



Nigel Bickle
Head of Provincial Development Unit
Ministry of Business, Innovation and Employment

20 April 2018

Hon Shane Jones
Minister for Regional Economic Development

Dear Minister,

RESPONSE TO THE INTERNAL REVIEW OF THE WASTE TO ENERGY PROJECT

Please find **attached** a copy of the Internal Review of the processes leading up to the approval of funding, and subsequent announcement by you, of \$350,000 government investment relating to a Waste-to-Energy project to be delivered by Renew Energy Limited (REL).

The review was commissioned by the Provincial Development Unit after being made aware that the then CEO of REL had been referred to the Serious Fraud Office by the State Services Commissioner. This was in relation to his dealings with an unrelated company while also being a public servant in 2017.

A key finding of the review was that officials should have carried out appropriate background checks on the personnel of REL prior to funding being approved and announced. As you will be aware no funds have been transferred. While I am confident that due diligence prior to any funds being transferred to REL would have picked up this issue, we should have carried out these checks before any funding was approved by Senior Regional Officials (SROs) and before any announcement was made.

Had these checks been undertaken, we would have been in a position to brief the SROs and you on the matter and any associated risks prior to your announcement. On this occasion we let them and you down. I want to personally apologise to you for not bringing this issue to your attention earlier.

The review notes that on 2 March 2018 Mr Gallagher resigned as CEO and has since sold his shareholding in REL. To date, no funding has been provided to REL from the Provincial Growth Fund. The funding relating to the feasibility study was put on hold as soon as this issue arose. The review notes that Mr Gallagher's withdrawal may open the way for REL to receive funding from the PGF. REL will need to make an application for funding. If they do apply for funding, it will be assessed in accordance with our standard processes and evaluation criteria.

While I do not offer it as an excuse, you will be well aware of the context in which the team was working at the time. We were in an establishment phase and we were quickly transitioning from an organisation set up to approve and manage around \$11M/pa in development funding to one responsible for administering \$1Bn/pa. Staff were working hard to ensure we supported the government to be able to announce a credible package of projects on the 23rd of February 2018.

You will note that the review makes a number of findings and recommendations which are aimed at strengthening the processes and practices relating to how proposals like the Waste-to-Energy project are assessed and managed. I accept all the findings and recommendations. The recommendations are being implemented by the Provincial Development Unit.

We will be engaging with the Office of the Auditor General on the policies and practices governing the Provincial Growth Fund.

The following changes have since been made:

- Due diligence on personnel is now carried out before applications are considered by Ministers and other decisions makers for funding and announcements.
- If due diligence cannot be completed within the available time, then the Minister's Office will be informed of this risk, and where practicable, an announcement delayed until the process has been completed.
- The introduction of a robust application process that is proportional to the types of applications.
- Applicants will also need to declare that they have not been convicted or are under investigation for any offences bearing on the operation of the business.

All projects that have had funding announced to date will continue to undergo due diligence processes in accordance with our current standards. No funding has been provided to any of the projects announced since the launch of the Provincial Growth Fund on 23 February as they are subject to contract negotiations.

You will also be aware that subsequent to the launch of the PGF, you announced the appointment of the Independent Advisory Panel who will also play a role in the assessment of proposals and ensuring the fund is applied in a prudent and responsible manner.

I have also briefed the Chair of the Independent Advisory Panel, Department of Prime Minister and Cabinet, the State Services Commission and the Treasury on the review and my response to it.

Once again, I apologise that we did not get this right on this occasion and for the position we placed you and your fellow Ministers in. I can assure you we have taken on board the lessons to be learned from this and will continually review and update our assessment processes as required.

I intend to issue a press release and publish the review and my response to it on the Ministry of Business, Innovation and Employment's website following your consideration.

Please let me know if you would like a more detailed briefing on the review or if there are other stakeholders who should be informed about the review and response.

Yours sincerely



Nigel Bickle
Head of Provincial Development Unit



DATE	19 April 2018
TO	Nigel Bickle, Head of Provincial Development Unit and John Doorbar, Regional Economic Development Director, MBIE
PREPARED BY	Chris Mathieson, Director, Legal Services, MBIE
SUBJECT	Renew Energy Limited: Review of funding approval process

Introduction

I have been asked by John Doorbar, Regional Economic Development Director to review and report on the process leading up to an announcement by the Minister for Regional Economic Development (**Minister**) of funding in relation to a proposed waste-to-energy plant on the West Coast.

Overview of the facts

While the Ministry of Business Innovation and Employment (**MBIE**) had been aware of the waste-to-energy project for several years, prior to early 2018 it had not seen the project as a priority for funding and Renew Energy Limited (**REL**) had made no funding application to it under the Regional Growth Programme (**RGP**)¹.

In April 2017, a director, shareholder and CEO of REL, Gerard Gallagher, was referred to the Serious Fraud Office (**SFO**) in relation to alleged conflicts of interest while an employee of CERA in Christchurch. This followed an investigation by the State Services Commission and a report by former Solicitor-General, Michael Heron QC. Both the details of the referral, and Mr Heron QC's report, are in the public domain.

On 23 January 2018, at a meeting between officials from MBIE and New Zealand Trade and Enterprise (**NZTE**) there was a discussion about NZTE's pipeline of projects and which projects might fit the criteria for a PGF announcement. NZTE advised that the waste-to-energy project on the West Coast, which was being considered for feasibility funding through NZTE's Strategic Investment Fund (**SIF**) might fit the criteria.

Between 6 and 8 February 2018 MBIE prepared "one pagers" on a glasshouse project and the South Island waste baling plants project. Both projects were associated with the main waste-to-energy project.

At this stage NZTE was in discussions with Development West Coast (**DWC**) for a further \$100,000 of SIF funding for a feasibility study into the waste-to-energy project, and a further \$50,000 for the glass house project. Verbal approval had been given to DWC, subject to NZTE's Investment Committee approval, which had not been given.

The one pagers were referred to the Senior Regional Officials (**SROs**) group which considered them (along with a number of other projects) on 8 February 2018 and approved Provincial

¹ The Regional Growth Programme was a regional funding programme put in place by the previous government.



Growth Fund (**PGF**) funding of \$150,000 for a business case in relation to the waste baling plants. PGF Ministers were briefed on the decisions on 9 February and met on 12 February to agree on the projects to be announced at the launch of the PGF on 23 February.

On 23 February 2018, at the PGF launch in Gisborne, the Minister announced funding of \$350,000 for a feasibility study in relation to a waste-to-energy plant in Buller.

This figure comprised:

- funding from NZTE of \$200,000 (the \$150,000 referred to above and \$50,000 that had been approved through NZTE's SIF in August 2016²) and
- \$150,000 from the PGF.

On 28 February 2018 Radio New Zealand ran a story highlighting that Mr Gallagher was being investigated by the SFO. A similar story was run on 28 February 2018 by Newshub.³ MBIE has since emailed REL stating that the funding for the project is being reviewed.

On 2 March 2018 Mr Gallagher resigned as CEO and has since sold his shareholding in REL.

Terms of Reference

The purpose of this review is to assess the process leading up to the 23 February announcement to understand how a Ministerial announcement came to be made where the CEO of the funding recipient had earlier been referred to the SFO and how a similar situation could be avoided in relation to future funding processes.

In that context I address the following questions:

- What level of due diligence⁴ in relation to REL personnel should have been undertaken by MBIE prior to the 23 February 2018 announcement?
- Did the due diligence that was undertaken meet that standard?
- What level of due diligence of company personnel is expected to be undertaken on new applications for funding under the PGF?
- How could the process for making these kinds of funding decisions be improved to avoid this kind of situation occurring again?
- Given that Mr Gallagher has now resigned as CEO of REL, does the fact that he was referred to the SFO preclude the Government from funding the REL project going forward?

² This work was completed by 30 January 2017

³ <http://www.newshub.co.nz/home/new-zealand/2018/02/government-funding-project-linked-to-gerard-gallagher-under-serious-fraud-office-investigation.html>

⁴ By "due diligence" in this context I mean the process of investigating the circumstances of the applicant prior to committing to funding. Such an investigation can be on a continuum from "light touch" checks to formal investigation of such things as banking and financial records.



Given that the focus of this review is on the system in relation to funding applications I have not included officials' names. This is not an employment investigation and any questions of employee conduct are out of scope. I also do not make any comments on the viability of the project generally.

Process

In preparing this report I have reviewed relevant documents and obtained accounts from MBIE officials. NZTE and the Ministry for the Environment (**MfE**) have provided comments on a draft of this report.

Executive Summary

1. In summary, my responses to the questions are as follows:

What level of due diligence in relation to REL personnel should have been undertaken by MBIE prior to the 23 February 2018 announcement?

- Prior to 23 February 2018, REL had made no application to MBIE for Crown funding of the project. As a result, no formal due diligence process on the part of MBIE had been triggered.
- MBIE had though, over time, collected information about the project through DWC and Buller District Council (**BDC**).
- At a meeting on 23 January 2018 MBIE agreed to consider inclusion of funding in relation to the South Island waste baling plant project as part of the PGF.
- At that stage MBIE officials were aware NZTE had already provided some funding for the project in 2016.
- Between 6 and 8 February 2018 MBIE prepared, "one pagers" for two projects associated with the main waste-to-energy project, namely the glasshouse operation and the South Island waste baling plants. The one pagers discussed questions of probity and risk but did not raise any risks in relation to REL personnel. The documents implied some level of investigation/due diligence had been undertaken in relation to the projects, and that all material risks had been assessed and recorded.
- MBIE officials knew the one pagers about the projects were being provided to the SRO group for decision and, that if the projects were approved, they would likely be included in the 23 February 2018 PGF announcement.
- In my view, the MBIE officials who prepared and approved the one pagers, were obliged to identify all material risks and report them accurately to the SROs group and Ministers.
- In my view the MBIE officials should have provided them with all information material to the decisions being proposed, including what checks, if any, had been undertaken and what these had disclosed. This should have included checks on and any risks relating to, the company personnel, including Mr Gallagher.



- Sufficient due diligence (at least in the form of internet and media searches) should have been undertaken to obtain this information.

Did the due diligence that was undertaken by MBIE meet that standard?

- Based on my discussions with MBIE officials, it appears no due diligence was done in relation to REL personnel prior to the 23 February 2018 announcement. This was not consistent with MBIE's normal standards of due diligence in relation to funding decisions.
- Had internet searches have been done of REL's personnel, the referral of Mr Gallagher to the SFO would have been quickly picked up.

What level of due diligence of company personnel is expected to be undertaken on new applications for funding under the Provincial Growth Fund?

- Due diligence of the applicant's personnel for PGF funding should be undertaken as a part of (and consistent with) a documented evaluation and decision process for funding applications. That process is still being developed by MBIE.
- Due diligence should be done to a level that provides an appropriate level of protection for the Crown as funder, while not unnecessarily slowing down the process, consistent with the Government's policy objectives around the PGF. It should also be consistent with Office of the Auditor-General principles.
- A flexible and proportionate approach needs to be taken to due diligence as it will necessarily vary with the size, status and nature of the organisation that is proposed to be funded and the level of risk associated with it.
- Applications for funding should, in my view, include a declaration on behalf of the applicant personnel that they:
 - have not been convicted of, or are under investigation for, any criminal offences that might have a bearing on the operation of the business; and
 - have not been declared bankrupt or have been involved in insolvent companies (among other things).
- The applicant should also be required to state whether it has applied for (or has been granted) funding in relation to the same project from other Crown agencies. If it has been declined it should explain why that was.
- The applicant should also be required to consent to information being sought from their accountants, banks or other third parties that have knowledge of its business.
- MBIE should separately undertake internet and media searches in relation to the company (including under any former names) and of the directors, chief executive and major shareholders and make any other inquiries as may be appropriate.

How could the process for making these kinds of funding decisions be improved to avoid this kind of situation occurring again?



- Ideally funding decisions under the PGF should only take place after:
 - an application for funding has been made and all supporting information (including a business case, as appropriate) has been provided to MBIE;
 - the application has been properly evaluated (including all necessary due diligence) in accordance with the prescribed process (once it has been finalised) against PGF fund criteria;
 - the appropriate decision process has been followed.
- In situations where no application for funding has been made and therefore no formal due diligence of personnel has been undertaken, I suggest:
 - due diligence of company personnel be undertaken, to the extent practicable, prior to the announcement. If practicable, the announcement should be delayed until that has been completed;
 - if the process cannot be completed within the available time the Minister's office should be informed of the risks arising;

where, for some reason, due diligence cannot be completed prior to the announcement I suggest the announcement be couched as the Government supporting funding *in principle*, subject to further detailed evaluation (including due diligence in relation to personnel) and decision.

Given that Mr Gallagher has now resigned as CEO of REL, does the fact that he was referred to the Serious Fraud Office preclude the Government from funding the REL project going forward?

- No. Now that Mr Gallagher has sold his shares in REL he has no formal role with REL and I see no reason why the SFO referral, in itself, now prevents funding being provided to REL under the PGF. The Provincial Development Unit of MBIE will still need to undertake due diligence on the new owners and officers of REL (as set out above) to assess their suitability to receive funding and to make sure that the proposal remains within the PGF criteria.

Factual background

2. The idea of a waste-to-energy plant on the West Coast first arose in June 2015. The Mayor of BDC, Garry Howard wrote to then Minister of Economic Development, Hon Stephen Joyce in relation to the closing of the Holcim Cement Plant, suggesting it could be converted into a waste-to-energy plant.
3. BDC had been in discussions with a French company, Veolia, which operates similar plants overseas, including in Australia. Those discussions did not progress and BDC sought proposals from other interested parties. These included a company called N2ENZ Limited. This was renamed Waste Energy Limited⁵ and later Renew Energy Limited on 25 June 2016.

⁵ On 25 June 2016 - Companies Register



4. In July 2016 NZTE was introduced to the project by the West Coast's economic development agency DWC. The waste-to-energy project was identified, at that stage, in the West Coast's economic action plan. NZTE agreed to support DWC to progress the project and to provide REL with \$50,000 in funding from its SIF for feasibility study costings. The same amount was to be contributed by DWC.
5. The feasibility study commenced on 31 August 2016 and was completed on 30 January 2017.
6. During 2016 BDC continued to communicate with MBIE about the project, but officials were sceptical as to whether the project was viable. MfE was opposed to the project, for a range of reasons, detailed below. The company had approached MfE for funding from the Waste Minimisation Fund (**WMF**) for a feasibility study (\$185,000 contribution) but that application had been declined on the basis that the independent WMF Assessment Panel did not consider that the project was economically viable, and had concerns about associated environmental impacts. Specifically, the Panel's feedback included:
 - a. The project backers were naïve in relation to certain key questions such as; waste supply, technology and market realities.
 - b. They had concerns about where REL would get a constant supply of waste, given that waste supply was tied up in contracts and this was seen as a highly competitive industry.
7. Additional concerns around the planned use of low grade coal as a feedstock were also communicated to MBIE by MfE. Even under international best practice for pyrolysis systems, the latest technologies still emit large quantities of greenhouse gases and release a range of harmful pollutants, such as toxic metals and dioxins, that can contaminate land and water.
8. Overall, MfE detailed how the funding of a waste-to-energy plant of this nature was directly contrary to the transition to the circular economy that they are working towards, as well as placing at risk previous investments made by the WMF, particularly in the South Island. This application followed an application to the WMF in 2015 that was also declined.
9. MBIE convened a meeting in July 2016 with NZTE and MfE, at which time issues with the project were discussed. These included; the science, the waste supply and the access to cheap coal to allow the company to continue to generate electricity while it was working on obtaining a sufficient supply of waste.
10. NZTE and MBIE visited the West Coast in August 2016 and were briefed on the project by DWC.
11. On 20 September 2016, MBIE and MPI, working in partnership with other agencies and stakeholders published the *Te Tai Poutini West Coast Growth Study*. The Study mentioned the possibility of the waste-to-energy in the following way:

“Opportunity

There is a proposal to establish a waste-to-energy plant in Buller that would generate 60 megawatts (MW) of power annually. The facility would take a combination of local feedstocks



(e.g., solid municipal waste and waste coal) and solid waste from the South Island. A new company, Waste Energy (WC) Ltd, has been formed to manage the project and an advisory board has been formed involving BDC and Buller Electricity. Potential investors and a site have been identified. The rationale for establishing the facility in Buller is to have ready access to waste coal, which will help to ensure minimum energy levels are generated and will also keep transport costs down.

A feasibility assessment and preliminary business case is underway. Construction of the facility will provide an estimated 1,000 jobs over 12–18 months, and operating the facility will initially require around 65 jobs. Although the potential impacts are significant, there are still key questions about its validity and practicality to be answered. The assessment and case should be finalised so that the viability of the project can be determined, including key risks and how they might be managed, the full range of costs and benefits, as well as whether there is any role for local or central government in facilitating the project.”

12. MBIE continued to have a watching brief in relation to the project, but this was not seen as a priority project to take forward. Kevin Stratful, the economic development manager at BDC (who was also seconded into DWC), continued to champion the project with officials, although on 16 August 2017 he also took up a position as a director of REL. After that date MBIE continued to deal with him in his DWC role.
13. In January 2017, CERA announced that it was undertaking an investigation in relation to the actions of Gerard Gallagher (and some others), relating to the period they were employed by CERA. The story was reported by *The Press*. The allegation was that these persons had used their positions at CERA to generate fees for another company they were involved in.
14. An MBIE official was aware of this at the time, and it was raised with Kevin Stratful as being “not a good look”. The official, at that stage, felt MBIE should keep its distance from the project. That person, however, left MBIE in March 2017 and while he returned in late October 2017, he was not involved in the process leading up to the announcement in early 2018.
15. On 12 April 2017, *Stuff* reported that Otakaro Limited (which took over CERA’s commercial functions) had referred two former CERA staff, Gerard Gallagher and Simon Nikoloff to the SFO. This followed a second review by Otakaro and an investigation by the State Services Commission undertaken by Michael Heron QC, who identified a conflict of interest. A report in the *New Zealand Herald* states that the referral was made by State Services Commissioner, Peter Hughes.
16. I have not located any press release from the SFO as to whether they have decided to investigate the matter or, if they have, where that investigation is at. I understand from officials that they have had no contact with the SFO until quite recently⁶ and have no information on whether an investigation has been launched in relation to the two individuals or, if so, what stage it might be at.
17. In July 2017 the *West Coast Economic Development Action Plan 2017* was published but the waste-to-energy plant was not included in it.

⁶ An MBIE official called the SFO in March 2018 and was informed that the two individuals had been referred to SFO.



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18. On 18 August 2017 Mr Gallagher retired from his role as a director of REL but remained a founder shareholder and CEO.

NZTE funding for second feasibility study

19. In September 2017 NZTE was in discussions with DWC about contributing a further \$100,000 for the purposes of a second feasibility study on the waste-to-energy project, on the basis that a further \$200,000 would be contributed by external investors. If the project proceeded it would be on condition that there was an independent representative on the REL Board. NZTE had been advised by DWC during 2017 that Chinese investors had shown interest in investing in the waste-to-energy project.

Provincial Growth Fund

20. The previous government funded regional projects under the RGP. Under the RGP, SROs (senior public servants assigned to particular regions) could approve funding of up to \$100,000. The SROs group met monthly.
21. On 18 December 2017 Cabinet agreed to establish the PGF and invited the Minister for Regional Economic Development to report back in February 2018 on; the detailed criteria for assessment and making decisions at each tier of the Fund, mechanisms to ensure a coordinated and consistent approach across the regions and success measures. The first tranche of Fund projects was to be announced in late February.⁷
22. The MBIE website links to a Cabinet paper that discussed the operational design of the PGF. For investments under \$1,000,000 the process requires that applications be approved by the SROs group with decisions to be made monthly. The paper goes on to state that in such cases:
- “Will require a single stage (light) business case. Officials work with applicants to help them meet the requirements.”⁸
23. The PGF therefore continued to use the SRO model but substantially increased the SRO group’s financial authority to make funding decisions.
24. Accordingly, at the end of 2017, while MBIE was aware of the waste-to-energy project and that NZTE had contributed to funding to it, its involvement was limited. It had not itself received an application for funding under the RGP.

Events in late January/early February 2018

25. On 23 January 2018, a meeting was convened of officials from MBIE and NZTE at MBIE. The purpose of the meeting was to identify projects that could be announced at the launch of the PGF in Gisborne on 23 February 2018. There was a discussion about the waste-to-energy project. NZTE advised it was in the process of assessing a further \$100,000 of SIF funding for the waste-to-energy project for which conditional verbal approval had been given to WCDT. The funding application was still subject to NZTE’s Investment Committee

⁷ CAB-17-MIN-0554

⁸ February 2018 paper para 31



approval, which had not yet been given. An associated glass house project was also discussed. The scope of this project was to include glass houses throughout New Zealand. NZTE had advised WCDT that it would be willing to fund a further \$50,000 for feasibility of this project if extended to glass houses throughout NZ. This project was also yet to be considered by NZTE's Investment Committee. An MBIE official who attended the meeting did not recall NZTE making this explicit in the meeting.

26. On that basis MBIE picked this up as a proposal. At the time it was working on around 30 potential projects, which produced a considerable volume of work. MBIE staff were prioritising work between them.
27. On 7 February 2018, MBIE officials attended a regular weekly meeting at the Minister's office with the Minister, the Minister's office staff, NZTE and MPI. The "Provincial Growth Fund – Pipeline of projects" was on the agenda, as was the "PGF launch on 23 February 2018". MBIE officials do not recall any particular discussion of the waste-to-energy proposal at that meeting.
28. Between 6 and 8 February, MBIE officials prepared "one pagers" for the projects to be submitted to the SROs group for decisions at their meeting on 8 February and for reporting to the PGF Ministers on 9 February. These were for the glasshouse operation (NZTE) and the waste baling plants (MBIE) and were based on information provided by Kevin Stratful.
29. The lead MBIE official who prepared the one pagers was aware that two directors had resigned from the REL board but did not know their names. At the time he did not make the connection with the April 2017 SFO referral.
30. The key person for both projects was stated to be Kevin Stratful. The one pagers described the projects and assessed them against the PGF criteria. Each contained sections on "Probity" and "Risks" but made no mention of the fact that Mr Gallagher, who at that stage was still CEO of REL, had been referred to the SFO.
31. The one pagers in relation to both operations were provided to the SROs for their meeting at the Ministry for Primary Industries on 8 February 2017 at 5.00pm. At the meeting the SROs group considered and approved the proposal to fund the development of a business case for the Waste to Energy South Island Baling Plants (\$150,000). The West Coast SRO was not present. The project was assessed under the existing criteria for the RGP and under the draft PGF criteria.
32. On 9 February 2018, MBIE provided a briefing to Ministers Jones, Parker, Robertson and Twyford⁹ with recommendations that included approving funding of \$150,000 for the development of a business case for the building of Waste to Energy South Island Baling Plants. This was for Ministers to note prior to their meeting on 12 February 2018 to approve funding of projects to be announced at the PGF launch on 23 February. The one pager in relation to the baling plants was attached.
33. On 21 February 2018, MfE wrote to an MBIE official expressing concerns about the project. The MfE concerns were discussed with the Minister's office and with the Minister. The MBIE official replied, advising that he had discussed the issues with the Minister and that it

⁹ Entitled: "Recommendations for funding from the Regional Growth Initiative Fund and Provincial Growth Fund"



had been agreed to rein the proposal back from the development of a business case to a feasibility study with MfE involvement. They would go ahead with the requirement that MfE would be involved in the project assessment. The following day MBIE emailed MfE with the reworded press release stating:

“The Provincial Growth Fund will provide \$350,000 to assess the feasibility of establishing a waste-to-energy plant in the Buller District near Westport.”

34. On 22 February 2018, MfE emailed MBIE, reiterating that MfE would not support this project going forward based upon their concerns of environmental harm, and that they welcomed an opportunity to comment on the environmental implications of the project at the appropriate time.

35. On 23 February 2018, the Minister launched the PGF in Gisborne including announcements of the projects to be launched. This included funding of the waste-to-energy plant:

“We are also providing \$350,000 to assist in understanding the opportunity of a waste-to-energy plant in the Buller District”

36. The accompanying press release stated;

“The Provincial Growth Fund will provide \$350,000 to assess the feasibility of establishing a waste-to-energy plant in the Buller District near Westport.”

and went on to describe the project.

37. On 27 February 2018 RNZ made inquiries of MBIE and the Minister’s office in relation to Mr Gallagher’s referral to the SFO following the conflicts of interest at CERA. RNZ and Newshub ran stories on this the following day.

38. MBIE later emailed REL advising that they were reviewing the process.

39. On 2 March 2018, Kevin Stratful advised MBIE, that following an emergency board meeting Mr Gallagher had resigned as CEO of REL and would be selling his shares in REL. That has now occurred.¹⁰ Mr Gallagher also advised the REL board that he would resign as a director of Waste Energy Limited (a related company), as that company was to be deregistered. David McGregor has since been appointed as new CEO of REL.

40. On 7 March 2018, West Coast Mayors wrote to MBIE expressing support for the REL waste-to-energy project. They went on to say;

“Recent changes of the Director, and Chief Executive, clears the way for Government support and we look forward to confirmation of funding to be made forthwith”

Discussion

Given the circumstances, what level of due diligence should have been undertaken by MBIE prior to the 23 February 2018 announcement?

41. MBIE was aware of the waste-to-energy project and had been receiving information about it, in particular from Mr Stratful. It was aware that REL had received \$50,000 in funding from NZTE in 2016. It was also aware NZTE had verbally agreed to further feasibility

¹⁰ The Companies Register shows the vacation date as 15 March 2018.



- funding for the project of \$150,000. That funding application was though still subject to approval by NZTE's Investment Committee.
42. Due diligence inquiries in the context of funding applications normally occur after an application has been received and is being evaluated. Prior to 23 February 2018, no application for Government funding had been made by REL to MBIE in relation to the waste-to-energy project under the RGP or the PGF.
 43. During 2017, in the absence of an application, and given that the project was not seen as a funding priority, no one in MBIE had undertaken due diligence in relation to the company personnel (the directors, major shareholders and chief executive). Instead MBIE had, over time, collected information about the project through the DWC and BDC.
 44. Following the meeting on 23 January 2018, between 6 and 8 February, MBIE prepared, "one pagers" for two projects related to the waste-to-energy project; namely the glasshouse operation and the South Island waste baling facilities. The one pager in relation to the glasshouse operation recommended the Government announce it is supporting the project and is continuing to work with them. It also discussed questions of probity and risk, but did not raise any risks in relation to REL personnel. The one pager in relation to the baling facilities recommended a business case be developed for the initiative. It also discussed probity and risks.
 45. MBIE officials knew that the one pagers were being provided to the SROs group for decision and, if approved, would go to the PGF Ministers. They also knew, that if approved, this funding decision would be included in the 23 February PGF announcement. The one pagers imply that some level of due diligence or investigation had been undertaken in relation to the project and that all material risks had been assessed and, if need be, referred to.
 46. In my view, the MBIE officials who prepared and reviewed the one pagers had assumed an obligation to express the position accurately to the SROs and Ministers. This should have included making all reasonable inquiries into those risks, including any risks relating to the company personnel, and satisfying themselves there was no need to refer to them.
 47. Ministers and the SROs were entitled to rely on officials to provide an accurate picture of all material risks. Equally, if they had not made those inquiries, SROs and Ministers needed to be informed of that.
 48. Accordingly, while a formal due diligence process had not been triggered by an application and a business case, *sufficient* due diligence or investigation still needed to be undertaken to properly inform the SROs and Ministers of all material project risks, including those relating to company personnel, given that officials were aware that the funding was going to be; decided by the SROs, referred to PGF Ministers and publicly announced. If that due diligence could not be done in time, Ministers needed to be informed of that.
 49. I am advised by an MBIE official that due diligence on company personnel would normally have involved doing:



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- media searches on the company, including on any previous names;
 - a Google search on the company;
 - a Companies Office search, identifying the directors, chief executive and major shareholders, and then doing both Google and media searches on those persons.

50. Depending on the number of searches that needed to be done, this could take a couple of hours. It could certainly have been done between 23 January 2018 (when the officials met and decided the project could be included in the PGF announcement) and 22 February 2018 (the day before the announcement). If a problem had been identified, the Minister's office could have been advised prior to the announcement. This could have resulted in the funding for the feasibility study being removed from the list of projects being announced.

Did the due diligence that was undertaken meet that standard?

51. No. My understanding from talking to the officials involved, is that no due diligence was done in relation to REL personnel prior to 23 February 2018.
52. This was not consistent with MBIE's normal standards in relation to funding decisions. In relation to company personnel for a company for which funding was being considered, this would have, at least, normally involved the Internet and media searches referred to above.
53. Had those searches been done, the referral of Mr Gallagher to the SFO would, in my view, have been quickly identified.

What level of due diligence is expected to be undertaken on new applications for funding under the Provincial Growth Fund?

54. The process to be followed in relation to applications for funding under the PGF is still being designed. Accordingly, rather than setting out a detailed due diligence regime, I propose to set out some principles to be considered and an approach that could be taken in relation to undertaking due diligence in relation to company personnel, to inform the design.
55. The process will need to strike a balance between enabling applications to be processed and decided quickly to meet Government pace objectives, while ensuring that there is sufficient rigour to ensure good quality decision making and proper accountability for the expenditure of public funds.
56. The Auditor-General published guidance on funding processes in 2008. One of the key principles referred to is the need to obtain value for money:
- Value for money** – Public entities should use resources effectively, economically, and without waste, with due regard for the total costs and benefits of an arrangement, and its contribution to the outcomes the entity is trying to achieve. Where practical, this may involve considering the costs of alternative supply arrangements.
57. This requires close consideration of the intended objectives of the funding and, where it is a business; its track record, its financial position, the experience and skills of the directors and key staff relevant to the business and of any matters that suggest that there will be problems with the governance of the organisation.



58. Also relevant is the principle of integrity, namely that:

Integrity – anyone who is managing public resources must do so with the utmost integrity. The standards applying to public servants and other public employees are clear, and public entities need to make clear when funding other organisations that they expect similar standards from them.

By applying these principles sensibly, public entities can demonstrate that they are spending public money carefully and properly managing the process for spending it.

59. In this context it is clearly important to make proper inquiry into the character and competence of the key officers of a funding recipient and their suitability to receive and properly manage and apply the funds.

60. In relation to conditional grants the guidance refers to the need to have a:

Systematic process for considering applications or requests against criteria.

61. The Auditor-General has also published a good practice guide that sets out principles to underpin management by public entities of funding to non-government organisations¹¹. In the context of value for money it states:

We expect a public entity to manage any risks to its own interests, and to use arrangements and processes such as monitoring, review, and evaluation to meet its need to demonstrate effectiveness and value for money.

62. In my view it is important that the PGF evaluation process is systematic, transparent and consistent and is focussed on delivering effective and efficient outcomes consistent with the Government's objectives.

63. The process also needs to involve assessment of all material risks in relation to the project (including in relation to the key personnel who will be driving the project). Due diligence processes should be structured to identify all known (and knowable) risks in relation to the decision to ensure a well-informed decision is made.

64. The Auditor-General's website does not however set out any particular requirements as to how due diligence is to be undertaken in the context of funding agreements, however in light of the above, in my view, applications for funding under the PGF should be accompanied by detailed information about the company personnel including provide full details of:

- their qualifications and experience;
- their skills and any technical capabilities;
- any relevant criminal convictions or investigations by any prosecuting agency or regulator (in particular convictions for any offences related to fraud or dishonesty);

¹¹ <https://www.oag.govt.nz/2006/funding-ngos/docs/funding-ngos.pdf>



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- any conflicts of interest;
 - whether they have previously been bankrupted or whether any companies in which they have had a governance or senior management role have gone into liquidation, receivership (or the like) and the reasons for that.
65. The application should also set out whether the applicant has approached any other Crown agencies for funding of the same project, whether that funding was granted and if not, why not.
66. An officer of the applicant should be required to make a declaration as to the correctness of all the information in relation to company personnel that is provided.
67. In addition, the officer of the applicant should consent (on behalf of the company personnel) to information being provided to the Crown by their accountant, bank, the New Zealand Police and other agencies, such as the SFO.
68. Officials will then have the ability to carry out the online checks of the company personnel set out above to pick up any general concerns or suggestions of impropriety, and will also be able to follow up on particular queries as each situation requires. This could include credit checks of key individuals to pick up any track record of non-payment of debts.
69. The process needs to be flexible and proportionate. The level of due diligence necessarily will vary and will reflect the size, nature and status of the organisation and the level of risk associated with it. Small start-ups and private companies, especially those with no track record are likely to require more scrutiny than larger, more established businesses.

How could the process for making these kinds of funding decisions be improved to avoid this kind of situation occurring again?

70. Where practically possible, funding decisions should not be made without an application for funding and supporting business case being received and properly evaluated. This will ensure consistency of approach and that due diligence is undertaken, both on the project and on the company personnel.
71. If that is not practical, then due diligence, at least in relation to company personnel should be done prior to any funding announcement. Further MBIE officials should ensure sufficient time is allowed for that to occur prior to a funding announcement being made. The process should be able to be completed in a couple of hours. Where that is done, officials will then be able to raise any concerns in relation to the individuals involved ahead of any approval or announcement being made.
72. If that had been done in this case there is a very high prospect Mr Gallagher's referral to the SFO would have been picked up.
73. Equally, where due diligence of company personnel has not been completed, the Minister's office should be informed of that ahead of any announcement.
74. Another option would be for announcements to be made on an "in principle" or conditional basis; namely subject to provision of a formal application and supporting business case from the applicant and evaluation and decision, in accordance with the fund criteria. This would then be reflected in the communications information provided.



Given that Mr Gallagher has now resigned as CEO of REL, does the fact that he was referred to the Serious Fraud Office preclude the Government from funding the REL project going forward?

75. The fact that Mr Gallagher was referred to the SFO by the State Services Commissioner is not evidence he has committed a criminal offence and he has not, to the best of my knowledge, been charged with any offence. The referral and Mr Heron QC's report however do raise serious concerns about whether the Government should fund organisations that have a CEO against whom such allegations have been made in a former role.
76. In my view, those concerns have now been removed following Mr Gallagher's resignation as CEO and the sale of his shares in REL. Accordingly, I do not consider that the referral of Mr Gallagher to the SFO in April 2017 should, in itself, prevent funding being provided for the project.
77. That does not necessarily mean that funding has to be approved. The Provincial Development Unit of MBIE will still need to undertake due diligence on the new owners and officers of REL and make sure that there are no new concerns arising in relation to their suitability for receiving and managing the funding, and generally that the proposal remains within the PGF criteria.

Chris Mathieson

Director, Legal Services

Ministry of Business, Innovation and Employment