

Chapter 7

Primary Energy Pty Ltd

Introduction

7.1 On 2 August 2004, the Hon Jim Lloyd MP, Minister for Local Government, Territories and Roads, approved a \$1.2 million RPP grant under the SONA procedures for Primary Energy Pty Ltd to assist it to raise capital to build an ethanol plant at Gunnedah, in the New England region of New South Wales.

7.2 This chapter discusses the project background and traces the grant application and approval process. The Primary Energy case highlights concerns about the administration of applications made under one program but funded under another, the way the SONA guidelines are employed to circumvent eligibility restrictions and the latitude for intervention at the ministerial level under discretionary programs such as RP.

Background

7.3 Ethanol is an alcohol which can be used for a variety of purposes. In particular, ethanol can be blended with petrol to provide a fuel used for transport. It can be manufactured from a range of agricultural crops such as wheat and sugar cane.¹ According to Primary Energy, the proposed ethanol plant (or 'bio-refinery') would use around 300,000 tonnes of grain to produce 120 million litres of fuel grade alcohol and 90,000 tonnes of high protein stock feed meal per annum.²

7.4 The grant recipient, Primary Energy Pty Ltd, describes itself as 'an Australian renewable energy company'.³ The company and its managing director, Mr Matthew Kelley, are based in the Gunnedah region, as will be the proposed ethanol plant. Gunnedah is located in the federal electoral division of Gwydir. The local member for this electorate is the former Deputy Prime Minister and former Minister for Transport and Regional Services, the Hon John Anderson MP.

Application

7.5 Primary Energy initially applied for funding for its ethanol plant project under the Namoi Valley Structural Adjustment Package (Namoi Valley SAP). The Namoi

1 M. Roarty and R. Webb, "Fuel Ethanol – Background and Policy Issues", *Parliamentary Library Current Issues Brief No. 12 2002-03*, 10 February 2003, pp 1-2.

2 NENWACC, *Namoi Valley Structural Adjustment Package Application Form*, p. 9, in answers to questions on notice, received 15 July 2005.

3 NENWACC, *Namoi Valley Structural Adjustment Package Application Form*, p. 6, in answers to questions on notice, received 15 July 2005.

Valley SAP was established in September 2002 and its purpose as explained to the Committee was to:

...enhance the ability of business and the community to deal with the economic downturn imposed by the introduction of the New South Wales government's water sharing plan.⁴

7.6 The New England North West Area Consultative Committee (NENWACC) established a sub-committee, known as the Namoi Valley Structural Adjustment Committee, to deal with applications made under the SAP.

7.7 Mr Humphries, Chairman of NENWACC explained that funding under the Namoi Valley SAP also aimed to assist the region's traditional agricultural enterprises to diversify, for example into tourism, horticulture and viticulture industries.⁵

7.8 On 6 February 2003, Primary Energy submitted an expression of interest under the Namoi Valley SAP.⁶ This was followed in June 2003 by a more detailed application seeking \$1.5 million funding from the Structural Adjustment Package.⁷ In this application, Primary Energy proposed to commence construction of the plant in January 2004, with a completion date around January 2005.⁸

7.9 A key point to note is that the grant application was not to fund the actual construction of the ethanol plant itself, but to assist the project to get off the ground financially before construction started. As Dr Dolman of DOTARS explained to the Committee:

...this project was not a project about building the ethanol plant; it was actually to assist Primary Energy to raise capital to build the ethanol plant.⁹

7.10 Ms Riggs of DOTARS, likewise, clarified the purpose of the funding:
the project that we have provided funding for is not about the capital construction of anything; it is a precursor to the possibility that this

4 Mr Humphries, Chairman, NENWACC, *Committee Hansard*, 29 June 2005, p. 62.

5 Mr Humphries, *Committee Hansard*, 29 June 2005, p. 63.

6 NENWACC, *Namoi Valley Structural Adjustment Package Expression of Interest*, p. 9, in answers to questions on notice, received 15 July 2005; see also Mr Humphries, Chairman, NENWACC, *Committee Hansard*, 29 June 2005, p. 79.

7 *Committee Hansard*, 12 August 2005, p. 48.

8 NENWACC, *Namoi Valley Structural Adjustment Package Expression of Interest*, p. 9, in answers to questions on notice, received 15 July 2005.

9 *Committee Hansard*, 17 August 2005, p. 20; see also Ms Riggs, DOTARS, *Committee Hansard*, 17 August 2005, p. 22; and Correspondence from Mr Kevin Humphries to the Hon Wilson Tuckey MP, dated 26 June 2003, in additional information provided by NENWACC, *Minutes and recommendations - Namoi Valley Structural Adjustment package material relating to Primary Energy Pty Ltd*, received 26 June 2003.

company might secure capital to proceed with the construction of the plant.¹⁰

7.11 This point was reinforced by one of Primary Energy's advisers, Mr Josh Carmody, a partner in the law firm Baker and MacKenzie. Mr Carmody explained that funding had been sought 'essentially to take a greenfield infrastructure project to financial close', that is, to enable Primary Energy to arrange the financing to build the plant. Mr Carmody said that the funding was intended to 'relieve some of the cost burden' from Mr Kelley as he attempted to attract financial partners to support the project.¹¹ He also put the rationale for seeking government assistance into perspective, pointing to the difficulties facing fledgling projects in regional areas:

To take any project that is being financed on a project finance basis to financial close is a challenging task, and for any piece of greenfield infrastructure in regional Australia where the capital cost is in the order of \$100 million it is a challenging task.¹²

7.12 The application suggested that the regional benefits of the proposed ethanol plant included the creation of 50 permanent jobs and 350 indirect jobs in the region, as well as an injection of around \$1.083 billion into the region over a five year period. The application also claimed that, among other things, the ethanol plant would be a 'catalyst' for construction of a natural gas pipeline in the region.¹³ However, the committee subsequently heard that the viability of the pipeline was not contingent on the Primary Energy ethanol plant. Indeed, construction of the pipeline recently started in the absence of the ethanol plant.¹⁴

7.13 The application provided a business plan and other materials, including correspondence providing documentary support for the project. However, the NENWACC declined to provide the business plans and these other materials to the Committee. Mr Kelley subsequently provided *in camera* information containing details of the Primary Energy business model.¹⁵

7.14 The Committee notes the application also listed a number of highly placed government figures as referees willing to express support for the project. These included a member of the Prime Minister's Office, the head of the Prime Minister's energy taskforce and three federal ministers, including the local member, the then

10 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 22.

11 Mr Carmody, *Committee Hansard*, 15 September 2005, p. 3.

12 Mr Carmody, *Committee Hansard*, 15 September 2005, p. 3.

13 NENWACC, *Namoi Valley Structural Adjustment Package Application Form*, p. 11, in answers to questions on notice, received 15 July 2005.

14 Mrs Margaret Thomas, Chair, Central Ranges Natural Gas and Telecommunications Association Inc and Mr David Adams, Managing Director, Central Ranges Natural Gas Pipeline Pty Ltd, *Committee Hansard*, 11 August 2005, pp 30-33.

15 Mr Kelley, *in camera* answers to matters taken on notice, 2 October 2005.

Deputy Prime Minister and Minister for Transport and Regional Services, Mr Anderson.¹⁶ Mr Kelley informed the Committee that he had not contacted any of these individuals to seek their permission to list them as referees for the project. It appears that he had met them all in connection with briefings he gave various ministerial offices on the project. He told the Committee that he had had more contact with Mr Anderson due to Primary Energy's base in his electorate.¹⁷

7.15 At a meeting on 24 June 2003, the Namoi Valley Advisory Committee considered the application and proposal. Primary Energy also gave a presentation to that committee at this meeting.¹⁸ The subcommittee recommended that Primary Energy be offered \$1 million.¹⁹ The application was also endorsed by the NENWACC on 26 June 2003.²⁰

7.16 Mr Humphries, in his capacity as Chair of the Namoi Valley Advisory Committee,²¹ wrote to the Hon Wilson Tuckey MP, who was then Minister for Regional Services, Territories and Local Government. The letter, dated 26 June 2003, recommended that Primary Energy be given \$1 million under the Namoi Valley SAP. This recommendation was 'contingent on a positive financial "due diligence" exercise'. At the same time, the letter also stated that:

The "due diligence" investigation of Primary Energy Pty Ltd has been managed by the Department of Transport and Regional Services and no obvious financial risks were identified in providing this funding.²²

7.17 The consideration of the application and Mr Humphries's letter to the minister occurred on the eve of the termination of the Namoi Valley SAP. As is discussed later in the chapter, the impending termination of the program and the implications for the application do not appear to have been taken adequately into account at this point of the process.

16 NENWACC, *Namoi Valley Structural Adjustment Package Application Form*, pp 17-18, in answers to questions on notice, received 15 July 2005.

17 Mr Kelley, *Committee Hansard*, 15 September 2005, p. 16.

18 Mr Humphries, *Committee Hansard*, 29 June 2005, p. 79. See also Mr Carmody, *Committee Hansard*, 15 September 2005, p. 3.

19 *Committee Hansard*, 29 June 2005, p. 85; see also additional information provided by NENWACC, *Minutes and recommendations - Namoi Valley Structural Adjustment package material relating to Primary Energy Pty Ltd*, received 26 June 2003.

20 NENWACC, *Minutes and recommendations - Namoi Valley Structural Adjustment package material relating to Primary Energy Pty Ltd*, additional information received 26 June 2003; see also Mr Humphries, *Committee Hansard*, 29 June 2005, p. 63.

21 Mr Humphries was also chair of NENWACC.

22 Correspondence from Mr Kevin Humphries to the Hon Wilson Tuckey MP, dated 26 June 2003, in additional information provided by NENWACC, *Minutes and recommendations - Namoi Valley Structural Adjustment package material relating to Primary Energy Pty Ltd*, received 26 June 2003; see also *Committee Hansard*, 29 June 2005, p. 85.

Adequacy of due diligence

7.18 The Committee's concerns mentioned in Chapter 2 about the adequacy of due diligence testing of applications are manifest in the Primary Energy case. No evidence was provided to corroborate Mr Humphries' claim to the minister that the department had 'managed' a due diligence investigation of Primary Energy at this stage.

7.19 The extent to which the department did investigate the company seems limited to background checks on Mr Kelley and his co-developers, but these checks apparently occurred well after Mr Humphries's letter to the minister, when the department was under ministerial pressure to process the application. (This is discussed below.) The checks showed, according to Dr Dolman, that Mr Kelley and his associates had 'extensive experience in developing greenfields infrastructure assets and operating and maintaining renewable fuel facilities'.²³ The department also sought additional information about the project from the applicant and his advisers.²⁴

7.20 The confusion about the responsibility for conducting due diligence, also mentioned in Chapter 2, seems apparent in this case. The department's evidence suggested that the checking of the applicant's bona fides and the project's viability and risk was done at the advisory committee level. Dr Dolman told the Committee that the Namoi Valley SAP committee put the project through a 'process of checking' and that it had also been considered by NENWACC.²⁵ Mr Humphries, the chair of both the Namoi Valley SAP committee and NENWACC, in his letter to the minister said the department had 'managed' the due diligence process. In this case, it seems the left hand did not know what the right hand had done.

7.21 As to the risk assessment of the project, Dr Dolman observed:

I guess also that, while there is a degree of risk associated with any project, this in essence was a fairly high risk project. It also had very significant benefits for the community.²⁶

7.22 Under the department's procedures at the time, the level and nature of due diligence depended on the size and nature of the project, with private enterprises subject to more extensive checks than public entities such as councils. The assessment of financial risk of applicants and the commercial risk of projects was also meant to be conducted by external consultants. For a 'fairly high risk project' like Primary Energy involving over \$1 million in funding, a high level risk assessment conducted by external consultants should have been automatic. However, the department was unable to satisfy the Committee that adequate due diligence for a project of the size and level of risk of Primary Energy had been conducted or that departmental procedures had

23 Dr Dolman, *Committee Hansard*, 17 August 2005, p. 20.

24 Dr Dolman, *Committee Hansard*, 17 August 2005, p. 20.

25 Dr Dolman, *Committee Hansard*, 17 August 2005, p. 20.

26 Dr Dolman, *Committee Hansard*, 17 August 2005, p. 20.

been followed. The Committee considers that the Primary Energy case is one example of possible systemic weaknesses in the administrative procedures around due diligence of funding grants (other examples are discussed in Chapters 6 and 10).

7.23 Two further factors that might account for the inadequate due diligence with this application relate to the way the application was handled within the department, where the application appears to have been sidelined for a year and then processed under urgent pressure from ministers' offices. These are discussed in the next section.

Transfer to Regional Partnerships Program

7.24 Shortly after the application was sent to the minister, the RPP commenced on 1 July 2003. The Namoi Valley SAP ceased to exist and was brought under the umbrella of the RPP.²⁷

7.25 Primary Energy's application did not progress any further for another year. The applicants themselves were not informed of the reason for the delay. In Mr Carmody's view:

The application was submitted and there was an inordinate amount of delay. We subsequently learnt that there was this rolling over of the Namoi Valley package into a successor funding arrangement. From the applicant's perspective, to some extent it [was] a mystery of the machinery of government...²⁸

7.26 Ms Riggs of DOTARS explained her understanding that the application, along with a number of other projects related to the Namoi Valley SAP, was 'put on hold until it became clearer how NSW might be proceeding with its water sharing arrangements'.²⁹ The relevance of the water sharing arrangements to these projects remains unclear. It seems strange to the Committee, however, that a concern of such magnitude as to delay consideration of several projects for a lengthy period time was not flagged earlier on in the application process by the regional DOTARS officer with the local ACC. It also seems an extraordinary administrative oversight by the department that the applicant was not informed of the reason for the delay during this time.

7.27 Then, on 5 July 2004, over one year later, Senator Ian Campbell, then Minister for Local Government, Territories and Roads, wrote to the Acting Deputy Secretary of DOTARS declaring that 'sufficient progress had been made by the company on the project to warrant its [the application] now being assessed'.³⁰ In sharp contrast to the 'inordinate delay' over the previous year, Senator Campbell requested

27 DOTARS, *Submission 14*, p. 11.

28 Mr Carmody, *Committee Hansard*, 15 September 2005, p. 17.

29 Ms Riggs, *Committee Hansard*, 12 August 2005, p. 49.

30 Ms Riggs, *Committee Hansard*, 12 August 2005, p. 50.

the department 'progress the application so that the funds can be provided within the next two weeks'.³¹

7.28 The Committee received little other evidence about the reasons for the minister's intervention at this point in time, nor the reasons the application was then required to be dealt with urgently (within two weeks), when it had been on hold for the past year. The Committee does observe, however, that the minister's request to expedite the application occurred in the lead up to the announcement of the federal election when there was a surge in funding approvals. As was shown in Chapter 2, over half of the total RPP funding was approved during this period.

7.29 On 9 July 2004, the law firm, Baker and McKenzie, provided a letter and supplementary information to DOTARS on behalf of Primary Energy. This letter indicated that an oral briefing had been given by Baker and McKenzie to Mr Peter Langhorne, a senior adviser to the then Minister for Transport and Regional Services, John Anderson.³² In view of Mr Langhorne's subsequent intervention in the process on this matter (discussed below), this briefing may also have been a factor in the apparently sudden interest in the project within government circles.

7.30 According to the evidence from DOTARS, the supplementary information from Baker and McKenzie included:

...advice on the nature of the project and it also included reference to the fact that capital reserves were not a significant issue for this project given that it was about raising funds to build a plant.³³

7.31 This advice helped to inform the department's assessment of the application and its subsequent brief to the minister on approving funding for the project, which is discussed in the next section.

Changes in departmental advice to the minister

7.32 On 23 July 2004, DOTARS provided advice to Minister Lloyd's office, who became Minister for Local Government, Territories and Roads on 18 July 2004, on the application from Primary Energy ('the original advice'). The junior minister, Minister Lloyd, was the relevant decision-maker in this case, rather than the former Minister for Transport and Regional Services, the Hon John Anderson MP. This was because, as noted earlier, the project is located in the electorate held by the former Minister Anderson. As DOTARS explained to the Committee:

...it was established practice in the portfolio that if a project were in a minister's electorate then one of the other ministers or the parliamentary secretary would become the decision maker, even if it was otherwise common for that program to be the subject of the first minister. So that was

31 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 9.

32 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 9.

33 Dr Dolman, *Committee Hansard*, 17 August 2005, p. 20.

common and established practice in the portfolio. It was also established practice in the portfolio that any briefing to either the junior minister or the parliamentary secretary was copied to the portfolio minister.³⁴

7.33 Witnesses from DOTARS refused to reveal the nature of the recommendation made in this original advice to the Minister, on the ground that it constituted advice to the minister.³⁵ In the introduction to the report, the Committee has commented on the illegitimacy of this ground as a basis for a claim to withhold information from the Senate or one of its committees.

7.34 Subsequent events, as outlined below, suggest that the department's original recommendation may have been to reject the funding application from Primary Energy.

7.35 A few days after the original advice was sent to Minister Lloyd, on either the 26 or 27 July 2004, the then Acting Secretary of DOTARS, Ms Lynelle Briggs, took a call from Mr Langhorne, chief of staff to Minister Anderson, in relation to the Primary Energy application. According to evidence from Ms Briggs, Mr Langhorne drew her attention to the department's original advice, and said to her that it 'failed to take regard of a letter that Ms Riggs had received from Senator Campbell'.³⁶ The Committee queried whether Mr Langhorne asked for the recommendations in the minute to be altered:

Senator O'BRIEN—Following, you suspect, the receipt of a copy [of the department's advice] in Minister Anderson's office, Mr Langhorne rang you as the acting secretary to ask you to have the recommendations altered?

Ms Briggs—He rang me, as I said, to ask me whether I had seen Senator Campbell's letter. He did not think the minute accurately reflected that. Clearly, his intent was to see if I agreed with that and to take it from there. I would hasten to add that he did not put me under any duress to change the minute nor would he have, because we operated on some quite clear operating environments in that office around the department's advice being the department's advice.³⁷

7.36 The department's original advice of 23 July 2004 was then withdrawn at the request of the acting secretary of DOTARS. Ms Lynelle Briggs explained to the Committee:

I read the correspondence from Senator Campbell and the minute that had gone across to the office [of Minister Lloyd]. I formed the view, in doing so, that the minute was inadequate. It did not give due regard to Minister

34 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 18.

35 *Committee Hansard*, 17 August 2005, pp 11, 15-16; see also *Committee Hansard*, 12 August 2005, p. 55.

36 *Committee Hansard*, 17 August 2005, p. 3.

37 *Committee Hansard*, 17 August 2005, p. 4.

Campbell's correspondence and it may therefore have misled the new minister, Minister Lloyd, about the chain of events and the circumstances at that stage.

When I met with the officials concerned, I said to them that that was my view and that I thought that the department's brief did not responsibly and rigorously deal with a request that Minister Campbell had made in that letter. For that reason, I thought the minute was inadequate; that is probably the description I would use. When a minister makes a request of his department—and it is very rare that a minister does that in writing—then it is my professional view that it is the department's responsibility to see that that request is implemented. That was, in effect, what I said to the staff.

I then asked that the minute be withdrawn.³⁸

7.37 Minister Lloyd's office also returned the original brief to the department, with the annotation 'As discussed, please provide replacement brief'.³⁹

7.38 Ms Briggs was at pains to point out to the Committee that, although the Minister's office had received the original advice, the advice had not actually been read by Minister Lloyd.⁴⁰ Ms Briggs explained that, in her view, her role in the process was:

...to ensure that the minister's request was implemented and that the department operated professionally at all times in its handling of the issue. It was also to ensure that Minister Lloyd was advised on the outstanding issues.⁴¹

7.39 DOTARS revised the advice in relation to the Primary Energy project, and provided the new advice to Minister Lloyd on 28 July 2004. On 2 August 2004, just weeks before the 2004 federal election was announced, Minister Lloyd approved \$1.2 million in RP funding for the project.⁴²

7.40 Before examining the progress with the project to date, the Committee outlines its concerns about three aspects of the assessment of the Primary Energy application: the intervention in the department's assessment and advice on the application by ministers and their staff; conflicting evidence to the Committee from departmental officers; and the use of the SONA guidelines to bypass the eligibility criteria of the RP program.

38 *Committee Hansard*, 17 August 2005, p. 3.

39 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 16.

40 Ms Briggs, *Committee Hansard*, 17 August 2005, p. 4.

41 Ms Briggs, *Committee Hansard*, 17 August 2005, p. 4.

42 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 9.

Ministerial intervention in departmental assessment

7.41 The Committee has four concerns about the intervention by either ministers or their staff in the department's consideration of the application. First, the direction from Senator Campbell on 5 July 2004 'to progress the application so that the funds can be provided within the next two weeks'⁴³ seemed to pre-empt any assessment of the project under the RPP. Instead, as discussed later in the chapter, the application had to be assessed under the (then) unpublished SONA guidelines.

7.42 Second, the Committee is equally concerned with the degree of intervention on the part of a ministerial staffer that caused the department to revise its advice on the project. Although the Committee was not provided with a copy of either the original advice or Minister Campbell's letter, there can be little doubt based on Ms Briggs's words that the revised brief differed significantly from the original brief tendered to Minister Lloyd. According to evidence received from Ms Briggs, the revised advice was 'consistent with the request from Minister Campbell and the agreed programme guidelines'.⁴⁴ When questioned about the changes, Dr Dolman indicated:

Senator O'BRIEN—I think we can take it that the brief would have had to have been changed substantially as a result of that interception and intervention.

Dr Dolman—It is probably fair to say there was a change in nuance.⁴⁵

7.43 Dr Dolman's claim that the difference between the two briefs was merely a 'change in nuance' is difficult to reconcile with Ms Briggs's description of the original advice as 'inadequate' in that it 'did not responsibly and rigorously deal with' Minister Campbell's direction that funding for the project proceed.

7.44 That said, it is hard to accept that the original advice 'did not give due regard' to Minister Campbell's letter, in the way that Ms Briggs suggested. Dr Dolman, the DOTARS officer who signed the original advice to the Minister, gave evidence to the Committee that he was aware of Minister Campbell's letter when the original advice was prepared, and indeed that the letter was appended to the original advice.⁴⁶ It seems to the Committee more likely that the original advice placed different weight on factors relevant to the eligibility and viability of the project than did the minister's letter, and that the department initially came to a quite different conclusion to Minister Campbell as to whether the project should be funded.

7.45 The involvement of Mr Langhorne, the chief of staff in Minister Anderson's office, raises two further concerns about the decision making process in relation to this grant. The first is the growing tendency of ministerial staff to act as proxies for their

43 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 9.

44 *Committee Hansard*, 17 August 2005, p. 9.

45 *Committee Hansard*, 12 August 2005, p. 57.

46 *Committee Hansard*, 17 August 2005, p. 24.

ministers by inserting themselves into the internal decision making of departments or – as was seen in the Tumbi Creek case in Chapter 5 – administration of programs.⁴⁷

7.46 The other, arguably greater, concern in this case is that Mr Langhorne's involvement in the formulation of the departmental advice to the minister transgressed the department's practice of quarantining ministers from decisions related to projects from their own electorates. As Minister Anderson's chief of staff, Mr Langhorne was effectively acting in his minister's name, even if the minister had not been personally privy at that stage to the detail of the application. Because the application concerned a project in Minister Anderson's electorate, neither the minister nor any of his staff should have been involved in any way with the decision making on the project. By intervening to have an advice from the department to another minister changed, Mr Langhorne gave rise to a possible conflict of interest.

7.47 As this example illustrates, the department's practice of copying all briefs to the senior portfolio minister (in this case, Mr Anderson) is at cross purposes with the practice of keeping ministers at arm's length from applications originating in their own electorate. The Committee believes that in cases such as the Primary Energy application, the portfolio minister *and* his office should be quarantined from all departmental briefs until *after* a decision has been made.

Conflicting evidence

7.48 The Committee is concerned about a marked disparity in the evidence presented by departmental officers during its examination of the two briefs that went to the minister. The Committee examined this matter with departmental officers over two hearings, on 12 and 17 August 2005.

7.49 At the 12 August hearing, departmental officers indicated that the department had received a letter from Mr Langhorne in relation to the Primary Energy application. When asked about the letter, Ms Riggs stated:

Senator O'Brien – can you confirm that you did receive a letter from Mr Langhorne – the senior adviser to the former Minister for Transport and Regional Services – in relation to this application?

Ms Riggs – yes, I believe I did.⁴⁸

7.50 Ms Riggs went onto say that she was on leave when the letter was sent to the department, and then commented:

But I have seen it since. I believe there is such a letter.⁴⁹

47 See Senate Finance and Public Administration References Committee, *Staff employed under the Members of Parliament (Staff) Act 1984*, October 2003, particularly chapter 2.

48 Ms Riggs, *Committee Hansard*, 12 August 2005, p. 50.

49 Ms Riggs, *Committee Hansard*, 12 August 2005, p. 50.

7.51 A little later in her evidence Ms Riggs qualified her knowledge of such a letter, saying that her answers were made on the basis of 'the presumption of the accuracy of my memory that such a letter exists'.⁵⁰

7.52 Dr Dolman also told the Committee he recalled seeing the letter from Mr Langhorne about the Primary Energy application:

Senator O'Brien – You saw Mr Langhorne's letter, didn't you?

Dr Dolman – I did see Mr Langhorne's letter. I am not sure I can recall the full details, but I know the brief we provided did address the issues raised in that letter and in the letter that Minister Campbell had written.⁵¹

7.53 This evidence left the impression that the letter from Mr Langhorne had influenced, if not been instrumental in causing, the revision of the original brief to the minister on the Primary Energy application.

7.54 However, at the hearing on 17 August Ms Riggs told the committee that following her evidence on 12 August a search of departmental files had failed to locate any letter from Mr Langhorne concerning the Primary Energy application. Ms Riggs instead pointed to the letter the department had received from the law firm, Baker and McKenzie, on behalf of Primary Energy. Ms Riggs said she believed that it was the Baker and McKenzie letter she had had in mind when responding to the Committee's questions about a letter from Mr Langhorne.⁵²

7.55 Dr Dolman, on the other hand, at the hearing on 17 August told the Committee that he had been referring to the letter from Minister Campbell to the department when responding to questions about the Langhorne letter. Dr Dolman went on to suggest that he thought that he and Ms Riggs had between them mixed up the letters from Baker and McKenzie and from Minister Campbell when answering questions at the earlier hearing.⁵³

7.56 The Committee finds these explanations unconvincing. Ms Riggs told the Committee on 12 August in response to questioning that she had seen a letter from Mr Langhorne. She did not seek to take the matter on notice as would normally be the case, particularly if a senior departmental witness had some doubts about the existence of a letter from a senior minister's chief of staff. Dr Dolman, who on 12 August did not qualify the 'accuracy of his memory', had a clear recollection of the letter as he advised that the issues it raised were addressed in the second, revised brief that went to the minister on the Primary Energy application. At the earlier hearing he also referred to a separate letter from Minister Campbell. His later claim on 17 August that

50 Ms Riggs, *Committee Hansard*, 12 August 2005, p. 50.

51 Dr Dolman, *Committee Hansard*, 12 August 2005, p. 58.

52 Ms Riggs, *Committee Hansard*, 17 August 2005, pp. 8-9.

53 Dr Dolman, *Committee Hansard*, 17 August 2005, p. 10.

he was referring to the minister's letter when answering questions about a letter from Mr Langhorne is therefore not a satisfactory explanation for the shift in his evidence.

Funding eligibility and the SONA procedures

7.57 Another aspect of particular concern about the Primary Energy application is the processing of it under the SONA guidelines. A number of the Committee's general concerns about the use of these guidelines, discussed in Chapter 2, are thrown into sharp relief in this case.

7.58 The application process relating to Primary Energy was complicated by the fact that the funding application from Primary Energy was assessed under the RPP, even though the application was initially made and assessed under the Namoi Valley SAP. Ms Riggs explained to the Committee that, with the lapsing of the SAP, the only mechanism available to progress the application at the time was through the Regional Partnerships appropriation:

...the Namoi Valley Structural Adjustment Package had not been allocated discrete funding by the government, so if the application was to be progressed it had to proceed under the funding envelope of the Regional Partnerships Program. The initial assessment was under the Namoi Valley Structural Adjustment Package guidelines which had been separate and had different elements from those of Regional Partnerships.⁵⁴

7.59 DOTARS used the application made under the Namoi Valley SAP and some additional material, including the information provided by Baker and McKenzie, to assess the project under the RPP.⁵⁵

7.60 However, Primary Energy's application did not meet the RPP guidelines. In particular, the RPP guidelines provide that commercial enterprises requesting funding for planning, studies or research are not eligible for RPP funding.⁵⁶ The evidence to the Committee shows that the grant to Primary Energy has been expended on, among other things, a CSIRO study, research on a production life cycle analysis and project planning.⁵⁷ The RPP guidelines also provide that projects will be ineligible where they are requesting funding for 'seed funding for the development of prospectuses'.⁵⁸ When asked to confirm that the grant had been spent on activities ineligible under the RPP, Dr Dolman replied:

54 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 9.

55 *Committee Hansard*, 17 August 2005, pp 20-21.

56 DOTARS, *Submission 14*, Attachment D, Regional Partnerships Guidelines, p. 6.

57 Dr Dolman, *Committee Hansard*, 12 August 2005, p. 60.

58 DOTARS, *Submission 14*, Attachment D, Regional Partnerships Guidelines, p. 7.

That is correct. Both the planning aspects of it and the fact that it involved a prospectus were outside the Regional Partnerships guidelines, but they were not outside the Namoi Valley Structural Adjustment Package guidelines.⁵⁹

7.61 Because the Primary Energy application fell outside the RPP guidelines, the department resorted to considering it under the SONA procedures instead. As outlined in Chapter 2, the SONA procedures can be used:

...where a project or initiative would require the waiver of some specific part of the guidelines or eligibility criteria.⁶⁰

7.62 In the case of Primary Energy, Dr Gary Dolman informed the Committee that:

The reason this [project] was considered under the SONA procedures was that it was an application under the Namoi Valley Structural Adjustment Package. The reason for that was that it was for a prospectus, which is precluded from funding under Regional Partnerships eligibility guidelines. Those eligibility restrictions did not apply under the Namoi Valley Structural Adjustment Package. I guess that was the reason why this was put forward under the SONA procedures: that it would have been unfair to judge the project against criteria that did not apply at the time the application was made.⁶¹

7.63 Given the apparently different criteria under the Namoi Valley SAP and the RPP, the Committee questions the appropriateness of DOTARS' use of the original application made under the Namoi Valley SAP to assess the project under the RPP. There was an apparent absence of any appropriate transitional arrangements to deal with an application such as in the Primary Energy case where a decision was pending. The Committee considers that it may have been appropriate for DOTARS to request that Primary Energy provide a fresh application under the RPP, particularly given the fact that the application was over a year old by the time DOTARS considered it again and the project timetable was out of date. This option appears to have been precluded, however, due to the urgency required for approving the application at the ministerial level.

7.64 In this regard, there is a strong sense from the evidence that a decision was made at a senior ministerial level to get funding for the project regardless of program criteria or constraints and that the department was left to find the vehicle to achieve this end.

7.65 The Committee considers that the funding granted to this project illustrates the way in which the SONA procedures can circumvent, and even undermine, the RPP guidelines and eligibility criteria. Indeed, the SONA criteria appear to be so broad that

59 Dr Dolman, *Committee Hansard*, 12 August 2005, p. 59.

60 DOTARS, *Submission 14*, Attachment H, Procedures for SONA, p. 1.

61 *Committee Hansard*, 12 August 2005, p. 58.

the government can, as it has in this case, apply the SONA procedures arbitrarily to fund almost any project the government feels inclined to fund.

Project progress and outcomes

7.66 For the Committee, the fact that construction of the ethanol plant has yet to be confirmed, let alone started, casts further doubts on the merits and viability of the funding grant to Primary Energy. The Committee sought to identify the progress made with the project, what the grant money had been expended on and when construction on the plant will start and production begin.

7.67 Following the minister's approval of the grant on 2 August 2004, DOTARS and Primary Energy entered into a funding agreement in relation to the ethanol plant project on 28 September 2004. Grant payments of just over \$1 million have now been paid to Primary Energy for meeting various milestones under the funding agreement.⁶² Payments have been made as follows:

- the first payment, on 29 September 2004, of \$426,800, made on signing of the funding agreement;
- a second payment, on 27 January 2005, of \$342,100 for meeting milestone one of the agreement; and
- a third payment, on 11 May 2005, of \$235,400 for meeting milestone two of the agreement.⁶³

7.68 According to the department, these initial milestones involved:

...work on plant design and specifications, further legal fees, further project management and project development, further office expenditure and travel, some promotional activities, some tax-structuring advice and project accounting.⁶⁴

7.69 The Committee was concerned to discover that the first payment of \$426,800 was simply for signing of the contract between the department and Primary Energy. This is in contrast to the milestones other projects have had to achieve, even in cases involving lower amounts of grant funding. The department indicated that the first payment reflected a direction in Minister Campbell's letter for an instalment to be paid as soon as possible on approval of the application due to some urgency with the project.⁶⁵ However, in the Committee's view the urgency with the first payment may have as much reflected the year long delay in the processing the application as anything else.

62 Dr Dolman, *Committee Hansard*, 12 August 2005, pp 60-61.

63 Dr Dolman, *Committee Hansard*, 12 August 2005, pp 60-61.

64 Dr Dolman, *Committee Hansard*, 12 August 2005, p. 61.

65 Dr Dolman, *Committee Hansard*, 12 August 2005, p. 60.

7.70 The Committee notes also that the funding agreement was varied on 6 July 2005, among other things, to specifically refer to funding for a CSIRO study.⁶⁶ Ms Riggs explained to the committee:

...the approved project includes work under contract by the CSIRO. I am advised that Primary Energy approached CSIRO in September 2003 with a request to undertake the study. However, work on the study did not commence until 14 October 2004 after the signing of the funding agreement and the first payment.⁶⁷

7.71 A payment of \$155,100 was due to be paid on 1 August 2005 for meeting milestone three of the funding agreement. Evidence to the committee did not indicate whether Primary Energy had met this milestone, or whether the payment had been made. A final payment of \$50,600 is to be paid on 1 March 2006 on meeting milestone four of the funding agreement.⁶⁸

7.72 Mr Kelley, the managing director of Primary Energy, told the Committee that 'we have gone the extra step and we have had each milestone payment externally audited in accordance with the [funding] agreement'.⁶⁹ The department confirmed that it had received detailed reports on project activity against the first two milestones.⁷⁰

7.73 In discussing the project's progress, Ms Riggs reminded the Committee that the milestones relate not to plant construction but are 'about doing the necessary work in order for this company to then approach the capital market in order to attract funds, which would then facilitate the construction of an ethanol plant'.⁷¹

7.74 In terms of the project's timetable, on 15 September 2005 Mr Kelley told the Committee that:

We have 12 to 18 months of build time, so that is why we are not producing ethanol now. We are aiming to financially close this project this year, which does not give us long, but it is possible and we are hoping to be in production by the first quarter of 2007.⁷²

7.75 The Committee also took confidential evidence from Mr Kelley and Mr Carmody about the structure of the project finance for the plant and the identity of the

66 DOTARS, *Regional Partnerships Funding Agreement between DOTARS and Primary Energy Pty Ltd*, tabled 12 August 2005.

67 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 9.

68 Dr Dolman, *Committee Hansard*, 12 August 2005, p. 61; see also DOTARS, *Regional Partnerships Funding Agreement between DOTARS and Primary Energy Pty Ltd*, tabled 12 August 2005.

69 Mr Kelley, *Committee Hansard*, 15 September 2005, p. 14.

70 Dr Dolman, *Committee Hansard*, 17 August 2005, pp 22-23.

71 Ms Riggs, *Committee Hansard*, 17 August 2005, p. 22.

72 Mr Kelley, *Committee Hansard*, 15 September 2005, p. 2.

financial partners (or equity investors) who intend to invest in the project. Mr Carmody told the Committee in public evidence that Primary Energy's financial partners 'have not made any financial contribution as we speak today' but that

Those entities we have disclosed to you today have every intention of becoming equity investors...⁷³

7.76 The Committee remains concerned about the progress and viability of the Primary Energy project. It considers that DOTARS should monitor the project closely. The Committee also believes that to satisfy the Parliament that the project is on track and that public money has been expended appropriately the department should table in the Senate future external auditor's reports on progress against milestones.

Conclusion

7.77 As the Primary Energy ethanol plant is not expected to start production until 2007, it is impossible for the Committee to determine whether grant funding of \$1.2 million in this case represents value for money. However, the Committee is concerned at the approach and decision making associated with this project which the department classified as high risk. The evidence to the Committee raises more questions than it answers about the adequacy of the due diligence checks on the project, the reason for truncated time given to the department to assess the application and the role of ministerial staff in prompting the department to revise its original advice to the minister. The year long delay in processing the Primary Energy application also reveals shortcomings in transitional arrangements for applications under consideration when a program lapses.

7.78 The Committee is particularly struck by the parallels this case shares with case studies relating to Tumbi Creek and A2 Dairy Marketers discussed in Chapters 5 and 6. As with those cases, the Committee was unable to examine relevant evidence to explain why the minister at the time sought to have the assessment of the project rushed through the department. Similarly, Primary Energy adds a further example to those two cases and others of the expansion in power of ministerial staff and their ability to directly intervene in the provision of advice from departments to ministers. The cases of Primary Energy and A2 Dairy Marketers also point to possible systemic weaknesses in the RPP procedures for due diligence testing of applications. In all three cases, ministerial direction to fast-track the departmental assessment of applications occurred during the surge in funding approvals prior to the announcement of the federal election.

7.79 The Primary Energy case also demonstrates the degree to which the SONA procedures provide almost unlimited discretion for ministers to approve projects even when confronted with restrictions under the RPP guidelines. In the chapter that follows, the Committee examines another case – the funding for the National Centre of Science, Information and Communication Technology, and Mathematics Education

73 Mr Carmody, *Committee Hansard*, 15 September 2005, p. 9.

for Rural and Regional Australia – which also reveals the scope under the SONA procedures for ministers to approve projects otherwise ineligible under RPP.