Draft EU directive on renewable energy: are the provisions on biofuels compatible with WTO law?

On 23 January 2008, the European Commission published a package of climate action and renewable energy measures that are designed to reduce greenhouse gas ("GHG") emissions. This package includes a draft Directive on renewable energy that would introduce environmental requirements for biofuels. This bulletin focuses on one of the main questions raised in relation to the Commission's proposal on biofuels, namely its compatibility with the law of the World Trade Organisation (WTO).

It is important to note that the Commission's climate change package contains proposals that still need to be approved by the EU Council of Ministers and the European Parliament and that the proposals are likely to undergo alterations. The Commission hopes that the proposed measures will be adopted by the end of 2008.

Binding target for biofuels

The draft directive lays down a 10% binding minimum target for the market share of biofuels in 2020 to be observed by all Member States. This 10% target has been set at the same level for each Member State in order to ensure consistency in transport fuel specifications and availability. To achieve this target, a combination of domestic EU production and imports from non-EU countries will be necessary.

Sustainability requirements

The Commission contends that biofuels – alongside vehicle fuel efficiency – are one of the few measures realistically capable of making a significant impact on GHG emissions from transport. However, the Commission also takes the view that biofuels should only be promoted if they are produced sustainably and do not lead to an overall worsening of GHG emissions.

Therefore, the Directive sets out stringent environmental sustainability criteria: biofuels must achieve at least a minimum level of 35% GHG emission savings and respect a number of requirements related to land use (designed to prevent land with high biodiversity value, such as natural forests and protected areas, being used for the production of raw materials for biofuels). These environmental criteria are important because only biofuels that fulfil the criteria will be taken into account for (i) measuring compliance with Member States' 10% target for biofuels; and (ii) eligibility for consumption subsidies. In practice, this is likely to substantially hinder the marketing of biofuels that do not meet the environmental criteria.

1) 35% GHG emission savings

The GHG emission savings from the use of biofuels must be at least 35%
compared to fossil fuels (although there is an exemption until 2013 for biofuels that are produced by installations that were operational in January 2008). This requirement applies equally to both domestic and imported biofuels and there are two ways in which this 35% target can be met.

- **Default GHG emission savings**: The Directive allocates a series of default GHG emission savings values that specific crops are on average expected to meet (e.g. rape seed biodiesel has a GHG emission saving of 36%). These default values can be used without further verification and producers of biofuel in this category will be able to demonstrate fulfilment of the 35% criterion with minimal effort (in most cases they will merely need to document the nature of the biofuel and the type of feedstock used).

- **Specific GHG emission savings**: Alternatively, a producer of biofuels from a crop not automatically meeting the 35% requirement, (or a biofuel that is not currently listed in the Directive as having a default value e.g. soy) can prove to a Member State that in his specific case the 35% requirement is met. Biofuel producers of this category will need to provide detailed evidence of their production practices (including any carbon stock changes caused by land use change) and operators may have to change these practices in order to meet the environmental criteria.

2) Land use impact

Requirements for biofuel raw material produced in the EU or imported from outside the EU

A) **Minimum biodiversity requirements**: biofuels must not be produced from:

- raw materials obtained from land classified, in or after January 2008 (whether or not the land still has this status), as:
  - undisturbed forests or biodiverse grassland; or
  - areas designated for nature protection purposes (designated as such by the states themselves), unless it can be shown that the production of raw material does not interfere with those purposes.

- raw materials obtained from land that had the status of wetlands or continuously forested areas in January 2008 but no longer has this status (since these lands have "high carbon stock" and therefore it is doubtful whether converting them would have an overall positive effect of reducing GHG emissions).

B) **Additional requirements for biofuel raw material produced only in the EU**

- Biofuel raw material must meet "cross-compliance" environmental and agricultural rules and principles laid down in other EU Environmental Directives.
- There exists a specific disincentive for crops from EU land that is prone to high nitrous oxide emissions from cultivation.

**Demonstrating compliance**

Member States will need to put measures in place to verify that the target of 10% biofuels is reached and that these biofuels meet the sustainability requirements. Since Member States already require reporting of fuel-related information by fuel suppliers through the fuel excise duty system, the Commission proposes extending this arrangement to cover biofuel aspects, rather than establish a separate stand-alone administrative structure.

In order to demonstrate compliance with the environmental criteria, fuel suppliers will have to make claims about matters including: (i) geographical location of the land on which the raw materials for biofuel production are cultivated, (ii) the nature of the raw material used, and (iii) the energy source used in the biofuel production process. The draft directive proposes putting into place a procedure for the mutual acceptance by Member States of verification schemes that meet...
adequate standards of accuracy, reliability and fraud resistance. Once such a verification scheme is in place in a Member State, all other Member States would be required to accept evidence from it as conclusive proof of compliance with the environmental criteria.

The draft Directive also allows the use of a so-called "Mass balance system" which allows consignments of raw material or biofuel with different environmental characteristics to be mixed, provided that:

- The environmental characteristics of each consignment of raw material or biofuel that is added to the physical pool are described in associated documentation;
- it is ensured that the withdrawn quantity of raw material or biofuel – with which this documentation is associated – does not exceed the added quantity.

Compliance schemes in non-EU countries

In order to reduce the administrative burden on biofuels from non-EU countries, the Commission can decide that other certification schemes give reliable proof of compliance with the environmental criteria. In particular, the Commission may, provided that the scheme in question meets adequate standards of reliability, transparency and independent auditing, determine that:

- bilateral and multilateral agreements between the EU and non-EU countries demonstrate that biofuels produced from raw materials cultivated in those countries comply with the land use criteria;
- voluntary national or international schemes setting standards for the production of biomass products contain accurate data for a GHG emission savings of at least 35% or demonstrate that consignments of biofuel comply with the land use criteria; and
- national, multinational or international schemes to measure GHG emission savings contain accurate data for GHG emission savings of 35%.

If the Commission gives its approval to these schemes, the Member States will have to accept certification by these schemes as proof of compliance with the environmental criteria of the biofuels directive (in stead of requiring each supplier to provide evidence of compliance with the environmental criteria).

Questions raised about the compatibility of the environmental criteria with WTO law

Questions have been raised as to whether the Commission's attempt to distinguish between sustainable and unsustainable biofuels is contrary to the principles of free trade laid down in the WTO rules, and in particular those of the General Agreement on Trade and Tariffs (GATT) and the Agreement on Technical Barriers to Trade (TBT). Malaysia and Indonesia have already raised concerns that environmental criteria for biofuels may force them to change their production practices in order to continue exporting to the EU. Brazil is also concerned that environmental criteria may have an impact on its exports of soy-based biofuel to the EU.

The key points of WTO law that will arise in relation to the proposed rules on biofuels are:

- Whether making a distinction between biofuels on the basis of the production process, as opposed to the inherent characteristics of the product violates Article XI of GATT, which prohibits quantitative restrictions on imports. According to the GATT panel report in the Tuna-Dolphin dispute, Article XI:1 GATT does not permit different treatment of products based on their method of production as opposed to their properties as products for consumption.
- Whether less favourable treatment of non-EU biofuel that represents only 34% GHG emissions savings violates Article I or III of GATT because it would have the effect of discriminating against imports from certain non-EU countries.
Whether possible violations of these provisions could be justified on the basis of Article XX of GATT which allows exceptions to Articles I, III and XI if the relevant measures are (i) "necessary to protect human, animal or plant life or health" or if the measures "relate to the conservation of exhaustible natural resources"; and (ii) do not constitute a means of arbitrary discrimination or a disguised restriction on international trade.

Whether the environmental criteria of the draft Directive comply with Article 2(2) of the Agreement on Technical Barriers to Trade, which requires that technical regulations "shall not be more trade-restrictive than necessary to fulfil a legitimate objective".

In that context, the following questions will likely arise:

- Whether the measures are "necessary" to protect the environment and whether they are the least trade-restrictive measure available to do so.
- Whether the administrative burden on foreign producers is not higher than for domestic producers and whether the EU should pursue good faith negotiations with the exporting states prior to imposing its own unilateral measures (as was suggested in the Shrimp – Turtle dispute).
- Whether the EU's measures would be more proportionate, and, therefore, less trade restrictive, if they provided for a sliding scale of GHG emissions savings values (rewarding biofuels on the basis of the level of GHG emissions savings they achieve, as opposed to a system that gives a biofuel with 35% savings the same treatment as a biofuel representing 70% savings, while effectively preventing the marketing of a biofuel representing 34% emissions savings).

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