



13 June 2014

ANNOUNCEMENT OF NZ MARKETS DISCIPLINARY TRIBUNAL

TRIBUNAL APPROVAL OF SETTLEMENT AGREEMENT BETWEEN NZX LIMITED AND FONTERRA CO-OPERATIVE GROUP LIMITED IN RELATION TO FSM RULE 9.1.1

1. The NZ Markets Disciplinary Tribunal (“Tribunal”) has approved a settlement agreement between NZX Limited (“NZX”) and Fonterra Co-operative Group Limited (“Fonterra”) dated 5 June 2014 (“Settlement Agreement”) in respect of FSM Rule (“Rule”) 9.1.1.

Background

2. Fonterra is a multinational dairy co-operative owned by approximately 10,000 New Zealand dairy farmers.
3. The Fonterra Shareholders' Market (“FSM”) was established as part of the Trading Among Farmers scheme on 30 November 2012. It is a private market, which enables Fonterra shareholders to trade co-operative shares (which are quoted under the ticker code FCG) between themselves.
4. The Fonterra Shareholders' Fund (“FSF”) is a separate unit trust established to invest in the economic rights of shares in Fonterra. FSF has units quoted on NZX's main board (under ticker code FSF) and ASX. They enable persons who are not entitled to trade on the FSM to gain access to certain benefits they would have received if they were entitled to own a share, and thus to indirectly participate in the economic performance of Fonterra.
5. The FSF is designed to supplement liquidity in the FSM by enabling units to be exchanged for FCG shares by participants in the FSM market. That system is designed so that FSF units and FCG shares should trade at similar prices. As a consequence, information about FCG shares is equally relevant to FSF units.
6. Fonterra is subject to the FSM Rules. Rule 9.1.1 of the FSM Rules requires that when Fonterra becomes aware of any Material Information concerning it, it shall immediately release that information to NZX unless a reasonable person would not expect the information to be disclosed, the information is confidential and confidentiality is maintained, and one of five listed provisos applies.

7. On Monday, 5 August 2013 Fonterra released an announcement to NZX disclosing that three batches of WPC80 manufactured at its Hautapu plant contained a strain of clostridium, which has the potential to cause botulism, and that eight customers had been identified as having received affected product. This followed Fonterra making a number of releases to NZX on this issue, with the first being just after midnight on Friday 2 August. By agreement with NZX, Fonterra replaced the releases it had made over the weekend with one announcement on Monday, before trading began, providing the latest information then available to Fonterra.
8. The previous week Fonterra had initiated a process to trace product after receiving an email from AgResearch at approximately midday on Wednesday, 31 July 2013, that indicated one strongly positive result for botulinum toxin. Fonterra was aware on that date that some affected product had been provided to six customers, including a nutritional customer who uses the product to produce infant nutritional products, but Fonterra was not aware on that date and was actively seeking to discover whether any potentially affected product had entered the consumer market or if it was still held by its customers.
9. Fonterra's trace back exercise of all affected product was completed on 18 August 2013, and on 28 August 2013 the Ministry of Primary Industries announced that the bacteria found in the affected batches did not contain the botulinum strain of clostridium and that the affected product posed no risk to the public.
10. On Wednesday 31 July 2013, Fonterra lodged an announcement with NZX in relation to its forecast cash payment for the 2013/14 season.
11. On Wednesday 31 July 2013, FSF units closed at \$7.30. The unit price decreased over the next two days to close on Thursday 1 August 2013 at \$7.18, and Friday 2 August 2013 at \$7.12 (a decrease of 2.46% from close of market on 31 July 2013).
12. The intra-day trading price for FSF units on Monday 5 August ranged between \$6.50 and \$6.93, and closed at \$6.86. The intra-day low price of FSF units of \$6.50 during trading on Monday 5 August 2013 represented a \$0.62 decrease (8.70%) compared to the previous day's closing price of \$7.12.
13. The price of FSF units decreased by \$0.26 (3.65%) between close of market on Friday 2 August and close of market on Monday 5 August 2013.
14. Similar market effects were observed in respect of FCG.
15. NZX Regulation ("NZXR") has investigated whether the announcement released on 5 August 2013 (taking into account the first announcement was made after the market had closed on Friday 2 August) was sufficiently timely to meet the continuous disclosure obligations under the FSM Rules. NZXR has completed an investigation of this matter including involving analysis of information provided by Fonterra.
16. As a result of the investigation, NZXR considers that Fonterra breached Rule 9.1.1 of the FSM Rules by failing to release Material Information to NZX concerning the contamination of its WPC80 product with clostridium capable of causing botulism, immediately after coming into possession of that information by midday on 31 July 2013.

17. While Fonterra does not accept NZXR's view as recorded above, it acknowledges that view and has agreed to make certain payments as outlined below.
18. The Tribunal acknowledges that the matters which are addressed in this announcement arose as a part of a significant and fast moving incident for Fonterra. Further, the Inquiries put in place by Fonterra/its Board as a result of these events examined and made recommendations in relation to a wide range of matters, including Fonterra's overall governance and communications. In this context, the Tribunal notes that it has been advised that:
- a. Fonterra has since instigated a new Food Integrity Quality Council, chaired by the newly created position of Group Director Food Safety and Quality (the latter reporting directly to the CEO). A key focus for the Council is the possible impact of events and circumstances on Fonterra's reputation. This has been factored expressly into the decision-making functions and tools used by the Council.
 - b. Fonterra's CEO, each of his direct reports and senior executives have signed variations to their employment contracts to record a commitment to the highest standards of food safety and food quality, which includes an express commitment to meeting all applicable Fonterra policies and regulatory requirements. These include policies and standards in relation to disclosure of material information and escalation of issues.
 - c. Fonterra has also established a permanent, multi-disciplinary group Incident Management Team (IMT), whose role is to assess emerging issues for their potential to develop into critical incidents, and in such scenarios, address, among other matters, stakeholder engagement. One of the key functions of the IMT is to ensure that information in relation to critical incidents (including any incident that could result in a critical incident) is escalated promptly to ensure that all regulatory and other requirements are analysed and met appropriately. The IMT works seamlessly with Fonterra's existing Disclosure Committee.
 - d. Fonterra has instigated detailed e-learning modules in relation to all of its policies and standards, including its disclosure policy and standards. Employees in Group Functions and the various Business Units are required to study Fonterra's policies and standards in a structured manner online and to complete a test at the end of each module. Compliance with this requirement is monitored through the Office of the Chief Financial Officer.

Determination

19. The Tribunal considers issues in relation to continuous disclosure provisions of the rules as a serious matter. The obligation to disclose material information in a timely manner is a fundamental obligation placed on Fonterra under the FSM Rules.

20. Timely disclosure of market sensitive information is essential to maintaining the integrity of the market. Compliance with continuous disclosure requirements ensures that the market is informed of relevant information at all times. These provisions are designed to promote the equality of information in the market so that all investors are able to make informed investment decisions. It is a critical part of ensuring that NZX's markets are efficient, transparent and fair.

21. In determining to approve the Settlement Agreement, the Tribunal considered certain mitigating factors, including that:

- a. Fonterra has co-operated fully with the NZXR inquiry.
- b. Immediately after the issues arose, Fonterra voluntarily put in place two separate and wide ranging Inquiries (the internal Operational Review and the Independent Board Inquiry).
- c. Fonterra has been willing to resolve this matter at a very early stage, consistent with the principles of speed and certainty.
- d. The issue appears to have arisen in part from a lack of internal escalation by senior management at Fonterra and, as noted at paragraph 18 above, steps have since been taken by Fonterra to improve the escalation process.
- e. Fonterra has already suffered significant reputational consequences as a result of the events that are the subject of this announcement.

22. In determining to approve the Settlement Agreement, the Tribunal considered certain aggravating factors, including that:

- a. Fonterra was aware of the expectations of the market and regulators to ensure the timely disclosure of information.
- b. Fonterra lodged an announcement with NZX following market close on Friday 2 August 2013, approximately two and a half days following Fonterra coming into possession of what NZXR considers was Material Information.
- c. The Tribunal considers that continuous disclosure obligations are amongst the most fundamental obligations of a listed issuer, and are critical to the fair and efficient operation of the FSM and Main Board markets.
- d. As a large and prominent company, Fonterra has an obligation to uphold high public standards and any breaches of continuous disclosure obligations have the potential to affect a significant number of people.

23. NZX and Fonterra have reached a settlement and agreed that:

- Fonterra will pay the NZX Discipline Fund \$150,000 (plus GST, if any) in relation to the conduct in this case.
- This announcement by the Tribunal will be made.

- Fonterra will pay the costs of the Tribunal and will contribute to the costs incurred by NZX in relation to this matter.

Approval

The Settlement Agreement is approved by the Tribunal pursuant to Rule 10 of the NZ Markets Disciplinary Tribunal Rules (“NZMDT Rules”), and as such, the Settlement Agreement is the determination of the Tribunal.

The Tribunal records that, while acknowledging that Fonterra does not agree with NZXR’s view that there has been a breach of the FSM Rules in this case, it is nevertheless concerning and disappointing that a disclosure issue has been required to be raised by NZXR with Fonterra and that Fonterra has not accepted that a breach occurred. The Tribunal also records that Fonterra could have managed its compliance with continuous disclosure obligations better in this case. The Tribunal reinforces the need for organisations, and particularly those of the size and standing of Fonterra, to devote proper resources, time and training to their continuous disclosure obligations and to foster a culture of openness and transparency in relation to continuous disclosure issues.

The Tribunal

The Tribunal is a disciplinary body which is independent of NZX and its subsidiaries. The Financial Markets Authority approves its members. Under the NZMDT Rules, the Tribunal determines and imposes penalties for referrals made to it by NZX in relation to the conduct of parties regulated by the market rules.

Dated 13 June 2014