

5 March 2010

FONTERRA CAPITAL RESTRUCTURE

You will no doubt be aware of the recent capital restructure and probably also aware that, as a result, the amount that you are paid as a shareholder is broken down into two components, namely a component for the price paid for milk and a dividend paid on the shares held in Fonterra.

Previously, Fonterra paid shareholders for the milk component and the value-added component and this was described as the “payout”. It is this term that has been used in sharemilking agreements as a means of determining the percentage to be paid to the sharemilkers under those agreements.

Shareholders will receive payment of the milk price component in the normal course of the year as milk is supplied. However, the dividend is paid in two instalments in each financial year with the first interim dividend announced on 31 March (and paid by 20 April) and the second, final dividend being announced on 31 May (and paid by 20 October).

The issue for owners and sharemilkers is how the change in the way the payout is now calculated might affect sharemilking agreements.

Whether the sharemilker is entitled to the dividend will depend on the terms of the contract. It is most probable, in just about every case, that an existing agreement will entitle the sharemilker to a proportion of the dividend. This is because, pursuant to the contract between the parties, the owner has agreed to pay a portion of the “payout” which includes the value-added component. Dairy farming is a complicated business and there are a number of scenarios that could apply to confuse, complicate and compromise what appears at first to be rather simple.

To illustrate the point, let’s say, the owner has contracted with a sharemilker who owns the cows and there is a 50/50 sharemilking agreement in place. The owner and the sharemilker meet and agree that the sharemilker is entitled to 50 percent of the dividend, and they shake hands.

What if:

- The owner decides to invest in Fonterra and before 31 March owns the maximum number of shares that he is entitled to own, namely 120% of production. Should the sharemilker be entitled to a dividend on all of the shares or just the shares required for production.
- The shares held by the owner are less than the production in that season. If the production exceeds the previous year in this situation, then the sharemilker is denied a dividend on the additional production; somewhat of a disincentive to the sharemilker.

Both of these scenarios demonstrate the difficulties that will exist where the parties come to a casual arrangement about the change in how to calculate what is due to a sharemilker under the agreement. In the example referred to above, the owner has invested in additional shares and clearly the sharemilker should not be entitled to a dividend on those surplus shares (“dry shares”).

The second scenario above illustrates what happens when the owner has not “shared up” to the likely production in that season; the sharemilker is not receiving what they would have received under the old regime.

There is an understandable respect and dependence that dairy farmers have on the advice that Fonterra is giving its shareholders. A form has been produced giving the owner the option of electing to pay the sharemilker a proportionate share of the sharemilker’s entitlement to the dividend. However, it doesn’t provide the one option that we would recommend. That is a dividend paid upon the wet shares only.

We think that the form is inadequate on the basis that it does not account for the problems referred to in paragraphs 1 and 2 above. It gives the owner the option to pay a dividend on shares, excluding additional shares, i.e. dry shares, but this does not cover every contingency as demonstrated above. The form should have provided a fourth option whereby the dividend is paid on the production in that season, i.e. payment of a dividend on wet shares only (where the production is less than the shares held), thus returning the parties to the situation they were in before.

If you would like to know more about the issues arising from the capital restructure, then you have the opportunity of learning more about this and many other issues by attending the BlackmanSpargo “Working Knowledge for Farmers” seminar to be held at the Reporoa War Memorial Hall on Wednesday 17 March 2010 between 11.00am and 1.00pm.

More details about this and other issues are available on our website, www.rurallaw.co.nz

Yours faithfully

BLACKMANSPARGO

A handwritten signature in black ink, appearing to read 'Ian Blackman', with a large, stylized loop at the top.

Ian Blackman

Director

DDI: 07 343 1620

Email: ian@blackmanspargo.co.nz