EMERSON ADVISORY
333 BAY STREET, SUITE 2400
BAY ADELAIDE CENTRE, BOX 20
TORONTO, ONTARIO, CANADA M5H 2T6

H. GARFIELD EMERSON
PRINCIPAL

DIRECT 416 865 4350
FAX 416 364 7813
gemerson@emersonadvisory.com

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IS THE "MCCAIN GOVERNANCE AGREEMENT" IN THE BEST INTERESTS OF MAPLE LEAF FOODS?

Michael McCain Personally Acquired a Controlling Influence in Maple Leaf Foods

With comparisons to an arranged and assumptive accession, in 2011 Michael McCain successful took personal ownership of his family's controlling influence in Maple Leaf Foods Inc. (TSX: MFI). The public recognition of this generational assignment of authority was officially and ritually observed at the Company's annual shareholders' meeting held on May 2, 2012. Wearing red carnations in the labels of their sedate blue and grey business suits to identify them as the corporate directors, a 'changed and renewed' reduced board of 10 directors was duly elected (one new director with four long-time directors retiring, including 80 year old Chairman Purdy Crawford who was an original director selected to the MFI board in 1995 by his close personal friend, the late Wallace McCain). Following completion of the corporate formalities, President and CEO Michael McCain confidently and passionately addressed the gathering, committing to shareholders to "dramatically build shareholder value", hailing the past fiscal year as one in which "we delivered". Proudly and appropriately, he praised and celebrated the accomplishments of his father, the late Wallace McCain, as a "giant of a man", a hard working entrepreneur who was the "creator of industries" and who unflinchingly and with perseverance successfully "competed with the best in the world". Michael McCain triumphantly presented himself as the fit and proper successor to his father, and unquestionably asserted himself as a CEO and shareholder firmly in command of the Company.[1]

Ontario Teachers' Pension Plan Terminated its Joint Control with the McCain Family

Until Ontario Teachers' Pension Plan ("OTPP") terminated its 15-year partnership with McCain Capital Corporation ("MCC") on June 30, 2010, Maple Leaf Foods was under the joint control of the late Wallace McCain and his family, through MCC, and OTPP. That controlling partnership was in place from the time they jointly acquired majority ownership of MFI from Hillsdown Holdings plc in April 1995.

In 2009 it became evident that OTPP had grown dissatisfied with this joint but several investment with the McCain family, with Maple Leaf Food's operating underperformance under McCain management and with the Company's proposed long-term strategy and new business plan promoted and driven by Michael McCain, which required large capital expenditures of $1.3 billion.

On June 29, 2010, the day before OTPP terminated its partnership with the McCain family, the MFI directors adopted a 'poison pill', which had the effect of preventing OTPP from selling privately is 36% interest as a single block to one purchaser. Presumably the directors believed that it was not 'in the best interests of the Company' that this 36% largest single holding should be bought *en bloc* by a third party.[2] It would have created significant unwanted challenges to the McCain family controlling influence of Maple Leaf Foods.

Following the publicly stormy corporate divorce with the McCain family and its termination of the partnership, OTPP disposed of its entire 36% MFI share interest later in 2010. OTPP first privately sold 11.35%, at a 9% discount to market, to a $2.5 billion hedge fund managed by Toronto-based West Face Capital Inc. ("West Face Capital"), and later distributed the balance to the public through a secondary 'bought deal' prospectus offering.

MCC remained the largest shareholder with 31.34% of the voting shares of MFI after OTPP dispersed its shares.

[1] At March 22, 2012, Michael McCain, through McCain Capital Inc., which he owned 100%, held 32.69% of MFI's common shares (45,773,783 shares). Michael McCain also held the benefit of the rights granted to him by the MFI board under the McCain Governance Agreement referred to in this note.

[2] The 'poison pill' adopted by the MFI board on June 29, 2010 was not placed before the Company's shareholders for ratification within six months of its implementation, as is required for its continuance after that period. The rights plan was "allowed to expire" on December 29, 2010, without receiving shareholder approval. Well before that date, OTPP had disposed of all its shares in MFI on a relatively broad distribution basis without affecting control of the Company and the rights plan had achieved at least an initial primary purpose of blocking OTPP's sale of its entire block to a single buyer.

As the second largest shareholder in Maple Leaf Foods, West Face Capital immediately demanded significant corporate governance improvements at MFI. The board of Maple Leaf Foods, defensively and with a sense of injured innocence and superior *hauteur*, firmly rejected the requests of West Face Capital to introduce a higher standard of substantive independence on the board. The directors considered West Face Capital an activist interloper looking for a quick short-term gain. West Face Capital countered aggressively with a public solicitation for a trial of strength with the board and the McCain family's controlling influence by requisitioning a special shareholders' meeting to force a proxy contest and to put its shareholder friendly demands to a vote of a majority of the equity owners of the Company. The shareholder vote requisitioned by West Face Capital would have requested fundamental changes to introduce higher standards of board independence and to alter its composition and structure. Jim Hankinson, a MFI director since 1995 and Chairman of the Corporate Governance Committee, publicly responded by denouncing the West Face Capital initiative a "costly and unnecessary process", labelling it as "unproductive and contrary to the best interest of Maple Leaf Foods and its shareholders." [3]

Though firmly rejecting West Face Capital's activist intervention, MFI's incumbent board was forced to retreat from its opposition when certain of its directors directly contacted its largest shareholders to solicit their votes, and then discovered substantial support for West Face Capital's analysis and position. Their conclusion from this new exercise of direct shareholder engagement by the board was that as incumbents they would loose the vote. This compelled the MFI independent directors to enter into a Settlement Agreement with West Face Capital to prevent its proposal from proceeding to a shareholder vote that West Face Capital would probably have won.

[When confronted in late 2011 and early 2012 with demands for governance changes from its largest shareholder, Pershing Square, a U.S. $11 billion hedge fund holding 14.2% of the shares, the board of Canadian Pacific Railway Limited strongly rejected its requests and stoutly defended its CEO and business strategy. Ultimately, and overwhelmingly, Canadian Pacific lost the proxy contest to Pershing Square, whose proposals were endorsed, among others, by OTPP, Canada Pension Plan Investment Board and Institutional Shareholder Services (ISS).[4]]

The result of Maple Leaf Foods' Settlement Agreement with West Face Capital was essentially to maintain the *status quo*, with some corporate governance enhancements introduced over the next 18 months. This was a clear and first victory for the McCain family. The McCain family's successful defence of its controlling influence in Maple Leaf Foods after OTPP dismantled the protective joint control partnership, and West Face Capital's activist shareholder

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[3] Maple Leaf Foods Press Release, December 3, 2010.

[4] When confronted with requests for two board seats and senior management changes from Pershing Square with a significant investment of 14.2%, its largest shareholder, the board of Canadian Pacific Railway Limited approved in principle the appointment of William Ackman, the CEO of Pershing Square, to the Canadian Pacific board, but subject to Pershing Square entering into a confidentiality and standstill agreement, which it refused. The CP board unanimously endorsed and defended its CEO and management team and its business strategy and rejected Pershing's management, board and business changes. Pershing Square then commenced a proxy contest to elect seven nominees as CP directors. Recognizing certain defeat at the hands of CP shareholders, on the morning of CP's AGM, the Chairman of the Board, John Cleghorn, who lead the opposition to Pershing Square, the CEO, Fred Green, and four other incumbent directors announced they would not stand for re-election later that day. Pershing Square successfully and by an overwhelming margin elected all its seven nominees as directors to the 16 member CP board. Each of the nine CP nominees received less than 50% of votes cast 'for' their election and, in each case, a majority of the votes cast were 'withheld' from their election. As shareholders cannot vote 'against' a nominee, a 'withheld' vote is effectively an 'against' vote.

intervention to restructure the board, is reviewed in "*Maple Leaf Foods Inc.: The Challenge to McCain Control and Director 'Independence'.*", at www.governancecanada.com.

McCain Rebuffed West Face Capital's Challenge

Under the Settlement Agreement dated February 2, 2011, Maple Leaf Foods successfully neutered and removed West Face Capital's opposition and brought the hedge fund within the family tent. West Face Capital is currently bound by the Settlement Agreement until a nominee of West Face Capital no longer serves on the board. In withdrawing its requisition that challenged MFI's board independence and composition, West Face Capital also agreed to the following:

- The CEO of West Face Capital would be appointed (in 2011)[5] to a 14 member MFI Board, serve on the Corporate Governance and the Human Resources and Compensation Committees and be re-elected later in the year at the 2011 AGM as one of 14 directors; the CEO of West Face Capital was to be a member of an Executive Committee if one is established while he is a director;

- The Special Committee and the Shareholders Relations Committee of the Board were dissolved;

- All the current incumbent 12 members of the Board who had supported MCC and opposed West Face Capital were to be re-elected at the 2011 AGM;

- One new independent and unaffiliated director would be recruited and elected to the Board at the 2011 AGM;

- At the 2012 AGM, Maple Leaf Foods, in its sole discretion, would either nominate not more than 10 directors (reduced from 14)[6], or nominate not more than 12 directors and four of the current incumbents would be replaced with two new independent and unaffiliated directors;

- West Face Capital agreed to support the board and deliver to management proxies in favour of the agreed nominees for election to the board at the 2011 AGM and in favour of the nominees to be approved by the board for election at the 2012 AGM;

- West Face Capital agreed to a "standstill" not to engage in certain prohibited activities including proxy contests, requisitioning shareholder meetings or proposing other candidates for election to the board; provided that, if West Face Capital owns 7.5% of more of MFI's shares and its nominee is not elected to the

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[5] The Chairman of the MFI Corporate Governance Committee unemotionally announced that "Mr. Boland's appointment [the CEO of West Face Capital] is part of an ongoing process to make changes in the composition and structure of our board that reflect the recent significant changes in our shareholder base."

[6] Ten nominees, including one new nominee, were presented for election and were elected as directors at the May 2, 2012 AGM, and four incumbent directors retired from the board.

board at the 2012 AGM,[7] these restrictions and those referred to in the next bullet cease to apply;

- West Face Capital agreed to be silenced and not to "say, publish, or communicate, in any media or forum, any matter or thing that would reasonably be expected to undermine, disparage or reflect adversely on the reputation, qualifications, character, conduct or behavior of the Company or its subsidiaries or any of their respective directors, officers, employees, agents or representatives in connection with any matter arising out of or relating to the Company or any of its subsidiaries;".

MFI Board Approved a Related Party "Material Contract" with Michael McCain. Why?

At the 2011 AGM in late April, 2011, MCC controlled 31.34% of the Company's shares,[8] and the only other large shareholder was West Face Capital with 11.35%. Through the Settlement Agreement between MFI and the hedge fund manager, MCC had indirectly frozen West Face Capital as a threat to its controlling influence, at least temporarily. The Settlement Agreement and the newly created friendship between CEO Michael McCain and the hedge fund's CEO[9] might not, however, last for the long term. With less than legal control of the Company, Michael McCain might well have sensed the possibility that future events could unfold which challenged his minority though current controlling influence over MFI. The OTPP's unilateral termination of its joint control with the McCain family and the following instability were recent cautions to keep in mind when associating with venturers that have predominantly financial requirements to satisfy, even those with objectives for, in their view, the longer term. A financial investor's long term is never as long as the perspective of a controlling family with no intention to sell and intent on passing the patrimony from one generation to the next. Absent legal control, additional safeguards would be useful to strengthen the McCain position.

After the 2011 AGM, the Maple Leaf Foods board continued controlled by long serving members comfortable with and supportive of the McCain hegemony and its management.[10] The twelve incumbent directors who opposed West Face Capital's intervention in 2010 were re-elected at the 2011 AGM and eight of the 14 Board members had long associations with, or were part of, the McCain family.

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[7] West Face Capital's CEO was re-elected as a director at the May 2, 2012 AGM.

[8] MCC was the owner of 43,890,784 common shares of MFI, representing 31.34% of the issued and outstanding voting common shares. The Wallace McCain Family Trust, which was itself controlled by the late Wallace McCain, controlled such MFI shares. A majority of the shares of MCC were held by members of the Wallace McCain family, including Messrs. Wallace F. McCain, J. Scott McCain and Michael H. McCain.

[9] Jacquie McNish, *War and Peace and Cold Cuts*, Globe & Mail Report on Business Magazine, February 24, 2012. In October 2011, Greg Boland, the CEO of West Face Capital and a director of Maple Leaf Foods as a result of the Settlement Agreement was quoted: "To their credit, we have seen a change in the way Michael [McCain] and the board thinks." Globe & Mail, Report on Business, October 20, 2011.

[10] The late Wallace McCain was then Chairman of the Board, and his sons, Michael and Scott, were, as well as board members, President and Chief Executive Officer and President and Chief Operating Officer, Agribusiness Group, respectively. Three directors, Purdy Crawford, Jim Hankinson and Gordon Ritchie, had served since 1995 and several others for more than 10 years.

Wallace McCain passed away, after a long battle with cancer, on May 13, 2011, at the age of 81. In June 2011, the MFI board was advised of various estate planning steps being taken in connection with the wishes and directions of the late Wallace McCain.

Within a relatively short period of time thereafter, on July 28, 2011, Maple Leaf Foods publicly announced that its board had implemented changes to "further enhance the Company's governance structure". These board sanctioned changes were stated to be "precipitated by a proposed reorganization transaction" which resulted in Michael McCain, the Company's President and CEO, acquiring all the MFI common shares held by MCC.[11]

The McCain Governance Agreement and the 'Poison Pill' Constituted a "Material Change" in Maple Leaf Foods

This private reorganization of the McCain family share ownership in MFI was external to Maple Leaf Foods and internal to the McCain family, and did not involve the Company. The board, however, was required to waive the application of the new 'poison pill' that it simultaneously had just adopted as part of the 'governance enhancement'. These two changes constituted a "material change"[12] in the affairs of Maple Leaf Foods, and the Company promptly filed a Material Change Report[13] with respect thereto. Accordingly, the board of Maple Leaf Foods judged that the changes the board approved and implemented "would reasonably be expected to have a significant effect on the market price or value" of the common shares of the Company.

No Substantive Change in Control of Maple Leaf Foods

Prior to the board's implementation of this material change in the affairs of the Company, a shareholders' agreement existed between MCC and Michael McCain, Scott McCain, Martha McCain and Eleanor McCain, all shareholders of MCC. Maple Leaf Foods was not a party to the family's agreement that provided that all the Maple Leaf Foods shares held by MCC (31.3%) and all the Maple Leaf Foods shares held by the four McCain siblings were to be voted as one block. In practice, voting control over the Maple Leaf Foods shares held by MCC and Michael McCain was exercised by Michael McCain.[14]

It was not explained why the private McCain family estate reorganization following the death of the late Wallace McCain and the transfer of the McCain family ownership in MFI from

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[11] These shares were transferred to the control of Michael McCain in accordance with the wishes and directions of his father, the late Wallace McCain. The transfer was completed by private agreement on December 2, 2011 at an ascribed value of $11.74 per Maple Leaf Foods common share in the context of a division of the assets of MCC between Michael McCain and the other children of the late Wallace McCain. The consideration paid by Michael McCain consisted of cash and securities of McCain Capital Inc., Michael McCain's holding company of which he owns 100%, and the price per share was not in excess of 115% of the market price of the Maple Leaf Foods common shares. Amended Early Warning Report dated December 8, 2011 filed by Michael McCain.

[12] A "material change" requiring the filing of a material change report is defined as "a change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer". National Instrument 51-102 – *Continuous Disclosure Obligations*, s.1.1.

[13] Maple Leaf Foods filed a Material Change Report dated July 28, 2011, the date of the 'material change'.

[14] Amended Early Warning Report filed by MCC dated August 2, 2011.

the family's holding company, MCC, to the family member, Michael McCain, "precipitated" or caused these so-called 'enhanced governance' changes to be implemented by the directors of the public company, nor why they were 'in the best interests' of the other shareholders and stakeholders of Maple Leaf Foods. The primary recital to the McCain Governance Agreement blandly stated the justification as:

> "WHEREAS MCC proposes to complete a reorganization that would involve, among other things, the transfer to and/or the acquisition by MHM [Michael McCain], directly or indirectly, of MCC's entire interest in the Company (the "Proposed Reorganization");"

The board's self-proclaimed 'enhancement' of MFI's governance structure announced July 28, 2011 was achieved by (i) the Company entering into a new Governance Agreement (referred to in the Company's public documents as the "McCain Governance Agreement"[15]) with Michael McCain and MCC; and (ii) the board adopting a new shareholders' rights plan or 'poison pill'.[16] These combined changes were recommended to be "in the best interests of the Company" by a 2011 Special Committee composed of all directors independent of Michael McCain and MCC.[17] The Special Committee comprised all directors, other than Michael McCain, Scott McCain and Purdy Crawford, the former Vice-Chairman and Lead Director who became Chairman of the Board as successor to the late Wallace McCain effective June 22, 2011.[18] It was first disclosed in 2010 that Mr. Crawford had been a director of MCC for many years.[19]

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[15] Maple Leaf Foods Management Proxy Circular dated March 22, 2012 at p.17.

[16] Long standing regular corporate counsel for Maple Leaf Foods, Osler, Hoskin & Harcourt LLP., acted, in this related party transaction, for Michael McCain and MCC, and not for the Company. Oslers had also acted for the McCain family personally for many years, as well as for Maple Leaf Foods. External counsel who advised the Special Committee and the Shareholders Relations Committee in 2010 in opposing and then settling with West Face Capital, Goodmans LLP., acted this time for Maple Leaf Foods in connection with the McCain Governance Agreement. Both such counsel advised Maple Leaf Foods with respect to the concurrent adoption of the replacement 'poison pill'.

[17] Maple Leaf Foods News Release dated July 28, 2011. The Chair of this 2011 Special Committee was Jim Hankinson, a director since 1995. Mr. Hankinson was also the Chair of the Corporate Governance Committee since 2006; the Chair of the 2010 Special Committee that recommended the 'poison pill' that prevented OTPP from selling its 36% interest as a single block; and the Chair of the 2010 Shareholders Relations Committee that opposed the governance changes initiated by West Face Capital and that conducted the consultations with shareholders that resulted in MFI being forced to enter into the Settlement Agreement with West Face Capital. Mr. Hankinson did not stand for re-election and ceased to be a director at the May 2, 2012 AGM.

[18] Maple Leaf Foods Material Change Report dated July 28, 2011. On June 29, 2011, Maple Leaf Foods announced that Purdy Crawford was appointed by the board as non-executive Chairman of the Board effective June 22, 2011. Prior to the passing of the late Wallace McCain, Purdy Crawford was Vice-Chairman and Lead Director. MFI also announced at that time that Purdy Crawford would retire from the board at the Company's next annual meeting in 2012, which he did on May 2, 2012.

[19] The dialogue that was initiated by West Face Capital in 2010 during its intervention to change the composition of the MFI board whether Purdy Crawford was an "independent director" continued in the Company's Management Proxy Circular dated March 22, 2012 at p.19. The factors discussed concerned his long personal relationship with the McCain family, with his directorship on MCC controlled by the McCain family, with his association with Osler, Hoskin & Harcourt LLP, the law firm that regularly advised both Maple Leaf Foods and the McCain family, and with respect to the fact that his daughter is employed by Maple Leaf Foods. The 2012 Management Proxy Circular disclosed that Mr. Crawford was no longer a director of MCC.

As the McCain family estate reorganization transferred MCC's entire interest in Maple Leaf Foods to Michael McCain following the death of Wallace McCain, the Company reasonably and properly agreed in the McCain Governance Agreement not to hinder such transfer under its newly adopted shareholder rights plan or to cause a 'flip-in event' as a result of the transfer.[20]

There was no substantive or effective 'change of control' of the Company, or 'change that would affect materially the control' of Maple Leaf Foods, flowing from the transfer. Michael McCain, the long serving President and CEO of the Company, was and had been for some time a critical part of the McCain family ownership block and, in practice, exercised voting control of MCC's holding of Maple Leaf Foods' shares prior to the transfer of those shares directly to him. While there was a technical change in the 'control person'[21] of Maple Leaf Foods from MCC to Michael McCain, the waiver of the 'poison pill' on the transfer can be justified as a reasonable exercise of the directors' business judgment in light of the circumstances.

The Board provided Protection to Michael McCain as a Minority Shareholder, but the Board did Not provide Protection to the Minority if he becomes the Majority Shareholder

How the private inter-family transfer of 31.3% of the Company's shares "precipitated" the additional provisions of the McCain Governance Agreement, however, has not been explained by the board. As a result of the McCain Governance Agreement, the board granted Michael McCain, for the first time, valuable rights of access to corporate assets, namely, access to Maple Leaf Foods' proxy circular entitling him to select nominees for election as directors and to representation on the Company's board.[22]

Under the terms of the McCain Governance Agreement, the board granted him, as a minority shareholder, the right to select nominees for election as directors[23] and "the right to cause the [MFI] Board to nominate for election to the Board…a number of nominees" proportionate to his "direct or indirect ownership interest of voting securities of the Company from time to time". The board also obligated the Company to nominate each of Michael

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[20] The 'poison pill' is triggered where there is a proposed acquisition of 20% of more of the outstanding common shares of MFI. The rights plan was amended by the board on December 5, 2011 based on recommendations from Institutional Shareholder Services (ISS). Maple Leaf Foods News Release dated December 5, 2011. The rights plan was approved by the shareholders at a special meeting on December 14, 2011 with a majority approval of 93.96% of the votes cast by unaffiliated shareholders, excluding the 44,673,922 shares held by "Grandfathered Persons" (the McCain family holdings).

[21] A person or company owning more then 20% of a company's voting rights is deemed, in the absence of evidence to the contrary, to hold sufficient shares "to affect materially the control" of the company and to be a "control person" of the company.

[22] One of the principal 2012 projects of the Canadian Coalition of Good Governance, Canada's leading coalition representing institutional investors managing close to $2 trillion, is to consider proxy access and other preferential rights for long term shareholders.

[23] The McCain Governance Agreement provides that the qualifications of McCain's proposed selected nominees must be reviewed by the Company's Corporate Governance Committee, and if it "disapproves, acting reasonably" (i.e., objectively), McCain must replace the nominee with another until McCain and the Committee, "acting in good faith", agree to the selection of McCain's nominees.

McCain's nominees for election as a director and to recommend to shareholders that they vote in favour of Michael McCain's nominees for election to the board.

In return for granting Michael McCain the right to board representation proportionate to his ownership, the board secured the 'yes' or 'for' votes of the 32% of the issued shares of the Company held by Michael McCain in favour of the election of the board's own nominees as directors. The board agreed to nominate and recommend that shareholders vote to elect Michael McCain's nominees and Michael McCain agreed to vote his shares in favour of the election of the board's nominees.

While not a complete lock up of circular control, the reciprocal covenants in the McCain Governance Agreement between the CEO, who is also the largest though a minority shareholder, and a friendly incumbent board for the nomination, recommendation and voting for the election of the director nominees of the other, reinforced with the power and authority of the Company's management proxy solicitation process, together with the concurrent adoption of a new 'poison pill', created an effective deterrent to an unsolicited third party intending to acquire a dominant position in Maple Leaf Foods.

The MFI board had adopted policies for individual voting for directors and 'majority voting', requiring a director who receives a majority of "withheld" votes to tender his or her resignation for consideration.[24] By agreeing to the reciprocal voting covenants and the board's obligation to recommend in favour of the McCain nominees in the McCain Governance Agreement, together with Michael McCain's 32% of the votes contractually in its hands, the board has rendered these shareholder friendly policies practically nugatory.

Termination of the McCain Governance Agreement

Maple Leaf Foods' obligations to Michael McCain and his rights under the McCain Governance Agreement continue until he owns more than 50% of the Company's voting shares (in which case he will be in a position to select and elect all the directors on the board), or until his death.[25] There is no 'sunset' clause requiring re-confirmation, extension or termination of the Company's obligations or Michael McCain's rights after a finite or appropriate period of time, nor upon a material change in circumstances or relationship other than death.

As referred to under "Contested Elections" below, if there is a "Contested Election" (as broadly defined in the Agreement) prior to such a termination, Michael McCain's is not required to comply with his obligations to the Company during and, in some cases, after the Contested Election, but, Maple Leaf Foods continues to be required to comply with its obligations to Michael McCain. Why the board granted Michael McCain such a "leg up" and protective advantage should there be a Contested Election is not explained.

The board neither publicly disclosed nor discussed their rationale why it was in the 'Company's best interests' that Michael McCain would have the freedom to select and elect

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[24] Maple Leaf Foods Management Proxy Circular dated March 22, 2012, at p.21 under "Individual Voting for Directors".

[25] The McCain Governance Agreement also terminates in the event of the dissolution, bankruptcy or insolvency of Maple Leaf Foods.

100% of the directors if he owned 51% of the shares, as he will not then be bound by the Agreement, while he is only entitled to nominate 50% of the directors if he owned 49% of the shares. It would have been more appropriate and in the interests of the other public shareholders if the Agreement did not terminate unless he acquired 100% (or, say, over 90%) of MFI. In such a case, if he owned 60%, for instance, he would only be entitled to nominate 60% of the directors, leaving 40% of the nominees to be independently chosen and nominated by the independent directors on the board.

Under the terms of the McCain Governance Agreement as approved by the board, it is not fully accurate to say that "Mr. McCain will have the right to nominate that number of directors of the Company that is proportionate" to his ownership[26]. This statement omits to disclose that proportionate board representation applies only while Michael McCain owns 50% or less of the issued voting shares of the Company. In this regard, the board has not only granted him a significantly enhanced and privileged position as a minority shareholder by this right to proportionate board representation, but the board has also allowed him complete freedom as a majority shareholder.

If Michael McCain owns 50% or more, the McCain Governance Agreement terminates and he is then in a position to select and elect 100% of the directors, and is not limited to a number of directors that is proportionate to his ownership. Once he has legal control, McCain is not bound by any agreement, the board's Corporate Governance Committee will not have a contractual right with the then majority shareholder freely to identify and nominate directors who are independent of and who do not have a material relationship with management or the McCain family members, and Michael McCain will not be obligated to vote for the election of any such independently selected nominees.

Though the board granted Michael McCain the right to board representation while he is a minority shareholder, the Maple Leaf Foods board did not provide similar protection to the minority shareholders if Michael McCain becomes a majority shareholder. Michael McCain has secured protection of his own interests while he is a minority shareholder but he has not agreed to equivalent pro rata protection for the Company's minority shareholders once he achieves majority ownership.

Conversely, Maple Leaf Foods remains bound by the McCain Governance Agreement and McCain's rights continue even if McCain's ownership may be reduced by a significant amount, say, to below 20%, or if he ceases to be the CEO or part of the executive team, or if he develops new interests that conflict with the interests of Maple Leaf Foods, or if he becomes incapacitated. While the Agreement is not assignable, it is binding on the successors of the parties.

Michael McCain's rights to board representation that he was granted by the board under the McCain Governance Agreement are not related to a continuing relationship with Maple Leaf Foods or even to the maintenance of a continued minimum share ownership. Why Maple Leaf Foods board should have granted him, as an individual minority shareholder, these broad ongoing rights to board representation is neither evident nor explained.

[26] Maple Leaf Foods press release dated July 28, 2011.

McCain Governance Agreement is a "Material Contract" of Maple Leaf Foods

In addition to being a material related party transaction that was the subject of a filed "material change report", the McCain Governance Agreement is recognized and listed as a "material contract" of Maple Leaf Foods. A "material contract" is any contract that a public company is a party to "that is material to the issuer".[27] Under "Interests of Management and Others in Material Transactions" in the Company's 2012 AIF, it is stated that, except for Michael McCain's disclosed interest in the McCain Governance Agreement, he does not have "any material interest … in any transaction within the three most recently completed financial years that has materially affected or is reasonably expected to materially affect the Company or any of its subsidiaries". This is an appropriate further acknowledgement by the Company that the McCain Governance Agreement 'materially affects or is reasonably expected to materially affect' Maple Leaf Foods. The McCain Governance Agreement is separately listed as a "material contract" of the Company in its AIF.[28]

In its Management Proxy Circular dated March 22, 2012, the board of Maple Leaf Foods, however, took the questionably inconsistent position by stating that Michael McCain did not have "any direct or indirect material interest, since January 1, 2011, in respect of any transaction or proposed transaction that has materially affected or will materially affect the Corporation or any of its subsidiaries."[29]

As a Material Related Party Transaction, the McCain Governance Agreement was Not Approved by a 'Majority of the Majority' of the Shareholders

It is also noteworthy that this related party material contract between the Company and Michael McCain, an insider of the Company, was not placed before the shareholders in general meeting for their approval, with the 32% of the shares held by Michael McCain not voting on the resolution to approve the McCain Governance Agreement. It would appear that a condition for approval by a disinterested 'majority of the majority' shareholders would be reasonable and appropriate where the CEO and largest but still minority shareholder was granted by the board special and broad rights of access to the Company's proxy and board representation which are not available to any other shareholder.

The independent directors on the Maple Leaf Foods' board did not enunciate the reasons why granting Michael McCain personally these significant rights as a shareholder 'enhanced the Company's governance structure'. The Company stated only that the Governance Agreement was "precipitated" by the reorganization of MCC whereby Michael McCain acquired all the shares of Maple Leaf Foods owned by MCC.

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[27] National Instrument 51-102 – *Continuous Disclosure Obligations*, s.1.1.

[28] The McCain Governance Agreement is listed as a "material contract" under the headings "Interests of Management and Others in Material Transactions" and "Material Contracts" in the Company's Annual Information Form dated March 22, 2012, at pp.31-32.

[29] At p.59.

Maple Leaf Foods' Board Composition under the McCain Governance Agreement

The incumbent directors of Maple Leaf Foods in 2011 and Michael McCain agreed to the following composition for the board:

- Upon completion of the MCC reorganization, Michael McCain "shall have the right to cause the board to nominate for election to the board" a number of nominees proportionate to his direct or indirect ownership interest in the Company from time to time. (With 32% of the shares and a board of 13 or 14, Michael McCain is entitled to nominate four directors; with a board of 10, he would be entitled to nominate three directors. At the 2012 AGM, Michael McCain nominated two of the ten directors, himself and his brother, Scott McCain, the Company's President and COO, Agribusiness Group.)

- Maple Leaf Foods agreed to recommend to its shareholders that they vote in favour of Michael McCain's nominees and that the Company would vote proxies received in the manner specified in such proxies;[30]

- After receiving Michael McCain's nominees, the "Corporate Governance Committee of the Board shall promptly review the qualifications of the nominees selected" by him and, within five days, notify Michael McCain "if it disapproves, acting reasonably, of any of them." Michael McCain is then required to "replace any nominee not approved by the Corporate Governance Committee of the Board, acting reasonably, with another selection", and so on until Michael McCain and the Corporate Governance Committee, "acting in good faith", agree to McCain's selections.

- All other directors are to be identified by the Corporate Governance Committee and nominated by the Company and be "independent of, and not have a material relationship with, management of the Company", Michael McCain, or, subject to the next bullet, West Face Capital.

- Maple Leaf Foods has the right to nominate one nominee of West Face Capital, whether or not under the Settlement Agreement.

- Michael McCain is required to vote his shares in favour of the election of the nominees as directors selected by the Corporate Governance Committee and the board, using the management forms of proxy.

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[30] Under Canadian rules for voting for the election of directors where a shareholder can only vote "for" or "withhold" from voting, and cannot vote "against" a nominee for election as a director, Michael McCain's nominees and the other nominees selected by the board are assured of being elected as directors in uncontested elections. If all other shareholders "withheld" their votes on the election of McCain's nominees and ignored the recommendations of the Company to vote in their favor, his "yes" votes alone would ensure the election of his nominees, as well as the other nominees selected by the board. In such an unlikely outcome where all shareholders other than McCain "withheld" their votes on his nominees in defiance of the recommendation of the board, the Company's policy on "Individual Voting for Directors" would apply.

There are several significant qualifications to these voting requirements.

First, the board has the right to select its own nominees other than in accordance with the McCain Governance Agreement. In that event, Michael McCain will "not be required to vote" in favour of the board's nominees not selected in accordance with Agreement, and "may nominate for election alternative nominees to the nominees that were not selected [by the board] in accordance with" the Agreement. The board is still required, however, to put forward Michael McCain's nominees for election and recommend that shareholders vote in their favour.

Second, if one third or more of the directors who are elected (excluding Michael McCain's nominees) "do not qualify for nomination" by the Corporate Governance Committee under the terms of the Agreement, Michael McCain is not thereafter "required to comply" with the Agreement relating to board composition. Maple Leaf Foods, however, is not relieved of its obligations to continue to comply with the McCain Governance Agreement with respect to its obligations to Michael McCain.

"Contested Elections"

An important exception in the McCain Management Agreement and resulting benefit to Michael McCain arise in the event of a "Contested Election" (as defined in the Agreement). These provisions create either a temporary or permanent termination of Michael McCain's obligations to the Company under the Agreement in respect of board composition. Maple Leaf Foods is, however, not relieved of any of its obligations to Michael McCain in the event of a Contested Election

Michael McCain is "not required to comply" with the board composition provisions, including voting in favour of the Company's nominees for election as directors, <u>during</u> a Contested Election. If there is a Contested Election, Michael McCain is also thereby free to put forward his own candidates for board election without restriction, including nominations in excess of his proportionate ownership interest. This is a reasonable provision in the event of an unsolicited bid for control of Maple Leaf Foods from a third party.

McCain is also "not required to comply" with such provisions <u>after</u> a Contested Election if it resulted in the removal or replacement of <u>any</u> of McCain's nominated directors, or one third or more of the directors who "qualify for nomination" by the Corporate Governance Committee serving on the board immediately prior to the Contested Election. It is arguable that the McCain Governance Agreement, including the grant of board representation rights to Michael McCain, should terminate in the event that a majority of the incumbent directors are removed or replaced following a Contested Election

A "Contested Election" is extremely broadly defined. It is triggered including when any person, firm or company, <u>other than Michael McCain</u>, (i) solicits or takes any action to solicit any voting proxies; (ii) proposes to or solicits Company shareholders to vote <u>any</u> shares on <u>any</u> matter; (iii) seeks to call or requisition a shareholders' meeting, seeks to obtain representation on or to nominate or propose the nomination of any person to the board other than pursuant to the Agreement; or seeks to effect the removal of any board member or otherwise alter the board's composition, if there is "a reasonable prospect" that an action in item (iii) "might result in" a removal of <u>any</u> of Michael McCain's nominated directors, or in the removal of one third or more of the directors who "qualify for nomination" by the Corporate Governance Committee serving on the board immediately prior to the Contested Election.

It is noteworthy to note that Michael McCain is free to take any action that constitutes a "Contested Election" that is not in breach of his obligations under the terms of the Agreement, and, in such a case, Maple leaf Foods remains obligated to fulfill its obligations to him.

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