Trade, Investment and Risk

This section highlights the interface between international trade and investment law and municipal and international risk regulation. It is meant to cover cases and other legal developments in WTO law (SPS, TBT and TRIPS Agreements and the general exceptions in both GATT 1994 and GATS), bilateral investment treaty arbitration and other free trade agreements such as NAFTA. Pertinent developments in international standardization bodies recognized by the SPS and TBT Agreement are also covered. Risk regulation refers broadly to regulation of health, environmental, financial or security risks.

Of recurrent interest in this area are questions of whether precautionary policies can be justified, the extent to which policy can and should influence risk regulation and the standard of review with which international judicial and quasi-judicial bodies assess scientific evidence.

Issues Arising from the European Commission's Proposal on Biofuels

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I. Introduction

On 17th October 2012, the European Commission (hereinafter, the Commission) adopted its proposal for a directive amending the *Fuel Quality* Directive[1] and the *Renewable Energy Directive*[2] (*i.e., 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*[3]). The *Fuel Quality Directive* lays down technical specifications on the quality of fuel used in transportation, and requires EU Member States to reduce by 6% the greenhouse gas intensity of transportation fuels by 2020. The *Renewable Energy Directive* establishes a common framework for the promotion of energy from renewable sources in the EU by, *inter alia*, setting mandatory national overall targets and measures for the use of energy from renewable sources in order to reduce emissions and to achieve the EU's climate change and energy policy objectives. In relevant part, it requires that, by 2020, 10% of the energy used for transport in the Union must originate from renewable sources. Both directives also provide for "*sustainability criteria*", which prescribe the way in which biofuels can be "*sustainably*" produced for the purposes of compliance with the targets and requirements provided under the relevant EU legislative framework. These criteria are based on two drivers: (i) a greenhouse gas emissions saving threshold of at least 35% must be achieved from the use of biofuels and bioliquids (as of 2017, this target will be 50% for existing installations); and (ii) the land used to produce biofuels must have certain characteristics (*i.e.*, must not have high biodiversity value and/or high carbon stock). "*Unsustainable*" biofuels and bioliquids are admitted in the EU market, but are not eligible for reaching compliance with the prescribed targets and are not entitled to financial support.

The Commission's proposal is based on provisions included in the *Fuel Quality Directive* and the *Renewable Energy Directive* calling for a review of the impact of the emissions arising from indirect land use change (hereinafter, ILUC), *i.e.*, emissions driven by the increased demand for land for biofuel production, and to propose ways of minimising such impact. According to the Commission, ILUC emissions are likely to be significant – estimates cited by the Commission suggest that almost the entire biofuel production in 2020 is expected to come from crops grown on land that could be used to satisfy food and feed markets – and may partially or totally offset the greenhouse gas emissions savings arising from the use of biofuels, decreasing their overall sustainability.

II. The content of the proposal

The Commission's proposal has been drafted on the assumption that, although scientific evidence on the impact of ILUC was not conclusive when the *Fuel Quality Directive* and the *Renewable Energy Directive*

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1 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 (*OJ* L 350, 28.12.1998, p. 58), last amended by Commission Directive 2011/63/EU of 1 June 2011 amending, for the purpose of its adaptation to technical progress, Directive 98/70/EC of the European Parliament and of the Council relating to the quality of petrol and diesel fuels, *OJ* L 147, 2.6.2011, p. 15.

2 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 (*OJ* L 140, 5.6.2009, p. 16–62).

3 COM(2012) 595 final.

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were being developed, recent scientific findings endorse the idea that ILUC has an impact on the environment. On this basis, the proposal is notably aimed at starting the transition to biofuels that "*deliver substantial greenhouse gas savings*" when estimated ILUC emissions are taken into account.

In particular, the proposal provides for a primary distinction between biofuels, which results in two main categories: (i) "*first-generation*" or "*conventional*" biofuels (*i.e.*, those made from sugar, starch, or vegetable oil) and (ii) biofuels produced from feedstock that does not create an additional demand for land (so-called "*advanced*" biofuels, such as, *inter alia*, agriculture, aquaculture, fisheries and forestry residues, algae or municipal waste). On this basis, the proposal suggests capping the contribution of "*first-generation*" biofuels to the achievement of the *Renewable Energy Directive* target at 5 %, which broadly corresponds to current consumption levels. The proposal also suggests incentivising the use of "*advanced*" biofuels, whose contribution towards the achievement of the *Renewable Energy Directive* targets is worth twice the contribution made by "*first-generation*" biofuels.

In addition, the Commission's proposal attributes an estimated "*ILUC emissions factor*" to different biofuels according to the feedstock used to produce them, to be taken into account for the purposes of the monitoring and reporting requirements that EU Member States need to comply with both under the *Fuel Quality Directive* and the *Renewable Energy Directive*. In particular, biofuels are attributed different estimated ILUC emissions factors depending on whether they originate from: (i) food crops, and, in such latter instance, whether they have been produced from cereals and other starch rich crops (estimated ILUC emission factor equal to 12 gCO2/MJ), sugars (estimated ILUC emission factor equal to 13 gCO2/MJ) or oil crops (estimated ILUC emission factor equal to 55 gCO2/MJ); or (ii) feedstock other than those indicated above or whose production has led to direct land use change (with an emission factor already factored into the calculation), which are attributed an estimated ILUC emissions factor equivalent to zero. Such values are the result of a precautionary approach to the best available state of science, inasmuch as a 2010 Commission report identified a number of "*uncertainties*" regarding the modelling employed to estimate the effects of ILUC, the greenhouse gas emissions of which are "*inherently uncertain*", since they require projecting the impacts of past data into the future, an operation that can never be entirely validated.

The proposal also suggests improving the greenhouse gas performance of the biofuel production process by raising the greenhouse gas emissions saving threshold (*i.e.*, the first "*sustainability criteria*"). In particular, should the proposal be adopted, biofuels produced in plants starting operations prior to 1st July 2014 are to achieve a greenhouse gas emissions saving threshold of at least 35 % until 31 December 2017, and of at least 50 % from 1 January 2018; while biofuels produced in plants starting operations after 1st July 2014 are to achieve an emissions saving threshold of at least 60 %.

III. Comments

Certain requirements foreseen in the Commission's proposal may raise issues of compatibility *vis-à-vis* the EU's obligations under the WTO. In particular, inasmuch as it discourages the use of "*first-generation*" biofuels *vis-à-vis* "*advanced*" biofuels, the proposed amendment to the *Fuel Quality Directive* and the *Renewable Energy Directive* may arguably lead to discrimination between imported "*first-generation*" biofuels and "*advanced*" biofuels of foreign or domestic origin, in a manner which is inconsistent with Articles I and III:4 of the of the General Agreement on Tariffs and Trade (hereinafter, GATT).

A key aspect of the analysis relates to the criterion of "*likeness*" of the products affected by the measure (*i.e.*, biofuels), which must be satisfied in order to trigger the application of WTO non-discrimination obligations. In line with the ruling of the Appellate Body in *EC – Asbestos*,[4] "*likeness*" between biofuels would have to be determined on the basis of four criteria, namely: (i) physical characteristics of the biofuels compared, (ii) whether they can serve the same end uses, (iii) whether consumers perceive them as capable of satisfying a given need, and (iv) their tariff classification. It appears that none of these four criteria would allow the EU to put in place discriminatory measures of the kind that are envisaged in the proposed legislation. The measure at issue would, in fact, result in discriminatory treatment granted on the basis of process and production methods, in particular, on the basis of the environmental impact indirectly connected to the biofuel production – a

4 *European Communities – Measures Affecting Asbestos and Products Containing Asbestos,* Appellate Body Report, WT/DS135/AB/R, adopted 5 April 2001.

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factor, according to relevant WTO case law, not affecting the "*likeness*" of products unless it impacts on the physical characteristics of the final products in a way that they no longer constitute "*like*" products.

The measures envisaged in the Commission's proposal may also arguably affect the EU's obligations under Article XI of the GATT, which prevents WTO members from adopting import prohibitions or restrictions other than duties, taxes, or other charges. This provision, which has been invoked in a number of disputes related to import restrictions prompted by "*environmental*" policies, is of relevance inasmuch as it is shown that, albeit in the absence of an explicit restriction on imports, the EU's requirements affecting biofuels will likely limit competitive opportunities or have a limiting effect on trade.[5]

The GATT provides for a number of exceptions to the above-mentioned rules. In particular, the most relevant exceptions that may justify measures taken on the basis of environmental considerations are those provided under Article XX of the GATT that allow WTO members to adopt measures that are, *inter alia*: "*[...] (b) necessary to protect human, animal or plant life or health*" or "*[...] (g) relating to the conservation of exhaustible natural resources, if such measures are made effective in conjunction with restrictions on domestic production*". The scope, reach and conditions connected to the general exceptions provided in Article XX(*b*) and XX(*g*) of the GATT, as well as their invocation in connection with environmental measures, have been interpreted by a number of WTO panels and the Appellate Body.[6] In particular, Article XX(*g*) requires that, to be justified, measures be *primarily aimed* at the conservation of exhaustible natural resources. Such a concept has been found to include living and non-living resources[7] as well as clean air,[8] findings that are relevant for the purposes of assessing the Commission's proposal. Further, this provision requires that restrictive measures are adopted in an even-handed manner, a requirement which the proposal could be considered to fulfil, given that it applies to domestic and foreign products equally. Article XX(*b*) of the GATT allows the application of measures necessary for the protection of human, animal or plant life or health, and along with GATT Article XX(*g*), this provision may also offer a basis for the justification of environmental measures affecting trade. A policy to reduce greenhouse gas emissions could arguably fall within the range of those concerning the protection of human, animal and plant life or health. However, the test under this provision is rather strict, as it requires evidence that the measures are, in fact, necessary to protect human, animal and plant life or health and constitute the "*least inconsistent*" choice from a WTO and trade policy perspective. Finally, Article XX of the GATT also requires that any such measure not be applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade (the so-called "*chapeau*" of Article XX of the GATT). The "*chapeau*" embodies the principles of non-discrimination and "*least trade-restrictive*" measure, both of which must be taken into account when choosing the environmental measure to be adopted.[9]

The requirements envisaged by the proposal may also arguably qualify as "*technical regulations*" within the meaning of Annex 1:1 of the WTO Agreement on Technical Barriers to Trade (hereinafter, TBT Agreement), provided that it is established that they (i) apply to an identifiable product or group of products, (ii) lay down product characteristics, and (iii) are mandatory, as established by the WTO Appellate Body in *EC – Asbestos* and in *EC – Sardines*[10] and as later clarified in *US-Tuna II*.[11] It is noted that

5 Edmond McGovern, *International Trade Regulation* (Exeter: Globefield Press, 2012), 5.21–3.

6 See, *inter alia*, panel and Appellate Body reports in *Brazil – Measures Affecting Imports of Retreaded Tires* for Article XX(b), WT/DS332; panel and Appellate Body Reports in *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58 (including the compliance panel and Appellate Body reports under *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Article 21.5 – Malaysia*); and *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2.

7 *United States – Import Prohibition of Certain Shrimp and Shrimp products,* Appellate Body Report WT/DS58, adopted 6 November 1998, paras. 127 et sqq.

8 *United States – Standards for Reformulated and Conventional Gasoline,* Panel Report, WT/DS2/R, para. 6.37.

9 There is extensive case law that elaborates on the requirements of the *chapeau*, namely *United States – Standards for Reformulated and Conventional Gasoline,* Appellate Body Report, WT/DS2/AB/R, adopted 20 May 1996; and *United States – Import Prohibition of Certain Shrimp and Shrimp Products,* Appellate Body Report, WT/DS58/AB/R, adopted 6 November 1996.

10 *European Communities – Trade Description of Sardines*, Appellate Body Report, WT/DS231/AB/R, adopted 26 September 2002.

11 *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, WT/DS381. The Panel found the measure at stake which established the requirements for use of a "dolphin-safe" label on tuna products, to be "*mandatory*" within the meaning of the TBT Agreement even if the obligations it laid down were only addressed at operators participating in the market *under certain conditions* (*i.e.*, trading with products bearing a dolphin-safe label), and still allowed tuna products (without a dolphin-safe label) to be placed on the market. The Appellate Body found that the Panel did not err in its characterisation of the measure as a technical regulation, upholding the Panel's interpretation of the term *"mandatory"* under the TBT Agreement.

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the TBT Agreement allows WTO Members to adopt measures directed (*inter alia*) at the protection of the environment, inasmuch as they are in compliance with a number of principles. Reflecting the basic non-discrimination principles under Articles I and III of the GATT, Article 2.1 of the TBT Agreement establishes that technical regulations cannot result in discrimination *vis-à-vis* "*like*" products of national origin, or originating in any other country. In addition, Article 2.2 of the TBT Agreement requires WTO members to 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 fulfil a legitimate objective, such as, *inter alia*, the protection of the environment. Article 2.2 of the TBT Agreement arguably embodies a necessity test that closely resembles the one developed by WTO case law under Article XX of the GATT. An argument could be made that the EU measures on biofuels result in unnecessary barriers to trade inasmuch as they are more trade restrictive than necessary to protect the environment.

The specific trade-distortive features of the Commission's proposal, as it currently stands, would appear to consist in the 5 % limit posed on the contribution that can be made by food crop-based biofuels to the 10 % target set by the *Renewable Energy Directive*, and the incentives granted to "*advanced*" biofuels *vis-à-vis* "*first-generation*" biofuels. The specific estimated ILUC emissions factors attributed to biofuels on the basis of the feedstock employed for their production will be relevant, until 2020, for monitoring purposes only. However, it is clear that the distinction operated between biofuels on the basis of the estimated ILUC emissions they generate is among the core features of this proposal, and will likely be factored into the calculation of the overall "*environmental impact*" (calculated in greenhouse gas emissions) of biofuels once the "*transition*" phase terminates (*i.e.*, after 2020). In particular, future amendments to the *Fuel Quality Directive* may provide for the inclusion of ILUC as a relevant factor for the calculation of greenhouse gas emissions for purposes of compliance with the 6 % target established by the *EU Fuel Quality Directive*, something which was already suggested in earlier versions of the Commission's proposal, and which would likely entail restricting or *de facto* excluding food crop-based biofuels, and especially those obtained from oil crops (which are attributed the highest ILUC emissions factor), from the EU market.

V. Conclusions

The Commission's proposal includes requirements which stand to negatively affect trade in "*first-generation*" biofuels *vis-à-vis* "*advanced*" biofuels, considered by the Commission to be more environmentally "*efficient*". In addition, by attributing estimated ILUC emissions factors to different biofuels according to the feedstock used for their production, it also sets the framework for discrimination to occur within "*first generation*" biofuels. These requirements add to the "*sustainability criteria*" foreseen in the *Fuel Quality Directive* and the *Renewable Energy Directive*, which already provide a distinction between "*sustainable*" and "*unsustainable*" biofuels, affecting exports of certain types of biofuels to the EU in a manner which raises issues of WTO compatibility broadly similar to those reviewed above.

The Commission asserts that the classification of biofuels described above is the best possible one, in light of the current stage of scientific developments. It is noted that the asymmetric differentiation between "*first-generation*" biofuels and "*advanced*" biofuels, as well as the sub-categorisation of biofuels only within the former group, recalls the controversy raised by the Commission proposal for an implementing measure under the *Fuel Quality Directive*, aimed at establishing the life-cycle greenhouse gas intensity of fossil fuels. A draft of that proposal submitted to EU Member States at the beginning of 2012 attributed higher "*polluting values*" to fossil fuels obtained through oil sands and shale oil, a differentiation which could arguably result in discrimination *vis-à-vis* fossil fuels originating in certain WTO Members.

In this light, the question of whether the Commission proposal concerning ILUC embodies a somewhat arbitrary distinction among biofuels is at least pertinent, and the possible impact on the EU's WTO obligations should certainly be taken into consideration by EU institutions and key stakeholders in the decision-making process leading to the adoption of this proposal.

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