The ground war with Europe over Alberta's oil

LAWRENCE HERMAN

From Wednesday's Globe and Mail
Published Wednesday, Feb. 22, 2012 2:00AM EST

Will there really be a trade war with the European Union over imports of Canadian fuel from the oil sands?

The media have been reporting it this way, based on letter sent in December to the EU environmental commissioner by Canada's EU ambassador. It said that if the proposed EU fuel quality directive (FQD) is enacted, Canada will march to the World Trade Organization.

This comes at an unfortunate time, since Canadian and European negotiators are trying to put the final touches on a groundbreaking, comprehensive economic and trade agreement. A high-profile controversy involving Canada's oil sands certainly doesn't help that process.

But when it comes to anything that tarnishes the international reputation of Alberta's oil, the federal government has no choice other than to get in the fight. For Ottawa, this is shaping up as a battle for hearts and minds, not unlike the battles Canada has been engaged in over the years fighting foreign restrictions on imports of seal products or Quebec-made chrysotile asbestos.

It will involve an air war and a ground war. The air war will be the ongoing PR battle, the battle for the heart.

The ground war, the battle for the mind, will be the trade battle, and that's what the Canadian ambassador's letter was all about – preventing EU carbon offsets in the FDQ being imposed that differentiate between bitumen-derived products and conventional fuels. These offsets are effectively a border tax on Canadian oil sands fuels to compensate for the carbon emitted in their production.

There's a fundamental WTO legal issue at stake in the ground war.

It concerns the WTO prohibition against governments discriminating against "like" goods from different countries. This is the famous most-favoured-nation treatment rule. It requires fully equivalent treatment to imports of "like" goods wherever they come from. And the equally famous "national treatment" rule means that you can't discriminate against imports in favour of "like" domestic products. It means that all duties, taxes or other border measures – such as carbon offset requirements – that differentiate between these "like" goods are WTO-illegal.

The question comes down to what is "likeness" in WTO terms.

Numerous WTO panel decisions have said that "likeness" is based on the intrinsic nature of the goods, *not* how they are made. Likeness is determined by physical properties, usage and, importantly, whether the goods compete in the same market. It is the direct "competitiveness" of the goods that is normally critical in determining likeness, according to these decisions.

How the goods are made – production and process methods – is not a differentiating factor when the imported goods are like domestic products and other imports in every other respect. A 2011 WTO Secretariat Working Paper examined the jurisprudence in depth going back many years and concluded that border measures based on production methods that don't affect the "likeness" of the final product would be in contravention of the WTO Agreement.

Coming back to the Canada-EU dispute, the issue is this: Can the EU apply differential border measures – such as carbon offsets – on fuel from Canada that is produced from bitumen but is "like" conventional fuels in terms of physical and chemical properties, end-usage and, importantly, that competes in the same market?

Canada says definitely not. Admittedly, each case must be looked at on its facts, but WTO jurisprudence leads to the conclusion that Canada is right.

Lawrence Herman is international trade counsel at Cassels Brock & Blackwell LLP and a senior fellow at the C.D. Howe Institute.