



Dairy for life

# FONTERRA CO-OPERATIVE GROUP LIMITED

## GOVERNANCE AND REPRESENTATION REVIEW

Notice of Special Meeting of Shareholders  
and Explanatory Notes

10.30AM ON 12 OCTOBER 2016

CONVENTION CENTRE, 354 MAIN STREET,  
PALMERSTON NORTH





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# FONTERRA CO-OPERATIVE GROUP LIMITED – SPECIAL MEETING

The meeting will be held at **Convention Centre, 354 Main Street, Palmerston North at 10.30am on Wednesday, 12 October 2016.**

## Meeting Documents

Each Shareholder has been sent:

- A summary of the Governance and Representation Review recommendations
- 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 resolutions to be voted on by Shareholders) and Explanatory Notes (Part One).
  - Governance Recommendations and Independent Expert Panel's Report (Part Two).
  - Shareholders' Council Review Recommendations and Independent Expert Panel's Report (Part Three).
  - Five Year Review of the Recommendations (Part Four).
  - Governance related amendments to the Constitution and the Shareholders' Council By-laws (Part Five).
  - Representation related amendments to the Shareholders' Council By-laws (Part Six).
  - Summary of key changes to relevant documents (Part Seven).
- 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 Monday, 10 October 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 Monday, 10 October 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 milk solids production, with one vote for every 1,000kg of milk solids supplied during the season ended **31 May 2016**. 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 or on the Board's estimate of milk solids production for this season. In the case of a dry farm conversion and farm amalgamations/divisions, voting entitlement is based on the Board's estimate of milk solids production for this season. Milk supplied on Contract Supply and milk which is not backed by shares or counting vouchers is excluded from milk solids production when calculating voting entitlements.

In accordance with the Companies Act, the Board has fixed **14 September 2016** as the date for determining voting entitlements of Shareholders for this meeting. Accordingly, those persons who are, on **14 September 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 Shareholder's voting entitlement as described above.

## Votes Required and Quorum

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The special resolutions detailed in this Notice of Meeting will each be passed if they are 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 resolutions to be considered at the meeting.

## Results of Voting

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

## Meeting Attendees

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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 Wednesday 12 October, 10:30am at Convention Centre, 354 Main Street, Palmerston North so that we can vote on the recommended changes to our Constitution and Shareholders' Council By-laws arising from the Governance and Representation Review.

You have told us over the past couple of months that you liked most elements of the original proposal and the overall goals behind the changes, but some of you thought there was potential for "choice" to be eroded from shareholders' voting rights.

In this new recommendation we have listened carefully and addressed the question of choice. Now any farmer shareholder can choose to stand in his or her own right alongside the candidates who have gone through the Independent Nomination Process.

As a result voting farmers will be able to choose to follow the guidance of the Independent Selection Panel, Board and Council, or to vote for a farmer who has stood outside the process.

Farmers told us they supported the original recommendations on the size and composition of the Board, the introduction of an attributes and skills matrix and the change to a clearer, more representative voting method that lifts the benchmark of farmer support for Directors to a minimum 50 per cent. All of these improvements have been retained.

Our current process for appointing Independent Directors is working well and does not change under this recommendation.

We gave serious consideration to the idea of having the Independent Selection Panel recommend a shortlist of candidates for farmers to vote on. Having talked this through, it is clear that a vote off the shortlist will not deliver the outcome farmers are looking for.

A vote off a short list does not answer farmers' call for choice, it just gives farmers more of the same. Candidates from the same process, measured against the same criteria, by the same people.

The best way to give voting farmers a real choice and achieve the outcome we are looking for is to provide the ability for farmer candidates to stand outside the nomination process.

Our new recommendation is a democratic solution that ensures that your Board is most likely to attract leaders of the calibre and diversity needed to govern a business of Fonterra's scale and complexity. But the ultimate choice is yours.

The Independent Expert Panel (Governance) has reviewed these amendments and unanimously supports the recommendations. It recommends that they be adopted by farmers.

The findings of the Shareholders' Council Review detailed within this document will re-focus Council on its core constitutional responsibilities – particularly its role as the "cornerstone shareholder". The recommended changes are fully explained later in the document and in the following letter from the Chairman of the Shareholders' Council. Your Council's representation recommendations have been reviewed by a separate Independent Expert Panel which recommends that they also be adopted by farmers.

The recommendations have unanimous support from the Board, and 95 per cent support from your Shareholders' Council.

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.

After a very good discussion it is now time for our Co-operative to move forward. Our priority must be to stay focused on delivering wealth to our farmers. We ask for your support by voting in favour of both resolutions.



**John Wilson**  
Chairman

## LETTER FROM THE CHAIRMAN OF THE SHAREHOLDERS' COUNCIL

Dear Farmers,

This Notice of Meeting provides important information for you to consider ahead of your vote on two resolutions that support the strengthening of our governance and representation model.

On behalf of your Shareholders' Council, I strongly encourage you to give this information your very close consideration and to exercise your ownership and control rights by voting on both resolutions.

Significant work has gone into refining these recommendations since the first governance and representation vote in June this year.

Key proposed changes to the governance framework include:

- The Director Elections process now provides a direct pathway for Shareholders, outside of the Independent Selection Panel process, to put themselves forward as a Farmer Director candidate if they believe their skill-set will add value to our Co-operative.
- The Shareholders' Council retains full control over the election process and as such your Council will ensure that every candidate is given a fair opportunity to have a conversation with their fellow farmers regarding their attributes and skills in a setting that is free of the politics this review has always sought to eradicate.
- Ultimately, via a simple First Past the Post, Majority vote, we farmers will choose the best people to put onto our Board.

In regards to representation, we have listened to your feedback around wanting a more agile Council that is focussed on its core constitutional responsibilities – particularly its role as the “cornerstone shareholder”.

The representation recommendations included in this Notice of Meeting provide this focus by more clearly defining Council's representative role, aligning our structure to better deliver for farmers, and by holding Council accountable for its performance.

Furthermore, Council has recommended changes that, as we redefine the time commitment and the duties Councillors are expected to carry out, should result in a wider section of the shareholder base feeling able to commit to standing for the Council.

The recommendations will improve your Council and enable it to better meet your expectations. However, it is important to note that for the Shareholders' Council's representation role to be most effective we are reliant on there being a strong connection with our farmers.

As such we all have an obligation to engage with and gain a greater knowledge of our Co-operative, and to communicate via the many channels available to us.

A well-informed shareholder base is critical to the success of our Co-operative's model and every farmer shares in this responsibility.

In closing, your Council has rigorously considered and debated the proposal, especially in light of the Co-operative Principles, of which we are the guardians and taken into account your views as well as those of two separate Independent Expert Panels. The recommendations have 95 per cent support from your Shareholders' Council.

In light of this and based on our Co-operative's ultimate function, which is to enhance the wealth of its farmer shareholders, we recommend farmers vote to support the recommendations.

The mandate for change must come from you and we seek your strong support for the representation recommendations as well as for the governance recommendations. Both resolutions require 75 per cent shareholder support to be successful.

It's important that you participate in this process and make a decision that will ensure the enduring success of our Co-operative.

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

**Duncan Coull**

**Chairman,  
Fonterra 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.

|  |
|--|
| <b>10.00am - Registration / Morning Tea</b>  |
| <b>10.30am - Welcome</b><br>Welcome / Introduction – John Wilson, Chairman of the Board  |
| <b>10.45am - Meeting Proceedings</b><br>Presentation: John Wilson, Chairman of the Board<br>Duncan Coull, Chairman of the Shareholders' Council<br><b>Resolution 1: Governance related amendments to the Constitution and the Shareholders' Council By-laws</b><br><b>Resolution 2: Representation related amendments to the Shareholders' Council By-laws</b> |
| <b>Voting Paper Collection</b>   |
| <b>Announcement of Voting Results</b>  |
| <b>General Business</b>  |
| <b>12.00 / 12.30pm - Closing / Lunch (approximately)</b>   |



# VENUE

## Elwood Room, Convention Centre Palmerston North, 354 Main Street, Palmerston North

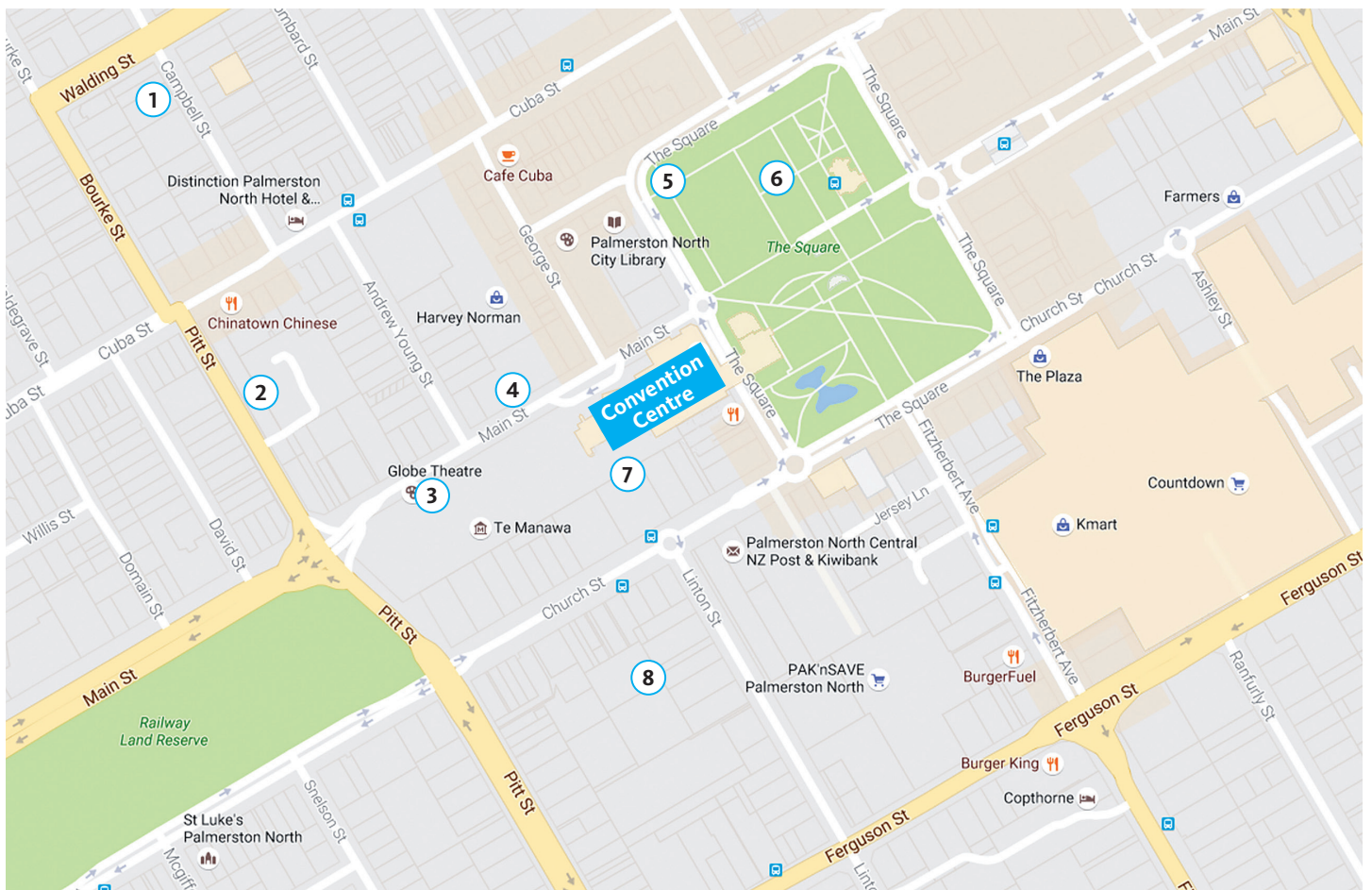
### Please note

- There are a number of parking options available. Please see the Parking Map below and Key to the right.
- Should you require any assistance with finding the location of the venue or parking, please contact your local Area Manager or Councillor.

### Key

- 1: Campbell Street metered spaces – off street parking
- 2: Pitt Street metered spaces – off street parking
- 3: The Globe Theatre/Te Manawa metered spaces – off street parking
- 4: Angled carparks between Convention Centre and Te Manawa – on street parking
- 5: Along the inside of the Square only (ie: parallel with the inner Square) – on street parking
- 6: The central Square metered spaces – off street parking
- 7: Behind the Convention Centre and alongside Animates metered spaces – off street parking
- 8: Linton Street metered spaces - off street parking.

### Parking map



## A GUIDE TO READING THIS DOCUMENT

There is a lot of important and detailed information within this booklet. To make it easier to follow, we have set it out in separate sections.

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|                          |   |
|--------------------------|---|
| <b>PART 1</b><br>Page 9  | Contains the formal Notice of Meeting and provides logistical and background information.   |
| <b>PART 2</b><br>Page 12 | Discusses the governance recommendations in detail. It also includes the full report from the Independent Expert Panel (Governance).  |
| <b>PART 3</b><br>Page 25 | Discusses the Shareholders' Council Review recommendations in detail. It also includes the full report from the Independent Expert Panel (Shareholders' Council Review).  |
| <b>PART 4</b><br>Page 35 | Discusses the five year review of the recommendations.  |
| <b>PART 5</b><br>Page 36 | Is the governance related amendments to the Constitution and the Shareholders' Council By-laws.   |
| <b>PART 6</b><br>Page 38 | Is the representation related amendments to the Shareholders' Council By-laws.  |
| <b>PART 7</b><br>Page 40 | Is a list of the key changes to relevant supporting documents and instructions on where to find more information.<br>You may find this table helpful as a "road map" for how the overall recommendation would be implemented. |

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### Quick guide to changes:

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We recommend that you read this document in full. However, if you are familiar with the detail from the first round in June and just want to see the improvements we have made since then, you'll find a quick guide in Part One on page 11.

## 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 **12 October 2016 at 10.30am at Convention Centre, 354 Main Street, Palmerston North.**

### Meeting Proceedings

Presentation: Joint Chairs of the Governance and Representation Review Committee

#### **Resolution 1: Governance related amendments to the Constitution and the Shareholders’ Council By-laws**

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 Sub-Part 1 of Part Five of the Notice of Meeting; and*
- (b) *the proposed amendments to the By-laws of the Shareholders’ Council, as set out in Sub-Part 2 of Part Five of the Notice of Meeting (with the By-laws re-numbered appropriately if Resolution 2 is not passed), are approved.”*

#### **Resolution 2: Representation related amendments to the Shareholders’ Council By-laws**

To consider and, if thought fit, to resolve:

“That the proposed amendments to the By-laws of the Shareholders’ Council, as set out in Part Six of the Notice of Meeting, are approved.”

**Please read the table of governance related Constitutional amendments and amendments to the Shareholders’ Council By-laws provided in Part Five of this booklet, the representation related amendments to the Shareholders’ Council By-laws in Part Six of this booklet, and the Explanatory Notes below.**

**There is also a detailed commentary on the proposed changes in Parts Two and Three of this booklet, and there are two Independent Expert Panel Reports (one on the governance recommendations, and one on the Shareholders’ Council Review recommendations) included in Parts Two and Three of this booklet.**

Resolution 1 is a special resolution required by section 106(1) (a) of the Companies Act 1993. Resolution 2 is a special resolution required by clause 16.7 of the Constitution. As the alterations to the Constitution of the Company that are contemplated by these resolutions 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 14 September 2016. The Shareholders’ Council has also (on 13 September 2016) approved the changes to the Shareholders’ Council By-laws, subject to Shareholders’ approval.

The key governance documents referred to in this Notice of Meeting are available to view online at [www.nzfarmsource.co.nz](http://www.nzfarmsource.co.nz). They are:

- Director Election Rules
- Code of Conduct for Farmer Director candidates
- Board Charter
- People Culture and Safety Committee Charter
- Nominations Committee Charter
- Independent Selection Panel Terms of Reference
- Terms of Reference for the five year review of the changes
- Conformed copies of the Constitution and the Shareholders’ Council By-laws showing the changes
- Board - Shareholders’ Council Interface Document (includes a detailed explanation of the roles of the Board, Shareholders’ Council and Management).

# EXPLANATORY NOTES

The Resolutions have 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](mailto:gov.rep@fonterra.com). The resulting recommendation was put to Shareholders at a special meeting on 10 June 2016, and received 63.74 per cent support of votes cast - a strong majority, but less than the 75 per cent support required for the changes to be approved.

The Committee has since consulted with Shareholders through a series of farmer meetings and focus groups, as well as online consultation via the email address [gov.rep@fonterra.com](mailto:gov.rep@fonterra.com) and is now putting the refined recommendation to Shareholders. The outcomes of this review are outlined in the governance sections of this booklet.

At the same time, the Shareholders’ Council committed to undertake and bring back to Shareholders, prior to the 2016 Annual Meeting, a review of the Shareholders’ Council. The outcomes of this review are outlined in the representation sections of this booklet.

## Effect of resolutions

The governance recommendations involve amendments to Fonterra’s Constitution. The resolutions have been proposed as special resolutions of Fonterra’s Shareholders, to give effect to those amendments. If Resolution 1 is passed by the requisite majority of greater than 75 per cent of votes cast by Shareholders entitled to vote on the resolutions, Fonterra’s Constitution will be amended as set out in the table in Part Five of this booklet and the Shareholders’ Council By-laws will be amended as set out in Part Five of this booklet. If Resolution 2 is passed by the requisite majority of greater than 75 per cent of votes cast by Shareholders entitled to vote on the Resolutions, the Shareholders’ Council By-laws will be amended as set out in Part Six of this booklet.

If Resolution 1 is not passed, the governance related changes to the Constitution and the Shareholders’ Council By-laws would not take effect. If Resolution 2 is not passed, the representation related changes to the Shareholders’ Council By-laws would not take effect.

**It is important that you read the detailed commentary set out in Parts Two and Three of this booklet, the two Independent Expert Panel Reports in Parts Two and Three, and the specific proposed changes to the Company’s Constitution in Part Five (Sub-Part 1) of this booklet and the Shareholders’ Council By-laws in Parts Five (Sub-Part 2) and Six of this booklet. This will provide you with the detail that you need to enable you to vote on the special resolutions set out above.**

John Wilson  
**Chairman, on behalf of the Board**  
**Notice of Meeting dated 23 September 2016.**

# QUICK GUIDE TO THE KEY CHANGES SINCE THE 10 JUNE SPECIAL MEETING

| FEEDBACK   | IMPROVEMENT   |
|--|---|
| <b>Governance</b>  |   |
| Farmers told us they wanted to protect their right to nominate themselves for the Board and to choose between different candidates in a contested election format.   | <ul style="list-style-type: none"> <li>A new appointment process for Farmer Directors that retains the confidential nomination process but that also delivers the choice that farmers have asked for.</li> </ul>  |
| The size and way the shortlist of candidates was to be presented by the Independent Selection Panel was not clear.   | <ul style="list-style-type: none"> <li>The Independent Selection Panel will recommend an appropriate set of candidates (equal to the number of vacancies to be filled) to the Nominations Committee.</li> </ul>   |
| Farmers told us that they were concerned that the Shareholders' Council required a 75 per cent vote to object to a candidate. The concern was that a candidate could be nominated with less than 50 per cent support of the Shareholders' Council. | <ul style="list-style-type: none"> <li>To be endorsed by the Shareholders' Council in the Independent Nomination Process, Farmer Director candidates will require 75 per cent support from the Shareholders' Council.</li> <li>If less than 75 per cent support is obtained and a candidate is still nominated by the Board, it will be stated in the voting pack and the reasons for the failure to obtain the required level of support will be given.</li> </ul> |
| Farmers wanted to ensure that the Shareholders' Council retained control over the Director election process.   | <ul style="list-style-type: none"> <li>The improved Farmer Director election process re-introduces Shareholders' Council control of elections. Clause 16(1)(b) of the Constitution will be reinstated. The Shareholders' Council will operate the Farmer Director election process, as it does today.</li> </ul>  |
| <b>Representation</b>  |   |
| Farmers told us that a robust review of the Shareholders' Council was an important part of their overall decision to support the recommendations.  | The Shareholders' Council has undertaken a full review of the Co-operative's representation function, including seeking independent advice for Shareholders from an Expert Panel on representation.   |
| Farmers told us they want their Shareholders' Council to focus on its core role here in New Zealand.   | The previous recommendation that " <i>The Shareholders' Council formally engage with off-shore milk suppliers</i> " has been removed.   |
| Farmer feedback was that, if the role of the Shareholders' Council was more focussed, the workload on individual Councillors would be manageable.  | The previous recommendation of, " <i>An extra Councillor within the Wards of the sitting Shareholders' Council Chairman and Deputy Chairman to assist with their workload</i> " has also been removed.  |
| Farmers told us that they valued the experience and insights of long-serving Councillors and would not want to see that lost.  | The recommended maximum length of term for Councillors has been increased to three, three-year terms. The June recommendation was for a two term limit.   |

## PART TWO

# GOVERNANCE RECOMMENDATIONS

### Summary of the governance recommendations:

The recommended governance model includes the following key features:

- Reduction in the size of the Board from 13 to 11 Directors
- New balance of the Board to 7 Farmer Directors and 4 Independent Directors
- Modernised eligibility criteria for Farmer Directors
- An attributes and skills matrix for the Board
- A new Farmer Director Nomination Process that delivers:
  - A confidential, rigorous assessment process with Board and Shareholders' Council buy-in that will attract a broader range of Shareholders to better ensure access to the skills the Co-operative needs; and
  - A choice for farmers by also enabling candidates with the required level of Shareholder support to nominate themselves outside of this process
- Replacing the current Single Transferable Vote system with a 'First Past the Post, Majority' voting system under which:
  - Shareholders will cast a yes or no vote for each candidate
  - All candidates will need at least 50 per cent support to be appointed to the Board; and
  - Of the candidates that achieve 50 per cent support, those with the highest number of votes will be appointed.

### Board composition

#### Size of the Board

We recommend 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-operative based in New Zealand.

Our research found there is no "right" number for a Board. We acknowledge and agree with the body of research about the effectiveness of human decision making. It generally concludes that smaller groups are more likely to create an environment for efficient decision making. However, when this theory 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.

Fonterra Directors have unique workload requirements because of our Co-operative's status in New Zealand and highly-regulated environment.

Fronting up to farmers as owners and being accountable for the performance of the Co-operative will always be a very important part of our Board's responsibilities. Our unique regulatory requirements and our Co-operative structure require a large Board Committee work programme. As New Zealand's largest multi-national company, stakeholder relations will 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 need on our Board. Our Co-operative benefits from having Directors who are exposed to ideas and experience from other organisations.

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-operative, 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.

We recommend a change to the constitutional criteria 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.

The new wording modernises the criteria to ensure that all Shareholders are able to stand for the Board and the Shareholders' Council. It is important that the criteria keep pace with the way farmers structure their businesses.

The wording change just defines who can put themselves forward for consideration as a Farmer Director. They have still got to get through either the Independent Nomination Process or the Self Nomination Process 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

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 determine the required 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 not approve a candidate where it believes this skill requirement is not met by the collective Board. Ultimately, farmers will have the final say.

## Getting the right balance on our Board

We need access to a range of people and opinions to give ourselves the best chance of getting the right skills to match our business over time.

Currently, under the Constitution, there can be a maximum of nine Farmer Directors and a maximum of four Independent Directors.

Going forward, the maximum number of Farmer Directors will be set at seven, and the maximum number of Independent Directors at four.

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

There are a number of other requirements for Directors that support those 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.

## Why just a reduction of Farmer Directors?

Independent Directors give our Board access to highly specialised financial skills (which are required by our regulatory framework) and current international experience (that is critical to the success of our Co-operative). The Board and Shareholders’ Council believe that retaining four Independent Directors is critical to maintaining adequate access to the specialist financial skills and current international experience that our Co-operative requires.

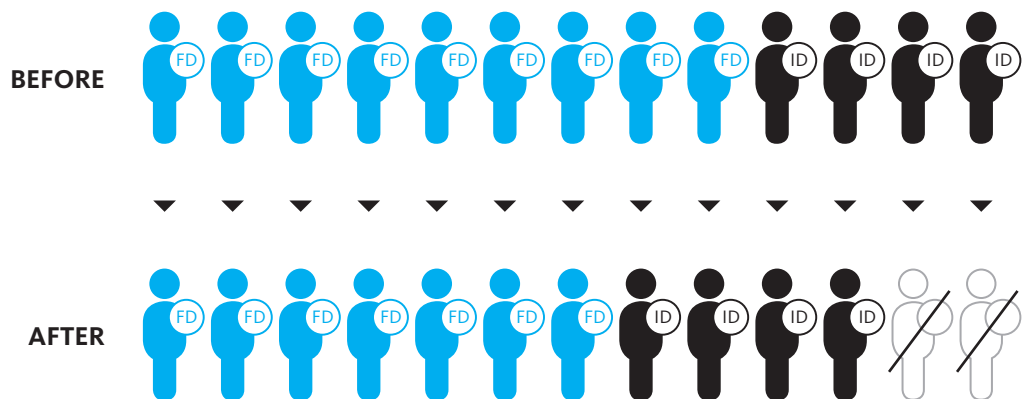
## What our Board could look like

### 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



## Attributes and skills matrix

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### Attributes all of our Directors should have

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

We have defined a set of attributes that we expect every Board member to demonstrate. They are what make them fit to govern our Co-operative. Every Director candidate must be able to demonstrate the attributes.

#### Attributes:

- Understanding of and commitment to the highest standards of governance
- Understanding of and empathy with the Co-operative
- 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

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

We recommend the development of a new skills list, and that the Board is mapped against it to identify any skill gaps.

This will be updated annually by the Board and made available to farmers, and will provide useful information for farmers to judge candidate information against when voting.



# DIRECTOR APPOINTMENT PROCESS

## Summary of recommendation:

- Retain current method for appointing Independent Directors.
- New Farmer Director Nomination Process
  - An Independent Nomination Process
    - Farmers can choose to make a confidential application and be assessed by an Independent Selection Panel, with Board and Shareholders' Council endorsement
  - A Self-Nomination Process
    - Farmers with a threshold level of support can nominate themselves directly if they choose to stand outside the Independent Nomination Process.
- A new Farmer Director Election Method
  - Shareholders' Council is responsible for the election rules
  - Removal of the current Single Transferable Vote (STV) election process in favour of a simple 'First Past the Post Majority' voting system
  - All candidates will require the support of at least 50 per cent of Shareholder votes cast to be successful.

## Details of the recommendation:

We have improved the original recommendation to give farmers choice. The new appointment process for Farmer Directors is the best of both worlds. The confidential Independent Selection Panel will give us access to the best candidates from within our farmer base, and the ability for candidates to stand outside of that process will give farmers choice.

### Independent Director Appointments

Independent Directors will continue to be appointed by the Board as they are today.

Expert advice strongly suggests that if we asked Independent Director candidates to stand for election in a contested format we would not attract the best Independent Director candidates to our Board.

The existing process for selecting Independent Directors works well. Farmers can (and do) make informal suggestions to the Board about names for Independent Directors and these are taken into consideration.

### Farmer Director Nomination Process

The Board and the Shareholders' Council have:

- Developed an Independent Nomination Process where farmers are given guidance on preferred candidates by an Independent Selection Panel, the Board and the Shareholders' Council.
- Enabled farmers with the required level of support (signatures from 35 different Shareholders) to nominate themselves directly to stand for election. This gives farmers the choice that they have asked for:
  - 1 Farmer Director candidates can choose to participate in the **Independent Nomination Process**, which is confidential and offers a rigorous assessment by an Independent Selection Panel and an endorsement by the Board and Shareholders' Council
  - 2 Or, Farmer Director candidates can nominate themselves under the **Self-Nomination Process** with the support of a group of fellow farmers
- Voting farmers then have a choice of accepting the guidance of the Independent Selection Panel, Board and Shareholders' Council, or selecting a candidate who has opted to stand outside the process.

The recommended Independent Nomination Process is summarised in the diagram on page 17.

### 1 Independent Nomination Process for Farmer Director Candidates

- Everyone who meets the Farmer Director eligibility criteria can put themselves forward.
- Applications are confidential, drawing out the broadest range of candidates from within our farmer base and giving us the best chance to access the skills the Co-operative needs.
- The assessment process is carried out by a totally independent selection panel which makes a clear recommendation.
- There is oversight and input from the Shareholders' Council which will act as farmers' eyes and ears in the nomination process and make sure decisions are made in the best interests of the Co-operative.
- Farmers retain the final say and have access to the information needed to support their decision.

## 2 Self-Nomination Process for Farmer Director Candidates

The key features of the self-nomination process are set out below. The design aims to give farmers choice, and:

- Creates a level playing field for all candidates.
- Is open to all farmers but discourages frivolous nominations which are a waste of Co-operative resources.

These features will be contained in the Farmer Director election rules. The Farmer Director election rules will be governed by the Shareholders' Council, which will be responsible for updating the rules at its discretion. The draft election rules are available to view at [www.nzfarmsource.co.nz](http://www.nzfarmsource.co.nz).

### Timing

- When the call for applications for the Independent Nomination Process is made, all farmers will be given information describing the nomination process, the details that will need to be presented in the voting pack, and the requirements that need to be satisfied – including the timing of the period for lodging applications for the Self-Nomination Process.
- Farmers who intend to nominate themselves will be able to prepare their applications during the period that the Independent Nomination Process is underway.
- The period for lodging Self-Nominations will be at least five business days following the announcement of the candidates nominated under the Independent Nomination Process.

This timing:

- Enables Shareholders to see the candidates recommended by the Independent Selection Panel, the Board and the Shareholders' Council before deciding whether to put themselves forward to the vote.
- Ensures that all candidates under the Self-Nomination Process have an equal amount of time to prepare their applications.
- Prevents the Independent Selection Panel, Nominations Committee and Shareholders' Council from being perceived to be influenced in their assessment of candidates by who is applying outside the process.

### Threshold of Support Required

- Farmers wishing to nominate themselves to stand for the Board will need to obtain the support of 35 different entities who are Shareholders. Entity names, and the individuals who signed on their behalf, will be published.
- The purpose of this requirement is to discourage frivolous nominations and ensure that Co-operative resources are not wasted.

### Other Rules

- Candidates who opt to use the Independent Nomination Process in any year and are not successful cannot then stand outside of that process in the same year. This is to preserve the robustness of the Independent Selection Panel.
- It is important that once the support threshold is met, Self-Nominated candidates are provided with a level playing field to compete for a seat on the Board. Self-Nominated candidates will be subject to the same Code of Conduct as other candidates and will be included in the relevant voting pack and the official 'meet the candidate' events.

## Why not vote from a shortlist?

We gave serious consideration to the Independent Selection Panel recommending a shortlist of candidates for farmers to vote on. Having talked this through with farmers since June, a vote off the shortlist will not deliver the outcome farmers are looking for.

We have confidence that the Independent Nomination Process will deliver the best possible candidates, with the diversity of attributes and skills we will need on our future Board. However, if farmers want to consider a candidate who brings a different skill set altogether, a vote off the shortlist will not deliver that outcome.

Voting off a short list would just give farmers more of the same. Candidates from the same process, measured against the same criteria, by the same people. The best way to give voting farmers a real choice and achieve the outcome we are looking for is to let candidates stand outside the nomination process.

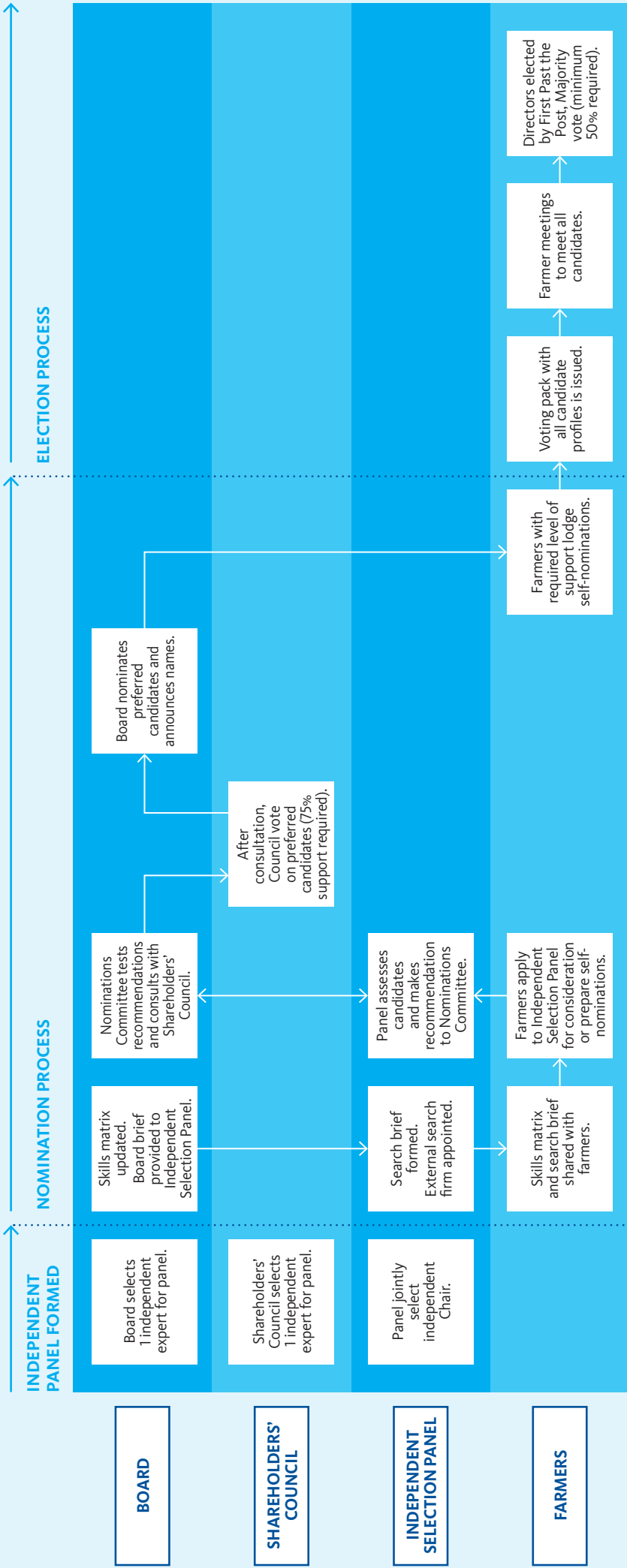
# Farmer Director Selection Process

**NOMINATIONS COMMITTEE**

- 2 Independent Directors
- 2 Farmer Directors
- 2 Shareholders' Council observers

**INDEPENDENT SELECTION PANEL**

- 1 independent expert appointed by Shareholders' Council
- 1 independent expert appointed by Board
- 1 independent expert appointed by panel members as Chair



**Independent Selection Panel formed:**

Your elected Board and Shareholders' Council have an equal voice in appointing the Independent Selection Panel. They will each choose one independent expert to sit on the Panel. Those two independent experts will then select a third independent expert to act as Chair of the Panel. The Panel will ensure the rigour and independence of the independent Nomination Process.

**Nomination Process:**

A search brief that details the skills and attributes the Board is looking to fill will be shared with all farmers. At the same time, information and instructions for the self-nomination process will be shared with farmers – including the information that candidates will need to provide for the voting pack. The Independent Nomination Process will proceed first, with candidates undergoing a confidential assessment process. The Independent Selection Panel will form its recommendation and present that to the Board's Nominations Committee. The Nominations Committee will select its preferred candidates based on the Panel's recommendation and consult with the Shareholders' Council, which will use information from its observers on the Nominations Committee to decide whether or not to support the preferred candidates. The Board will then nominate the preferred candidates and their names will be announced. The window for lodging self-nominations will then open. Any farmer with the support of 35 Shareholders can put their name forward.

**Election Process:**

Once all nominations have been received, the voting pack will be sent to Shareholders and the election process will begin. During the election period, farmers will have the opportunity to meet all of the candidates at a series of meetings hosted by the Shareholders' Council Chairman. All candidates will adhere to a strengthened Code of Conduct. Farmer Director elections will take place using First Past the Post, Majority voting. To be appointed to the Board a candidate must obtain at least 50 per cent support from Shareholders. Of the candidates that get 50 per cent support, the candidates with the highest number of votes will be appointed.

## Election Method: 'First Past the Post Majority'

- The recommended voting method would operate as follows:
  - Each Shareholder must vote yes or no for each candidate
  - Shareholders can only vote yes for as many candidates as there are seats to be filled, but may vote no for as many candidates as they wish
  - Candidates require 50 per cent support from those voting to be elected to Board
  - Of the candidates with more than 50 per cent support, the person/s with the highest number of votes is / are selected.
- If not enough candidates obtain 50 per cent support:
  - Another election must be held for the unfilled positions
  - Shareholders' Council will have discretion to set rules for a second election depending on circumstances at the time – the focus will be on the most efficient process – with a likely 1-2 month timeframe
  - If it sees a need, Board can use its constitutional power to make a temporary appointment to fulfil requirements of the Constitution until the next election.
- Farmers told us they want an election process that is free of politics and focussed on getting the best people onto the Board. Contested elections do increase the potential for electioneering on representation issues. To avoid this risk, all candidates will be subject to a strengthened Code of Conduct which is controlled by the Shareholders' Council. It is available to view on [www.nzfarmsource.co.nz](http://www.nzfarmsource.co.nz).
- The Shareholders' Council will set the election rules and can develop them over time to respond to issues that arise. In setting the election rules (including the Code of Conduct) the Shareholders' Council will consult with the Board as well as relevant experts and take their views into account before making their final decisions.

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

- Balances international best practice with our unique Co-operative requirements
- Delivers better information to help farmers make their decision, giving independent guidance based on attributes and skills of the candidates
- Means farmers don't have to consider candidates who cannot gather a threshold level of support

- Better ensures we get the best Directors with the right skills by delivering a confidential, independent process for assessment and nomination that will cater to a broader group of farmers
- Gives farmers the choice to nominate themselves directly to a vote if they choose not to go through the Independent Nomination Process.

## Length of term and rotation of Directors

The current rotation rule for Farmer Directors will be applied with changes necessary to preserve three-year term lengths.

The Board can 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 considered 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 he or she 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. If this occurs, that fact is explained to farmers, together with reasons for the extension.

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-operative, 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 review is maintaining 100 per cent farmer ownership and control of our Co-operative. Ownership is not affected by the recommendation. The way farmers vote changes, but farmers still have the final say.

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

The diagram opposite helps to illustrate how your control toolkit will strengthen under the new recommendation.

## Farmer Control

### Current and Future Recommendations

#### NOW

##### HOW YOU EXERCISE CONTROL NOW

###### YOU

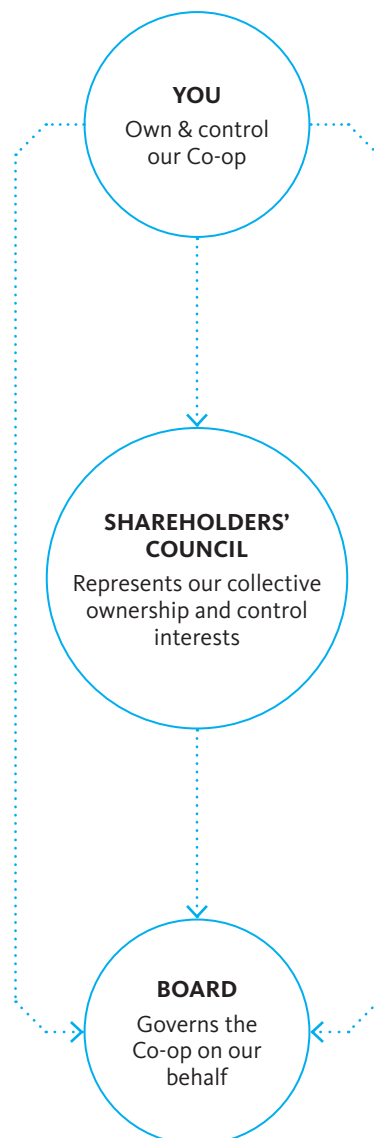
- Elect Councillor on SHC to represent your interests
- Elect Farmer Directors under STV system
- Ratify Independent Director appointments (50% approval required)
- Have the power to propose, vote on and pass a non-binding resolution relating to the management of the Co-op
- Can call a special meeting of Shareholders (together with Shareholders 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 elected by farmers using a First Past the Post, Majority process
- 50% farmer support now required for Farmer Directors to be appointed
- Farmers can still remove Director(s) 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 Nominations Committee – this provides increased transparency of the selection and assessment process for Independent Nomination Process candidates
- Shareholders' Council is consulted by the Nominations Committee on the recommended Independent Nomination Process candidates
- Shareholders' Council 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.

## Implementation

The key considerations of the Board and the Shareholders' 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 a transition to the new Board composition rules.

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 14 months.

The transition plan is as follows:

|             | <b>Transition Changes</b>  |
|-------------|--|
| <b>2016</b> | At the 2016 Annual Meeting the number of Farmer Director seats will be reduced by one. Two Farmer Director seats are required to be vacated and filled at the Annual Meeting.  |
| <b>2017</b> | At the 2017 Annual Meeting the number of Farmer Director seats will be reduced by one again to bring the total number of seats on the Board to eleven. Two Farmer Director seats are required to be vacated and filled at the 2017 Annual Meeting. |
| <b>2018</b> | From 2018 onwards the new Board composition will apply.  |

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

# INDEPENDENT EXPERT PANEL REPORT (GOVERNANCE AND REPRESENTATION) AMENDMENTS TO ORIGINAL REPORT

## Introduction

The Governance and Representation Review Committee appointed a panel of experts to undertake an independent and objective review of the recommendations of the first round of governance and representation in June this year ("Panel").

As part of its work to refine the recommendations detailed within this Notice of Special Meeting, the Committee approached the Panel to undertake a further review of the updated recommendations and provide an updated guidance to Shareholders. Their report is set out below.

## Updated Shareholders' Council Review recommendations

The Panel notes that a separate expert panel has been formed to review the Shareholders' Council Review recommendations. Therefore, the Panel has limited its review of the representation aspects to a determination whether they detract from, or complement the revised governance recommendations.

The Panel unanimously supports the Shareholders' Council Review recommendations. It is our view that they do complement the revised governance recommendations.

## Summary of Panel views on updated governance recommendation

The Panel has reviewed the revised governance recommendations as a package. The views outlined in our original report still stand in respect of matters that have not been changed in the updated recommendation.

The Panel was strongly in favour of the removal of contested elections in the June recommendation. We believe that confidentiality for all candidates, and the removal of the contested election format, is critical to Fonterra's ability to gain access to the best possible people for its Board.

The Panel remains of the opinion that the single most effective way to improve Fonterra's governance is to attract and elect directors of the highest possible quality and calibre.

However, the Panel acknowledges that the June recommendation did not attract sufficient support from farmers and has reviewed the analysis of the feedback that was received in respect of the June recommendations.

The new recommendation aligns as closely as possible to best practice and is an acceptable compromise that will enable the Co-operative to move its governance structure forward. Shareholders will have to accept that some of the quality candidates Fonterra had sought to attract may still be put off standing for the Board. That is the necessary trade-off for giving Shareholders a choice.

On balance, the refined appointment process that is being recommended remains a significant improvement of the Co-operative's current system and will widen the pool of quality Director candidates compared to today.

The Expert Panel also supported the purity of the single appointment process for both Independent and Farmer Directors that was originally proposed. However, with the reintroduction of potentially contested elections, we strongly support the Co-operative's intention to separate and retain the current Independent Director appointment process. Independent Directors of the calibre required by Fonterra will not put themselves forward under a contested process.

**ISSUED 13 September 2016**



Chris Moller (Panel Chair)



Dame Therese Walsh



Dr Michael Cook



Dr Adrie Zwanenberg

# ORIGINAL INDEPENDENT EXPERT PANEL REPORT

## JUNE NOTICE OF MEETING

### 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 back-drop. 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 the 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 cooperatives 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 cooperatives, and has occupied board positions with numerous cooperatives, 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 THREE

# SHAREHOLDERS' COUNCIL REVIEW AND RECOMMENDATIONS

Since June, a working group from the Shareholders' Council has been leading a review of the representation function and reporting back to the full Shareholders' Council. Their findings and subsequent recommendations are detailed in this section.

This process has been a continuation of the thorough, year-long Governance and Representation Review process and has been overseen by the Governance and Representation Review Committee.

### Summary of the recommendations:

1. The Shareholders' Council's role is refocused on the delivery of its constitutional duties alone.
2. The number of Shareholders' Council committees is reduced from four to three.
3. Over the next 12 months, the number of Shareholders' Council Wards is reviewed to establish if and how they can be reduced within the range that is permitted under the current Constitution.
4. The interface document between the Shareholders' Council and Board is updated and made available to farmers.
5. Shareholders' Council's communications with farmers will be written in a distinctive "owner's voice" and make better use of the Co-operative's modern communication tools.
6. Shareholders' Council will lead an oversight committee to refresh the Fonterra Networkers programme.
7. A regional Young Farmers Forum is established to improve the connection with our young farmers.
8. Introduce a set of attributes and capabilities for Councillors, to help farmers assess candidates during Shareholders' Council elections.
9. Introduce a maximum term for Councillors of nine years.

#### **Please note:**

- The previous recommendation that "*The Shareholders' Council formally engage with off-shore milk suppliers*" has been removed.
- The previous recommendation of "*An extra Councillor within the Wards of the sitting Shareholders' Council Chairman and Deputy Chairman to assist with their workload*" has also been removed.

### Details of the recommendations:

#### **"A Shareholders' Council that is focussed on its core role and accountable to its farmers."**

Farmers want a Shareholders' Council that continues to evolve, is lean and agile, and acts in the best interests of shareholders, providing genuine challenge to the Board on matters of shareholder interest.

To achieve that, the Shareholders' Council must focus its efforts on what is most important to farmers, and delegate or stop its other activities.

In recent times, Councillors have increasingly stepped in to support their fellow farmers in a variety of representative and advocacy roles within their communities. While the Shareholders' Council will continue its advocacy work on the big issues, such as DIRA, the ever-increasing scope of the role has made it less attractive to potential new Councillors and arguably diluted the Shareholders' Council's work on its core constitutional role.

The introduction of the Co-operative's new regional Farm Source model (regional heads and area managers) as the day-to-day connection between farmers, their Co-operative, and the community, provides the Shareholders' Council with the opportunity to refocus its effort and avoid duplication of effort with the Farm Source team.

Clarification of the roles and responsibilities of the Shareholders' Council, the Board and Management can be found in Appendix 1 of the Working Interface Document which can be viewed online at [www.nzfarmsource.co.nz](http://www.nzfarmsource.co.nz).

There are three recommendations related to the role of the Shareholders' Council. These changes will concentrate the Shareholders' Council's effort and improve its performance in the areas that are most important to farmers.

**Recommendation 1: The Shareholders' Council's role is refocused on the delivery of its constitutional duties as per Clause 16.1 of the Constitution.**

It is recommended that the role of the Shareholders' Council (Council) be set to the Constitution and focussed on the following areas:

1) *Monitoring:*

- Council will continue to act as the Co-operative's "cornerstone shareholder", monitoring and reporting on the performance of the Co-operative against specified targets and its strategy.
- Council will continue to provide farmers with an objective, independent opinion on matters which they deem to be significant from an owner's perspective.

2) *Farmer Connect:*

- Council will be responsible for ensuring we have an informed and connected farmer base within the Co-operative.
- Council will continue to represent the collective view of farmers up to the Board, and provide farmer-minded analysis of key Board decisions back out to the farmer base.
- Council will work with the Board to develop a pipeline of future leaders through educational programmes such as the Understanding your Co-operative Programme and the Governance Development Programme.
- Council will play a supportive role in developing farmers' understanding of the Co-operative's strategy and how key Board decisions relate to that strategy.
- Importantly, Council will continue to educate all farmers on the benefit of being in a Co-operative, who we are and why our Co-operative exists.

3) *Guardians of our Co-operative principles:*

- Council will be guardians of our Co-operative principles and continue to act as a sounding-board for the Co-operative's Board on matters that impact our individual farming businesses.
- Council will also continue to perform all of its existing formal and constitutional roles including:
  - Managing the Director elections process in consultation with the Board
  - Approving the company's Mission statement and values as proposed by the Board
  - Appointing the Milk Commissioner
  - Considering and, in consultation with the Board, proposing changes to the Constitution

- Ability to call a Special Meeting of Shareholders
- Consulting with the Board in relation to the Fonterra Shareholders' Market and Fonterra Shareholders' Fund
- Consulting with the Board in relation to the Milk Price Manual and Principles
- Sitting on the Board's Co-operative Relations Committee.

*(A full list of the Shareholders' Council's constitutional functions are detailed in Clause 16.1 of the Constitution)*

The Shareholders' Council's representative role requires a connection with the farmers of our Co-operative. For this to occur effectively, farmers have a responsibility themselves to engage with their Co-operative. This includes opportunities to gain knowledge and communicate in the many forums available such as meetings, educational seminars, emails and the Farm Source website.

A well informed shareholder base is critical to the model that our Co-operative operates under and every farmer shares this responsibility.

Recommendation 1 does not require any changes to the Constitution or the Shareholders' Council By-laws.

**Recommendation 2: The number of Shareholders' Council Committees is reduced from four to three.**

It makes sense that, with the role of the Shareholders' Council being concentrated under three focus areas, its committee structure be aligned to match.

Currently, the Shareholders' Council has four committees: the Performance Committee, Co-op Development Committee, Representation Committee and the Governance and Ethics Committee. A reduction down to three committees is recommended:

- 1) Cornerstone Shareholder Committee (monitoring and reporting)
- 2) Co-operative Culture Committee (representation, knowledge transfer, leadership development, and farmer connect)
- 3) Governance and Ethics Committee (guardians of our Co-operative principles).

Recommendation 2 does not require any changes to the Constitution or the Shareholders' Council By-laws.

**Recommendation 3: Over the next 12 months, the number of Shareholders' Council Wards is reviewed to establish if and how they can be reduced within the range that is permitted under the current Constitution.**

Currently, there are 35 Wards and each Ward has one Councillor. Within the current Constitution, the Shareholders' Council already has the ability to reduce the number of Shareholders' Council Wards down as low as 25. With the Shareholders' Council's role refocused on the things that matter most to farmers, reducing the size of the Shareholders' Council needs to be looked at. The Shareholders' Council will review the Ward boundaries with a view to reducing the number of Councillors, taking into consideration the contrasting demographic and geographical features of each Ward.

A smaller Shareholders' Council will increase the pool of potential Shareholders' Council candidates in each Ward, increasing competition and therefore the calibre of future Councillors. A leaner, more agile Shareholders' Council will increase the accountability of individual Councillors.

Recommendation 3 does not require any changes to the Constitution or the Shareholders' Council By-laws.

**Measure of success:**

We will measure the Shareholders' Council's performance against its objective of: "A Shareholders' Council that is focussed on its core role and accountable to its farmers," through:

- Voting participation
- Meeting attendance
- Contested Shareholders' Council elections
- Pipeline of future leaders putting themselves forward for Director nominations.

**“A working relationship between the Shareholders' Council, Board and Management that is based on mutual respect.”**

It's clear that across the farmer base there are different perceptions of the way and frequency that the Shareholders' Council, Board and the Co-operative's management team do and should interact. But at the end of the day, farmers just want to know that their voice is being heard by the right people, and that their Councillors are getting reasonable access to the information they need to fulfil their role.

This already happens today. The working relationship between the Shareholders' Council, Board and Management follows guidelines set out in a working interface document. The working interface also sets out the way information is shared between the groups.

It's in everybody's interest that Councillors continue to have quality information that enables them to stand alongside our Directors and challenge key decisions, then go back out to the farmer base and explain how those decisions are in the best interests of the Co-operative.

**Recommendation 4: The interface document between the Shareholders' Council and Board is updated and made available to all farmers.**

It is recommended that the interface document is updated and made available to farmers to provide transparency on how current interactions take place between the different groups. It will allow for the full Shareholders' Council and Board to meet at least twice a year, with one session set aside for familiarisation with the Co-operative's vision and strategy. This session will better empower Councillors to play a supportive role in developing farmers' understanding of the Co-operative's strategy.

The interface document will be available to all farmers. This will improve the understanding of each group's role. As owners, it will put farmers in a better position to judge whether or not the future Shareholders' Council and Board are continuing to interact as they should. It will continue to make each group accountable for their actions and build trust amongst farmers.

Recommendation 4 does not require any changes to the Constitution or the Shareholders' Council By-laws.

**Measure of success:**

We will measure the Shareholders' Council's performance against its objective of: "A working relationship between the Shareholders' Council, Board and Management that is based on mutual respect," through:

- Shareholders' Council and Board Chairs will discuss from time to time their respective views on how effectively the respective relationships are working
- Farmer feedback.

**“Trusted and transparent owner-to-owner communications.”**

Our farming businesses are directly impacted by decisions made by the Co-operative and we rely on the success of the Co-operative to grow our wealth. As such, we have a strong collective interest in ensuring that our voice is well represented up to the Board, that the rationale for key Board decisions is shared with us, and that we have enough information to individually hold the Board to account for performance.

Farmers want quality, independent analysis of the Co-operative's performance and a clear view of their Shareholders' Council's position on things that really matter to them.

**Recommendation 5: The Shareholders' Council will ensure communications reflect a distinctive 'owner's voice' and make better use of the Co-operative's modern communication tools.**

It is recommended that the Shareholders' Council's communications approach better reflect a distinctive 'owner's voice' and be based on a 'more concise, more often' principle. Farmers are time-poor and only want to read information that is important to them. They also want to receive it in a range of formats, appropriate to the content.

The Shareholders' Council's communication will be targeted at all farmers, not a select few. For the most part, they will be linked to the three new focus areas of the Shareholders' Council's role. The Shareholders' Council will use the Co-operative's existing Farm Source App and website to post regular updates and its position on issues that are important to farmers.

Individual Councillors will send out updates to their Wards from time to time to update them on Shareholders' Council activities and respond to unique topics of interest from within their Ward. They will be encouraged to use the Co-operative's existing regional Facebook pages to communicate informally within their Wards or with the wider farmer base.

The Shareholders' Council will continue to formally report on the Co-operative's performance through its existing reporting programme, including its Annual Report.

Recommendation 5 does not require any changes to the Constitution or the Shareholders' Council By-laws.

**Recommendation 6: The Shareholders' Council will lead an oversight committee to refresh the Fonterra Networkers programme.**

Our Fonterra Networkers programme is long overdue for a refresh. The traditional role of the Networker to share information within the farmer base has largely been superseded by modern technology.

It is recommended that the Shareholders' Council lead a committee, which includes the Chief Operating Officer Farm Source, to refresh the programme so that it aligns to a new purpose of 'building a stronger connect within our farmer base.'

The group will be opened to all suppliers who are interested in playing an active role in their Co-operative by:

- Supporting their local Councillor to canvas farmer sentiment on internal Co-operative issues
- Attending Co-operative meetings and the annual conference
- Taking part in field trials or providing a farmer's perspective on management initiatives that might impact on-farm practices
- Telling our story within their communities
- Championing our Co-operative culture within the wider organisation.

Recommendation 6 does not require any changes to the Constitution or the Shareholders' Council By-laws.

**Recommendation 7: A regional Young Farmers Forum is established to improve connection with the Co-operative.**

We all know how hard it is to get established in this industry. Our younger farmers' focus is rightfully on building their business, not on the internal workings of their Co-operative.

That said, their voice and connection to this Co-operative is vital to our future success. We need to make it easy for that voice to be heard and responded to.

It is recommended that a regional Young Farmers Forum be established to give our younger farmers an opportunity to interact with the Co-operative's leadership and senior management, and network with other young farmers starting out in Fonterra.

The Forum will be open to all supplying farmers and sharemilkers under 40 years old. Each region will have its own Chair from within its membership and that farmer will determine the best way for farmers in their region to interact. Local Councillors will act in a mentoring role and help provide opportunities for young farmers to grow and lead.

Recommendation 7 does not require any changes to the Constitution or the Shareholders' Council By-laws.

**Measure of success:**

We will measure the Shareholders' Council's performance against its objective of: "Trusted and transparent owner-to-owner communications," through:

- Positive farmer feedback
- Farmer comments in response to the Shareholders' Council's Farm Source posts
- Membership and participation in the Young Farmer Forum.

**"A high-performing organisation that has the respect of all farmers."**

We will strengthen the overall effectiveness of the Shareholders' Council if we do more to lift the skills and capabilities of individual Councillors and increase their accountability for performance. The Shareholders' Council also needs to reflect the age, gender and background diversity of our farmer base.

**Recommendation 8: Introduce a set of attributes and capabilities for Councillors, to help farmers assess candidates during Shareholders' Council elections.**

It is recommended that the desired attributes and capabilities of our Councillors be defined and formally included in the Shareholders' Council's systems – including its succession and development planning, election documents and performance reviews.

Councillors need to have or be working towards the following attributes and capabilities:

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

The Shareholders' Council will also let farmers know if they endorse sitting Councillors who are standing for re-election, so farmers will know if their local Councillor has been performing in the eyes of their peers.

The list of required attributes and capabilities and the requirement for the Shareholders' Council to endorse sitting candidates will be set out in the Shareholders' Council By-laws. Therefore, recommendation 8 requires a change to the Shareholders' Council By-laws.



**Recommendation 9: Introduce a maximum term for Councillors of nine years (three, three-year terms).**

It is recommended that the Shareholders' Council introduce a maximum term for Councillors of nine years. That is, a maximum of three, three-year terms after which a Councillor must retire unless he or she is asked by the Shareholders' Council – for continuity or experience reasons – to extend the term by another three years.

A maximum term for Councillors will help to ensure that the Shareholders' Council is refreshing itself on a regular basis and providing new opportunities for fresh leadership to come through from the farmer base.

A nine year tenure gives new Councillors time to get up to speed with Shareholders' Council business, make a significant contribution to our Co-operative, pass on their knowledge to the next group of Councillors, and then freely retire having done their bit.

As they do now, our alumni of ex-Councillors will remain connected members of our Co-operative. Their insights and experiences gained while on the Shareholders' Council will not be lost to us.

The maximum term for Councillors will be set out in the Shareholders' Council By-laws. Therefore, recommendation 9 requires a change to the Shareholders' Council By-laws.

**Measure of success:**

We will measure the Shareholders' Council's performance against its objective of: "A high-performing organisation that has the respect of all farmers," through:

- Positive farmer feedback to the Shareholders' Council's leadership
- Attendance at Shareholders' Council events
- Contested Shareholders' Council elections
- Sitting Councillors who exhibit the majority of the defined attributes and capabilities.

# INDEPENDENT EXPERT PANEL REPORT (SHAREHOLDERS' COUNCIL REVIEW)

## 1. INTRODUCTION

1.1 **Introduction:** The Governance and Representation Review Committee ("the Committee") has appointed a panel of experts, known as the Shareholders' Council Review - Independent Expert Panel ("the Panel"), to undertake an objective and independent review of recommendations in relation to Fonterra's representation structures and processes which have been prepared by the Shareholders' Council ("the Recommendations"), assist the Shareholders' Council to fine-tune the Recommendations, and report to Fonterra's shareholders ("Shareholders") on the results of the Panel's review.

1.2 **Panel Members:** The Panel comprises the following individuals:

- (a) Sir Mark Solomon;
- (b) John Spencer; and
- (c) Sue Lindsay.

1.3 **Credentials:** The credentials of the Panel Members are appended to this report. They cover a deep and diverse range of experience relevant to representation and governance, across iwi, community and commercial organisations.

## 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 **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 Shareholders' Council Review - Discussion Document (which sets out the Recommendations) and other applicable cornerstone documents, including extracts from previous reviews, the Shareholders' Council's constitutional responsibilities and the Notice of Meeting for the Special Meeting held on 10 June 2016;
- (b) Discussed the Recommendations, and the rationale for them, in depth with the Management team supporting the Governance and Representation Review Committee;
- (c) Reviewed feedback from focus group discussions of the Recommendations and (through a representative Panel member) observed a focus group discussion, in order to understand the diversity of opinions throughout the Shareholder base; and
- (d) 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.

2.3 **Reporting and recommendation:** The Panel has sought to summarise its views on the Recommendations, and provide Shareholders with an objective assessment of the extent to which the Recommendations adequately address and deliver the desired outcomes of the issues that have been identified as requiring focus, 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 to assist Shareholders in determining whether to adopt the Recommendations.

## 3. PANEL VIEWS

3.1 **Summary of Panel's view:** The Panel unanimously supports the Recommendations. This is because:

- (a) It is essential for a co-operative of Fonterra's size and geographic scale to have a high performing and effective representative body, to ensure that there is a formal way for the representative voice of Fonterra's farmers to be heard by the Board and management of Fonterra. The Panel sees it as essential that the roles of the Shareholders' Council, and other bodies or structures involved in Fonterra's representation function, are well understood by all involved. In order for the Shareholders' Council to be effective, it must have credibility, status and *mana* as the constitutional protector of Fonterra's co-operative principles.
- (b) In the Panel's view, the Recommendations are well-targeted to achieve their stated goals of strengthening Fonterra's representation structures and processes. The Panel sees role clarity and communication as the key to improvement in this area: having clear understanding of the roles, accountability and lines of communication between the Shareholders' Council and the Board, between farmers and the Shareholders' Council, and between farmers and the Board, and farmers and Management is essential to build credibility, trust and for all functions to be effective. The three areas of focus of the Recommendations reflect this: role clarity will enable better communication of Council's functions and activities, a strong working relationship will provide clear lines of accountability and expectations between the various functions, and the Shareholders' Council's communications to farmers will be more targeted, transparent and useful.
- (c) The Panel notes that the successful implementation of the Recommendations does not come down to just one body or one set of changes - instead, the Board, Shareholders' Council, and Management team must be aligned in their commitment to working together to achieve the desired improvements for Fonterra.

3.2 **Observations:** The Panel also makes the following observations for Fonterra to consider in giving effect to the Recommendations.

*Role clarity and Communications*

- (a) It will be important to ensure that the respective roles of the Shareholders' Council and the Board are set in a relationship of mutual respect, to avoid an "us and them" approach. As noted above, the Shareholders' Council should have credibility, status and *mana* as the constitutional protector of Fonterra's co-operative principles, and it should therefore have a clear focus on its functions and duties under Fonterra's Constitution.
- (b) The Panel endorses the Recommendation to refocus the Council's role on its constitutional duties. Getting this right will address the imbalance of workload and perceptions of what good performance looks like for the Council. By the very nature of this re-focus, the Council will become more effective, the role will become more attractive and perceptions of performance will be based off a common understanding of what is expected of Council and Councillors.
- (c) Considering the re-defined scope of the Council, the Panel supports the Recommendations to change the Committee structures and intention to review the number of Wards.
- (d) The Panel noted the possible overlap and duplication between activities carried out by the regional management teams and the Shareholders' Council, and considers that a clear definition of each body's role would ensure farmers know who to approach in relation to particular issues.
- (e) Greater visibility for farmers over the matters discussed by the Shareholders' Council (for example, in separate updates from the Shareholders' Council) would give farmers a level of comfort and understanding as to the Council's activities. Communications from the Shareholders' Council should show its distinctive voice and opinions on relevant issues. The Panel also invites Fonterra to consider the extent to which the distinctive voice of the Shareholders' Council could be publicised in rural and other news media.
- (f) Communications should be on the basis of a "no surprises" policy - that is, issues relevant to farmers, the industry and Fonterra should be communicated to the Council and/or the Board as they arise (to the extent practicable in the circumstances, including any confidentiality considerations).
- (g) To achieve this, the Panel supports (and considers that Shareholders as a whole support) the use of multiple platforms and forms of communication, including a strong focus on improved use of modern technology to enhance Shareholder engagement and amplify trust and transparency.

- (h) The Panel particularly supports the Recommendation for a regional Young Farmers Forum. As young farmers are the future leaders of Fonterra, the Panel supports an approach that improves young farmers' connection and engagement, and highlights the value of Fonterra's co-operative principles for the next generation of its farmers.

*Working relationship*

- (i) The Panel particularly supports the Recommendation for a revised "Interface Document" to be published and for it to be adhered to. Scheduled meetings should involve more collaborative agenda setting and participation by a wider section of the Board. It is recommended that the first part of these meetings should take place without management present. The Panel also suggests that the Shareholders' Council accompany the Board on its annual results roadshow, in addition to having separate Shareholders' Council presentations to farmers.
- (j) The re-write and publishing of the Interface Document should be a priority, but this document alone will not change the perception of the credibility of the Council, or perceived lack of respect. Both parties will need to agree on the working relationship protocols and find ways to demonstrate that mutual respect - this is paramount to achieving the desired outcomes of this Review. If the Shareholders' Council is utilised as a "sounding board" for relevant decisions, the Board and Council will need to ensure that this does not slow down the decision-making process or compromise Fonterra's agility. This function would need to be carefully defined in the "Interface Document" between the Council, the Board and management.

*Other comments*

- (k) In keeping with the role of the Shareholders' Council as constitutional protector of Fonterra's co-operative principles, the Panel supports the Council being a larger body than the Board. The Panel supports the Recommendation that any reduction in size should be within the range already permitted under Fonterra's Constitution, which the Panel understands to be 25.
- (l) The Panel endorses the Recommendation for there to be a statement of the desired skills and capabilities for Shareholders' Council members. A key part of having a high performing and effective representation body is the ability to have "the best people for the job", and the Panel considers that a statement of desired skills and capabilities will allow Shareholders to hold their Shareholders' Councillors to account and to make the best informed decisions about the membership of their representative body.

(m) In keeping with this, the Panel invites Fonterra to consider requiring Shareholders' Councillors to commit to ongoing training and building of relevant broad based Co-operative and Governance knowledge to enhance the effectiveness of their roles. In the Panel's view, this could assist to build the desired set of skills and capabilities and maximise the Shareholders' Council's performance. The Shareholders' Council should be seen as a skills enhancement arena for future industry leaders.

(n) Finally, it should be considered how special interest groups are engaged with. There should be clear processes for engagement with special interest groups on relevant matters, to ensure that special interest groups' views can (where appropriate) be represented as part of Shareholders' views as a whole.

**3.3 Recommendation:** The Panel unanimously supports the Recommendations and recommends that the Recommendations be adopted by the Shareholders.

**ISSUED: 13 September 2016**



Sir Mark Solomon



John Spencer



Sue Lindsay

## APPENDIX

**Sir Mark Solomon** is committed to the betterment of his iwi, kotahitanga for Māori and the wider well-being of people and the environment. He is a strong advocate for the Māori economy and was instrumental in setting up the Iwi Chairs Forum (2005). He is the elected Kaiwhakahaere (Chair) of Te Rūnanga o Ngāi Tahu, a position he has held since 1998. Sir Mark's contribution to his community has been diverse and significant, ranging from roles as a school board trustee, to a past board member of the Museum of New Zealand (Te Papa Tongarewa). In 2013 he was awarded Knight Companion of the New Zealand Order of Merit for services to Māori and Business. In April 2015 he received an Honorary Doctorate from Lincoln University as Doctor of Natural Resources, recognising his enduring interest and concern for our natural environment. Sir Mark's current directorships include the Advisory Board on CERA Transition, and he is a trustee of Pure Advantage and a member of the NZ China Council. He was an original member of the Minister for Māori Affairs Māori Economic Taskforce, established in 2009.

**John Spencer** has been appointed by the Fonterra Board as an independent Chairman of the Candidate Assessment Panel. John was appointed to the CAP in 2012 as an Independent member. John has extensive governance experience: he is presently the Chairman of Kiwi Rail Limited, Raukawa Iwi Development Limited, Tertiary Education Commission, Waikato Regional Airport Ltd and a Director of Mitre 10 Limited. Previously, John was the Chairman of Tainui Group Holdings, WEL Networks and AsureQuality. Prior to the formation of Fonterra, John was the Chief Executive of New Zealand Dairy Group.

**Sue Lindsay** is an internationally award-winning executive, recognized as New Zealand Young Executive of the Year, and winner of the World Young Business Achiever Award. Her career has taken her from running the family farm to the leadership of CRT in Southland, where she is directly credited with masterminding a strategy that increased revenues by over 200% in less than five years. Leaving her corporate career, Sue has become one of this country's most sought-after speakers. She is a Master Executive Coach and retained by leaders as a mentor and strategist. Sue is the cofounder and CEO of Think Actual, an insights and strategy consultancy working with clients across New Zealand and Australia. Her governance experience includes the SOE Genesis Power and The Dairy Women's Network. She is currently a Director of Ashburton Trading Society and a member of the BNZ Growth Programme Faculty (a position she has held for eight years).

## PART FOUR

# 5 YEAR REVIEW OF THE RECOMMENDATIONS

These recommendations will improve our governance and representation structures and processes to consistently deliver the best outcomes for our Co-operative.

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

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

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-operative.

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 timeframe and in the manner specified above.

The Terms of Reference for this review are available for farmers to view on [www.nzfarmsource.co.nz](http://www.nzfarmsource.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 FIVE

## GOVERNANCE RELATED AMENDMENTS TO THE CONSTITUTION AND THE SHAREHOLDERS' COUNCIL BY-LAWS

## 1. Amendments to the Constitution

| Proposed amendment  | Explanatory notes  |
|---|--|
| <p><b>12. APPOINTMENT, ROTATION AND REMOVAL OF DIRECTORS</b></p> <p>12.1 <b>Number of Directors:</b> There shall be <del>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:</del></p> <p>(a) <del>not more than 9 until the conclusion of the 2016 annual meeting, 8 until the conclusion of the 2017 annual meeting, and 7 thereafter, are</del> Directors elected by Shareholders in accordance with clauses 12.2 and 33.4 or appointed by the Board in accordance with clause 33.1; and</p> <p>(b) <del>not more than 4 are</del> Directors appointed by the Board in accordance with clause 12.4.</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>12.2 <b>Election by Shareholders:</b> Subject to clause 12.1, a person may be elected or removed as a Director <del>from the conclusion of an annual meeting of the Company</del> 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.</p>  | <p>The changes in this clause allow for the scenario where not enough candidates receive 50% support, in which case the Shareholders' Council may run a second election or by-election, and Directors will be elected at the end of the process in accordance with the rules set by the Shareholders' Council.</p>   |
| <p>12.3 <b>Qualifications of Directors:</b> No person shall be elected as a Director by Shareholders or hold office as a Director elected by Shareholders in accordance with clause 12.2 <del>1(a)</del> unless he or she <del>has a direct or indirect interest in a Shareholder that is supplying Milk to the Company which comprises either:</del></p> <p>(a) <del>a direct or indirect legal or beneficial interest in that Shareholder (including as a beneficiary of a trust); or</del></p> <p>(b) <del>a right or entitlement to participate (directly or indirectly) in the distributions of, or made by, that Shareholder,</del></p> <p>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:</p> <p>(a) is a Shareholder <del>that is supplying Milk to the Company;</del> or</p> <p>(b) is a shareholder of a company that is a Shareholder <del>that is supplying Milk to the Company;</del> or</p> <p>(c) is a member of a partnership that is a Shareholder <del>that is supplying Milk to the Company;</del> or</p> <p>(d) <del>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,</del></p> <p>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. <del>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.</del></p> | <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> |

| Proposed amendment  | Explanatory notes   |
|---|---|
| <p>12.7 <b>Rotation of Directors:</b> At each annual meeting of the Company 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. 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 eligible for re-election. <b>Where the application of this rule would cause an elected Director to serve a term exceeding three years, then that Director must also retire from office.</b></p>  | <p>This change preserves the three year rotation cycle for Farmer Directors.</p>  |
| <p>33.3 <del>[Not used] <b>Re-election of retiring Director:</b> 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:</del></p> <p><del>(a) — some other person is elected to fill the vacated office; or</del></p> <p><del>(b) — it is resolved not to fill the vacated office.</del></p>   | <p>The process for election of directors is now covered in clause 12.2 and 33.4. As a result this clause is no longer needed.</p>   |
| <p>33.4 <b>Nomination of Directors:</b> <del>Notwithstanding anything in clauses 12.7 or 33.1, n</del> No person may be elected as a Director by a postal ballot of Shareholders in accordance with clause 12.2 <del>(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,</del> that person qualifies to be appointed as a Director in terms of clause 12.3 and has been nominated <b>in accordance with the written procedures adopted by the Shareholders' Council in accordance with clause 12.2 for holding postal ballots of Shareholders for the election or removal of Directors 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.</b> 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.</p> | <p>These changes provide a mechanism for persons who wish to put themselves forward for election (including retiring Directors seeking re-election) to apply in accordance with the rules adopted by the Shareholders' Council under clause 12.2.</p> |

Please note that under FSM Listing Rule 3.1.1(b) and clause 48.4(d) of the Constitution, if any provision in the Constitution is inconsistent with the FSM Listing Rules, that provision shall be deemed amended, or deleted, to the extent necessary to make that provision consistent with the FSM Listing Rules. A copy of the FSM Listing Rules can be viewed at: [www.nzx.com/regulation/FSM-rules](http://www.nzx.com/regulation/FSM-rules).

## 2. Amendments to the Shareholders' Council By-laws

- 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 pursuant to clause 12.1(a) of the Constitution) 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 **Approval to stand:** The Council must assess (and resolve, by 75% majority in accordance with clause 5.8) whether it approves the candidacy of any proposed candidate for election as a Director (pursuant to clause 12.1(a) of the Constitution). The matters to be considered by the Council for the purposes of each such resolution shall be limited to an assessment as to whether there is anything in the process by which the candidate has been nominated, or pertaining to the candidate themselves, that causes the Council to consider that the candidate is not a suitable person to put himself or herself forward for election as a director. The chairperson of the Council must advise the Nominations Committee as to the outcome of each such resolution, and the Board will disclose the outcome, and any reasons provided by the chairperson of the Council for it, in the nomination that forms the basis for the postal ballot in which the candidate is proposed to be elected.

## PART SIX

## REPRESENTATION RELATED AMENDMENTS TO THE SHAREHOLDERS' COUNCIL BY-LAWS

- 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:**
- Councillors may not serve for longer than nine 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 nine years, for longer than the date of the third Election since that Councillor was first elected) unless the Council resolves (by 75% majority in accordance with clause 5.8), for reasons of continuity or experience, to approve the Councillor standing for re-election for a fourth term; and
  - Councillors shall not hold office for more than 12 years (or, where the Election cycle in a Ward is such that the period between the time a Councillor was first elected and the fourth Election in that Ward is greater than 12 years, for longer than the date of the fourth 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.
- 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.

## 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   |

| 2008 - 2010 |                       |   |
|-------------|-----------------------|---|
| Ward        | District              | Year of annual meeting of the Company in which Councillors retire |
| 1           | Northern Northland    | 2008  |
| 2           | Whangarei             | 2009  |
| 3           | Northern Waikato      | 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 | 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 |
| 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 |

|    |                      |      |
|----|----------------------|------|
| 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 | 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 SEVEN

## SUMMARY OF KEY CHANGES TO RELEVANT DOCUMENTS TO GIVE EFFECT TO THE RECOMMENDATIONS

As well as the amendments to the Constitution and the Shareholders' Council By-laws that are contemplated by the Shareholder resolutions 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](http://www.nzfarmsource.co.nz).

| Changes to documents   | Where in document | Where to find details of the specific changes   |
|--|-------------------|---|
| <b>1. Constitution</b>   |                   |   |
| (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 14 months.)   | Clause 12.1       | In Part Five of the Notice of Meeting. A marked up copy of the full Constitution showing the changes is also available to view online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a> |
| (b) Voting for Directors in accordance with the processes adopted by the Shareholders' Council (including an ability to hold a second election or by-election not linked to an annual meeting, if insufficient candidates achieve 50% support).  | Clause 12.2       |   |
| (c) Updated version of the current qualification test for Farmer Directors, reflecting modern ownership structures.  | Clause 12.3       |   |
| (d) Amendment to rotation rule, to preserve three-year terms.  | Clause 12.7       |   |
| (e) Sitting directors will not automatically be deemed re-elected if no candidate achieves the requisite level of support.   | Clause 33.3       |   |
| (f) Any intending candidate must be nominated in accordance with the procedures adopted by the Shareholders' Council.  | Clause 33.4       |   |
| <b>2. Director Election Rules</b>  |                   |   |
| (a) Candidates may apply under either the Independent Nomination Process or the Self Nomination Process. The particular process that a candidate has followed will be disclosed. A candidate who has applied under the Independent Nomination Process may not then apply under the Self Nomination Process for the same election cycle.  | Para 3.2(a)       | Online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a>  |
| (b) Under the Independent Nomination Process, candidates will need to apply to the Independent Selection Panel and be endorsed by it, the Nominations Committee and the Board, and the Shareholders' Council will also consider whether it approves the candidacy.   | Para 3.2(b)       |   |
| (c) Under the Self Nomination Process, candidates may nominate themselves. The nomination must be seconded by at least 35 Shareholders. The names of the Shareholders and individual signatories will be disclosed. (The purpose of this requirement is to avoid frivolous nominations.)   | Para 3.2(c)       |   |
| (d) Self-nominated candidates will have a period of at least five working days following conclusion of the Independent Nomination Process to submit their nominations.   | Para 3.4          |   |
| (e) Voting will be by "first past the post majority voting", under which all candidates must have at least 50% support to be elected and the highest-ranked candidates will be elected if there are more successful candidates than vacancies. If there are fewer successful candidates than vacancies, the Shareholders' Council must conduct a second election or by-election. | Para 4.2          |   |

| Changes to documents  | Where in document | Where to find details of the specific changes                                |
|---|-------------------|--|
| <b>3. Terms of Reference of Independent Selection Panel</b>   |                   |  |
| (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 3            | Online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a> |
| (b) The functions of the Independent Selection Panel include publishing the skills matrix and a search brief, engaging appropriate search firms, assessing candidates, providing a recommended set of candidates (and alternatives) to the Nominations Committee and providing a report on its process for inclusion in the relevant voting pack.   | Para 2            |  |
| (c) The Independent Selection Panel's assessment of candidates will be confidential until the names of the nominated candidates are released by the Board. The names and assessment of candidates that are not ultimately nominated will be kept confidential.  | Para 7 and 8(c)   |  |
| <b>4. Nominations Committee Charter</b>   |                   |  |
| (a) The Nominations Committee is responsible for recommending to the Board candidates for election as Farmer Directors and appointment as Appointed Directors.  | Para 2.1          | Online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a> |
| (b) The Independent Selection Panel will identify and select an appropriate set of candidates (equal to the number of vacancies) that it recommends be nominated for election as Farmer Directors, and will also list any alternative candidates that it has identified. The Panel's recommendations will have regard to the desired attributes and the skills matrix.  | Para 2.3 and 2.4  |  |
| (c) 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 approves the candidate being nominated.   | Para 2.5          |  |
| (d) 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 satisfy the Farmer Director eligibility criteria, and two observers appointed by the Shareholders' Council. The two observers will participate in the proceedings relating to Farmer Directors but not Appointed Directors.  | Para 3.1 and 3.2  |  |
| (e) 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, giving its reasons for the recommendation, and reporting the Shareholders' Council's views. If the Nominations Committee recommends a candidate that was not on the Independent Selection Panel shortlist, the Nominations 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 not approved a candidate but the Nominations Committee has maintained its recommendation, the Board will disclose this fact (and the reasons for the Shareholders' Council's non-approval) to Shareholders. | Para 7.2          |  |

| Changes to documents   | Where in document | Where to find details of the specific changes  |
|--|-------------------|--|
| <b>5. Board Charter</b>  |                   |  |
| (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 Independent Selection Panel in forming its list of recommended candidates and published to Shareholders along with the search brief for Directors.  | Para 2.2 and 2.3  | Online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a>   |
| (b) The Board is responsible for nominating candidates for election as Directors based on the recommendations of the Nominations Committee and Independent Selection Panel and the views of the Shareholders' Council. The Board is also responsible for appointing Appointed Directors.   | Para 2.6          |  |
| (c) If the Shareholders' Council has not approved any proposed candidate but the Nominations Committee has maintained its recommendation with respect to the candidate, the fact of the non-approval, and the Shareholders' Council's reasons for it, will be disclosed to Shareholders.   | Para 2.6          |  |
| (d) In the case of a 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 the Independent Selection Panel and the Nominations Committee to recommence their processes. The Shareholders' Council will also hold a second election or by-election.   | Para 2.7          |  |
| (e) The Board will comply with the Director Election Rules adopted by the Shareholders' Council.   | Para 2.10         |  |
| <b>6. People, Culture and Safety Committee Charter</b>   |                   |  |
| (a) Remove existing nomination-related processes.  | Throughout        | Online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a>   |
| <b>7. Shareholders' Council By-laws</b>  |                   |  |
| (a) Maximum term of nine years (plus any part term where a Councillor was elected out of the usual Election cycle), unless the Shareholders' Council resolves by 75% majority to approve the Councillor extending for a fourth term of three years.  | BL 1.5            | In Parts Five (Sub-Part 2) and Six of the Notice of Meeting. A marked up copy of the full By-laws showing the changes is also available to view online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a> |
| (b) Shareholders' Council to decide by 75% majority whether to endorse sitting Councillors who wish to stand for re-election.  | BL 1.6            |  |
| (c) Create and publish an attributes and capabilities list for Shareholders' Council.  | BL 4.4            |  |
| (d) Shareholders' Council to appoint a member of the Independent Selection Panel and two observers to the Nominations Committee.   | BL 4.5            |  |
| (e) 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            |  |
| (f) If the Shareholders' Council does not approve (by 75% vote) 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 Shareholders' Council's non-approval and the reasons for it in the nomination that forms the basis for the postal ballot by which the candidate is proposed to be elected. | BL 4.7            |  |

| Changes to documents  | Where in document | Where to find details of the specific changes                                |
|---|-------------------|--|
| <b>8. Working interface</b>   |                   |  |
| (a) Refine and publish the “working interface” document between the Board and Shareholders’ Council.  | Completed         | Online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a> |
| <b>9. Five year review</b>  |                   |  |
| (a) A review of the changes will be completed by the Board and Shareholders’ Council no later than the 2021 annual meeting of Fonterra. Either the Board or the Shareholders’ Council may require the review to be carried out earlier if it considers that the changes are having a material unintended negative impact on Fonterra. The Shareholders’ Council is responsible for ensuring that the review is carried out within the specified time frame. | Para 1            | Online at <a href="http://www.nzfarmsource.co.nz">www.nzfarmsource.co.nz</a> |
| (b) The scope of the review will be to assess whether there are any material unintended negative consequences from the changes, whether the agreed outcomes defined by the 2016 review are being met (including farmer engagement and analysis of the quality, number and type of candidates), and whether further improvements to the Board’s size and composition would provide further flexibility.  | Para 2            |  |
| (c) The review will be undertaken by a joint committee of the Board and the Shareholders’ Council, with input from independent experts as required.   | Para 3            |  |
| (d) The review committee will report to Shareholders not later than the 2021 annual meeting of Fonterra (or earlier if required by the Board or Shareholders’ Council). Any changes to Fonterra’s constitution arising from the review will require 75% Shareholder support and, for changes to Part A of the Constitution, the support of 50% of Shareholders’ Councillors.  | Para 4            |  |
| (e) The Board and Shareholders’ Council will monitor the operation of the 2016 changes, and the Shareholders’ Council will retain all its usual rights and powers under clause 16 of Fonterra’s constitution.   | Para 5            |  |







If undelivered please return to:

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Fonterra Elections 2016  
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