



# FONTERRA SPECIAL MEETING

Notice of Special Meeting of Shareholders

**10.30am on Monday, 25 June 2012**

By audio and visual communication between locations in Hamilton, Whangarei, Rotorua, Hawera, Palmerston North, Nelson, Ashburton and Invercargill.



**Dairy for life**



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### What's proposed and why?

In June 2010, farmer Shareholders voted to change Fonterra's Constitution to enable the Board to put in place a regime for Trading Among Farmers.

Your Board believes it is desirable that there be a final vote on the implementation of this important step in the evolution of our Co-operative, and has convened a Special Meeting of Shareholders on 25 June 2012 for this purpose.

### Important information

The information in your Voting Pack is important and requires your immediate attention. It has been prepared to assist you in understanding the resolutions that will be proposed at the Special Meeting on 25 June 2012.

### About the booklets

There are three separate booklets in your meeting pack:

This Notice of Meeting booklet gives notice of the meeting, sets out the resolutions that will be proposed at the Special Meeting, and provides an overview of the key elements of Trading Among Farmers which have been developed in accordance with the mandate from farmer Shareholders.

A description of the technical features of Trading Among Farmers is set out in the Blueprint for Trading Among Farmers included in your meeting pack.

Finally the condensed Due Diligence Report contains information about the advice given to the Board in the course of the Due Diligence process.

### What are we voting on?

The meeting on 25 June 2012 is intended to be the final vote by Shareholders before any implementation of Trading Among Farmers. It is important that you read the detail set out in this Notice of Meeting Booklet, the Blueprint for Trading Among Farmers and the condensed Due Diligence Report. This will provide you with the information that you need to enable you to vote.

### What if I have questions?

Any questions relating to the resolutions set out in the Notice of Meeting can be referred to your Director, Shareholders' Councillor or Area Manager (all their contact details are set out in the latest Farmlink), or the electionz.com Helpline on 0508 666 446 before the Special Meeting.

## Fonterra Co-operative Group Limited Special Meeting 2012

A Special Meeting of Shareholders of Fonterra will be held at **10.30am on Monday, 25 June 2012**. The Special Meeting will be held by audio and visual communication between eight locations, with the principal location at **Claudelands Event Centre, Hamilton** linked to venues in Whangarei, Rotorua, Hawera, Palmerston North, Nelson, Ashburton and Invercargill. Details regarding these venues are set out later in this booklet.

### Special Meeting Documents

Each Shareholder has been sent:

- This Notice of Meeting booklet, which includes:
  - Letter from the Chairman;
  - Letter from the Chair of the Fonterra Shareholders' Council;
  - Notice of Meeting (including the resolutions to be voted on by Shareholders); and
  - Overview of Trading Among Farmers.
- Trading Among Farmers Summary Sheet.
- A separate booklet titled "Blueprint for Trading Among Farmers".
- A separate booklet containing a condensed Due Diligence Report.
- A Special Meeting Voting Paper. Use this Voting Paper:
  - If you are attending the Special Meeting, to vote in person.
  - If you are unable to attend the Special Meeting, you can cast a vote by **internet, post or fax**. Instructions on how to cast a vote in this manner can be found on the Voting Paper.

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.

**Internet, postal and fax votes** must be received by electionz.com Limited no later than **10.30am on Saturday 23 June 2012**.
- A Proxy Form. Use this Form:
  - If you are unable to attend the Special 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 Proxy Form, so that electionz.com Limited receives it by no later than **10.30am on Saturday 23 June 2012**.
  - If you are a company or other body corporate, you can appoint a representative to attend and vote on your behalf by completing this form.

Further instructions are on the back of the Proxy Form.

All proxy/representative appointments must be received by electionz.com Limited by no later than **10.30am on Saturday 23 June 2012**.

## Shareholders' Voting Entitlement

Voting at the Special Meeting will be by poll. In order to vote, you will need to either 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 the Shareholder's milksolids production, with one vote for every 1,000kg of milksolids supplied during the season ending **31 May 2012**. If a Shareholder did not supply in the 2011/2012 season but now owns a farm that supplied during that season, the voting entitlement will be based on that farm's supply in the 2011/2012 season. In the case of dry farm conversions and farm amalgamations/divisions, voting entitlement is based on the Board's estimate of milksolids production for the 2012/2013 season. Milk supplied on Contract Supply and milk which is not backed by shares (Unshared Supply) is excluded from milksolids production when calculating voting entitlements.

In accordance with the Companies Act 1993, the Board has fixed **23 June 2012** as the date for determining the Shareholders' entitlements to vote at the meeting. Accordingly, those persons who are, on **23 June 2012**, registered as Shareholders will be entitled to vote at the Special Meeting in respect of the shares registered in their name on that date.

## Votes Required and Quorum

The ordinary resolutions will be passed if they are approved by a simple majority of the votes of those Shareholders entitled to vote and voting on the resolutions.

The special resolution will be passed if it is approved by a majority of **75% 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 or are present in person or by a representative, who between them hold or represent the holder or holders of not less than 2% of the voting rights entitled to be exercised on the resolutions to be considered at the meeting.

## Results of Voting

The results of voting at the Special Meeting will be announced at the meeting if the results are available. They will also be available on Fencepost via [www.fonterra.com](http://www.fonterra.com) as soon as the vote counting is complete and the Chairman has declared the results.



28 May, 2012

Dear Shareholders,

I would like to invite you to attend a Special Meeting of Shareholders being held on Monday, June 25 at 10.30am for a final vote on Trading Among Farmers. The Special Meeting will be conducted through a visual and audio link across eight sites with the main venue at Hamilton and seven other venues at Whangarei, Rotorua, Hawera, Palmerston North, Nelson, Ashburton and Invercargill.

Trading Among Farmers is all about ensuring a stable, permanent capital base for our Co-operative so that our future is more secure. It is all about retaining 100% farmer control and ownership. That is not negotiable. The integrity of our Farmgate Milk Price is also not negotiable. Under Trading Among Farmers, our Farmgate Milk Price will continue to be robust and transparent and Fonterra's Board will continue to set the Farmgate Milk Price.

During the past months we have used some of the best legal minds and co-operative specialists to stress test the concept and proposed trading system as part of the Due Diligence process. Essentially they have given Trading Among Farmers a tick in terms of retaining 100% farmer control and ownership and the integrity of our Farmgate Milk Price.

The Due Diligence process has influenced the special resolution being put to the Special Meeting. We are looking for even more controls around Trading Among Farmers. We are now recommending to Shareholders that some of the previously agreed limits are strengthened still further and we are recommending that other limits should be included in the Constitution. You can be confident of the Board's commitment to operate well within even these lower thresholds under key policies it will adopt relating to the Fund size. Due Diligence has confirmed that we can protect our Co-operative's future within these new limits and still offer our farmers some financial flexibility. These are our objectives – not to raise capital.

While the final vote around Trading Among Farmers is an ordinary resolution, your Board is not looking to proceed on the basis of a bare 50% majority. We want a clear mandate from you that the Shareholder base wants to proceed with this important step forward.

I encourage you to take the time to read all the information provided to you in the Voting Pack and consider the implications it will have for your farming business and your Co-operative. Many farmers have asked me to give it to them on one page. We have done that. But you should also read and understand the detail, which is contained in this Notice of Meeting booklet (especially the "Overview on Trading Among Farmers" section), in your copy of the Blueprint for Trading Among Farmers, and in the condensed Due Diligence Report.

To encourage your participation in deciding the future of our Co-operative, there will be internet, postal and fax voting for the Special Meeting. So if you are unable to attend the Special Meeting in person, you can have your say by casting your vote by internet, post or fax or by way of "proxy". Voting instructions are in your Voting Pack.

Your Board is absolutely unanimous in its belief that Trading Among Farmers can be a lasting solution. Should a future Board in 10 or 15 years from now decide to change any key aspect of our capital structure in our Constitution or the Fonterra Farmer Custodian structure, this would be the subject of another 75% farmer Shareholder vote. Your Board and our Chief Executive Officer believe that we need permanent capital to implement our strategy and remain a strategic player in the global dairy industry.

We broke new ground with the formation of Fonterra and now have an opportunity to refine that model and to break new ground again.

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

A handwritten signature in black ink, appearing to read "Henry van der Heyden".

Henry van der Heyden  
Chairman  
Fonterra Board of Directors

Dear Shareholders,

The time has come for you to provide a final mandate on Trading Among Farmers (TAF) to your Board of Directors.

The Shareholders' Council and its independent advisors have worked alongside your Board for the past two years developing the TAF concept for implementation.

It is pleasing to be able to inform you that your Council has resolved with an overwhelming majority to support the introduction of TAF and expects, based on the information currently available to it, to be subsequently able to pass the fifth pre-condition.

This resolution is made without pre-empting the Council's right to a final decision on TAF. As such, the Council will await the final report from the Board and consider this before voting on the final pre-conditions.

During the consultation process the Board agreed to support a number of Council-proposed changes both in the Constitution and the various legal documents under which TAF will be managed, all of which we believe will give greater protections to ownership and control, and monitoring of TAF from Shareholder farmers' perspectives.

Some of these are included in the special resolutions to amend Fonterra's Constitution which will be considered at the meeting on 25 June. The Council is pleased that the Board have agreed to these various critical changes.

Throughout the deliberations a critical consideration has been the size of the Fonterra Shareholders' Fund and how this might be structured to best protect the Co-op moving forward.

As a result, considerable emphasis has been placed on the terms of the Fonterra Shareholders' Fund Risk Management Policy which is detailed in the Blueprint. The final form of this Policy gives the Council the right to closely monitor the size of the Fund and initiate appropriate action should it move toward various thresholds.

Shareholders will note that the Council's right to nominate two members of the Milk Price Panel (including one independent) is also proposed to be enshrined in Fonterra's Constitution and we are satisfied with this outcome.

As we head towards the Special Meeting and final vote it is vital that you gain a clear understanding of what you are being asked to vote on. Read the information provided to you, attend the upcoming farmer meetings and speak to your Shareholders' Councillors, Area Managers or Networkers where necessary.

This is an important step in the history of our Co-op and I urge you to use your right of control, and vote.

Yours sincerely



Ian Brown

**Chair, Fonterra Shareholders' Council**

## Notice of Special Meeting 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 **Monday, 25 June 2012 at 10.30am**. The meeting will be held by means of audio and visual communication. The principal venue will be **Claudelands Event Centre, Brooklyn Road, Hamilton** which will be connected by audio visual link to:

- **Whangarei - Forum North, Rust Avenue, Whangarei;**
- **Rotorua - Novotel Hotel, 11 Tutanekai Street, Rotorua;**
- **Hawera - TSB Hub, Waihi Road, Hawera;**
- **Palmerston North - Awapuni Racecourse, Racecourse Road, Palmerston North;**
- **Nelson - Petite Fleur at Seifried Estate, Corner State Hwy 60 and Redwood Road, Appleby, Richmond, Nelson;**
- **Ashburton - Ashburton Hotel, 11-35 Racecourse Road, Ashburton; and**
- **Invercargill - Ascot Park Hotel, Corner Tay Street and Racecourse Road, Invercargill.**

Shareholders may attend and vote at the meeting in Hamilton or any of the above venues.

Refreshments will be provided.

### Special Meeting Agenda

Below is the recommended programme for the Special Meeting. Shareholders should note that the order may change at the discretion of the Chairman.

<b>10.00am</b>	<b>Registration / Morning Tea</b>
<b>10.30am</b>	<b>Welcome / Introduction</b>
	<p><b>Chairman’s Address</b></p> <p><b>CEO’s Address</b></p> <p><b>Capital Structure Committee Chairman’s Address</b></p> <p><b>Trading Among Farmers Due Diligence Committee Chairman’s Address</b></p> <p><b>Shareholders’ Council Chair’s Address</b></p> <p><b>Resolutions : Trading Among Farmers</b></p> <ul style="list-style-type: none"> <li>- Discussion and Questions</li> <li>- Voting on Resolutions</li> </ul> <p><b>Shareholder Proposals</b></p> <ul style="list-style-type: none"> <li>- Discussion and Questions</li> <li>- Voting on Shareholder Proposals</li> </ul> <p><b>Business Update</b></p>
<b>12.30 - 1.00pm</b>	<b>Closing / Lunch (approximately)</b>
	<b>Announcement of Results (if available)</b>

### Speakers will be :

**Chairman’s address :** Henry van der Heyden

**CEO’s address :** Theo Spierings

**Capital Structure Committee Chairman’s address :** John Wilson

**Trading Among Farmers Due Diligence Committee Chairman’s address :** John Waller

**Shareholders’ Council Chair’s address :** Ian Brown



## Trading Among Farmers

### Resolution 1: Trading Among Farmers

To consider and, if thought fit, to pass the following resolution as an ordinary resolution:

*That the Board continue to take such steps as the Board considers necessary or appropriate to prepare the Company for “Trading Among Farmers” (as that term is used in the Constitution of the Company):*

- (a) *in accordance with clause 49 of the Constitution of the Company; and*
- (b) *in a manner that is consistent with the Blueprint for Trading Among Farmers sent to Shareholders with the Notice of Meeting, in the form tabled at the meeting and signed by the Chairman for the purposes of identification.*

### Resolution 2: Constitutional Changes for Trading Among Farmers

To consider and, if thought fit, to pass the following resolution as a special resolution:

*That, with effect from 25 June 2012, the New Constitution (as that term is defined in the Constitution of the Company) be amended as follows:*

- (a) *By inserting the following new clause as clause 1.6 following clause 1.5 in the New Constitution:*

1.6 **Authorised Fund:** The primary purpose of the arrangements in clause 7 is to facilitate:

- (a) liquidity in relation to the trading of Co-operative Shares; and
- (b) the ability of Shareholders to exchange some or all of the rights or interests in Co-operative Shares for securities issued by an Authorised Fund, and vice versa,

but subject always to the rights, powers and limitations contained in this Constitution (including in clause 7).

*and in clause 7.1 of the New Constitution, by inserting the words “for the purpose set out in clause 1.6” after the words “to acquire, hold, or dispose of some or all of the rights or interests in Co-operative Shares”.*

#### Explanatory Note

The effect of the proposed new clause 1.6 of the New Constitution is to clarify that the primary purpose of an Authorised Fund under clause 7 of the New Constitution is to facilitate:

- (i) liquidity in relation to the trading of Co-operative Shares; and
- (ii) the ability of shareholders to exchange some or all of the rights or interests in Co-operative Shares for securities issued by an Authorised Fund, and vice versa (as contemplated by the Dairy Industry Restructuring Amendment Bill).

The effect of the amendment to clause 7 of the New Constitution is to clarify that the purpose of an Authorised Fund under that clause will be as set out in clause 1.6.

- (b) *In clause 3.2(a) of the New Constitution, by deleting the reference to “25%” and replacing it with “15%”.*

#### Explanatory Note

The effect of this amendment is to reduce the aggregate number of Shares held in excess of the number of Shares required to be held by Shareholders in accordance with the Share Standard (ie, the aggregate number of “Dry Shares”) from 25% to 15% of the total number of Co-operative Shares then on issue in the capital of the Company (excluding treasury stock).

- (c) *In clause 7.3 of the New Constitution, by deleting the full stop at the end of the clause, inserting a comma and then inserting the following on a new line:*

provided that at any time the maximum number of Co-operative Shares in which any Disposing Holder (except an RVP or any Custodian acting on behalf thereof) may dispose of rights or interests to or for the benefit of any Authorised Fund shall not exceed 33% of the minimum number of Co-operative Shares required to be held by the Disposing Holder at that time in accordance with this Constitution.

### Explanatory Note

The effect of this amendment is that any limit specified by the Board on the number of Co-operative Shares in which rights or interests may be placed with the Fonterra Shareholders' Fund by any Shareholder (except any RVP or any Custodian acting on behalf of an RVP) cannot be more than 33% of the minimum number of Co-operative Shares required to be held by the Shareholder under the Constitution.

- (d) *In clause 7.5 of the New Constitution, by deleting the reference to "25%" and replacing it with "20%".*

### Explanatory Note

The effect of this amendment is to reduce the aggregate number of Co-operative Shares in which rights or interests may at any time be placed with the Fonterra Shareholders' Fund from 25% to 20% of the total number of Co-operative Shares then on issue in the capital of the Company (excluding treasury stock).

- (e) *By inserting the following new clause as clause 10.3 following the existing clause 10.2 in the New Constitution:*

10.3 **Milk Price Panel:** The Board shall establish and maintain a committee known as the "Milk Price Panel" ("**Panel**"). The following requirements shall apply to the Panel:

- (a) The Board shall set the terms of reference for the Panel which must provide that, for each Season, the Panel will:
- (i) supervise the calculation of the Milk Price;
  - (ii) advise the Company on the application of the Milk Price Manual; and
  - (iii) recommend to the Board the Milk Price.
- (b) The Panel may make recommendations to the Board in respect of the Milk Price Manual.
- (c) The Panel must at all times comply with the following requirements:
- (i) it must comprise five members;
  - (ii) not less than 50% of the members must qualify for appointment as "independent" ("**independent**") members (within the meaning of any applicable enactment or, if there is no applicable enactment, as determined by the Board from time to time);
  - (iii) the Shareholders' Council is entitled to appoint up to two members (at least one of whom must be independent), and the remaining members shall be appointed by the Board; and
  - (iv) the chairman of the Panel must be independent and shall have no casting vote.
- (d) The Board must identify (and annually disclose) which members it has determined, in its view, to be independent.

*and by making consequential amendments to the clause numbers of existing clauses 10.3 to 10.5 of the New Constitution.*

### Explanatory Note

The effect of this amendment is to add a new clause 10.3 to the New Constitution to include Fonterra's existing arrangements in relation to the Milk Price Panel in the New Constitution. This new clause:

- (a) requires the Board to establish and maintain a Milk Price Panel;
- (b) requires the Board to set the terms of reference for that Panel which must provide that, for each Season, the Milk Price Panel must supervise the calculation of the Milk Price, advise Fonterra on the application of the Milk Price Manual, and recommend the Milk Price to the Board;
- (c) permits the Milk Price Panel to make recommendations to the Board in respect of the Milk Price Manual;
- (d) prescribes that at all times the Milk Price Panel must comply with the following requirements:
  - (i) it must comprise five members;

- (ii) not less than 50% of the members must qualify for appointment as independent members;
  - (iii) the Shareholders' Council is entitled to appoint up to two members (at least one of whom must be independent), and the remaining members will be appointed by the Board; and
  - (iv) the Chairman of the Milk Price Panel must be independent and will have no casting vote.
- (e) The Board must identify (and disclose annually) which members it has determined, in its view, to be independent.

As a consequence of the above amendment, existing clauses 10.3 to 10.5 of the New Constitution will be renumbered to reflect the insertion the new clause as clause 10.3.

(f) *in clause 16.10 of the New Constitution, by inserting the following words after the first sentence in this clause:*

In addition the Board will, subject to legislative and regulatory requirements and the Market Rules, consult with the Shareholders' Council in relation to matters on which consultation is contemplated in clause 16.1, including the terms of the Risk Management Policy adopted from time to time by the Board (and on any changes thereto) in relation to an Authorised Fund, and the Board will take all practical steps to facilitate such consultation.

#### **Explanatory Note**

The effect of this amendment to clause 16.10 of the New Constitution is to confirm that the Board will consult with the Shareholders' Council in relation to matters on which clause 16.1 of the New Constitution (which sets out the functions of the Council) contemplates consultation will occur. These matters include the terms of the Risk Management Policy adopted by the Board in relation to an Authorised Fund or any changes to that Policy. This obligation on the Board to consult with the Shareholders' Council will be subject to legislative and regulatory requirements and the Market Rules applying to the FSM, but the Board will take all practical steps to facilitate this consultation.

*Resolution 2 is a special resolution required by section 106(1)(a) of the Companies Act 1993. As the alterations to the Constitution of the Company that are contemplated by the above resolution do not impose or remove a restriction on the activities of the Company, Shareholders will not have the benefit of the minority buy-out rights set out in section 110 of the Companies Act 1993.*

*As required by clause 18 of the Company's Constitution, the proposed constitutional changes have been approved by a majority of the Shareholders' Council and a certificate has been provided to the Board as conclusive evidence of that fact.*

*The changes to the Constitution set out in Resolution 2 are not a pre-condition to Trading Among Farmers. Accordingly, if Resolution 1 is passed, the Board may choose to proceed with Trading Among Farmers regardless of whether Resolution 2 is passed.*

*It is important that you read the Overview of Trading Among Farmers on pages 11 to 27 of this Notice of Meeting booklet. You have also been provided with the Blueprint for Trading Among Farmers and the condensed Due Diligence Report, which include additional information. These documents will provide you with all the information you require to enable you to vote on the resolutions set out above.*

## Shareholder Proposals

**The Company has received the following two proposals from Shareholders. Your Board does not support either proposal and recommends that you vote against them.**

If passed, the Shareholder Proposals will not be binding on the Board as the Constitution of the Company specifically mandates the Board to proceed with Trading Among Farmers subject to pre-conditions set out in the Constitution. In order for a resolution to bind the Board, it would need to be posed as a special resolution amending the Constitution.

The Board considers the Shareholder Proposals to be unnecessary and undesirable as Shareholders will be able to give a clear indication to the Board of their views on Trading Among Farmers by voting on Resolution 1. The implementation of Trading Among Farmers will remain subject to the satisfaction of all five pre-conditions set out in the Constitution, as well as the Board determining that it should proceed. If Resolution 1 is not well supported, that will be an important consideration for the Board in determining whether to proceed with Trading Among Farmers.

### Resolution 3: M. Beach Proposal

The Company has received the following proposal from Mr Murray Beach, Main Road, Havelock, Shareholder 39064, for Shareholder consideration and resolution at the Special Meeting.

M. Beach Proposal: *“To Wipe Trading Among Farmers.”*

**Your Board does not support this proposal and recommends that you vote against it.**

The Shareholders' Council respects the right of Shareholders to propose resolutions for consideration by all Shareholders. The Council has expressed support for Board Resolution 1, and this proposal has a contrary effect.

The proposing Shareholder was entitled to provide a statement in support of the proposal. The following was supplied:

*My reasons for wiping trading among farmers is that it has now been going on for approximately eighteen months and still has a few months to go. This is costing the shareholders a lot of money for a scheme that we don't really need. The question shareholders need to ask themselves is 'are we alright as we are now'. If the answer to this question is yes, why do we want to take the risk of bringing in a scheme with uncertainties attached.*

The proposal is contrary to the mandate the Board was given by Shareholders in 2010. The Board has been diligently pursuing this mandate, as reflected in the materials provided to Shareholders in this Voting Pack in support of Resolution 1. Shareholders are referred to that material which describes the nature and benefits of Trading Among Farmers, and the manner in which relevant concerns have been addressed.

The Board's view is that the M. Beach Proposal is the opposite of Resolution 1 (as proposed by the Board). The reasons provided in support of Resolution 1 are similarly applicable in voting against the M. Beach Proposal.

### Resolution 4: Upson Downs Limited Proposal

The Company has received the following proposal from Upson Downs Limited, C/-Johnston O'Shea Ltd, 9-11 Reyburn Street, Whangarei, Shareholder 18101, for Shareholder consideration and resolution at the Special Meeting.

Upson Downs Proposal: *“For TAF to move forward, and in the interests of Fonterra Shareholder unity, no less than 75% of voting Shareholders support be expressed by way of vote after all relevant information has been presented to Shareholders and legislation is in place.”*

**Your Board does not support this proposal and recommends that you vote against it.**

The Shareholders' Council respects the right of Shareholders to propose resolutions for consideration by all Shareholders. The Council notes that Upson Downs Limited has taken the effort to explain in some detail the rationale behind its proposal. The Council notes that Shareholders are being given an opportunity at the 25 June meeting to express their support or otherwise in respect of Trading Among Farmers. The Council further notes that at the meeting certain amendments to the New Constitution will be proposed (in connection with Trading Among Farmers) by special resolution. In order to be passed, that special resolution will require the support of 75% of those voting and entitled to vote. The Council considers that the Upson Downs Limited proposal would also conflict with the mandate given to the Council under clause 49.2(e) of the Constitution. Accordingly, the Council does not support the Upson Downs Limited proposal.

The proposing Shareholder was entitled to provide a statement in support of the proposal. The following was supplied:

*The shareholder vote taken June 2010 was a mandate to deliver on 5 pre- conditions. It specifically said there would not be a second vote.*

*What our constitution now says is that TAF can come into effect with 50% support from Fonterra Shareholder Council. It is morally wrong that 50% FSC support can bring about a change to the Fonterra Constitution.*

*To change our constitution requires 75% support of voting shareholders. This resolution provides for shareholders to make an informed choice, when due diligence has been completed, when necessary legislation is in place, and when the need for shareholder unity, in the short history of Fonterra, has never been greater.*

*The 5 pre-conditions include 100% ownership and control.*

*We are inviting outside capital into our co-operative, but at what cost? What are we prepared to give up? TAF may provide for 100% ownership in the legal context, but it is influence that shapes the New Zealand political landscape. The unit holders in the Fonterra fund will be able to exert influence, irrespective of the fund size.*

*By implementing TAF we acknowledge that market rules will override the Fonterra constitution, and that market rules can be changed from time to time, as the market sees fit. This appears at odds with 100% control.*

*As Fonterra, we are moving away from the basic premise of a Co-operative, that is, for the collective good, that we contribute our capital in proportion to milk supply. Through allowing dry shares, we have agreed to de-link ownership and supply in the name of flexibility.*

*The Fonterra Constitution states:*

*The purpose of the Company in carrying out its business is to maximise the wealth of its Shareholders by:*

- a) The sale of their Milk*
- b) providing a purchaser of that Milk and*
- c) enhancing the value of the Co-operative share.*

*In the 10 years since the formation of Fonterra we have witnessed an enhanced share value result in a loss of milk supply to Fonterra. This will not change under TAF, and we in fact, invite a Capital focused market to determine the value of our business. A market that is driven by short term gain. If the returns are not acceptable they invest elsewhere. We will be captive to this behaviour.*

*Our constitution will provide for as much as 25% of the Fonterra dividend stream to leave the co-operative and probably New Zealand. This appears at odds with the purpose of the Company, to maximise shareholder wealth.*

*The tension between a theoretical Milk Price and the Dividend stream does not appear resolvable, and will inevitably turn one group of investors against the other. Under proposed DIRA legislation, unit holders will have all the same rights as supplying shareholders except to supply milk and vote.*

*Will a vote for TAF unify the Fonterra Co-operative?*

The proposal creates an additional process requirement which the Board believes is unnecessary, particularly in light of the resolutions being proposed by the Board at this meeting. This Voting Pack includes all relevant material, and Resolution 1 seeks a confirmation from Shareholders of the earlier mandate to prepare for Trading Among Farmers, based upon that material.

The Upson Downs Limited proposal implies a further vote in the future, given legislation remains to be enacted. However, the Board believes there is adequate information provided in this Voting Pack, and safeguards for Shareholders through the Board's resolutions, for Shareholders to provide the Board with a confirmation of the mandate under Resolution 1. Consequently, the Board believes the Upson Downs Limited proposal to be undesirable as it will simply extend the period of uncertainty for the Co-operative before a decision can be made to introduce Trading Among Farmers.

## Overview of Trading Among Farmers/Explanatory Notes

This section contains an overview of key aspects of Trading Among Farmers. It is intended to provide a summary of the overall structure, the different parts of it, how it will operate, and the steps that have been taken to keep and strengthen 100% farmer control and ownership of the Co-operative. It does not contain all of the detail - there are more detailed descriptions in the Blueprint, and the results of the Due Diligence by the Board are set out in the condensed Due Diligence Report Booklet. You are encouraged to read this additional material.

### Section 1: Key Features of Trading Among Farmers



Trading Among Farmers (TAF) is a system that has a number of separate components that work together.

#### The Structure

Fonterra will establish the Fonterra Shareholders' Market (FSM) to provide a market for trading in Co-operative shares. The FSM will be a "private" market designed for trading between farmer shareholders and Fonterra itself. The approved Registered Volume Provider (RVP) will also trade on the FSM but any Co-operative shares it buys will be held in the name of the Fonterra Farmer Custodian.

The FSM will have its own specific market rules, based on the listing rules applying to the New Zealand Stock Exchange (NZX) and the NZX Participant Rules. However, they have been adapted and there are controls to reflect Fonterra's co-operative status and ethos and the Trading Among Farmers system.

The Fonterra Shareholders' Fund (Fund) will also be established to facilitate liquidity in relation to the trading of Co-operative shares so as to lead to better discovered prices in the FSM. The assets of the Fund will be economic rights of Co-operative shares but not legal title to Co-operative shares. The Fund will be a unit trust under the Unit Trusts Act 1960.

The key features of the FSM and the Fund are described below and in the Blueprint.

#### Operation of TAF

Farmer shareholders will be able to sell economic rights of some of their Co-operative shares to the Fund.

When we refer to the "economic rights of a Co-operative share" we mean the rights to receive dividends and other economic benefits derived from a Co-operative share, including any change in the value of the Co-operative share,



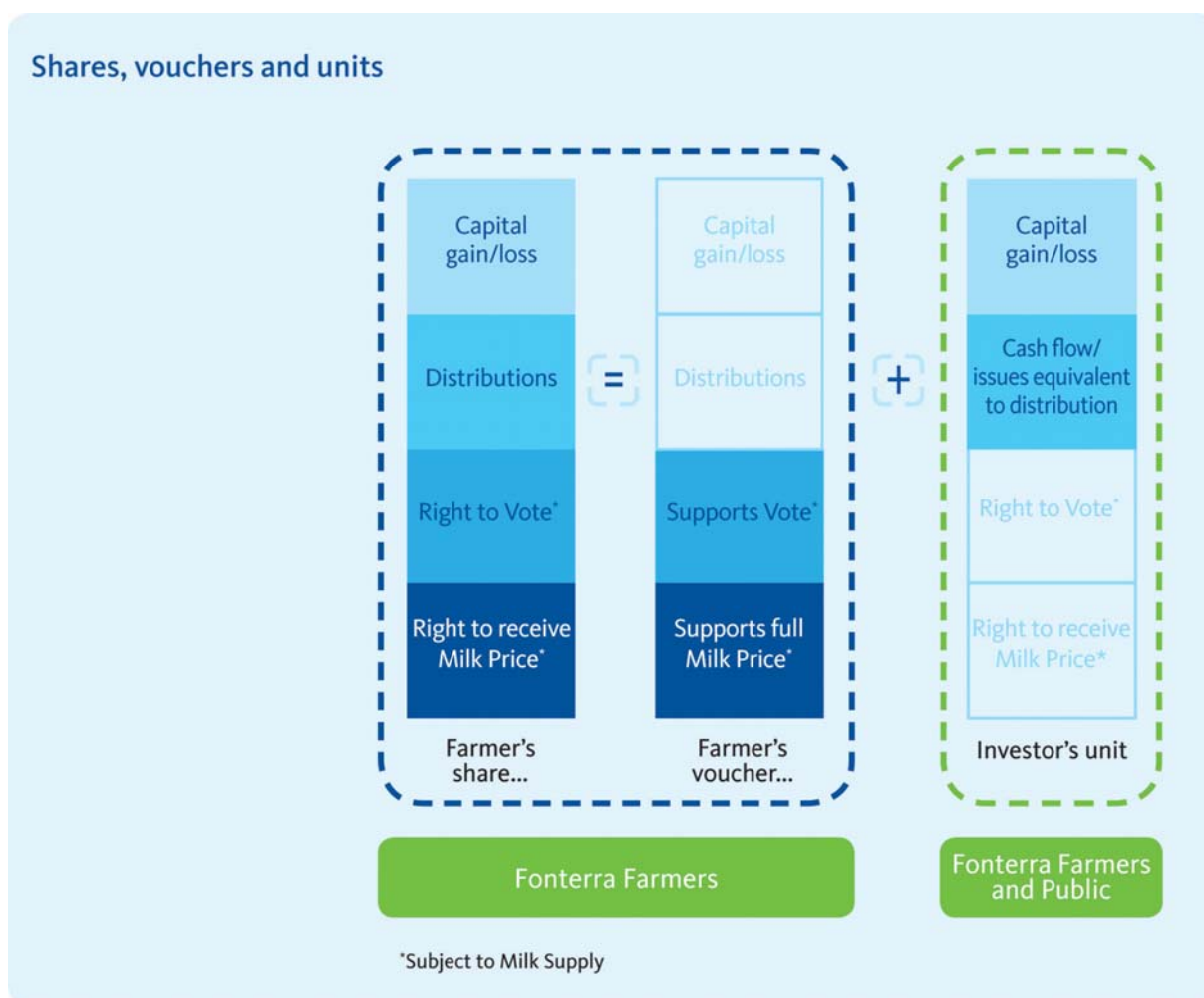
as well as the other rights and benefits comprised in the Co-operative share. It does not include any right to hold the legal title to a Co-operative share, or to exercise production-based voting rights.

The process for selling economic rights of Co-operative shares to the Fund will involve two key steps:

- (a) Farmer shareholders will transfer legal title to Co-operative shares to the Fonterra Farmer Custodian (legal title to Co-operative shares will not pass to the Fund).
- (b) The Fonterra Farmer Custodian will hold the economic rights of those Co-operative shares on trust for the trustee of the Fund.

This is what is meant in this booklet wherever we refer to “selling economic rights of Co-operative shares to the Fund”.

Farmer shareholders will receive cash as consideration for this sale. They will also receive an acknowledgement (which will be called a “voucher”) that economic rights of Co-operative shares have been sold to the Fund. The number of vouchers that a farmer shareholder can hold is subject to limits.



## The Fund and Units

Units in the Fund will be issued to farmers and other members of the public. The owner of a Unit will receive the benefits from the economic rights of Co-operative shares that have been sold to the Fund.

The returns from owning Units are expected to be the same as the returns from holding Co-operative shares. But how these returns are treated in the hands of individual shareholders and owners of Units will depend on their own particular circumstances.

Units will trade on the NZSX. Fonterra and the Fund will have an arrangement with each other in relation to matters such as disclosure of information, to enable the Fund to comply with its regulatory obligations.

## The RVP

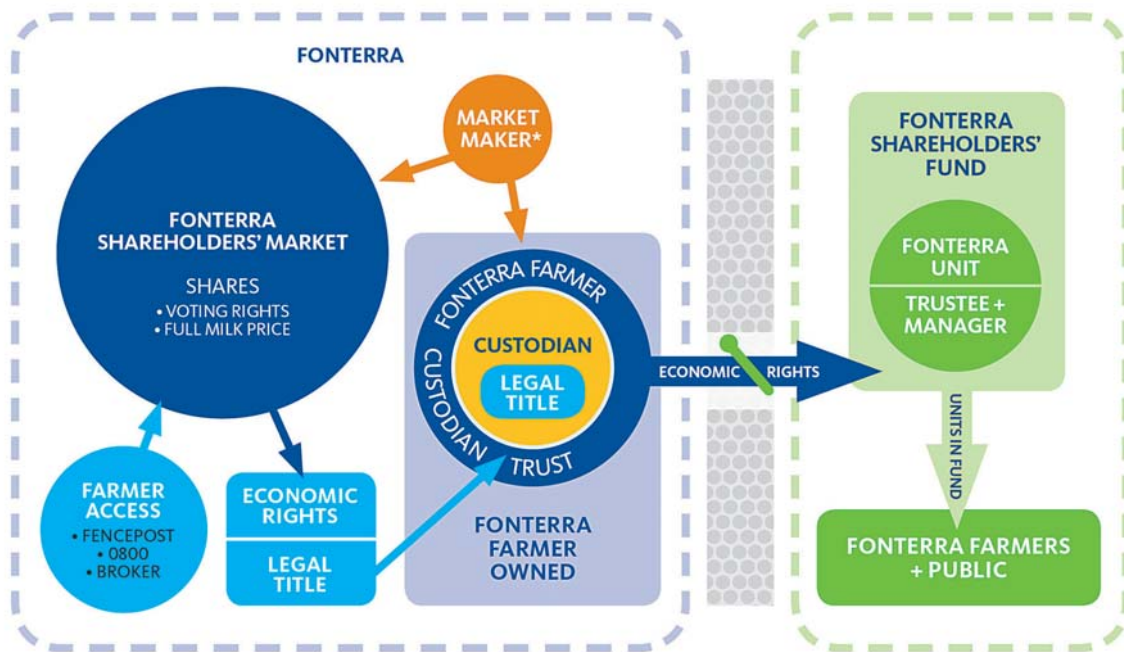
An approved RVP - or “market maker” - will be appointed by Fonterra to buy and sell Co-operative shares on the FSM. This is intended to help with trading and liquidity in that market. Any Co-operative shares purchased by the RVP will be held by the Fonterra Farmer Custodian. Like farmer shareholders, the RVP will also be able to participate in the Fund by buying and selling Units. This is intended to promote “price convergence” between the FSM and Fund.

## “Fungibility” and “conversion”

Units will be “exchangeable” for Co-operative shares, but only by farmer shareholders, the RVP (through the Fonterra Farmer Custodian) and Fonterra itself. A Co-operative share and a Unit can effectively be “swapped”, but only by farmer shareholders, the RVP and Fonterra. No other holder of Units will be able to do this. This is a key feature of TAF and is referred to as “fungibility”.

The Fund will support the FSM by allowing farmer shareholders and investors to access the economic benefits of Co-operative shares. This is intended to create a more liquid market for farmer shareholders (and the RVP) to trade Co-operative shares.

## Trading Among Farmers design in more detail



\*MARKET MAKER (OR REGISTERED VOLUME PROVIDER) ENSURES THERE'S ALWAYS A BUYER AND SELLER

## Section 2: Maintaining 100% Farmer Control and Ownership

Protections have been built into the TAF structure to keep and strengthen 100% farmer control and ownership of the Co-operative. The following is a statement of what we mean when we talk about 100% farmer control and ownership in the context of TAF:

### 100% Farmer Control and Ownership of the Co-operative

#### 100% farmer ownership

This means that the only shareholders of the Co-operative can be:

- farmers who supply milk to Fonterra;
- those people who supplied milk to Fonterra but are selling down their shares over three seasons (exiting farmers); and
- the Fonterra Farmer Custodian, which will be ultimately owned and controlled by farmers who supply milk to Fonterra and hold Co-operative shares.

If you look at Fonterra's share register at the end of a trading day, you will only see as legal owners of Co-operative shares the people described above.

Fonterra will be using a system approved by the Reserve Bank to transfer Co-operative shares between parties who are entitled to hold them. As part of this approved system, shares may be temporarily held during the course of a day by approved market participants who are subject to the rules of the FSM.

There have always been and will continue to be people who have beneficial rights in Co-operative shares – such as the beneficiaries of a family trust or passive investors in a farm syndicate. This will not change under Trading Among Farmers.

Under Trading Among Farmers both the Fund and the RVP will have beneficial rights in Co-operative shares. However, they will not be legal owners of Co-operative shares.

#### 100% farmer control

This means that farmers who supply milk to Fonterra and who hold Co-operative shares are the only people who can:

- vote on Co-operative matters on the basis of their share-backed production; and
- appoint and remove Fonterra Directors.

However if Directors or farmer shareholders try to take an action which will adversely affect the rights of the Fund or the RVP, then those parties may have legal rights to take steps to protect their interests. Under the terms of the documentation constituting TAF, those steps would be taken in the name of the Fonterra Farmer Custodian.

### The Documentation

In the statement above we refer to the documentation constituting TAF. The documentation includes:

- (a) The Form B Constitution.
- (b) The structure and constitution of the Fonterra Farmer Custodian.
- (c) The structure of the Fonterra Farmer Custodian Trust, under which farmer shareholders will effectively own and control the Fonterra Farmer Custodian.
- (d) The terms of the trust (Custody Trust) under which the Fonterra Farmer Custodian will hold Co-operative shares in which economic rights have been sold to the Fund.
- (e) The Unit Trust Deed for the Fund (including the provisions which establish the "Fonterra Unit").
- (f) The Authorised Fund Contract between Fonterra and the Fund.
- (g) The RVP Contract.
- (h) The Market Rules for the FSM.
- (i) Board policies and oversight, in accordance with the Form B Constitution.

## Core Commitments

At the heart of 100% farmer control and ownership is a commitment that the only people who will be entitled to be registered as the legal owners of Co-operative shares will be:

- (a) Fonterra farmer shareholders (including those who have applied (and been accepted) to supply milk to Fonterra, or have ceased supply but are selling down their shareholdings over three seasons);
- (b) Fonterra itself (when it holds “treasury stock”); and
- (c) the Fonterra Farmer Custodian (when it holds Co-operative shares in which economic rights have been sold to the Fund, or when it holds Co-operative shares for the RVP).

These restrictions derive from the Form B Constitution.

To complete the technical requirements for transferring Co-operative shares between these eligible holders, Co-operative shares may also temporarily be held by approved market participants as part of a clearing and settlement system approved by the Reserve Bank. This system is also overseen by the Financial Markets Authority (FMA).

### What is Treasury Stock?

A company is allowed to buy back its own shares in certain circumstances and subject to procedures and limits. Shares that are bought back can either be cancelled or held by the company. Shares that are held are known as ‘Treasury Stock’. This is a convenient way for a company with shares as Treasury Stock to use them to issue back to shareholders. However, Treasury Stock can only be re-issued if the proper approval processes have been followed. While shares are being held as Treasury Stock the rights in the shares can’t be exercised and they don’t receive dividends or other distributions.

## The Custodian Arrangements

Two other key planks of the control and ownership restrictions are the Fonterra Farmer Custodian, and the Fonterra Farmer Custodian Trust (which is the trust that allows farmer shareholders to control the Fonterra Farmer Custodian).

### The Fonterra Farmer Custodian

The Fonterra Farmer Custodian is a legal instrument set up to hold the legal title to Co-operative shares placed with the Fund.

The Fonterra Farmer Custodian will be set up as follows:

- (a) It will be a limited liability company with all its shares held by the trustees of the Fonterra Farmer Custodian Trust.
- (b) The Directors will be the trustees of the Fonterra Farmer Custodian Trust.
- (c) The constitution of the Fonterra Farmer Custodian will recognise that only the trustees of the Fonterra Farmer Custodian Trust can hold the shares in the Fonterra Farmer Custodian.
- (d) There will be restrictions on any change in the shareholding of the Fonterra Farmer Custodian, including the granting of any security or encumbrance over any share of the Fonterra Farmer Custodian.
- (e) Changes to the Fonterra Farmer Custodian structure will require a 75% resolution of farmer shareholders.

### The Fonterra Farmer Custodian Trust

The Fonterra Farmer Custodian will be wholly owned and directly controlled by three trustees under a separate trust that is referred to as the Fonterra Farmer Custodian Trust.

The Fonterra Farmer Custodian Trust will be structured as follows:

- (a) The Trustees will be three farmer representatives:
  - (i) a farmer directly elected by farmer shareholders;
  - (ii) a farmer Director of Fonterra; and
  - (iii) a member of the Shareholders’ Council.
- (b) The discretionary beneficiaries of the trust will be Fonterra farmer shareholders.

- (c) Fonterra will be nominated as the “final beneficiary” with limited rights and powers, to ensure continuity of the trust.
- (d) The sole purpose of the trust will be to hold the shares in the Fonterra Farmer Custodian, and to hold one special Unit in the Fund (called the Fonterra Unit), which confers on the holder rights to prevent certain changes to the trust deed establishing the Fund (see further comments below).
- (e) Any material change to the trust deed of the Fonterra Farmer Custodian Trust will require a 75% resolution of farmer shareholders.

The trust deed for the Fonterra Farmer Custodian Trust will also contain confirmations by Fonterra, for the benefit of the trustees of the Fonterra Farmer Custodian Trust (on behalf of supplying shareholders to Fonterra) that:

- (a) Fonterra will authorise only one “Authorised Fund”.
- (b) Fonterra will require the Trustee of the Fund to agree that there will only be one “custodian”, being the Fonterra Farmer Custodian.
- (c) Apart from the operation of the clearing and settlement arrangements referred to in the box above, the only persons who may be registered as the holders of Co-operative shares will be:
  - (i) shareholders (in effect, supplying shareholders, but including those who have applied (and been accepted) to supply milk to Fonterra, or have ceased supply but are selling down their shareholdings over three seasons);
  - (ii) the Fonterra Farmer Custodian, when it holds shares for the RVP or economic rights of shares for the Fund; and
  - (iii) Fonterra itself (when it holds treasury stock).
- (d) Fonterra will maintain registration as a co-operative dairy company under Part 3 of the Co-operative Companies Act 1996.

The Fonterra Farmer Custodian, and the trust that will own it and the Fonterra Unit, will all be under the control of farmer shareholders.

The Trust Deed for the Fund will create one “Fonterra Unit” that will be held by the Fonterra Farmer Custodian Trust. This will be a “special unit” that will allow the Fonterra Farmer Custodian Trust to prevent any changes to the following key features of the Trust Deed for the Fund without its approval:

- (a) The governance structure of the Board or the Manager of the Fund.
- (b) The scope and role of the Fund.
- (c) The obligation of the Fund to facilitate the issue of a Unit when a farmer (or RVP) sells economic rights of a Co-operative share, or to surrender a Unit when a farmer (or RVP) exchanges a Unit for a Co-operative share.
- (d) The limit of 15% on the number of Units that can be held by any person (or their associates) in the Fund.
- (e) The terms of the Fonterra Unit.

As an added protection, the Fonterra Farmer Custodian Trust could only agree to these changes by obtaining at least 75% voting support from farmer shareholders.

### Other control and ownership protections

There will be other important components of 100% farmer control and ownership. In particular, the Manager of the Fund, the Trustee of the Fund, or any Unit holder in the Fund (except as outlined in Section 4) cannot call for transfer of legal title to Co-operative shares held by the Fonterra Farmer Custodian.

### What will be held by the Fonterra Farmer Custodian?

It is also important to understand what will be held on trust by the Fonterra Farmer Custodian for the Trustee of the Fund.

As explained in Section 1 above, the intention is that farmer shareholders will be able to sell economic rights of some of their Co-operative shares to the Fund.

The process for “selling economic rights of Co-operative shares to the Fund” is described in Section 1.

## The Authorised Fund Contract

The Authorised Fund Contract also contains terms that enhance 100% farmer control and ownership, including the following:

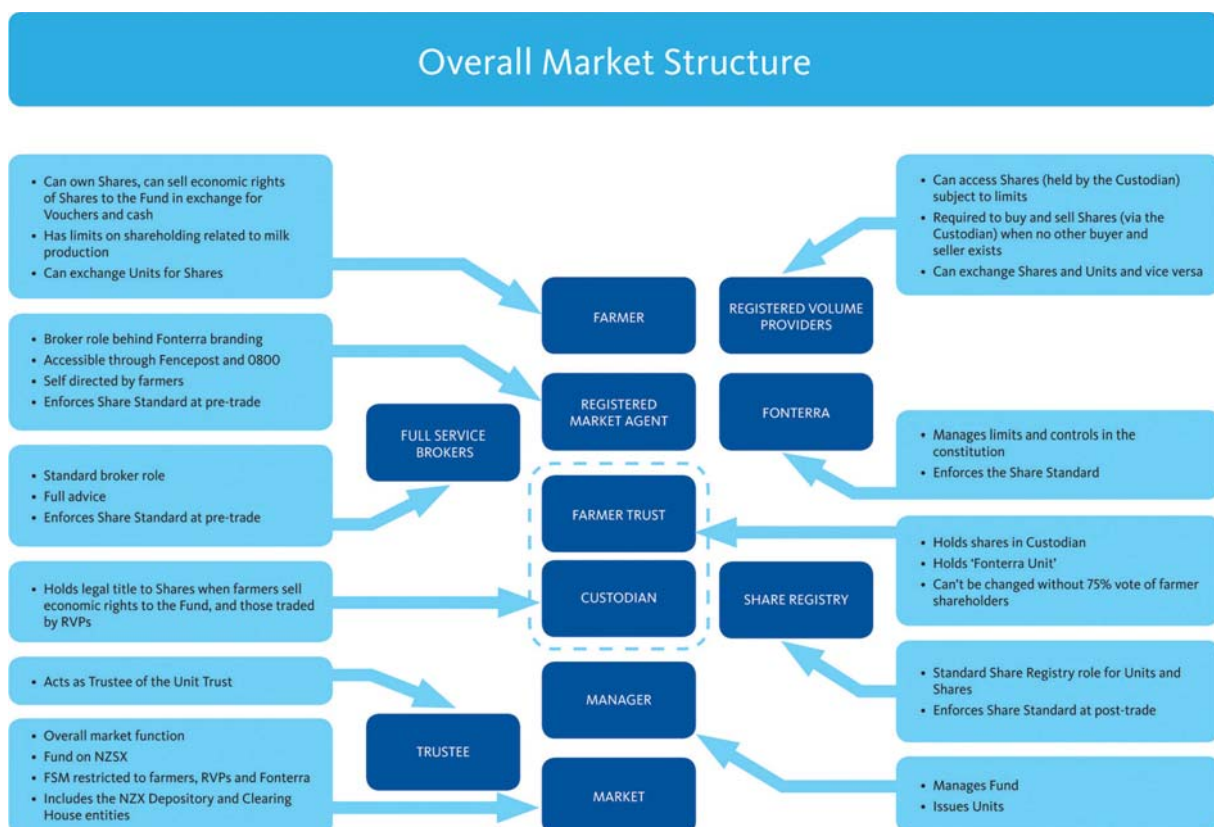
- (a) The Manager and Trustee must act in accordance with the Trust Deed.
- (b) Farmers, the RVP and Fonterra are the only persons who may exchange a Unit for a Co-operative share and vice versa.
- (c) An acknowledgement that the Trustee and Manager cannot:
  - (i) directly or indirectly exercise, control or exert influence on any production-based voting rights in any Co-operative shares held by the Fonterra Farmer Custodian (where economic rights of those shares have been sold to the Fund);
  - (ii) call for a meeting of shareholders of Fonterra;
  - (iii) attend or speak at any meeting of shareholders unless invited to do so.
- (d) Obligations on Fonterra, such as compliance with the FSM Market Rules.

## Summary

The above protections are key components of the structure that protects 100% farmer control and ownership of the Co-operative. Further details can be found in the Blueprint.

## Participants and Roles

A high level overview of the participants in Trading Among Farmers and their major roles is shown below:





## Section 3: Fonterra Shareholders' Market

### Overview

As described in Section 1, the FSM will be a “private” market designed for trading between farmer shareholders, the Fonterra Farmer Custodian (on behalf of the RVP) and Fonterra. The FSM is designed to be the central focus of TAF. Other features that support the FSM are described in the following sections.



### Market operations

The FSM will be a registered market under the Securities Markets Act 1988 and will be operated on Fonterra's behalf by NZX. The FSM will be governed by a set of Market Rules. This will ensure it operates in a robust and transparent manner with oversight by the FMA.

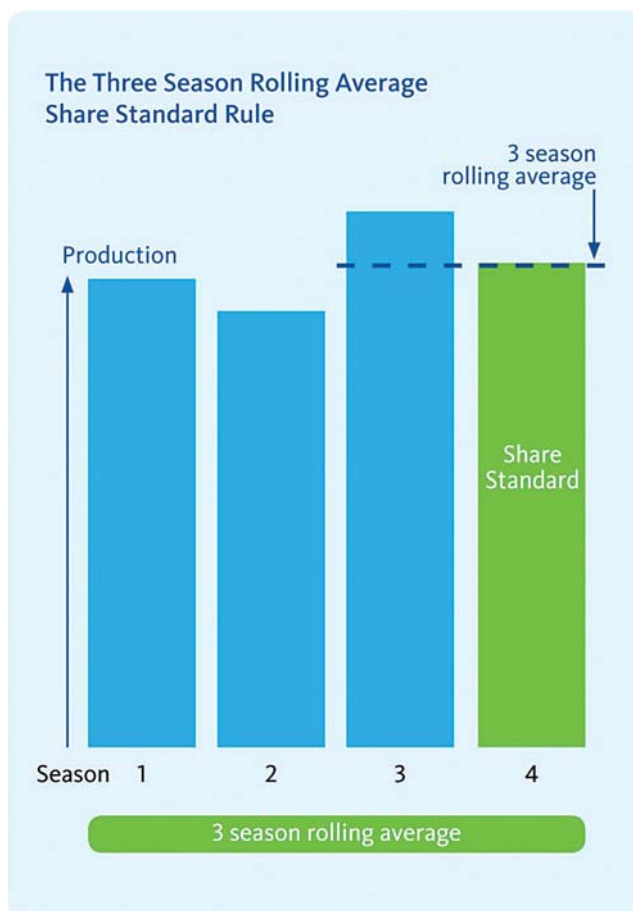
Fonterra has developed the Market Rules for the FSM in conjunction with the NZX. A draft of those Market Rules has been released for public consultation and the final form of these Market Rules will need to be approved by the FMA.

The FSM and the Fund need to work closely together in order to drive liquidity for the trading of Co-operative shares by farmer shareholders. To assist with this, the Market Rules will need to be as similar as possible to the rules applying to the Fund. This consistency will aid in promoting “fungibility” across the FSM and the Fund Market, as well as for ease of operation. However, Fonterra will have a series of controls which are designed to ensure that changes to the rules going forward will not affect features unique to Fonterra, particularly its co-operative status and ethos.

Farmer shareholders will access the FSM either through a standard full service brokerage model or via Fencepost (Fonterra's internet portal) and the standard Fonterra 0800 number. Direct Broking Ltd (a subsidiary of ANZ National Bank) has been appointed as the Registered Market Agent (or RMA). The RMA will provide a share brokerage service that will sit behind Fencepost and the 0800 number.

## Share Standard

The Fonterra Share Standard requires that, as a minimum, one Co-operative share is held for every one kilogram of milk solids supplied by a farmer shareholder. Under TAF, the Share Standard will be based on a rolling three season average of milksolids supplied to Fonterra in the preceding three seasons or, in certain circumstances, an estimate provided by the farmer shareholder.



Under the Form B Constitution:

- The Board has the discretion to allow a period over which new entrants and growing farmer shareholders will be permitted to “build up” their holdings of Co-operative shares to meet the minimum requirements under the Share Standard. The Board intends to set this at three seasons at the launch of TAF. This is the “three years in” rule.
- Exiting farmers and those farmer shareholders reducing supply may also be given an equivalent period to sell down their holdings of Co-operative shares. The Board also intends to set this at three seasons at the launch of TAF. This is the “three year out” rule.
- Farmer shareholders will also be allowed to meet the Share Standard by holding either Co-operative shares or (within limits to be specified) “vouchers” issued in relation to the sale of economic rights of “Wet” shares to the Fund.

## Thresholds that apply to the FSM

Although Fonterra has only one class of Co-operative share, the terms “Dry share” and “Wet share” are sometimes used in relation to shareholding.

The term “Wet share” is used to describe the component of a farmer shareholder’s shareholding that is backed by production (i.e. to meet the Share Standard). The term “Dry share” is used to describe the component which is not backed by production. For example, if a farmer shareholder owns 120,000 Co-operative shares and has a three season rolling average of 100,000kg/MS per season, 100,000 of those Co-operative shares would be referred to as “Wet shares”, with the remaining 20,000 referred to as “Dry shares”.

The Board will, on the launch of TAF, adopt a policy that will require that the total number of Dry shares on issue at any time must be around 5% of total Co-operative shares on issue.



- The RVP will be prohibited from exercising, or directing the exercise of, voting rights attached to any Co-operative shares held by the Fonterra Farmer Custodian on its behalf. For any Co-operative shares held by the Fonterra Farmer Custodian on behalf of the RVP on a dividend record date, the dividend entitlement would be paid to the Fonterra Farmer Custodian on behalf of the RVP or direct to the RVP at the Custodian's instruction.

The RVP will be required to ensure the smooth execution of transactions and improve liquidity through continuous quoting of both buy and sell orders with a contracted maximum spread between buy and sell prices quoted. A key role for the RVP will be to ensure that the spread between buy and sell prices is restricted to a narrow range.

Under the Form B Constitution, the RVP must hold rights or interests in no more than 5% of the total number of Co-operative shares on issue at any point in time (via the Fonterra Farmer Custodian). Under the terms of the RVP Contract, the percentage of Co-operative shares held for the RVP (by the Fonterra Farmer Custodian) will likely be set at a level much lower than this 5% limit - currently anticipated to be 1.5%.

## Voting

Under Trading Among Farmers, voting at shareholder meetings will continue to be on a poll or postal ballot. A farmer shareholder supplying milk to Fonterra in a season has one vote for every 1,000 kilograms of milksolids supplied by that farmer shareholder during the preceding season, to the extent that production is backed by shares and vouchers.

- Where voting is by show of hands or by voice, every shareholder who is supplying Milk to Fonterra in the current season has one vote. This has never been used at a Fonterra shareholders' meeting.
- Neither the RVP nor the Fund (or the Fonterra Farmer Custodian in relation to either) can exercise any voting rights attached to Co-operative shares. As well, they cannot instruct the Fonterra Farmer Custodian to vote, or seek to influence how any other shareholder votes except on an interest group resolution as discussed below.
- Unit holders are able to vote in relation to the operation of the Fund. These voting rights are set out in the trust deed for the Fund and are subject to the rights of the Fonterra Unit (which are described in section 2 above).
- If farmer shareholders took an action targeted at the economic rights of Co-operative shares purchased by the Fund, the Fund could have legal rights to protect those interests. This might apply, for example, if farmer shareholders tried to pass a resolution to prevent or restrict dividends being paid on the shares in which economic rights have been sold to the Fund.
- If this situation was to arise, the Fonterra Farmer Custodian as the holder of the legal title to those Co-operative shares could form an 'interest group' in relation to that decision. This would give the Fonterra Farmer Custodian an 'interest group' vote, which could be used to prevent the adverse action being taken. The Fonterra Farmer Custodian would have to vote in the manner directed by the Fund.
- The Fonterra Farmer Custodian would not form an interest group on a decision that treats all Co-operative shares in the same way (including the Co-operative shares held on behalf of the Fund by the Fonterra Farmer Custodian).
- The Fund could also direct the Fonterra Farmer Custodian to take an action to prevent a breach of the Form B Constitution or if there was a breach of duties by Fonterra Directors. Every Fonterra farmer shareholder also has this right.

## Section 4: Fonterra Shareholders' Fund

### Overview

The purpose of the Fonterra Shareholders' Fund is to facilitate liquidity of trading of Co-operative shares on the FSM so as to lead to better discovered prices in the FSM. As described above, the Fund will support the FSM by allowing non-farmer investors limited access to the economic benefits of a Co-operative share, thereby creating a more liquid market for farmer shareholders (and the RVP) to trade Co-operative shares.

This will allow farmer shareholders to sell economic rights of Co-operative shares to the Fund as well as sell Co-operative shares on the FSM, and will allow an RVP to move between the two markets in order to match supply and demand. This should facilitate price convergence between the two markets.

The features of Units and Co-operative shares have been designed to be as close as possible, including equivalence of dividend flows and other economic benefits that flow from Co-operative shares. Essentially, the features of Units issued by the Fund should be as consistent as possible with the characteristics of "Dry shares" held by farmer shareholders.



Units in the Fund could primarily be created as follows:

- A farmer shareholder sells economic rights of Co-operative shares to the Fund, Units are created which are then sold on the NZSX and the cash paid to the farmer shareholder; or
- An RVP sells economic rights of Co-operative shares to the Fund, and the RVP receives Units (which it can then sell on the NZSX for cash if it wishes).

In addition, Units could be cancelled in two ways:

- Farmer shareholders and Fonterra can exchange Units for Co-operative shares.
- The RVP can exchange Units for Co-operative shares (on the basis that the relevant Co-operative shares immediately pass to the Fonterra Farmer Custodian to be held by it).

#### *Limits on the size of the Fund*

The Board of Fonterra will adopt a Fund Risk Management Policy designed to manage the size of the Fund. In summary, this Policy will provide as follows:

- the number of Dry shares on issue will fall within an acceptable tolerance of 5% of total shares on issue (excluding treasury stock).
- the Board will manage the Fund size within a target range for the actual Fund size of between 7-12% of total shares on issue (excluding treasury stock), and a potential Fund size (i.e., allowing for Dry shares that may find their way to the Fund) of between 7-15% of total shares on issue (excluding treasury stock).
- The Policy sets out steps the Board must follow if the size of the Fund falls outside these thresholds, with the interventions becoming more onerous and intrusive the higher the threshold. These steps include regular monitoring and reporting, consultation with the Shareholders' Council and bringing proposals to farmer shareholders.

- The Board has a variety of tools to reduce actual or potential Fund size, including buying back Units or Co-operative shares. The Policy stipulates thresholds designed to ensure that Fonterra's balance sheet is strong enough to be able to use these tools to reduce the Fund to within the target range.

## Fund Unit Trust Structure

The Fund will be established as a unit trust under a Unit Trust Deed in accordance the Unit Trusts Act 1960.

The Trustee of the Fund will be The New Zealand Guardian Trust Company Limited, a trustee company who holds a licence under the Securities Trustees and Statutory Supervisors Act 2011.

The Manager of the Fund will be wholly owned by another licensed trustee company, Trustees Executors Limited. Under the Unit Trusts Act, the role of the Manager is to manage the investments of the unit trust, and to issue Units to the public. The Manager of the Fund will play a relatively contained role in relation to the Fund. Fonterra will manage most of the services needed by the Fund.

The Manager will have a board of five directors, three of whom will be elected by Unit holders in the Fund (Fund Directors), and two of whom will be Fonterra representatives (who would be Fonterra Directors or senior executives).

As noted in Section 2, Fonterra will enter into an "Authorised Fund Contract" with the Manager and Trustee of the Fund. This will establish the Fund as an "Authorised Fund" under Fonterra's Constitution.

In addition to the matters discussed in section 2, the Authorised Fund Contract will:

- specify the services to be provided to the Manager by Fonterra;
- contain termination arrangements (including the rights of Fonterra in this regard); and
- reinforce the independence of the Directors appointed by the Fonterra Board to be "Appointed Directors" on Fonterra's Board, by specifying the following requirements in relation to the appointment of such directors:
  - the Board of Fonterra will follow a robust selection process to identify a suitable candidate or candidates;
  - as a vacancy arises (or prior to any three-yearly re-ratification of an incumbent Appointed Director), the Board will seek the support of the Fund Directors to a list of possible candidates determined by the Board;
  - the Board will consult with the Fund Directors on possible candidates; and
  - at the time of launch of the FSM, the appointments of each of the four incumbent Appointed Directors will be deemed to be confirmed.

The Board can appoint an Appointed Director who is not supported by the Fund if this resolution of the Board is supported by a majority of Appointed Directors. This would also need to be disclosed.

It is possible for the Manager to be removed by the Trustee, the Court or by 75% resolution of Unit holders. However, the requirements around governance of the Manager and its board would be set out in the Trust Deed and in the Authorised Fund Contract and would continue to apply despite the appointment of a replacement Manager.

The costs of the Fund should not be extensive and will be, in general terms, reimbursed by Fonterra.

## Fonterra Unit

There are some key features of the Fund that are not able to be changed by Unit holders without the approval of the Fonterra Farmer Custodian Trust. This protection is provided by the terms of the 'Fonterra Unit' described in Section 2 above.

## Fund Thresholds and Limits

### *Aggregate threshold*

Under Trading Among Farmers:

- The Form B Constitution provides that Farmer shareholders may, in aggregate, dispose of economic rights in up to 25% of total Co-operative shares on issue to the Fund.<sup>2</sup> However, as noted above, the Board will, on the launch of TAF, adopt a Fund Risk Management Policy that aims to maintain an actual Fund size of 7-12% of total shares on issue (excluding treasury stock) and a potential Fund size of 7-15% of total shares on issue (excluding treasury stock).

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<sup>2</sup> It is proposed that this threshold be reduced from 25% to 20%. For this reduction to occur, shareholders would need to approve this change to Fonterra's Constitution by a special resolution. A special resolution having this effect will be voted on by shareholders at the Special Meeting on 25 June 2012. This is not a pre-requisite to TAF.



- If the constitutional threshold were at any time to be exceeded, the Board of Fonterra is required by the Form B Constitution to take steps to bring the number of economic rights of Co-operative shares placed with the Fund back within the threshold within an appropriate timeframe.

#### *Fonterra Shareholders' Fund transfer limit (FSF transfer limit)*

The Form B Constitution does not prescribe any limit on the extent to which an individual farmer can dispose of economic rights of shares to the Fund. The setting of the FSF transfer limit is at the discretion of the Board, subject to the need to comply with the aggregate constitutional threshold noted above.

The FSF transfer limit will restrict the number of economic rights of "Wet shares" that a farmer shareholder may sell to the Fund. Farmer shareholders will however generally be free to sell economic rights of all of their "Dry shares" to the Fund as they see fit, but the Board can suspend transfers of economic rights of "Dry shares" to the Fund under the Fund Risk Management Policy if the size of the Fund at any time warrants that action.

The Board initially intends to set the Fund transfer limit at a level that is well within the aggregate target threshold noted above.

The Board will maintain the discretion to set and apply the Fund transfer limit. The Board has previously indicated that it intends to adopt a policy of not setting the Fund transfer limit above 33% (but the actual transfer limit set by the Board could be set significantly below this).<sup>3</sup> At launch, the Board will target a level lower than this, consistent with its Fund size objectives (see further comments below).

There may be periods from time to time in which shareholders will not be able to sell economic rights of Co-operative shares to the Fund. This is part of the process for managing the Fund size. But even then shareholders would still be able to sell Co-operative shares on the FSM.

#### *Vouchers*

As described in Section 1, when a farmer shareholder sells economic rights of "Wet shares" to the Fund within the Fund transfer limit the farmer shareholder may also receive vouchers.

Under the Form B Constitution, the Share Standard can be satisfied by the holding of both Co-operative shares and vouchers, to the extent permitted by the Board.

The number of vouchers that qualify for this purpose will match the individual Fund transfer limit. For example, if the individual Fund transfer limit is set at 15% of the minimum shareholding, then only 15% of the minimum holding required by the Share Standard can be satisfied by vouchers. The same limit applies to the number of vouchers that can be accrued by farmer shareholders. When a farmer shareholder reaches the limit on the number of vouchers that can be accrued, no further economic rights of "Wet shares" will be able to be sold to the Fund.

A voucher is not a security. A voucher simply records that a farmer shareholder has transferred the economic rights of one "Wet share" to the Fund, but has retained voting and production rights (including the share-backed milk payment). Vouchers are currently not proposed to be transferrable; however the Board may develop a policy which would allow for the transfer of vouchers in certain circumstances.

#### *Limit on individual holdings of Fund units*

Under the terms of the Unit Trust Deed, individuals and their associates (excluding Fonterra) will be permitted to hold no more than 15% of the Units on issue in the Fund.

## **Fund Launch**

Given the unique nature of TAF, a dual supply and demand offer process will be required at the time of launching the Fund. The supply offer will provide farmer shareholders the opportunity to tender their Co-operative shares for transfer to the Fonterra Farmer Custodian for placement of economic rights with the Fund. The demand offer will provide potential investors in the Fund the opportunity to tender their interest in buying Units. There will need to be an appropriate process established to match the demand and supply offers to determine a buy/sell price applicable to both the supply and demand offers. The details of the demand and supply offer process are yet to be determined.

The amendments to DIRA required to facilitate Trading Among Farmers currently require a minimum Fund size at launch of \$500 million, which represents approximately 8% of Fonterra's total shares at the current share price. The Board considers that a Fund size close to \$500 million at launch is sufficient to ensure a well-functioning market that will result in appropriate price discovery.

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<sup>3</sup> It is proposed that this 33% limit be included in the Constitution. For this to occur, shareholders would need to approve this change by a special resolution. A special resolution having this effect will be voted on by shareholders at the Special Meeting on 25 June 2012. This is not a pre-requisite to TAF.

## Termination of Fund Arrangements

As noted above, Fonterra has a range of tools and policies to manage the size of the Fund, including suspending the sale of further economic rights of shares to the Fund. Terminating the Fund is a last step because it is likely to result in Fonterra reverting to issuing and redeeming Co-operative shares as it does currently under the Dairy Industry Restructuring Act 2001.

While TAF has been designed to deliver on its objectives, any change involves some risk. For that reason, Fonterra will retain the unilateral right to give notice to terminate the Fund without cause within two years after the launch of TAF. Termination would occur within 12 months of notice being given (which could happen any time during this two-year period). If this occurred, the economic rights of shares would be acquired by Fonterra on the basis of a pre-specified valuation methodology and process.

It was noted to farmer shareholders in meetings in February this year that any compulsory sale by Unit holders would need to be at a price that reflects the hassle, uncertainty and other costs of an early termination. In a similar manner to when you enter into a long-term contract to lease some of your land, but with an option for you to terminate early, there is a price for the option.

The fair buy-out price would be set at a premium to the price at which Units traded before notice of termination was disclosed. The precise level of that premium has yet to be established, since the Trustee of the Fund and the board of the Manager of the Fund are stakeholders that will need to be consulted. The basis of valuation and extent of the premium over the previously traded value is a factor that may influence the issue price of Units in the Fund. Accordingly, this detail will be finalised in the offer documents that will precede the launch.

The other circumstances that may result in an unwind of the Fund are where:

- Unit holders vote by an extraordinary resolution to liquidate the Fund. Unit holders will have this right, like shareholders in a company. This would not result in Fonterra being required to purchase Units or economic rights of Co-operative shares, although it will be able to choose to do so if it wishes; and
- In certain cases of breach of the Authorised Fund Contract.

As noted above, oversight of the Fund will be conducted by an independent Trustee with significant experience in conducting this role. The Manager of the Fund is expected to attract a board of high commercial calibre. The likelihood that the Trustee of the Fund, the Manager of the Fund or Fonterra would breach the terms of the Trust Deed or the Authorised Fund Contract is therefore expected to be low. However, it is necessary to set out what the consequences of breach would be. In severe cases of breach, the unwind and termination of the Fund could be a potential outcome.

Further information regarding the likely circumstances where the Fund could be “wound up” or suspended, and the consequences of this wind up are set out in the Blueprint.

## Section 5: Legislative Changes and Regulatory Approvals

The Dairy Industry Restructuring Amendment Bill (DIRA Bill) was introduced into Parliament on 27 March 2012. The DIRA Bill is intended to make the changes to the Dairy Industry Restructuring Act 2001 and to other legislation that are necessary to allow TAF to be implemented (TAF Provisions).

Fonterra considers that the TAF Provisions in the DIRA Bill will allow TAF to be implemented, subject to the comments noted below.

Fonterra has provided detailed submissions on the TAF Provisions to the Primary Production Committee, which is the select committee charged with reporting back to Parliament of the DIRA Bill. These submissions contained a number of suggested amendments to the TAF Provisions. Parliament will decide on the final wording of any amendment to the TAF Provisions and once amendments to the DIRA Bill are reported back, Fonterra will consider whether the necessary amendments have been made to the TAF Provisions to enable TAF to proceed.

Fonterra has been advised that certain waivers, approvals, consents and other confirmations from regulatory and other bodies (or comfort to a similar effect) will be required in order to implement TAF. These approvals are currently being sought or will be applied for in the coming weeks. Fonterra has a process in place to monitor these approvals so as to ensure that the necessary approvals are obtained to enable TAF to proceed.

## Section 6: Tax

### Income of the Fund

The Fund will elect to be what is known as a “PIE” for income tax purposes. Such a PIE is treated effectively as a flow through for income tax purposes so that income derived from the economic rights of Co-operative shares held by the Fund is taxed as if those rights were held by Unit holders.

The Fund will attribute investors their portion of the income from the Co-operative shares and pay tax on their behalf. Where the required notification is given to Inland Revenue, the Fund will pay tax on behalf of resident investors at their marginal tax rate, capped at 28% as opposed to the highest marginal tax rate which is 33%. No further tax will be payable on distributions made by the Fund.

### Sale Proceeds of Co-operative Shares and Units in the Fund

A farmer shareholder should not be subject to any tax on gains made from disposing of economic rights of Co-operative shares to the Fund or from the sale of Units provided that:

- the farmer shareholder does not carry on a business of dealing in shares;
- the Co-operative shares or Units were not acquired for the purpose of disposal; and
- the gains on the sale of the economic rights of Co-operative shares or the Units have not been derived from a profit making scheme.

In addition, the distribution of Fonterra shares on the redemption of Units will not give rise to assessable income.





**Dairy for life**