

## **CARBON BORDER ADJUSTMENT MECHANISM (“CBAM”)**

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With Regulation (EU) 2023/956 of the European Parliament and Council of 10 May 2023 (“**Regulation**”), the Carbon Border Adjustment Mechanism or “**CBAM**” came into force as of 1 October 2023.

The new environmental policy mechanism established by the European Union is the expression and implementation of the 'polluter pays' principle and it aims to apply to specific products imported within the customs territory of the European Union the same carbon emission costs that are incurred from production plants located within the European Union, already subject to the regulation of the Emission Trading System (“**ETS**”) with regard to numerous products. In other words, CBAM entails the application of a price for the emissions incorporated in the imported products included in the scope of application of the aforementioned mechanism.

The Regulation, together with other measures<sup>1</sup>, is included in the Union's sustainable policy strategy set out in the European Green Deal, which, if properly implemented, will hopefully lead its Member States to climate neutrality by 2050, with no longer net greenhouse gas emissions and an economic growth decoupled from resource use. Specifically, CBAM is part of the European Union's «Fit for 55 in 2030» package, whose goal is to reduce net greenhouse gas emissions by at least 55 per cent by 2030.

In fact, CBAM Regulation is aimed at protecting these valuable interests of the European Union: since many international partners have not yet adopted environmental policies as ambitious as those of the European Union, carbon leakage (*i.e.* the transfer of production to other countries) would risk undermining the aims pursued by EU policy.

### **THE RECIPIENTS**

Pursuant to Article 2 of the Regulation, CBAM discipline applies to: *“goods listed in Annex I originating in a third country, where these goods, or processed products from these goods resulting from the inward processing procedure referred to in Article 26 of Regulation (EU) No 952/2013, are imported into the customs territory of the Union”*.

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<sup>1</sup> Within the framework drawn by the European Union are, by way of example, the Corporate Sustainability Due Diligence Directive (Directive (EU) 2019/1937), the Corporate Sustainability Reporting Directive (Directive (EU) 2022/2464, Regulation (EU) 2020/852 on taxonomy, the Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2988).

The Regulation therefore identifies its recipients among those who are importers of specific categories of goods and which, at the time of the Regulation's entry into force, are<sup>2</sup>: **cement and cement products, electricity, fertilizers, various cast iron products, iron and steel, aluminum and chemicals**. In the future, the list will be extended to include further types of goods, including those subject to the ETS legislation.

## IMPORTERS OBLIGATIONS

The new offsetting system introduces a series of obligations for importers, aimed at reducing the amount of emissions incorporated in the goods listed above, which can be summarized in the following steps.

Firstly, it is expected that the importer, before importing the goods within the customs territory of the European Union, must obtain the status of authorized CBAM declarant through a special **application for authorisation**<sup>3</sup>. The application will be transmitted through the CBAM registry as provided for in Art. 14 of the Regulation.

Secondly, CBAM regulation introduces the obligation for each declarant to submit, by 31 May of each year from 2027 onwards, the **CBAM declaration**: a document that will report the total quantity of each type of goods imported in the previous calendar year, as well as the emissions incorporated in the goods themselves.

CBAM regulation is based on a mechanism whereby each Member State sells CBAM certificates to authorized registrants, *i.e.* certificates “*in electronic format corresponding to one tonne of CO<sub>2</sub>e of embedded emissions in goods*”. The price of CBAM certificates, as provided for by Art. 21 of the Regulation, is calculated as the average of the closing prices of EU ETS allowances<sup>4</sup>, a further instrument, as mentioned above, developed by the European Union to reduce carbon dioxide emissions.

Art. 22 of the Regulation then provides that the authorized CBAM declarant must also ensure that the number of CBAM certificates on its account in the CBAM registry at the end of each quarter, corresponds to at least 80% of the embedded emissions, determined by reference to default values in accordance with the methods set out in Annex IV, in all goods it has imported since the beginning of the calendar year.

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<sup>2</sup> For a specific identification of the goods subject to the measures within the scope, please refer directly to Annex I of the Regulation, which specifies the relevant Combined Nomenclature.

<sup>3</sup> Art. 5(5) specifies the essential content of the application for authorization to be submitted by each importer.

<sup>4</sup> Although the EU ETS has a different scope of application, the underlying logic is the same as that of the border carbon adjustment mechanism: for each tonne of CO<sub>2</sub> emitted, certain operators (such as, for example, those in the aviation sector or in the production of certain chemicals) are required to apply for a permit. Therefore, industries have to buy ETS allowances through auctions which follow the rule of supply and demand and which, since the CBAM Regulation came into force, also constitute the average price basis for the purchase of CBAM certificates.

When submitting the annual statement, by 31 May each year, the authorized CBAM declarant shall repurchase through the account on the CBAM registry the certificates purchased equal to the incorporated emissions declared.

The Commission will then cancel the repurchased certificates and, in case of surplus certificates, the registrant may request the Member State to buy back the surplus at the payment price at the time of purchase<sup>5</sup>.

## IMPLEMENTATION PHASES OF CBAM REGULATION

The obligations under CBAM regulation can be summarized mainly in two steps:

- the **transitional phase**, from 1 October 2023 until 31 December 2025, in which each importer must submit to the Commission the **CBAM report** containing information on the goods imported during that quarter, for each quarter of a calendar year and within one month after the end of the quarter (see Art. 35 of the Regulation). It is important to note that during the transitional phase, which is already in force, the Commission may impose sanctions on the importer if the CBAM report is not submitted or if the Commission's request for additions is not promptly acted upon<sup>6</sup>.
  - As from 31 December 2024, by means of a special application, the importer will be able to obtain the status of authorized CBAM declarant, as specified above;
- as of 1 January 2026, with the start of the **implementation phase**, all the measures provided for in the new CBAM Regulation will be fully implemented, including the obligation to purchase CBAM certificates and to submit the annual CBAM declaration, which, as anticipated above, will be finalized on 31 May each year.

## THE SANCTION SYSTEM

The Regulation provides for specific penalties against:

- an authorized CBAM declarant who fails to surrender, by 31 May of each year, the number of CBAM certificates that corresponds to the emissions embedded in goods imported during the preceding calendar year;
- a person other than an authorized CBAM declarant who introduces goods into the customs territory of the Union without complying with the obligations under this Regulation.

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<sup>5</sup> It is important to note that the Commission will cancel certificates not surrendered or repurchased by 1 July of each year, without providing for any kind of compensation mechanism, as expressly stated in Art. 24 of the CBAM Regulation.

<sup>6</sup> As provided for in the Regulation Art. 35, "Reporting obligation".

Please note that if the penalty has not been paid within the prescribed time limit, the competent authority shall secure the payment by all means available to it under the national law of the Member State concerned.

## **INNOVATION, SUSTAINABILITY AND GREEN ECONOMY**

The team of Eptalex specialized in sustainability and green economy, led by Amine Moughanime, provides assistance on CBAM issues, sustainability and ESG issues. The team's strengths lie in conducting ESG due diligence and supply chain evaluation, with a sharp focus on emerging economies. They offer comprehensive solutions for businesses, seeking to enhance their governance, sustainability strategies, ESG management, and sustainability reporting, while also extending their support to the digital innovation sector.

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We remain at your disposal for any clarification or provide further insights as needed.

Best regards.

## **CONTACTS**

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