing with a master confectioner in Lancaster, Pennsylvania.[11] Following his candy education and two failed attempts at creating his own businesses, Hershey tasted his first business success through making caramels.[12] After growing a business that shipped to Europe and employed 1,400 people, Hershey chased his next passion by embracing a growing "sweets" trend: chocolate.[13] This shift in priorities ultimately led to the formulation of the Hershey Company in 1894, which produced Hershey chocolate caramels, breakfast cocoa, sweet chocolate and baking chocolate.[14]

Since its founding over 120 years ago, the Hershey Company has grown into a global leader and was North America's top producer of chocolate, owning 44% of the market in 2016.[15] The company manufactured and sold via large candy brands such as Hershey's Kisses, Reese's Peanut Butter Cups, and Twizzlers.[16] In addition, the company produced a large quantity of grocery goods including baking chocolate, syrup, cocoa mix, cookies, nuts, mints, and bubble gum.[17] Through these efforts, the company had grown to be #362 on the *Fortune 500* list, with revenues of $7.4 billion.[18, 19] Its massive scale was evidenced by statistics such as manufacturing 70 million Hershey Kisses every day in 2012.[20]

Beyond growing his confectionery giant, Milton Hershey and his company made a tremendous impact on the community that surrounded his headquarters. Believing that workers who were well taken care of would be more productive, Hershey established a model community that included housing, schools, churches, parks and public transportation. The unprecedented range of amenities made Hershey, Pennsylvania a new kind of industrial town.[21]

Despite the significance of these investments, Hershey's primary emphasis on philanthropic giving was best represented by his creation of the Milton Hershey School for underprivileged children, to which, prior to his death, he donated his entire net worth (including his Hershey's stock) to be held in trust for the benefit of the school.[22] This investment in the community and emphasis on charity that Milton Hershey championed was woven into the culture of his company. In 2016, programs such as Hershey's *Good Business, Better Life, Bright Future* continued this tradition, with an aim of improving the lives of Hershey employees, stakeholders, and the communities in which they lived.[23]

Values of the Hershey Company

The Hershey Company took pride in the level of transparency surrounding its products; from participating in Smart Label programs, divulging full ingredient information (including where ingredients were sourced), and openly discussing the company's relationship with its sources. The company also made an effort to engage in discussions with consumers about ingredients and product making processes.[24]

The Hershey Company viewed its duty as a corporate global citizen to include not only maintaining responsible business practices but also to provide a better life and brighter future for those in the communities in which it operated. The company gave back to communities in the U.S. and abroad through volunteer projects, community partnerships, and sponsor events with organizations like the Children's Miracle Network and the United Way Campaign. The Hershey Company also invested in aid programs, fought malnourishment through their Feeding America program and other food provision programs, and provided nutrition education in Ghana.[25] Hershey Co. also invested in sustainable sourcing and supply chain management as part of its transparency and positive community impact efforts. The company had been increasing its use of sustainably farmed ingredients, committing to the use of 100% certified sustainable cocoa by 2020 and having achieved the use of 100% certified sustainable palm oil in 2013,[26] all in collaboration with the communities from which it sourced ingredients. Additional sustainability efforts included fighting deforestation in source communities and introducing environmentally sustainable practices at various locations, including recycling and zero waste-to-landfill facilities.

The Hershey Trust Company Overview

The Hershey Trust Company was established in 1909 by Milton Hershey for the sole purpose of overseeing and providing for the Milton Hershey School.[27] Simply put, the mission of the trust was to ensure that there was suitable money available to ensure that the Milton Hershey School was able to run in perpetuity.[28] The trust was established with a $60 million contribution from Hershey, but that number swelled with the overall growth of the Hershey Company.[29] In 2016, the trust was worth more than $12 billion — two thirds of which was Hershey's stock.[30] Its high value not only made the Milton Hershey School one of the wealthiest residential schools in the world, but it also made the trust a powerful force inside the chocolate company.[31] The Hershey Trust Company owned 9% of the Hershey Company's general stock and 99.5% of its Class B stock.[32] This dominant ownership of the Class B stock – which provides the owner 10 votes per share – gave the trust control of more than 80% of the voting rights.[33] As such, the Hershey Trust Company was able to name three members to the Hershey Company's board of directors and effectively veto any major move that it deemed not in the best interest of the organization.[34] This organizational structure had allowed the company to implement many of its social, environmental, and community-focused programs, because many of these programs aligned well with the overall mission and purpose of the Hershey School and thus the Trust Company. Nonetheless, the de facto veto power also caused rifts between the leadership of both organizations, and had brought the effectiveness of this governance structure into question on more than one occasion.

Values of the Hershey Trust Company

On paper, the values of the Hershey Trust were similar to those of the Hershey Company in the sense that they emphasized philanthropy and transparency in business dealings but were also different in that they were solely focused on the town of Hershey, Pennsylvania and its main beneficiary, the Milton Hershey School. The trust was established to fund the Milton Hershey School but has also devoted funds to community improvement by building a hospital and a medical school, gardens, a theatre, and other community spaces. While the company was investing in global sustainability, supply chain improvements, and overall image, the trust's legal and moral obligations were only to the town.

Despite the trust's positive roots and outward image, allegations had been made against it by various news outlets and prominent media regarding the mismanagement of funds — such as overcompensation of board members — which had resulted in the reopening of an old investigation by the Pennsylvania attorney general's office.[35] Previously, the acquisition of a golf course near the Milton Hershey School property raised an investigation in 2010 after the golf course was built, closed, and turned into housing for the school, leading to benefits for Hershey Trust executives that owned shares in the golf course.[36] Additional issues surrounding

improper investment, mismanagement and wasteful use of funds, as well as an abuse allegation at the Milton School and a failed expansion of the same institution, led to the dismissal of a top trust official.[37] These issues were ultimately resolved in the Attorney General's investigation, finding that the trust had not acted outside of its duty in its purchases or other financial interactions. However, the allegations and subsequent investigation created distrust of the organization's aims. In an agreement with the Attorney General's office at the end of its investigation, the trust agreed to make several adjustments in its management, including replacing several top board directors, meant to restore the community's trust in the board and allow the board to better serve the Milton School.

Regarding the issue of a potential takeover, the trust had a significant stake in voting any offer up or down. While it was potentially in the interest of the Hershey Company to consider a mutually-beneficial sale, there was no guarantee that the trust would be allowed to maintain any position of power within the company if a sale were to proceed. Such a deal may also be looked on unfavorably by citizens of Hershey, PA, which received the main benefits of the trust's actions, giving the trust's board an additional incentive to reject an acquisition bid. With the majority of the voting power, the trust was easily able to decide for or against any offer.

Alternative Governance Models

The Hershey Company was far from the only company owned by a charitable foundation. Other notable examples included Robert Bosch GmbH, Newman's Own, and IKEA, each of which had unique corporate structures.

Robert Bosch GmbH

Robert Bosch GmbH (Bosch) was a large, privately-owned, German engineering and electronics firm. The company's ownership was divided among three separate groups: The Robert Bosch Foundation, a charitable institute that owned 92% of the company but none of the voting rights; the Bosch family, which owned 8% of the company and 7% of the voting rights; and the Robert Bosch Industrial Trust KG, which owed 93% of the voting rights.[38] Like the Hershey Trust, the Bosch Industrial Trust was the primary decision maker in Bosch affairs. In Bosch's case, however, none of the decision making was made by members of the charitable foundation. Instead, the board of the industrial trust was made up of the CEO of Bosch and other industry figures. Despite this, Bosch's protection from shareholder interests allowed it to make freer entrepreneurial decisions, plan for the long-term, and focus on employee well-being and job security.[39, 40]

Newman's Own

Newman's Own was an American food company founded in 1982 by actor Paul Newman and writer A. E. Hotchner. Since 2005, Newman's Own had been solely owned by the Newman's Own Foundation, a charitable non-profit that received and distributed all after-tax profits from Newman's Own. Unlike other charitable foundations, Newman's Own Foundation did not accept donations or raise funds — they only received funds from Newman's Own.[41, 42]

IKEA

In contrast to Newman's Own's simple two-tier corporate structure, the IKEA Group, a set of Swedish furniture companies, had a notoriously complex ownership structure. Most individual IKEA stores were owned by a Dutch holding company, INGKA Holdings, which was in turn owned by a Dutch non-profit, the Stichting INGKA Foundation.[43] This foundation, in turn, had an independent philanthropic arm, Stichting IKEA Foundation, and an arm that managed its financial assets, Stichting IMAS Foundation. All IKEA store

profits had to go to one of these entities for donation or reinvestment, or back to the individual stores as a financial cushion. All trademarks and branding were owned by a separate Luxembourg-based company called Interogo. This structure greatly reduced IKEA's tax rate and made it immune to a takeover without requiring it to be significantly generous.[44]

Historical Questions: To Sell or Not to Sell?

Fourteen years before Mondelez's 2016 offer, the Hershey Trust had faced similar circumstances. By the mid-1990s, the Hershey Trust had become embroiled in conflict surrounding the management of its enormous funds. The complaints had primarily come from the Hershey School alumni association, but eventually drew in the Pennsylvania attorney general's office and local courts. An employee of the trust had stated that the board feared that what had happened to the Beryl Buck Trust would happen to the Hershey Trust.[45] The Buck Trust, designed to alleviate poverty in a wealthy California county, had exploded with wealth well beyond the scope of its mission, leading to a court intervention that subsequently dictated the way the trust spent its money.[46] Acting preemptively, the Hershey Trust Company went to the Dauphin County Orphans' Court to request a diversion of funds to an education think tank. The Orphans' Court denied the request, citing a violation of donor intent, and the proposal seemingly increased the attorney general's office's scrutiny of the trust's management. In late 2001, the 17 members of the trust's board met with a deputy attorney general who was investigating their potential mismanagement of funds, who advised them to diversify the trust's assets by selling its share of the Hershey Company.[47]

The Wrigley Offer

Taking the advice of the Pennsylvania attorney general's office into account, the Hershey Trust's board of directors voted 15-2 to consider selling their share of the Hershey Company. The board informed Hershey Co. president Richard Lenny of its intentions and asked him and the company to begin soliciting bids. Lenny argued forcefully against the sale, claiming that the company was much more valuable on its own, and even offered to buy the shares back over time at a small premium. The trust rejected the offer and threatened to replace Lenny if he continued to oppose the sale.[48]

Just before the September 2002 deadline, Hershey announced it had received two offers: a $12.5 billion cash-and-stock offer from the Wm. Wrigley Company, as well as a $10.5 billion joint offer between Nestle SA and Cadbury-Schweppes PLC.[49] The Wrigley offer included a price of $89 per share, a 42% premium over Hershey's share price at the time.[50] Additionally, Wrigley offered to change the name of the company to Wrigley-Hershey and keep all of the Hershey facilities open. Although the offers were viewed as attractive by many observers, the Hershey Trust announced the next day that the board had voted 10-7 to reject both offers.

Reasons for Rejection

The news of the possible sale was met with an extreme backlash from Hershey, PA community members fearing job loss, fewer taxes, and reduced tourism. Despite Wrigley's assurance that no jobs would be cut or moved as a result of the merger, the opposition continued. Beyond the economic value of the company to the town, many town residents felt a strong emotional connection to the company as well. The most ardent supporters were known as Hershey-ites, and they led the protests and petitions against the sale.[51] Although the official reason given for the rejection was that both deals failed to meet the trust's objectives, it was widely speculated that the trust bowed to these pressures from the community. Many board members felt personally villainized; one claimed his wife had been receiving nasty looks at the supermarket and some were reportedly near tears in the meeting.[52] One observer commented that the trust would not have voted to sell even if "God had walked in and offered $110 a share."[53]

The deal had also received significant opposition from attorney general Mike Fisher, who was mounting a campaign for the governorship at the time. Fisher's request for an injunction to block the sale was granted by the Orphans' Court after he argued that a sale would devastate the town and its workers.[54] Although this was viewed by many as an unprecedented use of the attorney general's power, Pennsylvania law required that charitable trusts consider the "special value" of their assets to the local community.[55]

The Mondelez Vote

Mere hours had passed since the meeting with Toni DuBois,[ii] Mondelez's Chief Executive Officer, but Dylan had just returned to her Chicago office and was exhausted. She sighed, pushed away from her desk, and gently rolled her chair, still sitting, over to the 15th floor window. She spotted a line of children streaming from a large brick building and, imagining it was the Hershey School, marveled at how this was really at the nexus of everything, a $12 billion promise. But to whom? It didn't quite feel real. Right now, the young people in another brick building in Hershey, Pennsylvania seemed like they were part of another universe, and no concern of hers at all.

As if the internal politics surrounding this decision were not hard enough to navigate, the Pennsylvania attorney general's office had just reopened an old investigation regarding potential conflicts of interest within the trust – with fairly immediate consequences. Concerned that some of the terms of the agreement reached in 2013 between the attorney general's office and the trust were being violated, the office announced that it was seeking the resignation of board members who had served over ten years – and next year was Dylan's 10 year anniversary on both boards.[56]

The 2013 agreement, which concluded the former investigation, explicitly required board members to disclose "all actual or potential conflicts of interest" to either the School or the Trust Company, and the attorney general did not feel that the board had honored this commitment.[57] Dylan felt conflicted. She had witnessed, over a decade of service, how much good came out of the trust, and how many beneficiaries it served, but it was clear that there were still major internal problems at the company. The question was whether they were simply the result of individuals' poor decision making, or, instead, due to a deeper structural problem in the governance of the organization.

Mentally staring down the likely end of her tenure as a board member, she began to consider the unique circumstances of her own appointment, back in 2007. Despite the careful language used internally to discuss the penultimate CEO's departure – not that it was discussed often, if ever – the fact of the matter was that he had been ousted by a trust board that was intolerant of his independent streak.[58] When the next CEO succeeded him, in 2007, that same trust board asked six of the Company's board members to resign, and another two followed suit. In a show of strength to the new CEO, the trust installed eight hand-picked directors to the Hershey Company's board, Dylan among them.[59]

Coming back to the present, Dylan bitterly began to consider whether this – all of this, all of her work – could be neatly summed up as a "conflict of interest." She had always thought of the Hershey Company as unique, and she had been proud to be part of such a special corporation that was not blindly subject to the whimsy of investors, or to a holding company. The Hershey School, and Hershey, PA, itself, were at the heart of this company – wasn't that a good thing?

The shrill ring of her desk phone broke her reverie. She had not been looking forward to this call, but she steeled herself and picked up.

ii Toni DuBois is a pseudonym. This character is not meant to represent any specific individual, and instead is a tool to build context and promote course discussion and learning.

An hour later, Dylan's mind was racing. The call had been from Antoine Miller,[iii] the CEO of the Hershey Company. He had called to debrief the Mondelez offer with her, and she could tell that he was excited but was hiding it well.

On paper, the deal made some sense, he said. But despite Mondelez's reasonable bid of $23 billion, he knew the board of the Hershey Trust would be reluctant to consider a sale at any price. Maintaining autonomy was a high priority for the trust, because it allowed them to make corporate decisions in the interest of the Hershey School. But Mondelez was under pressure to make a major acquisition, having been the recent target of a prospective acquisition itself, and Miller expected them to push hard on this offer.[60]

Beyond the immediate concern of the offer, however, and focusing more on the long-term strategy of the deal, Miller noted how it could solve a major pain point for Hershey Co. – diversifying away from candy, the sales of which were lagging in the North American market, and leveraging the Mondelez's success in international markets. Both internal and external analyses of the merger were estimating that the synergies of the deal could result in sales increases of over 10%, given that the companies were perceived as somewhat complementary.[61] Finally, Mondelez had offered to keep the Hershey name and move its headquarters to from Deerfield, IL to Hershey, PA; a small offer, but not meaningless given the nature of the Trust as a centerpiece and major investor in the community. This could be good, he said, and asked her to keep an open mind, especially in discussing the deal with other board members. Dylan was already imagining what the board members would say. There was a strong sense in the community that the company should stay independent, out of a perceived obligation it has to the 14,000 members of the "sweetest place on earth." It was the legal obligation of the trust to protect those interests, which made Dylan's role as a member of both boards that much more difficult.

Conclusion

Dylan hung up the phone feeling more conflicted than before. Despite her old reservations about Antoine Miller, which were due to the original nature of her board directorship as a counterbalance to his authority as CEO, he had proven to be a capable and careful leader. Under his guidance, the company had doubled its market value to $20 billion, widened its profit margins, and increased its market share in the U.S. by 3%.[62] There was no doubt that he wanted the best for the company. The question was how the board of the trust would weigh the strategic monetary interests of Hershey Co. – and, by extension, of the majority-shareholding trust — against the trust board's conception of what it meant to serve the Hershey, PA community and the Hershey School.

How would the trust board members perceive this potential change in the trust's authority, given their historical resentment of outside influences? Would this offer incite the attorney general to weigh in again on this deal, as the former attorney general had? And where did Dylan's responsibilities lie? As a member of both boards, like two of her colleagues, she had duties to each – were they conflicting, or could this deal actually create more wealth for the school and the town? With only a few hours remaining before the final board convened, Dylan was increasingly unsure of how she would vote.

iii Antoine Miller is a pseudonym. This character is not meant to represent any specific individual, and instead is a tool to build context and promote course discussion and learning.

Exhibits

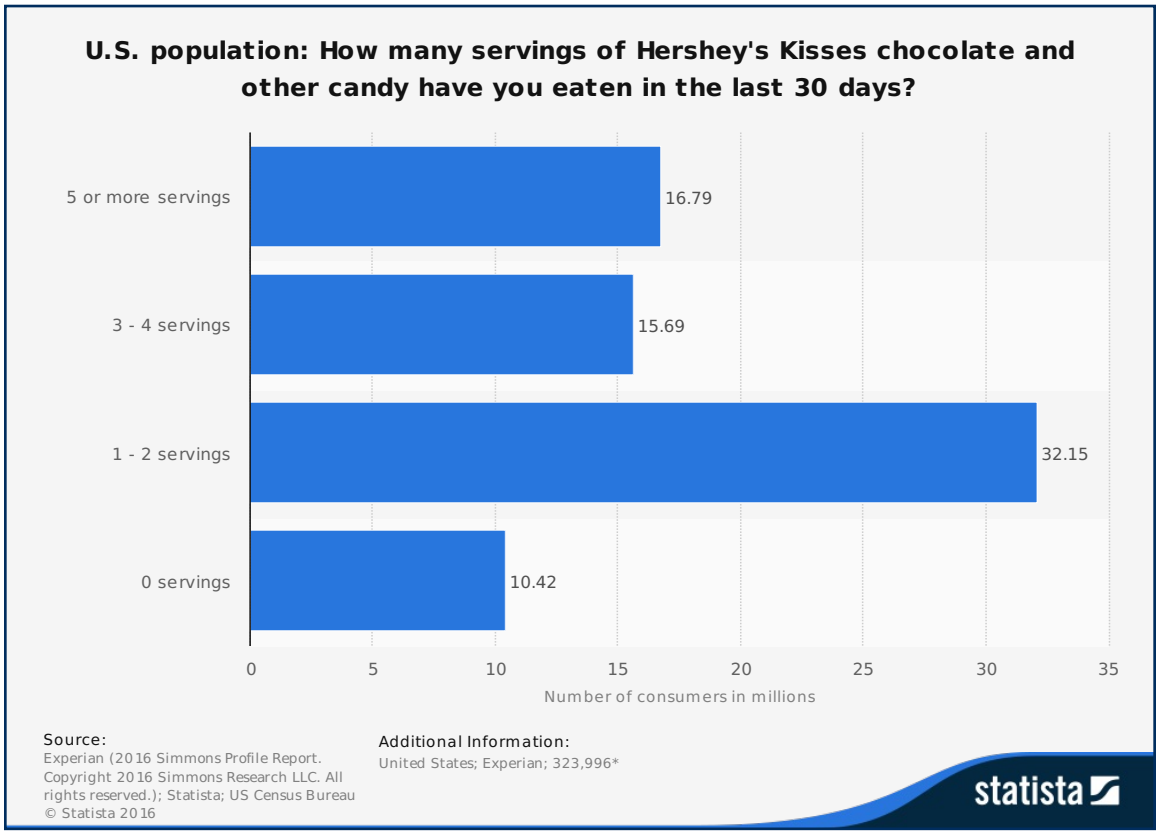
Exhibit 1

Hershey's Net Sales

Source: Bender, Joshua. "Topic: The Hershey Company." Statista. The Statistics Portal, 2016. Accessed 12 Dec. 2016. https://www.statista.com/topics/2342/the-hershey-company

Exhibit 2

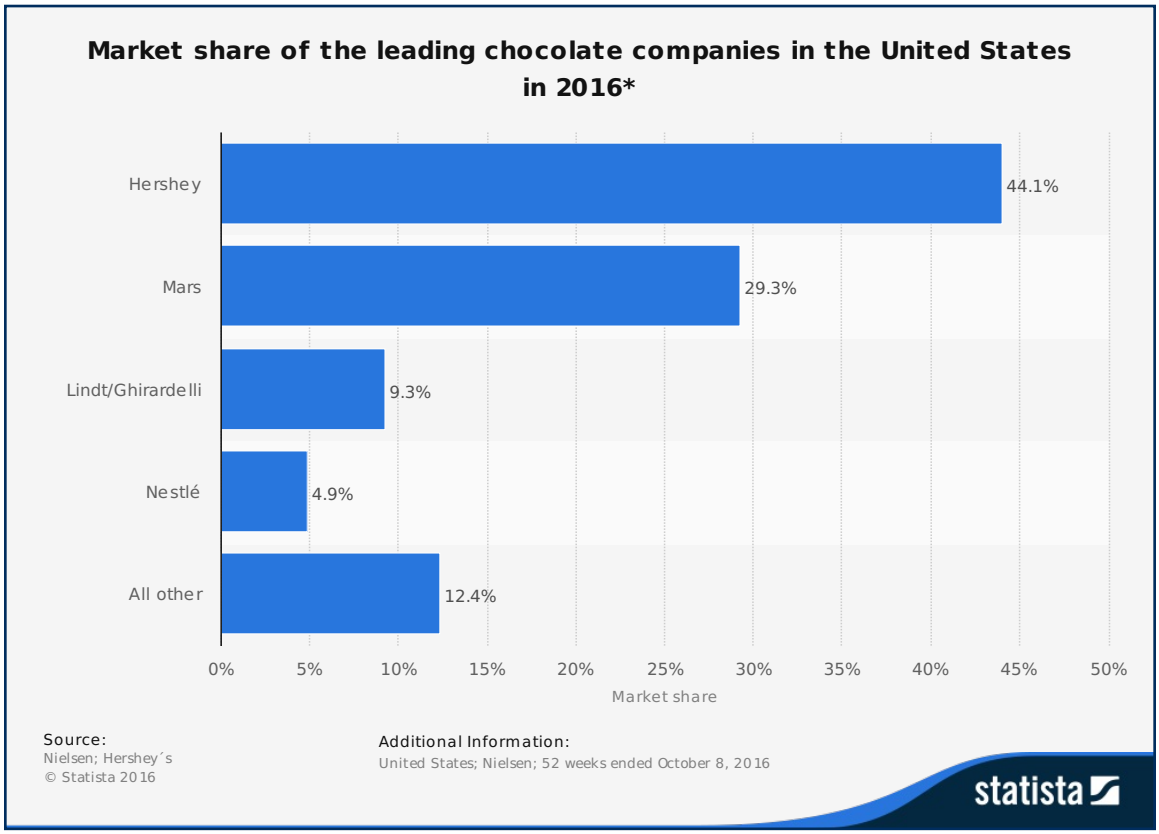
Servings of Hershey's Eaten in the Last 30 days by US Consumers



Source: Bender, Joshua. "Topic: The Hershey Company." Statista. The Statistics Portal, 2016. Accessed 12 Dec. 2016. https://www.statista.com/topics/2342/the-hershey-company

Exhibit 3

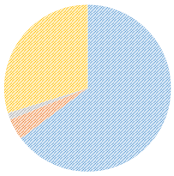
Chocolate Market Share - US, 2016

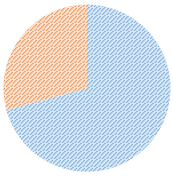


Source: "U.S. Market Share of Chocolate Companies, 2016." Statista. The Statistics Portal, 2016. Accessed 12 Dec. 2016. https://www.statista.com/statistics/238794/market-share-of-the-leading-chocolate-companies-in-the-us

Exhibit 4

Milton Hershey School Funding





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Notes

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