

MEMORANDUM PREPARED BY SIDLEY AUSTIN
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RE: WTO-Consistency of the Application of Proposed Amendments to the EU
 Renewable Energy Directive to Trade in Biofuels

1. This memorandum discusses key amendments proposed for the EU Renewable Energy Directive and presents an analysis under WTO rules applicable to international trade in biofuels. In particular, the memorandum analyzes two possible amendments: (i) the exclusion of biofuels produced from cereal and other starch crops, sugars and oil crops from 5 percent of the share of the EU transport energy market; and (ii) the inclusion of emissions from indirect land use change (“ILUC”) in calculating the greenhouse gas emissions savings from use of such biofuels.

2. These amendments, if applied, are potentially challengeable under the WTO *Agreement on Technical Barriers to Trade* (“TBT Agreement”). The WTO Appellate Body clarified the TBT jurisprudence in a series of decisions taken in the second quarter of 2012 in *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products* (“US – Tuna IP”), *United States – Measures Affecting the Production and Sale of Clove Cigarettes* (“US – Clove Cigarettes”), and *United States – Certain Country of Origin Labeling Requirements* (“US – COOL”). This memorandum analyzes the WTO-consistency of the proposed amendments in light of these decisions.

3. In the alternative, if these measures are deemed not to be technical regulations under the *TBT Agreement*, they could nonetheless be challenged under Articles I, III, and XI of the General Agreement on Tariffs and Trade (“GATT”) 1994 and defended under Article XX of the GATT 1994. Therefore, this memorandum also provides this alternative analysis on WTO-consistency.

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4. This memorandum presents the analysis as follows:

Section I provides an executive summary of the findings of the memorandum.

Section II provides an overview of the two proposed amendments at issue.

Section III provides an analysis of how Articles 2.1 and 2.2 of the *TBT Agreement* could apply to the proposed amendments, using the recent decisions in *US – Tuna II*, *US – Clove Cigarettes* and *US – COOL*.

Section IV analyzes how Articles I:1, III:4, XI:1 and XX of the GATT 1994 apply to the proposed amendments.

I. **EXECUTIVE SUMMARY**

5. WTO rules, particularly those set forth in the GATT 1994 and the *TBT Agreement*, constitute the primary source of external legal discipline on internal EU decision making involving regulation of trade in biofuels.

6. The above-mentioned three Appellate Body reports, all adopted and circulated by the WTO in 2012,² represent a consolidated step forward in understanding how WTO tribunals will interpret TBT Article 2.1, which applies the basic non-discrimination principles of the GATT 1994 to product standards, and TBT Article 2.2, which requires that mandatory standards be no more trade-restrictive than necessary to fulfill a government's legitimate non-trade policy objective. These Appellate Body reports resolve certain key interpretative differences relating to these TBT provisions that had emerged from the various panel reports.

7. The end result of this new jurisprudence is that the EU cannot maintain product standards on biofuels that discriminate (either *de jure* or *de facto*) against Brazilian and other origin biofuels in favor of EU biofuels.

8. The European Commission has proposed two key amendments to the EU's Renewable Energy Directive which are vulnerable to challenge under the *TBT Agreement* and the GATT 1994. One amendment would impose a cap on the market share of biofuels

² See, *supra*, n 2.

produced from cereal and other starch crops, sugars and oil crops in the EU's transport energy market. The second would include estimated emissions from indirect land use change in calculating the greenhouse gas emissions savings from use of such biofuels. Both amendments appear to be based on environmental concerns, without intention to discriminate against imports. However, some facts suggest that they would result in less favorable treatment and restrictions of imports of biofuels from certain WTO Members, particularly many developing countries that produce first-generation biofuels. This makes the proposed amendments vulnerable to a WTO challenge. Such vulnerability to a WTO challenge would, in turn, lead to uncertainty and instability in the EU regulatory regime.

9. Thus, as the EU institutions and stakeholders consider the European Commission's proposal, they will very likely need to make various adjustments to the EU Renewable Energy Directive in order to ensure consistency with WTO rules.

II. PROPOSED AMENDMENTS: CSO MARKET SHARE CAP AND ILUC FACTORS

A. Current regulation of biofuels in the EU

10. The EU's regulations on biofuels are set out in two instruments, the Renewable Energy Directive³ and the Fuel Quality Directive.⁴ Currently, under the Renewable Energy Directive, only biofuels that meet the EU's sustainability criteria are counted towards achieving the targets of 10 percent renewable energy in transport energy and 20 percent renewable energy in total energy consumption by 2020. These target-linked sustainability criteria are critical because EU Member States take measures to achieve the targets primarily by requiring mandatory blending of transport fuels with biofuels that meet the EU sustainability criteria. In addition, only biofuels that meet the sustainability criteria are eligible for financial support from the EU and EU Member States. Under the Fuel Quality Directive, only biofuels that meet the sustainability criteria are counted towards achieving the

³ Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, as amended ("Renewable Energy Directive").

⁴ Directive 98/70/EC of the European Parliament and of the Council of 13 October 1998 relating to the quality of petrol and diesel fuels and amending Council Directive 93/12/EEC, as amended ("Fuel Quality Directive").

target of 6 percent reduction in life-cycle greenhouse-gas emissions of transport fuels by 2020. Both Directives are implemented by national legislation in the 27 EU Member States.

11. Thus, meeting the sustainability criteria is effectively an indispensable requirement for meaningful market access in the EU biofuels market. Biofuels that do not meet the EU's sustainability criteria are effectively banned from the 10 percent segment of the EU's transport energy market. This is because non-conforming biofuels cannot compete with conforming biofuels because they do not qualify for mandatory blending requirements, nor for financial support. Given the (current) higher costs of biofuels compared to conventional fuels in the EU, real market access for biofuels can only be achieved by qualifying for mandatory blending or significant financial support.

B. Proposed amendments

12. The European Commission has issued a proposal to amend both the Renewable Energy Directive and the Fuel Quality Directive.⁵ This memorandum is concerned in particular with two amendments in the proposal relating to the Renewable Energy Directive.

13. *Firstly*, the European Commission proposes to impose a cap of 5 percent on biofuels produced from cereal and other starch rich crops, sugars and oil crops ("CSO crops" and "CSO biofuels") in meeting the 10 percent target for share of renewables in the EU's transport energy market (for brevity, to be referred to as the "CSO cap" in this memorandum). This cap, if adopted, would effectively ban all CSO biofuels from the remaining 5 percent market segment within the 10 percent market segment targeted for renewable transport energy.

14. *Secondly*, the Commission proposes to attribute estimated indirect land use change ("ILUC") emissions to CSO crops. The same ILUC factor is attributed to all feedstocks in each sub-group of crops: (i) 12 gCO₂eq/MJ for any cereal or other starch rich crop (e.g. corn, wheat); (ii) 13 gCO₂eq/MJ for any sugar (e.g. sugar cane, sugar beet); and (iii) 55 gCO₂eq/MJ for any oil crop (e.g. palm oil, sunflower oil, jatropha oil). Non-CSO feedstocks are not assigned any ILUC factors. The Commission's proposed amendment as currently

⁵ Proposal for a Directive of the European Parliament and of the Council amending Directive 98/70/EC relating to the quality of petrol and diesel fuels and amending Directive 2009/28/EC on the promotion of the use of energy from renewable sources, COM(2012) 595 final ("Amendment Proposal").

drafted would require EU Member States to tabulate the given ILUC factor as part of the estimated emissions for CSO crops when reporting their greenhouse gas emission savings. However, as currently drafted by the Commission, this is only a reporting obligation, and would *not* form part of the sustainability criteria. In other words, the amount of ILUC tabulated by Member States would create no impact on biofuels' eligibility for financial support or inclusion in meeting the 5 percent or 10 percent targets.

15. However, it is anticipated that starting with this reporting requirement, the European Parliament will then propose to include ILUC factors for CSO biofuels in the sustainability criteria. This would make it more difficult for CSO biofuels to be eligible for mandatory blending, financial support and inclusion in meeting the renewable energy targets. Thus, CSO biofuels suffer two forms of significant market access barriers; first, they are *de facto* restricted to a mere 5 percent of the EU biofuels market, and second, they face exclusion from even that small market if the ILUC factors are enforced.

16. For the purposes of this memorandum, we assume that the European Parliament would propose to include ILUC factors for CSO biofuels in the sustainability criteria of the Renewable Energy Directive. Thus, where we refer to the proposed CSO ILUC factors, we are referring to their (expected) inclusion in the sustainability criteria, and not merely the reporting of ILUC factors as provided in the current proposal of the Commission.

III. ANALYSIS UNDER THE *TBT AGREEMENT*

17. The *TBT Agreement* deals with three types of measures – technical regulations, standards and conformity assessment procedures – each of which is defined in Annex 1 to the Agreement. The *TBT Agreement* imposes its greatest level of discipline on those measures that meet the definition of technical regulations. A regulatory measure that is a technical regulation could (and often would) be covered by both the *TBT Agreement* and the GATT 1994, but if a measure were subject to the *TBT Agreement*, it would be analyzed under the *TBT Agreement* as *lex specialis* prior to any examination under the GATT.⁶ Therefore, we first analyze the CSO cap and ILUC factors (as part of the overall Renewable Energy

⁶ See Panel Report, *US – Tuna II*, paras. 7.40-46.

Directive) under the *TBT Agreement*, and as a threshold matter, whether they would fall within the scope of the Agreement as a “technical regulation.”

B. Annex 1.1 - Definition of “technical regulation”

18. To fall within the scope of the *TBT Agreement*, the CSO cap and ILUC factors must constitute a “technical regulation”,⁷ which is defined as follows:

Document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labeling requirements as they apply to a product, process or production method.⁸

19. This definition has been interpreted by the Appellate Body to require that a technical regulation must: (i) apply to an identifiable group of products; (ii) lay down one or more characteristics of the products; and (iii) require mandatory compliance.⁹ Importantly, the measure must be examined “as a whole” to determine its proper legal character.¹⁰

i. Identifiable group of products

20. To meet the definition of “technical regulation,” a measure must apply to an “identifiable” group of products. The CSO cap clearly does so, namely biofuels and bioliquids produced from CSO crops.¹¹ The CSO ILUC factors also clearly apply to biofuels and bioliquids produced from CSO crops.¹²

⁷ In light of the definitions of “standard” and “conformity assessment procedure,” if the CSO cap and ILUC factors do not meet the definition of “technical regulation,” then they would not fall within the scope of the other defined terms, either, and thus would fall outside the scope of the *TBT Agreement*.

⁸ Annex 1.1 of the *TBT Agreement*.

⁹ Appellate Body Report, *EC – Sardines*, para. 176; Appellate Body Report, *EC – Asbestos*, paras. 66-70; Appellate Body Report, *US – Tuna II*, para. 183.

¹⁰ Appellate Body Report, *EC – Asbestos*, para. 64.

¹¹ Article 2(2)(b) and (c) of the Amendment Proposal.

¹² Annex II, para. (2) of the Amendment Proposal.

ii. Characteristics of the products

- (a) “*product characteristics or their related processes and production methods*”

21. The second element of determining whether a measure is a “technical regulation” involves examining the subject-matter, or content, of technical regulations. The first sentence of TBT Article 1.1 establishes that a technical regulation may lay down “product characteristics or their related processes and production methods”. Until the panel and Appellate Body decisions in *US – Tuna II*, it had been unclear whether feedstock-related targets and sustainability criteria (including ILUC factors) could fit within this first sentence. This is because the physical characteristics of the final biofuel product do not vary according to the particular feedstock, nor according to compliance with sustainability criteria. Sugarcane ethanol, miscanthus ethanol, and wheat straw ethanol have identical product characteristics, although they are produced from different feedstocks. Sugarcane ethanol that meets the sustainability criteria and sugarcane ethanol that does not meet the criteria have identical product characteristics, although they have undergone different processes or production methods. Thus, it could be argued that the CSO cap and ILUC factors lay down processes and production methods that do not *relate to product characteristics*, and are therefore outside the scope of this definition.

22. However, the recent dispute settlement reports in *US – Tuna II* suggest that this definition could be interpreted more widely to include processes and production methods that *apply to a product*. The panel in *US – Tuna II* stated that “the labeling requirements laid down in the US dolphin-safe labeling provisions ‘apply to’ a product, namely tuna products”, and decided that the subject-matter of the measures was within the scope of a technical regulation. The panel did not consider whether there was any relation between the measures and the product characteristics. This part of the panel’s decision was not appealed, and therefore stands to clarify the scope of technical regulations subject to the *TBT Agreement*. Although the measures at issue in *US – Tuna II* were “labeling requirements” as listed in the second sentence of TBT Article 1.1, it is arguable that similar reasoning would apply also to the *first* sentence. If the *first* sentence of Article 1.1 could be interpreted broadly to include

regulations that *apply to products*, then the CSO cap and ILUC factors would clearly satisfy the subject-matter test for technical regulations under the *TBT Agreement*.

23. It should be noted that other elements of the Renewable Energy Directive do appear to describe production methods that *relate to* product characteristics. For example, Annex III (referred to in Article 5(5) of the Directive) describes the energy content of transport fuels according to their production methods. Thus, if the measure at issue in a dispute were sufficiently broad to encompass Annex III of the Directive, then the measure might well satisfy the subject-matter test under the first sentence of the definition of “technical regulation.”

(b) “*terminology, symbols, packaging, marking or labeling requirements*”

24. If the CSO cap and ILUC factors were held not to fit within the *first* sentence of the definition, either on their own or within the broader scope of the Renewable Energy Directive, they could nonetheless fit within the *second* sentence of the definition.

25. The second sentence of Article 1.1 (“It may also deal with ...”) further elaborates on the subject-matter of technical regulations, and enumerates some specific items that technical regulations may also “include or deal exclusively with”. As described by the Appellate Body in *EC – Asbestos*:

In addition, according to the definition in Annex 1.1 of the TBT Agreement, a ‘technical regulation’ may set forth the ‘applicable administrative provisions’ for products which have certain ‘characteristics’. Further, we note that the definition of a ‘technical regulation’ provides that such a regulation ‘may also include or deal exclusively with terminology, symbols, packaging, marking or labeling requirements’. The use here of the word ‘exclusively’ and the disjunctive word ‘or’ indicates that a ‘technical regulation’ may be confined to laying down only one or a few ‘product characteristics’.¹³

26. Thus, the subject-matter of a technical regulation may be confined to one of the elements enumerated in the second sentence, including “terminology,” as they apply to a product, process, or production method.

¹³ Appellate Body Report, *EC – Asbestos*, para. 67.

27. The CSO cap and ILUC factors establish “terminology” essential to the design and implementation of the Directive, and this “terminology” will clearly have a significant impact on trade in biofuels. No WTO panel has yet interpreted “terminology” as the subject-matter of a technical regulation. The panel in *US – Tuna II* analyzed a “labeling requirement” and found it to fall within the second sentence of the definition of “technical regulation.” In *EC – Sardines*, the panel and the Appellate Body agreed that a “naming” regulation also fit the definition in that it “identified” a product. In *EC – Asbestos*, the Appellate Body concluded that product characteristics may include “not only features and qualities intrinsic to the product itself, but also related ‘characteristics’, such as the means of identification.” It might well be that, with the adoption of the CSO cap and ILUC factors, goods will be identified based in part on the terminology set forth in the Directive. Thus, for example, goods might be identified as “biofuels produced from cereal and other starch rich crops, sugars and oil crops” or “biofuels *not* produced from cereal and other starch rich crops, sugars and oil crops.” Indeed, it will be necessary for the EU and the EU Member States to use such terminology in order to track compliance with the amended Directive. If such terminology is applied, then the CSO cap and ILUC factors would fit within the second sentence of the definition of “technical regulation”.

28. In addition, if the EU were to impose various forms of “marking” requirements on the products to enable inspectors to track the supply of CSO biofuels, then the subject-matter of the second sentence of Annex 1.1 would be satisfied and the TBT Agreement would clearly apply.

iii. Compliance is “mandatory”

29. Finally, if the CSO cap and the ILUC factors are adopted, it will be mandatory to comply with them.

30. The Appellate Body in *US – Tuna II* noted that in some cases it may be relatively straightforward and in others it may be more complex to determine whether a measure is a technical regulation (subject to the disciplines of Article 2 of the *TBT Agreement*) or a standard (not subject to those disciplines). Both technical regulations and standards could, for instance, contain “compulsory” or “binding” and “enforceable” conditions that must be met in order to use a label. Under the measures at issue in *US – Tuna II*, it was possible to

sell tuna products without a “dolphin-safe” label in the US, but any producer, importer, exporter, distributor or seller of tuna products had to comply with the measure in order to make any “dolphin-safe” claim. In reaching the conclusion that the measures required mandatory compliance, the Appellate Body considered that “a panel’s determination of whether a particular measure constitutes a technical regulation must be made in light of the characteristics of the measure at issue and the circumstances of the case.” When it is necessary to consider “additional characteristics of the measure”, the exercise may involve considering “whether the measure consists of a law or regulation enacted by a WTO Member, whether it prescribes or prohibits particular conduct, whether it sets out specific requirements that constitute the sole means of addressing a particular matter, and the nature of the matter addressed by the measure”.¹⁴

31. If the CSO cap is adopted, it will not be possible to sell CSO biofuels in the 5 percent segment of the EU’s transport energy market reserved for non-CSO renewable energy. Similarly, if the CSO ILUC factors are adopted, some CSO biofuels will fall out of compliance with the sustainability criteria and, as a result, it will not be possible to sell those biofuels in the 10 percent segment reserved for renewable energy meeting sustainability criteria. Therefore, these measures reflect a relatively straightforward case for demonstrating that compliance is mandatory to achieve the benefits of market access (and accompanying mandatory blending and financial support for eligible biofuels).

32. Further, given the higher costs of biofuels compared to conventional fossil fuels, there is effectively no market for biofuels that cannot be either included in mandatory blending requirements, counted toward targets under the Renewable Energy Directive, or be eligible for financial support. Although it will arguably not be “impossible” to market CSO and ILUC-accounted biofuels in the EU at a general level, the sustainability provisions in the Renewable Energy Directive make it practically prohibitive to do so. Thus, the Renewable Energy Directive may be found, under the rationale in *US – Tuna II*, as a mandatory measure even though it does not require a prohibition on the sale of the product in question.¹⁵

¹⁴ Appellate Body Report, *US – Tuna II*, para. 188.

¹⁵ Panel Report, *US – Tuna II*, para. 196.

33. Thus, imposing the CSO cap and ILUC factors would constitute “technical regulations” under the *TBT Agreement*, as they apply to CSO biofuels as an identifiable group of products, lay down the processes and production methods applying to biofuel products, and require mandatory compliance. Having established that the measures would constitute technical regulations, the following sections analyze their compatibility with Articles 2.1 and 2.2 of the *TBT Agreement*. Finally, to the extent these measures may *not* be deemed to be technical regulations, they would be subject to challenge under Articles I, III, and XI of GATT 1994 as set forth in Section IV below.

B. Article 2.1 – National Treatment and MFN Treatment

34. Article 2.1 of the *TBT Agreement* requires WTO Members to ensure national treatment and most-favored-nation (“MFN”) treatment in respect of technical regulations. It provides that:

Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favorable than that accorded to like products of national origin and to like products originating in any other country.

35. Thus, to establish whether the CSO cap and ILUC factors are consistent with Article 2.1, two factors must be considered: (i) whether biofuels of different origins are “like products”; and (ii) whether biofuels from certain countries are afforded “less favorable treatment” than biofuels originating in the EU and other countries.

i. “Like products”

36. Ethanol products of different national origin – for example, Brazilian sugarcane (CSO) ethanol, EU miscanthus (non-CSO) ethanol and EU wheat straw (non-CSO) ethanol – are like and competitive products that compete in the same market. Thus, by any reasonable definition of “like product”, they will be considered by any future WTO panel to be “like products”.

37. The Appellate Body in *US – Clove Cigarettes* found that “the determination of likeness under Article 2.1 of the *TBT Agreement*, as well as under Article III:4 of the GATT 1994, is a determination about the nature and extent of a competitive relationship

between and among the products at issue.¹⁶ This focus on the competitive relationship between products is consistent with the panel’s ruling in *US – Tuna II*, and is a significant correction of the panel’s ruling in *US – Clove Cigarettes* issued earlier. The panel in *US – Clove Cigarettes* had held that likeness under TBT Article 2.1 should *not* “be approached primarily from a competition perspective”.¹⁷ It had allowed the US’s declared policy objective to permeate the likeness analysis, stating that “the weighing of the evidence relating to the ‘likeness’ criteria should be influenced by the fact that [the measure] is a technical regulation having the immediate purpose of regulating cigarettes with a characterizing flavor for public health reasons.”¹⁸ In overturning the panel’s considerations in this regard, the Appellate Body noted that “in determining likeness based on the competitive relationship between and among the products, a panel should discount any distortive effects that the measure at issue may itself have on the competitive relationship, and reserve the consideration of such effects for the analysis of less favourable treatment.”¹⁹

38. With the strong competitive relationship between all ethanol origin products in mind, the four criteria for assessing “likeness” are: (i) physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes. These criteria have been repeatedly applied by the panel in TBT cases, and were recognized also by the Appellate Body in *US – Clove Cigarettes*.²⁰

39. Applying criteria (i), (ii) and (iv) on physical properties, end-use and tariff classifications, it can be seen that ethanol fuels of different origins are like products. There is no difference in the product characteristics depending on where an ethanol fuel has been produced and whether it is produced from CSO feedstock or non-CSO feedstock. Ethanol

¹⁶Appellate Body Report, *US – Clove Cigarettes*, para. 120, underlining added.

¹⁷ Panel Report, *US – Clove Cigarettes*, para. 7.119.

¹⁸ Panel Report, *US – Clove Cigarettes*, para. 7.119.

¹⁹ Appellate Body Report, *US – Clove Cigarettes*, para. 111.

²⁰ Appellate Body Report, *US – Clove Cigarettes*, para. 104; Panel Report, *US – Clove Cigarettes*, paras. 7.121-123.

has the same physical properties, end-uses and tariff classification, whether it has been produced in the EU or in another country, and regardless of the feedstock used.²¹

40. Applying criterion (iii) on consumer preferences suggests that ethanol fuels of different origins are still like products. It may be argued that some consumers would prefer to use ethanol from certain feedstocks or certain origins, due to concerns over the sustainability of biofuel production and land use. Indeed, the Appellate Body has recognized that the regulatory concerns underlying a measure may be relevant for the likeness analysis to the extent they have an impact on the competitive relationship between and among products, and that this may be through consumer preferences.²² However, the likeness analysis should not be *based* on the regulatory purposes of technical regulations, as this would lead to circular reasoning that justifies less favorable treatment of products that would have been like in the absence of regulation. As the Appellate Body explained in *US – Clove Cigarettes*, “[i]f products that are in a sufficiently strong competitive relationship to be considered like are excluded from the group of like products on the basis of a measure’s regulatory purposes, such products would not be compared in order to ascertain whether less favourable treatment has been accorded to imported products. This would inevitably distort the less favourable treatment comparison, as it would refer to a ‘marketplace’ that would include some like products, but not others.”²³

41. In considering consumer preferences, the Appellate Body in *US – Clove Cigarettes* noted that “it is not necessary to demonstrate that the products are substitutable for all consumers or that they actually compete in the entire market.” Further, it noted that “if the products are highly substitutable for some consumers but not for others, this may also support a finding that the products are like.”²⁴ Indeed, it would be very difficult to argue that there are entirely separate markets for ethanol of different feedstocks or origins. There is a very high degree of competition and substitutability between ethanol of different feedstocks and origins, despite some consumers’ potential preferences for certain ethanol fuels.

²¹ We note that ethanol for fuel may also be considered a “like product” with ethanol for industrial use, as they are identical in physical properties and are capable of serving the same end-uses, although they are applied toward different uses. We do not examine this further, as this memorandum is focused on the treatment of biofuels under the Renewable Energy Directive.

²² Appellate Body Reports, *US – Clove Cigarettes*, para. 117-118; *EC – Asbestos*, para. 122.

²³ Appellate Body Report, *US – Clove Cigarettes*, para. 116.

²⁴ Appellate Body Report, *US – Clove Cigarettes*, para. 142.

42. Having examined ethanol under each of the four criteria for a likeness assessment, we conclude that ethanol products of different origins are like products.²⁵

ii. “Less favorable treatment”

43. Having established that ethanol from different origins covered by the EU Directives are like products, the next step in the analysis of assessing compliance with TBT Article 2.1 is to determine whether the Directives impose “less favorable treatment” on imported ethanol. The Appellate Body clarified the steps for establishing this under TBT Article 2.1, by applying a consistent test across the three cases in *US – Clove Cigarettes*, *US – Tuna II* and *US – COOL*. This corrected the previous confusion from divergent reasoning given by different panels in those cases. Applying the Appellate Body’s analytical steps, it can be seen that the EU’s proposed CSO cap and CSO ILUC factors may afford less favorable treatment to ethanol of certain origin, in violation of TBT Article 2.1.

44. The two main steps to establishing “less favorable treatment” are as follows. *Firstly*, the complainant must show that the technical regulation at issue modifies the conditions of competition in the relevant market to the detriment of the group of imported products vis-à-vis the group of like domestic products or like products originating in any other country. If this is the case, then, *secondly*, it will be up to the respondent to show that the detrimental impact on imported products stems exclusively from a legitimate regulatory distinction, rather than reflecting discrimination against the group of imported products. If the respondent cannot do this, there will be a violation of TBT Article 2.1.²⁶ In order not to constitute a violation of Article 2.1, the measure must be “even-handed” in the manner in which it addresses the legitimate objective pursued.²⁷

²⁵ The same considerations apply to make biodiesel of different feedstocks and origins “like products”. Further, it may be argued that biofuels – encompassing both ethanol and biodiesel – of different feedstocks and origins are like products. For the purposes of this memorandum, we focus on ethanol, but the analysis herein could potentially be applied to biofuels as the broader like product category.

²⁶ Appellate Body Report, *US – Clove Cigarettes*, para. 180-182; Appellate Body Report, *US – Tuna II*, para. 211-215; Appellate Body Report, *US – COOL*, para. 268.

²⁷ Appellate Body Report, *US – Tuna II*, para. 232.

(a) *Conditions of competition*

45. For ethanol, the key question in this regard is whether the EU's proposed amendments would modify the conditions of competition in the EU market to the detriment of ethanol from a particular WTO Member, as compared to EU ethanol or ethanol originating in any other Member.

46. Both the CSO cap and the CSO ILUC factors are *de jure* origin-neutral, as they favor non-CSO feedstocks over CSO feedstocks, without specifying any particular origin. However, these measures may create significant *de facto* modifications of the conditions of competition to the detriment of many non-EU countries. This is because eligible ethanol from non-CSO feedstocks are highly innovative products that are being produced by few producers in a few countries, mainly on a pilot basis. Two main examples of such innovation are miscanthus ethanol in the EU and switchgrass ethanol in the US. Both miscanthus and switchgrass are cellulosic and thus non-CSO feedstocks which can be converted to ethanol. However, it has proved difficult to convert such plant material into ethanol, requiring more complex technology than the technology required to convert CSO feedstocks into ethanol. Many WTO Members have not yet invested in such non-CSO biofuel production to the degree that the EU and the US have. Therefore, by modifying the conditions of competition to the detriment of CSO ethanol, the EU is *de facto* modifying the conditions of competition to the detriment of WTO Members that do not produce non-CSO ethanol to any significant degree.

- CSO cap: The CSO cap effectively bans CSO biofuels from a 5 percent segment of the EU's transport energy market. This is to the detriment of WTO Members such as many developing countries that cannot access this market segment, compared to the EU (potential violation of national treatment) and the US (potential violation of MFN treatment) that will be able to access this market segment with their current non-CSO biofuel production.
- CSO ILUC factors: The ILUC factors apply only to CSO biofuels, and not to non-CSO biofuels. This means that CSO biofuels are automatically attributed with greenhouse gas emissions that make them less likely to meet the sustainability criteria

under the Renewable Energy Directive, and therefore make them less likely to qualify for financial support in the EU. As with the CSO cap, this is to the detriment of WTO Members such as many developing countries that export only CSO biofuels to the EU, compared to the EU and the US that have non-CSO biofuel production and will have a competitive advantage in securing financial support from the EU.

47. CSO ethanol and non-CSO ethanol are like products, with no differences in physical characteristics or use. They differ only in production method and feedstock. CSO ethanol is relatively easy to produce and thus is the most reasonable production method for ethanol biofuel. Producing non-CSO ethanol is technology-intensive, making it the reserve of particular economies that have chosen to invest in such technology, such as the EU and the US. Thus, by banning CSO ethanol from 5 percent of the EU transport energy market, and subjecting CSO ethanol to additional ILUC accounting, the EU would be modifying the conditions of competition in the ethanol market in favor of certain ethanol products that currently are limited to production in only a few WTO Members including the EU. This would be to the detriment of countries such as many developing countries that currently do not export non-CSO ethanol.

48. In this regard, it is important to note that the EU's proposed amendments would not prevent any WTO Member from developing non-CSO ethanol. It would be open to any WTO Member to produce non-CSO ethanol that can benefit from the incentives offered by the Renewable Energy Directive. However, as the Appellate Body has stated in *US – Tuna II*, “[a]n enquiry into whether a measure comports with the ‘treatment no less favourable’ requirement in Article 2.1 does not hinge on whether the imported products *could* somehow get access to an advantage, for example, by complying with all applicable conditions.” In that case, it was open for Mexico to comply with the US requirements for dolphin-safe tuna labeling, but this did not signify that Mexican tuna was being treated no less favorably than US tuna. The Appellate Body noted that “the fact that a complainant could comply or could have complied with the conditions imposed by a contested measure does not mean that the challenged measure is therefore consistent with Article 2.1.”²⁸ Applying this reasoning to the EU's proposed amendments in the Renewable Energy Directive, the fact that other non-EU

²⁸ Appellate Body Report, *US – Tuna II*, para. 220-221.

WTO Members *could* develop non-CSO ethanol does not mean that the proposed amendments would be consistent with Article 2.1.

49. It may be argued that, since non-CSO-ethanol supply is currently so limited, the advantage offered to non-CSO-ethanol-producing countries is in fact negligible. However, even if non-CSO-ethanol supply is expected to be limited in the short-term, this limited advantage is nonetheless an advantage. In this regard, the Appellate Body in *US – COOL* noted that “‘*any* adverse impact on competitive opportunities for imported products vis-à-vis like domestic products that is caused by a particular measure may potentially be relevant’ to a panel’s assessment of less favourable treatment under Article 2.1.”²⁹

50. In assessing a *de facto* discrimination claim of this kind, a panel will need to “base its determination on the totality of facts and circumstances before it, including the design, architecture, revealing structure, operation, and application of the technical regulation at issue.”³⁰ Therefore, the discrimination analysis for the EU measures will depend heavily on the facts and circumstances of the current ethanol market. We do not have a clear enough assessment of the current ethanol market to determine to what extent the EU measures would create *de facto* discrimination. However, we understand from discussions with UNICA that the EU and the US are significantly ahead of other economies in production capacity of non-CSO ethanol.³¹ Although the larger developing countries such as Brazil and China have started investing in non-CSO ethanol production, such production is unlikely to be a significant part of the EU ethanol market. This is in contrast to the substantial share of the EU ethanol market that is currently occupied by developing countries’ CSO ethanol products. Further, the technology-intensive nature of non-CSO ethanol production *de facto* excludes many developing countries from producing non-CSO ethanol to any significant extent. Again, this is in contrast to the substantial potential of many developing countries to produce

²⁹ Appellate Body Report, *US – COOL*, para. 286; quoting Appellate Body Report, *US – Tuna II*, para. 225, original emphasis, underlining added.

³⁰ Appellate Body Report, *US – Clove Cigarettes*, para. 206.

³¹ As of February 2013, the US appeared to have around 500 million liters of production capacity for non-CSO biofuels (according to a presentation delivered by Daniel Nibarger, International Economist, Biofuels Group, Global Policy Analysis Division, USDA FAS-Office of Global Analysis at the 5th SMTP meeting also attended by UNICA in Brussels on February 7, 2013). In the EU, the FP7 program had financed a facility for advanced biofuels that will reach a production capacity of 180,000 tonnes per year (which, if all the production were to be ethanol, would amount to around 235 million liters). Brazil had started constructing a new facility for advanced biofuels, based on European technology and European funds, which will reach 82,000 liters in production capacity. Therefore, it appears that the US and the EU have a clear lead in production of advanced biofuels.

CSO ethanol for the EU market. Therefore, the facts appear to show that the supply of non-CSO ethanol is currently limited to a few WTO Members with the requisite technical capacity, including the EU.

51. Thus, the facts appear to support the thesis that the EU's proposed CSO cap and ILUC factors would modify the conditions of competition in the EU market to the detriment of ethanol from particular WTO Members, including many developing countries, as compared to ethanol originating in economies that have developed non-CSO ethanol production, including the EU and the US.

(b) *Legitimate regulatory distinction*

52. If it is established that there would be a detrimental impact on competitive opportunities for imported ethanol from the application of the EU measures, a panel would need to assess whether this detrimental impact stems exclusively from a relevant regulatory distinction. This would be a two-step analysis, according to the Appellate Body decision in *US – COOL*.³² Firstly, the panel would identify the relevant regulatory distinction. Then, secondly, the panel must examine, based on the particular circumstances of the case, whether this distinction is designed and applied in an even-handed manner, or whether it lacks even-handedness, for example, because it is designed or applied in a manner that constitutes arbitrary or unjustifiable discrimination.

53. With regard to both the CSO cap and the CSO ILUC factors, the relevant regulatory distinction is the distinction between CSO feedstocks and non-CSO feedstocks in the production of biofuels. This distinction is made on the basis of the EU's assertion that CSO biofuel production causes indirect land use change.³³ In brief, CSO feedstocks are grown on land that could be employed for producing crops for food and feed. The food and feed crop production may be displaced to another area of land, which may need to be converted, for example, from grassland to cropland in a way that raises greenhouse gases and contributes to climate change. The 5 percent cap on CSO biofuels and the ILUC accounting of CSO biofuels are intended to limit this purported ILUC effect.

³² Appellate Body Report, *US – COOL*, para. 341.

³³ Recital 5 of the Amendment Proposal.

54. However, it may be argued that this very distinction between CSO feedstocks and non-CSO feedstocks is flawed. Crucially, the EU’s proposed focus on CSO feedstocks fails to take into account the potential ILUC effect that non-CSO crops can have. Non-CSO crops, such as miscanthus and switchgrass, are grown on land that could be used for other purposes. As the demand for non-CSO crops goes up to meet the artificially created EU demand for non-CSO biofuels, it is likely that there would be both direct and indirect land use change to produce the additional quantities eligible for mandatory blending and financial support. However, there will be no cap on the share of non-CSO biofuels in the EU’s transport energy market. There will also be no accounting of non-CSO biofuels’ potential ILUC effects when determining eligibility for the mandatory blending, financial support and meeting targets for renewable energy.

55. Even if the distinction between CSO biofuels and non-CSO biofuels is deemed to be a legitimate regulatory distinction, this distinction would *not* be designed and applied in an even-handed manner, and would lack even-handedness because it would be designed or applied in a manner that constitutes arbitrary and unjustifiable discrimination. In order to be even-handed, the difference in treatment of CSO and non-CSO biofuels should be “calibrated” to the risks of ILUC of biofuels of different feedstock.³⁴ However, this is not the case. In the first instance, there is no recognized method of attributing any ILUC effects to each biofuel feedstock. The EU’s Impact Assessment Report on ILUC acknowledged that the scientific basis for regulating ILUC by feedstock was still weak.³⁵ Against this non-existent scientific and evidentiary background, it is currently not possible for any regulator to take measures that are calibrated to address ILUC effects. Indeed, the EU does not claim that the proposed amendments have been calibrated in this way.

- CSO cap: The 5 percent cap on CSO biofuels has been set without any particular calibration on the impact this would have on potential ILUC effects.
- CSO ILUC factors: The ILUC factors attributed to CSO biofuels have a poor scientific basis. The EU Impact Assessment Report on ILUC estimates ILUC effects by biofuel feedstock (15.4 gCO₂eq/MJ for sugar cane, 7.2 for sugar beet, 10.1 for

³⁴ Appellate Body Report, *US – Tuna II*, para. 297.

³⁵ See, for example, section 5.1.3 on Assessment limitations.

corn, 54.9 for rapeseed, etc.), while acknowledging that these estimates were poorly supported by evidence.³⁶ The EU’s proposed amendments now group all CSO feedstocks together and attribute an ILUC factor across a sub-group of feedstocks, i.e. 13 gCO₂eq/MJ for all sugars (including both sugarcane and sugarbeet), 12 for all cereals and other starch rich crops (including corn), and 55 for all oil crops (including rapeseed).³⁷ There is no reasoning given for how this might have been calibrated to address ILUC effects.

56. It may be argued that, although the EU’s proposed amendments fail to calibrate and capture all potential ILUC effects, it does address the potential ILUC effects of CSO crops to some extent. However, the Appellate Body in *US – Tuna II* observed that the fact that the US measure addressed dolphin safety in some respects but not others meant that it was not “evenhanded”.³⁸ Similarly, the EU’s proposed CSO cap and ILUC factors are not evenhanded when viewed overall in the way that they attempt to address potential ILUC effects of biofuels.

57. Indeed, we understand that there have been concerns raised on the potential ILUC effects of non-CSO feedstocks that are grown on land, and it is possible that the EU institutions may agree to make all land-using feedstocks subject to the 5 percent cap and ILUC factors. In that case, the only feedstocks not subject to the 5 percent cap and ILUC factors will be algae, straw, animal manure, and other specific feedstocks listed in Annex IX. However, even with this more stringent distinction, the EU’s measures will fail to calibrate and capture all potential ILUC effects. Such a distinction would assume that the feedstocks listed in Annex IX have no ILUC effect, but this may not be the case. Wheat straw, for example, would be classified as an agricultural waste or residue, and assumed to have no ILUC effect. However, wheat straw is currently used for animal feed and, increasingly, for biogas electricity generation. If wheat straw were to be diverted from these uses to ethanol production, alternative feedstocks would be needed to supply animal feed and biogas electricity. Sourcing such alternative feedstocks would potentially cause land use change that

³⁶ EU Impact Assessment Report on ILUC, Annex XVI.

³⁷ Annex I of the Amendment Proposal.

³⁸ Appellate Body Report, *US – Tuna II*, para. 297.

would raise greenhouse gas levels in the atmosphere.³⁹ Therefore, there is still an ILUC risk with so-called wastes and residues, which would not be addressed by the EU's measures.

58. To conclude with respect to Article 2.1 TBT, the EU's proposed CSO cap and ILUC factors may result in a detrimental impact on competitive opportunities for imported biofuels. This detrimental impact would not stem exclusively from a legitimate regulatory distinction. Therefore, both of these measures would be vulnerable to challenge as being in violation of Article 2.1 of the *TBT Agreement*.

B. Article 2.2 – More trade-restrictive than necessary

59. An additional basis to challenge the EU's proposed CSO cap and ILUC factors is under Article 2.2 of the *TBT Agreement*. Article 2.2 requires WTO Members to ensure that technical regulations are not more trade-restrictive than necessary to fulfill legitimate objectives. It provides that:

Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfill a legitimate objective, taking account of the risks non-fulfillment would create. Such legitimate objectives are, inter alia: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, inter alia: available scientific and technical information, related processing technology or intended end-uses of products.

60. The Appellate Body has clarified the legal standard for a measure to be consistent with TBT Article 2.2 in its decisions on *US – Tuna II* and *US – COOL*. Factors to be assessed are: (i) whether there is a legitimate objective within the meaning of Article 2.2; (ii) the degree of contribution made by the measure to the legitimate objective at issue; (iii) the trade-restrictiveness of the measure; and (iv) the nature of the risks at issue and the gravity of consequences that would arise from non-fulfilment of the objective(s) pursued by the

³⁹ In addition to the potential ILUC effect of wheat straw ethanol, there is also the risk that biogas electricity plants that rely on wheat straw will no longer be viable if wheat straw is diverted to ethanol production. If this is the case, it is not clear whether it would be better for the environment to use the wheat straw for biogas or for ethanol production.

Member through the measure.⁴⁰ Assessing these factors will, in most cases, involve: (v) “a comparison of the trade-restrictiveness of, and the degree of achievement of the objective by, the measure at issue, with that of possible alternative measures that may be reasonably available and that are less trade restrictive than the challenged measure, taking account of the risks non-fulfilment would create.”⁴¹

i. “Legitimate objective”

61. The European Commission has set out its overall objectives for the proposed amendments to the Renewable Energy Directive and the Fuel Quality Directive, which include, *inter alia*, the CSO cap and the CSO ILUC factors. In its Explanatory Memorandum for the amendments, the Commission notes that “the aims of the current proposal are to”:

- limit the contribution that conventional biofuels (with a risk of ILUC emissions) make towards attainment of the targets in the Renewable Energy Directive;
- improve the greenhouse gas performance of biofuel production processes (reducing associated emissions) by raising the greenhouse gas saving threshold for new installations subject to protecting installations already in operation on 1st July 2014;
- encourage a greater market penetration of advanced (low-ILUC) biofuels by allowing such fuels to contribute more to the targets in the Renewable Energy Directive than conventional biofuels;
- improve the reporting of greenhouse gas emissions by obliging Member States and fuel suppliers to report the estimated indirect land-use change emissions of biofuels.⁴²

62. These objectives relate broadly to the protection of the environment, which is specifically listed as a legitimate objective in TBT Article 2.2. However, it is important to note that the EU has defined these objectives more narrowly than general protection of the environment or climate change mitigation. Of the four objectives given above, the second relates to an amendment to raise the greenhouse gas emission saving threshold for biofuels from new installations, and is not directly relevant for the CSO cap or the CSO ILUC factors.

⁴⁰ Appellate Body Report, *US – Tuna II*, para. 322.

⁴¹ Appellate Body Report, *US – Tuna II*, para. 320.

⁴² Section 2 of the Explanatory Memorandum to the Amendment Proposal.

Thus, the declared objectives of the proposed amendments at issue in this memorandum are: (i) to limit the contribution that conventional biofuels (with a risk of ILUC emissions) make towards the attainment of renewable energy targets; (ii) to encourage a greater market penetration of advanced (low-ILUC) biofuels; and (iii) to improve the reporting of greenhouse gas emissions. With these declared objectives, the EU’s proposed amendments are given a fairly narrow and focused aim. These objectives would relate to the CSO cap and the CSO ILUC factors as follows:

- CSO cap: This measure appears to aim at limiting conventional biofuels and the risk they pose for ILUC emissions, and encouraging low-ILUC biofuels.
- CSO ILUC factors: This measure appears to aim at limiting conventional fuels and the risk they pose for ILUC emissions, encouraging low-ILUC biofuels, and improving the reporting of greenhouse gas emissions.

63. However, in order to be in compliance with TBT Article 2.2, the objectives must be “legitimate objectives” within the meaning of Article 2.2. The list of legitimate objectives given in Article 2.2 is non-exhaustive, and WTO panels and the Appellate Body have generally recognized the objectives expressed by the regulating country as being “legitimate objectives” for the purposes of the Article 2.2 analysis.⁴³ In *US – Tuna II*, the Appellate Body noted that the objectives listed in the recitals of the preamble of the *TBT Agreement* and provisions of other covered agreements may guide or usefully inform a panel’s determination of which objectives, in addition to those expressly listed in TBT Article 2.2, can be considered “legitimate” for the purposes of TBT Article 2.2. In that case, the provision of information to consumers on origin was considered to bear “some relation” to the objective of prevention of deceptive practices reflected in both TBT Article 2.2 and GATT Article XX(d). The objectives of the EU’s proposed amendments to limit risk of ILUC emissions, encourage advanced biofuels and improve reporting of greenhouse emissions bear some relation to the objective of protection of the environment, as listed in TBT Article 2.2 and the preamble to the *TBT Agreement*. Therefore, it is likely that the EU would be considered to be pursuing a legitimate objective within the meaning of Article 2.2.

⁴³ See, for example, Appellate Body Report, *US – COOL*, para. 445.

ii. Degree of contribution to the legitimate objective

64. The Appellate Body in *US – COOL* emphasized that the measure at issue must actually contribute to the legitimate objective, but that it need not meet any particular minimum level of fulfillment of that objective.⁴⁴ In that case, the Appellate Body was not able to ascertain the degree of contribution made by the COOL measure to the US’s legitimate objective of providing consumers with information on origin. Nevertheless, the Appellate Body noted that the COOL measure did make “some contribution” to this objective.

65. The Appellate Body in *US – Tuna II* noted that “[t]he degree of achievement of a particular objective may be discerned from the design, structure, and operation of the technical regulation, as well as from evidence relating to the application of the measure.” It also referred to “actual” contribution by the measure “as applied”.⁴⁵ With the CSO cap and ILUC factors as proposed by the Commission, it is not yet possible to discern any actual contribution by the measure as applied, since the measures have not yet been applied. However, it is possible to forecast what would be the impact of the measures if they are applied to the biofuels market in its current state.

- CSO cap: The CSO cap will necessarily limit the contribution of conventional biofuels towards the attainment of the targets in the Renewable Energy Directive. However, it is not clear that this would achieve the objectives of limiting the risk of ILUC emissions and encouraging low-ILUC biofuels. As explained above, non-CSO feedstocks such as miscanthus and switchgrass also use land, and thus pose the risk of ILUC emissions. Even agricultural wastes and residues, such as wheat straw, have the potential to cause ILUC. Indeed, these feedstocks may have lower productivity per hectare of land than sugarcane ethanol, and thus require more land to produce the same quantity of ethanol. However, the ILUC risks of these non-CSO feedstocks would *not* be limited by the CSO cap. Further, there are CSO feedstocks that present

⁴⁴ Appellate Body Report, *US – COOL*, para. 468.

⁴⁵ Appellate Body Report, *US – Tuna II*, para. 317.

low ILUC risk, such as sugarcane ethanol, but such low-ILUC biofuels would be *discouraged* rather than encouraged by the CSO cap.⁴⁶

- CSO ILUC factors: Applying ILUC factors to CSO biofuels would give CSO biofuels a competitive disadvantage over non-CSO biofuels by making it more difficult for CSO biofuels to qualify for financial support in the EU. For the same reasons as explained above in relation to the CSO cap, CSO biofuels do not present a high risk of ILUC emissions, as there are biofuels such as sugarcane ethanol that have low ILUC risk. Conversely, non-CSO biofuels do not present a low risk of ILUC emissions, as explained above. Therefore, it is not clear that penalizing CSO biofuels will reduce the risk of ILUC emissions or encourage low-ILUC biofuels.

In relation to the objective of improving reporting of greenhouse gas emissions, there would be limited contribution to this objective by applying ILUC factors to CSO biofuels. The EU's proposed attribution of an ILUC factor to each group of CSO feedstocks would not capture the potential ILUC greenhouse gas emissions from non-CSO feedstocks. As a result, the CSO ILUC factors would produce misleading information on greenhouse gas emissions attributable to biofuels in the EU market. Thus, it will be difficult for the EU to show that the CSO ILUC factors make a meaningful contribution to improving reporting of greenhouse gas emissions.

66. Therefore, the EU's proposed amendments are likely to make little, if any, contribution to the declared objectives.

iii. Trade-restrictiveness

67. The CSO cap and ILUC factors would, if applied, restrict the trade of CSO biofuels to a considerable degree.

- CSO cap: CSO biofuels will be effectively banned from a 5 percent segment of the EU's transport energy market.

⁴⁶ Both the California Air Resources Board and the US Environmental Protection Agency have classified sugarcane ethanol as an advanced biofuel when ILUC is accounted.

- CSO ILUC factors: With ILUC factors included in the sustainability criteria for CSO biofuels, some CSO biofuels may become effectively banned from the 10 percent segment of the EU's transport energy market that is mandated for renewable energy meeting sustainability criteria.

68. Consequently, the EU's proposed amendments are very likely to be found to be trade-restrictive within the meaning of Article 2.2.

iv. Nature of the risks and gravity of consequences

69. The nature of the risks at issue relate broadly to climate change, which carries grave consequences. However, failing to achieve the three objectives in the European Commission's Explanatory Memorandum would not necessarily lead to increased climate change risk.

70. Regarding the first two objectives listed by the European Commission: If the EU does not limit conventional biofuels (with ILUC risk) and does not encourage advanced (low-ILUC) biofuels, the EU will continue to use conventional biofuels. Conventional biofuels may achieve lower greenhouse gas emission savings than advanced biofuels, but they nonetheless achieve significant savings over fossil fuels. For example, sugarcane ethanol is estimated to achieve 55 percent greenhouse gas emission savings over fossil fuels, even taking into account the potential ILUC effects. The EU's declared objective to limit conventional biofuels would limit these environmental benefits of sugarcane ethanol. Further, the EU's declared objective to encourage advanced biofuels would effectively replace *real* supply of sugarcane ethanol with *hoped-for* supply of non-CSO biofuels. Given the current biofuels market and available technologies, the EU's measures will likely mean that the EU will fail to fill its target of 10 percent renewable transport energy with *real* supply of renewable energy. Instead, it is likely that, consistent with the 5 percent cap, the EU will fill 5 percent of its transport energy needs with *real* supply of CSO biofuels, and will rely on *double-counting and quadruple-counting* of non-CSO biofuels to fulfill the remaining 5 percent of the 10 percent renewable transport energy target. Even with such double- and quadruple-counting, it is uncertain whether the EU will obtain sufficient supply of non-CSO biofuels to fulfill the 10 percent target. Therefore, it is not clear that the EU's objectives to

limit conventional biofuels and encourage advanced biofuels will result in reduced risk of climate change.

71. Regarding the third relevant objective listed by the European Commission: If the EU does not improve reporting of greenhouse gas emissions, there will be lower quality data on greenhouse gas emissions, but this would not necessarily exacerbate climate change.

72. Therefore, the EU's declared objectives would not necessarily lead to reduced risk of climate change. Thus, the consequences that may arise from non-fulfilment of the EU's objectives may not be particularly grave in practice.

v. Comparison with possible alternative less-trade-restrictive measures

73. Taking the above factors into account, the EU's proposed CSO cap and ILUC factors can be compared with possible alternative less-trade-restrictive measures. In making such a comparison, the Appellate Body in *US – COOL* stated that “it will be relevant to consider whether the proposed alternative is less trade restrictive; whether it would make an equivalent contribution to the relevant legitimate objective, taking account of the risks non-fulfilment would create; and whether it is reasonably available.”⁴⁷

74. The above analysis showed that the CSO cap and ILUC factors would be considerably trade-restrictive, while making a limited contribution to the EU's stated objectives, and that those objectives would not carry particularly grave consequences if not fulfilled. Therefore, it is likely that there would be alternative, reasonably available measures that are less trade restrictive, while making an equivalent contribution to the legitimate objectives, taking account of the risks non-fulfillment would create. For example, the EU could offer financial support and other incentives to advanced (low-ILUC) biofuels, without imposing a cap on CSO biofuels. Although this may still affect competitive opportunities between biofuels of certain feedstocks, the trade-restrictiveness of such a measure would be less than the 5 percent cap on CSO biofuels as currently proposed. In addition, the EU could conduct deeper research into ILUC effects and emissions associated with different biofuel feedstocks produced for the EU biofuel market. This would yield better reporting of greenhouse gas

⁴⁷ Appellate Body Report, *US – COOL*, para. 471.

emissions than the inaccurate reporting of ILUC factors arbitrarily attributed per feedstock group as currently proposed.

75. Therefore, the EU's proposed CSO cap and ILUC factors are vulnerable to challenge as being more trade-restrictive than necessary under Article 2.2 TBT.

IV. ANALYSIS UNDER GATT 1994

76. If the CSO cap and ILUC factors are held not to be "technical regulations" under the *TBT Agreement*, they fall outside the scope of the *TBT Agreement*. However, the measures may nevertheless be deemed to be inconsistent with WTO law, under the provisions of GATT 1994.

A. Article III:4 – National Treatment

77. GATT Article III:4 requires WTO Members to ensure national treatment in respect of all laws, regulations and requirements. It provides that:

The products of the territory of any Member imported into the territory of any other Member shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

78. Thus, to establish whether the EU's proposed amendments are consistent with Article III:4, two factors must be considered: (i) whether biofuels of different origins are "like products"; and (ii) whether imported biofuels are afforded "less favorable treatment" than biofuels originating in the EU. There is some question whether GATT Article III:4 even covers a measure regulating production methods primarily (a so-called "nPR PPM"), but as Professor (and current WTO Appellate Body member) Peter van den Bossche noted in his 2007 study, "the broad scope of application given to Article III:4 in the case law to date pleads against the exclusion of measures regulating nPR PPMs from the scope of application of Article III:4."⁴⁸ As described above with respect to TBT Article 2.1, (i) ethanol of

⁴⁸ P. Van den Bossche, N. Schrijver and G. Faber (2007) *Unilateral Measures addressing Non-Trade Concerns*. A study on WTO Consistency, Relevance of other International Agreements, Economic Effectiveness and Impact on Developing Countries of Measures concerning Non-Product-Related Processes and Production Methods. The Hague: the Ministry of Foreign Affairs of The Netherlands.

different origins are “like products”; and (ii) imported ethanol from certain countries including many developing countries are afforded “less favorable treatment” than ethanol originating in the EU. Therefore, the EU’s proposed CSO cap and ILUC factors are vulnerable to challenge as being in violation of national treatment.

B. Article I – Most-Favored Nation Treatment

79. Similarly, the EU’s proposed amendments would raise questions under GATT Article I:1, which provides that

[W]ith respect to all rules and formalities in connection with importation or exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any Member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other Members.

The EU would not be permitted to accord different treatment to ethanol from different countries where (as demonstrated above) those ethanol products should be considered as “like” products. As described above with respect to TBT Article 2.1, the CSO cap and ILUC factors would afford “less favorable treatment” to ethanol from certain countries including many developing countries, compared to like ethanol from countries such as the US that currently produce non-CSO ethanol.

C. Article XI:1 – Quantitative Restrictions

80. Finally, if the EU’s CSO cap and ILUC factors were not considered to fall within the scope of GATT Article I or III, then they would fall within the scope of GATT Article XI:1, the prohibition on quantitative restrictions at the border. Outside the context of GATT Article I or III, the application by the EU of the CSO cap and ILUC factors to foreign-produced biofuels would have the effect of limiting access to the EU market in a manner inconsistent with Article XI:1.

D. Article XX – General Exceptions

81. It is necessary to consider whether, if the measures are inconsistent with any of the aforementioned GATT rules, they can nevertheless be justified under the General Exceptions

provision in Article XX. This provision saves measures that would otherwise be GATT incompatible if they serve certain enumerated public policy objectives and are applied in an objective, transparent, non-arbitrary and non-protectionist manner.

82. Under Article XX GATT, it must first be determined whether a measure is "provisionally justified" under one of the sub-paragraphs (a) through (j). If it is, the measure must then be evaluated for compliance with the Article XX chapeau. For the EU's proposed CSO cap and ILUC factors, the most relevant exceptions listed in Article XX GATT are:

[...] nothing in this Agreement shall be construed to prevent adoption or enforcement by any Member of measures:

(b) necessary to protect human, animal or plant life or health; [...]

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

i. Provisional justification under Article XX(b)

83. Under Article XX(b) relating to the protection of human, animal or plant life or health, it must be demonstrated that there is a real health risk and that the measures in question are either an indispensable means of addressing the risk or (i) there is a close connection between the measure and solving the risk and (ii) the trade-restrictive impact is not disproportionate to the contribution of the measure to addressing the risk.⁴⁹

84. Applying these considerations to the EU's proposed amendments on biofuels, it is unlikely that the CSO cap and ILUC factors would be justifiable under GATT Article XX(b). All of the reasons why the CSO cap and ILUC factors will likely violate Articles 2.1 and 2.2 of the TBT Agreement are relevant for assessing the likely inability of the EU to sustain a defense under Article XX(b). As discussed above, these amendments relate broadly to climate change but will not necessarily reduce or be particularly effective in reducing greenhouse gases in the atmosphere. Thus, it would be difficult for the EU to establish the necessity for it to apply these measures to meet its objective of reducing the risk to human, animal or plant life or health. Further, as also discussed above, the trade-restrictive impact is

⁴⁹ Appellate Body Report, *EC – Asbestos*; Appellate Body Report, *Korea – Beef*.

considerable and disproportionate to the contribution of the measures to addressing the risk, and the measures arbitrarily discriminate between non-CSO and CSO biofuels,

ii. Provisional justification under Article XX(g)

85. To be provisionally justifiable under Article XX(g), a measure must: (i) relate to the conservation of exhaustible natural resources, which may include living or non-living resources and need not be rare or endangered to be potentially “exhaustible”; (ii) be primarily aimed at such conservation; and (iii) impose restrictions, not just in respect of imported products but also with respect to domestic products.⁵⁰

86. The EU’s proposed amendments on biofuels are primarily aimed at conservation of exhaustible natural resources threatened by climate change. They impose restrictions on domestic biofuels as well as imported biofuels, even though the impact of the restrictions *de facto* differ according to country of origin. Therefore, the CSO cap and ILUC factors appear to be provisionally justifiable under Article XX(g).

iii. Compliance with Article XX chapeau

87. The chapeau of Article XX requires that “measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade”.

88. The CSO cap and ILUC factors, if adopted, would be applied in a manner that constitutes such arbitrary or unjustifiable discrimination.

- CSO cap: The CSO cap would ban CSO biofuels from 5 percent of the EU’s transport energy market, even if those CSO biofuels are achieving greater greenhouse gas emission savings than some non-CSO biofuels. For example, sugarcane ethanol saves 70 percent in greenhouse gas emissions compared to fossil fuel, but will nonetheless be banned from this 5 percent market segment. Given that non-CSO biofuels are currently produced in only a few countries including the EU, there is arguably discrimination in a manner that is arbitrary or unjustifiable.

⁵⁰ Appellate Body Report, *US – Shrimp Turtle*, para. 127; Appellate Body Report, *US – Reformulated Gasoline*, paras. 19-20.

- CSO ILUC factors: The ILUC factors on CSO biofuels would also constitute arbitrary or unjustifiable discrimination. As discussed earlier, it is arbitrary to attribute ILUC factors only to CSO biofuels, without attributing ILUC factors to non-CSO biofuels that may also carry ILUC risk.

89. Therefore, the EU's proposed amendments on biofuels would not be in compliance with the chapeau of Article XX, and thus cannot qualify for an exception to the GATT obligations for national treatment, MFN treatment and prohibition on quantitative restrictions. Thus, the CSO cap and ILUC factors could be found to violate these GATT obligations.

E. Conclusions

90. The analysis above shows that the EU's proposed amendments to impose a 5 percent cap and ILUC factors on CSO biofuels are vulnerable to challenge under the *TBT Agreement* and the GATT. The success of such a challenge would depend on the strength of the facts, including evidence of discrimination between WTO Members, such as between the EU, US and many developing countries.

91. It is incumbent on the EU institutions and stakeholders to ensure that the Renewable Energy Directive provides a stable regulatory regime for biofuels and renewable energy in the EU. It is also incumbent on the EU institutions to ensure the WTO-consistency of the Renewable Energy Directive, and not to adopt amendments that discriminate between biofuels according to origin. The WTO rules presented in this memorandum should act as external legal discipline to guide decision-makers as they consider the proposed amendments in the coming months.

March 20, 2013