Submission to 2019 Review of the Australian Domestic Gas Security Mechanism ADGSM

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Australian Government
Department of Industry, Innovation, and Science (DIIS)
Industry House, 10 Binara Street, Canberra ACT 2601.

Re: **Submission in Response to Review of the ADGSM: International trade and investment law perspective**

Thank you for the opportunity to make this contribution to the review of the ADGSM.

This submission summarises the author's ongoing research on the ADGSM and Australia's potential liability under international trade and investment laws. The following paragraphs highlight arguments that will enable the DIIS to determine the appropriate structuring of the ADGSM or any successor regime from a trade and investment angle.

1) Understanding Australia's potential liability under WTO law and international investment laws

By being a party to an increasingly complex web of multilateral and bilateral trade and investment treaties, Australian policies may trigger liability under the law of World Trade Organisation (WTO) or through investment treaties providing for investor-state dispute resolution (ISDS).

The difference between the two systems is that the WTO dispute settlement system is applied on a state-to-state basis under the WTO norms, whereas the ISDS mechanism allows the foreign investors to directly seek redress against the host state within the framework of a settled Bilateral Investment Treaty (BIT) or a Free Trade Agreement (FTA).

The Australian Government must carefully tread a fine line when applying the ADGSM. It must ensure a judicious and legitimate application of the ADGSM mechanism because any use perceived as unjustifiable may entail liability under WTO law through a state-espousal strategy.[1] The state-espousal

[1] Briefly, the state-espousal strategy may be used by well-endowed, multi-national corporations (MNCs) to access the, otherwise off-limits WTO dispute settlement system through espousal of investor claims by their governments against Australia. For example, the action launched by Cuba, Indonesia, Ukraine, Honduras and Dominican Republic against the Australian tobacco plain-packaging legislation in the WTO, alleging violation of the WTO's *Agreement on Trade-Related Aspects of Intellectual Property Rights*. This action was launched in parallel to ISDS proceedings instituted by Philip Morris under the *Hong Kong–Australia BIT*. See generally Panel Report, *Australia — Certain Measures Concerning Trademarks, Geographical Indications and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging*, WTO Doc WT/DS435/R; WT/DS441/R; WT/DS458/R; WT/DS467/R (28 June 2018). In this case, the WTO panel endorsed Australia's plain packaging laws by holding that they contributed to improving public health by reducing and discouraging use of tobacco products: [7.228]–[7.232], [7.1725], [7.1731], [7.2794]–[7.2795];

strategy shows that well-endowed MNCs can sometimes challenge prejudicial governmental measures with high-cost implications.

From a purely WTO perspective, the Australian Government can take comfort in the knowledge that foreign investors in LNG projects cannot immediately challenge the imposition of the ADGSM under the norms of WTO. Rather, the challenge must come through another WTO Member and must be based on a breach of WTO law. Therefore, for action under WTO law, the MNCs will have to lobby their respective governments for the espousal of their claims against Australia within the WTO dispute settlement system.

The same foreign investors can, at the same time, rely on BITs that Australia has signed and ratified for seeking redress. The BITs usually include obligations to treat foreign investors fairly and not to expropriate the investments, whether directly or indirectly, without adequate compensation.

The implication of the obligations to treat foreign investors fairly and equitably is often referred to as the National Treatment (NT) standards. Since foreign investors may have invested in the Australian LNG sector with the expectation of extracting and exporting gas from Australia, any limits on such activity in the form of export caps or quotas or any such restrictions may potentially be viewed as indirect expropriation. The export restrictions will only be considered as permissible if they are seen to satisfy a legitimate public purpose and if the restrictions apply uniformly to all investors (local and foreign).

A quick survey of major LNG projects in Australia along with the origin of the investor and corresponding BITs shows several intertwining layers of potential liability owed by Australia to foreign investors (see Annex 1). This is especially true in the case of Gladstone LNG (GLNG) where, for example, Malaysian investment can be safeguarded under either ASEAN-Australia-New Zealand Free Trade Area (AANZFTA) or Malaysia-Australia Free Trade Agreement (MAFTA).

The AANZFTA specifically includes an *Annex on Expropriation and Compensation* to Chapter 11 of the agreement which will play an important interpretational role in the event of an ISDS challenge to Australian policies. Note that Paragraph 4 of the *Annex on Expropriation and Compensation* specifically alludes to measures that are intended to "…achieve legitimate public welfare objectives, such as the protection of public health, safety and the environment" as not constituting an expropriation. Therefore, as long as the ADGSM or any of its successor regimes are seen to address a public welfare imperative, Australia will be able to deflect any expropriation claims in any ISDS setting under AANZFTA. Similar public welfare grounds can be found in other FTAs/BITs, albeit in different wordings.

Overall, the ADGSM should always be looked upon as an exceptional measure that only provides temporary breathing room until 2023. The Australian Government must demonstrate the effectiveness of the ADGSM and stress the temporary nature of the measure; otherwise, the risk of a challenge increases over time. Even when a state-based espousal in the WTO appears to be a difficult proposition, the aggrieved foreign investor can import parallel arguments from the realm of WTO law to reinforce their claims in an ISDS setting.[2] For policymakers in host states such as Australia, this means that the

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See also 'Australia Wins Landmark World Trade Organisation Ruling on Tobacco Plain Packaging Laws', *ABC News* (Web Page, 28 June 2018) <http://www.abc.net.au/news/2018-06-29/australia-wins-landmark-wto-ruling-on-tobacco-plain-packaging/9921972>.; *Marrakesh Agreement Establishing the World Trade* Organization, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1C ('*Agreement on Trade-Related Aspects of Intellectual Property Rights*') ('*TRIPS Agreement*')

[2] This strategy is referred to as the "Convergence Argument" in academic literature (see e.g. discussion in Umair Ghori, 'The Confluence of International Trade and Investment: Exploring the Nexus between Export Controls and Indirect Expropriation' (forthcoming, February 2020) *New Zealand Yearbook of International Law;* Jurgen Kurtz, 'The Use and Abuse of WTO Law in Investor-State Arbitration: Competition and its Discontents' (2009) 20(3) *European Journal of International Law* 749, 751–759, 770–771; Robert Howse and Efraim Chalamish, 'The Use and Abuse of WTO Law in Investor-State Arbitration: A Reply to Jurgen Kurtz' (2010) 20(4) *European Journal of International Law* 1087, 1088–

design of export controls must be such that it remains compatible with both trade and investment norms.

Despite the potential for challenge, the reputation of Australia as an ideal investment venue is likely to remain intact. However, the government and the stakeholders must address the issue of pricing, development of new gas fields, incoming investments in the gas sector and the allegations by some stakeholders accusing the large gas exporters of cartel-like behavior.

2) Implications if LNG export caps or quotas are imposed

Australia may potentially face a claim for indirect expropriation by foreign investors under an ISDS setting or a claim under WTO law if quotas or export caps are imposed under the ADGSM. In response to a WTO action, Australia will likely base its defensive strategy on GATT Article XI.[3]

Generally speaking, GATT Article XI:1 bans the use of quotas by a WTO Member except in limited instances which are explained in GATT Article XI:2. GATT Article XI:2(a) permits WTO Members to "temporarily" restrict exports to prevent or relieve "critical" shortage of food or other essential materials.

In order to safely adopt the defence of GATT Article XI:2(a), the ADGSM must be seen as addressing "critical" shortage of an essential material (i.e., gas) within the domestic market. The problem here is that there is, *per se,* no critical shortage of gas in Australia. Rather, the gas shortage may be imminent unless the LNG producers divert a certain for meeting domestic demand.

In this regard, understanding the WTO dispute settlement decision of *China – Raw Materials* becomes especially important for the Australian policymakers since it provides crucial clues in deciphering the meaning of an important standard on which the defence of a "temporary" measure for relieving "critical" shortage is based.

In *China – Raw Materials,* China was held by the WTO Appellate Body to have failed in demonstrating that its export quotas on certain raw materials were temporarily applied to relieve a "critical" shortage. Preceding the Appellate Body proceedings, the dispute settlement panel in the case noted that any restriction under GATT Article XI:2(a) must be of limited duration. There is no doubt that this is an explicit acknowledgment by the WTO of the risk within GATT Article XI:2(a) for protectionist abuse, e.g., the panel observed that China had imposed export controls on bauxite for nearly a decade and that there were no signs of the export control measures being lifted until the bauxite reserves were depleted.

On appeal from the dispute settlement panel, the Appellate Body observed that "temporarily," in GATT Article XI:2(a), means measures applied to meet a "passing need" or measures applied on an interim basis. The Appellate Body report also clarified that what makes a shortage "critical" is how "essential" a product is for the exporting economy along with the general characteristics of that

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1090; Alford (n 98) 37; Frank Garcia et al, 'Reforming the International Investment Regime: Lessons from International Trade Law' (2015) 18(4) *Journal of International Economic Law* 861, 864; Brooks Allen and Tommaso Soave, 'Jurisdictional Overlap in WTO Dispute Settlement and Investment Arbitration' (2014) 30(1) *Arbitration International* 1, 28; Andrea Bjorklund, 'Convergence or Complementarity' (2013) 12(1) *Santa Clara Journal of International Law* 65, 68–70; Sergio Puig, 'The Merging of International Trade and Investment Law' (2015) 33(1) *Berkeley Journal of International Law* 1, 23–27; Roger Alford, 'The Convergence of International Trade and Investment Arbitration' (2014) 12(1) *Santa Clara Journal of International Law* 35, 46–47.

[3] General Agreement on Tariffs and Trade (GATT) 1994 forms part of the World Trade Organisation (WTO) Framework. Note that some Free Trade Agreements (FTAs) such as Malaysia-Australia FTA (MAFTA) already refer to GATT Article XI as the applicable standard in determining when export of certain goods can be restricted (see MAFTA, Article 2.10).

product. The Appellate Body further explained that the notion of "criticality" includes consideration of points in time where the conditions no longer remain "critical."

The observation made here that there is no actual gas shortage in Australia is not prejudicial to the interpretation of the WTO law. In another WTO case involving Chinese export controls (*China – Rare Earths*), the dispute settlement panel endorsed the position that WTO Members are entitled to take measures where shortages of a "critical" product are imminent and have yet to materialise.

The challenge for the Australian Government is to avoid the trap of extending "temporary" restrictions to the point where such restrictions become part of the regulatory landscape (similar to what was pointed out by the Appellate Body in *China – Raw Materials*). Timely emergence of new gas sources or alternatives to the ADGSM is important because there may still be risks of shortfalls in gas supply after the expiration of the ADGSM in 2023.

In the absence of any new gas projects coming online and gas shortfalls emerging from 2024 onwards, the likelihood of the ADGSM being extended beyond its "temporary" period means that any regulatory measures imposing quota restrictions or export caps on LNG invite the risk of violating WTO norms. Therefore, the emphasis here is for the Australian Government to understand the WTO's interpretation of "temporary" in line of the cases mentioned hereinabove.

3) Justification of ADGSM export restrictions under the "necessary" argument

GATT Article XX provides a series of general exceptions that allow WTO Members to derogate from their obligations, provided certain limited grounds are met. Considering the characteristics of the ADGSM, Australia may consider the defences of GATT Article XX(d) (measures "necessary" to secure compliance with local laws that are not inconsistent with the GATT) and/or XX(j) (measures "essential" to the acquisition and distribution of products general or local short supply).

The main connector in the application of GATT Article XX(d) is "necessary." Several WTO cases have interpreted this term. However, two notable cases for Australian policymakers in this regard are *Korea – Beef* and the *EC — Tariff Preferences* case.

In *Korea – Beef,* the Appellate Body endorsed the argument that the interpretation of "necessary" requires "weighing and balancing" of several factors. The Australian Government must be able to demonstrate that several alternatives to the ADGSM were considered before its triggering and, on balance, the ADGSM was the least-trade restrictive measure.

In the *EC – Tariff Preferences* case, it was held that when a country adopts any exceptional trade measure and then uses the "necessary" standard to defend it, the measures must be proven as useful to achieve the stated goals. In the *EC – Tariff Preferences* case, the EC attempted to justify the 'Drug Arrangement' within its Generalised System of Preferences ('GSP') scheme which extended preferential treatment to certain pre-selected countries. The EC measures were viewed as violating the GATT Most Favoured Nation ('MFN') obligations under Article I:1.

The dispute settlement panel in *EC – Tariff Preferences* rejected EC's justification that the Drug Arrangement enables economic development in countries facing narcotics problems by extending trade facilities and preferential entry to goods. The panel, in its reasoning, pointed out the declining utility of GSP schemes, lack of monitoring, lax compliance mechanisms for measuring "effectiveness" and the availability of less trade-restrictive options.

The *EC – Tariff Preferences* case underscores an important point for the Australian Government, i.e. in order for the ADGSM to be held as "necessary," the measures adopted thereunder must be demonstrated as effective in achieving its stated aim. A cursory review of the submissions received in

the recent 2019 Review of the ADGSM shows that many stakeholders view the ADGSM as an ineffective measure to bring down the price levels for gas in the domestic market.[4] In the event of a challenge, the points raised by domestic stakeholders and the financial/economic analysis on pricing level by the Australian Competition and Consumer Commission (ACCC)[5] will likely be considered in the WTO to counter the "necessary" argument by Australia.

In addition to the preceding argument, review of other trade disputes such as *EC – Asbestos* and *Brazil Retreaded Tyres* shows that the WTO expects the restraining Member to have already undertaken a comparative analysis of the measure in light of possible, less-trade restrictive alternatives. It will be very difficult for Australia to defend its position with the questionable effectiveness of the ADGSM in reducing gas prices.

The question of "necessary," therefore, represents a sum of multiple considerations that places the burden of proof onto the WTO Member adopting the restrictive trade measure (i.e. Australia). The considerations include (i) the importance of the interests or values at issue; (ii) the contribution of the measure to the objective pursued; (iii) the trade restrictiveness of the measure; (iv) the availability of the WTO-consistent or less trade-restrictive alternative measures.

4) Justification of ADGSM export restrictions under the "essential" argument

Another possible defence of the ADGSM can be under GATT Article XX (j) which enables a WTO Member to adopt measures that are "essential" to the acquisition or distribution of products in short supply. Interestingly, this defence has only ever been used once before in WTO dispute settlement (*India – Solar Cells*).

In interpreting "essential," the Appellate Body referred to past jurisprudence on the term "necessary" and then extended the argument to explain the "essential" criteria. More specifically, the Appellate Body stated in *India – Solar Cells* that design and necessity factors under GATT Article XX(d) are relevant in interpreting Article XX(j) as well. The Appellate Body explained that any WTO Member imposing a trade-restrictive measure must satisfy the "design" element by establishing a link between the measures and "acquisition or distribution of products in general or local short supply." The "essential" standard is activated only when the "design" element is satisfied because if the measure in question is not accomplishing the aim of "acquisition or distribution of products in general or local short supply" then it cannot be justified under GATT Article XX(j).

The Appellate Body noted that the word "essential" is closer to the indispensable end of the word "necessary" because the word "essential" is itself defined as "absolutely indispensable or necessary." The proposition seems to suggest that the "essential" test is more stringent even when it shares a common pedigree with the "necessary" test. However, there are no more cases beyond *India – Solar Cells* where the Appellate Body can demonstrate the stringent nature of the Article XX (j) "essential" test.

[4] See e.g. ACCC, 'Gas Inquiry 2017-2020' Interim Report (July 2019) <https://www.accc.gov.au/system/files/Gas%20inquiry%20July%202019%20interim%20report.pdf>, 17-18.; See also Mark Ogge, 'Just to Cap it Off: Submission to the 2019 Review of the ADGSM', *The Australia Institute* (September 2019), 1, 6-10; Bruce Robertson, 'Towards a Domestic Gas Reservation in Australia', *Institute for Energy Economics and Financial Analysis* (submission to the DIIS, July 2019), 2, 17-18; Bruce Robertson, 'IEEFA Submission to the 2019 Review of the ADGSM', *Institute for Energy Economics and Financial Analysis* (submission to the DIIS, July 2019), 1-4; Lock the Gate Alliance, 'Submission to the 2019 Review of the ADGSM' (undated) 1-3.

The Appellate Body in *India – Solar Cells* also endorsed a replication of the "weighing and balancing" series of factors used in the "necessity" analysis under GATT Article XX(d) for interpreting "essential" under GATT Article XX(j).

Therefore, judging by the way the Appellate Body has handled the meaning of "essential," it can easily be surmised that "essentiality" and "necessity" standards are conceptually similar but with varying degree of stringency. Both standards require assessing the extent to which the adopted measures contribute to the "acquisition or distribution of products in general or local short supply" along with the relative importance of the societal interests that the measures protect and the trade-restrictiveness of the measures.

5) Concluding thoughts

The defence under WTO law of the ADGSM, or any regime that succeeds it, is a multi-faceted undertaking. Australian Government must consider the nature of the ADGSM as well as the WTO norms on "necessary," "essential," "effectiveness" and "weighing and balancing" in the light of reasonably available alternatives.

The challenge for Australian policymakers is certainly not made easy by the fact that the consequences of the ADGSM cannot be fully measured as effective unless it is triggered. If, however, the ADGSM is triggered then the likelihood of a challenge by major importing countries increases. Therefore, the anticipation by the Australian Government of the grounds of any future challenge assumes critical importance for the long-term stability of gas prices in the country.

It is hoped that the above analysis is useful in securing Australia's national interest and energy security. The author is available to assist the DIIS or further discuss any aspect of this submission.

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ANNEX 1: **Investor breakdown of major LNG projects in Australia by the origin and possible FTA/BIT coverage**

PROJECT	*INVESTOR/ SHAREHOLDER*	*ORIGIN OF INVESTORS*	*POSSIBLE FTA/BIT COVERAGE*
PRELUDE FLNG	Royal Dutch Shell KOGAS INPEX Group	UK, South Korea & Japan	EUAFTA (proposed); JAEPA; KAFTA; CPTPP
NORTHWEST SHELF VENTURE	Woodside Petroleum BHP Billiton BP Chevron Royal Dutch Shell Japan Australia LNG	UK, US, Japan & Australia	EUAFTA (proposed); JAEPA; AUSFTA; CPTPP
PLUTO LNG	Woodside Petroleum Kansai Tokyo Gas	Australia & Japan	JAEPA; CPTPP
GORGON	Chevron Australia Shell Australia Mobil Australia Osaka Gas Tokyo Gas Chubu Electric	UK, US, Japan & Australia	EUAFTA (proposed); JAEPA; AUSFTA; CPTPP
WHEATSTONE	Chevron Australia Royal Dutch Shell Woodside Petroleum KUFPEC Kyushu Electric	UK, US, Japan, Kuwait & Australia	EUAFTA (proposed); JAEPA; AUSFTA; CPTPP;
DARWIN	ConocoPhillips Santos INPEX Group Eni JERA Tokyo Gas	US, Australia, Japan, Italy	EUAFTA (proposed); JAEPA; AUSFTA; CPTPP
ICHTHYS	INPEX Group Total CPC Corporation Tokyo Gas Osaka Gas Kansai Electric Power JERA Toho Gas	Japan, France, Taiwan & Australia	EUAFTA (proposed); CPTPP

AUSTRALIA PACIFIC LNG	Origin ConocoPhillips Sinopec	Australia, US & China	AUSFTA; ChAFTA
QUEENSLAND CURTIS LNG	Royal Dutch Shell CNOOC, Tokyo Gas	UK, China & Japan	EUAFTA (proposed); JAEPA; ChAFTA
GLADSTONE LNG	Santos PETRONAS Total KOGAS	Australia, Malaysia, EU, South Korea, France	MAFTA; AANZFTA; EUAFTA (proposed); KAFTA.