

COMMERCIAL-SENSITIVE

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Fonterra Capital Structure - Options, Mechanisms and Implications

Date:	5 October 2007	Treasury Priority:	High
Security Classification:	COMMERCIAL-SENSITIVE	Report No:	T2007/1891

Action Sought

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Minister of Finance (Hon Dr Michael Cullen)	<p>Note:</p> <p>at least two options are consistent with Fonterra and Government goals, including Fonterra's preference, but need modification to achieve National Interest goals;</p> <p>viable mechanisms do exist</p> <p>high level decisions on innovation systems or raw milk pricing are preferable to detailed arrangements</p> <p>fuller advice from officials will be available before 17 October.</p>	<p>Catch-up discussion with Treasury at 5pm on Tuesday 9 October.</p> <p>Meeting with Fonterra Directors at 3:30pm on Wednesday 17 October.</p>
Associate Minister of Finance (Hon Phil Goff)	Read report.	Meeting with Fonterra Directors 3:30pm Wednesday 17 October
Associate Minister of Finance (Hon Trevor Mallard)	Read report.	Meeting with Fonterra Directors 3:30pm Wednesday 17 October
Associate Minister of Finance (Hon Clayton Cosgrove)	None	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Information withheld under Section 9 (2) (a) of the Official Information Act 1982	Principal Advisor	Information withheld under Section 9 (2) (a) of the Official Information Act 1982	Information withheld under Section 9 (2) (a) of the Official Information Act 1982	✓
Tom Hall	Manager, Primary Sector	Information	Information	

	Votes and Entities	withheld under Section 9 (2) (a) of the Official Information Act 1982	withheld under Section 9 (2) (a) of the Official Information Act 1982	
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Enclosure: No

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Executive Summary

[Out of scope material removed]

Innovation

Ministers also raised the prospect of co-operation on innovation systems with Fonterra. This has developed into a proposal by departments to both engage with Fonterra on programme design and commit to funding of \$45 to \$95 million per annum. Treasury are concerned with this approach because:

- the proposals are not sufficiently developed to justify immediate commitments;
- the amount sought would absorb the bulk of the likely ET funding allocation in advance of the budget process; and
- we do not consider that a unique window of opportunity actually exists as:
 - such a package would not alter Fonterra's views on capital structure matters;
 - Fonterra are unlikely to reject substantial Government investment at any time; and
 - the process on innovation systems and drivers will continue well beyond October.

[Out of scope material removed]

Our preferred approach on innovation as a whole is to agree to explore innovation systems packages by December (for consideration in the Budget new initiatives process).

[Out of scope material removed]

Kevin Guerin

Principal Advisor, Business Regulation
for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance

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[Out of scope material removed]

Innovation Systems

1. Ministers also raised the prospect of co-operation on innovation systems with Fonterra. Officials have subsequently been discussing with Fonterra its innovation strategy and opportunities for innovation in the wider New Zealand dairy and food sectors.
2. This aligns with the Economic Transformation (ET) focus on developing innovation clusters and targeting more productive technology areas. Priority areas include pastoral systems and advanced food and derivatives. The food and beverage taskforce has also led to work on a Food Research Roadmap and the Food Infrastructure Project looking at pilot scale facilities. Areas identified with Fonterra for more detailed exploration are:
 - sustainable pastoral systems;
 - research and education capability;
 - dairy/food innovation clusters; and
 - internationalisation of firms.
3. This has developed into a proposal by the Ministries of Agriculture and Forestry (MAF), Economic Development (MED) and Research, Science and Technology (MORST) to both develop a package of work in co-operation with Fonterra and commit to a substantial level of funding for such a package.
4. An outline of potential commitments by Government and Fonterra as developed by the Ministry of Research, Science and Technology (MoRST), Ministry of Agriculture and Forestry (MAF) and Ministry of Economic Development (MED) projects a Government commitment, additional to existing resources of \$45 to \$95 million per annum subject only to industry commitments and approval of specific high-value projects.
5. Treasury does not support such a degree of commitment at this time because:
 - the proposals are not sufficiently developed for decisions at this time;
 - the amount sought would absorb the bulk of the likely ET funding allocation in advance of the budget process; and
 - we do not consider that a unique window of opportunity actually exists as:
 - such a package would not alter Fonterra’s views on capital structure matters;
 - the process on innovation systems and drivers will continue well beyond October.
6. We recommend that Ministers agree that officials should explore innovation systems packages by December for consideration in the new initiatives process.

[Out of scope material removed]