EU-Malaysia Palm Oil Dispute: WTO Confirms Legitimacy of Environmental Regulation but Cautions on its Concrete Implementation

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The WTO has issued an important ruling in the dispute launched by Malaysia against EU and French policies on biofuels (*EU – Palm oil (Malaysia)*, DS600). While the individual findings tended in Malaysia's favour, the broader architecture of the EU's renewable energy framework on biofuels was found to be WTO-compatible. As a result, the EU was heralded in the press as the ultimate victor.

The ruling is significant because it confirms the ability of WTO members to pursue regulatory action to reduce greenhouse gas emissions, including where these emissions occur outside of its own borders. This may have important repercussions on new legislative instruments being implemented by the EU (such as the Carbon Border Adjustment Mechanism "CBAM") and could represent another stone in paving the way towards wider adoption of trade-related climate policies by governments worldwide.

However, as often, the devil is in the details: the concrete application of the measure must not unjustifiably and disproportionately affect the treatment of a particular imported product. Policymakers must thus carefully craft environmental regulation, from the legislative instrument all the way to the technical minutiae.

Background to the case

The case was launched by Malaysia in April 2021 – shortly after Indonesia launched a similar dispute (*EU – Palm oil (Indonesia)*, DS593)[1]. It was adjudicated by a panel of experts under the WTO dispute resolution process. The panel circulated its 348-page report on March 5, 2024. Of note is that the Veblen Institute[2], a French think tank, submitted an *amicus curiae* brief arguing in particular that measures genuinely aimed at mitigating climate change should be justified under GATT Article XX.

For context, the renewable energy directive ("RED II") requires EU Member States to incorporate a certain share of renewable energy into their total energy mix. For the transport sector, 14% of energy consumed should be from renewable sources by 2030, including through the use of biofuels.

The dispute concerns measures taken by the EU to limit the use of biofuels that exhibit a high risk of

indirect land-use change (“ILUC”). ILUC occurs when the cultivation of crops for biofuels displaces the production of food and feed crops; this additional demand on the land leads to the extension of agricultural land into areas with high-carbon stock. This deforestation induced indirectly by the stimulus in demand for biofuels could in turn lead to an increase in overall greenhouse gas emissions.

More specifically, the measures challenged by Malaysia were: (i) the 7% maximum share that biofuels made from food or feed crops can contribute to the renewable energy target; and (ii) the high ILUC-risk cap and phase out, which set out a limit on the contribution that certain high-risk biofuels can make to meeting applicable targets for gross final consumption of energy from renewable sources in the EU’s transport sector and phase out this limit to 0% by 2030.

The EU issued a delegated regulation which sets out implementing rules for the determination of high ILUC-risk biofuels. According to the specific calculations set out in this delegated regulation, only biofuels made from palm oil were categorised as high risk. Furthermore, palm oil-based biofuels could be exempted from this categorisation only through individual certification schemes.

Malaysia also challenged a French law withdrawing a tax advantage for biofuels made from palm oil.

The panel sided with Malaysia on a number of its claims raised under the WTO Agreement on Technical Barriers to Trade (“TBT Agreement”) and the General Agreement on Tariffs and Trade (“GATT”). Notably, the panel found deficiencies in how the EU’s biofuel-related measures had been prepared, published, and administered. In addition, the French measure was found to constitute a discriminatory internal tax. An exhaustive summary of key findings is available here.

Of particular interest is the panel’s treatment of the concepts of discrimination under analogous provisions of the TBT Agreement and the GATT and of its application of the public policy exceptions under these respective texts.

Discriminatory treatment towards goods with higher risk of indirect GHG emissions

Articles 2.1 TBT and III:4 GATT prohibit WTO members from affording less favourable treatment to foreign goods that are “like-products” with domestic goods. This is the national treatment principle. Similarly, Article 2.1 TBT and I:1 GATT requires no less favourable treatment to be afforded to like-products from two different countries. This is the MFN principle. The legal tests to characterise discrimination under the TBT Agreement and the GATT are nearly identical, and the panel explicitly reasons in parallel under these two different agreements.

Malaysia claimed that the EU measures were discriminatory vis-à-vis palm oil-based biofuel because they

were the only type of oil crop-based biofuel that fell within the scope of the 7% maximum share and the high ILUC-risk cap and phase out.

For discrimination to be characterised, it is necessary to benchmark against the treatment afforded to like-products. The panel followed Malaysia's reasoning in considering rapeseed oil and soybean oil biofuels as like-products to palm oil biofuels. The panel followed the standard reasoning set out by WTO precedents, establishing that these products had:

- Physical characteristics that while not identical, were very similar;
- A same primary end-use, given that downstream users of biofuel did not distinguish between the crop of origin when using such fuels;
- Similar preferences from consumers for biofuels from different sources, despite arguments raised by the EU that consumers widely preferred palm-oil free products due to concerns surrounding deforestation; and
- An identical tariff heading at the six digit level under the EU's tariff nomenclature (3826.00).

With likeness established, the panel found that the measures on palm-oil based biofuels had a detrimental impact on the conditions of competition for that category of product. The RED II framework in essence stimulates demand for biofuels but withdraws the benefits of this stimulus for palm-oil based biofuels. This has the effect of almost completely halting imports of palm-oil based biofuels into the EU. Thus, the panel finds the existence of a discrimination.

Tackling domestically induced GHG emissions in third countries as a legitimate environmental objective under WTO law

Measures may be found to be WTO-compatible – despite discriminatory treatment – if they fall within the scope of legitimate public policy objectives. These legitimate objectives are provided for in Article 2.2 of the TBT Agreement and Article XX of the GATT.

The EU argued that the wider RED II framework pursues the "composite objective of mitigating climate change, preserving biodiversity, and addressing the associated moral concerns of the EU public".

The panel sided with the EU, considering that its policy on high ILUC-risk biofuels pursued the legitimate objective of limiting the risk of ILUC-related GHG emissions associated with crop-based biofuels.

First, the panel found for the first time that high carbon-stock land, such as forests and wetlands, could be considered as an exhaustible natural resource under Article XX(g) GATT. Second, the panel applied existing case law according to which policies that pursue the objective of reducing greenhouse gas emissions fall under the protection of human, animal, and plant life or health as provided for in Article

XX(b) GATT[3]. The TBT Agreement sets out similar principles for environmental protection which the panel applied by analogy. It nevertheless left open the question of whether the measures could fall within the scope of the public morals exception under Article XX(a) GATT.

In a very significant passage, the panel recognised that these objectives allow WTO members to regulate greenhouse gas emissions even where these emissions may occur outside of its borders.

Three elements supported this finding. First, the panel considered that the public policy objectives listed in the TBT Agreement and the GATT "do not have any inherent jurisdictional or territorial limitation" (§7.311). Second, because "climate change is inherently global in nature", a sufficient jurisdictional nexus could be established between the EU and the extra-territorial effects of its regulatory action (§7.314). Third – and importantly –, the panel added that the measures should not be characterised as regulating emissions outside the EU, but EU demand for crop-based biofuels (§7.315). The panel thus confirms the legitimacy of measures aimed at minimising adverse impacts generated in third countries induced by domestic demand, going beyond measures aimed at regulating only domestic production.

In a context where the extra-territorial impacts of climate regulation are subject to lively debate at the WTO level, these findings of the panel may serve to comfort the broader WTO compatibility of recent EU legislative instruments (CBAM, deforestation regulation, etc.). These have already been the subject of criticism by several nations exporting to the EU.

What's more, the panel followed the EU's reasoning in finding that the contested measures were not more trade-restrictive that necessary to fulfil the stated objective. The measures could therefore fall under the safe harbour provided for in Article 2.2 TBT and be provisionally justified under Article XX(b) and (g) GATT.

Insufficiently calibrated delegated regulation resulting in arbitrary treatment

The panel widely upheld the legitimacy of the objectives pursued by the RED II framework generally and cast aside Malaysia's arguments relating to potential less trade-restrictive measures. However, the panel ultimately ruled that, in its concrete application, the methodology used by the EU used to classify palm oil as a high ILUC-risk feedstock instituted an arbitrary and unjustified restriction on trade. This legal test stems from the chapeau of Article XX GATT and analogous wording in recital 6 of the TBT Agreement.

The EU set out the rules for determining which biofuels presented high ILUC-risk under a delegated regulation. This determination is based on a formula and applied using available data for, *inter alia*, the share of expansion into land with high-carbon stock.

The panel faults the EU for not applying the measures in an even-handed manner. This because: (i) the EU did not use data that was sufficiently up to date; (ii) the exception to the high ILUC-risk categorisation available under the low ILUC-risk certification scheme was too vague to be effective; and (iii) the design of the 10-year time limit for such low ILUC-risk certification (after which the benefit of the certificate would automatically be withdrawn in order to incentivise productivity gains) was unjustifiably disadvantageous to palm-oil based biofuels.

The panel in principle confirmed the EU's ability to design measures that aim to remediate the impacts of deforestation due to demand induced by its biofuels policy. However, the specific design of the delegated regulation resulted in arbitrary or unjustifiable discrimination *vis-à-vis* palm oil-based biofuels produced, notably, in Malaysia and Indonesia. This is why the panel ultimately sided with Malaysia on certain core claims.

The EU has already indicated it will comply with the panel report and will amend its methodology for high ILUC-risk determination (it is in any event required to do so under the new provisions of RED III). Its broader approach to extra-territorial environmental regulation does appear to have survived an important test at the WTO. Sometimes, to win, you have to lose.

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Notes

1. In that case, the panel announced that it will circulate its report on 6 May 2024 (See Communication from the panel, March 5, 2024)
2. Represented by Baldon Avocats and S.Noël Law Office
3. Appellate Body Report, *Brazil – Retreaded Tyres* (DS332), §151; Panel Report, Brazil – Taxation (DS472), §7.880.

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