



OVERSEAS COMPANIES AND THE EU AND UK CARBON BORDER ADJUSTMENT MECHANISMS

How Overseas Companies may be Impacted by the EU and UK Carbon Border Adjustment Mechanisms

This article focuses on the potential impact of the European Union's and the United Kingdom's Carbon Border Adjustment Mechanisms (CBAM) on overseas companies.

Carbon Border Adjustment Mechanisms (CBAM) are regulatory frameworks designed to account for the carbon costs of imported goods by imposing a carbon 'price' based on their carbon content with a view to creating a level playing field with local goods subject to domestic carbon emission compliance costs. CBAMs seek to foster fair global competition and mitigate the risk of decarbonisation compliance 'forum shopping' (or 'carbon leakage') for carbon-intensive industries such as aluminium, cement and fertilisers, as climate actions vary greatly between jurisdictions. CBAMs work by requiring importers of designated goods to report and pay off a carbon levy based on the quantum of carbon emissions associated with their production.

The EU and UK CBAMs are corollaries of their own domestic industrial decarbonisation policies and carbon pricing schemes (or emissions trading schemes or ETS). ETS schemes place a price on greenhouse gases (GHG) emitted by domestic producers and the liability applied by the CBAMs depends on the GHG emissions intensity of the imported goods and the differential between the carbon price applied in the country of origin (if any) and the carbon price that would have been applied had the goods been produced domestically; thus preserving the integrity of domestic climate objectives, promoting fair competition and incentivizing best decarbonisation practices in third countries globally.

The EU CBAM was enacted as part of the European Union's broader 'Fit for 55' legislative package. It was codified under the 'Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism' Reg. (EU) 2023/956 of 10 May 2023 which came into force on 1 October 2023. It is a key element of the 'European Green Deal' and the 'European Climate Law'—the latter enshrining the EU's commitment to reducing its net GHG emissions by at least 55% by 2030 (from 1990 levels) – and climate-

neutrality by 2050 in line with the Paris Agreement adopted at the 2015 UN Climate Change Conference (COP21)[1]. As a regulation, the EU CBAM is directly binding on all EU member states without the need for legislation at the national level. The UK government is in the process of finalising its own CBAM after public consultations carried out this year.

The UK CBAM will complement the UK's own emissions trading scheme (UK ETS) and is expected to be substantially comparable to the EU's, which is good news for overseas companies which have already invested time and expense in ensuring compliance with the EU CBAM. Directors of all overseas companies, particularly those in carbon-intensive sectors, should carefully evaluate the anticipated operational and financial implications of the EU and UK CBAMs on their businesses.

Both mechanisms target designated goods (and derived goods) from some of the most emissions-intensive industrial sectors such as cement, fertilisers, aluminium, iron, steel and hydrogen, whereas the EU CBAM also covers electricity and the UK's glass and ceramics. In both cases, additional sectors are expected to be added over time to cover a wider spectrum of high carbon embedded goods in line with their domestic ETS which already cover more products (the EU CBAM aims to mirror the scope of its ETS by 2030).

The EU and UK CBAM differ in the manner in which the price adjustment is 'paid'. Liability under the EU CBAM is satisfied by importers purchasing the relevant amount of carbon allowance certificates[2]. The UK CBAM on the contrary will work as a tax paid to HMRC[3] at the point of entry.

The EU CBAM will come fully[4] into force on 1 January 2026, and the UK CBAM is expected to come into force a year later, on 1 January 2027. The first reporting period for the EU CBAM will be the year ending 31 December 2026[5] with reporting (i.e. the amount of emissions embedded in the imported goods for the period) and 'payment' (i.e. the surrender of certificates[6]) due by 31 May 2027, and annually thereafter by 31 May in respect of the preceding calendar year. The first reporting period for the UK CBAM is expected to be the year ending 31 December 2027 with reporting and payment (to HMRC) due 30 May 2028, with quarterly reporting thereafter and payment within a month[7].

Both EU and UK CBAM are based on the valuation of the embedded carbon emissions of the relevant imported goods and take into account any (local) carbon price already paid. For most goods (except electricity), embedded emissions include both direct emissions released, and indirect emissions from electricity consumed during the production process of the goods and upstream products, and the CBAM will use default values in the absence of verified valuation of actual embedded emissions provided to them. It is therefore recommended that companies anticipate their reporting obligations and audit the embedded emissions of their products, with their suppliers where relevant.

In essence, CBAM liability is intended to be based on the difference between the effective EU/UK domestic carbon price and the effective overseas carbon price. Taking into account the effective carbon price domestically and overseas seeks to ensure that any adjustments or exemptions (domestically) or carbon pricing schemes through tax or otherwise (in third countries) are accounted for. Carbon price used in the EU/UK CBAM is essentially the price of the allowances under the relevant ETS adjusted to reflect any free

allocation of allowances. For overseas products, evaluating and verifying the 'credit' which should be allocated by reason of local tax or emissions trading systems may be a challenge, and is likely to incentivize export countries to conclude sectoral agreements with the EU/UK (as well as between the EU and the UK of course).

Overseas companies should explore opportunities for emission reduction to maintain competitiveness in the EU and UK markets and consider proactive investment in sustainable technologies and optimize supply chains to reduce emissions.

The unilateral introduction of CBAM in the EU and the UK has elicited varied responses from overseas nations, where its implications are anticipated to be substantial, particularly among economies reliant on exports of carbon-intensive goods; and moreover as the scope of products caught under the mechanisms is expected to grow. The regulatory requirements of CBAM raise a number of concerns with respect to economic competitiveness, equity (balancing trade, socio-economic and environmental goals) and compliance capacity. They also raise concerns of 'environmental measures as protectionist non-tariff measures' and infringement of the rules of the World Trade Organization, which are beyond the scope of this article.

If you would like to discuss how the EU and UK CBAM might apply to your business, please contact Pierre Brochet.

-
1. COP29 opens this week in Baku, Azerbaijan.
 2. One certificate per tonne of CO2 equivalent of embedded emissions, priced at the average EU ETS allowance auction price during the reference period and purchased from a central platform established by the EU Commission.
 3. His Majesty's Revenue and Customs department.
 4. The EU CBAM came into force on 1 October 2023 for an initial transitional phase to 31 December 2025 where importers are only required to report embedded emissions of relevant imported goods for information purposes.
 5. Importers must register with the relevant member state authorities as authorised CBAM declarants and will be included in a central EU-wide registry.
 6. Certificates cannot be traded; surplus certificates can be repurchased or credited to future reporting periods subject to conditions.
 7. Except for the 30 May 2028 payment deadline postponed to 30 June 2028.

Written by:



Pierre Brochet

Foreign Qualified Lawyer
pierre.brochet@azmilaw.com

Corporate Communications

Azmi & Associates

12 November 2024

This article does not constitute legal advice. Comprehensive advice must be obtained before taking any action or withholding any action purported to be described in this article.