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THE REPORT
ON THE CARBON BORDER
ADJUSTMENT MECHANISM
(CBAM)

LEGISLATIVE PROCEDURE AND CURRENT STATE OF PLAY

In December 2019, the European Commission adopted its Communication on the European Green Deal. The key measures envisaged in this context include the proposal for a carbon border adjustment mechanism (CBAM) for selected sectors, scheduled for 2021. The proposal would aim to ensure that the EU's ambitious climate objectives are not undermined by a relocation of carbon-intensive productions outside the EU.

On 14 July 2021, the Commission adopted its proposal for a CBAM, which would equalize the price of carbon between domestic products and imports in selected sectors.

In September 2021, the CBAM proposal was referred to the Parliament's ENVI Committee and MEP Mohammed Chahim (S&D, Netherlands) was appointed rapporteur. The Committees for opinion are INTA, BUDG, ECON, ITRE and IMCO.

The ENVI committee adopted a report on 17 May 2022. At the June I plenary, the parliament referred the report, ahead of the votes on the amendments, back to the Committee, which in turn voted to place the report on the June II part-session. On 22 June 2022, the Parliament adopted its position on the regulation, with 450 votes for, 115 against and 55 abstentions. It foresees the phasing in of the CBAM from 2027 with free allowances ending in EU emissions trading system by 2032. It supports a broadening of the scope to include organic chemicals, plastics, hydrogen and ammonia as well as indirect emissions. It also supports the need for a centralized EU CBAM authority and mentions that revenue from CBAM shall accrue to the EU budget, and be reflected in an increased support to least developed countries decarbonization efforts.

On 15 March 2022 the Council adopted its general approach on the CBAM, introducing changes to the CBAM governance, in comparison to the Commission's proposal, by means of greater centralization, e.g. an EU level centralized registry of CBAM declarants (importers). Furthermore, it foresees a minimum threshold exempting consignments with a value of less than 150 from CBAM obligations. In addition, it suggests the establishment of a 'climate club' through an alliance of countries which have in place carbon pricing instruments or other comparable instruments.

The trilogue meetings on the file begun on 11 July 2022, and on 13 December 2022 a provisional political agreement was reached.

NEXT STEPS IN THE LEGISLATIVE PROCEDURE

The agreement needs to be confirmed by ambassadors of the EU member states, and by the European Parliament, and adopted by both institutions before it is final.

Under the provisional agreement, CBAM will begin to operate from October 2023 onwards. Initially, a simplified CBAM would apply essentially with reporting obligations only. The aim is to collect data. From then onwards, the full CBAM will kick in. It would be phased in gradually, in parallel to a phasing out of the free allowances, once it begins under the revised EU emissions trading system (ETS) for the sectors concerned. This will ensure compatibility of CBAM with international rules on trade.

KEY TAKEAWAYS FOR THE ALUMINIUM INDUSTRY

CBAM will apply to aluminum products imported into the EU (as well as other industrial goods such as iron, steel, fertilizers, ammonia and cement).

CBAM certificates for imports of non-EU aluminum are only required in excess of the amount of free ETS allowances that EU aluminum producers receive.

Payment obligations under the CBAM are reduced to the extent non-EU aluminum producers have already paid an equivalent carbon price for emissions in the country of production.

Between 2023 and 2025, non-EU producers will need to report both direct and indirect emissions (i.e. emissions associated with the production of electricity, heating and cooling consumed during production).

Financial obligations (commencing from 2026) to account for emissions under CBAM only apply to direct emissions (at least initially) but CBAM may be extended to indirect emissions.

Responsibility for compliance with CBAM primarily rests with the importer of aluminum (not the non-EU producer, unless they are the same entity). The penalty regime under CBAM (which mirrors the penalties under the ETS) does not extend to non-EU aluminum producers (unless they are also the importer of the aluminum). However, non-EU producers will need to be conscious of other potential sources of liability for non-compliance (e.g. under customer contracts).

Free ETS allowances for EU aluminum producers will be phased out from 2026 to 2035 (10 percent reduction per year, reduced to zero by 2035).

Compensation granted to EU aluminum producers by Member States for indirect emissions costs embedded in electricity prices remains for now.

These proposals will only come into effect if and when they have been approved in accordance with the EU's legislative processes.

Importers will need to declare and purchase CBAM certificates to cover the greenhouse gas (GHG) emissions associated with the production of the imported aluminum products.

OVERVIEW OF KEY PROVISIONS OF CBAM FOR NON-EU ALUMINIUM PRODUCERS

Some of the key features of the proposed CBAM for non-EU aluminum producers to be aware of are:

- Between January 1, 2023 and December 31, 2025, importers of non-EU aluminum will be obliged to report both direct and indirect emissions. Non-EU producers will therefore need to be able to provide such emissions data, in accordance with the methodologies to be determined by the Commission.
- Emissions to be reported under CBAM should be based on actual emissions (and only using default values, based on average country emissions or the 10 percent most-polluting EU installations, as a fallback to the extent that actual emissions cannot be determined). The use of actual emissions (rather than default values) is an important part of designing CBAM to be WTO-compliant and also incentivizes non-EU aluminum producers to decarbonize their operations, thereby reducing the payment obligations under CBAM on import of their products.
- The responsibility for compliance with CBAM rests with the relevant importer of aluminum into the EU (not the non-EU producer directly unless it is also the importer of record). The penalty regime under CBAM (which mirrors the penalties under the ETS) does not extend to non-EU aluminum producers (unless they are also the importer of the aluminum). However, non-EU producers will need to be conscious of other potential sources of liability for non-compliance, for example, under contracts with its customers as the relevant contractual terms dealing with pass-through of CBAM compliance risk are developed.

- From 2026, aluminum may only be imported into the EU by an importer that is registered and approved with the relevant authority (within each Member State). Non-EU aluminum producers will therefore need to engage with their EU customers and/or obtain registration as importers in their own right.
- From January 1, 2026, the financial obligations under CBAM (i.e. of purchasing and declaring CBAM certificates against imports of aluminum) will apply. As the payment obligations rests with the importer and not with the non-EU producer, customers of non-EU aluminum producers will be incentivized to exercise their purchasing power to seek reductions in GHG emissions embedded in imported aluminum. There may therefore be increasing demand-side pressure for decarbonization of non-EU aluminum production to be imported into the EU.
- Emissions embedded in imported aluminum products will need to be reported and verified by an approved verifier all in accordance with detailed methodologies to be determined by the Commission in subsequent delegated acts.
- The price of CBAM certificates will be calculated as the average weekly auction price of the EU ETS allowances.
- Non-EU producers may register in a central EU database on a one-time basis (valid for five years) and disclose the emissions data filed with that registry to their customers, who may use such data in their emissions declarations for the imported products of that non-EU producer. This should reduce the administrative burden on both importers and non-EU producers, compared to ad hoc information sharing on a per delivery basis.

Credit is given to a non-EU producer for any carbon price paid in the country of production. However, the details of the methodology for calculating the appropriate credit are still to be proposed by the Commission in subsequent delegated acts (e.g., it will be important to the proper functioning of the CBAM that the price of carbon emissions paid in a non-EU country is truly equivalent per ton of emissions to that payable under the CBAM).

WAYS TO IMPROVE THE CBAM AFTER THE PROVISIONAL AGREEMENT

Firstly, it is important to notice that, under the provisional agreement reached in December 2022, the CBAM will begin to operate from October 2023 onwards, even in the case that a final agreement is not at hand by that date.

Therefore, at the time that the agreement needs to be validated and adopted by the ambassadors of the EU member states and by the European Parliament, there will still be margin for targeted improvements that could positively impact the aluminium industry. Among others:

- By proposing a more robust method to calculate indirect carbon costs on imports.
- By suggesting a more cautious approach to phasing in indirect emissions to allow EU producers to fairly compete with third countries on a more level playing field while the European electricity grid decarbonizes (ideally, after 2030).
- By designing a compensation mechanism for very likely rising in energy prices if the existing carbon leakage measures are completely phased out.
- By establishing a process for monitoring and reviewing the impact of the CBAM on the aluminium industry, including gathering data on GHG emissions, trade flows, and the competitiveness of domestic producers, and using that information to inform any necessary adjustments to the CBAM.
- By adjusting the scope of the CBAM to only apply to certain types of aluminium products or sectors of the aluminium industry that are most vulnerable to carbon leakage.
- By considering exemptions or exclusions from the CBAM for certain aluminium products or sectors that have low GHG emissions or that are already subject to carbon pricing or regulations in other countries.
- By implementing a “sectoral approach” to the CBAM, which would involve setting a sector-specific emissions performance standard for the aluminium industry and applying a carbon border adjustment to imported aluminium products that do not meet that standard.
- By setting the carbon border adjustment rate at a level that is high enough to effectively level the playing field for domestic aluminium producers, while also being low enough to avoid disrupting international trade or causing undue hardship for aluminium producers in other countries.