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EU Carbon Border Adjustment Mechanism (CBAM)

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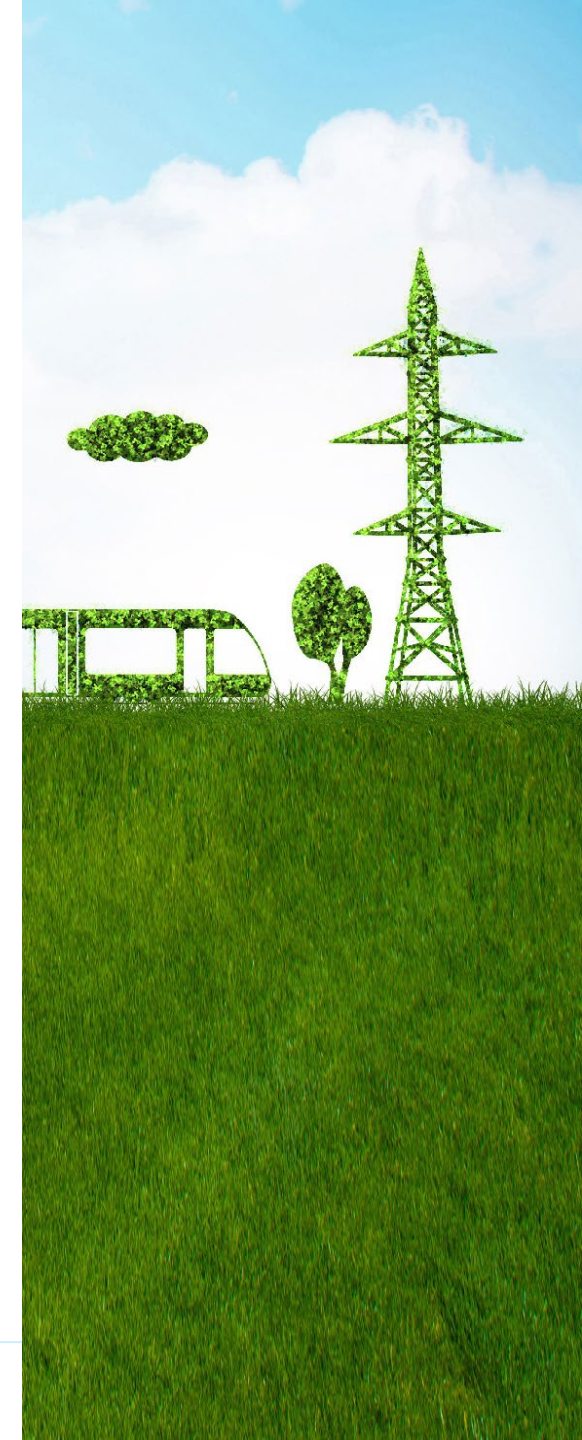
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XVI World Customs Law Meeting

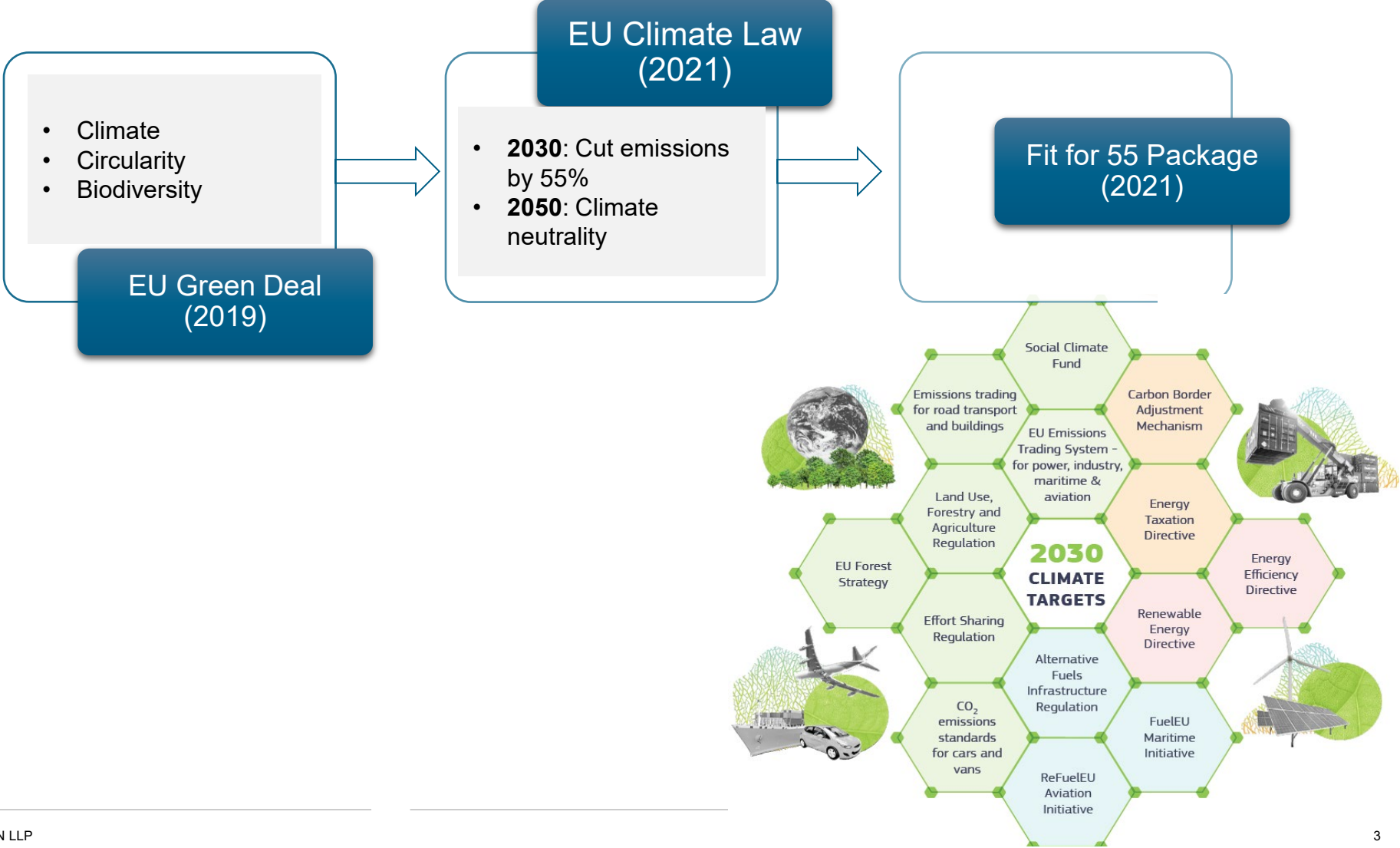
September 28, 2023

Agenda

1. Situating CBAM in the European Green Deal
2. What is CBAM?
3. Key features of CBAM
4. Practical considerations
5. WTO compatibility
6. Relevance to stakeholders



1. Situating the EU CBAM in the European Green Deal



2. What is CBAM?

- Measure that is part of EU's climate ambitions to reduce emissions and become climate neutral by 2050 (*fit for 55 package*)
 - Regulation (EU) 2023/956 (“**CBAM Regulation**”) entered into force 17 May 2023
 - Effective date of application: 1 October 2023
 - Phased Implementation: Transitional period from 1 October 2023 to 31 December 2025. Definitive period from 1 January 2026 onwards
- Linked to revision of the EU Emissions Trading System (“**EU ETS**”)
 - EU ETS is a cap-and-trade system; annual cap on emissions
 - EU operators either buy or receive allowances for free (prior to revision of the EU ETS);
 - Operators can trade allowances
 - Key changes to the EU ETS: reduced cap on emissions, free allowances to be gradually phased out
- Addressing the risk of “carbon leakage”
 - Following revision of the EU ETS, EU producers will have to pay for emissions allowances
 - Stated concern over possible shift of consumption or production activities to countries with less stringent carbon pricing mechanisms

3. Key features of the EU CBAM: product scope

- CBAM applies to imports of goods in six sectors, including certain precursors and downstream products
- In-scope CBAM goods identified by their Combined Nomenclature (“**CN**”) codes
- Goods released to the EU market after being put under inward processing will be subject to CBAM
- Additional products and services may be included in future after review of the CBAM Regulation
- Non preferential rules of origin to be applied to determine country of origin

Aluminium

Iron & Steel

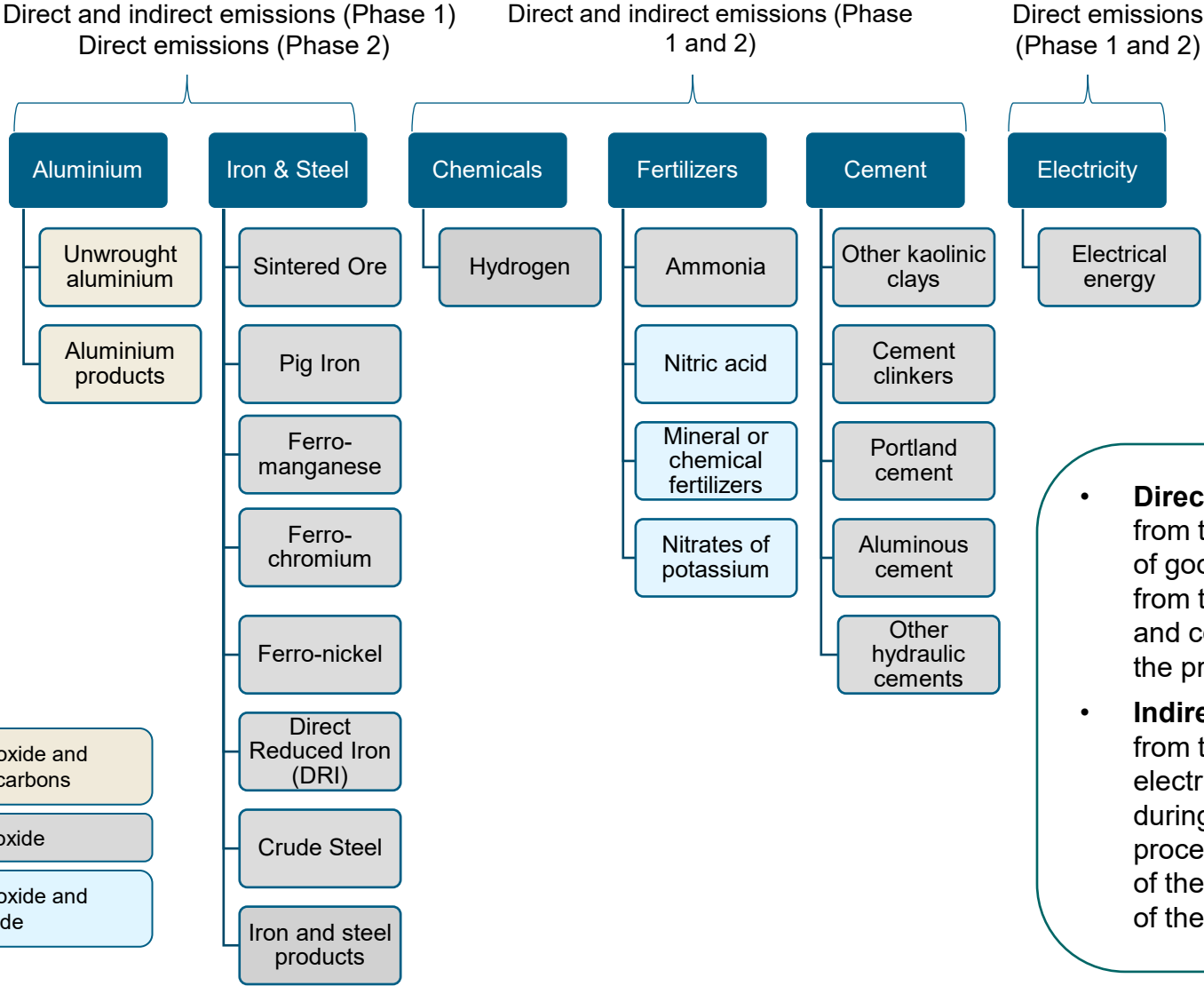
Cement

Fertilizers

Chemicals

Electricity

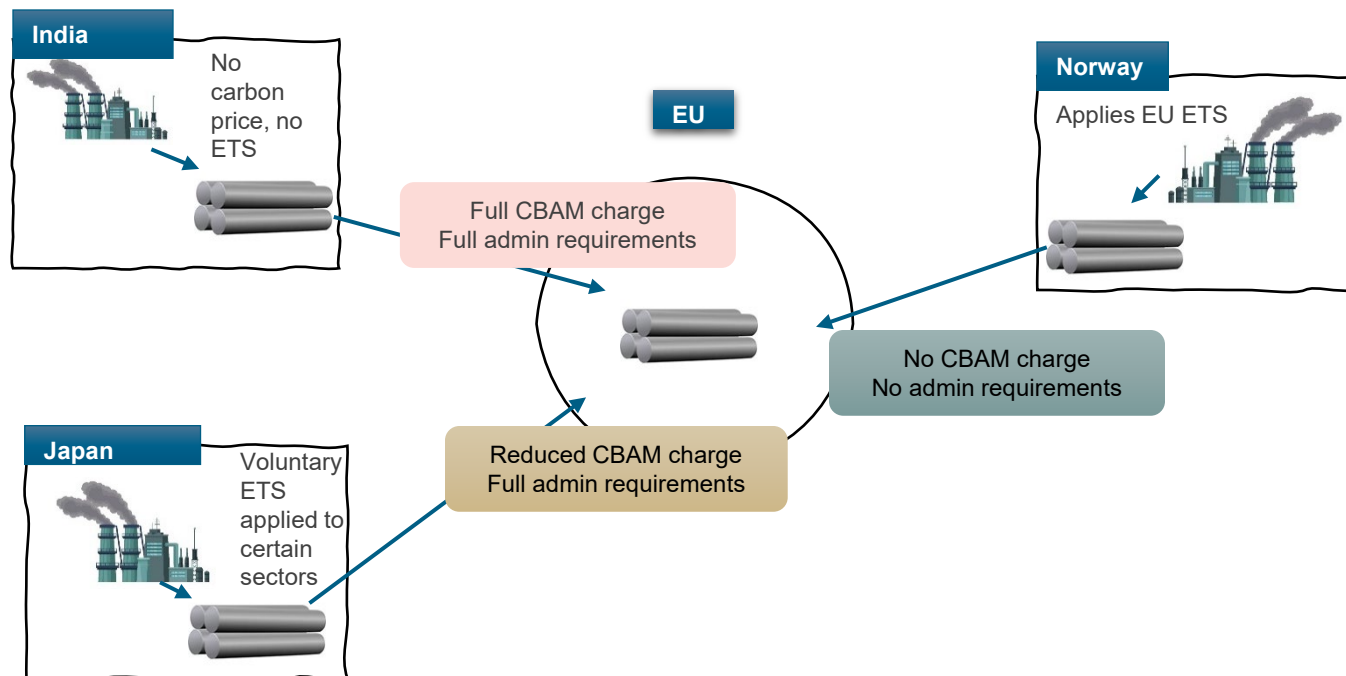
3. Key features of the EU CBAM: emissions scope



- **Direct emissions:** emissions from the production processes of goods, including emissions from the production of heating and cooling consumed during the production processes
- **Indirect emissions:** emissions from the production of electricity, which is consumed during the production processes of goods, regardless of the location of the production of the consumed electricity

3. Key features of the EU CBAM: country scope

- **Any** non-EU country **except** countries that are (1) subject to the EU ETS or (2) linked to the EU ETS
 - Only Iceland, Liechtenstein, Norway and Switzerland are exempt
- EU may conclude agreements with non-EU countries to take account of their carbon pricing mechanisms and reduce the CBAM charge



3. Key features of the EU CBAM: form and design

Implementation phase	CBAM obligations
Transitional period: From 1 October 2023 to 31 December 2025 (<i>phase 1</i>)	<ul style="list-style-type: none">• Reporting requirements only<ul style="list-style-type: none">– Submitting a CBAM report each quarterly containing:<ul style="list-style-type: none">○ Total quantity of each type of goods per installation imported in last quarter○ Total embedded direct and indirect emissions○ Carbon price paid in country of origin
Definitive period: From 1 January 2026 onwards (<i>phase 2</i>)	<ul style="list-style-type: none">• Administrative requirements (including reporting requirements)<ul style="list-style-type: none">– Applying for authorization to import CBAM goods– Verifying total quantity of embedded emissions for the imported CBAM goods– Buying and holding CBAM certificates– Submitting CBAM declarations of embedded emissions for imported CBAM goods in the year after importation– Surrendering CBAM certificates corresponding to the declared emissions in the year after importation• CBAM price<ul style="list-style-type: none">– CBAM price imposed by requiring importers to buy and surrender CBAM certificate– Chargeable base: Actual emissions or alternatively, punitive default values– Chargeable rate: Price based on the average auction price of EU ETS allowances, adjusted for any carbon price (ETS, carbon tax) paid at home

3. Key features of the EU CBAM: enforcement

- **European Commission (“Commission”)**
 - Coordinating overall implementation of the CBAM Regulation
 - Issuing guidelines on the CBAM Regulation
 - Running platforms used for purposes of compliance with reporting requirements
- **National competent authorities**
 - Authorization of importers in phase 2
 - Imposing penalties for non-compliance with CBAM obligations
- **Customs authorities**
 - Informing importers of CBAM goods of their CBAM reporting obligations
 - Implement ban on importation by non-authorized importers
 - Providing the Commission and national competent authorities with information on imported CBAM goods

4. Practical issues: reporting requirements in the transitional period

- **Who?**

- Importer or indirect customs representative

- **What?**

- CBAM report setting out (1) total quantity of goods imported in last quarter (2) total embedded direct and indirect emissions in those goods and (3) carbon price paid in country of origin
- Direct emissions will be based on actual emissions, unless they cannot be adequately determined
- Indirect emissions: based on default values, unless conditions are met (direct technical connection or power purchase agreement)

- **When?**

- First CBAM report due on **31 January 2024** for goods imported in Q4 2023
- Subsequent CBAM reports due every three months thereafter

- **How?**

- Submitted digitally to the Commission through the CBAM Transitional Registry

4. Practical issues: consequences of noncompliance or circumvention

- Penalties imposed by national competent authorities:
 - **Noncompliance with reporting obligations in the transitional period**
 - Ranging between 10-50 EUR per tonne of unreported emissions
 - Penalty increased in accordance with the European index of consumer prices
 - **Noncompliance with reporting obligations in phase 2**
 - Identical to the excess emissions penalty in the EU ETS (EUR 100) for each CBAM certificate not surrendered
 - Penalty increase in accordance with the European index of consumer prices
 - **Importing goods without authorization in phase 2**
- Prohibition on circumvention practices
 - Examples include: slightly modifying goods to change CN codes or artificially splitting shipments so that value is below *de minimis* threshold
 - Interested parties can notify the Commission of such practices
 - Commission can initiate an investigation assisted by national competent authorities and customs

5. WTO compatibility of CBAM

- **Why is the WTO relevant?**

- CBAM is a trade measure designed to support an internal EU environmental measure
 - CBAM raises an important questions about:
 - The reach of WTO rules on different forms of carbon measures affecting imports
 - The policy space allowed to Members to depart from WTO rules for environmental reasons

- **Who is interested?**

- CBAM is not the only proposed carbon border adjustment measure
 - Domestic carbon pricing schemes + increased ambition = political need to equalize competitive conditions for domestic producers (aka “deal with carbon leakage”)
 - Attention on issues of WTO compatibility
 - Countries with defensive interests watching to see how others react to CBAM
 - Developing country exporters, in particular, are potentially prejudiced by CBAM

5. WTO compatibility of CBAM

- **Potential claims under GATT 1994**

- **Phase 1 (reporting):** onerous requirements, including cost and risk of penalties, may have a limiting effect on trade in imported products, raises issues under Article XI:1

- **Phase 2 (CBAM pricing):** Fiscal or regulatory measure? Adjustment for internal measure or border measure?

- Border measure must comply with Article II; adjustment for internal measures must comply with Article III

- Exemption of countries linked to EU ETS also raises issue of discrimination between those countries and others under Article I:1

5. WTO compatibility of CBAM

- **Potential defences to violations of GATT 1994:**

- Article XX carves out policy space for measures, including measures:

“(b) necessary to protect human, animal or plant life or health;”

or

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

- Provided they comply with the “chapeau” of Article XX...

5. WTO compatibility of CBAM

- **Article XX Chapeau:** Members may take measures under paragraphs (b) or (g):
“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 ...”
- **CBAM raises issues under this discipline:**
 - Draws distinctions between countries where the same relevant conditions prevail
 - Applies same approach to countries where different conditions prevail

6. Relevance – affected stakeholders

- **EU producers of CBAM goods**
 - “Levelling the playing field”

- **Non-EU exporting producers of CBAM goods**
 - Competitiveness of products
 - Increased costs of compliance

- **Non-EU States exporting CBAM goods to EU**
 - Reduced competitiveness of imports/ foreign exchange earnings
 - Trade diversion

- **European Commission/EU Member States**
 - Implementation and enforcement of CBAM rules

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