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FONTERRA CO-OPERATIVE GROUP LIMITED GOVERNANCE AND REPRESENTATION REVIEW 2016

**Notice of Special Meeting of
Shareholders and Explanatory
Notes**

**10.30AM ON 10 JUNE 2016
CLAUDELANDS EVENT CENTRE,
CORNER OF BROOKLYN ROAD &
HEAPHY TERRACE, HAMILTON.**





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FONTERRA CO-OPERATIVE GROUP LIMITED - SPECIAL MEETING

The meeting will be held at **Claudelands Event Centre, Corner of Brooklyn Road & Heaphy Terrace, Hamilton at 10.30am on Friday, 10 June 2016.**

Meeting Documents

Each Shareholder has been sent:

- This Notice of Meeting booklet, which includes:
 - Letter from the Chairman of the Board
 - Letter from the Chairman of the Shareholders' Council
 - Notice of Meeting (including the text of the resolution to be voted on by Shareholders) and Explanatory Notes (Part One)
 - Detailed commentary regarding the Governance and Representation Review in relation to the matters to be voted on by Shareholders (Part Two)
 - The Independent Expert Panel's Report (Part Three)
 - Table of proposed constitutional amendments (Part Four)
 - Table of proposed amendments to the By-laws of the Shareholders' Council (Part Five)
 - Summary of key changes to relevant documents (Part Six).
- A combined Voting Paper/Proxy Form. Use this Voting Paper:
 - If you are attending the Meeting, to vote in person
 - If you are unable to attend the Meeting, and you do not wish to vote by internet, post or fax, you can appoint a proxy to attend and vote on your behalf by completing the Proxy Form and returning it to the address specified on the freepost envelope included in the Voting Pack or otherwise set out on the form, so that the Returning Officer receives it no later than **10.30am on Wednesday, 8 June 2016**. A proxy need not be a Shareholder
 - If you are a company or other body corporate, you can appoint a representative to attend and vote on your behalf by completing the Proxy Form
 - Further instructions are on the back of the Proxy Form.

You can vote by **internet, post** or **fax**. The instructions on how to vote in this manner can be found on the Voting Papers.

electionz.com Limited has been authorised by the Board to receive, at the address specified on the freepost envelope included in the Voting Pack or otherwise set out on the Voting Paper, and count, all internet, postal and fax votes.

You can also vote by proxy, or by attending the meeting in person.

All internet, postal, fax and proxy votes must be received by the Returning Officer by 10.30am on Wednesday, 8 June 2016.

Shareholders' Voting Entitlements

Voting at the Meeting will be by poll. In order to vote, you will need to cast an internet, postal or fax vote, attend in person and vote, or appoint a proxy or representative to attend and vote for you.

Each Shareholder's voting entitlement is based on their milksolids production, with one vote for every 1,000kg of milksolids supplied during the season ended 31 May 2015. If a Shareholder did not supply last season but now owns an existing farm that supplied last season, the voting entitlement will be based on that farm's supply last season. In the case of a dry farm conversion and farm amalgamations/divisions, voting entitlement is based on the Board's estimate of milksolids production for this season. Milk supplied on Contract Supply and milk which is not backed by shares is excluded from milksolids production when calculating voting entitlements.

In accordance with the Companies Act, the Board has fixed 12 May 2016 as the date for determining voting entitlements of Shareholders for this meeting. Accordingly, those persons who are, on 12 May 2016, registered as Shareholders will be entitled to vote at the Meeting in respect of the Shares registered in their name at that time backed by production.

A Shareholder's voting entitlement for a farm is shown on the Voting Paper enclosed for that farm with this pack. If a Shareholder appoints a proxy, the proxy will exercise that Shareholders' voting entitlement as described above.

Votes Required and Quorum

The special resolution detailed in this Notice of Meeting will be passed if approved by a majority of 75 per cent or more of the votes of those Shareholders entitled to vote and voting on the resolution.

The quorum for the Meeting is present if not fewer than 50 Shareholders have cast postal votes (including by electronic means) or are present in person or by a representative, who between them hold or represent the holder or holders of not less than 2 per cent of the voting rights entitled to be exercised on the resolution to be considered at the meeting.

Results of Voting

The results of voting at the Meeting will be posted on Farm Source at www.nzfarmsource.co.nz as soon as vote counting is complete and the Chairman has declared the results.

Meeting Attendees

The Meeting is held for the benefit of Shareholders and their authorised proxies and representatives. Fonterra management will also be in attendance, as well as invited members of the media.

John Wilson
Chairman, on behalf of the Board

LETTER FROM THE CHAIRMAN OF THE BOARD

Fonterra Co-operative Group Limited
Private Bag 92032, City, Auckland 1142, New Zealand
Fonterra Centre, 109 Fanshawe Street, Auckland 1010
t +64 9 374 9000
f +64 9 374 9001
www.fonterra.com

Dear farmers,

A Special Meeting of Shareholders is being held on 10 June 2016 at 10.30am at Claudelands Event Centre, Hamilton so that we can vote on the recommended changes to our Constitution and our Shareholders' Council By-laws arising from the Governance and Representation Review.

Given the critical role governance and representation plays in the success of our Co-operative, it has been important to work through this process together and give everyone an opportunity to have their say. As one farmer put it during the discussions, it's a Fonterra solution to a uniquely Fonterra matter.

The Board and Council have consulted with farmers at more than 400 farmer meetings across New Zealand and reviewed the submissions made by farmers. We have considered governance best practice, in relation to the unique context and values of our Co-operative.

An Independent Expert Panel made up of local and international experts in the governance and representation fields, including: Chris Moller and Dame Therese Walsh (NZ), Dr Adrie Zwanenberg (Netherlands) and Dr Michael Cook (US) has reviewed the recommendation. The Panel unanimously supports the changes and recommends that farmers vote to adopt them.

The recommendation asks you to accept some important changes, notably the way you would vote for Directors. Your Board considered this carefully and understands some farmers may feel uncertain about these changes.

If our Co-operative is to move forward and stay focused on delivering wealth to its farmers every month of the year, we need to move past the annual distraction of an electioneering process.

The Board and the Council are committed to undertaking a formal review of any changes after five years, or earlier if either the Board or Shareholders' Council has reasonable evidence these constitutional changes are having a negative impact.

The recommendation aligns to the outcomes we agreed were important to us as owners. It is designed to consistently deliver the best quality candidates for farmers to consider voting onto the Board and Council.

Most importantly 100 per cent farmer ownership and control is respected in this recommendation. A majority of seven Farmer Directors will sit on the Board, and the Chairman will also be a farmer. The benchmark of farmer approval for all Directors becomes an Ordinary Resolution requiring more than 50 per cent support.

The recommendation has unanimous support from the Board. It also has strong majority support from your Shareholders' Council.

Being part of this decision is important for your Co-operative. The recommendation includes a number of changes that are designed to operate together as a whole. Some changes may not reflect your preferred option but if you support the overall direction and believe that it is an improvement on where we are now, we ask for your support. The review will give us the opportunity to modify aspects of the recommendation if it is not operating as intended.

We must continue to take the Co-operative forward. We cannot stand still.

Undoubtedly you will have questions about aspects of the changes. There will be another round of farmer meetings to discuss the final recommendation with the Board and Shareholders' Council. I encourage you to attend one of these meetings.

Ultimately, the mandate for change must come from you with a 75 per cent majority support for the resolution.

To aid your participation in deciding the future of our Co-operative, there will be internet, postal and fax voting for the Special Meeting. If you are unable to attend the Special Meeting in person, please have your say by casting your vote through any of these options.

I look forward to seeing as many of you as possible at the Special Meeting.



John Wilson
Chairman

LETTER FROM THE CHAIRMAN OF THE SHAREHOLDERS' COUNCIL

Dear farmers,

This Notice of Meeting provides important material to consider ahead of your vote on the resolution which supports the strengthening of our governance and representation processes and structures.

On behalf of the Fonterra Shareholders' Council I encourage you to give this information your very close consideration.

Your Council has rigorously considered and debated the proposal, as you expect of your Cornerstone Shareholder. In light of this and based on our Co-operative's ultimate function, which is to enhance the wealth of its Farmer Shareholders, we strongly endorse the proposal.

Our role within the Governance and Representation Review process also gives us confidence in this proposal. As part of the Governance and Representation Review Committee, Council's representatives have evaluated best practice, consulted with leading experts and most importantly considered your feedback, which contributed to the shape of the final proposal.

Throughout this process your consistent feedback has been that you wanted your Co-op to continue to move forward and that having high calibre candidates standing for your Board and Council was integral to this.

You expressed that the current politicised election system was detrimental to achieving the above stated aim.

Most importantly, you were very clear that having the final say on who governs your Co-operative was of the utmost importance.

Your Council's view is that this proposal addresses your concerns and, through a transparent process, ensures you are delivered quality candidates while maintaining your ultimate right of ownership and control via the requirement for a candidate to attain 50 per cent Farmer Shareholder support.

This meets the objective of having the highest quality candidates on the Board which should drive governance performance and ultimately wealth for us, as Farmer Shareholders.

In terms of our Co-op's representation function, you said you wanted a strong and effective Shareholders' Council. As such, a formal review of the Council will be undertaken and finalised by 30 September and we will provide you the findings and seek your support for any changes that may arise at the 2016 Annual Meeting.

However, it is pragmatic that a decision on our new governance system comes first.

It is important to note that in addition to Board, Council and Shareholder scrutiny the proposal has been given a thorough review by an expert independent panel. Council has considered their advice carefully in our own evaluations and we encourage you to read their views and do likewise.

We are the owners of Fonterra and as such it is of absolute importance that we exercise our rights of ownership and control. A 75 per cent majority is required for constitutional change and the mandate for this change, quite rightly, must come from you.

Finally, on behalf of the Council I thank all the farmers whose participation in the process made this a truly Co-operative exercise and ask that you make a decision that will ensure the strength of our Co-op both now and in the years ahead.

A handwritten signature in black ink, appearing to read 'D Coull'.

Duncan Coull

Chairman of the Shareholders' Council

AGENDA

Below is the proposed programme for the Meeting. Shareholders should note that the order may change at the discretion of the Chairman. Shareholders should allow sufficient time to register their attendance upon arrival prior to the start of the meeting.

10.00am - Registration / Morning Tea
10.30am - Welcome Welcome / Introduction – John Wilson, Chairman
10.45am - Meeting Proceedings Presentations: John Wilson, Chairman of the Board Duncan Coull, Chairman of the Shareholders' Council Resolution 1: Amendments to Constitution and Shareholders' Council By-laws - Governance and Representation Review
Voting Paper Collection
Announcement of Voting Results
General Business
12.30pm - Closing / Lunch (approximately)

PART ONE

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS OF FONTERRA CO-OPERATIVE GROUP LIMITED

Notice is given that a Special Meeting of the Shareholders of Fonterra Co-operative Group Limited ("Company") will be held on **10 June 2016 at 10.30am at Claudelands Event Centre, Corner of Brooklyn Road & Heaphy Terrace, Hamilton.**

Meeting Proceedings

Presentation: Joint Chairs of the Governance and Representation Review Committee

Resolution 1: Amendments to Constitution and Shareholders' Council By-laws - Governance and Representation Review

To consider and, if thought fit, to resolve:

"That:

- (a) the Constitution of the Company be amended as set out in the first column of the table included in Part Four of the Notice of Meeting; and*
- (b) the proposed amendments to the By-laws of the Shareholders' Council, as set out in the table included in Part Five of the Notice of Meeting, are approved."*

Please read the table of Constitutional amendments provided in Part Four of this booklet, the proposed amendments to the By-laws of the Shareholders' Council in Part Five of this booklet, and the Explanatory Notes below.

There is also a more detailed commentary on the proposed changes in Part Two of this booklet, and the Independent Expert Panel's Report is included in Part Three of this booklet.

The above resolution is a special resolution required by section 106(1)(a) of the Companies Act 1993. As the alterations to the constitution of the Company that are contemplated by the above resolution do not impose or remove a restriction on the activities of the Company, Shareholders will not have the benefit of the minority buy-out rights set out in section 110 of the Companies Act 1993.

The changes to the Constitution have been approved by NZX, as required under rule 5.2.4 of the FSM Rules applicable to the Fonterra Shareholders' Market. As some of the changes will alter Part A of Fonterra's constitution, the approval of a majority of 50 per cent or more of Shareholders' Councillors is required under clause 18.1 of the Constitution. This approval was received on 11 May. The Shareholders' Council has also (on 11 May) approved the changes to the By-laws of the Shareholders' Council, subject to Shareholders' approval.

The key governance documents referred to in this Notice of Meeting (ie, the Board Charter, Nominations Committee Charter, Terms of Reference for the Independent Selection Panel and the full text of the By-laws of the Shareholders' Council incorporating the changes set out in Part Five), as well as a marked up copy of Fonterra's Constitution showing the proposed amendments and the Terms of Reference for the five-year review of the changes (described on page 30 of this Notice of Meeting), are available to view online at www.nzfarmsource.co.nz.

EXPLANATORY NOTES

Resolution 1 has been prepared to be put to Shareholders by the Governance and Representation Review Committee ("**Committee**"), a joint committee comprising representatives of the Fonterra Board and the Shareholders' Council.

Background

The Committee was established to develop and consider potential changes to Fonterra's governance and representation structures and processes. The results of that consideration were published in a booklet dated 13 April 2016, detailing the Committee's proposals. Following the publication of that booklet, the Committee consulted with Shareholders in detail on the proposals through a series of shed meetings, as well as online consultation via its Facebook page and email address gov.rep@fonterra.com. That consultation has now been completed, and the proposals have been refined and finalised by the Committee. Shareholders are now being asked to vote to adopt the final proposals.

Effect of resolution

The recommendation involves amendments to Fonterra's constitution. This resolution has been proposed as a special resolution of Fonterra's Shareholders, to give effect to those amendments. If the resolution is passed by the requisite majority of greater than 75 per cent of votes cast by Shareholders entitled to vote on the resolution, Fonterra's constitution will be amended as set out in the table in Part Four of this booklet, and the By-laws of the Shareholders' Council will be amended as set out in the table in Part Five of this booklet.

It is important that you read the detailed commentary set out in Part Two of this booklet, the Independent Expert Panel's Report in Part Three and the specific proposed changes to the Company's Constitution in Part Four of this booklet and the Shareholders' Council By-laws in Part Five of this booklet. This will provide you with the detail that you need to enable you to vote on the special resolution set out above.

John Wilson
Chairman, on behalf of the Board
Notice of Meeting dated 16 May 2016.

PART TWO

SUMMARY OF THE FINAL GOVERNANCE & REPRESENTATION RECOMMENDATION

Since last year the Governance and Representation Committee, made up of members of the Board and Shareholders' Council, has been leading work to fine-tune the Co-op's governance and representation model in consultation with farmers.¹

The Committee has considered the findings of a 2013 review undertaken by a working group at the request of the Board. That working group spent more than a year benchmarking our Co-op's governance and representation against what was considered world-class at the time and made a series of recommendations to the Board.

Their good work provided a strong platform from which to begin consultation with our farmer owners on how best to fine-tune our systems and adapt our Director attributes and skill set to meet the future demands of our Co-op.

The final recommendation that follows includes, in both the Board and Council's view, the best combination of changes to our governance and representation structures and processes to achieve our goals. It is inclusive of the agreed outcomes that were developed from farmer feedback, including two rounds of consultation over the past six months. It reflects the application of best practice governance standards and guidelines, tailored to suit the needs of our 100 per cent farmer owned and controlled Co-op.

The Board and Council believe these recommendations will enable us to achieve the six agreed outcomes that our Co-op requires including that:

1. The primary role of the Co-op is to maximise the value of our milk and grow our wealth.
2. 100 per cent farmer control and ownership of our Co-op and living our Co-op principles is non-negotiable.
3. Ongoing positive engagement in our Co-op requires greater transparency, less politics and better communication.
4. There is strength in maintaining separate governance and representation roles and we want processes that give us the best chance of getting the best people for those jobs.
5. We want maximum flexibility to ensure that our Co-op can respond quickly to its environment in the future.
6. Ensuring our future is important. We need to refocus our efforts on farm-to-leadership succession and development processes.

Findings From the Independent Expert Panel Review

As part of the review process, the Committee established an Independent Expert Panel to report on the effectiveness of the recommended model. The Panel is made up of local and international experts in the governance and representation fields, including: Chris Moller and Dame Therese Walsh (NZ), Dr Adrie Zwanenberg (Netherlands) and Dr Michael Cook (US).

The Independent Expert Panel has unanimously supported the vast majority of the recommendations. The Panel is of the opinion that the single most effective way to improve Fonterra's governance and representation (and, consequently, performance) is to attract and elect the highest quality and calibre of talent. To this end, the Panel strongly endorses the recommendations which relate to the manner in which Board members are identified, selected and appointed. In particular, the Panel endorsed the introduction of a single election process that applies equally to all Directors and the fact that the design ensures candidate confidentiality – which the Panel sees as imperative – and the elimination of the current appointment process.

In their report, the Panel notes that the recommendations form a total package and have been designed with careful consideration to function as a whole. Therefore, aspects of the recommendations should not be isolated from others, as the removal of one key element can detrimentally affect how other constituent elements of the recommendations function. The Panel unanimously supports the recommendations (in their entirety) and recommends that the recommendations (in their entirety) be adopted by farmers.

The Independent Expert Panel's full report is included on pages 22-24 of this Notice of Meeting.

¹ Whenever we use the term "farmers" in this Part, we mean Fonterra's farmer shareholders.

What is New in the Final Recommendation?

The Board and Council have made a number of changes to the draft proposal (the second Governance and Representation booklet) that was presented to farmers in April. The following changes have been made in response to feedback from farmers and the findings of the Independent Expert Panel:

Feedback	Recommended Change
Board Composition	
<ul style="list-style-type: none"> Farmers have expressed a concern that the proposed Board composition (of six Farmer Directors, three Independent Directors and two 'hybrid' Directors with no eligibility requirements) impacts Farmer control and, a corresponding desire to maintain a strong majority of Farmer Directors on the Board. Farmers have also expressed concern about how the 'hybrid' seats would be filled and some wanted greater certainty on the make-up of their Board. 	<ul style="list-style-type: none"> The Board and Council have weighed feedback from farmers and the implications of removing the 'hybrid' seats. On balance, Board and Council have decided to recommend that the Board be made up of seven Farmer Directors and four Independent Directors. It is fundamental to our Co-op that farmer ownership and control is not compromised. The Board and Council are aware that there was support for the flexibility that the 'hybrid' seat offered. The composition of the Board (including size and make-up) will be reconsidered when the operation of the recommendations is formally reviewed in 2021 (see below).
<ul style="list-style-type: none"> Feedback has underlined the importance of maintaining a strong connection between the farm and the Boardroom. There have been a lot of questions about the 'on-farm knowledge' skill and how it would be applied to the Board. 	<ul style="list-style-type: none"> The Board and Council have provided further clarification of the 'on-farm knowledge' skill and how it would be applied to the Board on page 10.
Director Selection Process	
<ul style="list-style-type: none"> Farmer feedback and the Independent Expert Panel have emphasised the critical role that the Shareholders' Council, as the elected representatives of farmers, plays in the assessment and selection process for Directors. 	<ul style="list-style-type: none"> The Board and Council believe that it is appropriate to further strengthen the voice of the farmer in the selection process. A second Shareholders' Council observer has been added to the Nominations Committee. There will be an equal number of Independent Directors and Farmer Directors on this Committee and a 75 per cent majority will be required for decision making.
<ul style="list-style-type: none"> The change in the nature of the farmer vote – from choosing between candidates to choosing whether to support a candidate nominated by the recommended process – has generated debate. This change is creating uncertainty for some farmers. Many farmers feel that to be sure they are making the right decision it is important to meet the nominated candidates prior to deciding whether to support them. 	<ul style="list-style-type: none"> The Board and the Council have considered farmer feedback. They have weighed the desire for choice between Director candidates against the implications of sacrificing confidentiality in the selection process and our primary goal of getting the best people onto our Board. The Board and Council agree with the Independent Expert Panel that maintaining the confidentiality of candidates is key to realising the benefits of the recommendation as a whole. The Board and Council have opted to retain this feature of the selection process. It is a significant change. A formal review of the impact of the change is appropriate. Details of this are set out below. In our Co-op it is entirely appropriate that nominated Director candidates meet farmers and answer their questions before farmers are asked to vote on their appointment to the Board. To provide farmers with an opportunity to meet the candidates prior to voting, a series of farmer meetings (hosted by the Chairman of the Shareholders' Council) has been added to the recommendation.

Shareholders' Council Review	
<ul style="list-style-type: none"> Farmers have requested clarity about the content of the Shareholders' Council review and have questioned whether the timing is appropriate. 	<ul style="list-style-type: none"> The formal review of the Shareholders' Council has been brought forward. The review findings will be shared with farmers at the 2016 Annual Meeting. The scope of the review has been strengthened and the terms of reference for the review are available for farmers to view on www.nzfarmsource.co.nz
Review of Recommendation	
<ul style="list-style-type: none"> The Board and Council acknowledge that the recommendation asks farmers to change an established practice within our Co-op (and the Co-ops that preceded it) in terms of choosing between Director candidates in elections. 	<ul style="list-style-type: none"> Board and Council are certain that the recommended changes will achieve the outcomes sought by farmers but agree that it is prudent to review the operation of the recommendations to ensure that there are no unintended impacts on our Co-op. If this recommendation is approved by farmers, the Board and the Council will undertake a formal review of the changes no later than the 2021 Annual Meeting, or earlier if the changes are having a material negative impact on the Co-op. The review will include the composition of the Board (including size and make-up). The Shareholders' Council is responsible for ensuring that the review is undertaken within the timeframe and in the manner described at page 21 of this document. The terms of reference for this review are available for farmers to view on www.nzfarmsource.co.nz

These changes are explained in more detail within the relevant sections of the recommendations that follow.

KEY FEATURES OF GOVERNANCE RECOMMENDATION

Summary of the recommendations:

- **SIZE:** Reduce size of Board from 13 to 11 Directors
- **ELIGIBILITY:** Change to the wording of the eligibility rules for Farmer Directors, principally to allow for modern farm ownership structures (including increased use of Limited Partnerships)
- **BALANCE:** Majority (seven) Farmer Directors. Chairman to be a Farmer Director
- **PROCESS:** One selection process for all Directors that is focused on increased transparency and independence.

Size of the Board

The Board and Council's recommendation is that the maximum size of Fonterra's Board be reduced to 11 Directors.

In developing this recommendation, we reviewed best practice guidance and relevant research, and thought hard about our diverse skills requirements and the unique Director workload that comes with Fonterra's status as a regulated, multi-national Co-op based in New Zealand.

Our research established that there is no "right" number for a Board. When theory about the effectiveness of human decision making (which favours small groups) is applied to governance, it is just one factor. The requirements of the company are just as important in determining the right size of the Board.

We are a Co-operative and fronting up to farmers as owners and being accountable for the performance of the Co-op will always be a very important part of our Board's responsibilities. Our unique regulatory requirements require a specific Board Committee work programme. As New Zealand's largest multi-national company, stakeholder relations will also continue to be a factor in Directors' workloads.

Good people usually have diverse interests and are in high demand. If the workload of our Directors is too high, we won't attract the kind of people we want and need on our Board. In addition, our Co-op benefits from having Directors who are exposed to ideas and experience from other organisations.

Further, a Board of 11 for a company like Fonterra is not unusual. Companies operating in Australasia that mirror Fonterra's scale and diversity have Boards of between 11 and 13. Our Independent Expert Panel have referenced co-operatives overseas that have much larger Boards.

Overall, we think that a reduction of two Directors strikes the right balance between our continuing drive for diversity, the ability for the Board to responsibly manage its workload, and efficiency.

Eligibility criteria

Eligibility criteria for Directors are a key tool for reinforcing farmers' ownership and control interest in the Co-op, but they also act as a barrier to participation in Fonterra's governance, which limits access to the skills we need.

The current eligibility criteria for Farmer Directors need to be updated to accommodate the increasingly complex ownership structures being used by our farmers.

The Board and Council are recommending a change to the constitutional definition for aspiring Farmer Directors to reflect modern ownership structures including limited partnerships.

The new wording is outlined in Clause 12.3 of Fonterra's Constitution and highlighted later in this Notice of Meeting.

It is important to remember that the wording change just defines who can put themselves forward for consideration as a Director. They have still got to get through the more independent selection process – including Shareholders' Council consultation – and they have to be supported by more than 50 per cent of Shareholder votes cast.

Keeping the connection between the boardroom and the farm

The Board and Council believe that it is important that farming knowledge remains at our boardroom table. Therefore, we are recommending that an 'on-farm knowledge and experience' skill is included in the Board skills matrix.

It is difficult to define the skill using a fixed metric such as number of years farming, and we want to keep the pool of talent we can choose from as open as possible, so we are recommending the following description for the on-farm knowledge skill requirement:

Has on-farm dairy knowledge, having run or owned a dairy operation as a member of our dairy Co-operative.

Prior to every election, the Board will be responsible for determining the required and desired level of this skill on the Board (i.e. how many Directors are required to demonstrate this skill) and whether or not the sitting Directors have the appropriate level of this skill.

The Shareholders' Council will have the right to object to a candidate where it believes this skill requirement is not met by the Board, collectively. Ultimately, farmers will have the final say.

Getting the right balance on our Board

We need to balance our need for diversity to give ourselves the best chance of getting the right skills to match our strategy as it evolves over time.

The Board and Council are not recommending any changes to the existing Fonterra Shareholders' Market Rules. Under the Fonterra Shareholders' Market Rules, if there are more than eight Directors on Fonterra's Board, at least three of them (or one-third rounded down) must meet the definition of Independent Director.

We are recommending changes to our constitutional requirements.

Currently, under the Constitution, there can be a maximum of nine Farmer Directors and a maximum of four Board-appointed Directors. Going forward, the maximum number of Farmer Directors will be set at seven, and the maximum number of Independent Directors at four.

Currently the Board Charter requires that all Directors elect the Chairman of the Board and that the Chairman must be a Farmer Director. This will not change.

It's important to remember that there are a number of other requirements for Directors that support the requirements discussed above. These won't change. For example, the Fonterra Shareholders' Market Rules also prescribe the minimum number of Directors we need to have and how many of them need to live in New Zealand.

We are a farmer Co-op, so a Farmer Director majority is important. The recommendation ensures that a Farmer Director majority is maintained at all times.

A modern Board that adheres to our Co-op's traditional principles

The Board and Council believe that the recommended composition of the Board strikes a better balance between where we've come from and where we want to get to. It:

- Is more inclusive of our diverse farmer base – anyone who satisfies the Farmer Director eligibility criteria can put themselves forward as a Director
- Respects 100 per cent farmer ownership and control by requiring a majority of the Board and the Chairman to be Farmer Directors
- Introduces an on-farm knowledge skill requirement
- Better ensures we get the best Directors with the right attributes and the required diversity of skills and experience by widening the pool of potential candidates who qualify to be Directors and maintaining the current number of Independent Directors.

WHAT OUR BOARD COULD LOOK LIKE

KEY

FD = Farmer Director: Meets updated Farmer Director definition under clause 12.3 of the Constitution

ID = Independent Director: Meets definition of Independent Director under the Fonterra Shareholders' Market Rules

Note: Chairman must be a Farmer Director in accordance with Board Charter

BEFORE



AFTER



Attributes all of our Directors should have

Our Co-op's Directors need to show they believe in and value the Co-op and that they have the ability to deliver governance at a level expected for a global dairy business.

The Board and Council have defined a set of attributes that we expect every Board member to demonstrate. They are what make them fit to govern our Co-op. Every Director must be able to demonstrate the attributes to be able to qualify for the Independent Selection Panel's shortlist.

Attributes:

- Understanding of and commitment to the highest standards of governance
- Understanding of and empathy with the Co-op
- Ability and knowledge to comprehend the wider commercial and economic framework in which Fonterra operates
- External governance experience
- Proven track record of creating value for shareholders
- Global perspective
- Time available to undertake a Director's responsibilities
- Sound judgement
- Ability to apply strategic thought to important issues
- Ability to question, challenge and critique
- Unquestioned honesty and integrity.

Skills that our Board should collectively possess

The Co-op has a skills list today that is used when we select and appoint our Independent Directors. It's regularly updated and published in Farm Source magazine to show our farmers what skills we are looking for on the Board.

The Board will continue to update and refresh the skills list regularly in line with the Co-op's strategic direction and priorities. In addition, the Board and Council recommend that the Board is mapped against the skills list to identify any skill gaps. This will provide useful information for farmer shareholders seeking to make informed decisions as to whether or not to vote for a Director candidate.

A NEW DIRECTOR APPOINTMENT PROCESS

Good governance requires a great team and that starts with the selection process. This section sets out the Board and Council's recommended changes to the appointment process for our Directors.

Summary of the recommendations:

- Removal of the current Single Transferable Vote (STV) election process for Farmer Directors and the current Board appointment process for Independent Directors
- A new Director selection process – one process for both Farmer and Independent Directors – with significant improvements to the current systems:
 - Designed to attract and select the most capable candidates and to ensure farmers continue to have the final say on who sits on their Board
 - A more transparent process with an emphasis on independence to provide farmers with quality information to make their decision
 - To be successful under the proposed new system, candidates will require the support of more than 50 per cent of Shareholder votes cast
 - Two Shareholders' Council observers on the Board Nominations Committee
 - An Independent Selection Panel
 - Shareholders' Council consulted on all Board candidates
 - Series of farmer meetings (hosted by the Chairman of the Shareholders' Council) with nominated candidates during election process.

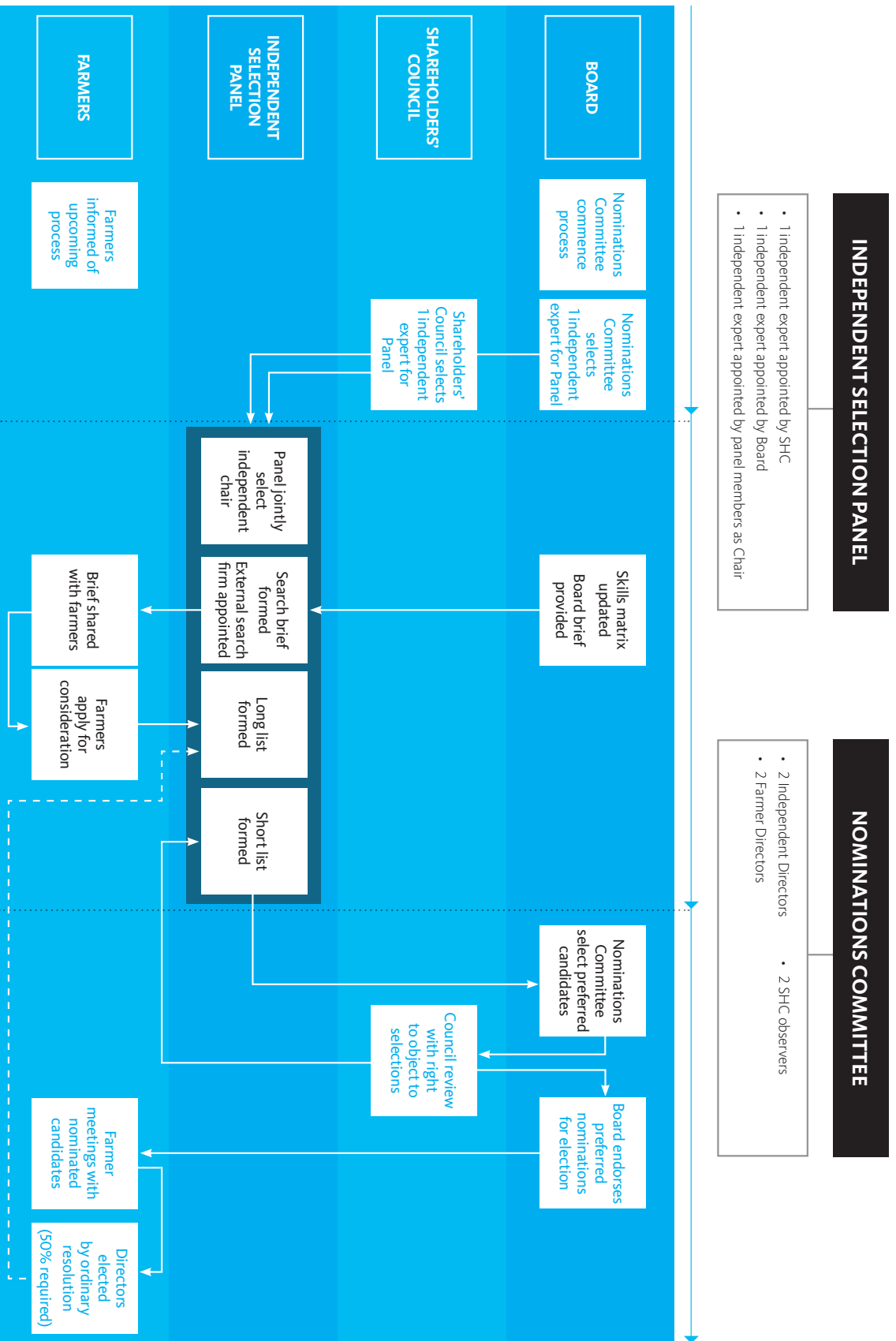
Details of the recommended appointment process

The recommendation is for all of our Directors to be subject to the same selection process. After all, once they are on the team we expect them to be able to do the same quality job.

We've added a series of checks and balances to the process to ensure that:

- Everyone who meets the Farmer Director eligibility criteria can put themselves forward
- The assessment and selection process is independent
- There is oversight and input from the Shareholders' Council – farmers' elected representatives. This gives farmers a voice in the selection process, prior to the vote
- Farmers retain the final say and that they get the information they need to support that decision
- Applications are confidential, drawing out more of the high quality candidates we know are within the farmer base
- It removes electioneering, drives a positive conversation about governance capabilities that we are looking for rather than representation issues and avoids the distraction created by the current election process which, too often, is played out in the media and picked up by our customers.
- It consistently delivers the best Directors with the required attributes and right skills to govern our Co-op.

The recommended process has some big advantages over what the Co-op is doing now.



Section 1: Commencing the appointment process is an important exercise in farmer control. Your elected Board and Shareholders' Council both have an equal voice in appointing the Independent Selection Panel. All farmers are also notified at this stage – anyone considering standing should prepare to put themselves forward.

Section 2: The selection process will be led by our Independent Selection Panel. The body of three experienced business practitioners will ensure the rigour and independence of the process. The Panel will communicate the search brief with farmers so that those who feel they have the attributes and skills required can put themselves forward. Forming the short list will involve extensive due diligence and interviewing.

Section 3: The Board Nominations Committee will select its preferred candidates based on the Panel's short list. The Board must consult with the Shareholders' Council which will be supported in its decision by the Shareholders' Council observers that sit on the Nominations Committee. This is an important step as the Council can exercise its right not to support candidates. But ultimately, it comes down to a farmer vote at a Shareholder Meeting – where the support of more than 50 per cent of votes cast are required for any candidate to be elected. During the election period, farmers will have the opportunity to meet the nominated candidates at a series of meetings hosted by the Shareholders' Council Chairman.

Combined with the plans to make the skills matrix transparent and to upgrade our development pathways and succession planning, this recommendation:

- Better reflects international best practice, but still incorporates our unique Co-op requirements
- Delivers better information to help farmers make their decision by giving farmers better access to independent opinion and ensures a clearer, professional focus on attributes and skills in the assessment and selection phase
- Means farmers don't have to consider candidates who don't meet the grade
- Provides improved transparency throughout the process – two Council representatives will observe the process of nominating Directors
- Better ensures we get the best Directors with the right skills by delivering a confidential, independent process for assessment and selection that will mean more farmers will be prepared to put themselves forward
- Still allows farmers to meet the nominated candidates during the election period before making their decision.

What happens if farmers say 'no' to a candidate?

The recommended selection and nomination process gives farmers a choice. Farmers can vote 'no' to a preferred candidate without compromising the Co-op.

The Board will immediately start the selection and nomination process again.

The Independent Selection Panel will return to the long list stage of the process. There will be a call for applications but on a shorter timeframe, reflecting that the process will have been run recently.

Once a new candidate is nominated, farmers will be asked to vote again.

The Board must always be able to meet the requirements of the Fonterra Shareholders' Market Rules and the Constitution. The Board will be able to use its existing power to make a casual appointment in the interim. It will not appoint the person rejected by farmers at the most recent election.

The person appointed on a temporary basis may put their hat in the ring to be considered for the permanent appointment. If they don't or they are not elected by farmers they will only sit until a new Director is voted in by farmers.

In most cases it is likely that the new candidate will come from the long list so the process will be shorter than the initial election process.

Length of term and rotation of Directors

The current rotation rule for Farmer Directors will be applied with changes necessary to ensure that farmers get the opportunity to decide whether to re-elect each Director every three years.

The Board will be invited to endorse any sitting Director to the Panel. If that sitting Director is nominated by the Board

for re-election, that endorsement would be communicated to farmers prior to voting.

The application of any sitting Director would be considered on its merits alongside all other applications. The need for continuity and experience on our Board would be weighed by the Independent Selection Panel in its recommendation.

If a sitting Director was not nominated for re-election after the Independent Selection Panel's assessment, his or her Directorship would continue until a replacement was elected at the upcoming Annual Meeting.

The Chairman would hold his or her office until the Directors elect a new Chairman. So, where a Director who is also the Chairman is re-elected, his or her Chairmanship would continue provided they had Board support.

Maximum term

Our existing Board Charter deals with maximum terms for Directors and this will not change.

The charter currently states that after nine years, a Director should consult with the Chairman and fellow Directors before seeking re-election for a further term.

It also states that after 12 years, a Director must seek formal guidance from the Board before reapplying for election and if he or she does so then that fact is explained to farmers, together with reasons for the extension, prior to the farmer vote.

The Chairman would be exempt from the 12 year limit, as Board support is continually required for the Chairman to stay in that role. This principle is important for the continuity of leadership of our Co-op, as historically, Directors have not been appointed as Chairman until after their second term.

STRENGTHENING FARMER CONTROL

One of the non-negotiable outcomes for the Board and Council was maintaining 100 per cent farmer ownership and control of our Co-op. Ownership is not affected by the recommendation. The way farmer shareholders vote changes, but farmer shareholders still have the final say.

As you can see from the Farmer Control diagram on the following page, farmers exert control of their Co-op predominantly through the Shareholders' Council which has a number of powers protected by the Constitution.

The recommended Director selection process includes a move away from a choice between candidates to a decision whether to support a candidate nominated by the assessment and selection process. If we maintain the status quo and have an election off the shortlist, we trade-off two key aspects of the design of the recommended process:

- Confidentiality for applicants
- We will still be subjected to the significant downside of electioneering.

The Board and Council are asking farmers to make this trade-off in order to attract the best possible Director candidates – an outcome all farmers want.

The diagram below helps to illustrate how your control toolkit changes under the new recommendation.

FARMER CONTROL

Current and Future Recommendations

NOW

HOW YOU EXERCISE CONTROL NOW

YOU

- Elect Councillor on SHC to represent your interests
- Elect Farmer Directors under STV system
Ratify Independent Director appointments (50% approval required)
- Have the power to propose, vote on and pass a non-binding resolution relating to the management of the Co-op
- Can call a special meeting of Shareholders (together with members who have 5% of voting rights)
- Can remove Director(s) at any time (50% farmer support required by way of ordinary resolution)
- Control the Constitution including the rules about who can sit on the Board (75% farmer support required to change).

SHAREHOLDERS' COUNCIL

- Board required to consult SHC on special projects
- Can request a special report on any matter of concern (to get information to decide whether to take action)
- Can request Special Meeting of farmers at any time (at which a vote to change our constitution / remove a Director can be held)
- Provides transparency about the Co-op's performance against agreed targets
- Appoints the Milk Commissioner
- Sits as observer on specified Board Committees.

BOARD

- Majority (9:4) required to meet requirements for Farmer Director.



RECOMMENDED

HOW YOU EXERCISE CONTROL UNDER THE RECOMMENDATION

YOU

Same as current system except:

- Farmer Directors and Independent Directors elected by farmers using a single process
- 50% farmer support now required by way of ordinary resolution for all Directors – not just Independent Directors
- Farmers can still remove Directors at any time (50% farmer support required by way of ordinary resolution).

SHAREHOLDERS' COUNCIL

Same as current system, plus

- Two Shareholders' Councillors sit as observers on the Board's Nominations Committee – this provides increased transparency of the selection and assessment process
- SHC is consulted by the Nominations Committee on its recommended candidates
- SHC provides reasons to farmers where it does not support the recommendation of the Nominations Committee (e.g. don't agree that skills matrix is fulfilled/Director has the required attributes/Committee has ignored Independent Selection Panel's recommendation).

BOARD

- Majority (7:4) required to meet Farmer Director definition under Clause 12.3 of the Constitution
- As is the case now, most Board resolutions will be decided by majority vote*. The Farmer Director majority will therefore have the ability to control decision making. But all Directors will remain subject to the requirement that they must act in the best interests of the Co-op.

* The only exceptions are those that currently exist – on some matters a higher majority (75%) is required, and the majority is required to include a majority of Independent Directors.

KEY FEATURES OF THE REPRESENTATION RECOMMENDATION

Summary of the recommendations:

- The structure of the Council was strongly supported in the first round of meetings, but we have committed to reviewing its structure and composition and reporting these findings back to farmers at the 2016 Annual Meeting
- Clarification of the Council's role within the Co-op
- Introduction of a maximum term for Councillors of two three-year terms – except when asked to stay on by the Council members for one final three-year term for reasons of continuity
- An extra Councillor within the Wards of the sitting Shareholders' Council Chairman and Deputy Chairman to assist with their workload
- Improved reporting on the performance of Council
- Details of the performance assessment process for individual Councillors will be communicated to farmers
- Formal introduction of an agreed set of attributes and capabilities, to help farmers assess Councillor candidates during elections.

Role of the Shareholders' Council

It is clear that better access to information and more transparency around our existing processes would improve farmers' understanding of and relationship with the Council.

Today, Council has considerable powers and influence but its role and powers need further clarification.

Perceptions about Council not challenging the Board enough generally came from a lack of information about the existing powers of Council and the processes between Council, Board and Management.

The Board and Council believe that the Council has adequate tools to fulfil its representation role, but that role is confused by the lack of clear role definition in the Constitution. Instead the Constitution contains a list of functions.

The Board and Council's recommendation is to include a clear definition of Council's role in the Constitution as:

The role of the Shareholders' Council is to represent the collective interest of Shareholders.

The Shareholders' Council already communicates with farmers in offshore milk pools, for example Bonlac Supply Company in Australia. We propose to formalise the Shareholders' Council's ability to do this by amending the Constitution to include the following functions:

Consulting with suppliers who supply Milk to the Company or its subsidiaries, whether in New Zealand or elsewhere, in relation to matters of mutual interest, and, where appropriate, representing the views of those suppliers and communicating them to the Board.

Structure and composition of the Shareholders' Council

The recommended governance changes will have a flow-on effect on the role the Council plays and the structure it needs to carry out those roles. Oversight of the proposed Board election process is an example.

The Board and Council are recommending a formal review of the structure of the Shareholders' Council be undertaken with the results being shared with farmers at the 2016 Annual Meeting.

Farmers can read the Terms of Reference for this review on www.nzfarmsource.co.nz.

The Council has recognised that the Chair and Deputy Chair have difficulty in fulfilling their Ward duties and propose that an additional Councillor be selected in the Chair and Deputy Chair's Wards. They would be a Full Councillor but be non-voting on Council decisions to avoid giving undue influence to any given Ward. The current wording of the Co-op's Constitution provides the flexibility needed to enable this change.

The Board and Council recommend that the eligibility criteria for Farmer Directors also be applied to Councillors so that we have one eligibility criteria across the Co-op.

Attributes and Capabilities of our Councillors

To strengthen the Shareholder's Council the Board and Council believe we need to do more to lift the skills and capabilities of the individual Councillors and increase their accountability for performance. The Board and Council also recognise the need for Council's members to have a level of age, gender and background diversity that is reflective of our Co-op's farmer base.

We recommend that the attributes and capabilities our Councillors require be defined and formally included in the Council's systems – including its succession and development planning, appointment process and performance reviews.

It is important that we avoid defining the attributes in a way that puts people off standing for election because they don't think that there is room to grow. But equally, we shouldn't apologise for drawing a line in the sand about the minimum standards we expect in our Councillors. This is a critical part of improving the effectiveness of Council.

The Board and Council also recommend that Council publish details of the formal performance assessment process that each Councillor goes through annually. Individual results will not be made public, but Council will provide farmers with reports on its overall performance.

Attributes and capabilities that Councillors need to have or be working towards

- In-depth farming knowledge and experience, and knowledge of the dairy industry
- Business acumen - financial literacy and ability to think strategically
- Awareness of the regulatory frameworks in which the Co-op operates and an understanding of the key drivers of wealth: Milk Price and profit
- Courage to question / challenge the status quo
- Communication skills (including presentation / public speaking capability)
- Interpersonal skills (approachable nature, empathy with fellow farmers)
- Passion for the Co-operative and understanding of the Co-op ethos that underpins it
- Honesty and integrity.

Rotation of Councillors and length of term

We recommend the introduction of a maximum term of two three-year terms for Councillors after which a Councillor must retire unless he or she is asked by the Council, for continuity or experience reasons, to extend the term by another three years.

At the conclusion of a maximum three terms, that person must retire.

The maximum term for Councillors will ensure that the Council is refreshing itself on a regular basis and that there are opportunities for new talent to come through from the farmer base.

The Shareholders' Council will create and publish an attributes and capabilities list for the Council and provide farmers with information about the current gaps on the Council prior to their vote so that they can better assess who to vote for in their ward.

The Council's endorsement will be required for all sitting Councillors who wish to stand for re-election.

KEY FEATURES OF THE OPERATING MODEL RECOMMENDATION

The recommendations so far have shown how we can improve our governance and representation and fine-tune the role, structure and composition of the Board and the Shareholders' Council.

But the job is only half done if we don't provide the best environment for them to work together and provide clear rules of engagement based on what we want the relationship to achieve.

Summary of the recommendations:

- Refinement and publication of the interface document that explains the working relationship between the Board and Council
- Clearer communication pathways between the Board, Council and farmers
- Creation of formal, sometimes separate development pathways for growing future governors and representatives.

We are confident that improvements in these three areas will help to increase farmer engagement, clarify what can be expected from the working relationships between Board and Council and result in clearer communication. This is so that farmers get the information they want and feel they are being heard, and create development pathways that identify and attract a pipeline of farmers to take on future leadership roles within our Co-op.

Currently the Board, Management and Council follow the guidelines in a working interface document that sets out the formal interactions and the way information is shared between the groups.

The Board and Council recommend that this document is published so farmers have open access to it. This will enhance the understanding of each party's roles. As owners, it will put farmers in a better position to be able to judge whether the Board and Council are functioning as they should. It makes the Board and our Shareholders' Council more accountable and builds trust among farmers.

Improved communications within the Co-op

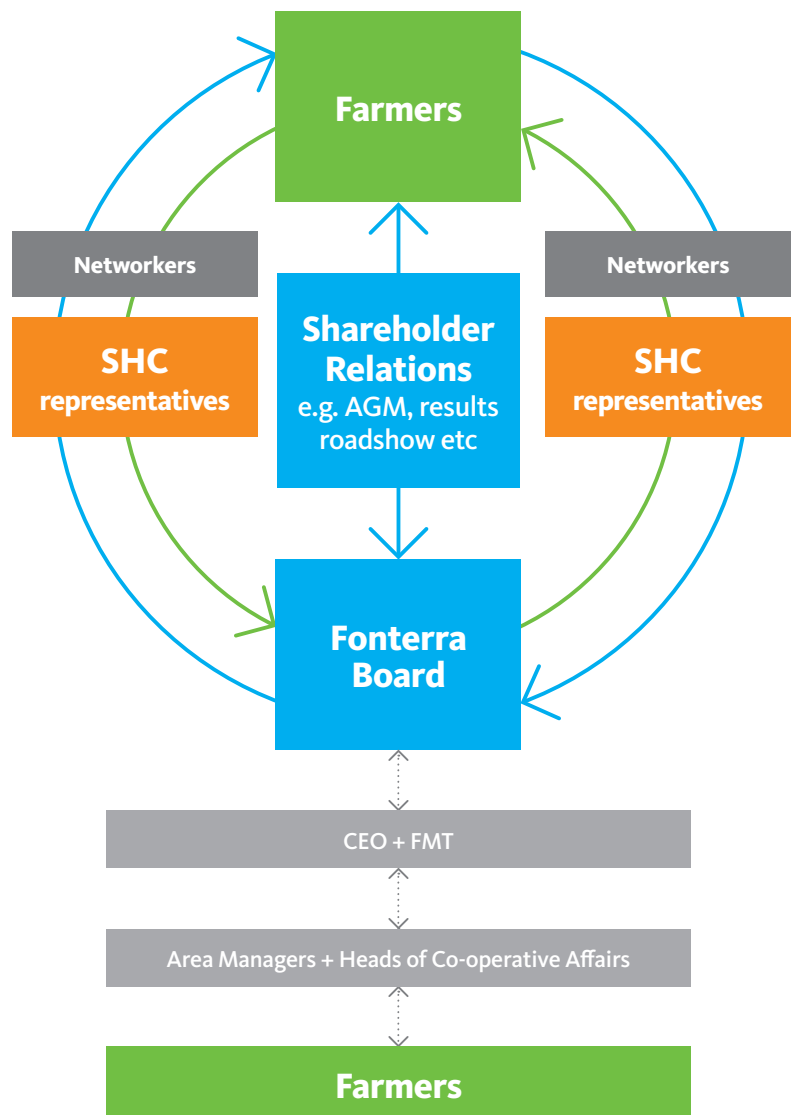
Our Co-op hasn't always got communications to our farmers right. The same can be said for the way we share information within our governance and representation structure. During the review the Committee identified ways of clarifying the channels of communication, so that clear, timely information is shared within all parts of our structure.

For example, improved use of Facebook, webinars, video and online surveys to quickly assess farmer sentiment.

The model below shows how communication will flow within the new operating model.

WORKING RELATIONSHIP BETWEEN YOUR BOARD AND COUNCIL

Communication Pathways



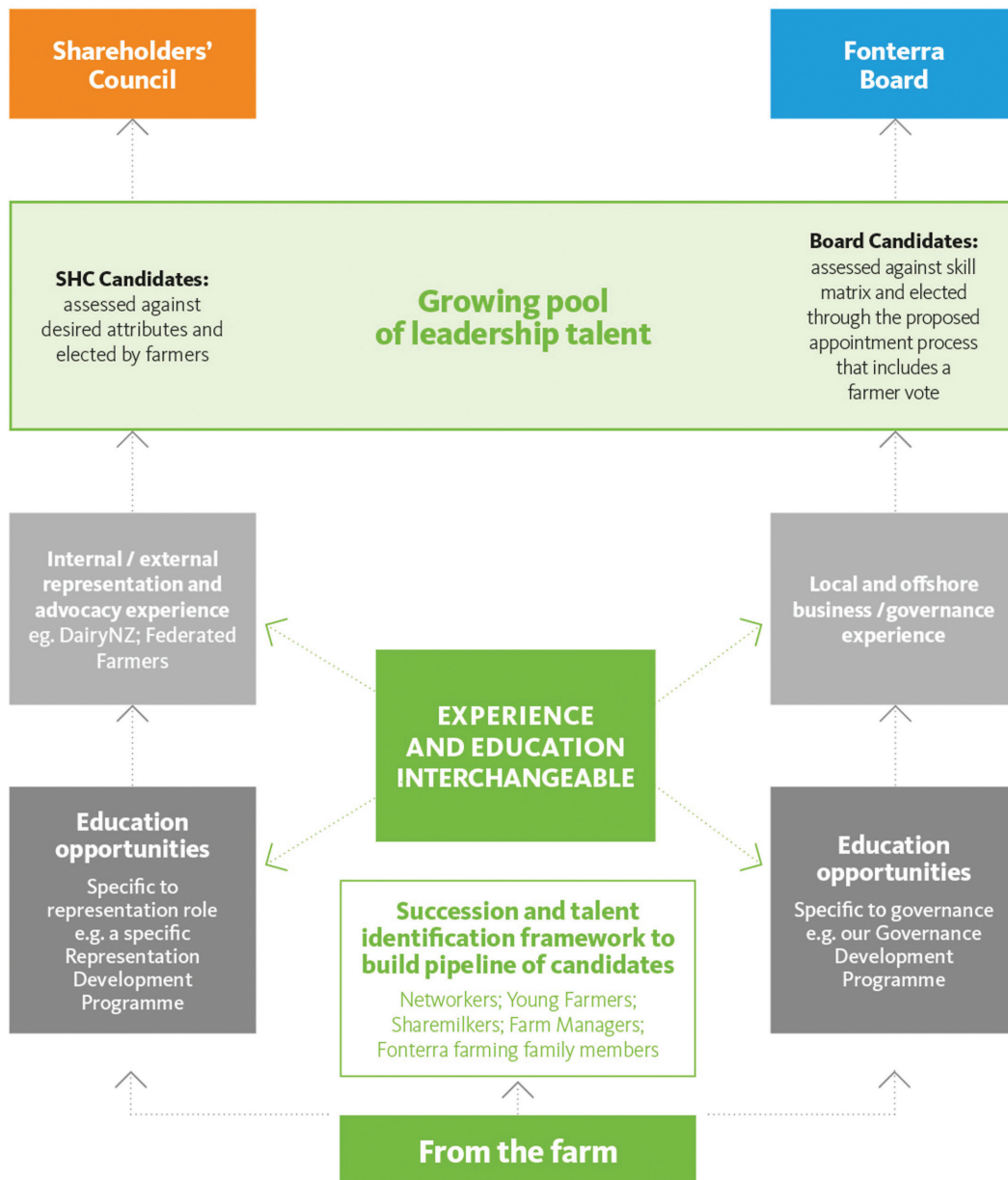
CREATING A PIPELINE OF FUTURE LEADERS

A development pathway that identifies and attracts a pipeline of young farmers who can come through the ranks and take on the baton of leadership was a key outcome for this review.

The diagram below shows our intention to create two separate development pathways for future governors and representatives. We are also exploring the re-establishment of a representation development programme, to mirror our successful Governance Development Programme.

This also highlights two key points. First, that the Council and Board are at equal levels. Second, that Council is not a stepping stone to the Board, rather a pathway that requires its own skill set.

GROWING LEADERSHIP Improving Our Development Pathway



IMPLEMENTATION

The key considerations of the Board and the Council in designing the implementation plan for the new governance structure were:

- Good governance – particularly the need to ensure continuity of knowledge and skills
- The need for the transition arrangement to set up a balanced rotation for the long term. For example, to avoid one type of Director all retiring in one year.

If farmers support the recommendation, the new Director assessment and selection process will apply for the 2016 Director elections. As current Directors come up for retirement, re-election will be under the recommended process, ensuring that farmers will determine the Board over the transition period.

The Board size will be reduced over the next two Annual Meetings – within 18 months.

The transition plan is as follows:

Current	Transition Changes	FD	FD	FD	FD	FD	FD	FD	FD	FD	FD	ID	ID	ID	ID
2016	At the 2016 Annual Meeting the number of Farmer Director (FD) seats will be reduced by one. Two Independent Director (ID) seats and two FD seats are required to be vacated and filled at the Annual Meeting.	FD	FD	FD	FD	FD	FD	FD	FD	FD	X	ID	ID	ID	ID
2017	At the 2017 Annual Meeting the number of FD seats will be reduced by one again to bring the total number on the Board to eleven. One ID and two FD seats are required to be vacated and filled at the 2017 Annual Meeting.	FD	FD	FD	FD	FD	FD	FD	X	X	ID	ID	ID	ID	ID
2018	From 2018 onwards the new rotation rules apply. There may be casual vacancies and the impact of this will need to be managed over time.	FD	FD	FD	FD	FD	FD	FD	X	X	ID	ID	ID	ID	ID

If the recommendation is supported by farmers, all other changes will be effective immediately after the Special Meeting.

FORMAL REVIEW

The Board and Council believe these recommendations will improve our governance and representation structures and processes to consistently deliver the outcomes farmers want.

We received significant support for the proposals during the consultation period. Farmers also asked us to consider a formal review of any changes to ensure that the new process is operating as intended and that the agreed outcomes are being met.

If the recommendation receives the required support of more than 75 per cent of Shareholder votes cast, the Board and the Council will commit to a formal review of the changes, to be completed no later than the 2021 Annual Meeting.

The scope of the review would be to assess:

- Whether there are any unintended consequences from the operation of the recommendation
- The agreed outcomes defined by the Governance & Representation Review are being met, including:
 - The level of farmer engagement - as measured by participation in the new Director selection process
 - Analysis of the quality, number and type of candidates that are putting themselves forward for the Board and Shareholders' Council.
- Whether further improvements to the Board's size and composition would provide further flexibility.

The Board or Shareholders' Council can decide to bring the review forward if they believe there is reasonable evidence that the recommendation is having a material unintended negative impact on the operation of the Co-op.

The review would be undertaken by a Committee of the Board and the Shareholders' Council, with input from independent experts as required.

The Shareholders' Council is responsible for ensuring that the review is undertaken within the time frame and in the manner specified above.

The Terms of Reference for this review are available for farmers to view on www.farmsource.co.nz.

Any constitutional changes that are suggested as a result of the review would require the support of more than 75 per cent of Shareholder votes cast – the same majority required to bring them into effect.

PART THREE

INDEPENDENT EXPERT PANEL REPORT ON THE FINAL RECOMMENDATIONS OF THE BOARD AND SHAREHOLDERS' COUNCIL

1. INTRODUCTION

1.1 **Introduction:** The Governance and Representation Review Committee ("the Committee") has appointed a panel of experts, known as the Governance and Representation Review - Independent Expert Panel ("the Panel"), to undertake an objective and independent review of the final Governance and Representation recommendations from the Board and the Shareholders' Council to be considered by Fonterra's Shareholders ("the Recommendations").

1.2 **Panel Members:** The Panel is comprised of the following individuals:

- Chris Moller (Chair);
- Dame Therese Walsh;
- Dr Michael Cook; and
- Dr Adrie Zwanenberg.

The credentials of the Panel Members are appended to this report. They cover a deep knowledge of the governance and representation of co-operatives in New Zealand, the United States of America and Europe, as well as publicly listed investor owned companies in those jurisdictions.

2. TERMS OF REFERENCE AND PROCESS

2.1 **Terms of reference:** The Panel has been engaged by the Committee to undertake an objective review of the Recommendations in order to report to the Shareholders on the results of the Panel's review.

2.2 **Benchmarking:** The Panel has been requested by the Committee to review the Recommendations against global governance best practice taking into account the co-operative ethos and nuances of Fonterra's uniqueness in New Zealand, including the regulatory framework it is required to operate under and the fact that some of its activities are listed on the NZX and ASX. To deliver on this brief, the Panel has been asked to consider the fine-tuning of the role, structure and composition of the Board and Shareholders' Council as recommended by the Committee. As such the Panel did not have a mandate to undertake a review from first principles or a blank sheet of paper; instead it was requested to consider where Fonterra is today and its evolution into the future.

2.3 **Process:** The Panel has sought to develop a comprehensive understanding of the Recommendations and Fonterra's rationale for seeking to implement the Recommendations. In doing so, the Panel has:

- (a) reviewed the Governance and Representation Review - Draft Proposal Booklet 2 ("the Booklet"), the revised Final Proposal, the Notice of Special Meeting of Shareholders and Explanatory Notes and other applicable cornerstone documents, such as

the Constitution of Fonterra, the Board Charter and the By-laws of the Shareholders' Council;

- (b) discussed the Recommendations, and the rationale for them, in depth with the Management team supporting the Committee; and
- (c) held Panel meetings (via conference calls) at which the Panel members reviewed and discussed the Recommendations and formed a collective view on the Recommendations, a summary of which is set out below.

3. PANEL VIEWS

3.1 **Summary:** The Panel has sought to summarise its views on the Recommendations, and provide Shareholders with an objective assessment of whether the Recommendations align with New Zealand and international best practice, having regard to Fonterra's particular structure and its regulatory and cultural backdrop. The Panel has also, as required under the Terms of Reference, provided a recommendation to Shareholders as to whether to adopt the Recommendations.

3.2 **"International best practice":** The Panel concluded that there is no single view of what constitutes "international best practice" for governance, with widely differing approaches adopted in various geographical jurisdictions, including New Zealand, North America, Europe and other parts of the world, and with differing approaches also being adopted between co-operatives and publicly listed investor owned companies. The Panel's consensus was that no one model fits every organisation and that best practice is to tailor governance and representation of a particular organisation to the needs and circumstances of the relevant entity, in this case Fonterra.

3.3 **Summary of Panel's view:** Within the constraints of the Terms of Reference, the Panel unanimously supports the vast majority of the Recommendations, while noting some areas of difference in terms of the emphasis placed on particular elements of the package. These elements are discussed in more detail below. For the purposes of this Report, where the Panel has not reported on a specific element of the Recommendations, Shareholders (and other readers of this Report) should infer that the Panel unanimously supports that element of the Recommendations.

3.4 **Best people:** The Panel is of the opinion that the single most effective way to improve Fonterra's governance and representation (and, consequently, performance) is to attract and elect Directors and Shareholders' Councillors of the highest possible quality and calibre. To this end, the Panel strongly endorses the Recommendations, which relate to the manner in which Board members are identified, selected and elected, in

particular the introduction of a single election process that applies equally to all Directors (including both Independent and Farmer Directors). The Panel also notes that the design ensures candidate confidentiality, which the Panel considers is imperative to attract the best possible talent. However, the Panel held divergent views on the requirement that candidates participate in a “roadshow” (of 4 - 6 meetings with farmers, prior to Shareholders voting on their election). The Panel’s views on this aspect are detailed in paragraph 3.5(c) below.

3.5 Areas of difference between Panel members: The Panel members held differing views on some aspects of the Recommendations in the following areas:

- (a) *The number of Directors* - Two Panel members observed that a Board of 11 is not large for a co-operative, noting that co-operative companies in the United States and Europe often have boards of 17 members or more (primarily as a result of the regulatory and reporting complexities, which those companies have been increasingly subjected to since the early 2000s). The two New Zealand Panel members observed that, in the context of other New Zealand organisations, a Board of 11 is a relatively large Board. The Panel also noted the resolution of the Shareholders last year and the farmer feedback on board size that has been received during the recent consultation process. On balance, the Panel concurs with the proposed reduction in Directors from 13 to 11 having regard to the work undertaken on this matter by Fonterra and its evolution over time.
- (b) *Requirement for the Chair to be a Farmer Director* - Two Panel members hold the view that it is best practice for the Chair of Fonterra to be elected by the Board based solely on merit. Notwithstanding this, the Panel unanimously supports the Chair being reserved for a Farmer Director on the basis that this practice reflects the position adopted by other agriculture co-operatives globally and is consistent with the fact that, for Fonterra’s Shareholders, 100% farmer ownership and control is non-negotiable.
- (c) *Candidate participation in Shareholder meetings* - The Panel agreed that it is a fundamental democratic principle that the candidates recommended for election to the Board should be required to address a Shareholder meeting, and noted that this is the expected practice in New Zealand. However, as noted above, the Panel had divergent views on the impact of the requirement that all candidates (being both Farmer and Independent candidates) participate in a “roadshow” ahead of a Shareholder meeting, as currently recommended. In particular the two New Zealand Panel members are strongly of the view that requiring candidates to participate in a “roadshow” would not be aligned with accepted best practice in New Zealand and that some very high quality Independent Director candidates, and possibly Farmer Director candidates, would not apply for the Fonterra Board because of it. Conversely, the two overseas Panel members, whilst acknowledging the concerns of their New Zealand counterparts, believe it is appropriate for a wider

group of Shareholders to have the opportunity to “eye-ball” the candidates in a series of meetings, as opposed to limiting it solely to the one appearance at the Shareholders’ meeting on the day they are required to cast their votes.

3.6 Observations:

- (a) **Nomination and election processes:** Whilst the Panel supports and recommends the nomination and election processes, it makes the following observations for Fonterra to consider:
- (i) The Board and the Nominations Committee should only depart from the shortlist compiled by the Independent Selection Panel in exceptional circumstances.
- (ii) The Panel notes that selection of Directors based on a skills matrix alone could (if not carefully implemented) be too limited, and might overlook the importance of attributes such as judgement, integrity and mutual respect, which are seen as fundamental to the establishment of a cohesive and constructive dynamic within a high performing Board. The Panel supports the recommended application of the list of attributes to every Director and it considers that it will be important to ensure that the skills matrix is prepared and implemented carefully, so that the desired set of skills and attributes (in an overall sense) is achieved.
- (iii) The Panel also noted the importance, for Fonterra, of ensuring that an appropriate number of the Board continue to have genuine on-farm experience, so that this knowledge can be brought to the Board table. However, the Panel noted that:
- Not every Farmer Director should be required to have on-farm dairy experience; rather the level of on-farm dairy experience should be assessed on a collective (i.e. the Board as a whole), not an individual, basis. Requiring every Farmer Director to have on-farm dairy knowledge could exclude a number of high quality candidates, who could bring other valuable (and possibly in demand) skills to the Board.
 - As currently proposed, the requirement that “on-farm dairy experience” be gained “*having run or owned a dairy operation as a member of our dairy Co-operative*” (emphasis added) could preclude some candidates who may have dairy farming experience previously gained in supplying other co-operatives in New Zealand or overseas or, in supplying a non-co-operative dairy company in New Zealand or overseas. The Panel is concerned that this could unnecessarily reduce the pool of potential candidates and the Panel recommends that the Committee consider deleting the words “as a member of our dairy Co-operative”. A requirement for Farmer Directors to have run or owned a dairy operation addresses the connection

between the farm and the Boardroom, would be less restrictive and would bring valuable alternative points of view to Fonterra.

- (b) **Representation:** The Panel notes that the Booklet sets out the powers and role of the Shareholders' Council. It further notes that an effective representative body, and effective participation by that body, is critical to ensure that both the governance and representation functions operate in the best possible manner. The Panel believes that it is important to maintain an appropriate balance between governance and representation, and that a strong representation function is likely to assist the overall success of the Recommendations. The Panel is satisfied that the representation changes proposed to be introduced with the Recommendations, particularly the introduction of a maximum term to achieve a refresh of Councillors, a transparent capabilities and attributes matrix and Council endorsement of sitting Councillors provide a framework for improvement capable of supporting the proposed Governance changes. The Panel notes the shortened timeframe in which the Shareholders' Council review is proposed to take place and notes that this should not be allowed to compromise a rigorous review. The previous work by Fonterra and the Shareholders' Council in this area will assist. Nevertheless, the Panel urges that the Governance changes not be delayed as they are the most significant and beneficial part of the overall package of the Recommendations.

- 3.7 **Recommendation:** The Panel notes that the Recommendations form a total package and have been designed with careful consideration to function as a whole. Therefore, aspects of the Recommendations should not be isolated from others, as the removal of one key element can detrimentally affect how other constituent elements of the Recommendations function. Accordingly the Panel, on balance, and having regard to the Recommendations (as a package) and the current state of Fonterra's evolution, unanimously supports the Recommendations (in their entirety) and recommends that the Recommendations (in their entirety) be adopted by the Shareholders.

Issued 11th May 2016



Chris Moller (Panel Chair)



Dame Therese Walsh



Dr Michael Cook



Dr Adrie Zwanenberg

APPENDIX

Chris Moller (Panel Chair) has been heavily involved in the management and governance of co-operatives having been a senior executive of the New Zealand Dairy Board for over a decade, the inaugural Deputy CEO of Fonterra and a Member of the Fonterra Candidate Assessment Panel. Chris is also a former Chief Executive of the NZ Rugby Union and Chairman of NZ Cricket, both of which are effectively co-operatives. Today Chris chairs Meridian Energy and SKYCITY, both in the top 10 of NZ listed companies, and the NZ Transport Agency.

Dame Therese Walsh is a professional Director and sits on the Boards of ASB Bank Ltd, Air NZ Ltd, NZX Ltd and TVNZ Ltd. She is also a Trustee of Wellington Regional Stadium, a Councillor at Victoria University and sits on a number of Government Panels including Chairing the International Aid Panel for MFAT. She is a Chartered Accountant and has worked in many co-operative type environments including NZ Rugby, NZ Cricket and Save the Children NZ. Most recently she was Head of NZ for the Cricket World Cup 2015, and prior to this was the Chief Operating Officer for the Rugby World Cup 2011.

Dr Michael Cook is the Robert D. Partridge Endowed Professor in Cooperative Leadership in the Division of Applied Social Sciences at the University of Missouri-Columbia, U.S.A. His primary research addresses factors affecting organisational structures, strategies, and governance of patron-owned and controlled enterprises. His research activities include work in more than 50 countries and 100 published works. Dr. Cook has been Executive Director of the Graduate Institute of Cooperative Leadership (GICL) since 1990. He received his Ph.D. from the University of Wisconsin. He also served for 12 years in senior management positions with three global enterprises, two of which were co-operatives, and has occupied board positions with numerous co-operatives, subsidiaries, and associations. In May 2012, Dr. Cook was inducted into the Cooperative Hall of Fame at the National Press Club, Washington, DC.

Dr Adrie Zwanenberg is a Dutch specialist in dairy co-operatives. He received a PhD in Food Economics in Cork, Ireland under the title: European Dairy Cooperatives Developing New Strategies. He was also the author of the independent report *Will Global Dairy Company be a true co-operative?* In this report, he compared Global Dairy Company (now Fonterra) to theoretical co-operative principles and to peer group practice. Adrie is the author of many other publications on dairy co-operatives. In his 18-year career at Rabobank he was Global Dairy Specialist, Global Head of Food & Agribusiness Research and Global Head of Investor Relations.

PART FOUR

AMENDMENTS TO CONSTITUTION

Amendment	Explanatory note
<p>12. APPOINTMENT, ROTATION AND REMOVAL OF DIRECTORS</p> <p>12.1 Number of Directors: There shall be not more than 13 Directors until the conclusion of the 2016 annual meeting of the Company, not more than 12 Directors until the conclusion of the 2017 annual meeting of the Company, and not more than 11 Directors thereafter, of whom:</p> <p>(a) not more than 9 Directors elected by Shareholders in accordance with clause 12.2 or appointed by the Board in accordance with clause 33.1 until the conclusion of the 2016 annual meeting, 8 until the conclusion of the 2017 annual meeting, and 7 thereafter, are qualified in terms of clause 12.3; and</p> <p>(b) not more than 4 Directors appointed by the Board in accordance with clause 12.4 are “Independent Directors” within the meaning given to that term in the Market Rules.</p>	<p>This change gives effect to the reduced maximum number of Directors and the new Board composition. It preserves the current approach of setting the maximum Board size, as well as the maximum number of farmer Directors and independent Directors (respectively). The reduction in Board size (to 11) and composition (to 7 and 4, respectively) will be staged over the next two election cycles.</p> <p>The change reflects the requirement in the Fonterra Shareholders’ Market Rules (“FSM Rules”) for a certain number of Independent Directors. Under the new process all Directors will be “nominated” by the Board and “elected” by Shareholders so, rather than referring to the previous “appointment” process in clause 12.4 of the Constitution, the clause needs to refer directly to the FSM Rules.</p>
<p>12.2 Election by Shareholders: Subject to clauses 12.1, 12.3 and 12.4, a person may be elected or removed as a Director from the conclusion of an annual meeting of Shareholders of the Company by a postal ballot of Shareholders held in accordance with the written procedures adopted by the Shareholders’ Council from time to time for holding postal ballots by Shareholders for the election or removal of Directors ordinary resolution.</p>	<p>This change reflects the move to voting for all Directors by ordinary resolution at meetings of Shareholders. An ordinary resolution is a vote of Shareholders requiring majority (more than 50 per cent) support. This change means that Shareholders will be able to vote on the resolutions using a full range of voting processes, including by post, in person at the annual meeting, by proxy or corporate representative, by fax, by electronic voting, etc.</p>

<p>12.3 Qualifications of Directors: No person shall be elected as a Director by Shareholders or hold office as a Director elected by Shareholders in accordance with clause 12.21(a) unless he or she has a direct or indirect interest in a Shareholder that is supplying Milk to the Company which comprises either:</p> <ul style="list-style-type: none"> (a) a direct or indirect legal or beneficial interest in that Shareholder (including as a beneficiary of a trust); or (b) a right or entitlement to participate (directly or indirectly) in the distributions of, or made by, that Shareholder, and, without limiting the entities, arrangements or structures through which any such interest may arise or be held, a person will be deemed to hold such an interest if he or she: (ac) is a Shareholder that is supplying Milk to the Company; or (bd) is a shareholder of a company that is a Shareholder that is supplying Milk to the Company; or (ee) is a member of a partnership that is a Shareholder that is supplying Milk to the Company; or. (d) is a person having a legal or beneficial interest in, or a right or entitlement to participate directly in the distributions of, a body corporate that is a Shareholder, and that No person shall take office as a Director unless he or she has signed a Confidentiality Deed and Indemnity in the form determined by the Board relating to information he or she may receive in his or her capacity as a Director. Only one shareholder of a company which is a Shareholder, or one member of a partnership that is a Shareholder, or one of two or more joint Shareholders, shall be eligible at any time to hold office as a Director. 	<p>This change updates the current eligibility criteria for a Farmer Director to reflect modern farm ownership structures, including the use of limited partnerships. It uses the same underlying Farmer Director eligibility criteria as are used in the current clause 12.3 (legal or beneficial interest or entitlement to participate in distributions), but makes it clear that these interests may be held directly or indirectly.</p> <p>The references to “supplying Milk to the Company” are intended to align with clause 8 of the Constitution, which limits voting entitlements to Shareholders who are supplying Milk. This is intended to exclude some persons who hold Shares only for functions related to Trading Among Farmers, eg the Custodian for the Fund and the RVP.</p> <p>While the limitation in the final sentence of clause 12.3 may have been appropriate when dairy farming was typically undertaken on a smaller scale and with simpler ownership structures, it no longer seems necessary and could have arbitrary consequences. For example, a farm consortium under a modern ownership structure (eg with cross-holdings) could have a large number of owners. This limitation would have disqualified all but one of the people applying to be a Farmer Director even if they met the eligibility criteria in respect of another farm.</p>
<p>12.4 Appointment by Board: Subject to clause 12.1, the Board may at any time appoint a person to be a Director for such period, and on such terms, as the Board thinks fit, provided however that the Board may not alter the rights or powers of a Director appointed pursuant to this clause. If the Shareholders do not ratify the appointment of any Director appointed pursuant to this clause by the first annual meeting of the Company following the appointment of that Director then that Director shall cease to hold office at the conclusion of that meeting. If a Director is appointed for a term exceeding three years, then that Director’s appointment shall be ratified by Shareholders every three years. Nomination: Before any person may be elected (or, in the case of a Director already holding office, re-elected) as a Director, he or she must first apply in accordance with clause 33.4 and be nominated by the Board, which shall have regard to the recommendations of the Nominations Committee and the Independent Selection Panel, and to the views of the Shareholders’ Council. If the Board does not follow any such recommendation, it shall disclose to Shareholders its reasons for doing so. If the Shareholders’ Council has objected to a candidate but that candidate is nominated by the Board, the Board will disclose that fact, and the reasons for the Shareholders’ Council’s objection, to Shareholders.</p>	<p>Under the new election process, all Directors (not just the previous “Appointed Directors”) will be “nominated” by the Board and “elected” by Shareholders.</p> <p>All Directors that wish to put themselves forward for re-election must go through the application process with all other candidates. It is expected that the Board would only depart from the recommendations of the Independent Selection Panel and the Nominations Committee, and the views of the Shareholders’ Council, in exceptional circumstances. The Board will retain the existing ability to appoint a Director to fill a vacancy in the Board “out of cycle” - see clause 33.1.</p>
<p>12.5 Managing Director: The Board may from time to time appoint one of the Directors appointed by the Board in accordance with clause 12.4 referred to in clause 12.1(b) to the office of managing Director for such period, and on such terms, as the Board thinks fit and, subject to the terms of any agreement entered into in any particular case, may revoke such appointment.</p>	<p>This change updates the reference to refer to Independent Directors. Under the new process all Directors will be “nominated” by the Board and “elected” by Shareholders so, rather than referring to clause 12.4, the clause needs to refer to clause 12.1(b).</p>

<p>12.7 Rotation of Directors: At each the annual meeting of the Company:</p> <ul style="list-style-type: none"> (a) in 2016, four Directors; (b) in 2017, three Directors; and (c) thereafter, one third of the Directors elected by Shareholders pursuant to clause 12.2, or if their number is not a multiple of three then the number nearest to one third, shall retire from office (provided that a Director is not required to retire pursuant to this clause before the third annual meeting of the Company following his or her election or most recent re-election or ratification by Shareholders, as applicable). The Directors to retire shall be those who have been longest in office since their last election. If two or more of those Directors were last elected on the same day, the Directors to retire shall (unless they otherwise agree among themselves) be determined by lot. A retiring Director is (subject to clause 12.4 and the Charter from time to time adopted by the Board) eligible for re election. 	<p>This clause will apply to all Directors and ensures that, once elected, they must retire and apply for re-election every three years. The maximum term of office for Directors is dealt with in the Board Charter.</p> <p>Paragraphs (a) and (b) are to reflect the staged transition to the smaller Board size and modified Board composition over two election cycles.</p>
<p>13. POWERS OF DIRECTORS</p> <p>13.1 Management of Company: The business and affairs of the Company shall be managed by, or under the direction or supervision of, the Board, provided that the chairperson of the Board shall be a Director qualified elected in accordance with clause 12.23.</p>	<p>This change preserves the reference to Farmer Directors. Now that all Directors will be nominated by the Board and elected by Shareholders, the clause needs to refer to clause 12.3 instead of 12.2.</p>
<p>16. SHAREHOLDERS' COUNCIL</p> <p>16.1 Establishment of Shareholders' Council: Subject to casual vacancies there shall be a Shareholders' Council of not fewer than 25 Councillors which shall be elected in accordance with the by-laws of the Shareholders' Council. The role of the Shareholders' Council is to represent the collective interest of Shareholders. The Shareholders' Council shall have the following functions:</p> <p>...</p> <ul style="list-style-type: none"> (b) adopting from time to time such written procedures as the Shareholders' Council thinks fit for holding a postal ballot of Shareholders for the election and removal of Directors members of the Directors' Remuneration Committee pursuant to clause 12.2 34.1; (q) consulting with suppliers who supply Milk to the Company or its subsidiaries, whether in New Zealand or elsewhere, in relation to matters of mutual interest and, where appropriate, representing the views of those suppliers and communicating them to the Board; and (qr) in relation to the Milk Commissioner: <p>...</p>	<p>This change confirms and clarifies the role of the Shareholders' Council ("SHC") and gives context to the SHC functions that are already listed in the Constitution.</p> <p>This change is necessary to ensure that there will be no change to the process for the selection of the Directors Remuneration Committee ("DRC"). The SHC will still set procedures for electing DRC members.</p> <p>The addition at clause 16(q) formalises the current practices of the SHC (e.g. consulting with offshore milk pools on relevant matters).</p>

<p>33. GENERAL PROVISIONS RELATING TO DIRECTORS</p> <p>33.1 Casual vacancies: Subject to clause 12.1, the Board may at any time appoint a person to fill a casual vacancy in the Directors to be elected by Shareholders pursuant to clause 12.2 who is qualified in terms of clause 12.3 to be a Director and shall appoint such a person if a casual vacancy would otherwise continue for six months or more. A Director so appointed holds office only until the conclusion of the next annual meeting of Shareholders of the Company but (subject to clauses 12.4 and 33.4) is eligible for re-election.</p>	<p>This provision will continue to apply to any unexpected vacancy on the Board.</p> <p>This provision will also apply where a nominated candidate fails to be elected by Shareholders at an Annual Meeting. The Board would not appoint the person who has failed to be elected. The person appointed by the Board in that scenario may only remain on the Board until a replacement Director is elected by Shareholders. The person appointed to fill the casual vacancy may apply to be considered by Shareholders for re-election at that meeting alongside all other candidates.</p>
<p>33.3 [Not used] Re-election of retiring Director: A Director retiring by rotation at an annual meeting of the Company shall, if standing for re-election, be deemed to have been re-elected unless:</p> <p>(a) — some other person is elected to fill the vacated office; or</p> <p>(b) — it is resolved not to fill the vacated office:</p>	<p>Directors that retire by rotation at the end of their 3 year term must apply to be re-elected by Shareholders and will be assessed with all other applicants.</p>
<p>33.4 Nomination of Directors: No person may be elected or re-elected as a Director by a postal ballot of Shareholders in accordance with clause 12.2 (other than a Director retiring at an annual meeting of the Company) unless, not more than four months nor fewer than two months before the annual meeting, that person qualifies to be appointed as a Director in terms of clause 12: has applied to the Independent Selection Panel, 3- and has been nominated by a Shareholder, and that nomination has been seconded by another Shareholder, entitled to vote in the postal ballot by written notice to the Company accompanied by the consent in writing of that person to the nomination. Notice of every valid nomination of a Director received by the Company before the closing date for nominations shall be sent by the Company to all persons entitled to vote in the postal ballot in accordance with the written procedures adopted by the Shareholders' Council in accordance with clause 12.2 has been nominated by the Board under clause 12.4 and has consented in writing to the nomination.</p>	<p>This amendment is to require all candidates for election or re-election as Directors to apply to the Independent Selection Panel and to be nominated by the Board before they may be elected or re-elected.</p>
<p>33.6 Timing of retirement and appointment: If:</p> <p>(a) a Director retires at an annual meeting of the Company and is not re-elected or deemed to be re-elected in accordance with this Constitution, the Director shall remain in office until, and his or her retirement shall take effect at, the conclusion of that annual meeting;</p> <p>(b) a Director is removed from office at a meeting of Shareholders by Ordinary Resolution, the Director shall remain in office until, and his or her removal shall take effect at the conclusion of the meeting;</p> <p>(c) a person who is not already a Director is elected as a Director in accordance with clause 12.2 by a postal ballot of Shareholders prior to an annual meeting of the Company, that person shall take office as a Director at the conclusion of the relevant that annual meeting.</p>	<p>This change is required to reflect the change to voting for Directors by way of ordinary resolution (rather than postal ballot under the former Single Transferable Vote mechanism).</p>

34. REMUNERATION AND OTHER BENEFITS OF DIRECTORS

34.1 **Power to authorise:** ~~Except in the case of Directors appointed by the Board in accordance with clause 12.4~~ The Board may not exercise the power conferred by section 161 of the Act to authorise any payment or other benefit of the kind referred to in that section to or in respect of a Director **qualified in terms of clause 12.3**, in his or her capacity as such, without the prior approval of the Shareholders, except as provided in this clause 34. There is, at the date this Constitution takes effect, and there shall continue to be, a committee of six **persons qualified in terms of clause 12.3 Shareholders** (“**Directors’ Remuneration Committee**”) elected by postal ballot of Shareholders. The provisions of ~~this Constitution~~ **the By-laws of the Shareholders’ Council** relating to the appointment, rotation and removal of ~~Directors~~ **Shareholders’ Councillors** shall apply to the appointment, rotation and removal of members of the Directors’ Remuneration Committee, with necessary modifications. The Board shall consider and recommend to Shareholders for their approval the form and amount of the remuneration to be paid to members of the Directors’ Remuneration Committee. The Directors’ Remuneration Committee shall consider and recommend **to Shareholders for their approval** the form and amount of ~~Directors’~~ remuneration to ~~the Shareholders for their approval.~~ ~~No such recommendation may be made which would result in any change to the terms of the remuneration for any Director appointed in accordance with clause 12.4~~ **be paid to those Directors who are qualified in terms of clause 12.3.** The Board may exercise the power conferred by section 161 of the Act to authorise any payment or other benefit of the kind referred to in that section to or in respect of **of any other** Director ~~appointed by the Board pursuant to clause 12.4.~~

These changes preserve the current appointment arrangements for the Directors’ Remuneration Committee. As the Director election process will change (and the SHC will no longer decide the process for holding a postal ballot in relation to election of Directors), the DRC election process will be modelled on the SHC election process (with necessary modifications).

In the same way as applies at present, the Directors’ Remuneration Committee will recommend to Shareholders the remuneration to be paid to Farmer Directors meeting the criteria in clause 12.3 of the Constitution. The other Directors’ remuneration will be decided by the Board.

The Directors’ Remuneration Committee is to be composed of persons meeting the criteria in clause 12.3 of the Constitution. This is to be the same qualification requirement for Directors or Shareholders’ Councillors.

48. DEFINITIONS AND INTERPRETATION

48.1 **Definitions:** In this Constitution, unless the context otherwise requires:

...

“Independent Selection Panel” means a panel of appropriately qualified individuals who do not have any “Disqualifying Relationship” to the Company (as defined in the Market Rules, but read as if references to “Director” were references to the members of the panel), to be established by the Nominations Committee and the Shareholders’ Council to oversee the identification and selection of potential candidates for appointment as Directors and to recommend appropriate candidates to the Nominations Committee, or any other body appointed to fulfil the same function.

...

“Nominations Committee” means a committee to be appointed and authorised by the Board and formed for the primary purpose of recommending, to the Board, candidates for nomination as Directors.

There will be Terms of Reference for the Independent Selection Panel that will describe its role (including the use of external advisers where appropriate to assist with the search and selection process).

There will be a defined Charter for the Nominations Committee that will describe its role.

These documents are available to view online at www.nzfarmsource.co.nz

PART FIVE

PROPOSED AMENDMENTS TO BY-LAWS OF THE SHAREHOLDERS' COUNCIL

Amendments

1.2 Representation of Wards:

- (a) Subject to casual vacancies, each Ward is entitled to be represented by at least one Councillor.
- (b) The Wards represented by the Chair and Deputy Chair of the Council may be represented by one additional Councillor elected at the next Election, in recognition of the additional workload associated with those roles, if:
 - (i) the Chair or Deputy Chair (as applicable) consider that the addition of a second Councillor in the relevant Ward is necessary to manage the workload in the Ward; and
 - (ii) the resolution put forward by the Chair or Deputy Chair is supported by a 75% majority in accordance with clause 5.8.

If an additional Councillor is to be elected pursuant to this clause and the period until the next scheduled Election exceeds six months, a special Election may be held for the purpose of electing such additional Councillor.

- (c) Additional Councillors elected pursuant to paragraph (a) above shall not be entitled to vote on resolutions of the Council or be counted in the quorum for a meeting of the Council, but shall be entitled to receive notice of meetings, attend and speak at meetings of the Council.
- (d) If an additional Councillor has been elected in a Ward represented by the Chair or Deputy Chair, and the Chair or Deputy Chair (as applicable) subsequently ceases to hold the relevant office, then the Council may determine (pursuant to clause 16.2 of the Constitution) that the relevant Ward shall thereafter be represented by only one Councillor, in which case:
 - (i) one or the other of the Councillors representing that Ward shall resign from office; or
 - (ii) if neither Councillor has resigned within three months then, at the next Election for that Ward, both Councillors in that Ward shall retire but may offer themselves for re-election (provided that only one Councillor shall be elected to represent the relevant Ward); and
 - (iii) if the period until the next scheduled Election for that Ward exceeds six months, a special Election may be held to elect only one Councillor for that Ward in accordance with paragraph (ii) above.

- 1.5 **Rotation of Councillors:** Schedule 1 sets out the year in which an election is to be held in each Ward for the rotation of Councillors on the basis that an election is to be held in each Ward at intervals of approximately 3 years. The Council may from time to time amend Schedule 1 or adopt a new Schedule 1. On the date of each annual meeting of the Company the Councillors in the Wards subject to rotation in that year in accordance with Schedule 1 shall duly retire. A Councillor retiring by rotation is eligible for re-election, **provided that:**

- (a) Councillors may not serve for longer than six years (or, where the Election cycle in a Ward is such that the period between the time a Councillor was first elected and the second Election in that Ward is greater than six years, for longer than the date of the second Election since that Councillor was first elected) unless the Council resolves (by 75% majority in accordance with clause 5.8) to approve the Councillor standing for re-election for a third term; and
- (b) Councillors shall not hold office for more than 9 years (or, where the Election cycle in a Ward is such that the period between the time a Councillor was first elected and the third Election in that Ward is greater than 9 years, for longer than the date of the third Election since that Councillor was first elected).

- 1.6 **2007 Election:** ~~Notwithstanding any other provision of these By-laws, the provisions in Schedule 2 shall apply in respect of 2007.~~ **Endorsement on re-election:** In the case of a Councillor standing for re-election, the Council shall determine (by 75% majority in accordance with clause 5.8), and communicate to Shareholders, whether it supports the Councillor's re-election.

- 2.2 **Delivery of notice:** Notice of every valid nomination of a Councillor to represent a Ward received by the Returning Officer before the closing date for nominations shall be sent by the Returning Officer to all Shareholders in that Ward together with voting papers and, for an Election scheduled under clause 1.5, at the same time the ~~postal ballot for the election of Directors~~ notice of the relevant annual meeting is sent to Shareholders.

- 4.1 **Exercise of functions by Shareholders' Council:** ~~The role of the Shareholders' Council is to represent the collective interest of Shareholders.~~ The Shareholders' Council is responsible for performing the functions required by the Constitution to be performed by the Shareholders' Council. Those functions are to be performed by, or under the direction or supervision of, the Shareholders' Council.

- 4.4 **Attributes and capabilities list:** The Council shall adopt and maintain a list of the attributes and capabilities that it considers should be represented on the Council, and ensure that such list is communicated to Shareholders together with the voting papers for each Election.
- 4.5 **Appointments to other bodies:** The Council shall appoint an independent member (who may not be a Councillor) to the Independent Selection Panel, and two observers (who shall be Councillors) to the Nominations Committee of the Board.
- 4.6 **Consultation on candidates for the Board:** The Nominations Committee will consult with the Council in relation to the persons that the Committee proposes to recommend for nomination by the Board (and election by Shareholders) as directors of the Company. The Council will have particular regard to whether the appropriate number of directors have sufficient “on-farm knowledge and experience”, in accordance with the Board’s skills matrix.
- 4.7 **Objection right:** If the Council resolves (by 75% majority in accordance with clause 5.8) to object to any proposed candidate, the chairperson of the Council must advise the Nominations Committee of that fact, and state the Council’s reasons for the objection. If the Nominations Committee maintains its recommendation with respect to the relevant candidate, the Board will disclose the fact of the Council’s objection, and the reasons for it, in the notice of the meeting at which the candidate is proposed to be elected by Shareholders.
- 5.8 **Voting:** Subject to clause 1.2(c), eEvery Councillor has one vote. The chairperson does not have a casting vote. A resolution of the Shareholders’ Council is passed if it is agreed to by all Councillors present without dissent, or if 75% of the votes cast on it are in favour of the resolution. A Councillor present at a meeting of the Shareholders’ Council is presumed to have agreed to, and to have voted in favour of, a resolution of the Shareholders’ Council unless he or she expressly dissents from or votes against, or expressly abstains from voting on, the resolution.

SCHEDULE 1: RETIREMENT OF COUNCILLORS

2016 - 2018		
Ward	District	Year of annual meeting of the Co-operative in which Councillors retire
1	Northern Northland	2017
2	Central Northland	2018
3	Southern Northland	2016
4	South Auckland	2017
5	Hauraki / Coromandel	2018
6	Hamilton	2016
7	Piako	2017
8	Matamata	2018
9	Western Bay of Plenty	2016
10	Cambridge	2017
11	Te Awamutu	2018
12	South Waikato	2016
13	Rotorua	2017
14	Eastern Bay of Plenty	2018
15	Taupo	2016
16	Otorohanga	2017
17	Northern Taranaki	2018
18	Coastal Taranaki	2016
19	Central Taranaki	2017
20	Egmont Plains	2018
21	Southern Taranaki	2016
22	Northern Manawatu	2017
23	Hawke’s Bay	2018
24	Southern Manawatu	2016
25	Wairarapa	2017
26	Tasman / Marlborough	2018
27	North Canterbury	2016

2016 - 2018		
Ward	District	Year of annual meeting of the Company in which Councillors retire
1	Northern Northland	2008
2	Whangarei	2009
3	Northern Waioa	2010
4	Southern Northland	2008
5	South Auckland	2009
6	Hauraki	2010
7	Coromandel	2008
8	Hamilton	2009
9	Morrinsville	2010
10	Te Aroha	2008
11	Western Bay of Plenty	2009
12	Cambridge	2010
13	Matamata	2008
14	Te Awamutu	2009
15	South Waikato	2010
16	Rotorua	2008
17	Eastern Bay of Plenty	2009
18	Otorohanga	2010
19	Taupo	2008
20	Northern Taranaki	2009
21	Coastal Taranaki	2010
22	Central Taranaki	2008
23	Egmont Plains	2009
24	Southern Taranaki	2010
25	Northern Manawatu	2008
26	Hawkes Bay	2009
27	Southern Manawatu	2010

28	Rakaia	2017
29	Ashburton	2018
30	South Canterbury	2016
31	Waitaki	2017
32	Otago	2018
33	Northern Southland	2016
34	Southern Southland	2017
35	Western Southland	2018

28	Wairarapa	2008
29	Tasman--Marlborough	2009
30	Northern Canterbury	2010
31	Central Canterbury	2008
32	Southern Canterbury	2009
33	Otago	2010
34	Eastern Southland	2008
35	Western Southland	2009

Subject to clause 1, this table shall be treated as being repeated for each subsequent 3 year period following the last annual meeting of the Company specified in the table for each Ward with the intent that the retirement of Councillors in subsequent years should follow this table in the same manner.

SCHEDULE 2: 2007 ANNUAL MEETING

- 1.— **2007 Election:** An Election of all Councillors in each Ward shall be held on a date in March 2007 to be nominated by the Shareholders' Council ("Election Date");
- 2.— **Deemed Retirement:** All existing Councillors in office on the Election Date shall be deemed to have retired at 5pm on the Election Date. All Councillors retiring under this clause shall be eligible for re-election;
- 3.— **Election Process:** The Election held under this Schedule shall be held in accordance with the process set out in clause 2 of the By-laws, with such changes as the Shareholders' Council deems appropriate to achieve administrative efficiency;
- 4.— **No election at 2007 Annual Meeting:** Due to the Election of all Councillors in each Ward to be held in March 2007, there shall be no retirement of Councillors by rotation at the 2007 annual meeting of the Company under clause 1.5 of the By-laws and, accordingly, no Election by rotation shall be held in 2007;
- 5.— **2008 Annual Meeting:** Clause 1.5 of the By-laws shall apply to the 2008 and each subsequent, annual meeting of the Company;

PART SIX

SUMMARY OF WHERE TO FIND KEY CHANGES TO GIVE EFFECT TO THE RECOMMENDATIONS IN THE DOCUMENTS

As well as the amendments to the Constitution and the By-laws of the Shareholders' Council that are contemplated by the Shareholder resolution set out in this Notice of Meeting, a number of internal documents will be updated to reflect the recommendations. This table summarises the key changes, identifies where in the relevant document the changes will be made, and sets out where details of the specific changes are available to be viewed.

The table below is only a guide and summary of the key changes. Copies of the underlying documents showing the changes are available to view online at www.nzfarmsource.co.nz.

Changes to documents	Where in document	Where to find details of the specific changes
1. Constitution		
(a) Composition: not more than 11 Directors, of which up to seven will meet a modernised version of the current Farmer Director qualification test and up to four will be Independent Directors. (The step down in Board size will occur over the next 18 months).	Clause 12.1	In Part Four of the Notice of Meeting. A marked up copy of the full Constitution showing the changes is also available to view online at www.nzfarmsource.co.nz
(b) Voting for nominated Director candidates by ordinary resolution.	Clause 12.2	
(c) Updated version of the current qualification test for Farmer Directors, reflecting modern ownership structures.	Clause 12.3	
(d) All candidates for election as Directors must first apply and be nominated by the Board (having regard to the recommendations of the Nominations Committee and Independent Selection Panel and the views of the Shareholders' Council). The Board will disclose its reasons if it does not follow any such recommendation. If the Shareholders' Council has objected to a candidate but that candidate is nominated by the Board, the Board will disclose that fact and the reasons for the Shareholders' Council objection.	Clause 12.4	
(e) At every Annual Meeting, one third (or the number nearest to one third) of the Directors are required to retire by rotation, except if this would mean they would retire before the third Annual Meeting since their most recent (re-)election. A transitional provision applies for the 2016 and 2017 annual meetings.	Clause 12.7	
(f) New definition of Shareholders' Council's role (to represent the collective interest of Shareholders) and new function (consulting with suppliers, in New Zealand or elsewhere).	Clause 16.1; BL 4.1	
(g) The same test will apply to Shareholders' Councillors as for Farmer Directors.	Clause 16.5	
(h) The Board may appoint to fill a casual vacancy.	Clause 33.1	
(i) Any intending candidate may apply to the Independent Selection Panel.	Clause 33.2	
2. Board Charter		
(a) The Board will prepare and maintain a list of attributes that all Directors must demonstrate and a "skills matrix" to be applied by the Nominations Committee in recommending candidates to the Board.	Para 2.5	Online at www.nzfarmsource.co.nz
(b) The Board is responsible for nominating Directors based on the recommendations of the Nominations Committee and Independent Selection Panel and the views of the Shareholders' Council.	Para 2.6	
(c) If the Shareholders' Council has objected to any proposed candidate but the Nominations Committee has maintained its recommendation with respect to the candidate, the fact of the objection, and the Council's reasons for it, will be disclosed to Shareholders.	Para 2.7	

(d) In the case of a casual vacancy created where a candidate fails to get 50 per cent support from Shareholders, the Board may not appoint the rejected candidate and must arrange for those bodies to recommence their processes.	Para 2.8	
3. Nominations Committee Charter		
(a) The Independent Selection Panel is authorised to identify and select a shortlist of candidates for recommendation by the Nominations Committee, having regard to the skills matrix.	Para 2.3	Online at www.nzfarmsource.co.nz
(b) The Nominations Committee will, in respect of each such candidate, consult with the chair of the Shareholders' Council with a view to determining whether the Shareholders' Council has any objections to the candidate being nominated.	Para 2.4(c)	
(c) The Nominations Committee will comprise two Independent Directors (under the FSM Rules - one of which will chair the Committee), two Directors (selected by the Board) who meet the Farmer Director eligibility criteria, and two observers appointed by the Shareholders' Council.	Para 3.1 and 3.2	
(d) The Nominations Committee will provide a report to the Board stating its recommended candidates, whether the candidate was recommended by way of the Independent Selection Panel shortlist, and its reasons for the recommendation, and reporting the Shareholders' Council's views. If the Nominations Committee has nominated a candidate that was not on the Independent Selection Panel shortlist, the Committee must advise the Board, and then the Board must advise the Shareholders, of that fact and provide its reasons. If the Shareholders' Council has objected to a candidate but the Committee has maintained its recommendation, the Board will disclose this fact and the reasons for it to Shareholders.	Para 7.2	
4. Terms of Reference of Independent Selection Panel		
(a) The Independent Selection Panel will comprise one independent expert selected by the Board, one independent expert selected by the Shareholders' Council and one independent chair appointed by those two members. Members will hold office for two to four years.	Para 4	Online at www.nzfarmsource.co.nz
(b) The functions of the Independent Selection Panel include publishing a search brief, engaging appropriate search firms, assessing candidates, providing a shortlist to the Nominations Committee and providing a report on its process for inclusion in the relevant Notice of Meeting.	Para 2	
(c) The Independent Selection Panel's assessment of candidates will be confidential until they are nominated by the Board.	Para 8 and 9(c)	
5. People, Culture and Safety Committee Charter		
(a) Remove existing nomination-related processes.	Throughout.	Online at www.nzfarmsource.co.nz
6. By-laws of the Shareholders' Council		
(a) New definition of Shareholders' Council role (as to functions, By-laws just refer to Constitution).	BL 4.1	In Part Five of the Notice of Meeting. A marked up copy of the full By-laws showing the changes is also available to view on online at www.nzfarmsource.co.nz
(b) An additional (non-voting) Councillor may be elected in the Chair's and Deputy Chair's Wards if resolved by a 75 per cent majority of the Council. If the Chair or Deputy Chair ceases to hold that role, the Shareholders' Council may (by 75 per cent majority) determine that the relevant Ward will again be represented by only one Councillor, in which case one of the two Councillors for that Ward must resign. If neither has resigned within three months then both shall retire (but may stand for re-election) at the next Election. If there are more than six months until the next scheduled Election, a special Election may be held to elect only one Councillor for that Ward.	BL 1.2	
(c) Maximum of two terms of three years (plus any part term where a Councillor was elected out of the usual Election cycle) unless the Council resolves by 75 per cent majority to approve the Councillor extending for a third term of three years.	BL 1.5	

(d) Council to decide by a 75 per cent majority whether to endorse sitting Councillors who wish to stand for re-election.	BL 1.6	
(e) Create and publish an attributes and capabilities list for Council.	BL 4.4	
(f) Shareholders' Council to appoint a member of Independent Selection Panel and two observers of the Nominations Committee.	BL 4.5	
(g) The Nominations Committee will consult with the Shareholders' Council, in relation to proposed candidates for nomination and election as directors. The Shareholders' Council will have particular regard to whether the appropriate number of directors have sufficient "on-farm knowledge and experience" in accordance with the skills matrix.	BL 4.6	
(h) If the Shareholders' Council objects (by 75 per cent vote) to a candidate, the Shareholders' Council Chair must advise the Nominations Committee of that fact and the Shareholders' Council's reasons. If the Nominations Committee maintains its recommendation, the Board will disclose the fact of the Council's objection and the reasons for it in the notice of the meeting at which the candidate is proposed to be elected.	BL 4.7	
7. Operating model steps		
(a) Refine and publish the "working interface" document between the Board and Council.	To be completed following vote on proposal and published before 2016 Annual Meeting	
(b) Separate development pathways for Directors and Councillors, involving a succession and talent identification framework, education opportunities for potential Shareholders' Councillors and Directors, representation/advocacy experience for potential Councillors and business/governance experience for potential Directors, and assessment of candidates for either role against the desired attributes or skills.	Ongoing work to be completed following vote on proposal	

Notes

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If undelivered please return to:

The Returning Officer
Fonterra Elections 2015
PO Box 3138
Christchurch 8140
Free phone 0800 666 034