

## WTO IMPLICATIONS OF REPORTING MEASURES FOR TAR SANDS UNDER THE FUEL QUALITY DIRECTIVE

The European Union (EU) Fuel Quality Directive (FQD) requires Member States to reduce the greenhouse gas (GHG) intensity of fuels in road vehicles and non-road machinery by 6% by 2020. To measure progress toward the target, the European Commission is designing measures to account for lifecycle GHG emissions from fossil fuels and reporting rules on fuel suppliers. These reporting measures will outline default values for the lifecycle GHG emissions of transport fuels derived from different sources, including fuels produced from unconventional feedstocks such as tar sands (also known as oil sands). Several questions have arisen whether the reporting measures and the inclusion of a default value for tar sands, as currently contemplated by the European Commission, comply with World Trade Organization (WTO) rules and jurisprudence, namely the General Agreement on Tariffs and Trade (GATT) and case law.

### SUMMARY OF ANALYSIS

- The Canadian government faces significant obstacles, if not insurmountable hurdles, in a WTO challenge against reporting measures setting out a default value for GHG emissions from tar sands. The European Union has a strong likelihood of success on the merits.
- Under Articles I and III of GATT, the analysis of whether tar sands fuels are a “like product” cannot be divorced from the legal provision at issue: the FQD, in general, and the reporting measures, in particular, which set out to achieve reductions in lifecycle GHG emissions of transport fuels. At the feedstock level, there is a very strong likelihood that tar sands will *not be considered like products* to conventional crudes and therefore no unlawful discrimination exists under WTO jurisprudence.
- In the instance tar sands are considered like products, the Canadian government *bears the burden to prove that tar sands fuels receive less favourable treatment* vis-à-vis other fuels under Article III of GATT. Simple assertions lacking evidentiary support, as offered to date, are inadequate.
- In the instance tar sands are considered to be like products receiving less favourable treatment, the European Union has proceeded in good faith, backed by the best available scientific evidence, and the reporting measures are rational and justifiable. The reporting measures will therefore represent *lawful discrimination* under Article XX(g) of GATT, which allows countries to adopt trade-restrictive measures relating to the conservation of exhaustible natural resources.
- In the instance any WTO violation is found and the Article XX(g) exception is inapplicable, unlikely under their current construction, the European Union will be provided *a reasonable period to amend the reporting measures* to come into compliance with WTO rules and jurisprudence. Nothing in the WTO is intended to force the European Union to abandon its pursuit of accurate accounting of lifecycle GHG emissions from transport fuels under the FQD.

---

\* Defense Terre provides law and policy analysis and advocacy to non-profit organizations and public-interest entities in the United States, the European Union and beyond. For more information, contact [tgrabel@defenseterre.org](mailto:tgrabel@defenseterre.org).

## TABLE OF CONTENTS

General Overview of WTO and GATT.....	1
Reporting Measures for Tar Sands.....	1
WTO Compliance of Reporting Measures.....	1
A. Likeness Determination.....	2
1. <i>End Use</i> .....	2
2. <i>Physical Properties</i> .....	3
3. <i>Tariff Classification</i> .....	5
4. <i>Consumer Tastes and Habits</i> .....	5
B. Less Favourable Treatment .....	6
C. Article XX General Exceptions .....	7
Conclusion.....	9
Appendix: Selected Appellate Body Cases.....	10
A. US – Gasoline (1996) .....	10
B. US –Shrimp (1998).....	11
C. EC – Asbestos (2001) .....	12

## **GENERAL OVERVIEW OF WTO AND GATT**

The WTO is an international organization regulating trade between nations. It consists of rules designed to reduce obstacles to international trade and contains an adjudicatory branch—the Panel and the Appellate Body—charged with settling disputes regarding the application of its rules. All measures impacting trade from member countries, including the European Union, must comply with these rules. The WTO specifies several trade-related obligations on member countries, including those found in GATT. Advantages granted to one country must be extended to all.<sup>1</sup> Foreign products must be accorded no less favorable treatment than those accorded to like products of national origin.<sup>2</sup> Member countries must generally refrain from adopting measures prohibiting or restricting imports of products from another member country.<sup>3</sup> The objective is to eliminate discrimination among “like products” regardless whether foreign or domestic. But WTO rules also contain several exceptions to the general rule against trade restrictions. In particular, under Article XX(g), member countries may discriminate between like products to achieve environmental objectives subject to certain conditions.<sup>4</sup> In the instance a WTO violation is found, member countries are provided a reasonable amount of time to come into compliance, which experience shows does not require abandonment of a measure with an otherwise legitimate purpose.<sup>5</sup>

## **REPORTING MEASURES FOR TAR SANDS**

The FQD requires the European Commission to set out reporting measures outlining methodologies to account for lifecycle GHG emissions from transport fuels other than biofuels, including petrol, diesel, gasoil, hydrogen and electricity. In their contemplated form, the reporting measures require fuel suppliers to report using a set of “default values” for GHG emissions associated with the whole lifecycle of the transport fuel, namely extraction, refining, transport and combustion. The default values are based on industry averages and differentiate mainly among the feedstock of origin. For example, values for hydrogen are differentiated depending on whether the hydrogen is produced from coal, gas or water. Values for petrol and diesel differ depending on whether the fuel is produced from natural crude, tar sands, oil shale, coal, natural gas, or waste plastic. For higher GHG-intense fuels, the European Commission will allow those fuel suppliers achieving lower GHG emissions than the default value to report their “actual values” instead, thereby providing regulatory flexibility and incentivizing GHG reductions. Higher GHG emissions will have implications for the measures and strategies adopted by member states and fuel suppliers to achieve the 6% target, and may make certain transport fuels more or less desirable due to their lifecycle GHG emissions. This approach is indistinguishable from that adopted to account for lifecycle GHG emissions from biofuels.<sup>6</sup>

## **WTO COMPLIANCE OF REPORTING MEASURES**

The Canadian government—a major tar-sands proponent—has come out strongly against the inclusion of a default value for tar sands fuels. The opposition stems from the fear that accounting for higher GHG emissions associated with tar sands would discourage imports of tar sands and tar sands-derived products into Europe, and set a precedent for regulatory measures in other world markets. In support of its opposition, the Canadian government relies on two main arguments: first that a feedstock specific default value for tar sands fuels is not scientifically defensible and, second, that it is not WTO compliant. To provide a robust scientific basis for its measure, the European Commission has concluded a multi-year, peer-reviewed, participatory process for ascertaining a default value for tar sands fuels, settling on a figure that reflects the industry average according to the best available scientific evidence.<sup>7</sup> This point

of opposition will likely have little, if any, traction under WTO jurisprudence due to the robust scientific activities leading up to and supporting the reporting measures and is not treated further in this briefing.<sup>8</sup>

The remaining point of opposition is WTO compliance. The Canadian government makes several arguments against a default value for tar sands fuels, including that: it violates the prohibitions against unlawful discrimination on “like products” since transport fuels derived from tar sands are like products to transport fuels derived from conventional crudes; it results in less favourable treatment of transport fuels derived from tar sands with implications for their attractiveness on the European marketplace; and it is arbitrary and unjustifiable because it focuses on the higher GHG intensity of tar sands while treating different types of conventional crudes the same. This briefing provides a legal analysis of these arguments in light of WTO rules and jurisprudence.

## **A. LIKENESS DETERMINATION**

The WTO prohibits discrimination against “like products” under Article I and Article III of GATT.<sup>9</sup> The Appellate Body uses four criteria as the basis for the likeness determination: end use, physical properties, tariff classification, and consumer tastes and habits.<sup>10</sup> The issue receives its most significant attention in *EC – Asbestos*, a case brought by the Canadian government against a French ban on asbestos and asbestos-containing products.<sup>11</sup> There, the Appellate Body declared that the criteria “provide a framework for analyzing the ‘likeness’ of particular products on a case-by-case basis,” serving as “tools to assist in the task of sorting and examining the relevant evidence.”<sup>12</sup> These criteria, however, do “not dissolve the duty or need to examine, in each case, all of the pertinent evidence.”<sup>13</sup> Indeed, the kinds of evidence to be examined in assessing the likeness of the products “will, necessarily, depend upon the particular products and legal provision at issue.”<sup>14</sup> Once all the evidence is examined, the inquiry turns to “whether that evidence, as a whole, indicates that the products in question are ‘like’ in terms of the legal provision at issue.”<sup>15</sup> The burden is on the party alleging the products are like.<sup>16</sup> To date, these criteria have not been applied to measures to reduce lifecycle GHG emissions. This would be a case of first impression.

The evidence as a whole, in the context of the FQD and reporting measures, and in consideration of the four criteria, demonstrates that tar sands are not like products to conventional crudes. As shown below, a feedstock-specific default value for tar sands is therefore permitted under Article I and III of GATT.

### **1. END USE**

All parties agree that tar sands and conventional crudes have the same end use as a transport fuel. Under WTO jurisprudence, however, the end-use criterion is more nuanced: the end use must be understood, and its relevance determined, in consideration of the particular product in question and within the context of the legal provision at issue.<sup>17</sup> This is particularly relevant in the case of non-product-related process and production methods targeting GHG reductions at stages coming before placement of the product on the market. As a result, analysis under the end-use criterion must consider the particular product in question and cannot be divorced from the object and design of the FQD and its reporting measures.<sup>18</sup>

The reporting measures in the FQD are part of a comprehensive regulatory framework designed to achieve reductions in lifecycle GHG emissions from transport fuels.<sup>19</sup> The FQD defines lifecycle GHG emissions as “all net emissions... that can be assigned to the fuel,” including “all relevant stages from

*extraction or cultivation*, including land-use changes, transport and distribution, processing and combustion, irrespective of where those emissions occur.”<sup>20</sup> With respect to combustion, the FQD does not affect tailpipe emissions, which represent around 80% of all emissions from fuel use. The GHG emissions from combustion are the same—a litre of one transport fuel emits an equal amount of GHG emissions during combustion as a litre of another transport fuel—and is therefore outside the control of fuel suppliers. But fuel suppliers can influence the GHG intensity upstream during production of the transport fuel. Indeed, in order to achieve the objectives of the legislation, the lifecycle GHG reductions *must* be achieved upstream *before* the transport fuel is used. Extraction is explicitly mentioned in the FQD as a stage along the lifecycle where GHG reductions may occur.<sup>21</sup> In the case of unconventional feedstocks, the share of upstream GHG emissions is higher due to their GHG-intense extraction methods, providing opportunities for GHG reductions – exactly the outcome envisioned in the FQD. This is not unlike the approach to cultivation adopted for biofuels. The FQD already contains robust reporting measures for lifecycle GHG emissions of biofuels that include feedstock-specific default values for biofuel cultivation, which the European Commission must review periodically and revise as needed.<sup>22</sup> Thus far, but by no means definitive, the feedstock-specific default values for biofuel cultivation have not been subject to a WTO challenge despite their implications worldwide.

The FQD left several reporting measures for future development.<sup>23</sup> This includes “the methodology for the calculation of life cycle [GHG] emissions from fuels other than biofuels.”<sup>24</sup> After years of scientific analysis, the European Commission is now positioned to set out feedstock-specific default values for fossil fuels similar to the approach adopted for biofuels.<sup>25</sup> The European Commission distinguishes between fuels derived from unconventional feedstocks—tar sands, oil shale, coal, gas, waste plastic—and conventional crudes based on the relative differences in GHG intensity of their production, including extraction.<sup>26</sup> The European Commission has identified a default value for tar sands-derived petrol of 107g CO<sub>2</sub>/MJ, which is 23% worse than conventional petrol used in Europe.<sup>27</sup> For conventional crudes, the European Commission will assign one default value for each petrol and diesel although, as the science progresses, it is expected to further differentiate among them depending on their production methods and relative GHG intensity. This makes sense given the science available.

Therefore, in the context of the FQD and its reporting measures on the process and production methods of transport fuels before placed on the market, the relevance of the end-use criterion is significantly diminished. Indeed, the end use is tangential to the core legislative objective and overall regulatory framework: to achieve lifecycle GHG reductions *before* the transport fuel is used.<sup>28</sup>

## **2. PHYSICAL PROPERTIES**

Under WTO jurisprudence, the Appellate Body requires panels to “examine fully the physical properties of products.”<sup>29</sup> In *EC – Asbestos*, the Appellate Body found defective an analysis that excluded “the health risks associated with [asbestos] from its examination of the physical properties of the product.”<sup>30</sup> Although this analysis often focuses on the final product as it crosses the border—and as subject to tariff classification, discussed below—the legal provision at issue here focuses on process and production methods. *EC – Asbestos* reaffirms that the physical-properties criterion should scrutinize the properties of the products at the point of regulation where the alleged trade restriction occurs – here, the feedstock level.<sup>31</sup> The physical properties therefore cannot be divorced from the objectives the measures are designed to achieve, including accurate GHG accounting at the extraction stage.

During extraction, the physical properties of tar sands differ from those of conventional crudes. On the one hand, tar sands are a dense mixture of bitumen, water, sand, heavy metals, and clay. They are

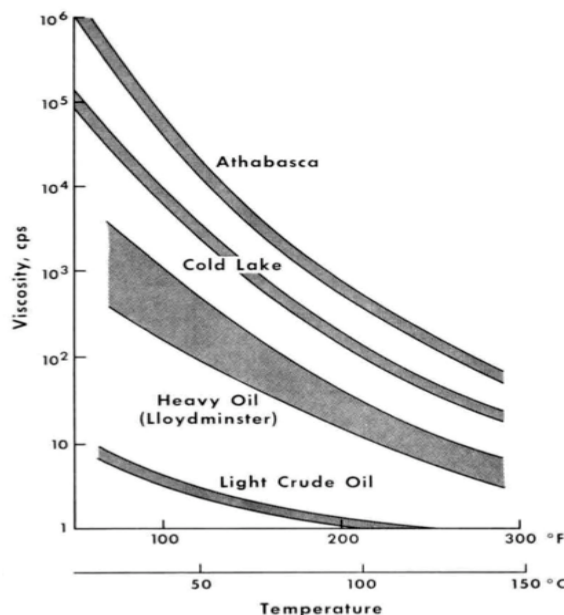
viscous at atmospheric pressure and temperature and have the consistency of cold molasses. Because of these physical properties, the extraction methods for tar sands differ from those used for conventional crudes. For deposits close to the surface, tar sands are extracted through surface mining. For deeper deposits, in-situ technologies using steam are required. Once extracted, tar sands must then be upgraded to separate out the bitumen to create what is referred to as “synthetic crude,” which is when the exploited tar sands first take on properties typically associated with conventional crudes. On the other hand, conventional crudes are recoverable from an underground reservoir. They are liquid at atmospheric pressure and temperature and, unlike tar sands, flow through a well without stimulation and through a pipeline without dilution.

Technical classifications reinforce the physical differences between tar sands and conventional crudes. The most common technical standard comes from the American Petroleum Institute (API), which categorizes all crudes based on their density compared to water – referred to as the “specific gravity” of the crude:

Classification	API Value
Light Crude	Greater than 31.1°
Medium Crude	22.3° to 31.1°
Heavy Crude	10° to 22.3°
Water	10°
Extra Heavy Crude	Less than 10°

Light, medium and heavy crudes are less dense than water and therefore float. Extra heavy crudes, which include tar sands and oil shale, are denser than water and therefore sink. The specific gravity of Canadian tar sands has an average value of 8°.<sup>32</sup>

Tar sands are also distinct from heavy and light crudes when considering their viscosity at different temperatures. This is demonstrated in the graph below, which compares tar sands extracted from the Athabasca and Cold Lake regions to heavy oil and light crude.<sup>33</sup>



As shown above, there are clear physical differences between tar sands and conventional crudes that explain the differences in GHG intensity associated with their extraction. At the feedstock level, tar sands cannot be said to share the same physical properties as conventional crudes. It is only after upgrading, which occurs following extraction, that they acquire any semblance to conventional crudes.

### 3. **TARIFF CLASSIFICATION**

Tariff classification is highly relevant to the likeness determination, especially in the context of the other criteria.<sup>34</sup> In *EC – Computer Equipment*, the Appellate Body found that conformity of tariff classifications to the Harmonized System for nomenclature in the World Customs Organization (WCO) must be considered.<sup>35</sup> In the European Union, Council Regulation (EEC) No 2658/87 provides tariff classifications for imported goods according to the Combined Nomenclature (CN).<sup>36</sup> Each year, the European Commission publishes an updated version of Annex I setting out tariff classifications—called CN codes—for all imported and exported products.<sup>37</sup> The annual updates account for changes agreed to at the international level, specifically the Harmonized System for nomenclature in the WCO.<sup>38</sup>

At the feedstock level, the tariff classification for tar sands differs from conventional crudes. Importers of tar sands and conventional crudes into the European Union would fall under different CN codes.<sup>39</sup>

CN Code	Description
2714 10 00	Bituminous or oil shale and tar sands
2707 99 11	Crude light oils (of which 90% or more by volume distills at temperatures of up to 200° C)
2707 99 19	Other crude oils
2709 00 90	Petroleum oils and oils obtained from bituminous minerals, crude (excluding natural gas condensates)

Once tar sands have been upgraded into synthetic crude, however, it bears noting that synthetic crude would have a different CN code than tar sands and would share the same CN code as some conventional crudes, i.e., once tar sands have been upgraded, their tariff classification upon import would change. It is therefore important to recall, as WTO jurisprudence requires, the legal provision at issue. Here, the FQD and the reporting measures focus on upstream emissions—at the extraction stage—and proposes reporting measures to account for those emissions based on the feedstock that was extracted whether imported in that form or any other. When analyzing the tariff classification for tar sands and conventional crudes at the feedstock level, as the reporting measures do, the CN codes are different.

### 4. **CONSUMER TASTES AND HABITS**

The Appellate Body declares that “evidence about the extent to which products can serve the same end-uses, and the extent to which consumers are – or would be – willing to choose one product instead of another to perform those end-uses, is highly relevant evidence in assessing the ‘likeness’ of those products.” Within the European Union, there has been much polemic regarding transport fuel derived from tar sands.<sup>40</sup> In general, European consumers perceive of transport fuels derived from tar sands as destructive and undesirable on both climate and environmental grounds.<sup>41</sup> Once in the fuel supply,

however, European consumers are unable to distinguish between fuels derived from tar sands and conventional crudes: they will pump into their tank whatever transport fuel the provider supplies. It is unclear the quantitative extent to which, if given the choice at the pump, European consumers would forego transport fuel derived from tar sands. But the aversion to tar sands remains tangible on a conceptual level and, if given the option, evidence suggests that consumers would wield their purchasing power to discriminate against transport fuel derived from tar sands.<sup>42</sup> The Appellate Body has identified this as a relevant consideration when analyzing consumer tastes and habits.<sup>43</sup>

## **B. LESS FAVOURABLE TREATMENT**

In the instance tar sands and conventional crudes are found to be like products, the Canadian government must still demonstrate that the reporting measures provide less favourable treatment to tar sands under Article III of GATT. Imported products “shall be accorded treatment no less favourable 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.”<sup>44</sup> The Appellate Body held that formally different treatment of imported and domestic goods did not, in and of itself, necessarily lead to less favourable treatment: “whether or not imported products are treated ‘less favourably’ than like domestic products should be assessed... by examining whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products.”<sup>45</sup> The Appellate Body has further declared that this examination cannot rest on simple assertion, but must be founded on a careful analysis of the contested measure and of its implications in the marketplace.<sup>46</sup> The burden to demonstrate less favourable treatment is on the party asserting the fact or the claim.<sup>47</sup> To date, during public consultation and the scientific review of default values, the Canadian government has not met its burden to demonstrate less favourable treatment.

The Canadian government argues that the default values would result in less favourable treatment for tar sands. The thrust of the argument focuses on the fact that tar-sands reserves are located in Canada, not the European Union, and therefore accounting for GHG intensity of tar sands would make them less marketable vis-à-vis conventional crudes. The Canadian government also notes that both it and its impacted industries have made GHG emissions data available, whereas other governments and industries have not, and that openness should not inure to the detriment of Canadian tar sands. A final argument, made on procedural grounds, is that the reporting measures establish a specific default value for unconventional crudes—namely tar sands and oil shale—while treating conventional crudes the same by assigning a single default value to all of them. The implication is that, although the best available science may confirm that tar sands have higher GHG intensity during extraction, and therefore higher lifecycle GHG emissions, the European Commission must set out feedstock-specific default values for all conventional crudes or refrain from assigning one to tar sands at all.

There are sound policy justifications for addressing at the outset those unconventional crudes that have substantiated differences in lifecycle GHG emissions. First, the GHG intensity is more straightforward when distinguishing between conventional and unconventional crudes. This is due to the physical properties of those unconventional feedstocks that require special extraction methods: mining and steam injection. The difference in GHG intensity of extraction among conventional crudes, on the other hand, is not as straightforward: the ranges tend to overlap and require further analysis. Second, a universal default value for all crudes—regardless whether conventional or unconventional—as advocated by the Canadian government is not supported by scientific evidence. Indeed, the Canadian position would actually provide more favourable treatment to tar sands than what is supported by the best available scientific evidence because it would ignore substantiated differences in the GHG intensity



of tar-sands extraction. Third, tar sands and oil shale are found in countries across the world: Canada, Venezuela, United States, European Union, and Russia, among others. So too are conventional crudes. The default values for unconventional crudes apply equally across the board as does the default value for conventional crudes. There is no distinction between domestic and foreign products. For example, Canadian tar sands receive similar treatment as Venezuelan tar sands; Estonian oil shale receives similar treatment as Chinese oil shale; and Norwegian conventional crude receives similar treatment as Canadian conventional crude. No inference of discriminatory intent is evident, making the argument that the European Union is targeting Canadian tar sands misplaced. The reporting measures transcend whatever form the imported product may take on—feedstock, transport fuel, or something in between—to account for known GHG emissions at each stage in its production.

In the final analysis, in a WTO challenge, the Canadian government must demonstrate less favourable treatment.<sup>48</sup> It has not, to date, shown that the conditions of competition in the European marketplace would inure to the detriment of its imported products and to the benefit of other like products. Simple assertions about less favourable treatment, without evidentiary support, are inadequate.

### C. ARTICLE XX GENERAL EXCEPTIONS

In the instance tar sands are like products receiving less favourable treatment, however unlikely, the reporting measures are nevertheless allowed under Article XX(g) of GATT. Countries may adopt discriminatory measures for like products for the conservation of exhaustible natural resources:

#### Article XX General Exceptions

Subject to the requirement that such 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, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

\*\*\* \*\*

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

The climate system, like clean air in *US – Gasoline*, is an exhaustible natural resource.<sup>49</sup> There will be no dispute on that point, especially in light of activities at the international level under the United Nations Framework Convention on Climate Change (UNFCCC) and Kyoto Protocol.<sup>50</sup> The reporting measures must therefore “relate to” the conservation of the climate system and be “made effective in conjunction with restrictions on domestic production and consumption.” Here, these requirements are met. To relate to the conservation of the climate system, the reporting measures must be “primarily aimed at” or have a “substantial relationship to” protecting the climate system.<sup>51</sup> The FQD, in general, and the reporting measures, in particular, are specifically designed to reduce lifecycle GHG emissions of transport fuel, a major contributor to climate change.<sup>52</sup> The measures must also be “made effective in conjunction with restrictions on domestic production or consumption” to ensure “even-handedness.”<sup>53</sup> The reporting measures apply to all crudes regardless of the national origin of the feedstock, including

on the European Union. The Article XX(g) exception relating to the conservation of exhaustible natural resources is therefore applicable.

But the reporting measures must also comply with the Article XX *chapeau* requirements, namely that they “are not applied in a manner which would constitute arbitrary or unjustifiable discrimination or a disguised restriction on international trade.”<sup>54</sup> There is no legitimate basis to conclude that the reporting measures are a “disguised restriction on international trade.” This *chapeau* requirement is not addressed further. The analysis then turns on whether their application constitutes arbitrary or unjustifiable discrimination. Several WTO cases set out the contours of this analysis, including *US – Gasoline*, *US – Shrimp*, and *EC – Asbestos*, which are described in the Appendix to this briefing. The three general elements in the *chapeau* requirements are: (i) the application of the measure must result in discrimination, the nature and quality of which must be different from the discrimination of like products that resulted in the initial WTO violation; (ii) that discrimination must be arbitrary or unjustifiable in character, focusing on both the actual provisions in the measure and how it is applied in practice; and (iii) that discrimination must occur between countries where the same conditions prevail.<sup>55</sup> In the words of the Appellate Body, the *chapeau* requirements are “but one expression of the principle of good faith.”<sup>56</sup>

To argue that the European Union did not engage in good faith is beyond the pale. First, to the extent any discrimination exists, the nature and quality of it is not different than that for the like-products analysis.<sup>57</sup> The discrimination for the like-products analysis scrutinized several issues, including: that the higher GHG emissions associated with tar sands could impact their competitive relationship; and that although the GHG intensity of tar sands may be more pronounced than for conventional crudes, potential differences among conventional crudes compels specific default values for each one. This discrimination is no different than that under the like-products analysis. Moreover, the Canadian government may place much emphasis on the fact that tar-sands reserves are located in Canada, not the European Union, but this argument is undermined by the fact that the European Commission focuses on unconventional crudes within its borders too, including oil sands in Estonia. It also ignores the fact that tar-sands reserves are found elsewhere in the world. Given the state of scientific evidence, it is appropriate to conclude that the reporting measures have a rational basis. Further, the European Commission is committed to ongoing scientific study with an eye toward further differentiation among crude-based fuels. This approach—setting out default values based on the best available scientific evidence, allowing actual values when possible, differentiating in the future as the science progresses, and updating as appropriate—is justifiable.

Second, the European Commission has exhibited good faith during the entire process. It engaged in a multi-year, peer-reviewed, participatory consultation to ascertain default values for unconventional and conventional crudes. The Canadian government participated frequently as impacted stakeholders, submitting scientific evidence and technical data, serving as peer reviewers, engaging in intergovernmental dialogue, and otherwise expressing their opinions and concerns. The scientific evidence surrounding the default values for tar sands, developed over the course of several years, makes a compelling case for differentiation and the European Commission has decided to act on it. This meets the *US – Gasoline* standard for good faith.<sup>58</sup>

Third, the European Commission treats unconventional crudes alike. In tandem with tar sands, the European Commission is tackling oil shale, which is also an unconventional crude. Oil-shale reserves, unlike tar-sands reserves, exist in the European Union in Estonia. In treating the various unconventional

crudes in similar fashion, based on the GHG intensity of their extraction methods and not their location, the European Commission has demonstrated a commitment to accurate reporting of GHG emissions.

Fourth, the reporting measures for crudes follow the regulatory framework in existence for biofuels, which is already a part of the FQD. Biofuels are treated according to their GHG intensity, which is based on the feedstock of origin. As noted above, the FQD adopts a feedstock-specific approach for reporting lifecycle GHG emissions from biofuels, including assigning feedstock-specific default values for biofuel cultivation and allowing actual values where appropriate. There is congruence in how lifecycle GHG emissions for transport fuels are being treated. Taking this larger view underscores the rational and justifiable basis for the reporting measures.

## **CONCLUSION**

The European Union has a strong likelihood of success on the merits in a WTO challenge against its reporting measures setting out a default value for GHG emissions from tar sands. Under WTO jurisprudence, tar sands will most likely not be considered “like products” to conventional crudes and therefore no unlawful discrimination exists under Article I and III of GATT. Even if this hurdle can be overcome, the Canadian government bears the burden to show that tar sands receive less favourable treatment vis-à-vis conventional crudes under Article III of GATT, which it has not met. Moreover, the European Union has proceeded in good faith, backed by the best available scientific evidence, and the reporting measures are rational and justifiable. Therefore, to the extent any discrimination is found to exist, the reporting measures are permissible under the Article XX(g) of GATT, which allows countries to adopt trade-restrictive measures relating to the conservation of exhaustible natural resources. In any event, if a WTO violation is found, the European Union will be provided a reasonable period to amend the reporting measures to come into compliance with WTO jurisprudence without having to abandon its pursuit of legitimate climate objectives in the FQD.

## **Défense Terre**

27 June 2011

For further information please contact:

**Tim Grabel**

**Senior Lawyer**

m +33 (0)6 32 76 77 04

tgrabel@defenseterre.org

## **APPENDIX: SELECTED APPELLATE BODY CASES**

The descriptions of the following cases focus on the Appellate Body analysis of compliance with the *chapeau* requirements under Article XX.<sup>59</sup>

### **A. US – GASOLINE (1996)**

The dispute arose when the United States (US) applied stricter rules on the chemical characteristics of imported gasoline than it did for domestically refined gasoline. To achieve clean air, the US instituted a program that required the dirtiest air basins, those in “nonattainment” of air quality standards, to use cleaner reformulated gasoline. Air basins in “attainment” were permitted to use dirtier conventional gasoline. To prevent refiners from dumping the pollutants extracted from reformulated gasoline into conventional gasoline—an inexpensive way to dispose of them—the US required conventional gasoline to meet a certain baseline for gasoline quality. For domestic refiners, the baseline was calculated as the quality of their gasoline in 1990, the so-called “individual baseline.” For foreign refiners, the baseline was fixed in the US Clean Air Act, the so-called “statutory baseline.” Venezuela and Brazil challenged the measure as violating the *chapeau* requirements, arguing that allowing domestic refiners to use individual baselines and requiring foreign refiners to use statutory baselines was unjustifiable discrimination.<sup>60</sup>

The Appellate Body found that the claim to exception under Article XX(g) was proper, but that the US unjustifiably discriminated in violation of the *chapeau*. It found unpersuasive the justifications proffered for barring foreign refiners from using individual baselines and allowing domestic refiners to avoid statutory baselines:

- *Barring foreign refiners from using individual baselines.* The US argued that it would prove too administratively burdensome to verify and enforce on foreign soil. But the Appellate Body noted that this categorical statement did not apply to all foreign refiners, and that the US had failed to seek cooperative arrangements with foreign refiners and the foreign governments to make that determination, including with Venezuela and Brazil.<sup>61</sup> In other words, the US could not justify the across-the-board application of the statutory baseline on foreign refiners.
- *Allowing domestic refiners to avoid statutory baselines.* The US argued that applying the statutory baseline to domestic refiners would have been physically and financially impossible because of the magnitude of the changes required in almost all US refineries, causing substantial delay in the programme. But the Appellate Body noted that although “this may very well have constituted sound domestic policy,” the US “disregard[ed] that kind of consideration when it came to foreign refiners.”<sup>62</sup>

The Appellate Body concluded that these two omissions—to explore adequately means of mitigating the administrative problems and counting the costs for foreign refiners of statutory baselines—constituted unjustifiable discrimination and a disguised restriction on international trade.<sup>63</sup> It therefore struck down

the measures. This case makes clear that countries implementing trade-restrictive measures must be able to justify them, and the WTO judiciary will scrutinize any justification to ensure it conforms to the stated objective.

## **B. US – SHRIMP (1998)**

The dispute arose when the US prohibited imports of certain shrimp and shrimp products. The import ban resulted from the listing of five species of migratory sea turtles under the US Endangered Species Act. As a result of the listing, the US government was required to prohibit any harassment, hunting, capture or killing of sea turtles. The US government therefore required its shrimp trawlers to use “turtle-excluder devices” in their nets when fishing in areas frequented by sea turtles. The US government also prohibited imports of shrimp harvested with technology that adversely affected sea turtles unless the harvesting country had a certified regulatory programme similar to that of the US or it was found that its particular fishing environment did not pose a threat to sea turtles.

The practical effect of the ban was to require shrimp-harvesting countries with any of the listed sea turtles in their waters to impose on their shrimp trawlers essentially the same requirements as those borne by US shrimp trawlers if they wanted to be certified to export shrimp products to the US. In essence, it required the use turtle-excluder devices. India, Malaysia, Pakistan and Thailand challenged the US ban on the grounds that it unjustifiably and arbitrarily discriminated against their shrimp and shrimp products.

The Appellate Body found both unjustifiable and arbitrary discrimination. Although the ban was proper under Article XX(g) since the protection of sea turtles was at its heart, the Appellate Body found several facets violated the *chapeau*, detailing in the clearest terms to date the *chapeau's* procedural and substantive requirements:

- *Essentially the Same Program.* The implementing regulations required foreign governments to adopt certified regulatory program that essentially dictated what a comparable regulatory program would entail.<sup>64</sup> The Appellate Body found that the US established “a single rigid and unbending requirement”<sup>65</sup> that required adoption of “*essentially the same* policies and enforcement practices as those applied to, and enforced on, domestic shrimp trawlers,” namely the use of turtle-excluder devices.<sup>66</sup> The certification process provided “little or no flexibility in how officials make the determination for certification pursuant to these provisions.”<sup>67</sup> In addition, the measure implied that, in certain circumstances, shrimp caught abroad using methods identical to those employed in the US would be excluded from the US market.<sup>68</sup> The Appellate Body found this was “difficult to reconcile with the declared objective of protecting and conserving sea turtles.”<sup>69</sup>
- *Unequal Treatment.* The US provided certain countries—mainly in the Caribbean—technical and financial assistance and longer transition periods for their fishermen to start using turtle-excluder devices. The Appellate Body found that the US impermissibly discriminated between countries by affording these countries preferential treatment.<sup>70</sup>
- *Duty to Negotiate.* The US made serious efforts to negotiate a pact with only certain countries, including those countries that received technical and financial assistance. The

Appellate Body found that the US failed to engage all shrimp-exporting countries “in serious, across-the-board negotiations with the objective of concluding bilateral and multilateral agreements for the conservation and protection of sea turtles before enforcing the import prohibition.”<sup>71</sup> This duty to negotiate—and the failure thereof—was heightened by the unilateral nature of the prohibition.<sup>72</sup>

- *Due Process.* The certification process was not subject to formal procedural protections that allowed for review and appeal. The Appellate Body found that the certification process “to be singularly informal and casual” with no written opinion or formal appeal procedure, failing to meet “certain minimum standards for transparency and procedural fairness in the administration of trade regulations.”<sup>73</sup>

In the wake of the Appellate Body decision, the US undertook a series of actions to address the issues outlined above. It engaged in across-the-board negotiations with shrimp-exporting countries.<sup>74</sup> It revised its regulations to require a regulatory program that was “comparable in effectiveness” rather than “essentially the same.”<sup>75</sup> On that point, the Appellate Body found “there is an important difference between conditioning market access on the adoption of essentially the same programme, and conditioning market access on the adoption of a programme *comparable in effectiveness*.”<sup>76</sup> The US also revised its regulations to permit sufficient flexibility for officials certifying programs, allowing them to take into account the unique circumstances in any given country. And it addressed the procedural fairness concerns, ensuring due process through transparent decision-making and the right to challenge an adverse determination.<sup>77</sup> Despite these actions, Malaysia nevertheless challenged the ban again through the “recourse” procedure. This time, however, the Appellate Body upheld the prohibition, finding that it no longer resulted in unjustifiable or arbitrary discrimination.<sup>78</sup>

### C. EC – ASBESTOS (2001)

The dispute arose when France prohibited the import of asbestos and asbestos-containing products.<sup>79</sup> Asbestos is a highly toxic material, exposure to which poses significant threats to human health, including asbestosis, lung cancer and mesothelioma. But due to resistance to very high temperatures, certain asbestos are widely used in various industrial sectors. To control the health risks associated with their release, France imposed a general ban on asbestos as well as on products that contained it. Canada, a major producer of asbestos-containing products, challenged the French law.

The Appellate Body upheld the ban. The objective of the French government to protect human health legitimately allowed it to halt the proliferation of asbestos within its borders under Article XX(b).<sup>80</sup> With regard to the *chapeau* requirements, the Appellate Body upheld the Panel findings that, in the text of the French law, “[o]nly the product in question is mentioned, without any reference to its origin” and, therefore, no discrimination based on national origin was readily apparent.<sup>81</sup> It was also important that, within the administrative aspects of the law, there was no “expressly discriminatory provision.”<sup>82</sup> The Canadian government’s failure to show discrimination beyond a general import ban was insufficient to meet its burden to establish unjustifiable and arbitrary discrimination under the *chapeau*.<sup>83</sup>

- <sup>1</sup> General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [hereinafter “GATT 1994”] at Article I.
- <sup>2</sup> GATT 1994, Articles III:4 and XI:1.
- <sup>3</sup> GATT 1994, Articles III:4 and XI:1.
- <sup>4</sup> GATT 1994, Article XX.
- <sup>5</sup> Compare Appellate Body Report, *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755 [hereinafter “*US – Shrimp*”] with Appellate Body Report, *United States — Import Prohibition of Certain Shrimp and Shrimp Products — Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001 [hereinafter “*US – Shrimp Recourse*”]; see also GATT 1994, Articles XXI-XXIII.
- <sup>6</sup> Directive 2009/30/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 98/70/EC as regards the specification of petrol, diesel and gas-oil and introducing a mechanism to monitor and reduce greenhouse gas emissions and amending Council Directive 1999/32/EC as regards the specification of fuel used by inland waterway vessels and repealing Directive 93/12/EEC [hereinafter “FQD”], Article 7d and Annex IV; 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 [hereinafter “RED”], Article 19 and Annex V.
- <sup>7</sup> See, e.g., Adam R. Brandt, Department of Energy Resources Engineering, Stanford University, *Upstream Greenhouse Gas (GHG) Emissions from Canadian Oil Sands as a Feedstock for European Refineries* (18 January 2011); European Commission, *Consultation Paper on the Measures Necessary for the Implementation of Article 7a(5)* (undated).
- <sup>8</sup> *EC – Asbestos*, paras. 113-116.
- <sup>9</sup> GATT 1994 at Article I and III:4.
- <sup>10</sup> Appellate Body Report, *EC – Asbestos*, paras. 101- 103; see also Appellate Body Report, *Japan — Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97 [hereinafter “*Japan – Alcoholic Beverages*”], fns. 46 and 58; see also Panel Report, *United States – Gasoline*, footnote 15, para. 6.8 (approach set forth in the *Border Tax Adjustment* case was adopted in a dispute concerning Article III:4 of the GATT 1994 by the panel).
- <sup>11</sup> See, generally, Appellate Body Report, *EC – Asbestos*, para. 102.
- <sup>12</sup> *EC – Asbestos*, para. 102.
- <sup>13</sup> *EC – Asbestos*, para. 102.
- <sup>14</sup> *EC – Asbestos*, para. 103.
- <sup>15</sup> *EC – Asbestos*, para. 103.
- <sup>16</sup> *EC – Asbestos*, para. 141.
- <sup>17</sup> *EC – Asbestos*, para. 103.
- <sup>18</sup> See FQD, Articles 7a and 7d.
- <sup>19</sup> FQD, Article 7a(2)(a).
- <sup>20</sup> FQD, Article 2(6) (emphasis added).
- <sup>21</sup> See, generally, FQD.
- <sup>22</sup> FQD, Article 7d(5)-(7) and Annex IV.
- <sup>23</sup> FQD, Article 7a(5).
- <sup>24</sup> FQD, Article 7a(5)(a).
- <sup>25</sup> Compare FQD, Article 7d(6) with FQD, Article 7a(5).
- <sup>26</sup> Adam R. Brandt, Department of Energy Resources Engineering, Stanford University, *Upstream Greenhouse Gas (GHG) Emissions from Canadian Oil Sands as a Feedstock for European Refineries* (18 January 2011)
- <sup>27</sup> Adam R. Brandt, Department of Energy Resources Engineering, Stanford University, *Upstream Greenhouse Gas (GHG) Emissions from Canadian Oil Sands as a Feedstock for European Refineries* (18 January 2011)
- <sup>28</sup> See, e.g., FQD, Recitals 8-9 and Article 1(b).
- <sup>29</sup> *EC – Asbestos*, para. 14.
- <sup>30</sup> *EC – Asbestos*, para. 116.
- <sup>31</sup> See, e.g., *EC – Asbestos*, para. 117
- <sup>32</sup> Aspentech, PowerPoint Presentation: *Modeling Heavy Oils in Aspen HYSYS* (26 January 2010), Slide 7; see also Adam R. Brandt, Department of Energy Resources Engineering, Stanford University, *Upstream Greenhouse Gas (GHG) Emissions from Canadian Oil Sands as a Feedstock for European Refineries* (18 January 2011), Table 2.
- <sup>33</sup> United States Geological Survey (USGS), *Heavy Oil and Natural Bitumen Resources in Geological Basins of the World*, Open File report 2007-1084, p. 2, located at P:\205 Fuel Quality\205.02 Diesel & Petrol Fuels\00 Ref Information\Greenhouse gas methodology\upstream of fossil fuels\Oil Sands\World Deposits USGS.pdf; see also Speight, James G, Ph D, and D Sc. *Enhanced Recovery Methods for Heavy Oil and Tar Sands*, 2009.
- <sup>34</sup> *EC – Asbestos*, paras. 124-125.
- <sup>35</sup> Appellate Body Report, *EC – Computer Equipment*, paras. 89-93.

- <sup>36</sup> See Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff.
- <sup>37</sup> Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff, Article 12.
- <sup>38</sup> European Commission, *The Combined Nomenclature*, available at [http://ec.europa.eu/taxation\\_customs/customs/customs\\_duties/tariff\\_aspects/combined\\_nomenclature/index\\_en.htm](http://ec.europa.eu/taxation_customs/customs/customs_duties/tariff_aspects/combined_nomenclature/index_en.htm) (last visited 27 June 2011).
- <sup>39</sup> Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff; Commission Regulation (EU) No 861/2010 of 5 October 2010 amending Annex I to Council Regulation (EEC) No 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff.
- <sup>40</sup> See, e.g., Friends of the Earth Europe, *Tar Sands – Fuelling the Climate Crisis, Undermining EU Energy Security and Damaging Development Objectives* (May 2010); The Co-operative Financial Services / WWF-UK, *Unconventional Oil: Scraping the Bottom of the Barrel* (July 2008); The Co-operative Financial Services / WWF-UK, *Toxic Fuels: Toxic Investments* (July 2010); Greenpeace UK, *Tar Sands in Your Tank - Exposing Europe's Role in Canada's Dirty Oil* (May 2010); The Co-operative Financial Services / WWF-UK, *CCS in the Alberta Tar Sands – A Dangerous Myth* (October 2009); The Co-operative Financial Services / WWF-UK, *Toxic Fuels: Toxic Investments* (July 2010).
- <sup>41</sup> *Id.*
- <sup>42</sup> See, e.g., The Co-operative Financial Services, Greenpeace, World Wildlife Fund, *Tarnished Earth: An Exhibition of Devastating Power*, located at <http://www.tarnishedearth.co.uk/> (over 20,000 people called upon the European Parliament to keep tar sands out of Europe, last visited on 27 June 2011); Avaaz, *No Tar Sands in Europe*, located at [http://www.avaaz.org/en/crude\\_politics/](http://www.avaaz.org/en/crude_politics/) (petition achieving 40,000 signatures within 36 hours, last visited on 27 June 2011).
- <sup>43</sup> *EC – Asbestos*, paras. 121-123.
- <sup>44</sup> GATT 1994, Article III:4.
- <sup>45</sup> Appellate Body Report on *Korea – Various Measures on Beef*, para. 137.
- <sup>46</sup> Appellate Body Report on *US – FSC (Article 21.5 – EC)*, para. 215, 221.
- <sup>47</sup> *EC – Asbestos*, para. 100; see also Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14.
- <sup>48</sup> Appellate Body Report, *Japan – Alcoholic Beverages II*; see also *EC – Asbestos*.
- <sup>49</sup> *US – Gasoline* at p. 19; see also *US – Shrimp* at Paragraph 129; Panel Report, *US – Canadian Tuna* at Paragraph 4.9; Panel Report, *US – Tuna (EEC)*, unadopted, at Paragraph 5.13; Panel Report, *US – Gasoline* at Paragraph 6.37.
- <sup>50</sup> United Nations Framework Convention on Climate Change, 1771 UNTS 107, 31 ILM 849 (1992) at Preamble 1 (climate and its adverse effects are a “common concern of humankind”).
- <sup>51</sup> Panel Report, *US – Tuna (Mexico)*, unadopted, at Paragraph 5.33; *US – Gasoline*, p. 18; Panel Report, *Canada-Salmon and Herring* at Paragraph 4.6; United Nations Convention on Biological Diversity, 1760 UNTS 79, 31 ILM 818 (1992) at Paragraph 3 (biological diversity is a “common concern of humankind”).
- <sup>52</sup> FQD, Recital 3-4 and Article 7a.
- <sup>53</sup> GATT 1994, Article XX(g).
- <sup>54</sup> *US – Shrimp* at Paragraph 150.
- <sup>55</sup> *US – Shrimp* at Paragraph 150-160.
- <sup>56</sup> *US – Shrimp* at Paragraph 158.
- <sup>57</sup> *US – Shrimp*, para. 150; Appellate Body Report, *US – Gasoline*, p. 23 (the “provisions of the chapeau cannot logically refer to the same standard(s) by which a violation of a substantive rule has been determined to have occurred”); Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/R and Add.1, adopted 5 April 2001, as modified by the Appellate Body Report, WT/DS135/AB/R [hereinafter “*EC – Asbestos Panel*”], para. 8.227 (discrimination can exist between foreign products themselves or foreign products and domestic ones); see also *US – Gasoline*, p. 22.
- <sup>58</sup> See *US – Shrimp*; *US – Shrimp Recourse*.
- <sup>59</sup> These summaries are extracted, with some slight modifications, from a legal analysis provided by the same author. See Tim Grabel, ClientEarth, *Legal Analysis: WTO Implications of European Union Tar Sands Policies* (June 2010), pp. 4-6.
- <sup>60</sup> *US – Gasoline*
- <sup>61</sup> *US – Gasoline*, pp. 23-24.
- <sup>62</sup> *US – Gasoline*, pp. 25-26.
- <sup>63</sup> *US – Gasoline*, pp. 26.
- <sup>64</sup> *US – Shrimp*, paras. 161-162.
- <sup>65</sup> *US – Shrimp*, para. 177, fn. 24.
- <sup>66</sup> *US – Shrimp Recourse*. Para. 140.
- <sup>67</sup> *US – Shrimp*, paras. 178-186.
- <sup>68</sup> *US – Shrimp*, para. 165.



<sup>69</sup> *US – Shrimp*, para. 165.

<sup>70</sup> *US – Shrimp*, paras. 173-175.

<sup>71</sup> *US – Shrimp*, paras. 166-171.

<sup>72</sup> *US – Shrimp*, para. 172.

<sup>73</sup> *US – Shrimp*, paras. 178-186.

<sup>74</sup> *US – Shrimp Recourse*, paras. 119-134.

<sup>75</sup> *US – Shrimp Recourse*, paras. 135-144.

<sup>76</sup> *US – Shrimp Recourse*, para. 144.

<sup>77</sup> *US – Shrimp Recourse*, paras. 145-150.

<sup>78</sup> *US – Shrimp Recourse*, paras. 153-54.

<sup>79</sup> See *EC – Asbestos Panel*; *EC – Asbestos*.

<sup>80</sup> *EC – Asbestos*, para. 168.

<sup>81</sup> *EC Asbestos Panel*, para. 8.228.

<sup>82</sup> *EC Asbestos Panel*, para. 8.228.

<sup>83</sup> *EC Asbestos Panel*, para. 8.229.