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**FONTERRA:  
WPC 80 PRECAUTIONARY RECALL  
BOARD INQUIRY, 2015 REVIEW**

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## FOREWORD BY OVERSIGHT COMMITTEE

Shortly after the August 2013 precautionary recall of products connected with certain of its protein concentrates (*WPC80*), the Fonterra Board established an independent inquiry process.

That process involved two tiers:

- a special oversight committee, appointed by (but operating independently of) the Fonterra Board (*Committee*), chaired by Sir Ralph Norris, comprising two other appointed (independent) directors, Simon Israel and John Waller, with two farmer-elected directors, Blue Read and Professor Nicola Shadbolt, and supplemented by two distinguished non-directors – retired High Court judge, Dame Judith Potter, and Auckland University Vice Chancellor, Professor Stuart McCutcheon;
- the independent inquiry team – Dutch dairy industry expert, Jacob Heida; Australian crisis management and communications expert, Gabrielle Trainor; and leading New Zealand lawyer, Jack Hodder QC.

The Fonterra Board accepted the 2013 Report recommendations, including the recommendation for this final 18 month review. The Committee has readily reconvened to contribute to that review. All Committee members have been very interested in Fonterra’s progress in relation to the areas highlighted by the 2013 Report.

After considering the Inquiry Team’s Report in draft, and testing aspects of it with members of that team, the Committee is satisfied that the Inquiry team has undertaken a thorough review and that there is a sound foundation for the Report and its positive conclusions.

The Committee has been well aware of the profound impact of the WP80 events on Fonterra and, accordingly, on New Zealand. It has been encouraged by, and accepts, the 2015 Report’s assessment of important, constructive and apparently well entrenched changes within Fonterra in those areas identified as less than satisfactory in the 2013 Report.

The Committee is pleased to commend the 2015 Report of the Fonterra Board. It also recommends that the Board publish the full report.

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Sir Ralph Norris

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Dame Judith Potter

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Simon Israel

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Professor Stuart McCutcheon

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Blue Read

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Professor Nicola Shadbolt

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John Waller

## PREFACE BY INQUIRY TEAM

The Inquiry team involved in the 2013 inquiry work and report, and reconvened in 2015 for this 18 month review, comprised Jacob Heida, Gabrielle Trainor and Jack Hodder QC. Their backgrounds are noted in the Committee's Foreword.

The Inquiry team's work involved several phases:

- Initial separate meetings with Fonterra's CEO and most senior executives, and with the Board's Chair
- Site visits to, and separate meetings with a range of local managers and operational employees, at Fonterra's Waitoa, Hautapu and Edgecumbe plants
- Separate meetings with most directors, including the chairs of three relevant Board committees, and the director members of the Board's WPC 80 Committee
- Meetings with a range of Fonterra personnel with relevant operational and FSQ responsibilities
- Meetings or telephone discussions with a range of shareholders, including shareholding suppliers, major investment entities, news media representatives, central government officials, Members of Parliament, Cabinet Ministers and some primary industry participants and commentators

- Reviewing a substantial volume of Fonterra's internal written material, requested to verify and clarify matters discussed at meetings
- Meeting again with senior executives, the CEO and the Board's Chair.

In the several dozen interviews undertaken, the Inquiry team proceeded on an explicitly confidential basis, as it did in its 2013 work. The Inquiry team is most grateful for the time, thoughtfulness and candour of all those involved in these interviews. It believes that its work has provided a good appreciation of the state of Fonterra's responses to the 2015 Report and recommendations, and the conclusions in this Report.

The Inquiry team has taken very seriously its responsibility to form an independent assessment. To avoid any doubt, we record that we have had full co-operation from Fonterra personnel throughout our work, and that no one has sought to inhibit our work or the development of our conclusions. We have again benefitted from the thoughtful oversight provided by the Committee.

This Report has been prepared with the Fonterra board of directors in mind as the primary audience. It is pleasing to the Inquiry team to be able to report positive conclusions to the Board, as explained in the Report.

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JACK HODDER QC

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GABRIELLE TRAINOR

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JACOB HEIDA

# 1 OVERVIEW

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- 1.1 This Report completes the work of the independent inquiry (**Inquiry**) established by the Fonterra board of directors in early August 2013 to consider the circumstances preceding, and Fonterra's responses following, the precautionary recall of WPC 80 and downstream products earlier that week.
- 1.2 The Inquiry's October 2013 report (**2013 Report**) was detailed, and included 33 recommendations. The Fonterra Board accepted the Inquiry's recommendations, including the suggestion that the Inquiry review Fonterra's response to the other recommendations after intervals of approximately nine months and 18 months. The nine month review in 2014 was essentially of a "desk top" nature - senior management presentations to the Inquiry team, which in turn briefed the oversight Committee, and noted positively the work programmes and progress as explained by management.
- 1.3 This 18 month review (**2015 Review**) has been, as foreshadowed at the time of the nine month review, more extensive and in-depth. It has involved the Inquiry team visiting several plants, reviewing a wide range of documents, and conducting confidential discussions with over 60 individuals, including directors, senior management, other Fonterra personnel, representatives of farmer shareholders, institutional shareholders, government officials, Ministers and MPs, primary industry analysts, news media personnel and others.
- 1.4 Overall, the Inquiry team is comfortable in advising the oversight Committee and the Fonterra Board that the events of 2013 have proved to be a catalyst for positive operational, cultural and governance changes. However, the gains made should not only be sustained and improved on but also be incorporated into "business as usual" practices to ensure that Fonterra is in the best position to manage all kinds of risks to its business – operational, commercial and reputational (which are frequently interrelated). The Inquiry team believes Fonterra recognises this need and that it aspires to maintain the momentum for continuous improvement.

## Positive Conclusions

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- 1.5 While the original recommendation was for the Inquiry "to review Fonterra's responses to the Inquiry's [2013] recommendations", and this has been done, the 2015 Review has been essentially concerned to inquire, first, whether material improvements within Fonterra have occurred in the light of the 2013 precautionary recall; and, second, whether these improvements have been effectively absorbed within "business as usual" practices.
- 1.6 The Inquiry team's conclusions are positive. The information gathered from the 2015 Review provides a sound platform to conclude that:
- (a) unsurprisingly, there have been significant positive developments within Fonterra, in the light of the 2013 precautionary recall, in all of the areas subject to recommendations in the 2013 Report; and
- (b) encouragingly, those improvements generally appear to have been incorporated into Fonterra's standard (and sustainable) business practices.
- 1.7 A little more particularly, the Inquiry team has satisfied itself that:
- (a) food safety and quality (**FSQ**) understandings and procedures have improved within Fonterra's processing operations;
- (b) understandings and procedures in relation to scientific and diagnostic aspects of FSQ issues have been revised and refined;
- (c) FSQ management and crisis management arrangements, including traceability capacities and escalation

- procedures, have been effectively overhauled;
- (d) a regular regime of crisis simulation exercises, including the participation of key internal and external stakeholders, is now in place and learnings are integrated as continuous improvement;
- (e) a more open communication style and approach has been implemented, and the internal communications capability has been improved - including through hiring a number of skilled senior people and through a major upgrade of Fonterra's digital and social media presence;
- (f) there has been a conspicuous and generally appreciated focus on building relationships – in particular, with politicians, regulators and opinion shapers - and on the importance of changing behaviours to better develop trusting relationships across Fonterra's other stakeholder groups;
- (g) there has been an effective focus on a "one company", and "leading global food product organisation", approach within Fonterra, and the substantial erosion of "silos" within the Company;
- (h) the separate Risk Committee of the Board has been established and is settling into its role.
- 1.8 Those conclusions are important. They reflect the Inquiry team's belief that Fonterra has undergone fundamental changes in the light of the events of 2013, and especially in relation to the promotion and embedding of FSQ processes and understanding.

## The Ongoing Journey

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- 1.9 However, as most senior Fonterra personnel explained to the Inquiry team, such changes must be seen as part of a "journey" towards best practice in all aspects of FSQ and wider risk management arrangements. Impressive progress has been made, but no one claims that the journey is complete. Indeed, it seems likely that the bar will continue to rise and that this journey can never be declared to have ended.

## Some Contextual Matters

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- 1.10 It is useful to identify some other contextual matters:
- (a) Fonterra is necessarily a complex organisation, perhaps uniquely so, given its cooperative structure and shareholding, its statutory obligations to accept supply, and its variety of products – involving numerous competitive international markets and different levels of supply chains;
- (b) as discussed in the Inquiry's 2013 Report, Fonterra's economic significance within New Zealand imposes an "involuntary national champion" role upon it, including the attraction of a fairly constant level of political and news media focus unknown to other commercial organisations;
- (c) in a globalised and competitive commercial environment, business resilience and adaptability are fundamental for survival and success – and this means ongoing changes; and
- (d) the 2015 Review was undertaken during a period where Fonterra's commercial strategies were attracting stakeholder and news media attention following major reductions in milk product prices and payouts – the Inquiry's role does not of course extend to an assessment of those strategies, but it is relevant to record the Inquiry team's acceptance of senior management and Board commitment to the primacy of FSQ matters within Fonterra.
- 1.11 To avoid any misunderstanding, it should be noted that the Inquiry's 2013 recommendations were not designed to provide prescriptive

detail, but rather to indicate particular areas within (or aspects of) Fonterra which warranted careful attention in the aftermath of the WPC 80 precautionary recall. In other words, the core question is not whether every part of every Inquiry recommendation has been adopted unconditionally – rather it is whether the relevant areas have received the appropriate careful attention. As indicated earlier, the Inquiry team is satisfied that the answer is “Yes”.

1.12 The balance of this report is organised by reference to the 2013 Report’s 32 substantive recommendations, grouped under more general headings:

- Food Safety and Quality
- Crisis Management Capability
- Communications, Stakeholders and Social Media
- Governance

## 2 FOOD SAFETY AND QUALITY

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- 2.1 The first group of recommendations in the 2013 Report were directed to matters of food safety and quality (FSQ). Notwithstanding that the WPC 80 precautionary recall was based on a “false alarm”, the Inquiry’s work in 2013 confirmed that FSQ practices within Fonterra had significant room for improvement to reach a “best in class” standard for nutritional product ingredients manufacturing.
- 2.2 The 2015 Review has left the Inquiry team with real confidence that FSQ practices within Fonterra have undergone major improvement, and are the subject of appropriate ongoing focus. These improvements cover operating requirements, training and education, infrastructure upgrades, monitoring and leadership.
- 2.3 The last mentioned matter – leadership – warrants attention. There has been conspicuous and consistent leadership from the chief executive and senior management on the fundamental importance of FSQ matters. It is also a standard item on the chief executive’s regular reporting to the Fonterra Board. Similarly, there have been significant senior appointments in this area, most prominently of Greg McCullough as Group Director, Food Safety and Quality. He has brought high level international experience and a strong global focus to FSQ matters within Fonterra.
- 2.4 This senior FSQ emphasis sits well with – indeed, is necessary for – Fonterra’s aspiration to be the world’s most trusted source of dairy nutrition. However, the question properly to be asked is whether the same attention to FSQ is established within all levels of the business. In some discussions with the Inquiry team this question was phrased in terms of whether “FSQ had become embedded in the culture of the workforce”.
- 2.5 While the Inquiry team has justifiable reticence in offering a definitive answer to that question, not least in terms of an elusive concept such as workplace culture, it has found reasons to offer an optimistic response. In particular, the Inquiry team’s site visits and discussions left it with the strong impression that the FSQ imperative for Fonterra was well recognised given:
- (a) the clear and consistent articulation of the FSQ “message” by the chief executive and his senior management team, including at their on-site visits;
  - (b) the increased workplace focus on Fonterra’s customers and their use of ingredients in products for human consumption – bringing a meaningful human story to the manufacturing processes; and
  - (c) the commitment of significant capital expenditure to upgrade operating assets in a manner which accords increased priority to FSQ considerations, recognising that the quality of physical infrastructure impacts on the ability to maintain appropriate FSQ standards. This has reinforced for its employees the credibility of Fonterra’s FSQ commitment.

### Operational Recommendations (1-11)

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- (R1) *Ensure that Fonterra’s specifications (and associated testing) for potential food quality and safety (FQS) issues across nutritional product ingredients manufactured for Fonterra are of “best in class” standard: consistent with the most rigorous requirements of customers, and with international best practice.*
- 2.6 In responding to both the 2013 Report recommendations, and the conclusion of its internal Operational Review (addressed and endorsed in the 2013 Report’s Appendix J), Fonterra merged Recommendation 1 into a redefined broader objective: *Ensure clear standards are fit-for-use, and aligned with global food manufacturing best practice*

- processes, procedures, and importing requirements for manufacturing and testing.*
- 2.7 Fonterra has clearly undertaken a comprehensive review of its specifications and routine testing in pursuing this objective. The review process has sought alignment with Global Food Safety Limits for specifications, particular regard to the requirements of specific markets, and clarification of product bulletins. Further, there has been a global approach, including a commitment to FSSC 22000, an ISO based food safety certification scheme for auditing and certification of food safety in the supply chain.
- 2.8 One point which attracted the Inquiry team's attention was that the standard specifications for WPC do not include universal testing for SRCs. At first sight, this was surprising because the 2013 Report recorded the absence of early SRC testing as one of the (many) contributions to the precautionary recall in August 2013.
- 2.9 Further inquiry on this point established that the scope of SRC testing was carefully considered by Fonterra after the precautionary recall, including in relation to international food safety criteria, and the decision made was that SRC testing would apply only to products (and ingredients provided for use in such products) to be consumed by infants of less than 12 months of age. The Inquiry team understands that Fonterra's logistic systems ensure that only tested ingredients will be supplied for "susceptible" end-user products.
- 2.10 Deviations which are sought by customers from any specified standard lists require senior level Group Quality approval within Fonterra. The Inquiry team was initially sceptical that any customers would insist that certain testing of ingredients (eg, for SRCs) not be undertaken. However, Fonterra provided confidential documents which show certain customers explicitly require no testing beyond what is contractually specified (and, at least in some cases, these exclude SRC testing).
- (R2) *Develop and implement freshly considered procedures and criteria for reworking of product identified as unfit for intended purposes, consistent with customer expectations and international best practice.*
- 2.11 The "reworking" of products (ie applying a further process to products previously processed but held back for some reason) featured in the narrative leading to the 2013 precautionary recall, as explained in the Inquiry's 2013 Report.
- 2.12 The relevant Fonterra FSQ standard for reworking has been substantially and appropriately revised. The end result is that, by virtue of rigorous preconditions and requirements for development of HACCP (Hazard Analysis Critical Control Points) plans, reworking will only occur with very careful prior attention to FSQ requirements, including authorisations and traceability considerations.
- (R3) *Improve understanding of, and criteria for, change control procedures when any non-routine use is made of equipment used in relation to nutritional products and their ingredients.*
- 2.13 Fonterra has undertaken a review of non-standard equipment and practices across all of its sites in New Zealand and overseas. This has resulted in significant and appropriate revisions to the relevant FSQ standard and HACCP plans, and a general requirement for Group Quality Manager approval of non-standard processes.
- (R4) *Revise operational "cleaning in place" programmes to address the desirability of acid washes for pipes and equipment that have been unused for 24 hours or more.*
- 2.14 This recommendation is fairly closely connected to Recommendations 2 and 3, noted above. A substantial and appropriate review of plant cleaning methodologies has been undertaken by Fonterra. While acid washes were not considered generally optimal, the relevant FSQ standard and criteria for CIP (cleaning in place) have been reviewed to include specific provision for the cleaning of equipment which has been unused for specified periods (and which may include an acid wash if appropriate).
- (R5) *Avoid use of flexible hoses in production processes, and particularly in processes involving nutritional products. Use of fixed stainless steel piping is preferable because it can be cleaned to a higher standard than flexible hoses.*

- 2.15 With the enhanced requirements for any use of non-standard equipment or processes, as noted above, and the removal of unnecessary equipment (in conjunction with an idle equipment register in the plants), the essence of this recommendation has been satisfied. That does not mean a total prohibition on flexible hoses in plants, but rather an appropriate FSQ appreciation of their proper utility and potential risks.
- (R6) *Undertake a review into the use of bactofuges in particular production lines (e.g. nutritional products) to assist with removal of potential contaminants from product.*
- 2.16 Fonterra has undertaken a review into the use of bactofuges, or BRC (Bacteria Removal Clarifier) technology, including a review of the effectiveness of BRC equipment used at two New Zealand plants in removing SRC from milk. The decision taken was not to invest further in this technology, in part because of the costs involved and some risks (increased thermophiles and thermophilic spores in the milk). However, the Inquiry team was advised that this topic is being revisited in 2015 and is expected to be considered by Fonterra's Food Safety and Quality Council later this year.
- 2.17 It may be relevant to reiterate at this point that the 2015 Review has sought to assess progress on the 2013 Report recommendations not by reference to unqualified adoption of suggestions but by considering whether the appropriate level of consideration given to the underlying issue.
- (R7) *Elevate FQS understandings and procedures to the same impressive levels as those for health and safety for all Fonterra personnel, through revised training, incentives and monitoring processes, and with consistent and conspicuous leadership from the directors and senior managers.*
- 2.18 Given the commentary which prefaces this series of recommendations (see paragraphs 2.1 – 2.5, above), there is little to add here in relation to Recommendation 7. In short, while almost everyone spoken to within Fonterra referred to FSQ understandings and procedures in terms of a "journey" to international best practice levels, the Inquiry team was left with the strong impression that very significant progress on that journey has occurred within Fonterra since August 2013.
- (R8) *Overhaul the procedures for non-routine microbiological testing within Fonterra to ensure senior management oversight of proposals for low probability/high risk internal work, and that such proposals are thoroughly assessed in advance for utility and the full range of possible consequences.*
- 2.19 This recommendation has been well integrated into Fonterra's standard procedures. Non-standard testing occurs only after appropriate request and senior approval processes have been applied. As with many other matters covered by recommendations in the 2013 Report, the recent criminal contamination threat (involving the "1080" poison) provided a rigorous but positive check for testing Fonterra's procedures, lessons for further improvements and an opportunity to work well with relevant government agencies, in the context of the central government responses to this issue.
- (R9) *Establish a revised protocol for engagement of external scientific and diagnostic resources to ensure that any work commissioned is by institutions or practitioners of international standing, is appropriately undertaken for, and funded by, Fonterra (i.e. asking whether the proposed work is not better undertaken on a pan-industry basis). And that the analyses sought will yield results that are robust.*
- 2.20 Fonterra has revised, extended and clarified its protocols for engagement of external scientific and diagnostic expertise. It has established an international network of leading institutions and consultants which covers most areas of relevant expertise, and can be drawn on promptly when required. Fonterra's Chief Scientist is appropriately involved in external testing initiatives, and sits on Fonterra's Food Safety and Quality Council.
- (R10) *Improve batch tracing systems across the Fonterra organisation to enable prompt and definitive product recalls to be undertaken at a "global best practice" level, including regular training and monitoring.*

- 2.21 The difficulties in tracing the products potentially affected by the WPC 80 precautionary recall were featured in the 2013 Report. Fonterra has improved its existing tracing systems substantially, and has tested these in its crisis management scenarios and in exercises at specific plants. Consideration is currently being given to a further enhanced traceability strategy. This strategy proposal recognises the complexity and delay associated with legacy paper-based systems, and the need for joint responses where enhanced inputs are involved and after products have left Fonterra's custody. This strategy contemplates impressively short and integrated tracing capability being implemented progressively.
- (R11) *Clarify and emphasise risk management protocols for early escalation to senior management of potential reputational risks, especially in relation to FQS matters, including regular training and monitoring. This includes establishing a reporting line between the National Quality Manager and the Group Director Food Safety and Quality. (In turn, the Group Director Food Safety and Quality should directly report to both the CEO and the Chairman of the Risk Committee: see Recommendation 27.)*
- 2.22 This composite recommendation, involving three elements, was a reflection of the 2013 Report's conclusion that the precautionary recall could be viewed as failure in some areas to "join the dots", in part because the actions and issues involved were not referred to appropriate and senior personnel to assess the proposed actions. The Inquiry team has been satisfied that each of the recommendation's elements has been translated into Fonterra's standard procedures and management structure.
- 2.23 On the first element, new "escalation" protocols are in place for potential risks, not least FSQ matters, and the subject of monitoring and training programmes. The Inquiry team was advised of several recent proactive actions in particular plants which illustrated plant level understanding and implementation of Fonterra's enhanced emphasis on FSQ and the new escalation protocols. A balance is of course required, and one of the concerns expressed to the Inquiry team by some Fonterra personnel
- was the need to avoid over-escalation and to ensure that decision-making responsibilities were equally understood.
- 2.24 On the second element of this recommendation, there is a reporting line between the National Quality Manager and the Group Director Food Safety and Quality. In Fonterra parlance, this is a "direct" or primary hierarchical reporting line. This is distinguished from a "dotted" reporting line which involves consistent reporting to a second senior person in addition to the direct reporting line.
- 2.25 On the third element, the Group Director has a direct reporting line to the Managing Director Global Brands & Nutrition, but also a dotted reporting line to the CEO. He also reports to the Chair of the Risk Committee.
- 2.26 The Inquiry team has met with all of those occupying these and other relevant positions in Fonterra, and is satisfied that these arrangements are working well.

### 3 CRISIS MANAGEMENT CAPABILITY

- 3.1 The 2013 Report included specific recommendations covering the broad area of crisis readiness, and other recommendations relating to organisational capacity in the more general context of Fonterra's communications style and structure, governance and general risk management, and stakeholder relationships.
- 3.2 The Inquiry team is confident that a serious critical incident at Fonterra would be handled vastly better now than it was in August 2013. Since then, Fonterra has methodically built an incident response<sup>1</sup> capability aimed at, and making real progress towards, becoming "best in class," based on strong leadership and resources, clear priorities, the establishment of clear process and structure and the engagement of some critical stakeholders.
- 3.3 In relation to the specific recommendations, it is convenient to take as a group the six of those covering crisis planning and incident management:
- (R12) *Revise the crisis management arrangements across the organisation to "best in class", recognising that FQS reputational risks are likely to affect every market in which Fonterra has a presence (and differently). These arrangements should include regular and realistic simulations at least once (and preferably twice) a year involving stakeholders such as customers, industry associations, scientific experts and regulators, ensuring that lessons from exercises and earlier crises are applied and incorporated into an ongoing crisis readiness programme. These simulations should include scenario testing of international product recall procedures and high-level media engagement.*
- (R13) *Establish a permanent (but not full time) multi-disciplinary Incident Management Team (IMT) whose members will be able to apply additional training, a regular and stakeholder-engaged simulation regime and specialist experience to advise on and manage emerging issues, potential crises and realised new crises (and who will be linked in to the Food Integrity Council, the relevant Board Committee and other relevant parts of Fonterra).*
- (R14) *Establish a Crisis Management Plan ("owned" by the proposed IMT) establishing best practice capability including: clear lines of command, highly-trained and credible spokespeople, use of dedicated IMT rooms on declaration of a crisis incident, template preparation (including backgrounders on all operating units and appropriate protocols for any likely crisis scenario such as a product recall, Q & A, timelines), "ghost" website readiness, social media strategy, third party endorsement and translation and language capability in all markets.*
- (R15) *Establish and sustain (with IMT oversight) protocols with key customers to enable the most effective response to future critical incidents, including product recalls, with clear communication lines and constructive understandings about engagement with regulators and media. (Involving key customers in simulation exercises will also strengthen Fonterra's relationships with those key customers.)*
- (R16) *Establish and sustain (with IMT oversight) relationships with a pool of scientific experts in food quality and safety who can speak to the media and the public in the event of an incident.*
- (R18) *Develop (through the communications team) a best practice "Master Communications Crisis Management Plan" aligned with the IMT's Crisis Management Plan, as well as template documents for all foreseeable scenarios, and capable of being adapted by regional offices for local market conditions and stakeholder requirements.*
- 3.4 As described in the October 2013 Report, Fonterra's flawed response to the WPC80 incident was not because a crisis plan did not exist in the organisation. Essentially, however, the plan was not a useful or "living" document that was part of a well-resourced capability, working across the group as part of an integrated cycle of crisis prevention, preparedness, management and continuous

<sup>1</sup> Crisis management, (critical) incident management and incident response are terms used interchangeably.

- learning. The Inquiry team is satisfied that the necessary rectification work, outlined in part below, has been undertaken with great commitment.
- 3.5 Fonterra began its work to significantly invest in and upgrade its crisis response ability soon after the WPC80 incident, its immediate Operational Review and our 2013 Report into it. The month following the release of our report, Fonterra conducted a group-wide crisis simulation exercise, based on a fire at a plant, using the existing crisis plan. That exercise confirmed the then crisis plan was deficient in a large number of significant respects.
- 3.6 Work revising, simplifying and making the plan useful continued, and Fonterra formed a dedicated Incident Management Team (**IMT**) in February 2014. Continuous learning from the exercises and a consequential refining of the plan and the aligned communications plan, was embedded in the simulation regime through the IMT.
- 3.7 In April 2014, a desktop crisis exercise was conducted, followed the next month by the first major simulation exercise, attended by Air New Zealand (a “benchmarking partner”), and external observers including from the NZ Ministry of Primary Industries (**MPI**). This simulation was based on a significant food safety scenario involving international markets. Improvements identified in the debrief included the alignment with the crisis plan of internal and external communication, including traditional and social media, and the need for urgent foreign language translation capability.
- 3.8 A protocol with key customers for critical incidents has been agreed and tested and will continue to be a key part of the critical incident regime. Other customers have been engaged to support the development of the incident management capability.
- 3.9 In November 2014, a major “live” simulation exercise took place, based on a refined plan and involving, for the first time, a Fonterra customer. Observers invited to critique the November exercise found many aspects of the simulation encouraging, and a range of important recommendations was derived from the “to improve” areas, such as mainstream media and social media response and the advance preparation of template materials. Future simulations should mimic real time international media reaction as the crisis unfolds, to better stress test Fonterra’s response.
- 3.10 Relationships with scientific and medical experts in New Zealand and across the world have been more systematically developed and deepened, and Fonterra is an active supporter of the MPI’s proposed New Zealand Food Safety Service and Research Centre, which arose out of a recommendation of the Report on New Zealand’s Dairy Food Safety Regulatory System, chaired by Miriam Dean QC.
- 3.11 IMT’s role in managing incidents to resolve them before they become critical seems to be working well. Over the past 18 months, the IMT has actively managed a number of incidents that have not escalated to a group-wide crisis, along with overseeing a number of other incidents that have been managed at business unit level. The IMT presents at the Board’s Risk Committee to integrate its work with the Committee’s agenda and committee members observe simulation exercises and report to the Board. The Board has adopted a comprehensive Incident Management Policy.
- 3.12 As is now publicly known, an extortion threat involving the NZ dairy industry and the “1080” poison arose in late 2014. The receipt of this criminal contamination threat led to a “real” and high-level critical incident, which was managed collaboratively by the MPI, Fonterra and other dairy industry players over several months on a “worst case” basis. If realised, this threatened contamination would have had very serious implications. It nonetheless provided a valuable stress test of all that Fonterra had put in place and learned in the previous year relating to incident responses. Both internal and external participants in this exercise agree that Fonterra’s performance during this critical incident was very far advanced from that during the WPC80 aftermath. The collaboration between Fonterra, the government and regulators, scientific and health experts, dairy industry manufacturers and other industry participants was constructive, led to a “good landing” and laid a foundation for co-operation in future incident management. The

- management of this serious incident, including a strong, collaborative focus on foreign markets led by the NZ Government, underscored Fonterra's more sophisticated approach to considering and meeting the needs of all its stakeholders during critical incidents: shareholders, staff, investors, government, regulators, customers ("as partners"), consumers, industry bodies and peers, media, advocates, opinion leaders.
- 3.13 The Inquiry team is satisfied that the current critical incident plans, manuals and materials, while inherently subject to continual refinement, are clear, reasonably jargon-free and usable. The international rollout of critical incident training, including systems and media training, based on the new plans and capabilities is underway, and should be progressed apace. Lead managers, and regulatory work streams, have been identified in key locations and the IMT is aware of the need for, and is working on, developing further capability to manage critical incidents in non-New Zealand time zones and in non-English speaking markets, as well as developing more and deeper relationships with key media in foreign markets.
- 3.14 Fonterra continues to refine its planning and critical incident infrastructure as it proceeds with its regime of six-monthly crisis simulations, based on key risks and accompanied by reviews of the simulations and real incidents. For example, it has identified the need for both tactical and strategic response teams. It has, as recommended, allocated a physical location from which to run critical incident management (used in the simulation exercises and during the "1080" incident), provided for ghost sites for crisis management, and has trialled the now widely-used WebEOC system which enables an accessible common repository of information, activity logging and events tracking during critical incidents.
- 3.15 Fonterra recognises that although very good progress has been made there is still more to do to get, and then to keep, Fonterra's crisis management response at best practice level.
- 3.16 Fonterra has recognised the need for continuing work programmes in particular areas, including embedding crisis response systems into induction and performance frameworks, enhancing internal communications during incidents, ensuring physical and technology crisis management resourcing and infrastructure is appropriate in all markets and developing specific plans aligned with specific risks.
- 3.17 The Inquiry team commends Fonterra for the leadership and focus that it has shown in investing seriously in its crisis management capability.

## 4 COMMUNICATIONS, STAKEHOLDERS AND SOCIAL MEDIA

### Communications Recommendations (17-19)

- (R17) *Continue building a directly-employed strong, specialist and experienced communications team, including in key global markets, supplemented with contracted high calibre local expertise where appropriate. (This is in line with Fonterra's 2012 Communications Review recommendation, including advice from McKinsey & Co, and in part already acted upon.)*
- (R19) *Develop a communications style and approach which better reflects Fonterra's values and aspirations as well as best practice risk communications, to enhance trust in Fonterra.*
- 4.1 Considerable positive change has been made in the Fonterra Communications Team structure (**Group Communications**), in its approach to communications and in the composition of its well-led team. It is now moving largely towards a model where:
- the lines of accountability are unambiguous - more key people are employed directly by Fonterra (the relatively unusual outsourcing aspects of Fonterra's communications arrangements were noted in the 2013 Report);
  - the tone and style of communications is more conducive to trusting relationships with direct stakeholders and communities;
  - capability is appropriate to the challenges of a global organisation of the complexity and significance of Fonterra; and
  - strategic communications and developing and maintaining meaningful stakeholder relationships are valued as core management disciplines, fully integrated into business planning and implementation.
- 4.2 A number of high-performing communications executives have over the past 12 months joined Fonterra as employees. Their backgrounds include strategic communications and digital media and their experience benefits Fonterra's communications challenges and the multiplicity and importance of its stakeholders. A review is in progress identifying communications resources in various business units and on specific projects, with a view to maximising their effectiveness.
- 4.3 In Greater China, Fonterra plans to recruit soon a Mandarin-speaking Communications Director, responsible for Communications and External Affairs. This role is to be based in Shanghai but work to the external affairs team in Beijing, with an indirect relationship into Group Communications based in Auckland. In general, Group Communications believes it has strong connections with communications teams in international markets.
- 4.4 A new Group Communications Strategic Plan (*"A Game Changer – Transforming The Way We Communicate at Fonterra"*) was adopted in August 2014. Communications plans are in place globally and for each region with defined structures and priorities. Greater China, for example, has built significant communications strategy, including in digital communications, to support the business objectives, based on five clear primary goals and a strong internal communications approach.
- 4.5 Principles have been set to seek to ensure Fonterra responds to stakeholders, particularly journalists, in a timely, more open way (though in some cases, Fonterra is said to fall short of the kind of plain, clear language that promotes trust). Individual members of the communications team now take responsibility for the relationships with individual journalists and their contact details are now accessible on media releases and generally. This is a small but highly significant cultural change from 2013.
- 4.6 A relationship-building programme for local and international journalists has been put in place including inwards and outwards familiarisation visits. For critical incident communications, guiding principles including clarity, respect and concern are specifically enunciated, and

- external feedback suggests that these principles are also generally acted upon.
- 4.7 The Fonterra website now contains more comprehensive information including all media releases and webcast facilities.
- 4.8 Employee communications have also been upgraded, with both traditional and digital publications adopting a more open, accessible tone and more engaging functionality such as video. A staff app is under development that will enable mobile interactive communication and the speedy provision of useful information and services.

## Stakeholder Recommendations (20, 21, 23)

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- (R20) *Conduct a systematic review of the quality of Fonterra's relationships with key stakeholders in all its markets to assist in enhancing trust and with effective management of any future critical event.*
- 4.9 Many of those interviewed by the Inquiry team recognised that the WPC80 incident was a catalyst for Fonterra to enhance its focus on its relationships, to engage more meaningfully and to work to ensure it valued mutual trust with all those who are important to Fonterra.
- 4.10 Since late 2013, Fonterra has conducted a number of individual stakeholder perception studies. A qualitative study was done in China in late 2013 and a study was also completed in Sri Lanka. A Group-wide stakeholder workshop held in May 2014 was designed to identify and develop a more strategic approach to stakeholder engagement in Fonterra's key markets and work in this area is progressing.
- 4.11 A more systematic approach to understanding how Fonterra is perceived has been adopted more recently. Through the Group Communications and Global Brands and Nutrition areas, Fonterra has put in place brand reputation research across five key markets to measure its standing, from which it can identify issues, develop plans to address any reputational concerns and track progress. The research, first done early in 2015, will be repeated bi-annually. The Inquiry team commends Fonterra for this initiative and the ongoing work in this area.
- (R21) *Consider the appointment of local advisory boards in each key foreign market to enhance capability, engage more sources of high-level advice and provide depth of knowledge of the politicians, regulators and opinion shapers.*
- 4.12 Since late 2013, the question of bolstering local advice in key markets has been specifically considered by each Fonterra region head. Responses have ranged from improving internal capability through strategic recruitments, engaging local consultancies and putting more formal mechanisms in place.
- 4.13 Importantly, in each market, relationships with New Zealand's diplomatic corps have been addressed and deepened.
- 4.14 Late last year, Fonterra established a China Advisory Board to support its business through a group of well-credentialed local people with a diversity of insights, connections, background and experience. In Sri Lanka, Fonterra has also enhanced its access to high-level local advice through the appointment of a senior business figure as a source of strategic advice. The Soprole business in Chile maintains an independent board with an advisory function.
- (R23) *Enhance and sustain programmes for community investment, volunteering and giving as an investment in stakeholder engagement and goodwill.*
- 4.15 One of the key drivers of reputation, contributing to an organisation's licence to operate, is sustained demonstration of social responsibility.
- 4.16 Fonterra is developing a global perspective on its work in responsibility and sustainability. It has worked on this over the last eighteen months or so, guided by best practice it has observed and the global standard on social responsibility (ISO 2600). It has talked widely to stakeholders in communities to focus on the things that matter to them – water, nutrition,

- food safety, climate change, the efficient use of natural resources and biosecurity.
- 4.17 Fonterra has several programmes in New Zealand and in other key markets in which it invests for community benefit. The widely-recognised Fonterra Milk For Schools in New Zealand (“the best move Fonterra has made in a decade”, according to a Cabinet Minister) has been operating in the nation’s primary schools for over two years and KickStart breakfast since 2009. Fonterra’s Grassroots Fund provides grants for community purposes and it also supports Catchment Care, a volunteer program to protect and enhance New Zealand’s waterways. Other community programs operate in Australia, Latin America, in China and with ChildFund in other parts of Asia. Work is also being done to support farmers and their communities in Sri Lanka through nutrition, education and community projects under the REFUEL program.
- 4.18 Volunteering in local communities continues, particularly involving Fonterra’s local employees
- and farmer owners, who have contributed in this way for decades. A senior government interviewee cited an event in Timaru, raising funds for cancer research, as one of myriad examples where Fonterra’s face is prominently seen supporting local causes, and in so doing, deepening relationships.
- 4.19 Sustainable dairying programs on ethical supply, waterway and nitrogen management, water, waste, energy and emissions are in place, in New Zealand and Australia and dairy development programs are in place in key markets, notably Sri Lanka and China.
- 4.20 The global reputation research to track Fonterra’s standing in its markets (see 3.11 above) considers perceptions of social responsibility as one of the drivers of reputation. Fonterra’s developing work in this area, built on the foundations of the work of its farmer owners in communities in New Zealand and now expanded globally, will now be measured through this research. The Inquiry team commends this focus.

## Social Media Recommendation (22)

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- (R22) *Establish a best practice digital and social media strategy, including stand-alone elements in, and responsive to the needs and nuances of, each key market.*
- 4.21 The Inquiry team is satisfied that Fonterra has significantly and steadily enhanced its digital and social media capability since October 2013. The recent recruitment to Group Communications of an expert manager of Digital Channels is a sign that progress will accelerate and its approach further mature.
- 4.22 From a position in 2013 where it had no ability to even monitor social media (except manually), Fonterra now has a more sophisticated capability, particularly in the critical China market. However, Fonterra recognises it has further to go to truly relate to its stakeholders through digital media. Fonterra’s primary usage for social media is as a channel for outgoing information rather than as a tool for two-way engagement.
- 4.23 In 2013, Fonterra employees were prevented from access to digital media through IT firewalls
- and Fonterra did not have a Facebook presence. Now all employees have access and protocols for usage and engagement have been developed and rolled out.
- 4.24 Across its four major platforms - Twitter, Facebook, Linked In and You Tube, growth in engagement (off a low base) has been recorded and importantly, Fonterra Live, the staff app, is about to be launched. Compared with 2013, in April 2015 Fonterra had 25,605 Facebook friends (2013: 0), 8,112 Twitter followers (2013: 4,237), 47,033 on Linked In (2013: 21,470) and 452 posts on You Tube (2013: 97). The Radian6 social media monitoring system has been employed to track relevant commentary.
- 4.25 Fonterra’s use of digital and social media in the management of critical incidents is a feature of its communications planning, but it has not yet been rigorously tested in a live situation.
- 4.26 Fonterra’s social media presence in China is said to be better than in any of its other markets, reflecting social media’s great importance as a communications channel there. Fonterra

China's e-commerce strategy is well-defined with some 25 per cent of consumer brands being sold in this way, and Fonterra has a real time monitoring capability to track e-sales through digital categories. Social media is seen to be an integral part of the brand management in China.

## 5 GOVERNANCE

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- 5.1 The 2013 Report included eight explicit recommendations directed to Fonterra's governance, in addition to the recommendation for the current 2015 Review. The short summary from the Inquiry team is that each of these substantive recommendations has been expressly adopted or appropriately addressed by the Fonterra Board or its Committees. Nevertheless, some commentary on each of those recommendations, and Fonterra's responses, may be of assistance to the Board.

### Governance Recommendations (24-33)

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- (R24) *The Board should explicitly endorse two unambiguous objectives as essential for Fonterra's future, and consistent with its cooperative ethos –*
- (a) *a "one company" approach (with appropriate incentives, governance and management processes) to ensure that Fonterra as a whole performs consistently in the manner expected of a leading global food products organisation, and*
- (b) *recognition of the paramount importance of Fonterra's global reputation, and the need to achieve and sustain a reputation second to none for the quality and safety of its food ingredients and products.*
- 5.2 The explicit endorsement of these objectives now appears as the introduction to the Board's own charter.
- 5.3 The Inquiry team acknowledges that unqualified endorsement. On objective (a), the team's extensive discussions with Fonterra personnel leave it with a strong impression that there has been a sustained and evidently successful move to a "one company" ethos and away from an earlier sense of business units operating as quasi-independent organisations. This "one company" approach is doubtless most readily achieved within New Zealand, but the Inquiry team learned of the work being done in various ways and at different levels to promote this approach across Fonterra's overseas operations.
- 5.4 On objective (b), the Inquiry team is satisfied that, with the Board's endorsement, the CEO and his team have very actively championed the importance of FSQ achievements in relation to Fonterra's global reputation. This has reinforced for the whole organisation the visceral lessons about such importance from the August 2013 precautionary recall events and aftermath.
- (R25) *The Board should explicitly accept responsibility for oversight of progress towards those objectives, including appropriate engagement with senior managers across the organisation, in particular with those managers responsible for championing the FQS imperatives.*
- 5.5 As indicated in the comments on R24, above, the Inquiry team is satisfied that the Board collectively, and directors individually, have demonstrated appropriate leadership on the "one company" and "global reputation/FSQ" directives.
- 5.6 The Board's endorsement of the "This is Fonterra" framework carries within it the "one company" imperative, and the CEO's regular reporting to the Board includes an FSQ section. In addition there have been FSQ focussed presentations to the Board by the CEO and the Group Director, Food Safety and Quality.
- 5.7 Further, the "global reputation/FSQ" objective is an integral part of the Risk Committee's role, and a significant underpinning of the work of the Cooperative Relations Committee. Each of these Committees has significant engagement with the relevant senior managers.
- (R26) *The Board should develop its own protocol for crisis management, including: the roles of the Chair and the CEO; the means for ensuring that sufficient timely and accurate information is available for all directors to assess their regulatory obligations; and the expectations of directors' availability.*

- 5.8 The impressive revised crisis management arrangements within Fonterra, noted earlier, are unsurprisingly focussed on the roles of management personnel, including that of the chief executive. These arrangements also provide for the briefing of the Chairman of the Board by the CEO and for the engagement and briefing of the Board's Risk Committee in particular of that Committee's Chairman.
- 5.9 These crisis management arrangements reflect an appropriate and orthodox recognition of the distinction between management and governance. However, this recommendation from the 2013 Report had a rather different focus: the Board's own arrangements and responsibilities during a crisis.
- 5.10 While an informal case-by-case approach is workable (and was illustrated by the recent criminal contamination matter), the topic of incident management is now addressed explicitly in the Board's own charter. The relevant provisions include a three tier system: Group Crisis; significant emergency and/or Group-led incidents; and regular incident reporting. Each of these tiers will have different levels of Board engagement, integrated with the work of the Risk Committee and the Incident Management Team. The inquiry team endorses these charter provisions.
- (R27) The Board should transfer the Risk component of the Audit, Finance & Risk Committee's load to a separate Risk Committee, which should be expected to oversee the work of the proposed permanent incident Management Team, with the expectation of direct engagement by the Committee with the leaders of that team.*
- 5.11 This recommendation has been fully adopted. The Risk Committee has some overlap of membership with (including the chair of) the Audit and Finance Committee. The Inquiry team considers this overlap, and the terms of the Risk Committee's charter, to be appropriate.
- 5.12 Having held discussions with relevant personnel and reviewed the business items currently on the Risk Committee's agenda, the Inquiry team is satisfied that the Committee is operating well, that there is a good relationship with the IMT, and that the new structure is very important for the "resilience" (rather than compliance-based) approach to risks which Fonterra has adopted.
- (R28) The Board should review the charter for its Cooperative Relations Committee with a view to ensuring that it gives greater prominence to establishing and sustaining relationships with key external stakeholders, not least those within New Zealand's government infrastructure.*
- 5.13 This recommendation's adoption is reflected in the text of the revised charter for the Cooperative Relations Committee. That text now explicitly indicates the CRC's ongoing and important role in relation to external stakeholders as well as to farmer shareholders.
- (R29) The Board should consider enhancing a programme of proactively developing and sustaining its acquaintance and relationships with Ministers, MPs, senior officials, overseas diplomats, industry allies and other "NZ Inc" leaders.*
- 5.14 This recommendation was one of several in the 2013 Report which reflected the Inquiry's finding then that various external stakeholders – including those in central government – had had little contact with Fonterra directors, and in turn there had been limited scope for relationships and goodwill to develop. The primary response to these recommendations has been the enhancement of the Government Relations team and its activities in Wellington, and an increased presence in Wellington of the Board's chairman and the chairman of the Cooperative Relations Committee, in particular.
- 5.15 It is also relevant that, in a small country, most of the Fonterra directors have significant ongoing connections within the primary industry and "NZ Inc". Overall, the Inquiry team is satisfied that the relevant 2013 Report finding, and the associated recommendations, have been appropriately considered and addressed.
- (R30) The Board should develop and articulate an explicit position regarding the relevance (and, importantly, the limits) of Fonterra's "national champion" role in relation to Fonterra's aspirations, behaviours and relationships.*

- 5.16 This recommendation, standing alone, seems with hindsight to have been overly cryptic, and a cause of some misunderstanding. It reflects a discussion in the 2013 Report of the “involuntary national champion” role which Fonterra has within New Zealand by virtue of its conspicuous export and economic significance in a small country and economy.
- 5.17 The essence of this recommendation was that, given the reputational and other risks of being perceived to “own” almost every issue relating to the dairy industry, Fonterra should consider developing an approach which countered such perceptions where the issue was not within Fonterra’s corporate control – for example, where the issue was one involving the other New Zealand dairy companies and/or all dairy farmers, and not just Fonterra and its farmer shareholders.
- 5.18 While the Inquiry team understands that this recommendation has only recently been explicitly addressed along those lines, it is satisfied that the Board’s and senior management’s assessment of new developments has consistently and consciously considered whether the development is best approached as a “cooperative/Fonterra” matter or an “industry” matter. In the latter case, of which there are recent examples, Fonterra has sought to avoid or limit its activity or commentary while contributing to industry-wide organisations or efforts.
- 5.19 It may also be noted that, from its discussions with a range of Fonterra personnel, the Inquiry team believes that this “national champion” role is widely recognised within Fonterra and seen as a source of both pride and responsibility.
- 5.20 More formally, the Board’s Cooperative Relations Committee (**CRC**) has recently adopted a fairly detailed “national champion position statement” developed in response to Recommendation 30. This position statement addresses the statutory and economic context, Fonterra’s aspirations, behaviours and relationships, and the limits of what Fonterra can or should do. Unsurprisingly, the Inquiry team welcomes this position statement and its adoption by the CRC.
- (R31) The Board should encourage renewed investment by Fonterra to maximise the constructive collaboration with the New Zealand Government (including regulatory agencies), and the alignment between Fonterra’s quality and commercial aspirations and the New Zealand Government’s economic, food safety and diplomatic objectives and responsibilities.*
- 5.21 The Inquiry team is satisfied that the Board has provided appropriate encouragement for, and Fonterra management has made good progress towards, the collaboration and alignment with the New Zealand Government referred to in this recommendation.
- 5.22 There is little to be added to the commentary on the associated preceding recommendations. However, it may be noted that their different responsibilities and roles mean that Fonterra and the Government will inevitably need to leave some distance between them: expectations of perfect harmony would be misconceived, but positive and constructive alignment should generally be achievable, and was well demonstrated (according to the Inquiry team’s discussions with Fonterra and Government personnel) in relation to the recent criminal contamination (by the 1080 poison) threat received by Fonterra.
- (R32) The Board should encourage investment by “NZ Inc” (including the NZ Government, Fonterra itself and other food products firms) in ensuring that New Zealand has pre-eminent scientific and diagnostic resources for FQS purposes.*
- 5.23 With appropriate encouragement from the Board, Fonterra has actively supported the ongoing work, led by the Ministry for Primary Industries, towards the establishment of a New Zealand Food Safety Service and Research Centre. This support has included active engagement with other industry parties to seek solutions to differences of approach. From its discussions, the Inquiry team understands that such support is well appreciated within central government, notwithstanding that the wide range of stakeholders and perhaps inevitable diversity of views has meant that the Centre’s commencement is still some time in the future.