
EU CARBON BORDER ADJUSTMENT MECHANISM (CBAM)

CONTEXT

The European Union (EU) has passed into law a suite of policies and regulations that should see its greenhouse gas (GHG) emissions drop by 55% from 1990 levels by 2030. By international standards, this commitment is a frontrunner in climate ambition.

Part of that package involves making GHG-emitting industries buy allowances for every tonne of carbon produced, under the EU's existing Emissions Trading System (ETS), and completely phasing out the granting of free allowances. Another part of the package – the CBAM – is aimed at ensuring that, as allowance prices increase and free allowances decrease, the EU's emissions do not simply shift to foreign producers who do not face a carbon price, and who might therefore gain market share – a process known as “carbon leakage”.

The EU CBAM will levy a charge on imports, aiming to make importers purchase GHG emission allowances for goods as if they had been produced by domestic firms.

STATUS - CBAM LEGISLATION

The CBAM entered into law¹ in May 2023. In June 2023, the Commission released draft implementing legislation² that detailed reporting obligations for importers during the transition period, including methodologies for calculating embedded carbon. But there are still some missing details that will be furnished in subsequent legislation.

¹ Final text of the legislation can be found - [EUR-Lex - 32023R0956 - EN - EUR-Lex \(europa.eu\)](#)

Reporting obligations for all importers will commence on October 1, 2023, and continue during a transition period that ends January 1, 2026. During the transition period, no actual charges will be levied, but all reporting obligations will be in place.

When the CBAM transition period ends, the CBAM charge will start to be assessed, but not yet at full value. The CBAM will gradually phase in as free allocation under the ETS is phased out, with full charges being assessed by 2034.

HOW WILL THE CBAM WORK IN PRACTICE?

Coverage: The CBAM will cover EU imports of iron & steel, aluminum, cement, nitrate fertilizers, hydrogen, and electricity. Coverage is for basic upstream materials and semi-processed goods, and a few manufactured goods such as steel screws, nuts, and bolts. Processed goods such as automobiles and agricultural products would not be covered. Since electricity is not an issue for those that are not EU neighbours, the remainder of this brief will focus only on the covered goods.

There is a scheduled review due at the latest by the end of the transition period, which is mandated to consider whether and how to add more sectors to the list of covered sectors, and more emissions. The most likely sectors to be added are plastics and organic chemicals.

Importer responsibilities: Before the act of import, importers (*declarants*) will have to apply

² Draft implementation legislation can be found - [EU Green Deal – reporting obligations during the transitional period of the carbon border adjustment mechanism. \(europa.eu\)](#)

to the national CBAM authority of their home country (the “competent authority”) for an authorization to import CBAM-covered goods. This is just a registration process, after which the declarant becomes an *authorized CBAM declarant*.

On a quarterly basis during the transition period, all CBAM declarants must submit a “CBAM report” to the competent authority that details:

- The total quantity (volume) of each covered good imported in the preceding calendar year quarter.
- The total tonnes of CO₂ equivalent emissions that were embedded in those goods, direct and indirect,³ calculated for each type of good imported.
- Any carbon price paid in the country of export, net of rebates like free allowances.

After the transition period, by May 31 each year, the CBAM declarant must submit a CBAM Declaration, with the above information for the previous calendar year, as well as evidence of verification by an accredited verifier. The Declarant at that time must also surrender a number of CBAM certificates equal to the number of tonnes of emissions embodied in its imports for the previous calendar year, adjusted for the percentage of CBAM phase-in up to 2034.

CBAM charges are also adjusted to account for any carbon price paid in the country of export, in the form of a carbon tax or ETS for example. An importer that fails to submit the required number of allowances may be assessed a penalty of €100 (indexed with annual increases equal to inflation) for each tonne of GHGs not covered.

Producer responsibilities: Producers may register their operations and installations in an EU-maintained CBAM Registry (registration valid for 5 years). Registered producers also need to submit verified data on the GHG-

intensity of each exporting installation, for each different type of exported good.

In theory the CBAM declarant could commission its own verification.

Calculating Carbon Content: There are three possible ways for declarants to calculate the amount of carbon embedded in imports of goods (electricity is treated differently).

First option	The CBAM declarant shows actual third-party verified data for direct emissions and uses an average GHG-intensity value (yet to be determined) to estimate indirect emissions.
Second option	If the data cannot be determined by the CBAM declarant, then the average emissions intensity for that good and country will be assumed for direct emissions (augmented by a yet-to-be-determined mark-up premium). For indirect emissions, the first option still prevails.
Third option	If the EU cannot source reliable data for average direct emissions intensity for a particular sector and country of export, it will assign a default, equal to the average of the EU’s X% most emissions-intensive producers, with the value of X still to be determined.

The second option involves the EU maintaining a database of weighted average emissions intensity for each sector in each trading partner (41 classes of goods). The regulation notes that these default values should be based on “reliable and publicly available” information, including that provided by exporting countries.

Indirect emissions will be calculated using one of three possible methods, with the final decision to be made before the end of the transition period:

³ For an explanation of direct and indirect emissions, see the section “Scope of emissions covered in the calculations” below.

- The emission factor of the EU grid;
- The average emission factor of the country of origin electricity grid, using IEA database figures; or
- Any other emission factor of the country of origin electricity grid, based on publicly available data in the country of origin, representing either the grid average or the weighted average of the CO₂ intensity of electricity produced from fossil fuels in that country.

During the transition period, declarants may use either the second or third of these methods. Exporters will be able to instead apply to have actual scope 2 data used under conditions, such as the existence of a power purchase agreement between the electricity generator and the installation.

Verification of emissions data: The first option involves use of actual data for direct emissions, which must be verified by a body accredited by the EU to do so. Any body already accredited under the EU's ETS is automatically accredited for CBAM data verification. Each Member State has a designated body that accredits ETS verifiers for its jurisdiction. The lists include major international assurance agencies such as SGS, Veritas, DNV, and EY. Additional verifiers from any country may be accredited by any of the EU Member State accreditation bodies, in accordance with CBAM implementing legislation.

Scope of emissions covered in calculations:

The CBAM will cover emissions of CO₂, nitrous oxide, and perfluorocarbons. For all goods, it will cover direct (scope 1) emissions – those that are produced within the boundaries and control of the installation. For cement and fertilizers, it will also cover what the EU is calling *indirect emissions*. Also known as scope 2, these are emissions embodied in any purchased electricity, steam or heat. It is likely that scope 2 emissions will eventually be covered for other sectors as well.

The CBAM will also cover other *selected upstream emissions* – those embedded in input goods. Only a select group of input goods would be covered: those that are also covered under CBAM as individual goods.

Purchase of CBAM Certificates: The CBAM declarant is responsible for purchasing enough CBAM certificates to surrender by the May 31st deadline.

The CBAM certificates can be bought at any time from the competent authority in the importer's Member State, on a common platform managed by the Commission. The price will be the average weekly closing auction price for ETS allowances for the previous week.

CBAM certificates not needed at the time of submission can be sold back to the competent authority (up to one third of total purchased) for the purchase price.

Use of revenues: The final text indicates that existing support should continue, and that the EU is working on establishing a facility of some sort for the use of CBAM revenues.