Fonterra's Failed History of Dairy Product Quality

In this center section – *The Milkweed* publishes the second in a series of articles detailing the long series of untoward actions engineered by Fonterra – New Zealand's dairy export colossus.

In this segment, the authors – Jim Eichstadt and Pete Hardin – focus on various aspects of Fonterra's sorry history of dairy product quality, from the "Powdergate" scandal of the late 1990s through to the current fiasco involving possible botulism contamination of Whey Protein Concentrate 80. Time and time again, management of Fonterra – and its predecessor organization, the New Zealand Dairy Board (NZDB) – have failed to produce and market dairy products with integrity.

No single measure better profiles a marketing entity in the dairy industry than that firm's allegiance to product quality and integrity. Thus, the authors believe it is high time to detail the at times sordid history of dairy product quality/integrity failures by Fonterra and NZDB.

Corrupt & Incompetent Fonterra Is Neither Clean nor Green!

by Jim Eichstadt

New Zealand's Fonterra Cooperative Group Ltd – the world's largest dairy exporter – is many things to many people. To New Zealanders, Fonterra is a Kiwi *tour de force* of allegedly unsubsidized, "clean and green" dairy production, as well as the island nation's biggest exporter, dollar-wise. To dairy farmers in the U.S. and other targeted export markets, Fonterra is a chronic, frequent pain in the region of their pocketbooks. To global consumers, the Kiwi dairy colossus is, well … increasingly, a source of heartburn, or worse.

In the August 2013 issue of *The Milkweed*, I cited the massive misinformation campaign being waged by Fonterra and its New Zealand government protectors in Wellington and foreign embassies. Fonterra is not the efficient and transparent business model of global commerce held aloft by New Zealand's free-trade zealots. Rather, Fonterra is a ruthless and unreformed near-monopoly exporter that exploits dairy producers and consumers worldwide.

Fonterra's list of sins is extensive:

• Its New Zealand Dairy Board heritage as an aggressive, government-sanctioned State Trading Enterprise (STE) export monopoly.

• The cosmetic "reforms" of the 2001 dairy co-op merger which seriously strain the World Trade Organization ban on STEs.

• The extensive network of foreign subsidiaries and joint ventures that tightens New Zealand's grip on global trade.

• The domination of ongoing global trade talks by four consecutive Kiwi chairmen of the WTO agriculture negotiating committee.

• The deceptive charm offensive being waged in Washington, D.C. to neutralize political opponents on Capitol Hill and co-opt gullible U.S. dairy cooperative leaders to do Fonterra's bidding.

Fonterra deserves credit where credit is due. Like its NZDB predecessor, Fonterra runs circles around its U.S. competitors in developing and marketing a wide range of innovative dairy products targeted to the needs of diverse customers around the world. (That may not be hard as hard as it seems, considering the marketing incompetence of some big U.S. dairy co-ops.) Prices fetched on Fonterra's Global Dairy Trade online auction platform are often significantly higher than U.S. cash dairy commodity market prices ($0.2613/pound for butter in late August-early September). The U.S. dairy industry has a lot to learn from the Kiwis about basic skills like new product development and marketing products with strong global demand.

That said, there is no excuse for Fonterra's many bad behaviors, which far outweigh the good. Its status as New Zealand's biggest exporter enjoying special privileges and protection by its government enablers has encouraged Fonterra to develop some very nasty habits. The long list of nasty habits includes corruption, incompetence, greed, and arrogance. Where to start?

Powdergate scandal reveals corruption

The "Powdergate" scandal provides insights into the culture of corruption that began under the NZDB and continues under Fonterra. Powdergate, uncovered in 2001, involved the fraudulent export of New Zealand milk proteins beginning in the late 1990s by employees of Kiwi Co-operative Dairies (Kiwi Dairies), one of the partners in the October 2001 mega-merger that formed Fonterra. New Zealand Ministry of Agriculture and Forestry (MAF – now the Ministry of Primary Industries) officials in 2001 raided Fonterra sites on the North Island in search of evidence. Authorities ultimately seized thousands of documents related to the milk protein export scam, according to news reports.

Kiwi Dairies employees circumvented NZ's Dairy Board Act by illegally exporting 10,000 tons of milk powders worth an estimated $75 million. The perpetrators mislabeled exported dairy proteins and falsified the country of origin by re-exporting the products through subsidiaries in Australia. In some cases, high-value dairy proteins were mislabeled as low-value animal feedstocks to avoid paying export fees to Fonterra. In other cases, quick-buck artists exported substandard ingredients like dairy-based industrial adhesives as higher-value products such as milk protein concentrate.

The Powdergate scandal soon reached U.S. shores, with the Food and Drug Administration impounding "five shipments of New Zealand whey protein concentrate re-exported from Australia between November 2000 and last April," *The New Zealand Herald* reported February 13, 2002. (Some illicit product involved was not detected by U.S. authorities.)

Four Kiwi Dairies officials implicated in Powdergate were dismissed and prosecuted. However, Craig Norgate, CEO of Kiwi Dairies when the scandal occurred, did not lose his job and went on to become CEO of Fonterra.

NZ glue powder sold as MPC in Wisconsin

The Powdergate crimes committed between the late 1990s and 2001 may only have been part of a larger pattern of New Zealand dairy export fraud going on prior to the MAF probe. A 1997 investigation by state officials in Wisconsin intercepted a large shipment of New Zealand "industrial adhesive" (glue) after some of the product had been sold as supposedly human-grade dairy proteins to a state dairy processor, DMV USA of LaCrosse, Wisconsin.

This incident, "Gluegate," raises huge questions about the product integrity of New Zealand dairy exports and the integrity of greedy middlemen in both countries who profit from trafficking in substandard or mislabeled food ingredients.

In January 2002, *The Milkweed* reported that a 1997 incident in which Wisconsin state investigator's swift action had prevented an unlabeled shipment of New Zealand glue powder sold as milk protein concentrate (perhaps with "a wink and a nod") from being processed into imitation cheese for human consumption. "Gluegate" and Powdergate may be different facets of a larger, more complex scam that has yet to be fully uncovered.

The Milkweed report documented the trail of five pallets (about 1,062 pounds) of unlabeled bags of New Zealand industrial adhesive – sold as milk pro-

NZ Glue Powder Traced from Ship to Imitation Cheese Plant in Wisconsin

Following are highlights of the story "Firm Tried to Sell NZ Glue as MPC in Wisconsin" published January 2002 by *The Milkweed*. The story follows the paper trail uncovered by Wisconsin state agriculture department investigators as unlabeled bags of industrial adhesive were shipped from Auckland, New Zealand … to the docks at Oakland, California … to a warehouse near Madison, Wisconsin, where some of the unlabeled bags of "glue" were sold, with a wink and a nod, as milk protein concentrate … to an imitation cheese plant at LaCrosse, Wisconsin.

See the link on our Web site to view the entire story www.themilkweed.com

"**October 8, 1997:** An international shipping container holding pallets with 675, 25-kilogram bags of "Hydracoat 2000 Adhesive Base" left Auckland, NZ on the German-registered ship, Direct Currawong. The manufacturer, Ngaroma Milling of Mount Maunganui, NZ, illegally stripped the outer layer from the bag–removing identification of contents (glue) and the manufacturer.

"**October 20, 1997:** The ship arrived at Oakland, California. The import agent, L.E. Coppersmith, Inc., South San Francisco, California, invoiced 664 bags to St. Charles Trading, a dairy ingredients marketer based in Lake St. Louis, Missouri.

"**November 7, 1997:** As part of a larger shipment, 662 bags of "Hydracoat 2000 Adhesive Base" (one "torn and leaking") arrived at Capitol Warehousing, Inc. in Windsor, Wisconsin (just north of Madison).

"**November 25, 1997:** DMV USA ordered 188, 25-kilogram bags of 56% (Protein) Kosher Milk Protein Concentrate from St. Charles Trading … DMV's successor firm, Main Street Ingredients, is now owned by New Zealand interests.

"**December 5, 1997:** On this day, the miracle occurred. Roberts Trucking, Inc. picked up 193 bags of "HC2000-A BG 30 PLT HYDRACOAT ADHESIVE BIND." The trucker's bill of lading notes: "BAG TYPE: STRIPPED." … Roberts Trucking delivered the five pallets at DMV's blending plant in LaCrosse … DMV's "Jeff" signed for the shipment. He noted receipt of five pallets, totaling 193, 25-kilogram bags of MPC 56%. "Jeff" further noted that the product was <u>not</u> Kosher, and that neither the manufacturer or the plant number were available …

"**December 9, 1997:** State investigator Grana on a regular visit to the DMV USA warehouse, found 193 bags of unlabeled product. She immediately placed a "hold" on the bags and contacted St. Charles Trading to determine the contents and source of the bags' ingredients. Ultimately, DATCP officials placed a permanent hold on these products ...

"**December 19, 1997:** St. Charles Trading's Kevin Coe sent inspector Grana (by fax) product descriptions for Milk Protein Concentrate (56% protein). Coe then attempted to convince Wisconsin officials that the product in the bag was MPC, not glue … DATCP subsequently tested three samples and found protein levels of 13.9%, 33.3% and 57.6%. The protein content variability shows little product integrity.

"**December 22, 1997:** DATCP inspector Philip Carley visited Capitol Warehousing (Warehouse 2) and placed a hold order on 1,770 bags of Hydracoat Adhesive Binders, totaling 97,350 pounds. Warehouse documents identify St. Charles Trading as the owner."

tein concentrate (MPC) – as it moved from the docks at Oakland, California to a warehouse at Windsor, Wisconsin to an imitation cheese plant operated by DMV USA at LaCrosse, Wisconsin. Nancy Grana, an alert investigator with the Wisconsin Department of Agriculture, Trade, and Consumer Protection (DATCP), became suspicious of the unlabeled bags – shipped as glue powder but received as MPC – during a routine plant inspection. She immediately embargoed the shipment and launched an investigation into the contents and origin of the product.

The five pallets of suspect product were part of a much larger shipment – more than 98,000 pounds – of unlabeled New Zealand glue powder being held at that warehouse near Madison. Fortunately, DATCP officials were able to impound the entire shipment of Kiwi adhesive mix before it was sold as MPC to unscrupulous dairy processors for potential use in cheese vats as a cheap milk substitute. (See sidebar story on page 8 for more details.)

Alert Wisconsin DATCP officials did everyone a huge service by detecting the fake milk proteins, but this case may have been an exception. This product had entered the country undetected and made it all the way to an end user in Wisconsin, by flying under the radar of FDA and U.S. Customs officials. The slip-up happened because Customs (now U.S. Customs and Border Protection) physically inspects only about 1% of imports. Instead, Customs officials rely almost exclusively on the inspection of paperwork, which can be doctored by unscrupulous exporters. How many more shipments of fraudulent, inferior New Zealand milk powders have eluded detection over the years and ended up in food products sold in the U.S.??

The bungled botulism whey powder recall

Fonterra's spectacular bungling of its recent recall of milk powder and whey protein for botulism contamination is further evidence of Kiwi incompetence. Fonterra launched product recall in early August after announcing that *Clostridium botulinum* – the deadly strain of bacteria causing botulism – had been found in three batches of whey protein concentrate (WPC80) produced at a New Zealand plant in 2012. The Kiwis said the botulism-contaminated powders had been mixed into a number of dairy products exported by Fonterra to make a wide range of food products, including infant formula and sports drinks.

The New York Times reported August 3, 2013 that the recalled "ingredient was exported to factories in China, Saudi Arabia, Vietnam, Thailand, Malaysia and Australia." Australia – a major dairy exporter itself – may have re-exported the Fonterra WPC80 in various forms. The botulism scare triggered a massive ban of Fonterra milk powder and whey powder by China, Russia, and Vietnam.

Ironically, the import bans may have been ordered far too late to protect consumers. Since the botulism recall had been launched 15 months after the contamination was first suspected in 2012, much of tainted product had long ago worked its way through the pipeline and been consumed by end users.

The Kiwis' mishandling of botulism scandal did double damage to Fonterra's reputation: First, it further debunked New Zealand's claim to be the world's premier source of "clean and green," "100% pure" dairy products. Secondly, the recall raised further questions about the basic competence of both Fonterra and New Zealand regulatory authorities. Just as the dust was settling from the botulism recall, New Zealand's Ministry of Primary Industry on August 28, 2013 announced that, on further examination, the tests had revealed that the product actually contained *Clostridium sporogenes*, a relatively harmless bug, rather than the deadly *botulinum* strain cited in the recall. (See article, this page.)

Fonterra products contaminated with DCD

A few days after the botulism scandal surfaced, New Zealand's "clean and green" image was further punctured by the discovery of chemical contamination in other Fonterra exports. Beginning in mid-August, two Asian countries found traces of dicyandiamide (DCD) in imported New Zealand milk powder. DCD is a granular compound applied to New Zealand dairy pastures to inhibit the buildup of nitrates resulting from the heavy use of fertilizer.

Sri Lanka on August 17, 2013 banned the sale, distribution, and advertising of Fonterra products after government officials discovered the presence of DCD in two shipments of Anchor brand milk powder. Fonterra challenged the findings and initially refused to obey the court order, news reports said.

"Health Ministry last week took measurers to ban the sales of 39 metric tons of Fonterra's milk powder in two batches after the Industrial Technology Institute (ITI) found traces of DCD in the Fonterra products. The Union accused Fonterra of continuing to mislead the public by questioning the test results by the ITI and claiming that their product is 100 percent healthy despite the ban imposed by the Ministry," *The Nation,* a Sri Lankan publication, reported August 18, 2013.

Fonterra's U.S. profits are so huge … and growing. As noted last month, Fonterra's U.S. operations in 2008 reported a net profit of US$1.3 billion on revenues of US$2.5 billion, equal to a 52% return on investment!

Fonterra was forced to temporarily suspend operations in Sri Lanka on August 23, 2013 to protect its employees from angry mobs. Protesters marched to denounce the tainted New Zealand imports, the online *International Business Times* reported August 26. Fonterra resumed operations in Sri Lanka on August 28.

Bangladesh took similar action on August 27, banning 600 tons of Fonterra milk powder after DCD was discovered in New Zealand products there.

Aluminum shavings in Kiwi cheese

The New Zealand dairy industry's basic competence and product quality were further challenged in 2009-10, when Fonterra several million pounds of Cheddar cheese contaminated with aluminum shavings in the U.S. In April 2010 *The Milkweed* cited a Fonterra memo to potential U.S. buyers stating that the metal shards – which ranged from 2 to 40 millimeters (0.0787" to 1.57") in length – had resulted from drilling work on a metal shipping container and the malfunction of a pressing machine at a New Zealand dairy plant over a ten-month period! The contaminated New Zealand cheese was sold, without intervention from public health officials, despite the obvious food safety hazards to U.S. consumers.

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"Botulism Scandal" – Is Fonterra Incompetent? Incontinent? Both? Or Worse?

by Pete Hardin

If it were a work of fiction, the plot couldn't possibly be more dim-witted and improbable. The saga of Fonterra's summer 2013 "Botulism Scandal" has caused the greatest dairy product recall in memory. Many items – including scarce infant formula products – were pulled from warehouses and off retail shelves throughout much of the world – starting in early August 2013. That's because Fonterra – New Zealand's dairy export colossus – announced possible contamination of 38 tons of Whey Protein Concentrate 80 (WPC 80) that had been manufactured 15 months prior, in May 2012.

The recall notice caused widespread reverberations. Chinese authorities pulled products containing New Zealand whey powders from stores' shelves and warehouses in many nations. Russia and some of its satellites announced a ban on all New Zealand dairy products. Sri Lanka banned New Zealand dairy imports (for other, equally-serious reasons). The financial reckoning of costs related to Fonterra's recent product and ingredient recall remains uncalculated, in terms of a dollar amount. The immense public relations damage to New Zealand's "clean and green" image is likewise incalculable.

But the even greater costs come to Fonterra's reputation. The global dairy trading colossus has soiled itself from head to toe …and the supposed "final version" of this sordid tale, straight from New Zealand's government's Ministry for Primary Industries (MPI): exhaustive laboratory results conducted both in New Zealand and the United States has found that the type of clostridium bacteria was not the botulism-spreading kind! Laboratory tests found that the Clostridium contamination was Clostridium *Sporogenes* and not the highly toxic (to humans) Clostridium *Botulinum*.

In other words, the wide ranging recall was all for no reason. Why Fonterra pulled the "emergency alarm" – citing possible botulism contamination of products – some 15 months *after* the WPC 80 in question had been manufactured is a puzzle. In a tight global market for whey proteins, why Fonterra still had amounts of that batch of WPC 80 remaining raises questions about inventory procedures. Why, 15 months after the manufacture of the WPC 80 in question, did Fonterra's management sound the botulism alarm … prior to more detailed laboratory tests that could have conformed whether or not the Clostridium contamination was *Sporogenes* or *Botulism*?

According to a report in the *Cheese Reporter* (a dairy industry weekly newspaper), Theo Spierings, the Chief Executive of Fonterra, stated that Fonterra had done the right thing by moving to a precautionary recall, once original testing showed the potential for botulism contamination. Spierings stated: "The original results fom AgResearch indicated presence of toxin-producing Clostridium *botulinum* in the affected whey protein concentrate and we could therefore not take any chances." Spierings claimed Fonterra was obligated to inform regulators and customers.

Fonterra is currently pursing two separate inquiries – one internal and the other external – into events leading up to the contamination. In early August, long-term failure to clean a pipe at a processing plant was credited as a source of the contamination leading to the product safety recall.

Amid their follow-up inquiries, Fonterra and New Zealand dairy and food safety regulators are wearing out the shoulder-pads on their tweed jackets, congratulating each other on doing the right thing. Fonterra, we should note – is New Zealand's largest corporate entity, and also the biggest player in New Zealand's currency futures.

Questions:

Why did Fonterra retail portions of the 38-ton batch of contaminated WPC 80, 15 months (or so) after the product was manufactured? Did Fonterra's management suspect something was wrong with that batch and retain inventories?

Is not testing for Clostridium *botulinum* a normal course of business, prior to selling commodities such as WPC 80 to customers?

How much will the financial costs be for this food safety "false alarm," and who is going to pay for it??? If insurance companies are as tight with their money in New Zealand as their U.S. counterparts … insurers might balk at paying for such a questionable food safety recall.

What does this embarrassing scandal reveal about Fonterra's basic inability to comply with global food safety rules? Those woefully inadequate standards – further weakened under the lax *Codex Alimentarus* rules enforced by the World Trade Organization – provide only the most minimal protection to dairy consumers in the U.S., Europe, and other developed nations. The fact that the world's largest dairy exporter can't get it right – even 15 months after the fact – speaks volumes about the sheer incompetence of global dairy trade and its largest player.

For now, the badly splattered New Zealanders must pat each other on the shoulder and mumble in unison: "Good show, old chap." Fact or fiction, this global dairy product and ingredient recall has been anything but a good show. Rather, the only conclusion *The Milkweed* can discern from the Fonterra WPC recall fiasco is the obvious fact that "The Emperor has No Clothes!" … and needs a good wire-brush scrubbing.

2009-10: Fonterra Sold Cheddar Contaminated with Aluminum Shavings in U.S.

by Pete Hardin

Got aluminum?

In late 2009 and into 2010, Fonterra sold an estimated several million pounds of Cheddar in the U.S. that was contaminated with aluminum shavings. Those aluminum shavings varied in size from two millimeters to 40 millimeters

Details of this aluminum shavings in cheese quality problem were revealed in an October 7, 2009 "Metal Contamination Resolution Report" prepared by Carrigan Tower, the Cheese Technical Manager for Fonterra Group. The memo was circulated to selected, potential buyers in the U.S. The memo was printed in its entirety in *The Milkweed's* April 2010 issue. (See: "Fonterra Selling 'Aluminum-Enhanced' (Contaminated) Cheese in U.S." – page 7, April 2010 issue of *The Milkweed*.)

That two-and-a-half page memo went to great lengths to offer a convoluted explanation for the aluminum shavings present in the Cheddar, no specific volume was mentioned. The October 7, 2009 memo attributed specific blame for presence of aluminum shavings in that Cheddar to the drilling of holes in aluminum shipping containers.

To believe that explanation, somebody must have drilled a lot of holes in shipping containers! That explanation leaves puzzling questions about why the "aluminum-enhanced" Cheddar in question was produced only at Fonterra's Whareroa cheese plant over a period of nine to ten months! That October 7, 2009 Fonterra memo claimed:

"A total of 12 cartonless cheese blocks manufactured between August 2008 and May 2008 (sic) have been found to be affected in the U.S."

The Milkweed believes the above-quoted statement contained a typographical error. The statement should have read "between August 2008 and May 2009." The notion that cheese produced at a single plant for a period of nearly ten months could contain aluminum shavings attributed to drilling holds in shipping containers seems a bit of a stretch. Attributing the contamination problem to product spanning ten months' production from a single cheese plant to shavings from holes drilled in metal shipping containers seems curious, at the least.

In April 2010, *The Milkweed* reported:

"Some U.S. sources discount Fonterra's formal explanation. They say that an aluminum joint in the press used to press curds into blocks at the cheese plant was grinding metal-on metal. These sources say the problem continued for about nine months before the problem was discovered."

The Milkweed also reported in April 2010 that regular buyers of Fonterra's Cheddar – such as Kraft Foods and Dairy Farmers of America's Borden Cheese division – refused to take delivery of offers for the aluminum shavings-contaminated Cheddar. *The Milkweed* originally reported that "a few million pounds of New Zealand-produced Cheddar" was offered to U.S. buyers on discount because of potential contamination by aluminum shavings. That information came from industry sources in early. Ultimately, *somebody* in the cheese processing business found the discounted, "aluminum-enhanced" Cheddar too good a bargain to let pass. Other source indicated that large quantities of that product containing potential aluminum shavings contamination was shipped to Wisconsin, for further processing into human food products. Yummy.

"VISUAL INSPECTION???"
How in Sam Hill can "visual inspection" detect aluminum shavings as small as two millimeters – less than 0.08 inches long (roughly one-tenth the length of a mouse turd) worked into a block of cheese?

All contamination – ID'd by visual inspection.

In the detailed memo, Fonterra described the problem identified to only "a total of 12 cartonless cheese blocks …." Further, that memo noted: "All of the contamination has been identified by visual inspection."

"VISUAL INSPECTION???" How in Sam Hill can "visual inspection" detect aluminum shavings as small as two millimeters – less than 0 .08 inches long (roughly one-tenth the length of a mouse turd) worked into a block of cheese?

(Editor's note: Contamination of cheese by aluminum shavings – particularly those as small as two millimeters long – cannot be removed by magnets. Aluminum, a non-ferrous metal, is not magnetically attracted.)

The bulk of Fonterra's curious October 7, 2009 memo details "Corrective Actions" to assure safe use of the potentially contaminated products. The memo noted, in part:

"Cartonless cheese in Fonterra warehouses will be visually inspected to ensure it is free from contamination before release to customers," and,

…"Once the cheese has been visually inspected and declared free of contamination, it is suitable for use in processed cheese manufacture."

"Suitable for processed cheese manufacture"??? The product was obviously adulterated, under FDA rules, by presence of unapproved materials – aluminum shavings. The ingestion of metal shavings poses an obvious risk of choking and/or damage to internal organs as the shavings pass through the digestive tract. Was FDA notified?

Contaminated, adulterated …

Technically, Fonterra should have deep-sixed the estimated several million pounds of aluminum shavings-contaminated cheese into depths of the Pacific Ocean. Product containing aluminum shavings is considered adulterated. The notion that "visual inspection" can detect microscopic shards of aluminum in large blocks of cheese in purely specious.

In 2006-2007, Fonterra's U.S. dairy operations turned a 53% net profit on \$2.5 billion dollars of sales. That lucre was primarily derived from net profits enjoyed by a long-term, lowball contract to buy nonfat dry milk powder from witless U.S. dairy cooperatives. Given all the net profit that Fonterra has made in the U.S., a reasonable person, concerned about dairy product contamination, would imagine that Fonterra could have take the hit for a few million dollars … or used the product internally (perhaps in the executive dining room at Fonterra headquarters in Auckland, New Zealand).

That same, "don't throw away anything" attitude, is what got Fonterra in trouble with the WPC 80 contamination/recall scandal in August 2013.

Fonterra is Neither Clean nor Green, con't

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While there may have been some equally greedy processors willing to risk their customers' health for a quick buck, it's hard to believe that Fonterra knowingly sold dangerously adulterated product. (See separate story on page 9 for more on this Fonterra scandal.)

Fonterra connected to melamine scandal in China

Fonterra has connections to the deadly 2008 melamine infant formula scandal in China. Fonterra had a 43% ownership stake in Sanlu, a large Chinese dairy firm that illegally used the toxic chemical melamine to increase the protein levels of their infant formula products. Other Chinese firms were implicated as well, but Sanlu was by far the largest offender. According to China's Ministry of Health, the tainted product sickened some 300,000 infants and killed six. Chinese courts came down hard on the melamine offenders – 14 officials were sent to prison, some with life sentences. The melamine scandal – like Wisconsin's NZ industrial adhesive scam 11 years earlier – involved cheap, inferior substitutes for pure, safe dairy ingredients in food products. New Zealand was connected to both scandals.

Greed: Tax evasion through "Transfer Pricing"

Fonterra's long list of sins extends beyond corruption and product integrity. Fonterra inherited NZDB's dirty habit of evading U.S. federal income taxes. Its near-monopoly structure and extensive global network of wholly-owned subsidiaries make it easy for Fonterra to hide its U.S. profits from Uncle Sam through a practice called "transfer pricing."

Sources say transfer pricing is a "huge" problem that costs the U.S. Treasury many billions of dollars in lost tax revenues every year. Under transfer pricing, a global corporation uses elaborate accounting tricks to shift taxable profits earned by its U.S. subsidiaries to other internal corporate entities located in other jurisdictions with much lower or no tax rates, either in the corporation's home country or other low-tax countries. Transfer pricing often involves the use of offshore "shell" corporate offices consisting of no more than a post office box on some Caribbean island.

Transfer pricing gives Fonterra an unfair advantage over its competitors in the U.S. who play by the rules and pay their fair share of taxes owed to the Internal Revenue Service. (For example, U.S. dairy farmers are required to pay federal income taxes on dividend earnings retained by their cooperatives. Those dividends often go unpaid during the co-op member's lifetime, if ever.) Fonterra's global network of subsidiaries and joint ventures located in 110 countries is tailor-made for transfer pricing.

Transfer pricing is a big deal because Fonterra's U.S. profits are so huge … and growing. As noted last month, Fonterra's U.S. operations in 2008 reported a net profit of US\$1.3 billion on revenues of US\$2.5 billion, equal to a 52% return on investment! Fonterra had the potential to avoid paying some or all of the income taxes owed on that \$1.3 billion profit in 2008. If so, New Zealand's allegedly unsubsidized dairy industry could have received a huge hidden subsidy from their plunder in the U.S. In addition to defrauding the IRS, Fonterra's scheme is transfers income from U.S. dairy farmers' pockets to its coffers in New Zealand.

The use of transfer pricing is not limited to Fonterra. Many global corporations routinely use transfer pricing and other illegal and legal tax dodges to avoid paying any federal income taxes on their U.S. earnings. Transfer pricing is reported to be a huge – and rapidly growing – problem in industries involving significant international commerce, including agriculture, high technology, and pharmaceuticals. Apple Inc., the high tech giant whose intellectual property rights are based in Ireland, is prime example. A U.S. Senate Permanent Investigations Subcommittee report, aired at a May 21, 2013 public hearing in Washington, D.C., alleged that Apple evaded \$10 billion in annual U.S. taxes owed over the past four years.

Manipulation of U.S. dairy import rules

Fonterra likes to flex its muscle in U.S. dairy markets through the skillful manipulation of USDA dairy import regulations. Section 6.25(b) dairy import rules, administered by the Foreign Agriculture Service, control the flow of licensed dairy imports entering the country under U.S. tariff-rate quotas. Fonterra and large European dairy traders have manipulated Section 6.25(b) rules to increase their share of U.S. dairy imports. This concentration of dairy imports into the hands of a few big foreign firms harms U.S. dairy farmers, consumers, and smaller domestic importers who help preserve market competition.

Section 6.25(b)'s "use it or lose it" rules tend to maximum U.S. dairy imports by penalizing importers who do not import the full annual quota of foreign dairy products they are allocated by FAS. Importers who do not fill their import quota over several years can lose their import licenses, putting them out of business. FAS policy tends encourages maximum import volumes regardless of market conditions. Over time, Section 6.25(b) rules transfer import licenses from typically smaller, American-owned firms to Fonterra and a few big European dairy traders. The FAS rules further hurt U.S. taxpayers by shifting business away domestic firms that pay their fair share of federal income taxes to large, global entities that evade taxes owed by engaging in transfer pricing schemes.