
EU adopts the Carbon Border Adjustment Mechanism Regulation

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On May 16, the Regulation establishing an EU Carbon Adjustment Mechanism (CBAM) was [published](#) in the Official Journal of the EU and entered into force the following day. Under the CBAM, **importers into the EU of carbon-intensive goods** (mainly cement, electricity, fertilizers, iron and steel, aluminum, and hydrogen) **will be required to pay a charge for the carbon emissions embedded in those products**. This charge will be **gradually phased in from 2026 to 2034**, and eventually will equal the charge that would have been paid by an EU producer under the EU Emissions Trading System (EU ETS). The CBAM also imposes detailed reporting requirements. The transitional period provided in the CBAM will apply as of October 1, 2023, with importers being subject only to reporting requirements until December 31, 2025.

The CBAM, which is the first instrument of its kind in the world, is expected to **significantly increase red tape and add costs for importers of carbon-intensive products into the EU**. These companies will soon face important reporting obligations and, at a future stage, carbon charges.

At the same time, the CBAM will also impact **a)** foreign producers of these goods, which may have to share in the added charges with their importers, and **b)** EU companies, which will have to pay higher prices for the imported goods in question, as well as for any derivative products. Businesses should therefore pay close attention to these developments and start reviewing their supply chains in preparation for the full application of this new legislation.

Background

The CBAM is a key component of the EU's efforts to make Europe the world's first climate-neutral continent by 2050, as outlined in the flagship European Green Deal (2019). To achieve this goal, the EU Commission (Commission) adopted the "Fit for 55" package in 2021, setting a target for the reduction of greenhouse gas (GHG) emissions by at least 55% by 2030, compared to 1990 levels.

As part of the "Fit for 55" package, the CBAM aims to address "carbon leakage," which occurs when EU-based companies move carbon-intensive production abroad to take advantage of lax emissions standards, or when customers replace EU products with more carbon-intensive imports. The CBAM is designed to complement the EU ETS and seeks to equalize the carbon price paid for EU products operating under the EU ETS and for imported goods. In that way, the EU aims to provide an incentive for third countries to regulate CO₂ emissions as well.

Key provisions

Essentially, the CBAM will impose a charge on imports of carbon-intensive products from countries that do not impose carbon charges or that impose lower ones than the EU does. Importers of covered products into the EU will be required to **purchase CBAM certificates** corresponding to the price that an EU producer of the goods in question would have had to pay for a carbon allowance under the EU ETS. However, if the products in question have already been subject to a carbon charge under an ETS in force in their country of production, then importers can deduct the corresponding amount from the price of the CBAM certificate.

The price of the CBAM certificates will be calculated depending on the weekly average auction price of EU ETS allowances, expressed in EUR per tonne of CO₂ emissions. These allowances traded at around EUR 85 on December 1, 2022.¹ It is important to note that CBAM certificates cannot be traded.

Scope

a. **Products**

The CBAM will initially apply to six groups of products, which are listed in Annex I with the corresponding CN codes. The groups of products are (1) **cement**, (2) **electricity**, (3) **fertilizers**, (4) **iron and steel**, (5) **aluminum**, and (6) **hydrogen**. In addition, the CBAM will also apply to some precursors used in the production of these goods, as well as to certain downstream products (e.g., screws, bolts, and similar articles of iron or steel). Before 2026, the Commission is meant to assess the possibility of extending the CBAM to cover other goods at risk of

¹ <https://www.statista.com/statistics/1322214/carbon-prices-european-union-emission-trading-scheme/>.

carbon leakage, such as organic chemicals and polymers. The ultimate goal is to expand the product scope to cover all EU ETS sectors by 2030.²

b. **Emissions**

The CBAM covers both direct emissions (i.e., GHG emissions from the production processes of covered goods, including emissions from the production of heating and cooling consumed during the production processes) and indirect emissions (i.e., GHG emissions from the production of electricity consumed during the production processes of covered goods). In particular, **both direct and indirect emissions** will be taken into account for **cement** and **fertilizers**. By contrast, **only direct emissions** will initially be taken into account for **iron and steel, aluminum, and hydrogen** (see Annex II).

Exemptions

The CBAM will **not apply** to imports from the **European Economic Area members** (Norway, Iceland, Liechtenstein), given that these countries participate in the EU ETS, or to **Switzerland**, which has a national ETS linked to the EU ETS. By contrast, the CBAM **will apply** to imports from the **United Kingdom**. It is worth noting that the UK government has announced a [consultation](#), running until June 22, on policy measures to address carbon leakage, including the possible adoption of a UK CBAM.

Furthermore, the CBAM will not cover shipments of **negligible value** (i.e., goods with an intrinsic value of a maximum of 150 EUR per consignment) or goods to be moved or used in the context of military activities.

Calculation of Emissions

Emissions will be **calculated based on total embedded emissions**, expressed in tonnes of CO₂-equivalent (“CO_{2e}”) emissions per megawatt-hour of electricity or, for other goods, in tonnes of CO_{2e} emissions per tonne of each type of good.

If actual emissions cannot be accurately determined, or in the case of indirect emissions, **default values** will be used for the calculation. These default values will typically be set at the average emission intensity of each exporting country and for each covered good, increased by a proportionately designed markup. When reliable data for the exporting country are unavailable, the default values will be based on the average emission intensity of a yet-to-be-

² The EU ETS covers the following sectors and gases, focusing on emissions that can be measured, reported and verified with a high level of accuracy: **a)** carbon dioxide (CO₂) from electricity and heat generation; energy-intensive industry sectors, including oil refineries, steel works, and production of iron, aluminum, metals, cement, lime, glass, ceramics, pulp, paper, cardboard, acids and bulk organic chemicals; aviation within the EEA and departing flights to Switzerland and the UK; maritime transport; **b)** nitrous oxide (N₂O) from production of nitric, adipic and glyoxylic acids, and glyoxal; and **c)** perfluorocarbons (PFCs) from the production of aluminum. Participation in the EU ETS is mandatory for companies in these sectors, but Directive 2003/87/EC also provides for certain exclusions, as well as for derogations and special measures for the aviation sector.

determined percentage of the worst-performing EU ETS installations (i.e., stationary units where production processes take place) for that type of good.³

These calculation methods are provided in Annex IV and will be set out in more detail in implementing acts to be adopted by the Commission.

Application

The CBAM foresees a **transitional period from October 1, 2023, until December 31, 2025**, during which importers will **only be subject to reporting obligations** and will not have to purchase CBAM certificates or pay any other fees. **As of January 1, 2026, the CBAM will fully apply** and will be **gradually phased in**. At the same time, the system of free emission allowances under the EU ETS will be phased out in sectors covered by the CBAM by 2034. Between 2026 and 2034, the CBAM will only apply to the proportion of emissions that no longer benefit from free allowances under the EU ETS due to the phase-out.

The phasing out of free allowances will be implemented according to the following schedule:

Year	Percentage of total free allowances to be phased out
2026	2.5%
2027	5%
2028	10%
2029	22.5%
2030	48.5%
2031	61%
2032	73.5%
2033	86%
2034	100%

The Commission is responsible for **monitoring this schedule**; before January 1, 2028, and every two years thereafter, it is supposed to report to the European Parliament and the Council of the EU (Council) on the CBAM's application, functioning, impact on carbon leakage (among others), and any necessary additional measures.

Obligations on companies

a. Transitional period (October 1, 2023–December 31, 2025)

During the transitional period covered by the **reporting requirement**, importers of covered goods or their customs representatives must submit a **quarterly CBAM report** to the Commission.⁴ The reports, which do not need to be verified, must include:

³ Point 4.1, Annex IV.

⁴ Recital 57, Article 35(1).

- the total quantity of each type of covered good imported during the quarter;
- the actual total emissions and indirect emissions embedded in the good; and
- the carbon price due in the country of origin for the embedded emissions, taking into account discounts or other forms of compensation.⁵

The first report covering imports between October and December 2023 must be submitted in January 2024. Failing to submit or correct a report will result in penalties imposed by the competent authority of the EU Member State where the importer is established.⁶

From 2025 onward, importers or customs representatives must apply for the status of authorized CBAM declarant, which will be granted by the competent authority of the EU Member State where the applicant is established and must be recognized by all EU Member States.⁷

b. Implementation of import charge (as of January 1, 2026)

From January 1, 2026, only authorized CBAM declarants can import CBAM goods into the EU. In that connection, authorized declarants must:

1. **Submit an annual CBAM declaration by May 31 of each year⁸** through the EU-wide CBAM registry. This declaration, which must be submitted for the first time in 2027 for the year 2026, must include the following information:
 - total quantity of each type of covered good imported in the previous year;
 - total emissions embedded in the good;
 - number of CBAM certificates to be surrendered, after adjusting for EU ETS allowances; and
 - a copy of the verification report of embedded emissions by an accredited verifier.⁹
2. **Use an accredited verifier to verify total emissions** declared in the CBAM declaration.¹⁰
3. **Purchase CBAM certificates** from the competent authority of their EU Member State of establishment, at the weekly average price of EU ETS allowances. These certificates are purchased on a common central platform. Authorized declarants must also ensure that the number of certificates on their account corresponds to at least 80% of emissions embedded in all covered goods they have imported since the beginning of the calendar year.¹¹

⁵ Article 35(2).

⁶ Article 26.

⁷ Article 5.

⁸ Article 6(1).

⁹ Article 6(2).

¹⁰ Article 8(1).

¹¹ Article 22(2).

4. **Surrender CBAM certificates** by May 31 of each year, in an amount corresponding to the emissions declared and verified in the annual CBAM declaration for the previous calendar year.¹²

Circumvention

The CBAM provides that the Commission will take action to address circumvention practices. These are defined as a change in the pattern of trade in goods, stemming from a practice, process or work, for which there is insufficient due cause or economic justification other than avoiding, wholly or partially, any of the obligations laid down in the CBAM. This includes **a) slightly modifying the goods** in question to make them fall under CN codes outside the scope of the CBAM, except where the modification alters their essential characteristics, and **b) artificially splitting shipments** into consignments of negligible value.¹³

The Commission is responsible for monitoring the market situation in the EU with a view to identifying circumvention practices. EU Member States, affected parties and other interested parties, such as environmental organizations and NGOs, that have relevant evidence may also notify the Commission of suspected circumvention. If the Commission concludes, after an investigation, that circumvention is occurring, it may adopt delegated acts to **extend the product scope of the CBAM to the slightly modified products in question**.¹⁴

Compliance with WTO rules

The EU has stressed that the CBAM is “[d]esigned in compliance with World Trade Organization (WTO) rules and other international obligations of the EU.”¹⁵ This issue had been much discussed during the legislative process,¹⁶ both as regards the provision of a carbon adjustment mechanism as such and in relation to the details of the CBAM (any applicable exemptions, the provision of free emissions allowances for EU-based companies, the calculation methods for the emissions, the reporting requirements, etc.). There are very few examples of carbon adjustment mechanisms, and none of them have been challenged before the WTO to date.¹⁷

The Government of India has already stated that it plans to challenge the EU’s CBAM at the WTO.

¹² Article 22(1).

¹³ Article 27(1) and (2).

¹⁴ Article 27(3)-(6).

¹⁵ Commission, “Carbon Border Adjustment Mechanism: Questions and Answers,” July 14, 2021.

¹⁶ See, for instance, EU Parliament, “Trade Related Aspects of a Carbon Border Adjustment Mechanism - A Legal Assessment,” Briefing Requested by the INTA Committee, April 2020.

¹⁷ Ibid.

Export rebates

Another option discussed in the context of the legislative process was the provision for export rebates for EU producers that export products subject to a charge under the EU ETS. The Commission ruled out export rebates in its impact assessment of July 2021 due to fears that they would constitute prohibited export subsidies under WTO rules. However, the Commission must reassess, by 2025, the risk of carbon leakage for goods produced in the EU intended for export to non-EU countries and, if needed, present a WTO-compliant legislative proposal to address this risk.¹⁸

Next steps

The EU's CBAM is the first regime of its kind in the world trading system. As such, it will have a very broad impact, far beyond the EU's borders. Foreign exporters, foreign and EU importers, as well as foreign producers of the covered goods seeking access to the EU market should review their supply chains, with a view to analyzing their emissions and quantifying their potential exposure.

As noted above, CBAM reporting requirements will apply as of October 1, 2023. In that context, companies should consider the need to track emissions and collect other relevant data, as well as monitor domestic carbon costs and charges. Importers that are established outside the EU will also have to appoint an indirect customs representative (i.e., a customs representative acting in their own name but on behalf of the importer) in the EU.

Ultimately, companies will have to examine the implications the CBAM has on their business model. It is likely that the CBAM will push carbon-intensive industries falling within its scope (i.e., located outside the EU, but exporting to the EU) to seek further opportunities to reduce their emissions and decarbonize their production processes, focusing on alternatives such as ammonia and hydrogen.

In addition, companies will need to consider the potential impact on their reputation of the CBAM and the broader EU trend towards decarbonization, as well as the potential impact on their relationships with customers, suppliers and other stakeholders. The CBAM may lead to a shift in consumer preferences toward more environmentally friendly products and companies, as well as to greater pressure on companies to reduce their carbon footprint. Companies may also need to consider how they will communicate to their stakeholders the potential consequences of the CBAM for their operations, pricing and product offerings.

It is important to note that even after its entry into force, the CBAM is still in the early stages of implementation and there may be changes or adaptations in the future (e.g., as regards the extension of the product scope, or the assessment of the phasing-out schedule in connection with the risk of carbon leakage and the potential need to adopt additional measures in that respect), as the EU continues to monitor its effectiveness and responds to feedback from

¹⁸ European Parliament Press Release, "Climate change: Deal on a more ambitious Emissions Trading System (ETS)", December 18, 2022.

stakeholders. Companies should stay informed about the latest developments and be prepared to adapt their strategies as needed.

Furthermore, the Commission still needs to prepare the implementing and delegated acts provided in the CBAM, regarding, among other things, the calculation methods for emissions. Interested parties will likely have an opportunity to submit any relevant comments to the Commission in the context of a future consultation.

Other laws of the “Fit for 55” package

Apart from the CBAM, the Council also adopted other laws as part of the “Fit for 55” package on April 25. In particular, it revised the ETS Directive,¹⁹ amended the MRV shipping Regulation²⁰ and reached a provisional [agreement](#) on a Regulation establishing a Social Climate Fund (SCF). These laws cover, among other things:

- **maritime transport emissions:** these will be included within the scope of the EU ETS for the first time. Non-CO₂ emissions (methane and N₂O) will be included in the MRV shipping Regulation from 2024 and in the EU ETS from 2026.
- **aviation emissions:** free emission allowances for the aviation sector will be gradually phased out; full auctioning will be implemented from 2026. Twenty million allowances will be reserved until December 31, 2030, to incentivize the transition of aircraft operators from the use of fossil fuels.

The EU ETS will apply for intra-European flights (including departing flights to the UK and Switzerland), while CORSIA, a global scheme for offsetting CO₂ emissions from international aviation adopted by the International Civil Aviation Organisation, will apply to extra-European flights to and from third countries participating in CORSIA from 2022 to 2027.

- **buildings, road transport and additional sectors:** a new, separate emissions trading system has been established for the buildings sector, the road transport sector and additional sectors (mainly small industry), which have so far proven difficult to decarbonize. The new system will apply to distributors that supply fuels to the sectors in question starting in 2027. A safeguard has been put in place whereby if energy prices are exceptionally high in the run-up to the start of the new system, this will be postponed until 2028.
- **Social Climate Fund:** The SCF is meant to be used by EU Member States to finance measures and investments to support vulnerable households, microenterprises and

¹⁹ Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, OJ L 275, 25.10.2003, pp. 32–46.

²⁰ Regulation (EU) 2015/757 of the European Parliament and of the Council of 29 April 2015 on the monitoring, reporting and verification of carbon dioxide emissions from maritime transport, and amending Directive 2009/16/EC, OJ L 123, 19.5.2015, pp. 55–76.

transport users and help them cope with the price impacts of the ETS for the buildings sector, the road transport sector and additional sectors.

The fund, established for the period from 2026 to 2032, will be financed by revenues coming mainly from the new ETS up to a maximum amount of EUR 65 billion, to be supplemented by national contributions.

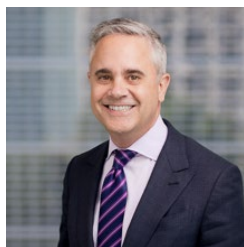
How can WilmerHale help?

WilmerHale has extensive experience regarding the substantive issues raised by the CBAM, the interpretation and application of WTO and other international rules that intersect with it, as well as international trade disputes and enforcement proceedings. We have extensive experience advising and representing clients in a wide range of sectors in international trade investigations, as well as in multiple high-profile trade disputes between the United States and the EU.

We are also highly experienced in helping stakeholders navigate complex decision-making processes involving political and strategic issues, such as the ones companies will face when the Regulation becomes operative. We are deeply involved in policy debates surrounding the EU's CBAM as well as similar proposals in the United States and other jurisdictions. In addition, WilmerHale can assist clients in making representations to the Commission as it develops implementing legislation for the CBAM, in voicing concerns that they may have and in seeking solutions before final implementing legislation and/or guidelines are adopted.

For further information, please contact a member of our European team or a member of our trade team in the United States.

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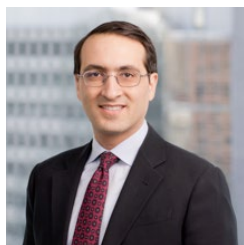
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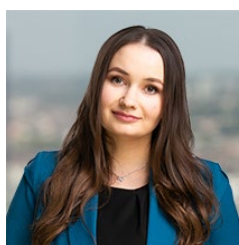
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