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## EU CARBON BORDER ADJUSTMENT MECHANISM: LEGAL CHALLENGES AND RELEVANCE IN LIGHT OF THE CURRENT SANCTIONS REGIME

PETROVA T.

**Tatiana Petrova** — Doctoral Student, Department of Private International and Civil Law, Moscow State Institute of International Relations (MGIMO University); Junior Associate, «Rybalkin, Gortsunyan, Dyakin and Partners Advocates», Moscow, Russia (Petrova\_T\_P@my.mgimo.ru).

### Abstract

Carbon Border Adjustment Mechanism (CBAM) is one of the European Union's Green Deal initiatives aimed at creating a “climate neutral” economy. The specific feature of this mechanism is the creation of additional costs when importing goods from non-EU countries, the production of which is associated with emissions of large amounts of greenhouse gases. The measure implies the reporting of carbon emissions amount and the sale of CBAM certificates depending on the amount of carbon emissions resulting from the production of imported goods. The author of the article analyses the dynamics of CBAM legal framework development as well as challenges that CBAM may face following its entry into force given the current trade restrictions introduced within the sanctions regime against Russia. The article also addresses challenges to CBAM in terms of its consistency with WTO law. The conclusion is made that new obligations for EU importers imposed by CBAM together with import bans and trade restrictions against the former major exporter of CBAM-covered goods to the EU would be very burdensome for EU importers. Furthermore, the compatibility of CBAM in its current form with WTO law non-discrimination standards is questionable; CBAM has been subject to criticism by the WTO members that are likely to be affected by the measure. This explains the recent shift of CBAM entry into force from January to October 2023 and could be a ground for further adjustment of CBAM rules.

### Key words

carbon border adjustment mechanism, climate change, climate neutrality, sanctions

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### Introduction

Carbon Border Adjustment Mechanism (hereinafter — CBAM) is one of the European Union's Green Deal initiatives aimed at creating an efficient economy with minimal environmental impact, or a so-called “climate neutral” economy.

One of CBAM goals is to prevent the risks of carbon leakage, that is the allocation of carbon-intensive production facilities outside the EU, in countries with less stringent climate policy. CBAM is expected to serve as an incentive for EU trade partners to lower their carbon emissions and contribute thereby to the prevention of climate change. As a result, the goal of emission reduction would concern not only EU producers, but also foreign enterprises exporting their goods to the European market. CBAM is also supposed to prevent companies from relocating their industrial sites to countries with less stringent carbon emission regulation.<sup>1</sup>

CBAM targets the importers of carbon-intensive goods, obliging them to report the carbon emissions amount and to sell a certain number of CBAM certificates depending on the amount of carbon emissions resulting from the production of imported goods.

CBAM was announced as part of the EU Green Deal in December 2019, before two major challenges to the EU economy, namely Covid-19 pandemics and the disruption of well-established trade relations with the Russian Federation during the year 2022. But despite this, EU authorities do not seem to give up pursuing the climate neutrality goals. Under the Provisional Agreement on CBAM the measure will start to operate from October 2023 onwards.

In this article the author is going to address the dynamics of CBAM legal framework development as well as challenges that CBAM may face following its entry into force given the current trade restrictions introduced within the sanctions regime against Russia.

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<sup>1</sup> Martinus M., Laopirun K. *The EU's Carbon Border Adjustment Mechanism (CBAM): Implications for ASEAN-EU Relations*, Singapore: ISEAS Publishing, 2023. P. 2. URL: <https://doi.org/10.1355/9789815104028> (accessed: 04.06.2023).

## 1. Legal framework of CBAM

The legal framework of CBAM was initially set out in the Proposal for a Regulation establishing Carbon Border Adjustment Mechanism, which was published on 14 July 2021 (hereinafter — CBAM Proposal).<sup>2</sup> On 13 December 2022 the Council of the EU issued a press release which stated that negotiators of the Council and the European Parliament reached an agreement of a provisional and conditional nature on the CBAM (hereinafter — Provisional Agreement).<sup>3</sup> The text of the Provisional Agreement was published on 8 February 2023.<sup>4</sup> On 18 April 2023 the European Parliament adopted the text of the Provisional Agreement.<sup>5</sup> On 25 April 2023 it was also adopted by the Council.<sup>6</sup> Under the Provisional Agreement, CBAM will begin to operate on 1 October 2023, and it will be phased in gradually.

The Provisional Agreement represents an amended version of CBAM Proposal. The norms of CBAM Proposal and Provisional Agreement will be further referred to as 'CBAM Regulation'. One of the remarkable differences of the Provisional Agreement from CBAM Proposal is the extension of the scope of goods and emissions covered by CBAM. The scope of the CBAM Proposal defined in Article 2 initially covered five groups of goods (the particularised list of goods is presented in Annex I of the Proposal): a) cement, b) electricity, c) fertilisers, d) iron and steel, e) aluminium. In addition to five categories of goods listed in CBAM Proposal the Provisional Agreement includes hydrogen.

Moreover, under the Provisional Agreement CBAM shall apply not only to direct emissions released during the production of goods but also to indirect emissions, i.e. emissions from the production of electricity consumed during the production process of CBAM-covered goods, regardless of the location of the production of the consumed electricity. CBAM Regulation shall be applicable if the covered goods or goods processed from them:

- originate in a third country;
- are imported into the EU customs territory, as well as to the continental shelf or the exclusive economic zone of EU Member States.

The main obligation introduced by the CBAM Regulation is the obligation for importers of the goods concerned to lodge a customs declaration for release for free circulation. The customs declaration can be lodged by an importer in its own name or by another person on behalf of an importer in accordance with the Union Customs Code. The person who lodges a declaration is referred to as "declarant".

A person who is going to import the covered goods to the EU shall apply for the authorization to the competent authority designated by a Member State (hereinafter — CBAM authority). The persons authorised by CBAM authority are called 'authorised declarants'. They are given an Economic Operators Registration and Identification number (EORI number) and an account number in the CBAM Registry. CBAM authority shall authorise a declarant if it meets criteria stipulated in Article 17 (1) of the CBAM Regulation, in particular:

- absence of any serious infringement or repeated infringements of customs legislation and taxation rules during the five years preceding the application, including no record of serious criminal offences relating to the declarant's economic activity;
- financial solvency, which enables a declarant to fulfil its obligations under the CBAM Regulation;
- establishment in an EU member state.

In order to get authorised, a declarant should supply a guarantee, if it was not established as a legal entity throughout the two financial years preceding the year when the application is submitted. The sum of the guarantee is defined by a CBAM authority on the basis of the maximum value of CBAM certificates that a declarant will have to surrender for a calendar year.

<sup>2</sup> Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism, COM/2021/564 final. URL: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52021PC0564> (accessed: 11.05.2023).

<sup>3</sup> Council of the EU Press Release "EU climate action: provisional agreement reached on Carbon Border Adjustment Mechanism (CBAM)". URL: <https://www.consilium.europa.eu/en/press/press-releases/2022/12/13/eu-climate-action-provisional-agreement-reached-on-carbon-border-adjustment-mechanism-cbam/> (accessed: 11.05.2023).

<sup>4</sup> Provisional Agreement Resulting from Interinstitutional Negotiations, European Parliament Committee on the Environment, Public Health and Food Safety, 8 February 2023. URL: [https://www.europarl.europa.eu/RegData/commissions/envi/inag/2023/02-08/ENVI\\_AG\(2023\)742452\\_EN.pdf](https://www.europarl.europa.eu/RegData/commissions/envi/inag/2023/02-08/ENVI_AG(2023)742452_EN.pdf) (accessed: 11.05.2023).

<sup>5</sup> European Parliament legislative resolution of 18 April 2023 on the proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism. URL: [https://www.europarl.europa.eu/doceo/document/TA-9-2023-0100\\_EN.pdf](https://www.europarl.europa.eu/doceo/document/TA-9-2023-0100_EN.pdf) (accessed: 11.05.2023).

<sup>6</sup> 'Fit for 55': Council adopts key pieces of legislation delivering on 2030 climate targets, press release. URL: <https://www.consilium.europa.eu/en/press/press-releases/2023/04/25/fit-for-55-council-adopts-key-pieces-of-legislation-delivering-on-2030-climate-targets/> (accessed: 11.05.2023).

Under Article 6 of CBAM Regulation the reporting obligation for authorised declarants consists in submitting a special CBAM declaration annually by 31 May for the preceding calendar year, which should contain:

- the total quantity of imported goods in tonnes (for electricity — in megawatt hours);
- the total amount of carbon emissions;
- the total number of CBAM certificates to be surrendered corresponding to the embedded emissions;
- a copy of the verification report issued by the accredited verifier.

Article 18 of the CBAM Regulation stipulates that the declared amount of embedded emissions shall be verified by an accredited verifier. Pursuant to Article 18 of the CBAM Proposal the verification can be conducted by the verifiers accredited in accordance with the Implementing Regulation 2018/2067 on the verification.<sup>7</sup> CBAM Regulation provides an opportunity to claim a reduction in the number of CBAM certificates to be surrendered, if a declarant paid for carbon emissions in the country of origin. As follows from Article 2 (12) in conjunction with Article 9 of the CBAM Regulation this can be done in accordance with agreements with respective third countries.

Chapter IV of the CBAM Regulation is dedicated to the procedure of CBAM certificates acquisition, surrender and re-purchase. It is suggested that a CBAM Authority of a Member State would sell CBAM certificates to authorised declarants. The price for CBAM certificates shall be uniform within the EU. The price would be calculated for each calendar week as an average price of the closing prices of EU Emission Trading System (hereinafter — EU ETS) allowances on the common auction platform. By 31 May of each year authorised declarants would have to surrender a number of CBAM certificates which corresponds to the amount of declared carbon emissions. In case of the excess of remaining CBAM certificates on a declarant's account after the surrender, a declarant may request CBAM Authority to re-purchase them. It is crucial that the request of the kind should be submitted before 30 June. Otherwise, the remaining CBAM certificates are cancelled.

Chapter VI is dedicated to the responsibility for the incompliance with the CBAM Regulation. Article 26 envisages two types of wrongdoers:

- authorised declarants could be liable for the failure to surrender a number of CBAM certificates corresponding to the embedded carbon emissions by 31 May of each year;
- any person other than an authorised declarant bringing goods into the EU customs territory — for the failure to surrender CBAM certificates pursuant to CBAM Regulation.

In both cases the liability would be imposed in the form of a penalty. Notably, payment of the penalty shall not release a wrongdoer from the obligation to surrender the required number of CBAM certificates to the CBAM Authority.

Moreover, Article 27 obliges the EU Commission to monitor and prevent the practices of circumvention of CBAM Regulation. In other words, it is in contemplation that CBAM Regulation and other relating rules would be consistently amended, if any patterns of trade would be revealed geared to the avoidance of obligations envisaged by CBAM legal framework.

Under the CBAM Proposal the measure was initially planned to enter into force on 1 January 2023. The period from 1 January 2023 to 1 January 2026 was scheduled as a transitional period, during which a simplified system of a CBAM scheme would be applicable to ensure a gradual adjustment to the new rules and obligations.

However, the shift of focus of EU politicians to other issues and the debatable nature of CBAM itself led to the change of CBAM timeline. According to the Provisional Agreement adopted by the European Parliament and the Council in April 2023, CBAM will begin to operate starting from 1 October 2023, and it would be phased in gradually. During the transitional period from 1 October 2023 until 31 December 2025 the obligations of importers shall be limited to the reporting obligations, i.e. without obligation to pay for CBAM certificates.

## 2. Legal challenges for CBAM

After the publication of CBAM Proposal, during the years 2021–2023 CBAM has been subject to open debate, as well as numerous suggestions for amendments to it.

<sup>7</sup> Commission Implementing Regulation (EU) 2018/2067 of 19 December 2018 on the verification of data and on the accreditation of verifiers pursuant to Directive 2003/87/EC of the European Parliament and of the Council. URL: [https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=uriserv:OJ.L\\_.2018.334.01.0094.01.ENG](https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=uriserv:OJ.L_.2018.334.01.0094.01.ENG) (accessed: 11.05.2023).

## 2.1. WTO Compatibility of CBAM

After the publication of CBAM Proposal in July 2021, a number of scholars and practitioners as well as the delegates of particular WTO member states questioned the compatibility of CBAM in its proposed form with WTO law. The document published by the Council of the EU on 3 October 2022 illustrates the amendments to CBAM Proposal introduced by the Council and the European Parliament.<sup>8</sup> Mainly, the amendments tried to address the risks of potential inconsistencies of CBAM with WTO law.

### 2.1.1. Compliance with non-discrimination principles of WTO law

The issue of CBAM compliance with Article I GATT (most-favoured-nation standard) arises, should the EU decide to adopt a different legal regime for the imported goods depending on the carbon pricing schemes in their countries of origin. In this case any distinction of the kind would potentially violate the most-favoured-nation principle.<sup>9</sup> So, the compatibility with Article I GATT can be ensured by the equal carbon border adjustment for all imported goods regardless of their origin.

The first point which could potentially breach Article I GATT is the establishment of different regimes for the goods imported from different countries by bilateral agreements.

CBAM Regulation contains a provision (Article 9) on carbon price paid in the country of origin. It provides that an importer being a CBAM declarant may claim a reduction in the number of corresponding CBAM certificates to be surrendered for the goods originating from third countries. The reduction claim shall be accompanied by the documentation proving that:

- the declared amount of emissions was subject to carbon pricing in the country of origin;
- the carbon price was actually paid, i.e. was not subject to an export rebate or any other form of export compensation.

Article 9 also contains a reference to implementing acts on the methodology on calculation of the reduction for the carbon price paid in the third country. These implementing acts could be adopted by the European Commission prospectively. This methodology is based on two factors:

- the conversion of the carbon price paid in third country in euro;
- qualifications of an independent person certifying the information on the declared emissions as well as the proof of the actual payment of the carbon price in a third country.

It is not clear yet whether the prospective methodology itself would discriminate between the goods originating from different third countries depending on their carbon pricing schemes. Most likely, the discriminatory treatment of goods could become explicit not out of the text of the calculation methodology, rather from the practice of its application.

The concerns of the potential differential treatment were raised by WTO members at the meeting of the Council for Trade in Goods. For example, the delegation of the Russian Federation noted that the EU seems to favour only the emission trading systems similar to its own for the purposes of the reduction for the carbon price paid in a third country.<sup>10</sup> Similarly, United States delegates pointed out that it should not be necessary for all WTO members to adopt the same domestic policy approach to addressing climate change.<sup>11</sup>

Russian WTO delegates also drew the attention to the verification provisions of CBAM Proposal. Namely, emissions declared by the importers can be verified only by a person accredited in accordance with Commission Implementing Regulation (EU) No. 2018/2067. The verification of embedded emissions only by an EU accredited verifier could potentially impede the mutual recognition of verification between the EU and its trading partners,<sup>12</sup> or lead to unfair preferential practices. Moreover, Article 2 (12) of the CBAM Proposal allows to conclude agreements with third parties in order to take account of their carbon pricing

<sup>8</sup> CBAM: Commission proposal / Council general approach / Position of the EP, Interinstitutional file 2021/0214(COD). 3 October 2022. URL: <https://data.consilium.europa.eu/doc/document/ST-13063-2022-INIT/en/pdf> (accessed: 11.05.2023).

<sup>9</sup> Dias A., Nosowicz A., Seeuws S. *EU Border Carbon Adjustment and the WTO: Hand in Hand Towards Tackling Climate Change // Global Trade and Customs Journal*. 2020. Vol. 15. № 1. Bacchus J. *Legal Issues with the European Carbon Border Adjustment Mechanism*. Briefing paper №125. 9 August 2021. URL: <https://www.cato.org/briefing-paper/legal-issues-european-carbon-border-adjustment-mechanism#background> (accessed: 11.05.2023).

<sup>10</sup> *Minutes of the Meeting of the Council for Trade in Goods 7 and 8 July 2022*, 6 October 2022, G/C/M/143. Para. 16.11. URL: <https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/G/C/M/143.pdf> (accessed: 11.05.2023).

<sup>11</sup> *Ibid.* Para. 16.35.

<sup>12</sup> *Ibid.* Para. 16.12.

schemes in the application of Article 9.

Bilateral agreements between the EU and third parties envisaged by Article 2 (12) of the CBAM Proposal stand a chance for becoming a rich soil for the creation of different treatment for the imported “like” goods originating from different WTO members. The regime of the bilateral agreement may potentially replace the rules of Article 9 of CBAM Proposal, which could establish more favourable conditions for some of the EU trade partners in violation of Article I GATT.

In this regard, the European Parliament package of amendments (which is specifically aimed at the achievement of WTO compatibility) suggested complementing Article 2 (12) of the CBAM Proposal with the provision that “*Such agreements shall not lead to undue preferential treatment of imports from the third countries...*”.<sup>13</sup> This amendment was not, however, reflected in the Provisional Agreement.

Meanwhile, the prospect of establishing a favourable regime in terms of climate preservation measure is currently considered by the EU and the USA. The provisions of the Inflation Reduction Act adopted in the USA on 16 August 2022 negatively affects the EU exporters impliedly favouring domestic producers of clean vehicles, sustainable aviation fuels.<sup>14</sup> In light of this US-EU interaction in terms of climate policy efforts intensified. For example, at the end of October 2022 US-EU Task Force on the Inflation reduction Act was launched.<sup>15</sup> In light of this, creating mutual preferences in environmental measure involving EU CBAM might be established. As some experts note this could lead to the establishment of climate clubs, where states with similar carbon pricing approaches enjoy mutual trade benefits.<sup>16</sup>

The second point concerns the scope of goods and emissions covered by CBAM Proposal. As previously said, CBAM Proposal initially covered five groups of products: cement; electricity; fertilisers; iron and steel; aluminium. The Provisional Agreement added hydrogen to the list of covered products. Furthermore, it extended the coverage of CBAM to indirect emissions, i.e. emissions from the generation of electricity used to produce CBAM-covered goods.

The mere fact of CBAM product and emission coverage expansion caused concerns among some WTO members delegates during the meeting of the Council for Trade in Goods. For instance, Indonesia requested the EU to provide clear and reasonable justification for that.<sup>17</sup> The delegates of India also noted that while the EU seeks to include indirect emissions in the calculation towards carbon emissions, the proposed rules do not have any offset for a national carbon price inherent in the cost of carbon-based input commodities.<sup>18</sup> In addition, experts note that the set of sectors covered by CBAM is designed in a way which affects exports from certain countries to a larger extent.<sup>19</sup>

According to the ResourceTrade.Earth research published in August 2021, exports to the EU in CBAM sectors have been concentrated among just a few trading partners. At the time when CBAM was initially designed the biggest share of the EU’s imports of CBAM-covered products was from the Russian Federation — 16,7 %. The second biggest share was accounted for China — 10,1 %. And almost half of CBAM-covered imports came from just five countries: Russia, China, United Kingdom (8,5%), Norway (7,3 %), Turkey (6,8 %).<sup>20</sup> It should be noted, however, that imports from Norway as well as from the other EFTA states are not covered by CBAM Regulation as follows from Annex II to it.

Evidently, the export structure of the covered goods has drastically changed in the wake of sanctions restrictions on Russian goods during the year 2022. Still, the burden of bearing additional costs for exporting carbon-intensive goods could be still distributed among just a few states, most likely, China, Turkey and the Persian Gulf countries. This economic and statistical setup of CBAM may have a discriminatory character. In the framework of a potential dispute the most affected countries may claim that CBAM was designed in a way which specifically targets their exports. In response, the EU would have to

<sup>13</sup> CBAM: Commission proposal / Council general approach / Position of the EP, Interinstitutional file 2021/0214(COD). Article 2 (12). P. 45–46.

<sup>14</sup> Boehm L., Scalamantrè C. *EU-US climate and energy relations in light of the Inflation Reduction Act* (Briefing), European Parliamentary Research Service, January 2023. URL: [https://www.europarl.europa.eu/thinktank/en/document/EPRS\\_BRI\(2023\)739300](https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2023)739300) (accessed: 11.05.2023).

<sup>15</sup> *Launch of the US-EU Task Force on the Inflation Reduction Act* (Statement), 26 October 2022. URL: [https://ec.europa.eu/commission/presscorner/detail/en/statement\\_22\\_6402](https://ec.europa.eu/commission/presscorner/detail/en/statement_22_6402) (accessed: 11.05.2023).

<sup>16</sup> Leal-Arcas R. *International Trade and Sustainability Perspectives from Developing and Developed Countries*. Springer International Publishing, 2022. P. 207.

<sup>17</sup> *Minutes of the Meeting of the Council for Trade in Goods 7 and 8 July 2022*. Para. 16.45.

<sup>18</sup> *Ibid.* Para. 41.46.

<sup>19</sup> Boytsova A., Talanov V. *Carbon worth its weight in gold* // Kommersant. 16 September 2021. URL: <https://www.kommersant.ru/doc/4985821> (accessed: 11.05.2023).

<sup>20</sup> Kardish C., Mäder M., Hellmich M., Hall M. *Which countries are most exposed to the EU's proposed carbon tariffs?* ResourceTrade.Earth, 20 August 2021. URL: <https://resourcetrade.earth/publications/which-countries...proposed...tariffs> (accessed: 11.05.2023).

scientifically substantiate the choice of CBAM-covered sectors as the most carbon-intensive ones.

Interestingly, the European researchers insist that a more conservative WTO-compliant approach for the design of CBAM minimizes the risk of retaliation by trading partners but has a smaller environmental impact.<sup>21</sup> Thereby an attempt is being made to justify the potential incoherence of the measure with WTO law.

### 2.1.2. The applicability of exceptions under Article XX GATT

Even if there is no way to design CBAM in a non-discriminatory manner, the EU may still legitimise this measure, if it falls under general exceptions. Article XX GATT can be invoked, in case the measure is inconsistent with some other GATT provision, since it is able to justify it.<sup>22</sup> In the context of CBAM purposes, the most relevant justifications could be paragraphs (b) and (g) of Article XX.

Paragraph (b) justifies measures necessary to protect human, animal or plant life or health. The three-tier test of Article XX (b) GATT used by the Panel in *US–Gasoline* case requires that:

- the policy in respect of the measures falls within the range of policies aiming at protection of the human, animal or plant life or health;
- the inconsistent measures are necessary for the fulfilment of the policy objective;
- the requirements of Article XX chapeau are met.<sup>23</sup>

Seemingly, it is hard to contest that CBAM as part of the EU Green deal is not aimed at the protection of humans, animals and plants from the consequences of climate change.

The necessity of the measure is, however, a less evident point. In *Brazil – Tyres*, the Appellate Body elaborated on the necessity test within the meaning of Article XX(b). It provided that a measure should be indispensable to be considered necessary. Nonetheless, it should contribute to the achievement of the objective. At the same time the contribution has to be weighed with the trade restrictiveness. And in any event, Respondent is expected to demonstrate that there are no other available measures which could be less trade restrictive.<sup>24</sup> Moreover, as follows from the *EC–Asbestos* case, “the more vital or important the common interests or values pursued, the easier it would be to accept as ‘necessary’ measures designed to achieve those ends”.<sup>25</sup> As long as climate change is a global problem, and the most WTO members are also parties to the Paris Agreement, the fulfilment of the ‘necessity’ criterion may take place.<sup>26</sup>

In this respect the EU could try to submit that CBAM is not the first step in the EU environmental agenda. The ETS having fundamentally the same purpose was launched in 2005, and 16 years later it became obvious that intra-community measures alone are not sufficient to reach the global objective. The EU CBAM proponents also substantiate the necessity of the measure by the urgency of climate change prevention.<sup>27</sup>

On the other hand, as pointed out by the opposing WTO members delegates, current provisions of international climate agreements have not yet been fully exhausted.<sup>28</sup> Nonetheless, the EU, in its turn, decided to introduce a unilateral measure which considerably affects international trade before discussing and fully addressing all the controversial issues of the measure with concerned WTO members.<sup>29</sup>

Article XX (g) GATT refers to 1) measures relating to the conservation of exhaustible natural resources, 2) if they are made in conjunction with restrictions on domestic production or consumption.

In this context it has to be established whether the climate on Earth could qualify as an exhaustible natural resource. Given that the Panel recognized that clean air is an exhaustible resource in 1996,<sup>30</sup> EU

<sup>21</sup> Bellora C., Fontagné L. *EU in Search of a WTO-Compatible Carbon Border Adjustment Mechanism*. SSRN. 2022. URL: <https://ssrn.com/abstract=4168049> (accessed: 04.06.2023).

<sup>22</sup> Bossche P. van den, Zdouc W. *The Law and Policy of the World Trade Organization: Text, Cases and Materials*. 3rd ed. Cambridge : Cambridge University Press, 2013. P. 546.

<sup>23</sup> *United States — Standards for Reformulated and Conventional Gasoline (US — Gasoline)*, WT/DS2/R (Panel Report). 26 January 1996. Para. 6.20.

<sup>24</sup> *Brazil — Measures Affecting Imports of Retreaded Tyres (Brazil — Retreaded Tyres)*, WT/DS332/AB/R (Appellate Body Report). 3 December 2007. Paras. 210–211.

<sup>25</sup> Appellate Body Report, *European Communities — Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R. 12 March 2001. Para. 172.

<sup>26</sup> Boklan D. *Combating Climate Change under the WTO: Exploring the Relevance of Process and Production Methods // Rethinking, Repackaging and Rescuing World Trade Law in the Post-Pandemic Era /* ed. by D. Boklan, A. Bahri, Z. Weihuan. Oxford : Hart Publishing, 2021. Ch. 8. P. 139.

<sup>27</sup> Smulders B. *WTO Law's Balance Between Trade and Global Climate and Environmental Interests: The Case of the European Union and Some Aspects of Its Green Deal // The EU and the WTO: Ever the Twain Shall Meet. Marco Broncker's Liber Amicorum /* ed. by F. Baetens, S. van den Bogaert. Wolters Kluwer, 2023. Ch. 10.

<sup>28</sup> Minutes of the Meeting of the Council for Trade in Goods. 7–8 July 2022. Para. 16.9.

<sup>29</sup> *Ibid.* Para. 16.6.

<sup>30</sup> *US — Gasoline* (Panel Report). Para. 6.37.

may claim that the climate may also be recognized as an exhaustible natural resource in the 2020s. In *US — Gasoline* the Panel identified the following features of an exhaustible natural resource: it should have value, be natural and could be depleted. The applicability of these criteria to the climate as a meteorological phenomenon is not fully evident. The value of the climate may potentially be demonstrated by the fact that the stability of climate conditions ensures economic stability as well. Further, the ability to be depleted could be proved by the contents of the Paris Agreement which proceeds from the notion that excessive emissions of greenhouse gases by human industrial activities contribute to climate change.

The second part of the paragraph (g) seems to be easier to prove for CBAM apologists. The concept of CBAM implies that the mechanism is applicable both to domestic and imported goods, whereas the aim of potentially differential treatment is the same for both types of products — creating an economic incentive for carbon emissions reduction and eventually climate preservation.

Importantly, any exception under Article XX has to comply with its chapeau. Any justification under Article XX is valid only if the measure would not constitute an arbitrary or unjustifiable discrimination, or a disguised restriction on international trade. As follows from WTO jurisprudence discrimination within the meaning of the chapeau focuses on the cause of discrimination and rationale behind the differentiation recognized as such in the substantive provisions of the GATT.<sup>31</sup> In other words, discrimination in the sense of the chapeau means that the measure's declared objectives have nothing to do with the measure's true hidden purposes.

For CBAM the chapeau test appears to be the trickiest keyhole, which it is bound to pass to comply with WTO law. Most likely the potential complainants would stress that CBAM is a disguised restriction with protectionist roots. That is why the authors of CBAM would probably need to underline in advance the primary environmental purpose of CBAM.

One of the possible means to do it is to make clear on what projects the revenue generated by CBAM will be redirected. For instance, these assets could be spent on further development of green initiatives. The step of the kind could strengthen the EU's position that CBAM is not designed to implicitly increase industry competitiveness of the Union, but actually to slow down climate change.<sup>32</sup>

No wonder that the European Parliament proposed to amend the CBAM Regulation with Article 24a, which would regulate the use of revenues generated by CBAM. The idea is to channel them to “*support climate mitigation and adaptation in least developed countries*”.<sup>33</sup> The justification of this amendment clearly states that this would strengthen CBAM as a measure falling under the exceptions of Article XX GATT.<sup>34</sup>

However, this amendment was not reflected in the Provisional Agreement. The adopted text of the Provisional Agreement does not clearly define how exactly revenues generated by the sale of CBAM certificates would be managed. It merely states in recital 55 that the EU should continue supporting low and middle-income countries, especially Least Developed Countries, to ensure their adaptation to the new obligations and to support climate mitigation and adaptation in these countries. Despite the existence of the declarative goal to support low and middle-income countries, the experts note that CBAM is likely to negatively affect many lower-income countries dependent on exports of carbon-intensive products to the EU, such as Mozambique, Zimbabwe, Algeria and Egypt.<sup>35</sup>

Thus, the compliance of CBAM with non-discrimination WTO standards and the applicability of GATT general exceptions to it are questionable. The context of the measure and its proposed effect could help to prove its life and health protection and/or exhaustible natural resources conservation purposes. However, WTO members that are likely to be affected by the measure have already questioned its necessity. Instead of deepening the cooperation in the framework of the existing international climate agreements, the EU introduces a unilateral measure which is declared to stimulate the reduction of carbon emissions by third countries exporting certain carbon-intensive goods to the EU.

The burden of proof that the measure complies with the chapeau criteria appears is also rather challenging. Given that the examples of justification of a measure under Article XX GATT are rather rare in

<sup>31</sup> United States — Measures concerning the Importation, Marketing and Sale of Tuna and Tuna Products, Recourse to Art. 21.5 of the DSU by Mexico (*US — Tuna II (Mexico)*), WT/DS381/AB/RW (Appellate Body Report). 20 November 2015. Para. 7. 316.

<sup>32</sup> Dias A., Nosowicz A., Seeuws S. *Op. cit.* P. 22.

<sup>33</sup> CBAM: Commission proposal / Council general approach / Position of the EP, Interinstitutional file 2021/0214(COD). Article 2 (12). P. 45–46.

<sup>34</sup> Opinion of the Committee on Development for the Committee on the Environment, Public Health and Food Safety on the proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism. 28 March 2022. URL: [https://www.europarl.europa.eu/doceo/document/DEVE-AD-704681\\_EN.pdf](https://www.europarl.europa.eu/doceo/document/DEVE-AD-704681_EN.pdf) (accessed: 11.05.2023).

<sup>35</sup> Kiseleva A., Kolesnikov Y. *Novelties of Tax Regulation of Decarbonization in the Russian Federation. // Current Problems of the Global Environmental Economy Under the Conditions of Climate Change and the Perspectives of Sustainable Development. Advances in Global Change Research / ed. by E. Popkova, B. Sergi. Springer Cham., 2023. P. 349. URL: [https://doi.org/10.1007/978-3-031-19979-0\\_37](https://doi.org/10.1007/978-3-031-19979-0_37) (accessed: 04.06.2023)*

WTO jurisprudence,<sup>36</sup> the justification could be feasible only upon the proper measure design, transparency of its funds, target character of the generated revenue and consideration of the other WTO members interests and concerns. Even though CBAM may not fully comply with WTO law, the perspectives of challenging CBAM within the WTO dispute settlement system are rather vague because of the current lack of a functioning Appellate Body.

## 2.2. Relevance of CBAM in light of the current sanctions regime

One of the biggest challenges for the EU Green Deal and for CBAM in particular is the dramatic change of economic and geopolitical reality in 2022. Building a green, climate neutral economy needs large financial support both on the Union and national level. In light of that, one of the experts of the European Council of Foreign Relations expressed doubt whether the European Green Deal survives the Russia-Ukraine conflict. At the same time, it is noted that further commitment to Green Deal goals would help the EU to regain some credibility as a leader by example on climate.<sup>37</sup>

As stated above, Russia used to be the largest exporter of CBAM-covered goods to the EU.<sup>38</sup> However, import and export bans imposed by the sanctions regime against Russia affected almost all categories of goods covered by CBAM Proposal. As of May 2023, the following CBAM-covered goods are prohibited for the importation from Russia to the EU:

- certain types of cement (portland cement, cement clinkers);<sup>39</sup>
- certain types of mineral or chemical fertilizers;<sup>40</sup>
- many types of iron and steel (metallic coated sheets, non alloy wire, seamless tubes);<sup>41</sup>
- some types of aluminium goods (aluminium plates, sheets and strip, of a thickness exceeding 0,2 mm, aluminium foil, aluminium containers).<sup>42</sup>

Thus, almost all categories of goods mentioned in the CBAM Proposal (except for the electricity) are subject to the import ban. The hydrogen added to the scope of CBAM in the Provisional Agreement on CBAM is currently not a subject to the import ban from Russia to the EU (only a subject to export ban from the EU to Russia<sup>43</sup>).

At the same time EU Regulation No. 833/2014 provides derogations from the import ban for iron and steel originating or imported from Russia. Article 3g (4) and (5) establishes import volume quotas for some types of Russian iron and steel goods for the time periods from October 2022 to September 2024, within which the import of the Russian iron and steel to the EU is allowed.

Moreover, the competent authorities of EU Member States may at their own discretion authorise the import of the Russian iron and steel, if they find it necessary for civil nuclear purposes (such as the maintenance of civil nuclear capabilities and civil nuclear facilities, the production of medical radioisotopes and similar medical applications, or critical technology for environmental radiation monitoring), as well as for civil nuclear cooperation, in particular in the field of research and development.

Certain types of aluminium and fertilisers as potential CBAM-covered goods are also under the import ban. However, the import of allowed types of aluminium and fertilisers serves as a ground for derogations for some types of services or transactions, which stresses the importance of these goods for the EU economy.

For example, the competent authorities of EU Member States may authorise a vessel under the Russian flag to access a port or lock,<sup>44</sup> a Russian road transport undertaking for the transportation of goods by road,<sup>45</sup> if it is necessary for the import of aluminium or fertilisers. Furthermore, the prohibition to engage in transactions with Russian entities listed in Annex XIX to the EU Regulation No. 833/2014 does not apply, if the transaction is necessary for the import of non-listed types of aluminium or fertilisers.<sup>46</sup>

<sup>36</sup> Ministry of Economy, Trade and Industry of the Government of Japan 2019 Report on Compliance by Major Trading Partners with Trade Agreements — WTO, EPA/FTA and IIA. Chapter 4: Justifiable Reasons. P. 222. URL: [https://www.meti.go.jp/english/report/data/2019WTO/pdf/02\\_04.pdf](https://www.meti.go.jp/english/report/data/2019WTO/pdf/02_04.pdf) (accessed: 11.05.2023).

<sup>37</sup> Dennison S. *Own coal: Why Europe could lose its green transition*. European Council on Foreign Relations. 1 July 2022. URL: <https://ecfr.eu/article/own-coal-why-europe-could-lose-its-green-transition/> (accessed: 11.05.2023).

<sup>38</sup> Kardish C., Mäder M., Hellmich M., Hall M. *Op. cit.*

<sup>39</sup> Council Regulation (EU) No. 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, Annex XXI.

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.* Article 3g and Annex XVII.

<sup>42</sup> *Ibid.* Annex XXI.

<sup>43</sup> *Ibid.* Article 3k and Annex XXIII.

<sup>44</sup> *Ibid.* Article 3ea (5)(a), Article 3ea (5)(b).

<sup>45</sup> *Ibid.* Article 3l (4)(a), Article 3l (4)(b).

<sup>46</sup> *Ibid.* Article 5aa (3)(a), Article 5aa (3)(f).



It appears that CBAM Regulation could create additional burden for EU importers responsible for the supply of carbon-intensive goods which are still important for the EU economy. Given the current sanctions regime against Russia which significantly affected the EU-Russia trade in CBAM-covered goods, EU importers have to search for alternative exporters of carbon-intensive goods and strictly follow the sanctions restrictions on the imports from Russia or the goods of the Russian origin.

Thereby EU importers currently concerned about sanctions compliance, building new commercial relations and supply chains would also need to report the embedded carbon emissions. The entry into force of the reporting obligation as a first phase of CBAM is currently scheduled for October 2023. This obligation alone, however, would arguably cause additional costs for legal and/or customs broker services, as well as for the services of an accredited verifier whose verification of the accuracy of the declared amount of embedded emissions is mandatory under CBAM Regulation.

## Conclusion

CBAM is designed to create additional costs when importing carbon-intensive products from non-EU countries. The measure which was determined to enter into force on 1 January 2023 is shifted to October 2023. Seemingly, the reasons for this shift are challenges to the operation of CBAM.

One of them is the necessity to design the measure in compliance with WTO law. Since the initial Proposal for CBAM Regulation has been heavily criticised mainly for the potential violation of WTO non-discrimination standards, the European Parliament started working to address the points of such criticism making the legal framework of CBAM more likely to be justified under GATT general exceptions. Nonetheless, the Provisional Agreement on CBAM adopted in April 2023 does not seem to reflect all the amendments aimed at addressing the WTO-compatibility concerns. In addition, due to the current lack of the functioning Appellate Body within the WTO dispute settlement system, the perspectives of challenging the measure by the affected WTO members seem to be quite vague.

Another serious challenge to CBAM was caused by the recent political events and strengthening of EU sanctions against Russia. Sanctions-related import bans and restrictions affected the CBAM-covered goods. CBAM could make it difficult for EU importers to struggle simultaneously with adaptation for new economic circumstances and comply with new obligations imposed on them by CBAM. At the same time the recent intensification of US-EU cooperation aiming to align their environmental measures discovers the potential for reciprocal adjustments with EU strategic partners in this sphere which is also questionable from the WTO law perspective.

In light of that, it appears that the EU would not give up its climate neutrality strategy, but it is still possible that CBAM legal framework could be further changed in order to address the concerns regarding the WTO-compatibility of the measure or to adjust the measure to the features of economic and political relationship with particular third states.

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## ПОГРАНИЧНЫЙ КОРРЕКТИРУЮЩИЙ УГЛЕРОДНЫЙ МЕХАНИЗМ В ЕС: ПРАВОВЫЕ ПРОБЛЕМЫ И АКТУАЛЬНОСТЬ В СВЕТЕ ДЕЙСТВУЮЩЕГО САНКЦИОННОГО РЕЖИМА

Петрова Т. П.

Татьяна Петровна Петрова — аспирант кафедры международного частного и гражданского права им. С.Н. Лебедева МГИМО МИД России, младший юрист адвокатского бюро «Рыбалкин, Горцуян, Дякин и партнеры», Москва, Россия (Petrova\_T\_P@my.mgimo.ru).

### Аннотация

Пограничный корректирующий углеродный механизм (англ.: *Carbon Border Adjustment Mechanism, CBAM*) представляет собой одну из инициатив Европейского союза в рамках «Зеленого курса» (англ.: *Green Deal*), направленную на создание «климатически нейтральной» экономики. Особенностью данного механизма является создание дополнительных расходов при импорте товаров из стран, не входящих в ЕС, производство которых связано с выбросами большого количества парниковых газов. Данная мера предполагает предоставление отчетности о количестве углеродных выбросов и приобретение особых сертификатов в зависимости от количества выбросов, выпущенных в атмосферу в результате производства импортируемых товаров. Автор статьи анализирует динамику развития законодательной базы пограничного корректирующего углеродного механизма, а также правовые проблемы, которые могут возникнуть после вступления в силу соответствующего регулирования,

учитывая текущие торговые ограничения, действующие в рамках режима санкций против России. В статье также рассматривается проблема соответствия пограничного корректирующего углеродного механизма праву ВТО. Автор приходит к выводу, что новые обязательства, налагаемые нормами о пограничном корректирующем углеродном механизме, наряду с торговыми ограничениями против бывшего крупного экспортера подпадающих под действие механизма товаров в ЕС, будут очень обременительными для импортеров. Кроме того, спорным является вопрос о соответствии регулирования пограничного корректирующего углеродного механизма в его текущей редакции стандартам недискриминации права ВТО. Пограничный корректирующий углеродный механизм подвергнулся активной критике со стороны стран — членов ВТО, которые могут быть затронуты этой мерой. Это, вероятно, объясняет перенос сроков вступления в силу Регламента ЕС о пограничном корректирующем углеродном механизме с января на октябрь 2023 года и может стать причиной дальнейших изменений в регулировании механизма.

## Ключевые слова

пограничный корректирующий углеродный механизм, изменение климата, климатическая нейтральность, санкции

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