Nuffield Farming Scholarship Report

WORLD CLASS LEADERSHIP AND CAPITAL STRUCTURES FOR DAIRY COOPERATIVES FIT TO MEET THE OPPORTUNITIES AND CHALLENGES OF THE 21ST CENTURY

A Thomas Henry Trust & Jimmy Young Award

With the Nuffield Farming Scholarships Trust

Jason Rankin

Jason Rankin N.Sch
4 Crossnamuckley Road
Newtownards
County Down
Northern Ireland
BT22 2AA

Tel: +44 28 91816248
Mobile: +44 7710 366730
E-mail: jason.rankin@btopenworld.com

Contents

Introduction

WHY STUDY THIS TOPIC?

As a dairy farmer I produce on a daily basis a perishable product with a short shelf life that needs to be collected on a regular basis. I regard my dairy cooperative (United Dairy Farmers) as an integral part of my business. Its performance (or lack of performance) will have a significant impact on the profits of my farm, both now and in the future.

While cooperatives in many other parts of the world have rationalised there has been a distinct lack of progress throughout the British Isles.

It is with this in mind that I chose to study "World class leadership and capital structures for dairy cooperatives fit to meet the opportunities and challenges of the 21st Century." On my travels I visited New Zealand and the United States.

I would like to thank my sponsors who made this all possible: the Thomas Henry Trust, United Dairy Farmers, Ulster Farmers Union, Royal Ulster Agricultural Society, Young Farmers Clubs of Ulster, Ulster Bank and Northern Bank.

MY NUFFIELD JOURNEY

In summer 2008, I spent five weeks in New Zealand looking at a wide range of dairy and other agricultural cooperatives. My travels took me from the Bay of Islands in the north right down to Invercargill in the south.

I went to New Zealand mainly focused on capital issues, in particular wanting to look at ways of extracting the asset value of cooperatives. When I had finished my time there I was much more focused on the importance of leadership, had completely turned away from asset release and was much more appreciative of the importance of traditional cooperative values.

In August 2009, I spent three weeks in the United States visiting Wisconsin, Minnesota, Ohio and Washington DC. People think of the US as the world's most capitalist country. However it also has a very strong cooperative ethos where merger of cooperatives happens with low levels of resistance. It is seen as a sign of strength and progress rather than failure. A weakness is a tendency to have oversized boards and a lack of outside expertise on the board.

DISCLAIMER

Acknowledgements

First of all I would like to thank all the people and organisations who so generously gave of their time to me.

New Zealand

Selwyn Tisch, Livestock Improvement Corporation
Blue Read, Fonterra Shareholders Council
Phil McKinnon, PGG Wrightsons
Harry Bayliss
Ramsey Margolis, New Zealand Cooperatives Association
Alistair Hercus, Buddle Findlay
Geoff Brown, New Zealand Stock Exchange
John Roadley
Prof Alan Robb
David Jones
Tom Mason N.Sch
Leonie Guiney
Les Keeper N.Sch
Eoin Garden, Silver Fern Farms
Frank Brenmuhl, Federated Farmers of New Zealand
Craig Osbourne, PGG Wrightsons
Prof Colin Holmes
Ken Bartlett, Livestock Improvement Corporation
Steve Allen, Tatua Dairy Cooperative
Kevin Old N.Sch, Tatua Dairy Cooperative
Richard Wyeth, Open Country Cheese
Jim van der Poel N.Sch, Fonterra Cooperative Group
David Graham, Balance Agri-Nutrients Ltd
Dennis Wallace, Livestock Improvement Corporation
Alex Duncan, Fonterra Cooperative Group

I would like to record my special thanks to Ramsey Margolis who has been of tremendous support and encouragement since I met him in New Zealand.

United States
Prof David Wieckert
Tom Lyons, Wisconsin Department of Agriculture
Accelerated Genetics
Prof Bob Cropp, University of Wisconsin
Larry Swalheim, Landmark Services Cooperative
David Ward, Cooperative Network of Wisconsin
Chuck Courtade, Dairy Farmers of America
Dennis Rodenbaugh, Dairy Farmers of America

J Charles Ling, USDA
Stephanie M.M. Smith, USDA
Bob Young, Farm Bureau
Roger Cryan, National Milk Producers Federation
Peter Vitaliano, National Milk Producers Federation
Sarah Gallo, National Farmers Union
Aiden Cassidy, Northern Ireland Bureau, Washington DC
Larry Quinn, USDA

United Kingdom
Roly Tavernor N.Sch
Paul Fox N.Sch
Brian Rothwell
Nick Everington, RABDF
Hayley Campbell-Gibbons, National Farmers Union

There are also many people at home who I owe a great deal of thanks to:

Michael McGirr N.Sch	For encouraging to me to do a Nuffield in the first place.
Will Taylor N.Sch	For his guidance and help throughout.
Brian McCracken	For always making sure that I brought my recommendations down to basics and to his wife Lynne for her invaluable proof reading skills.
Gareth Johnston	For further proof reading and formatting advice.
Michael Murphy	For his words of insight “If at the end of this process you can’t summarise your findings in two sentences you don’t know what you are talking about!”
John Stones N.Sch	For his advice, help and encouragement throughout the process.
David Dobbin and Euel Agnew	For their encouragement and support from day one and above all for confirming that what I was studying really mattered.
My parents	For their support and encouragement
Chris Catherwood	For being an absolutely fantastic farm manger. I could leave on my various travels and concentrate fully on my scholarship, knowing that the farm was in very capable hands.

Executive Summary

Cooperatives are a vital component of the dairy industry worldwide. They provide a stable market for a perishable product.

In my study I looked at leadership structures, including such issues as board composition, recruitment, election and evaluation; capital structures looking at share structures, valuation methods, capital funding etc; the issues surrounding the merger and consolidation of cooperatives; and the legislation under which co-operatives are incorporated and governed, which is in urgent need of review in the UK.

When I was just starting out on my Nuffield Journey I contacted one of the wisest and best informed people I know – Michael Murphy. One piece of advice he gave me has stuck with me through the whole process. "If by the end of your scholarship you can't summarise your findings in two sentences, you don't know what you are talking about!" So what are these two sentences? That question has followed me around the world, and now I must answer!

Leadership! That is the key issue, get this right and everything else will follow. Cooperatives must recruit and select the very best members they have onto their boards and then train them continually with regular evaluation of individual directors and the whole board's performance.

Training needs to start way before a person gets near the board. Modules on leadership and co-operatives need to be included in every agricultural course. Training must continue for all those holding positions in any agricultural organisation. In short we need a zero tolerance policy on ignorance. We don't just need intelligent and informed discussion at board meetings, we need it at member meetings too.

We live in a fast changing world, where we trade in a global market place. We need sensible, mature debate, where we can make the difficult decisions that are necessary or at least support those who do. We must deal with the reality of the world we are in, not the world as we think it should be. Those who can see only threats must be replaced by those who can see opportunities.

Finally it must be remembered that leadership is not just for board members. Co-operatives belong to their members: they are our businesses. It is up to each of us to play our part. As with all things in life if you are not part of the solution, you are part of the problem.

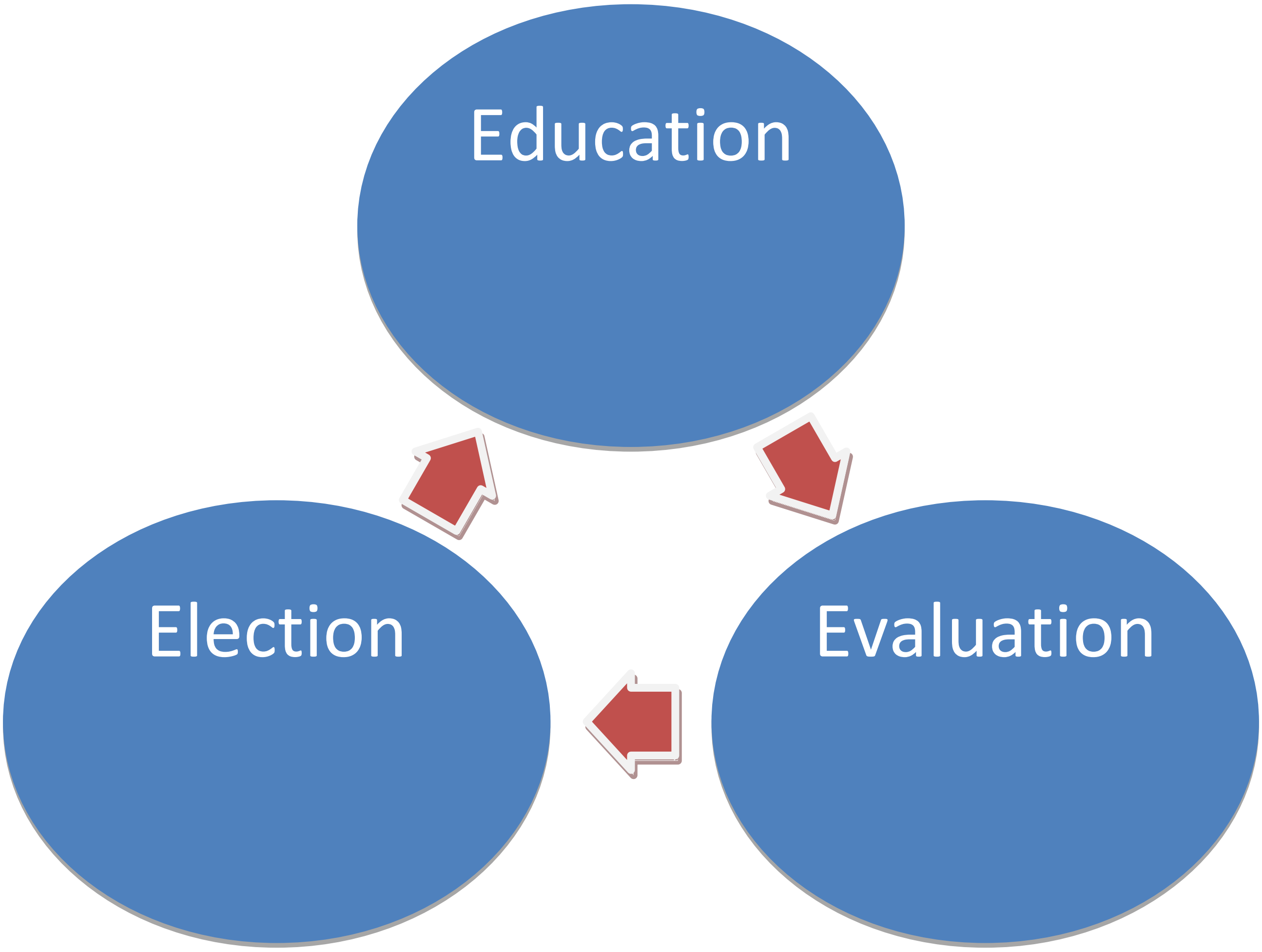
A summary of recommendations can be seen on page 25.

LEADERSHIP

The most important topic I studied is leadership. If you get leadership right everything else will follow. Indeed this does not just apply to cooperatives but to any organisation.

So what is leadership? There are many definitions; my favourite comes from Peter Drucker: "Management is about doing things right, leadership is about doing the right things". This is particularly relevant to cooperative governance where too often boards spend time debating management decisions rather than looking at the big issues.

The three key areas on cooperative leadership are education, evaluation and election.



EDUCATION

So where do we start on leadership? The level of ignorance on the basics of what cooperatives are all about and on corporate governance is incredible. We need to start at the very beginning.

> **Recommendation 1**
>
> **Modules on leadership, cooperatives and corporate governance should be included in all agricultural colleges (and not just for degree or HND students). This needs to be supplemented with further, more specialised courses and governance development programmes which should be operated by co-ops, NFU, YFC etc.**

In short we need a zero tolerance policy on ignorance. We don't just need our boards and committees to be well informed and educated. We need intelligent and probing questions coming from the floor at annual meetings as well. All shareholders have a joint responsibility for their cooperative.

Not all education need be formal or class based. Getting out, travelling, and meeting positive people are all a vital part of this process. I know I wouldn't be writing this report today if it was not for the beneficial influence of some quite remarkable people. We need to pick out our best young farmers and make sure they; *"Soar with the eagles and don't scratch with the turkeys"*

Annual meetings should be seized upon by directors and management as a real opportunity to positively engage with members. They should never be treated as a rubber stamp exercise or a purely social occasion.

EVALUATION

We need to actively trawl the members of our cooperative looking for the brightest and the best and encourage them to stand for the board. The board may wish to consider forming a nominations committee to identify potential candidates and encourage them to stand for election, however they should receive no preferential treatment to those candidates who are not approached by the nominations committee. I believe that in countries the size of the UK or Ireland there is no justification for geographical wards. We want the best directors on our boards period, whether they come from Devon or Dundee, Down or Dingle is of no relevance. Let's get one misconception cleared up right away: directors are not on a board to represent a particular sector or region; they are there to govern. Representation is the job of the shareholders council.

> **Recommendation 2**
>
> **Abolish geographical wards, all farmer directors to be elected on a whole-territory basis.**

One benefit of changing from a regional to a whole-territory system of election is that the election is no longer a popularity contest.

Recommendation 3

All cooperatives should put in place a candidate assessment panel which would interview and assess all those wishing to stand for elections and produce a report on each candidate. These reports would be shown to the candidates first, giving any who wish to do so a chance to bow out gracefully. Reports on all the remaining candidates would be sent out to all members along with the ballot papers.

It should be recognised that there is no such thing as the “ideal director”. A good board should have a mix of personalities. Leadership guru Brian Rothwell defines four different kinds of leadership style: Warrior, Sovereign, Magician and Lover. A mix of all these personalities is needed on any board.

ELECTION

The final choice as to who goes onto the board must remain with the active producer members of the cooperative. It is their co-op; it is their livelihoods that are at stake.

Recommendation 4

I recommend that votes should be allocated to members in proportion to their participation in the co-op (i.e. volume of milk supplied). Also, where there are more than two candidates in an election, the single transferable vote system should be used.

On my travels I asked those who I met what they felt was the best size for the board. The best answer came from Gary Oldman, a Nuffield Scholar and Vice-Chairman of Tatua Cooperative in New Zealand. He said that while seven was probably the best number for discussion and decision making it can take new directors time to get up to speed, so nine farmer directors would be a more prudent number.

Recommendation 5

My recommendation would be to have three farmer directors elected each year for a term of three years, with a further two to three “external non-execs” co-opted to the board to provide specialist knowledge.

I know there are those who say that farmers should be locked out of the board for their own good. I have to say that I completely disagree with this. If we can’t find sufficient people with the necessary skills and qualities to be a good director (albeit with a little training), then quite frankly there isn’t any hope for our industry.

Board remuneration is often a thorny and divisive issue at annual meetings. In a year when prices are poor, it is often tempting for the board not to seek a rise. It has often been said to me that, “We don’t want people to stand for the board just for the money”. While this is a valid point, it is just as important that good potential candidates are not put off because they feel they will lose too much. The age of the gentleman farmer is over!

The best idea I saw for solving this thorny issue was Fonterra's policy. Each year at the AGM, a small remuneration committee is elected. During the year they meet with directors and look at comparable positions elsewhere. They then come back to annual meeting the following year with an independent recommendation on board remuneration. This means that the Directors are not put in the undignified position of proposing their own pay rise. In Fonterra's case the recommendation of the remuneration committee typically passes with 95% of the vote.

Recommendation 6

Elect a small remuneration committee each year at the AGM to consider directors' pay and to make recommendations at the AGM the following year.

MANAGING THE BOARD

Now that we have our board in place, how do we keep them operating at peak performance? Education, evaluation and election.

EDUCATION

Recommendation 7

When a new director is elected they should undergo an intensive induction process. This should involve time with the chairman, CEO, CFO and other members of the executive team. During the first few months of their tenure they should see round all of the co-op's manufacturing operations and get a good grounding in marketing as well.

Recommendation 8

Board training should not end with induction but should be continual.

I believe the best practice is that one day each month the directors meet in the morning for their formal board meeting. This should usually finish by lunch time. The afternoon should then be given over to board development. This doesn't always have to be formal training, it might involve team building or a specialist briefing by the marketing team.

EVALUATION

Evaluation of every director on the board (including the chairman) should take place at least every 18 months. There are a variety of methods as to how this can be done. One very effective way is by 180 degree evaluation. Each director scores their colleagues on a scale of one to five on a variety of issues. Here are some examples of the key issues:

1. Understands his or her role is different from management
2. Is supportive of management
3. Avoids intruding inappropriately on management matters.
4. Observes management in action enough to be able to assess their capability
5. Takes the opportunity to discuss issues facing the business with the responsible senior management.
6. Is challenging of management.
7. Has constructive relationship with management.
8. Doesn't share inappropriate info with management or staff.
9. Adheres to agreed procedures for contact between management and directors outside board meetings.
10. Is outcome driven by giving clear guidance for management?

11. Has adequate exposure to employees, customers and facilities.
12. Puts in the required effort and has the appropriate level of commitment.
13. Is able to keep up with the diversity and amount of information about the business.
14. Takes the opportunity to learn as much as possible about the business.
15. Is well prepared for board meetings (i.e. has done his or her homework)
16. Adequately monitors business performance.
17. Understands the factors that drive performance of the business, i.e. industry sector, broad business awareness, informal business judgement and wide perspective.
18. Is sufficiently knowledgeable about the major business issues as reflected in his or her ability to probe and provide advice.
19. Has an increasing understanding of the business environment and key issues.
20. Understands and expresses the viewpoints / expectations of shareholders.
21. Is well grounded in risk management issues and procedures.
22. Carries out functions with utmost integrity.
23. Has an effective communication / interpersonal style.
24. Takes the opportunity to express his views with fellow directors.
25. Has good working relationship with fellow directors.
26. Contributes effectively to the development of business strategy.
27. Represents the company in a professional manner outside the boardroom.
28. Is available at outside boardroom events.
29. Contributes fully in his or her subcommittee accountability.
30. Gives guidance to fellow directors where necessary.
31. Raises issues for discussion without difficulty – an alternative view is easy for him or her.
32. Expresses views in ways that enhance rather than shut down discussion with fellow directors and management.
33. Enhances group discussions (e.g. offers questions and comments that add value to the discussion)
34. Participates in a manner which acknowledges and respects the contributions of others at the table.
35. Participates actively in discussions but does not dominate.
36. Receives “bad news” professionally.
37. Supports board decisions after decisions are made.
38. Does not disclose confidential information outside the company.
39. Accepts challenge from others without becoming defensive
40. Is willing to change his other viewpoint after discussion.
41. Focuses on strategic goals and policy rather than operational detail.
42. Understands and focuses on issues which are key to the success of the business.
43. Displays courage and independence on thought, speech and action.
44. Avoids apparent or real conflicts of interest.
45. Objectively considers trade-offs and consequences.
46. Displays aptitude for free (rather than ‘follow the leader’) thinking.
47. Is willing to risk rapport with fellow directors in taking a reasoned independent position.
48. Understands the differences between a cooperative and an investor owned firm.
49. Displays an understanding of and respect for cooperative values.
50. Is committed to keeping the cooperative in the control of its trading members.

These results are then collated and the averages presented. It is then the task of the chairman to meet each director and discuss their performance and to suggest remedial action that could be taken to address weaknesses (e.g. additional training, or possibly a change in behaviour). If at the next evaluation the board member has not improved sufficiently, the chairman should suggest that they stand down when their term expires.

The board must also conduct a regular evaluation of the performance and effectiveness of the Chief Executive Officer. A common failing of many co-operatives is that they are much to slow at replacing an ineffective CEO, or indeed they do not replace them at all. While board members must never interfere in the day to day running of the company they should receive briefings from and be able to question all senior management at regular intervals. Some CEO's can seek to control the board by being the only source of information; this must never be allowed to happen.

Recommendation 9

Regular board evaluation should take place at least every 18 months. The results must be acted upon! Regular evaluation of the CEO must also take place.

It is important to note that having a good chairman is a super-critical to the success of the board. Directors must not hesitate to replace an ineffective chairman. When I met John Roadley, the founding Chairman of Fonterra, he told me he questioned the need for a vice-chairman. The general opinion is that you need someone able to step in if the chair is incapacitated. However John says that if any of the directors are not capable of chairing a meeting they should not be on the board!

A set of behavioural and procedural rules must be agreed and adhered to by the board. These include issues such as induction, attendance, board papers, minutes, decision making, personal demeanour, out of meeting communications, director appraisal and the personal responsibilities of directors. An example of this can be seen in Appendix 10.

Recommendation 10

Directors to agree and adhere to procedures, behaviours and standards contained in the board's code of conduct. The chairman should ensure compliance.

ELECTION

Just as it is the board's responsibility to evaluate, hire and fire the chief executive, it is the responsibility of the members to evaluate, hire and fire the directors. Directors seeking re-election should be subject to candidate appraisal in just the same manner as other candidates.

Term limits can be somewhat arbitrary. Ideally the board should manage its own succession. However, once a director has served for 12-15 years you have to ask what more has he to give? If the grim reaper is the only person who removes directors from the board, then you are in trouble.

SHAREHOLDERS COUNCIL

In larger co-operatives it is very good practice to have a shareholders council. Their chief task is to represent the views of shareholders to the board and act as a conduit for communication between the board and members. Unlike directors they should be elected on a geographical ward basis.

Shareholders councils are also an invaluable method of providing a means for potential board candidates to learn, develop and be assessed by their peers.

It is important that the shareholders council is not just a talking shop. They should be consulted on any proposed changes in strategic direction and any proposed changes to the constitution of the cooperative. The duties, powers and responsibilities of the shareholders council should be clearly established in the cooperatives constitution.

They should be required to publish a brief annual report to the shareholders. Where possible they should have a separate secretariat from the board that is appointed by the shareholders council.

Unfortunately many existing Shareholders Councils or members committees have too large a membership to allow confidential information to be disclosed to them. For this reason I suggest that the Shareholders Council should have no more than 20-30 members depending on the size of the cooperative in question. All councillors must sign a confidentiality bond before taking office.

The Fonterra Shareholders Council has set a good example by establishing four subcommittees on representation, performance, cooperative development and governance & ethics. Further details can be seen in Appendix 1.

As a clear line needs to be made between representation and governance directors should not sit on the council. In the event of critical concern on a particular issue the shareholders council should have the right to call an extraordinary general meeting.

CAPITAL / SHARE STRUCTURES

The Oxford English Dictionary defines capital as "Wealth in the form of money or other assets owned by a person or organisation or available or contributed for a particular purpose such as starting a company or investing."

Every organisation requires a capital base from which to operate. The core capital base of a dairy cooperative is the property it owns, its processing plant, offices, transportation fleet, and working capital (money needed to bridge the gap between paying for a product and selling it – especially significant in cheese production). In addition to these physical assets, there are also of course intangibles such as brand names, goodwill etc.

For most non-cooperative companies, their share capital is stable. If a shareholder wishes to sell a share then they must find someone to buy it from them. The company is not obliged to buy it from them and indeed cannot do so unless given specific authorisation in its articles of association.

When a dairy farmer retires or moves to another milk buyer, he is usually entitled to have his share capital redeemed by the cooperative. Over the last few years in the UK we have seen significant industry restructuring with many farmers leaving the industry. This can create a significant pull on cash resources (my own cooperative United Dairy Farmers paid out over £600,000 in redeemed shares during the 08/09 financial year).

While in general the UK production has fallen slightly, most of the "lost" production from retiring farms has been taken up by those staying on. Indeed in Northern Ireland despite a significant reduction in the number of dairy farms, overall milk production had been increasing steadily until the start of 2009.

While cooperatives have been required to pay out the share capital of those farmers who have retired there has in general been no requirement for those farmers who are remaining and expanding to purchase additional share capital. As we are likely to see further significant rationalisation at farm level over the next few years, this is a completely unsustainable position.

Recommendation 11

Dairy cooperatives should create a production share standard. This means that for every 1,000 litres (or kgMS) of milk sold members are require to hold X number of shares. If they don't have that number then they must purchase the difference. To help farmers' cash flow co-ops may wish to consider allowing purchase payment of these shares to be made over a few years.

VOTING RIGHTS

It is critical that control of any cooperative must remain with transacting members.

ADDITIONAL CAPITAL REQUIREMENTS

From time to time, a cooperative may wish to make further significant investment. For example shifting production from a low value commodity product to a value added product. Given the current financial situation in credit markets it may be necessary or desirable to source some of the capital from the membership.

I am not in favour of a general blanket ‘capital deduction’ from member's milk cheques. It is much better that a cooperative decide on a good investment and then work out how to finance it rather than have a pool of money gathered up and then decide how they are going to spend it. The latter will almost inevitably lead to bad investment decisions as was the case with Dairy Farmers of Great Britain.

Recommendation 12

When seeking additional funds from members (over and above the production share standard) cooperatives should produce a business plan for members detailing the cost of the project, the benefits to the cooperative and its members, the various sources of finance and a schedule for repayment.

If members are being asked to meet the majority of capital required for a new investment they should ask the question: “If a bank isn’t willing to lend you the money then why should we?”

VALUATION AND TRADING OF SHARES

Before discussing these issues further, I think it is important to reconsider what a dairy cooperative is there for: it is there to provide a stable market for its members’ milk, to process and market that milk as efficiently and effectively as possible and to return as good a price as possible both now and in the future.

When most people think of New Zealand and cooperatives, they think of Fonterra. Another of New Zealand’s most successful co-ops is Foodstuffs (which actually comprises three cooperatives in different parts of the country). They are a type of cooperative franchise; grocery store owners join the cooperative and get access to not only discounted group buying but also to joint branding and marketing. Think of it as a cooperative version of The Spar.

Foodstuffs are actually a lot more cooperatively minded than Fonterra. When joining the cooperative you have to sign a pledge which includes the following: *“Shareholding in the cooperatives is an entitlement to enjoy the benefits of the co-op and its principles and is not held or regarded by the shareholder as a form of investment in equity securities.”*

This, I think, summarises the key issue of cooperative shareholding. Your shareholding is there to provide the co-op with the necessary base capital so it can do its job. It is not there as a get rich quick scheme. This is in complete contrast to Fonterra whose fair value share is at the root of many of their problems (for further details see Appendix 1).

There may be a case however for revising upwards the "fixed" value of each share in line with inflation provided the balance sheet of the cooperative can justify it. Any recommendation of the board on this issue must be approved by the members before it is implemented.

Recommendation 13

Maintain a fixed value share system.

DIVIDENDS

In general, the profits of the cooperative should be distributed to members in proportion to their participation. However if you are asking members to make further investments in share capital as they increase production it is not unreasonable to pay out a "dividend" on their share capital which is set at a competitive rate of interest in comparison to banks and building societies.

OUTSIDE SHARE CAPITAL

In general, outside share capital should be avoided. In any case voting rights must remain solely with the active producer members of the cooperatives. Many cooperatives have not removed "dry" shareholders from their share registers; these cooperatives also sadly tend not to offer or demand membership from new suppliers. They run the risk that the dry shareholders might at some stage opt for a "value grab" and try and convert the cooperative to an investor-owned company.

Some cooperatives may wish to allow retiring farmers to retain their capital in the cooperative in the form of preference shares. This is fine so long as these shares carry no voting rights and that the proportion of preference share capital to ordinary share capital is kept at a reasonably low level.

Recommendation 14

Non-transacting (dry) shareholders should either have their shares cancelled and repaid or converted into non-voting preference shares.

Legislation Governing Cooperatives

The legislation governing cooperatives (Industrial and Provident Societies Acts) throughout the United Kingdom is antique, having barely changed since Victorian times. Indeed these Acts cover a wide range of organisations other than cooperatives such as housing associations and other charitable bodies.

In general they have not kept up with the tightened reporting and accounting standards that apply to other companies. The current £20,000 limit on share capital is also unnecessarily restrictive given the major rationalisation in the dairy industry, which has resulted in fewer larger farms.

I feel that the approach New Zealand took towards revising its old Industrial and Provident legislation into a modern Cooperative Companies Act is one that should be used here.

In the 1990s, the New Zealand Cooperatives Association lobbied government for an update to the legislation. The response from government was: “We haven’t the time or resources to do it – do it yourself.”

So the 1996 legislation is very much a bottom up approach in which the co-ops from various groups sat around the table and thrashed out what they would like in this new Act. Law firm Buddle Findlay were commissioned to draft the legislation which was then presented to the Commerce Department and the Parliamentary draftsman for a final polish.

As Companies Acts go, the act is short and fairly simple, with the main body of the act extending to around 29 pages (which are slightly bigger than A5). This is because it works on the process of dual registration whereby a company registers both under the everyday Companies Act as well as the Cooperative Companies Act.

So in essence the Cooperative Companies Act is a list of additional requirements and exemptions from the mainstream Companies Act.

The main obvious requirement to registering under the Cooperative Companies Act is that the company truly is a cooperative. This is defined:

“A company, the principal activity of which is, and is stated in its constitution as being a cooperative activity and in which not less that 60 percent of the voting rights are held by transacting shareholders.”

A “cooperative activity” is defined as one or more of the following:

- Supplying or providing the shareholders of the company with goods or services, or both;
- Processing or marketing goods or services, or both, supplied or provided by its shareholders;
- Entering into any other commercial transaction with the shareholders of the company.

It also defines a “transacting shareholder”. It basically means a shareholder buying or selling presently or if ceased likely to resume doing so.

Furthermore it places a duty on the directors to pass a resolution stating whether or not, in the opinion of the board, the company has, throughout the accounting period to which the report relates, been a cooperative company. The resolution must set out in full the reasons for the directors' opinion. Every director who does not vote for the resolution must sign a certificate stating his or her reasons. The board of the company must ensure that there is attached to the annual report for, and the annual return of, the company, a statement setting out the date and terms of the resolution; and the name of any director who did not vote in favour of the resolution and the director's reasons.

The registrar may cancel the registration of the company if he or she is not satisfied that it is a cooperative company. No company can use the word 'cooperative' in its name if it is not registered under the Cooperative Companies Act.

Unlike other companies, a cooperative is permitted to issue shares that have a nominal value, and that value may be altered by resolution of the shareholders and there is no reason why the co-op cannot have different classes of shares including fair value or investment shares. Again, all options open to mainstream companies which are not excluded in the Cooperative Companies Act are available to co-ops,

The Act also provides for the surrender of shares at the option of the company. It also allows a co-op to hold its own shares although without right to a dividend or voting rights.

There are special provisions for dairy cooperative companies. This includes that its general suppliers must be shareholders (although there are exceptions), and it provides for the compulsory issue of shares (e.g. if a shareholder increases his milk supply, or if more capital is needed).

Recommendation 15

There is an urgent need to revise GB and Northern Ireland legislation governing cooperatives. The New Zealand approach provides a simple way of updating the legislation.

Any future legislation should include:

- **Requirement that voting rights are held by transacting shareholders only.**
- **The principal activity is a cooperative one**
- **A removal of the £20,000 share limit to be replaced by a limit on the proportion of shares which can be held by any one member (except in co-ops with a small membership)**
- **Allow voting rights to be allocated in proportion to participation (with a 5% cap)**
- **Require the board to pass a resolution each year stating whether or not they believe they have been a cooperative company and state their reasons.**

Merger and Consolidation

Merger and consolidation of cooperatives is a hot topic throughout the British Isles and nowhere more so than Ireland which has a very fragmented dairy industry.

When I left to go on my travels I wanted more than almost anything to find out how to merge two cooperatives. Co-ops at home who tried to merge seemed to come across endless difficulties in getting their act together on this issue.

The plain, simple and honest truth of it is that you just have to grow up and do it!! There are endless reasons that people can churn out as to why you shouldn't merge two cooperatives. I was very lucky to be granted an interview with John Roadley the founding chairman of Fonterra. He said that when a merger is economically sound the only thing that stops it is people. It is a people issue and it is down to the mindset of the leaders of the co-ops. You need to get them into a space were they realise that change needs to happen. There were of course directors who tried to stall the merger who called for more analysis to be done (more money for consultants). If you don't want something to happen you can always find reasons! Directors such as these who are unreasonably obstructing progress should be removed at the next election.

It is always preferable to merge two strong cooperatives that can build on each other strengths. When two weak cooperatives merge the losses will often continue. In the case of a strong and weak cooperative it is better for the strong co-op to take over the weak one.

It should also be remembered that having two co-ops working together can also produce many benefits and is a very worthwhile step that can lead to eventual merger.

Failure to agree on the valuation of the two cooperatives to be merged is often trotted out as reason for not proceeding with a merger. While it is easy to see why this would be a major problem with investor owned firms, it really shouldn't be a deal breaker in cooperatives so long as members existing shareholdings of fixed value shares are maintained.

Ideally, when two cooperatives merge they should have similar and compatible cultures. Where this is not the case there needs to be clear agreement and understanding of the culture or "modus operandi" of the merged entity. This was a significant problem in Fonterra where NZMP members felt they had a Kiwi Dairies system imposed on them.

Above all there needs to be a positive attitude towards the benefits of merger and consolidation. Directors should not see merger as an indication that their co-op has failed but rather a way of ensuring continuing success. Obviously a merger will mean that a number of directors will no longer be required, this should be accepted by those concerned with maturity and good grace.

An individual cooperative is only a means to an end, not an end in itself. The minute that a cooperative becomes institutionalised and is seen as being more important than the purpose for which it was set up is the moment it starts to stagnate.

Recommendation 16

All cooperative boards to have an "Opportunities for Growth Committee" which meets regularly to actively look at these issues and report back to the main board.

In my experience, the thrust for expansion, for take-over, for possible mergers, for sales growth, recognizing new and emerging markets should be the role and remit of the executive team. They should bring detailed analysis of their proposals to the main board supported with and by a due diligence exercise, carried out independently initially, in the case of a merger or take-over. This very clearly was not done effectively by Dairy Farmers of Britain in their purchase of ACC. (or the board were seeing through rose –coloured glasses). The role of the board is to evaluate the cost/benefit analysis proposed, does such a proposal fit with the overall vision and strategy of the company/co-op. This cooperative vision and strategy should already be in place and reviewed regularly.

Anti-Trust Legislation

While discussing mergers it is important to note the huge beneficial impact the Capper-Volstead Act has had in the United States. Indeed it is described as the legal foundation of the American farmer cooperative movement.

It provides limited protection from government anti-trust action to farmers who combine into associations and cooperatives to market their products. While the language of the Act is fairly vague, its effect has been to allow mergers of co-operatives to proceed unhindered. In the United States you also find a considerable number of federated cooperatives which enable local and regional cooperatives to work together on a nationwide basis.

What is a cooperative and what are its values?

It is important that all of those involved in a co-operative from members and staff to management and the board understand the values that are implicit in being a cooperative.

The International Cooperatives Alliance defines a cooperative thus:

"A cooperative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically controlled enterprise."

Edgar Parnell, former CEO of the Plunkett Foundation, says:

"In the real world co-operatives are formed and continue to exist only if they deliver real benefits to their members, most of which are in tangible economic terms."

What cooperatives are <u>not</u>:

- Cooperatives are not charities; a charity is based upon the principle of providing help to those that need it which is completely different from the cooperative approach of self-help.
- Cooperatives are not a part of the state – often when cooperatives are formed to take over from a state agency (such as the Milk Marketing board) its members (and often its staff) continue to regard it as a kind of social security agency with the limitless resources of the state behind it.
- The main purpose of a cooperative is not to drive social change. (They are not there to redistribute wealth between their members – Peter must never be robbed to pay Paul)

What cooperatives are:

- Cooperatives are private enterprises owned and controlled by legal persons (individuals, companies etc).
- Cooperatives should be run as efficiently and effectively as any other company.
- Cooperatives exist to provide benefits to their members.
- Cooperatives should always be democratically controlled by their trading members.

The main difference between a cooperative and an Investor Owned Firm (IOF) is that an IOF distributes its profits to investors (most of which probably do not trade with the IOF) in accordance with the amount of money invested; whereas a cooperative **should** distribute its economic surpluses to its trading members in relation to their participation in the cooperative.

In an article I wrote for the *NZ Agrifax Newsletter*. I said:

"The real ***value*** of a dairy cooperative is to secure the best price it can for its members' milk this year, next year and in ten / twenty years time."

The full article can be seen in Appendix 11.

The International Co-operatives Alliance defines seven cooperative principles:

1st Principle: Voluntary and Open Membership

Co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2nd Principle: Democratic Member Control

Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner.

3rd Principle: Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

4th Principle: Autonomy and Independence

Co-operatives are autonomous, self-help organisations controlled by their members. If they enter to agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

5th Principle: Education, Training and Information

Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of co-operation.

6th Principle: Co-operation among Co-operatives

Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures.

7th Principle: Concern for Community

Co-operatives work for the sustainable development of their communities through policies approved by their members.

What is striking to me about these principles is how well they echo with the conclusions I have reached as a result of my travels. The importance of education, a real economic stake in the co-op by the members, member control, democracy and a current hot topic, 'cooperation among cooperatives' which we would hope in many cases would lead to integration and merger resulting in efficiencies for members and a stronger market presence.

The seventh principle "Concern for Community" does not mean that cooperatives should be wimpish in making financial decisions. It does not preclude co-ops from making necessary redundancies or closing down an inefficient plant.

Many investor-owned companies such as supermarkets are now faking concern for the community. When I write that they are faking concern I don't mean that they are not doing some good works but rather that their reason for action is due to opinion polls and customer surveys rather than actual and heartfelt concern for the community.

Unlike investor owned companies who may have a relatively few owners domiciled far away from the area of operations, a cooperative is controlled by its members, who are located within a particular region or country. Cooperatives therefore by their very nature tend to be much more embedded in the community and aware of the needs of the community.

Summary of Recommendations

1. Modules on leadership, cooperatives and corporate governance should be included in all agricultural colleges (and not just for degree or HND students). This needs to be supplemented with further, more specialised courses and governance development programmes which should be operated by co-ops, NFU, YFC etc.

2. Abolish geographical wards, all farmer directors to be elected on a whole-territory basis.

3. All cooperatives should put in place a candidate assessment panel which would interview and assess all those wishing to stand for elections and produce a report on each candidate. These reports would be shown to the candidates first, giving any who wish to do so a chance to bow out gracefully. Reports on all the remaining candidates would be sent out to all members along with the ballot papers.

4. Votes should be allocated to members in proportion to their participation in the co-op (i.e. volume of milk supplied). Also, where there are more than two candidates in an election, the single transferable vote system should be used.

5. Have three farmer directors elected each year for a term of three years (nine farmer directors in total), with a further two to three "external non-execs" co-opted to the board to provide specialist knowledge.

6. Elect a small remuneration committee each year at the AGM to consider director pay and to make recommendations at the AGM the following year.

7. When a new director is elected they should undergo an intensive induction process. This should involve time with the chairman, CEO, CFO and other members of the executive team. During the first few months of their tenure they should see round all of the co-op's manufacturing operations and get a good grounding in marketing as well.

8. Board training should not end with induction but should be continual.

9. Regular board evaluation should take place at least every 18 months. The results must be acted upon! Regular evaluation of the CEO should also take place.

10. Directors to agree and adhere to procedures, behaviours and standards contained in the board's code of conduct. The chairman should ensure compliance.

11. Dairy cooperatives should create a production share standard. This means that for every 1,000 litres (or kgMS) of milk sold members are require to hold X number of shares. If they don't have that number then they must purchase the difference. To help farmers' cash flow co-ops may wish to consider allowing purchase payment of these shares to be made over a few years.

12. When seeking additional funds from members (over and above the production share standard) cooperatives should produce a business plan for members detailing the cost of the project, the benefits to the cooperative and its members, the various sources of finance and a schedule for repayment.

13. Maintain a fixed value share system.

14. Non-transacting (dry) shareholders should either have their shares cancelled and repaid or converted into non-voting preference shares.

15. There is an urgent need to revise GB and Northern Ireland legislation governing cooperatives. The New Zealand approach provides a simple way of updating the legislation. Any future legislation should include:
    - Requirement that voting rights are held by transacting shareholders only.
    - The principal activity is a cooperative one
    - A removal of the £20,000 share limit to be replaced by a limit on the proportion of shares which can be held by any one member (except in co-ops with a small membership)
    - Allow voting rights to be allocated in proportion to participation (with a 5% cap)
    - Require the board to pass a resolution each year stating whether or not they believe they have been a cooperative company and state their reasons.

16. All cooperative boards to have an "Opportunities for Growth Committee" which meets regularly to actively look at these issues and report back to the main board.

Appendix 1

Fonterra Cooperative Group Ltd

Fonterra Cooperative Group Ltd is the culmination of many years of rationalisation within the New Zealand dairy industry

Farmers' backs were against the wall. There was considerable duplication. The merger meant that plants could run on one spec, vastly improving efficiency.

The merger brought $300,000,000 of benefits.

The government was also a driver in the creation of Fonterra. The Thatcherite National government of the time did not like the export monopoly held by the New Zealand Dairy Board. They told the industry that if they did not agree how the Dairy Board should be dissolved and the industry restructured, they would do it for them. The first attempt to merge failed because the National government at the time made them go through the Commerce Commission which was opposed to the merger on the grounds that it was a monopoly.

When a Labour government came in, they were more sympathetic to the "social" ideals of a cooperative and facilitated a move around the Commerce Commission which contained safeguards for domestic supply. The creation of Fonterra was enabled by the Dairy Industry Restructuring Act (DIRA).

There were of course directors who tried to stall the merger by calling for more analysis to be done – more money for consultants. If you don't want something to happen you can always find reasons! By this time, however, there was a growing campaign among the grass roots and Federated Farmers in favour of the merger and obstructive directors were simply replaced by pro-merger candidates at the next election.

OFT Issues

The DIRA Act resulted in control of the domestic market being taken away from Fonterra with milk being very competitively sold to the New Zealand market. It is estimated that Fonterra (in effect NZ farmers) subsidise the domestic market to the tune of $14,000,000 a year.

In addition, Fonterra is obliged to supply milk to independent processors up to a maximum of 400 million litres each year, with each processor entitled to no more than 50 million litres.

SHARES

The number of shares a member of Fonterra has closely tracks his or her milk sales with one share needed for every kg of milk processed by the co-op. Shares are traded solely by the co-op. Each year a "fair value" for Fonterra's shares is set by a committee. In 2007/08, Fonterra shares were priced at $6.97. This dropped to $5.57 in 2008/09 as the value added section of Fonterra has made less money due to the rise in commodity milk price. When you take that it roughly costs $2.50 to $3.00 dollars to put in the processing capacity for a kilogram of milk solids, it allows a comfortable margin for investment in marketing etc.

Total payout consists of commodity milk price plus a “dividend” from the value added operations of the company.

The DIRA Act mandates the use of the fair value share. As a safeguard against Fonterra’s monopoly the government insisted that any dairy farmers who decided to leave Fonterra had to get their fair share out of the system. However conversely this necessitated a fair value entry system. Of course, the issue with this is that while farmers are paying in around $5 for each additional kgMS it only takes $2.50-$3.00 for the stainless steel, leaving Fonterra with a considerable slush fund, which has led to them investing considerable amounts of money offshore in downstream projects. Many question the wisdom of taking money from farmers for this project who might have better uses for it (more land, cows, better parlour etc). This relates back to the possible use of outside equity for these downstream non-core investments.

It should be noted that while the DIRA Act mandates the use of a fair value share, it was the decision of the Fonterra Board to price shares using a stock market type valuation rather than net assets. In the last few months, Fonterra have now announced plans to value shares at a more conservative level.

ISSUES WITH THE FAIR VALUE SHARES

The fair value share system has caused real problems. With each Fonterra share in 2008 $5.57 (in 2007 $6.97), it is significantly above the cost of stainless at $2.50-$3.00. The difference has supposedly been in invested in ‘value add’. However Westland Cooperative Dairy Co which operates in the least favoured area of the country – up to 8 meters of rain per year with a very dispersed milk pool and who have to transport all of their produce over the Alpine passes to the ports on the East coast – have a share price of only $1.50 and are able to match and exceed Fonterra’s total payout including a value add component.

Fonterra in the name of value add have been investing huge amounts of money in various parts of the world, including Bonlac, a 3,000 cow dairy farm in China, investments in Latin America, etc. The problem is that these ventures are not treated as separate entities or subsidiaries and their finances are merged in with the domestic finances, so no-one really knows how well they are performing. What figures have been released do not seem to add up. There is a general consensus that these ventures are continuing black holes for cash and it is doubtful if any of them have started to repay the capital invested in them.

If Fonterra had concentrated on its core business of processing and marketing commodity milk efficiently with its excellent processing infrastructure (it will soon have four 22 tonne/hour driers) and 40% of the world market, then there simply would be no opportunity for new start up companies as they would not be able to match Fonterra’s payout. The sad fact is that newly started up companies with eight tonne/hour driers are able to pay out more than Fonterra and retain profit. Synlait was started up in Canterbury by a group of large farmers when they realised that instead of giving Fonterra $5.50 -$7 per kgMS they could build their own factory for less than $3.00 and have a higher payout!

CONTRACT MILK

At the time I was in New Zealand, Fonterra had opened up the option of contract milk for those who wish to supply Fonterra but not invest considerable amounts in shares. The farmer still has to buy a nominal holding of $1,000 worth of shares and as such has a negligible vote in the election of directors. He or she does not receive the value added component of the payout and has a small amount deducted of the CMP (commodity milk price) deducted to allow for the fact that he has not helped invest in stainless steel etc.

Contract farms still got two votes in the shareholders council election – an issue that some felt needed addressing. With the deepening impact of the global credit crunch combined with the risk of share redemption, Fonterra removed the contract milk option. This meant that recently converted farms had to stump up a huge amount of cash to share up. The cost for a 700 cow unit would be around $2,500,000!

VOTING RIGHTS

In elections for company directors, farms are allocated one vote for every 1,000 kg of milk solids produced. In elections for the shareholders council, each farm is allocated two votes, the idea being that one vote is for the farm owner and the other is for the sharemilker. Each farming "entity" nominated one person to represent the farm.

CANDIDATE EVALUATION

Candidates for election to the board for the time undergo candidate evaluation. The Candidate Evaluation Panel consists of a small committee of two directors and two councillors who appoint an independent chairman. They evaluate each candidate and publish their findings to members. There is a feeling amongst some that this evaluation should be carried out by a suitably qualified independent company.

BOARD

The board consists of nine farmer directors. Three directors are elected each year for a term of three years. In addition, the farmer directors co-opt a further four external non-executive directors.

GOVERNANCE DEVELOPMENT PROGRAMME

This is open to for Fonterra members who have an interest in becoming directors in the future, and has been going for three years. A panel of the same composition as the Candidate Evaluation Panel but with different members selects which of the applicants go ahead to the programme. Eight people completed the course the first year with around four in each following year. The programme consists of an overseas market visit and an intense three day residential programme. The selection panel mentors and continually evaluates the participants.

SHAREHOLDERS COUNCIL

This is composed of 35 councillors who each represent a ward. The council appoints observers to the share valuation committee, and also appoints the milk commissioner who arbitrates disputes between shareholders and Fonterra. Each year they receive a statement of intention from the board and comment. They then receive a report every quarter on the performance of the company and how they are progressing with their statement of intentions. The directors must get the approval of council on any proposed change to Fonterra’s constitution before it is submitted to the shareholders where it must get 75% approval.

If the council is concerned about a particular topic, it has the power to ask for a formal report on any aspect of the company. This, along with the power to call an EGM, are the “nuclear buttons” that have so far not been exercised.

Each year the council prepared a report for shareholders which is included in the annual report and accounts.

The shareholders council has four subcommittees with every councillor serving on at least on committee. They are:

Representation
Performance
Cooperative development
Governance and ethics

The chairman, deputy chairman and two floaters (who change regularly) form the leadership team. The Shareholders Council has five staff at head office.

The council meets 9-10 times a year with each meeting lasting typically two days. Directors do not sit on the council.

It should be noted that Fonterra’s Governance Development Programme and Candidate Assessment Panels are both initiatives of the Shareholders Council.

PROPOSED CHANGES TO CAPITAL STRUCTURES

In early 2008, the board proposed sweeping changes to the capital structure of the cooperative. This would have seen the assets of the company being placed in 'Fonterra PLC'. Fonterra Cooperative would have owned a majority of the stock in 'Fonterra PLC'; a percentage would have been released for sale onto the New Zealand Stock Exchange. The board promoted this as a potential gold mine for the farmer members in line with that seen by the farmer members of Kerry Cooperative when it listed on the Irish Stock Exchange. This comparison was greeted with derision by many and farmers saw it as the thin end of the wedge for farmer ownership and control of their cooperative. In the end the board decided not to proceed with the vote of shareholders.

After working with the Shareholders Council alternative proposals were drawn up and the first two steps of this have now been accepted by the members of Fonterra.

The first step is to allow members to purchase 20% of additional shares over their production entitlement. Dividends will be paid out on based share ownership (milk price paid will be based on the commodity market). The second step is a more conservative valuation of the fair value share which fluctuated widely in recent years. This valuation recognises that there is a restricted market for shares as they can only be purchased by members and as such it is inappropriate to value them on a stock market basis. Share price will be held at $4.52 until the valuation based on a restricted market catches up.

The ultimate aim for Fonterra is to have a permanent equity base to give it certainty about its capital in any production season. To this end Step 3 will see the establishment of farmer to farmer trading of shares, instead of them being purchased or redeemed through Fonterra. The details of this have still to be worked out and this will be put to a vote at a future date.

While the change in valuation method for Fonterra's shares is to be welcomed, I am concerned at the consequences of the division of return from participation in the co-operative. An alternative would be to allow members to buy additional "preference shares" which would be paid a return based on central bank interest rates.

Appendix 2

Livestock Improvement Corporation Ltd

Origins

The early beginnings of herd testing in New Zealand started in 1906 when 38 herd test co-ops were formed throughout the country. In 1939, the 38 became 6, and in 1982 there was a system of formal co-operation leading to the establishment of the database. In 1988, the six merged to form LIC with the New Zealand Dairy Board acting as the trustees.

In 2001, with the DIRA review and the de-regulation of the NZ dairy industry and the dissolution of the NZ Dairy Board, LIC become a cooperative with $1 shares being issued to the users of the service. The average number of shares issued per farm was 300. However each $1 share had an asset backing of $30.

Investment Shares

In 2004, LIC became a hybrid cooperative in which each existing cooperative share was divided into 1 cooperative control share and 10 investment shares. These investment shares are listed on the Alternative market of the New Zealand Stock Exchange (NZAX).

The NZAX option was chosen to maintain liquidity rather than have the risk of LIC having a run on its funds due to mass share redemption.

There were six objectives which the LIC board sought to achieve through this change:

1. Cooperative ownership and control
2. Provide product and services
3. Potential release of capital
4. Not designed to raise capital
5. Easy entry
6. Designed to avoid a run on the bank

At first all members had to hold no less than two or no more than 30 investment shares for every one co-op share they hold. Co-op shares go up and down for each farm each year depending on their use of LIC's goods and services. Exiting farmers are required to surrender their co-op control shares immediately and have two years to sell their investment shares.

Only co-op control shares have a vote at elections and company meetings.

On the 1st July 2008, the restrictions on ownership of investment shares were relaxed and holders of co-op shares are entitled to buy any amount of investment shares, up to a maximum stake of 5% of the company. This change in the rules saw an increase in the investment share price from $2.20

to $3.30. The broker fraternity estimate that shares would trade at more than $5 if freely traded (i.e. not restricted to holders of cooperative control shares).

The cost to LIC of listing is around $25,000 per year (this is based on its market capitalisation). In addition there is the cost of linking up the share registry and in LIC's case the complication of the stock broker having to establish if you are entitled to buy in the first case any and in the second case further investment shares. There are further significant legal and accounting costs to being publicly listed.

LIC has around 10,000 shareholders. Much less than this and there would be insufficient liquidity for the stock to trade freely. LIC has recently started a voluntary investment scheme and a dividend re-investment scheme to help improve the liquidity of its shares (note these schemes buy existing shares rather than issuing additional shares).

LIC has considered the idea of placing 20% of the investment shares on the market (for sale to non-members) but decided against it. Given the fact that freely traded shares would realise a higher value, this may be reconsidered in the future. One New Zealand kiwifruit cooperative already allows non members to buy shares on the NZAX.

Also set up recently is an employee share trust, which will purchase and own Investment shares up to the maximum of 5% which is applicable to all shareholders. Participating staff members will receive units in the trust which must be redeemed on ceasing employment.

Dividend Payout

Cooperative control shares receive a standard dividend based on the prevailing interest rates; co-op control share dividends have priority over the investment share dividend. Investment share receive the balance and bulk of the dividend.

Shareholder Council

With 21 members, the shareholder council of LIC approves strategy. If the board wish to change strategy they have to get council's approval.

LIC pay their external directors more as they bring needed skills to the board table.

LIC's shareholders council meets three times a year and each meeting is spread over two days. Before each meeting they get a written report from all general managers which are the same as the board report less any sensitive areas still awaiting decision.

One of the general manager's then give a verbal report to each meeting on rotation. At each meeting the chair and CEO give a verbal report and are open for questions (this takes about two hours). They then leave and the council can then discuss matters freely.

There is a leadership team in the council of the chair, vice chair, and the two chairs of the council committees. They meet more often with the board chair and CEO.

The secretary to the council is separate to the company secretary.

The council undertakes training, one such recent example was training to enable councillors to better read and understand annual reports.

On occasion a group of councillors are taken away for a week.

Conclusions

Livestock Improvement Corporation is a world class dairy genetics company. While they do have a much stronger cooperative ethos than Fonterra, I question the value of having investment shares. This means that the dividend payments are no longer proportional to participation in the co-op. LIC maintain that the alternative of having a bottom line balance sheet value much greater than that of the issued share capital is unsustainable. I disagree. It is only unsustainable if the members of the co-op feel that they would be better off “carpet bagging” the co-op. A well run cooperative such as LIC should have no fear of such issues. Indeed, they would be more likely to earn member loyalty if they paid out dividends (or rather a rebate) based on participation in the co-op.

Appendix 3

Tatua Cooperative Dairy Company Ltd

Tatua was established in 1914 and is based near Morrinsville in the Waikato.

Shares / Milk Solids Entitlements

For each kilo of milk solids members sell they are required to purchase 5 x 50c shares = $2.50. This covers the cost of the stainless steel. The nominal share confers ownership, and gives voting rights which are capped at 5% of capital.

In addition there are **Milk Solids Entitlements (MSE)**

This is legally defined as a "Chose in Action". A Chose in Action is a "right" to supply or right to fish etc. Tatua's MSE is a Supply Right, and should not be regarded as a share.

One MSE confers the right to supply one kg of milk solids. If milk solids are supplied it gives the right and obligation to purchase "nominal share".

Example 1

Rights	100,000 MSE
Supply	100,000 kgMS

$250,000 nominal share value (100,000 x 5 x 50c)

Example 2

Rights	100,000 MSE
Supply	90,000 kgMS

They then have 10,000 MSE spare. They can either lease, sell or hold these entitlements. They will obviously have to hold 90,000 x 5 x 50c shares. If they have more shares than this they will be redeemed by the company. Production must always match shares.

MSE can be leased, sold or "stored". If leased or sold the lessee or purchaser must have Tatua board approval e.g. be an existing supplier / shareholder or an approved new supplier / shareholder.

If you are selling the farm it is normal for MSE and shares to be sold with the land as a going concern. If retiring you have 24 months to sell off the MSEs. Shares are redeemed for cash immediately on retirement.

Tatua do not set a value for MSEs, it is based on market demand. The company (Tatua) does not give advice or "determine value".

The company secretary matches purchasers and sellers, lessee and lessors. E.g. tenders, private transactions etc. Tatua and its officers do not get involved in determining value or any commercial aspects.

Shares can and must match MSE's if the production per kgMS is achieved.

Each season the company balances the register; so as to achieve a 1-1 relationship between supply and shareholding.

Example 3

Rights	100,000 MSE
Supply	110,000 kgMS

Can't lease or purchase or don't want to.

1. 100,000 kgMS paid at full Tatua payment
2. 10,000 kgMS at excess milk prices which is market derived (commodity milk price or competition driven).

If buying new land a farmer must own a minimum of 1,000 MSE's per effective Ha. There is nothing to prevent a Tatua farmer from supplying another milk processor on a second farm.

New MSE's are issued from time to time pro-rata based on shareholding (production).

Share holding gives:

- Ownership
- Votes
- Rights to MSE issues
- Liquidation issues
- Special dividends

When MSE where first issued it was based on a 5 year historical basis. Shares were bonused up to 5 shares per kgMS based on a three year average. The ability was given for shareholders to transition initially. Today when MSE's are issued it is on the latest shareholding.

Example 4

2007	100,000 kgMS
2008	90,000 kgMS

10,000 x 5 x 50c redeemed by Tatua.

Directors

Tatua has six farmer directors (chairman is a farmer) and 2 appointed external directors (board has power to appoint 3 external directors).

Directors serve three year terms. There are no term limits.

New director has an induction session with the CEO, chairman and a factory visit, a weeks training with the New Zealand Institute of Directors, travel to see overseas markets, and specialist training in finance.

Board assessment and evaluation has recently been introduced which will recommend training for areas in which directors are weak and recommend who should be appointed as an external director.

Supply Restrictions

No new members or new farms of existing members will be approved for supply if they are outside the collection area which is a 12km radius around the factory. Members are free to set up farms outside the collection area and supply Fonterra, Open Country Cheese etc.

There are 114 shareholders although it is estimated that these are held by around 70 families. It just takes three tankers to collect all the milk.

MSE values fluctuate depending on supply and demand but in general when the $2.50 share value and the MSE are combined, the total is around 50c over the Fonterra fair value share.

Appendix 4

Open Country Cheese

Open Country Cheese is a private milk processor listed as a PLC on the New Zealand stock market. It was set up in 2004 initially by a past Deputy Prime Minister of New Zealand who having a detailed understanding of the provisions of the Dairy Industry Restructuring Act (DIRA) saw an opportunity for profit.

The Dairy Industry Restructuring Act (DIRA) was the piece of legislation that allowed the creation of an effective monopoly – Fonterra but put in place a set of stringent safeguards primarily meant to protect the domestic market and the New Zealand dairy farmer (although the latter shows a complete misunderstanding by the politicians of a cooperative and how it is controlled by its members the farmers).

Among the safeguards are:

- Fonterra has to supply other dairy companies (and cooperatives) up to 400 million litres with a maximum of 50 million litres per processor.
- Fonterra has to freely allow farmers to leave and join (or rejoin). Leaving farmers are entitled to their fair share of the assets hence the fair value share system which has given Fonterra a lack of permanent capital and a redemption risk.
- Farmers are allowed to sell up to 20% of their milk to another supplier

While it was intended that this supply of 400 million litres was for the domestic market to ensure that New Zealanders continued to enjoy competitively priced dairy products nearly all of the private processors are producing bog standard commodities for the export markets.

Open Country Cheese was therefore able to start up with a guaranteed supply of 50 million litres from Fonterra (which it still receives). It has signed up 300 million litres from farmers. Currently it is recruiting around 100 farmers a year and has only lost two farmers back to Fonterra in the last year.

It should be noted that there is no requirement to buy shares when supplying Open Country Cheese or the other private processors. Farmers therefore get very large cash payment when they cash in their Fonterra Shares (last year this was $6.79 per kgMS).

The milk price farmers receive from OCC in 2007/08 was 22c/kgMS more than Fonterra's total payout which they reckon on balance means the farmer is 20c better off. The situation here is highly reminiscent of the situation with United and the other buyers where they promise to better United's price by a small margin.

While at the moment they are tracking Fonterra's payout, OCC have made no guarantees on price, stating simply that if farmers aren't satisfied they can return to Fonterra. However farmers would be well advised to bear in mind that if and when Fonterra's milk supply drops below 87.5% much of their legal obligations listed above including letting a farmer rejoin expire.

At the moment as they are expanding rapidly OCC is not returning a dividend however it is obvious that before long the investors will want a payback and that farmers' prices could soften then.

They have 230 farmer suppliers serviced by two field officers and take their farmers out for dinner once a year with around 400 attending.

OCC have a simple cheese factory with six cheddar "towers". This cheddar is sold off almost immediately at a very early stage. To spread their risk they have also more recently added at three tonne an hour powder dryer making standard WMP in 25kg bags.

They sell their entire product through trading agents such as Interfood, Fairfield and Greenfields.

Due to the fact that are producing very standard commodities and do not require a specialist sales force they claim that they are able to operate at a lower cost structure than Fonterra who they claim tend to over spec their factories and go for the Rolls Royce approach. They aim to keep everything simple. OCC employ 120 staff.

Last year, because they were selling on the spot market they were able to fetch a higher price for their cheese than Fonterra who were committed to longer term contracts.

Appendix 5

Ballance Fertiliser Co-op (Balance Agri-Nutrients Ltd)

Ballance was formed 50 years ago in order to secure supplies of fertiliser for New Zealand farmers. They manufacture single super (9.7 P) and have two urea plants. Rock phosphate is imported primarily from Morocco. 270,000 tonnes of urea were sold by Ballance last year.

At the start there were a number of regional fertiliser co-ops and private companies. As the co-ops merged the private companies couldn't compete and stopped trading. Today there are two nationwide fertiliser co-ops in New Zealand, Ballance and Ravensdown.

The share standard for Ballance is 30 shares per tonne of fertiliser bought. The share price is reviewed periodically and currently stands at $7. The other fertiliser co-op Ravensdown has kept their shares at $1 and issue bonus shares from time to time.

Fertiliser is sold at commercial prices and at the end of the year a rebate is paid based on tonnage purchased.

A new customer only has to initially buy shares to cover one tonne of fertiliser ($210). At the end of the year two-thirds of his rebate is held back to buy more shares. The other third is paid out to cover taxation. Once a member has sufficient shares to cover their purchases the entire rebate is paid out in cash.

There is a small 3% interest dividend on the shares. While there is no compulsion for non-transacting shareholders to sell up they are encouraged to do so, and the very small dividend means that they are better taking their money out. If they haven't quit farming but are buying fertiliser from the competition they have to wait five years for their share to be reimbursed.

Voting is per share.

There are eight elected directors from four wards with two independents co-opted on. It is likely that the vote will go nationwide in time. Directors are elected for three year terms. Half way through the term directors are evaluated by their fellow directors. There is one meeting a month. Board duties should take up no more than 2½ days a month. External directors get the same pay as farmer directors. While they may bring outside knowledge it is important to note that they do not have the same representation role as farmer directors.

Appendix 6

Capital Structures of US Cooperatives

US cooperatives traditionally operate a system of "rolling equity".

A member joins a cooperative the day they start trading with it. Traditionally no capital is required up front.

At the end of the year capital is divided into two sectors:

1. Profits obtained by trading with members
2. Profits obtained by trading with non-members

These non-member "external" profits are taxed as regular corporate profits and the remainder (after tax) is placed in retained earnings. These would only be distributed to members in the event that the cooperative was dissolved.

Profits allocated by trading with members are not taxed at the "corporate" level. These profits are apportioned to each member in proportion to their economic participation in the co-op.

Cooperatives must pay out a minimum of 20% of each year's allocated profits out in cash. Allocated profits not paid out in cash are added to the members' revolving equity account. Some co-ops have a policy of paying this out after 10 years i.e. members would be getting 1999 equity paid back now. The period of time can be much longer than this.

Cooperative members must declare and pay tax on 100% of their share of allocated profits. Some co-ops have a policy of paying out 30% of allocated profits as higher rate taxpayers are taxed at around 30%.

When a member leaves the cooperative (stops trading) he no longer has a vote, however he is not entitled to get his equity back until death although some co-ops have a policy of paying out retired former members who have reached the age of 65.

Appendix 7

Landmark Services Cooperative

Landmark is a very successful cooperative. In the last year their sales grew from $235 to $332 million with profits increasing from $11.2 million to $14.8 million. For some cooperatives "profits" is a dirty word, not so for Landmark. During the year $4.1 million of cash was paid back to members – Cash patronage of $2.8 million and $1.3 million in equity distribution.

Since 2006 Landmark has increased the cash proportion of equity from the legal minimum of 20% to 30%.

Each member is required to accumulate and maintain a vested equity account of $2,000. The Co-op aims to reduce the time taken to revolve equity over $2,000 from over 20 years to the goal of 10 years.

Landmark has four main divisions. These are energy, animal nutrition, grain marketing and agronomy, and they also have two smaller transport and retail divisions.

Energy Division – This includes supplying heating oil, diesel and propane (used for grain drying as well as domestic use). They also own give filling stations. Last year they sold 40 million gallons of fuel.

The animal nutrition division supplies a wide variety of livestock enterprises from five locations. Last year they sold $43 million of feed products.

The grain marketing division has grain storage for 12 million bushels. They have the facilities to load a 100 car train with grain. This gives them a lot of options on where they can sell their grain.

The agronomy division includes sales of seed, sprays and fertiliser along with a team of Agronomists to give advice as to how to use them. This division also has a precision contacting arm which includes John Deere 4930 sprayers with a 120 foot boom and GPS precision fertiliser applicators.

The retail division consists of five convenience stores (part of the previously mentioned filing stations), a tyre centre which includes two vans which operate 24/7 to fix tractor tyres and one hardware store. In addition to the five manned filling stations Landmark also operates three unmanned Pump 24 stations.

The transportation division provides the haulage services needed by all the other divisions of the co-op. This includes 14 "semis" as well as a range of smaller vehicles.

Landmark has 5,000 producer members. These are the farmers who trade with the co-op. Only these members have a vote. They also have another 50,000 customers who are called ordinary members. These are ordinary members of the public or other small businesses who use the filling stations, buy bulk fuel or use the hardware store and tyre centre.

The cooperative is currently attracting around 80 new members per month with around 20 of these being farmer producer members.

The normal number of directors on the board of Landmark is nine. At present it is eleven as they recently merged with another co-op. Two directors came in from the board of the other co-op. Over the next two years as elections are held this will again drop down to nine.

There are three electoral areas, with each area electing one director each year for a three year term. The board has a nominating committee which trawls the membership for possible candidates for election to the board. A profile is done on each candidate which is sent out to members along with the postal ballot paper.

New directors are given a thorough briefing by all the division managers as well as the CEO and CFO and are taken round all the companies various operations.

Each year, directors have a minimum of four days training, including a two day retreat.

Director's pay is modest with $500 being paid for a full day meeting and $350 being paid for a half day meeting.

The board has a Growth and Opportunity Committee. This spends its time looking for new opportunities including mergers with other cooperatives.

The board has no term-limits; however the board does carry out succession planning and board evaluation. There is a reasonable turnover of directors on the board.

The board has defined written "Position Objectives and Responsibilities" for both the CEO and the chairman of the board. The CEO's objectives and responsibilities are broken down into a number of areas and extend to five pages. The Chairman's is a little over two pages long.

Landmark will not take on any new project that has less than a 12% projected return on Investment. If returns are lower than this it's better not to make the investment and return retained equity to its members.

I was incredibly impressed by this operation. The CEO wore a company polo shirt top like the rest of the employees. As we went round some of the various operations I was struck by the rapport the CEO has with all the staff right down to the truck drivers. It felt very much like an organisation where everyone was pulling together.

Landmark's mission statement reads

"We are a cooperative business dedicated to providing rural and urban customers with the highest quality products and services. We will enhance producer profitability, exceed customer expectations and keep our cooperative financially strong."

It was evident to me that these are not just empty words.

Every chairman and CEO of Irish agricultural supply co-ops should book a space on the next plane to Madison to see this shining example of a thriving and vibrant cooperative.

For completeness I list Landmark's vision statement Below:

We will anticipate and meet the future needs of our customers by:

- *Conducting our business with the highest ethical standards.*
- *Positioning our cooperative to be financial strong.*
- *Evaluating growth opportunities to better serve our customers.*
- *Adapting the latest technology to gain maximum efficiency*
- *Informing our customers of the benefits of cooperative membership.*
- *Developing values customer relationships.*
- *Promoting pride of ownership with an aggressive equity revolvement program*
- *Hiring, educating and retaining the best employees*
- *Building a strong image in the marketplace.*
- *Being good stewards of our natural resources*
- *Supporting the communities that we serve.*

Appendix 8

David Ward
Director of Dairy and Government Relations
Cooperative Network of Wisconsin and Minnesota

Background

David is from a dairy background and was a seven-term member of the Wisconsin State Assembly and vice-chairman of the Joint Finance Committee.

The Cooperative Network serves more than 600 member cooperatives owned by Wisconsin and Minnesota residents by providing government relations, education, marketing and technical services for a wide variety of cooperatives including farm supply, health, dairy marketing, consumer, financial, livestock marketing, telecommunications, electric housing, insurance, worker owned cooperative and more.

Dairy Cooperatives in the Upper Mid-West

The Upper Mid-West is seeing a steady increase in very large dairy farms. Farms with 1,000 cows or more tend not to have a bulk tank but rather put the milk directly into a milk truck parked in the "dairy". This means that milk has to be chilled very rapidly before it gets to the truck. Electricity cost in the US is around 11 cents per kilowatt hour.

Most of the trucks are owned by the plant, in some cases they are owned by the farmer. In a few rare cases the farmer owns the tractor as well.

These larger farmers demand volume bonuses. By law these volume bonuses are restricted by:

1. The amount that can be justified by cost savings e.g. lower transport and administration costs, or
2. To meet competition.

In other words so long as the coop (or private dairy) up the road is paying very high volume bonuses you can too!!

There are eight dairy cooperatives operating throughout the state of Wisconsin as well as a number of small local co-ops operating in specific areas. Dairy farmers (especially the larger ones) will move from one co-op to another. There tends to be more loyalty to the milk truck driver than to the cooperative and if he moves jobs from one co-op to another many of the farmers on his old route will move with him.

The members of one cooperative who were performing poorly (Alto) accepted an offer from a private Canadian company to buy out the co-op. The Canadian company offered to pay the members all their revolving equity. Given that it was unlikely that these members where unlikely ever to see their equity otherwise they accepted by a two thirds vote of the members.

There are also a number of "Swiss" type co-ops. In a traditional co-op (or private) milk supply contract the milk becomes the property of the co-op as soon as the milk is pumped into the tanker. In Swiss style co-ops the milk remains the property of the co-op member until the finished product (cheese) is processed, matured and sold on the market.

Many cooperative dairy plants are now running at capacity. This raises the question as to how co-ops pay for expansion. This is a difficult issue. One cooperative in Michigan has a capital retains program deduction of 10 cents / cwt. However this can be tricky if the co-op down the road isn't deducting a capital levy.

David feels that the competition between cooperatives is a good thing as it keeps them on their toes. He wouldn't want to see rationalising to the point where farmers had only one choice. He highlighted that in the state of Vermont there are a few dairy cooperatives; however one has BST free policy so farmers using BST have fewer co-ops they can sell to.

Futures Contracts

Unlike Europe, farmers in the US have the ability to forward sell their milk on the futures market or by buying "puts". They can also lock in the price of their inputs.

Producers could have locked in the price for this entire year's supply at $16-$17 / cwt. Only 6% of producers take advantage of this scheme which would be the difference between making a substantial loss or a modest profit. Most farmers didn't take the option because they hoped for much higher prices.

Activities of the Cooperative Network

Around 15 years ago California took the title of America's Dairyland from Wisconsin. To try and encourage expansion of Wisconsin's dairy industry the Cooperative Network successfully lobbied the State Government to give tax credits for capital investment. Also land near settlements which had been zoned for building but was still being farmed was taxed at its full investment value. This was changed to the valuation on the agricultural economic potential of the land.

One relatively new development was the formation of a farmer health co-op. Most people in the US are provided with family health insurance by their employer. Individual policies can be very expensive and will often exclude cover for illnesses relating to pre-existing medical conditions.

The farmer health co-op now has 2,600 members. It was expected that the average age of those joining might be very old, however this has not turned out to be the case. The average age is 38. Some of their members have seen their premiums drop by up to 50% since joining.

The Cooperative Network provides a variety of board training for its members this includes subjects such as:

- How to hire a CEO
- What can I or can I not do as a director?
- Directors' legal responsibilities and liabilities.

They also run youth seminars at agricultural colleges and train cooperative employees on credit issues and have a committee of dairy plant managers to enable them to network and discuss common issues with state regulators.

They also help organise the annual Cooperative Day at the State Capitol in Saint Paul, Minnesota and Minnesota's Dairy Day at the Capitol.

They can also mobilise all cooperative members to aggressively lobby if one sector is threatened. A recent example was a proposal by the Governor and Legislature of Wisconsin to impose an oil gross receipts tax in the state budget. They pointed out that this tax would not just affect "big oil" companies but also cooperatives that distribute motor fuel. They got all their member co-ops to put a flyer in their monthly mailing to their members along with pre-printed post cards for their members to complete and mail into their local State Assemblyman and Senator.

Appendix 9

Dairy Farmers of America

Dairy Farmers of America operates in all of the 48 contiguous states. Its operations are divided into seven regions.

Each region has a council. The Mid-East Council is broken down into 18 districts. The members in each district elect the councillors. Each farm can have up to three voting members (on condition that they are a partner in the farm business). Each district also elects a delegate and a reserve onto the region's Resolutions Committee. They also elect delegates some of whom go forward to attend the company's annual meeting in Kansas City. It should be noted that governance structures vary slightly across the country.

The Mid-East Council appoints seven of its members to the corporate board. The number of Directors assigned to each region varies and is determined by a 50:50 mix of the number of farms and the volume of milk in a region.

The chair of each region along with the overall chairman and vice chairman form the Executive Committee of DFA. These are the directors whom the CEO keeps informed on a week to week basis.

Each region forms a business unit with its own P&L account. They are fairly autonomous, and are managed by a Chief Operating Officer (COO), with the council acting as the board for that region. They are responsible for collection and sales of milk in each region. Whilst most of DFA's factories are held by a separate business unit each area has a number of "balancing plants", which make powder, butter and condensed milk to use up any surplus milk on a day-to-day basis. In addition each area council draws up its own system of milk premiums.

Each region will trade milk with its neighbours from time to time depending on seasonality and supply and demand in each area. It is up to each COO to negotiate a price and if he can get a better deal outside DFA he will go with that.

Each region has a separate Resolutions and Policy Committee. They draw up new resolutions which are presented at the annual meeting for adoption. An example of a resolution was one to support the Cooperatives Working Together (CWT) herd buyout programme.

I can't help thinking that those who drew up DFA's system of governance must have taken a lot of inspiration from the United States Constitution. The executive committee is like the cabinet with the corporate board more like the senate. Each region enjoys a certain degree of autonomy like the constituent states. With resolutions being considered at each annual meeting; somewhat analogous to a meeting of Congress, including no doubt its own version of the President's State of the Union speech.

I asked Dennis about how DFA came about. It started at a time when prices were very low. Cooperatives had been fighting the bit out against each other. Finally at an industry meeting the chairmen of several large cooperatives got together to discuss the issues. Seven cooperatives were involved in the first set of negotiations. Four cooperatives joined together in the initial merger with another two joining shortly after. They also have joint ventures with Land O Lakes and Dairylea.

To get over certain issues, a procedure known as "grandfathering" was used. An example of this was the different patronage programs of each of the merging co-ops. While a new joint program was set up for new entrants existing members would continue to have the same rights to withdraw patronage upon retirement as they always had.

New offices where set up in a different location, to create a new feel and identity for the co-op. It also helped to avoid the feeling that one co-op had taken over another.

The system of regional councils was set up to allow for regional marketing of milk and more local control.

I then asked, if each region operates like its own mini-coop, what is the advantage of being merged at a national level?

The answer is combined strength and resources, such as being able to make investments, a meaningful R&D programme, market strength and position. DFA has a number of customers such as Dean Foods and McDonalds who purchase on a nationwide basis. DFA can offer them local product in every state. They also are in a better bargaining position with the banks, and have not had to ask their members for additional capital funding.

When a new member joins he is required to build up $1.75 in equity for every cwt of milk that he sells. 10 cents per cwt is taken of his milk check until he has $1 built up. The equity account continues to grow as the cooperative's profits are deposited at the end of each year. Traditionally DFA deposit 80% of the profits and 20% are paid out in cash. In 2009 due to the difficult financial situation farmers were facing the decision was made to pay out 100% of profits in cash to help get more money into farmers' hands. When a producer reaches $1.75 of equity per cwt 100% of the profits are returned in cash each year.

New directors and area councillors receive a day's training, this focuses on their fiduciary duties. There are no external directors on the board however legal counsel attends board meetings to look after the director's interests.

The corporate board meet one a month, each meeting lasting two days. Each area council meets between six and eight times a year.

I couldn't get exact pay for directors and councillors but it is pretty modest at around $300 a day for directors and $200 a day for councillors.

Appendix 10

DRAFT CODE OF PRACTICE FOR BOARD DIRECTORS

Induction

1. We have a formal induction programme that all new directors are required to undertake.

Attendance

2. Directors are expected to attend all board meetings.

3. Meeting dates will be set annually in September for the following calendar year.

4. Any emergency board meetings will be scheduled with as much notice as possible.

Board papers

5. Board papers and an agenda will be sent to directors seven days before a board meeting.

6. Individual directors are expected to ask questions of the relevant person on any topic that that they do not understand before the meeting.

7. Board members are expected to devote sufficient time to ensuring that they fully understand all of the material they are sent. Board time will not be spent on clarification of issues that could have been undertaken beforehand.

8. Board discussions are limited to those issues upon which we have all received paperwork. No new issues are introduced at our board meeting. We are not in the business of giving each other shocks.

Minutes

9. Minutes will be issued by the secretary within 48 hours of the end of a meeting.

10. Minutes record decisions taken and the reasons why. They also report who has agreed to do what, by when and to what standard. They do not record what was said at meetings.

11. When individual directors have agreed to take action on behalf of the board, they are expected to act with integrity and complete the action to the time and standard required.

12. If they are not able to complete the action, early notice to the chairman outside the meeting is expected.

Decision making

13. Decisions are made by consensus.

14. We consider the needs of all stakeholders when making a decision.

15. In the event of disagreement about a decision, the enthusiasm scale is used.

16. When a decision is reached, the chairman will ask for that decision to be minuted by the secretary.

17. After a decision is taken board members are expected to demonstrate full support for the decision.

Personal demeanour at board meetings

18. Directors are expected to dress smartly at all times when representing the organisation. As a minimum this means a jacket and tie for men or the female equivalent.

19. You are expected to arrive 15 minutes early for board meetings.

20. Our meetings start on time and every effort will be made to finish on time.

21. We attempt to follow the agenda at all times because thought has been put into deciding the priority of items.

22. All remarks at board are made through the chairman.

23. We all allow our colleagues to finish what they are saying without interruption.

24. We address the chairman as 'Chairman' and our board colleagues by their first name.

25. Everybody is regarded as equal in board meetings, including the chairman.

26. The chairman controls the boardroom process, not the subject matter discussed.

27. Our board meetings encourage objective debate, but not personal debate. We strive to separate the person from the issue under discussion.

28. We regard listening as more important than speaking at meetings.

29. Silence from a director is to be regarded as assent.

30. All opinions are respected at our board meetings.

31. Appropriate humour is encouraged.

Out of meeting communications

32. Directors are encouraged to communicate outside meetings by face-to-face one to one informal meetings, phone and email.

33. It is expected that every director has an email address and refers to his/her electronic mail daily.

34. Phone calls between directors are encouraged but not at anti social hours.

Director appraisal

35. Once a year, part of a board meeting is devoted to an appraisal of the performance of all directors on the board, including the chairman.

36. Where training needs are identified, directors are required to devote time and energy in ensuring that the necessary learning is carried out.

37. Where expense is involved with director training, the organisation will pay subject to approval from the FD.

The personal responsibilities of directors

38. We seek to promote and advance the status, profile and reputation of the organisation at all times.

39. We are professional in all of our dealings.

40. The organisation as a whole is more important than any one part.

41. Directors are expected to put the organisation before any personal self-interest.

42. We do not use our position as directors for personal gain.

43. What is said at meetings is regarded as confidential and must not be divulged to outside persons.

44. As directors we make responsible use of the resources of the organisation.

45. We are responsible for the modesty of the expenses we incur on the organisation's behalf.

Appendix 11

Article Written for “Agrifax”

The Agri-Business Newsletter of the New Zealand Stock Exchange

In January I was awarded a Nuffield Farming Scholarship to study “World Class Leadership and Capital Structures for Dairy Co-operatives fit to meet the challenges and opportunities of the 21st century.”

New Zealand with its very progressive dairy industry seemed like a natural place to start and so I spent five fantastic weeks there in July and August learning all I could about how the current dairy structure had evolved as well as looking at how co-operatives in other sectors operated.

It is always very refreshing to visit New Zealand with its pioneering spirit and business like attitude. In general the dairy industry is much better set up with good systems for new entrants to climb up the dairy ladder. It is a much more ruthless place, the European attitude is that we do not inherit the land from our fathers but rather borrow it from our children. In New Zealand farms are nearly always bought and sold by each generation. This has given NZ a much more dynamic and adaptable footing.

A result of this and the absence of capital gains tax, New Zealand farmers place a much greater emphasis on capital gain than their European counterparts. If anything this seems to have grown even more over the last few years. Indeed I think there is a danger that as farmers focus more and more on the value of their cows, land and Fonterra shares, they lose focus on the bread and butter issues of farming efficiently and profitably. While there are still many truly world class farmers in NZ, and Lincoln University is leading the world in grazing research, my perception is that the focus on efficient, profitable, grass based dairy production has slipped somewhat. This was backed up when earlier this week at the European Dairy Event in England I met up with an LIC salesman recently arrived from New Zealand, who said he was truly impressed with the grassland management, cow condition and fertility of those farms in the UK who were following the kiwi system. These are the things that dairy farmers must not lose sight of as they are needed to drive the profits, to pay the interest, to reap the capital gains they prize.

When I left for New Zealand one of the major items on my agenda was to find out ways of releasing the value of the wealth of my own co-operative, which is barely expressed in the nominal shares. I was very interested in Fonterra’s fair value system and keen to find ways to apply it back at home. In the end I left New Zealand with a far different set of conclusions that I thought I would when I arrived.

I have to say that among the senior figures in the industry many have a mental image problem with being involved in a co-operative. A common attitude is “We are a co-op because we are owned by our suppliers / customers but in every other regard we operate like a PLC”. They see co-operatives as being wimpish and socialist and somewhat running against the grain of the New Zealand free enterprise spirit.

During my time in New Zealand I attended a seminar organised by the New Zealand Co-operatives Association on co-operative governance. The meeting was well attended by representatives of Fonterra's Shareholders Council, however, not a single director of Fonterra attended. What became rapidly apparent was that when compared against the benchmark of co-operative, values Fonterra ticked hardly any of the boxes. It has moved far away from the ideals of a cooperative.

I firmly believe that the fair value share is at the root of Fonterra's problems. In the name of "increasing the wealth of farmers" by increasing the value of the Fonterra share, the board and management have invested huge amounts of money in overseas projects. Many of these seem to have precious little to do with the processing and marketing of New Zealand dairy produce.

Over the past few years the value of the share has increased to a level that is over double that of the cost of the stainless steel needed to process a kilogram of milk solids. While in Fonterra's defence it is true to say that the DIRA Act opened the door to private milk processors, it is Fonterra's own inflated fair value share that has opened the floodgates. Fonterra's own actions have helped its competitors get a foot in the door.

Getting out of this mess will be difficult, but I believe it is still possible, and indeed imperative for the long term prosperity of New Zealand dairy farmers. One of the best suggestions I heard was the idea of creating two sister companies. One a true co-operative with a fixed share price based on capital costs which will handle all the core activities and the other a hybrid structure with outside capital to invest in downstream areas not directly related to the processing and marketing of New Zealand dairy produce.

The real ***value*** of a dairy co-operative is to secure the best price it can for its members milk this year, next year and in ten / twenty years time. Trying to put a corporate price tag on it is completely inappropriate. Allowing retiring farmers to take far more money out of Fonterra than they ever put it in, while creating enormous hurdles for new entrants, is quite simply unethical. While it itself is only a few years old, Fonterra is a culmination of decades of hard work by generations of New Zealand dairy farmers.

Perhaps we should think as they did and treat our co-operatives not as something we inherit from our fathers but rather borrow from our children.