Environmental Justice Australia

# The real risks of EFIC support for Adani

## The legal, political and real sovereign risks associated with financing the Adani project

**Environmental Justice Australia**
**Climate and Finance Program**
**www.envirojustice.org.au**

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Domestically, Australian politicians have been talking up sovereign risk as a reason why current or future Australian governments might not revoke environmental approvals for the Carmichael mine. It is all hot air. The misuse of the term sovereign risk was eloquently outed by former Chief Economist of ANZ bank, Saul Eslake in a **recent paper**. The fact is, only a narrow band of sovereign risk exists for Adani, but its impact will be on Adani and its business associates. What's more, it is well and truly a possibility, and should it materialise, those risks will be felt acutely.

If the Export Finance and Insurance Corporation (**EFIC**) provides material support for the Carmichael project, loans, guarantees and insurance may all be compromised. This paper sets out the mechanisms which can be implemented to stifle concessional government support for Adani. The pathways to stopping finance to Adani are both legal and political.

On balance, we think the notoriety of the project, well-publicised civilian protests and jolting political discourse on Adani means that a significant risk exists that EFIC may not make good on its responsibilities as a result of legal or political interventions. If so, ratings agencies should not be surprised, and we suspect that Australia's standing in international finance markets will not be harmed.


*Protest outside Prime Minister Turnbull's Point Piper home, 27 May 2018 (Photograph: Stop Adani)*

# Background

The failure of the pro-coal Executive branch of the Australian government to come up with a funding solution for Adani's Carmichael mine was apparent in the form of the Northern Australia Infrastructure Facility (**NAIF**), which is now subject to the scrutiny of a Senate Inquiry after damning conflict of interest allegations and an indefinite veto which helped secure the incumbent Queensland State government. The Executive courted Chinese State Owned Enterprises to fund Adani, and in the same week changed the rules for EFIC to allow funding of Adani-like projects. We think that the Executive's drive to finance Adani with EFIC will likely fail – if not now, then sometime in the future.

EFIC has been approached by three parties in relation to Adani's Carmichael mine and railway. The applications were for two loans and one guarantee.

One application has been successful, one denied. The other is under consideration. We understand the successful candidate benefits from a facility on EFIC's commercial account. On 1 June 2018 under questioning by Senators, EFIC stated, "We had approved one [Adani related] transaction and were looking at a couple of others. I can now report that there are no transactions proceeding at the moment."

Adani itself has met regularly with EFIC. The latest known meeting was 15 February 2018.

EFIC is widely thought to be Adani's sole remaining hope to finance the Carmichael thermal coal mine and railway. EFIC is Adani's white knight. Neither EFIC or the Trade Minister has ruled out providing support to Adani or its business associates.

There is a prevailing misconception that export credit agency transactions are risk free. Our analysis finds that for the Carmichael project, EFIC's loans, insurance and guarantees are far from watertight. The Executive and Legislature of the day has multiple pathways to avoid paying out on contracts of insurance or guarantees. The Judiciary can also cast doubt over transactions, such as loans, if not made pursuant to the requisite legal standards.

There is a high degree of political and legal risk.

This report addresses:

1. the likelihood of effective legal challenge to the validity of EFIC financial support to Adani or its business associates for the Carmichael mine and railway;

2. sovereign risk relating to payment of EFIC insurance or contracts of guarantee.

We find that the notoriety and politicisation of the Adani project creates significant legal and political risk, particularly in light of Australia's ratification of the internationally binding Paris Climate Agreement. It raises a notable exception to the security and reliability of Australian export credit agency support.

# Legal risk

## Duty of care and diligence

EFIC has a commercial account and a National Interest Account (**NIA**). The commercial account is overseen in an independent manner by EFIC's directors. Under the Statement of Expectations (**SOE**), the directors are guided by the Australian Prudential Regulation Authority (**APRA**), and are unlikely to finance Adani-related loans due to their requirement to take into account APRA's comments on 1.5–2°C base case global warming scenarios.

Like NAIF before it, in our view, EFIC's directors would fall short of duties of care and diligence if they agreed to finance Adani or its business associates.[1] The requirement for Commonwealth officials to act with care and diligence appears in section 25 of the *Public Governance, Performance and Accountability Act 2013 (Cth)* (**PGPA Act**). The Explanatory Memorandum to the PGPA Act states:

> As a general principle, officials in the public sector should not be held to a lower standard of account than employees of publicly listed companies. If anything, they should be held to a higher standard, given that taxpayers do not have a choice as to whether they are to be 'shareholders' of public sector entities.

A legal opinion by top barrister Noel Hutley SC is unequivocal that climate risk should be taken into account by company directors where climate change poses significant risk. Supporting Adani is undoubtedly such a scenario.

While on the corporate account EFIC acts at arms-length from the politically charged Executive arm of Australian government, support under the NIA is a different proposition. It can be directed by the Minister for Trade, Steven Ciobo.[2]

However EFIC's NIA will use the same assessment criteria as on the commercial account. This means any project it supports must be commercially viable, and it must follow APRA's guidance. Under a 1.5–2°C climate change scenario, as required by APRA, EFIC's directors should almost certainly rule out any involvement. Ultimately a material conflict is likely to exist between EFIC's board recommendations and that of the Minister.

The duty for EFIC's officials to act with care and diligence is not just relevant to loans. It also applies to EFIC's contracts of insurance and loan guarantees. A trend is apparent in the insurance industry which increasingly sees thermal coal as uninsurable. Aon, for example, reports that insurers like Axa, Allianz, Lloyds and Dai-ichi Life are placing a blanket ban on supporting coal assets.[3]

## Duties to govern the Commonwealth entity

The PGPA Act requires EFIC's accountable authority, its Board, to promote the proper use and management of public resources. The term 'proper' is defined as 'efficient, effective, economical and ethical'.[4] Serious questions arise should EFIC's Board permit financial support to Adani under its governing framework.

Given the public distaste for public financial support and the federal opposition party's policy position not to use taxpayer monies to support Adani's mine, the likelihood of legal and political risk, as described in this report, is high. It would be neither efficient nor effective to permit financial support. The economics of the project appear dubious at best, undermined by a remote, isolated, low-quality resource (low energy, high ash and high sulphur relative to the Australian export benchmark). Longer term financial support from EFIC would clash with the known structural decline of the seaborne thermal coal market.

1 Section 25 *Public Governance, Performance and Accountability Act 2013 (Cth)* (**PGPA Act**); IEA World Energy Outlook 2016, 2017 sees no place for new coal basins under a 2C world (the IEA's Sustainable Development Scenario).

2 Sections 26, 29 *Export Finance and Insurance Corporation Act 1991 (Cth)* (**EFIC Act**)

3 https://www.theage.com.au/business/the-economy/insurance-industry-shift-from-coal-could-mean-higher-power-prices-20180518-p4zg68.html

4 Sections 3, 25 PGPA Act

Further, EFIC's board must be informed by the adverse impacts of the Carmichael mine on climate change. Both the International Energy Agency (**IEA**) and the former Secretary of the United Nations Framework Convention on Climate Change are among many who view the Carmichael mine as being inconsistent with limiting climate change to well below 2°C, the threshold deemed 'dangerous' by the Paris Agreement. Courts would have strong evidence of unethical behaviour when reviewing any EFIC decision to facilitate the Adani mine.

It should be noted that these obligations override the 'carve out' that EFIC enjoys from being required to notify the federal Department of Environment and Energy with respect to actions that might have a significant impact on the environment and protected areas such as the Great Barrier Reef: s 524(3) *Environment Biodiversity Protection and Conservation Act 1999 (Cth)*.

Worth noting is that EFIC has failed to provide the public information on the board's assessment of relevant criteria of the single Carmichael transaction EFIC has reportedly made a decision to support. This contradicts the SOE, which is made in the public interest, and EFIC's failure to publish the assessment appears to violate EFIC's obligations under s 9(3) of the *Export Finance and Insurance Corporation Act 1991* (Cth) (**EFIC Act**) which mandates that it follow the SOE. Importantly the SOE refers to the publication of the Board's assessment of the project, not whether or not it is proceeding. As such, EFIC's recent statements about the transaction not currently proceeding does not invalidate the need for publishing the assessment.

Publication of the Board's assessment is the Australian public's only check and balance on whether or not the Board is doing its job when it comes to assessing resource projects. This is all the more acute for onshore projects such as Carmichael, as the SOE was changed in September 2017 by Minister Ciobo in direct contradiction to the recommendation by the Productivity Commission, the government's economic advisory body. The current SOE removed the prior prohibition on EFIC support of onshore resource projects or related infrastructure. In our view it is difficult to see how EFIC's board can be satisfied the relevant assessment criteria is met given the outlook for thermal coal and Adani's plans to use minimal Australian content.

Further still, a statutory requirement exists that EFIC's board 'must take into account the effect of those decisions on public resources generally': s 15(2) PGPA Act. And in accordance with the directors' obligations to act with care and diligence, EFIC's board must adequately inform itself of climate change risks. It might be that EFIC's board does not know that, according to the final report on the implications of climate change for Australia's national security by the Senate Standing Committee on Foreign Affairs, Defence and Trade, climate change poses an existential threat to our security.

The committee cited favourably a submission by Dr Barnes:[5]

> … there are different tones and colours to the notion of being a secure economy from a national perspective – the notion of viable economies, the notion of viable environmental conditions and the notion of viable communities. With that slightly different lens, the notion of climate vulnerability and weather impacts on our financial systems are critical.

The Senators concluded:[6]

> Climate change is also adversely affecting other aspects of Australia's national security, including the economy, infrastructure, and community health and well-being.

According to the committee, the Commonwealth whole-of-government approach to climate change is facilitated through the Secretaries Board on Climate Risk and the Disaster and Climate Resilience Reference Group. We are of the view that if EFIC's board did not first review the findings above, and then, acting with the requisite degree of care and diligence, consult and follow advice from the Secretaries Board, it would be unable to demonstrate compliance with the law. We would be surprised if the Secretaries Board came to a view that differed from the IEA, which has confirmed that Adani's developing the isolated Galilee Basin is inconsistent with preventing dangerous climate change.

5 www.aph.gov.au/~/media/Committees/fadt_ctte/Nationalsecurity/report.pdf?la=en p 49

6 As above, p 91

## Unreasonable decisions by the Minister

Federal Trade Minister Steven Ciobo, however, has the final say. He can direct EFIC to do his bidding. However, his decision cannot be unreasonable, and is framed by the requirement to be in the national interest and public interest. Any such decision is open to legal challenge.

Relatively recently, in 2013, Australia's High Court expanded the types of decisions that might fall foul of the *Wednesbury* unreasonableness test (so unreasonable that no reasonable person acting reasonably could have made it). The test no longer applies to exceptional circumstances, but can be applied to decisions under a broad range of statutory powers. Any decision that lacks an 'evident and intelligible justification' is illegal.[7]

Courts will determine whether the Minister has the authority to make a decision. To do this they will scrutinise 'relevant features of the particular statutory framework within which that authority arises'.[8]

For EFIC in the current circumstances the Trade Minister only has authority to make a direction to EFIC if the transaction is 'in the national interest'.[9] The Minister's decisions are further curtailed by the requirement they must be in the 'public interest'.[10]

It is difficult to see how the Minister could determine support for Carmichael is in the public and national interest. The long-term thermal sea-borne coal market is on the decline, domestic resource-related projects are not exposed to market failure, and Adani continues to make misleading claims as to jobs benefits from the project. In our view, it is likely a court would seriously consider whether or not any Ministerial direction to EFIC to support Adani or its business associates was a decision that lacked evident and intelligible justification, and thus beyond the Minister's power.

Further, Adani's Carmichael mine and rail is inconsistent with limiting average global climate change to below 2°C, according to the conservative IEA, which means the project would set the world on a pathway inconsistent with the Paris Agreement's climate goals and towards what the IEA deems 'dangerous anthropogenic climate change'. Such a decision will likely be challenged. On its face, there appears to be no 'evident or intelligent justification' of such a decision being in the public interest.

Challenges to decisions can be made under the *Administrative Decisions (Judicial Review) Act 1976 (Cth).* While EFIC is exempt from the requirement to provide a Statement of Reasons to aggrieved persons for decisions relating to activities on the commercial account and the NIA, EFIC and relevant Ministers are not exempt from the statutory power to challenge those decisions.[11] The lack of information normally provided in a statement of reasons might lead challengers to seek further details under the *Federal Court Rules* preliminary discovery mechanism.

7 *Minister for Immigration and Citizenship v Li* [2013] HCA 18

8 *Minister for Immigration and Border Protection v Stretton* [2016] FCAFC 11

9 Section 27 EFIC Act

10 Section 9(2) EFIC Act

11 ss 5, 13, Schedule 2 (zb ) *Administrative Decisions (Judicial Review) Act 1977 (Cth)*

# Sovereign risk

## The National Interest Account

Either EFIC or the Commonwealth, or both, can shoulder the liability for an NIA transaction. But for EFIC to be liable, EFIC must provide written confirmation to the Minister to accept that liability. EFIC's directors have a discretion here and again, in our view, they would breach their duty of care and diligence if they allowed EFIC to take the fall for a transaction involving Adani's Carmichael project. Liability, therefore, will likely stay with the Commonwealth.[12]

EFIC ring-fences capital relating to the commercial account from its NIA in accordance with s 56(2)(b) of the EFIC Act. Whereas at the end of FY17 EFIC had more than $600 million in callable capital for its commercial account it confirmed:[13]

> We hold no capital against the National Interest Account exposures on the basis that the risks are borne by the Commonwealth.

If EFIC, on behalf of the Commonwealth, has to pay out Adani or its contractors under guarantees or insurance contracts it has two options to raise the cash.[14]

## Borrowing money from the Commonwealth

One option is for EFIC to borrow money from the Commonwealth. The relevant legislative power does not contain a standing appropriation power.[15] In fact, it is explicit that money needs to be appropriated by parliament for that purpose. Thus, to avoid falling foul of s 83 of the Constitution governing consolidated revenue, the Commonwealth can only lend money to EFIC pursuant to an appropriation act.

EFIC's callable capital, being the capital required to meet EFIC's general liabilities, arguably benefits from a standing appropriation power in the EFIC Act, such that a separate appropriations act is not required. However, there are carve outs that expose EFIC's customers to political risk. NIA Commonwealth-backed guarantees, contracts of insurance or losses under loans must be appropriated by an act of parliament.[16] No other appropriations power exists in EFIC's governing legislation.

The Productivity Commission, the Australian government's economic advisory body, credits appropriation acts as the method for NIA appropriation in its 2012 report into Australia's export credit arrangements, stating at p55:

> Any budgetary appropriation from the Consolidated Revenue Fund to EFIC that relates to the NIA is through the Department of Foreign Affairs and Trade and is scrutinised by the Australian Parliament

In current political circumstances the government requires support of the crossbench to pass an Appropriation Act. There is no guarantee this will occur. It is perfectly within the rights of parliamentarians to demand any annual appropriations act is in sufficient detail such that it lists individually money that might be bound to Adani or its associates, or other destinations such as the arms industry. Appropriations are receiving recent judicial scrutiny. As stated in the High Court decision *Wilkie v Commonwealth* 2017 [HCA] 40 at [71]:

> An appropriation must always be for the purpose identified by Parliament, albeit that '[i]t is for the Parliament to identify the degree of specificity with which the purpose of an appropriation is identified'.

A demand by parliamentarians for greater transparency would mean budgetary appropriations in the annual appropriations act must have a listing of individual EFIC transactions supported by the appropriation. It is the only true way for parliament to maintain oversight of what is a secretive financing vehicle that has access to a potentially limitless amount of taxpayer funds.

12 Section 64 EFIC Act

13 EFIC 2016/17 Annual report pp 73,74

14 Sections 58, 59 EFIC Act

15 Section 58 EFIC Act

16 Subsections 54(1), 54(9), 54(10) EFIC Act

Typically, major NIA loans are reported in the federal budget as contingent liabilities, but only after the loans have been made. However, those loans are not currently the subject of parliamentary scrutiny. The government's latest budget, published recently on 8 May 2018, did not list any loan to Adani or its business associates. In light of growing national public protests against subsidies for foreign billionaires and open-ended water access rights for one of the world's largest proposed new coal mines at a time of ongoing, severe water stress in large parts of Eastern Australia, the Trade Minister, Steven Ciobo, is understandably defensive, and has reiterated to press that there are no proposals 'for Adani to receive funding' on the NIA. Of course, that ignores the possibility of Adani's business associates receiving funding, or guarantees for loans to Adani.

The political situation in Australia is volatile. Protests regarding possible EFIC support are occurring outside Trade Minister Ciobo's offices and the residence of the Prime Minister. Fallout continues from the citizenship saga, and a federal election is expected in the short term. Parliamentarians may request that an appropriations act has the degree of specificity to identify any national interest transactions. Otherwise they may vote against appropriations acts wholesale. Currently the Labor Party is the electorate's preferred option. And Labor has ruled out public funding for Adani's Carmichael mine and rail project. An election is expected within a year.

In recent decisions the High Court has strictly enforced Constitutional requirements for parliamentary oversight of appropriations. The scope for legal challenge should not be under-estimated if funding does not occur via an appropriations act. If it does occur via an appropriations act, then there is substantial political risk of that act not passing.

The appropriations requirement is where S&P Global Ratings Direct, in its 2016 report equalising EFIC's rating with that of the government, may not apply to Adani. The fact is that Adani's Carmichael Mine and Railway project is heavily politicised. The spectre of government concessional financial support for Adani was instrumental in the Queensland state election. Queenslanders returned the State Labor government to power only after the Premier made a calculated decision to veto Commonwealth funding from NAIF on the eve of the election.

Additional proof of the poisonous nature of government concessional financial support can be seen in the scrutiny of the $5 billion NAIF that was beset by allegations of conflicts of interest, inappropriate Ministerial directions and was eventually subject to an invasive and critical Senate inquiry into its governance. The Senators' final report had not been released at the date of this report.

## Raising money on the financial markets

The second path is for the Commonwealth to direct EFIC to raise the money on the financial markets.[17] It did this in 2011, raising US$2.5 billion. EFIC states it has funded its activities via raising money on the markets, rather than borrowing from the Commonwealth.

However, to raise money, EFIC requires written permission from the Finance Minister. But again, a future Labor Finance Minister would be bound by Labor's promise of no taxpayer money for Adani, so any financier accepting the EFIC insurance would be doing so knowing that the sovereign guarantee is highly conditional and subject to cancellation.

In any event, an appropriation will need to be made to cover exposures on the NIA for insurance and guarantees, even if EFIC raises that money on the financial markets. As set out above, EFIC's 2017–18 Corporate Plan says it holds no capital against the NIA.[18]

Thus it appears that EFIC raises money on the financial markets as agent for the Commonwealth for any NIA transactions.

The standing appropriations power in the EFIC Act arguably means that EFIC can loan money on the NIA without an appropriation, but it cannot cover payouts of contracts of insurance or guarantees for NIA transactions, nor can EFIC recoup losses under loans. Under those circumstances, money raised on the financial markets must be appropriated from Consolidated Revenue by an appropriations act. As explained above, this is a risky proposition.

In circumstances where a Commonwealth-backed insurance contract, guarantee or losses on a loan crystallise, it seems likely that a change in government might yield circumstances where EFIC cannot access the money to pay a transaction on the NIA. The possibility exists with the current crossbench.

17 Subsections 59,66(7),67(7) EFIC Act

18 www.efic.gov.au/media/4107/corporate-plan-2017-18-final.pdf p 20

## Commonwealth guarantee

The federal government and EFIC would no doubt point to the Commonwealth guarantee in s 62 of the EFIC Act as a source of comfort for partners that might call on an EFIC guarantee, contract of insurance, or fail to repay a loan. But due to the significant politicisation of lending for coal projects, the substantial community opposition in Australia and unpredictable politics in this nation, there are risks that the Commonwealth in the form of the Executive, or parliamentarians in the Legislature, will refuse to indemnify transactions made by the pro-coal government of the time. Parties to EFIC transactions should heed the warning in EFIC's 2011 Circular for EFIC's US$2.5 billion capital-raising:

> The due payment by the Issuer [EFIC] of any money that becomes payable by it to a person other than the Commonwealth is guaranteed by the Commonwealth pursuant to the EFIC Act. There is no assurance that the Parliament of Australia will not introduce new legislation to amend the terms of, or remove, its legislative guarantee. The Parliament of Australia has the constitutional power to make amendments to the EFIC Act with retrospective effect.

If the Executive or Legislature of the day refuses to pay out a NIA facility by an appropriations act, or otherwise honour the government guarantee, a party to a transaction with EFIC could seek to obtain a judgment debt or order in an Australian court. Parties of course should factor in litigation risk given the opposition party's clear position against such any such future transaction. An outcome is not a *fait accompli*. Even if the court made the judgment or order, there is no watertight guarantee from the Commonwealth it would be paid out.

As the 2011 Circular points out:

> When a judgment attaches to the Commonwealth, the Registrar of the Court issues a certificate which the Minister for Finance and Deregulation is obliged to satisfy out of moneys legally available upon receipt of the certificate. The passage of an Appropriation Bill is required to make the moneys available, however, no execution or attachment can be issued against the property or revenues of the Commonwealth to allow investors to recover all or any part of their investment in Instruments issued under the Programme.

An appropriations act will therefore be required for the Commonwealth to pay out a judgment against the Commonwealth for any Adani-related payments. As outlined above, there is no guarantee of safe passage of any such appropriations bill.

There are many inherent risks to EFIC providing financial support to Adani. They materialise now for all transactions and are real and significant. Bankers and Adani's business associates should be aware of the substantial legal and political risks as political instability in Australia is etched into the landscape and significant community opposition to Adani's coal project continues to manifest.


*Protest outside Minister Ciobo's office, 24 May 2018 (Photograph: Alexander Watson)*

# About Environmental Justice Australia

Environment Justice Australia (formerly the Environment Defenders Office, Victoria) is a not-for-profit public interest legal practice. Funded by donations and independent of government and corporate funding, our legal team combines a passion for justice with technical expertise and a practical understanding of the legal system to protect our environment.

Our Climate and Finance program brings legal capacity and expertise to public interest climate change and finance issues in Australia. Climate risks are financial risks. The Paris Climate Agreement means 'business as usual' is no longer an option. Australian regulators have confirmed climate change is a financial risk. Barristers' advice puts directors on notice for not considering the risks. Government officials must act with care and diligence. These are the new realities for investors and financiers.

But climate change risks are not being taken seriously. That's where we step in.

Environmental Justice Australia exposed serious flaws in plans for a government subsidy to support Adani's Carmichael project – a proposal for the world's largest new coal mine. The Northern Australia Infrastructure Facility (NAIF) considered lending $1 billion in taxpayers' money to a coal railway to service Adani's mine. EJA exposed NAIF board members' conflicts of interest, raised serious questions about NAIF's Risk Appetite Statement and its Anti-Money Laundering policy and advised that NAIF's officials would breach their duties if the loan proceeds.

EJA is the only legal practice in the world to file court proceedings against a bank over climate risk disclosure. In August 2017 we lodged the case in the Federal Court of Australia against the largest public company in Australia, the Commonwealth Bank. The case was brought by long-term shareholders alleging the bank failed to adequately disclose climate related risks in its annual report.

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