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Emissions Reporting under the EU CBAM: The Proposed Implementing Regulation

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1 Introduction

The implementing regulation aims at providing a balance between flexibility, which makes sense for climate diplomacy and in a period of transition, with the inherent risk of weakening the quality of collected data informing the review in 2026 and further implementing decisions, including on indirect emissions. In our view, the benefits of flexibility in the transition period are worth the risks, if the commission is cautious about ensuring the robustness of information collected and the impact it can have on decisions in the upcoming implementing and delegated acts.

With the European Union (EU) Carbon Border Adjustment Mechanism (CBAM) Regulation officially in force since 17 May 2023,[1] a number of delegated and implementing acts are being elaborated that will determine key details of the CBAM. In preparation for the CBAM entering its transitional period in October 2023, the first implementing act has been released in draft form and made available for review.[2] The act lays out the rules on monitoring and reporting emissions under the CBAM during the transitional period, marking an important step in the operationalization of the CBAM. This paper focuses on the draft Implementing Regulation and how the rules it lays out could affect stakeholders both during and after the transitional period.

Building on previous work conducted ahead of the adoption of the CBAM Regulation with Phases I (2019-2020), II (2020- 2021) and III (2021-2022) of its project "Border Carbon Adjustments in the EU", the European Roundtable on Climate Change and Sustainable Transition (ERCST) has extended its analysis of the evolving CBAM into a fourth phase, providing decision makers and stakeholders with a better understanding of critical issues as the CBAM proceeds from adoption to implementation.

Phase IV of the ERCST project is intended to provide in-depth analysis of the implementation phase of the CBAM as it progresses to its full operationalization. The present report is the second in a series of four reports that together form the fourth phase of the "Carbon Border Adjustment in the EU" project. Each of the reports provides analysis and reflection around issues identified as important at this stage in CBAM implementation. The initial report covered the role of the CBAM in a portfolio of measures for industrial decarbonization. This report looks at the draft Implementing Regulation for emissions reporting during the transitional period including methods for calculating emissions. Future reports will address methods to credit foreign carbon pricing under the CBAM, and issues faced in the transatlantic negotiations on cooperation in the area of sustainable steel and aluminium.

[1] Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism, OJ L 130/52 (16 May 2023), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R0956>.

[2] Draft Commission Implementing Regulation laying down the rules for the application of Regulation (EU) 2023/956 of the European Parliament and of the Council as regards reporting obligations for the purposes of the carbon border adjustment mechanism during the transitional period, <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13873-The-reporting-obligations-during-the-transitional-period-of-the-carbon-border-adjustment-mechanism_en>.

The report is structured in four sections: first this introduction; then follows a second part providing an overview of the rules; the third part provides an initial analysis of the strengths and weaknesses of the draft Implementing Regulation; and the last section offers conclusions and discusses the way forward.

2 Overview of the Draft Implementing Regulation

The draft Implementing Regulation sets out the reporting obligations for importers under the CBAM during the transitional period. It is the first draft of an implementing act released following the adoption of CBAM, and is arguably the most urgent given the onset of reporting obligations with the beginning of the transitional period in October 2023. That said, it is currently a draft that is pending consultation and approval, so that the description of its content and requirements provided below are still subject to change.

2.1 Process of Implementing Acts

Implementing acts are typically adopted by the European Commission under the control of comitology committees consisting of Member States' representatives. There are two types of committee procedures: advisory and examination. This Implementing Regulation will be decided under the examination procedure, where the committee needs a qualified majority in favour of the proposed act to adopt it. If a qualified majority votes against it, it may not be adopted, and if there is no qualified majority for either approval or rejection, the Commission may adopt the act, or submit an amended version.

The comitology committees are set up by the Council and the European Parliament or the Council alone. They include one representative from each Member State and are chaired by the Commission. There is a CBAM committee which had its first meeting on June 20.

While the following description of the draft Implementing Regulation on reporting obligations in CBAM provides an overview, it is important to note that this information is subject to change and is not meant to substitute for future training materials and detailed guidance that will be provided by the European Commission to support businesses as they prepare for the beginning of emissions reporting during the transitional period.

2.2 Scope

The draft Implementing Regulation applies to goods imported into the customs territory of the European Union during the transitional period of the CBAM from 1 October 2023 to 31 December 2025, and lays down rules for emissions reporting. During the transitional period, importers must report on a quarterly basis the quantity, location, production route and direct emissions for embedded emissions of imported goods. For indirect emissions, the reporting declarant must additionally report electricity consumption and the amount of specific direct emissions. During the transitional period, reporting declarants will use default values defined by the Commission that reflect average the emissions intensity in the country of origin's electricity grid.

Importantly, during the transitional period, the importers of goods covered by the CBAM have to report emissions, but do not face any financial obligations. Data and insights from the transitional period will be used by the Commission to determine the rules and methods for reporting in the subsequent definitive period starting on 1 January 2026, when importers have to surrender certificates for reported emissions and thus begin facing a financial obligation comparable to that faced by domestic producers under the EU Emissions Trading System (EU ETS).

2.3 Methods for Calculating Emissions

The draft Implementing Regulation provides initial flexibility regarding the calculation of embedded emissions. During the transitional period, it allows for different approaches (see also Figure 1 below):

a) Throughout the transitional period, the draft Implementing Regulation allows two calculation methods: either based on calculation methods drawing on activity data and emission factors, or based on continuous measurement of greenhouse gas emissions in flue gases.

b) Until the end of 2024, the draft Implementing Regulation allows application of methods used under a local carbon pricing system or under existing emissions monitoring and reporting systems that are either compulsory or involve verification by an accredited verifier.

c) Until 31 July 2024, the draft Implementing Regulation allows the use of any other methods if information needed for the standard methods is unavailable or insufficient.

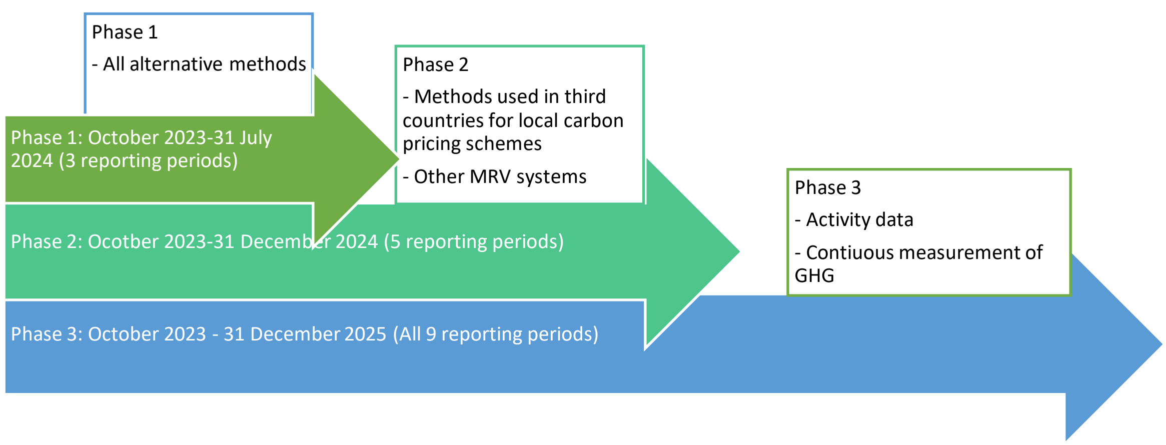

Figure 1: Compliance options during transitional period

Although the EU aims to align the reporting rules of the CBAM with those applied under the EU ETS, it also provides initial flexibility during the transitional period. However, translating the established facility-level framework of the EU ETS into a product-based reporting system as required by the CBAM is complex. Producers of CBAM-covered goods around the world that wish to continue exporting into the EU market will have to introduce or adapt existing reporting mechanisms to comply with the new requirements put in place by the EU.

Default values can be used for input materials or subprocesses contributing less than 20% of the total emissions for complex goods. There is also a possibility to use an aggregated goods category, or the “bubble approach”. This allows reporters to lump together several CBAM-covered production processes that lead to the production of a CBAM-covered good (for example, from an integrated steel mill), and report the total emissions for the whole process rather than report separately the emissions of each process.

Furthermore, the draft Implementing Regulation mandates reporting on carbon prices paid in the country of origin, covering aspects such as the form of the carbon price, any rebates or compensations available, and the type and quantity of embedded emissions covered by the carbon price.

2.4 Reporting and Modification

Reporting has to occur on a quarterly basis from 1 October 2023 until 31 December 2025, and should be submitted no later than one month after the end of the quarter. There is some flexibility during the transitional period to allow reporters to learn how to report. These flexibilities include the following:

- Modifications or corrections can be made within two months of the end of the relevant reporting quarter;
- The first two CBAM reports may be modified until the submission deadline for the third CBAM report, 31 July 2024;
- If a CBAM report is incorrect or incomplete, modifications or corrections can be made within one month after the approval of the request by the competent authority or the European Commission, and upon request by the reporting declarant.

The penalties if the reporter has not taken the necessary steps to submit the report or correct the report to comply with the regulation are 10 to 50 EUR per tonne of unreported emissions. That penalty amount compares to the penalty applied under the EU ETS of 100 EUR per tonne, plus surrender of allowances to cover any prior shortfall.

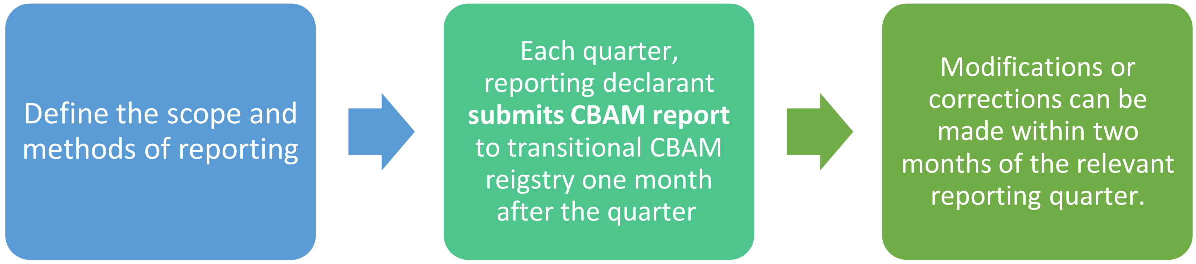

Figure 2: Emissions monitoring obligations during the transitional period

From 1 January 2026, different monitoring and requirements will apply, which will additionally entail verification by an independent accredited verifier. Details for this process and the relevant methods will be set out in an updated or new Implementing Regulation on emissions reporting. The timeline of emissions reporting during the definitive period will follow an annual rather than a quarterly cycle, as shown in Figure 3 below.

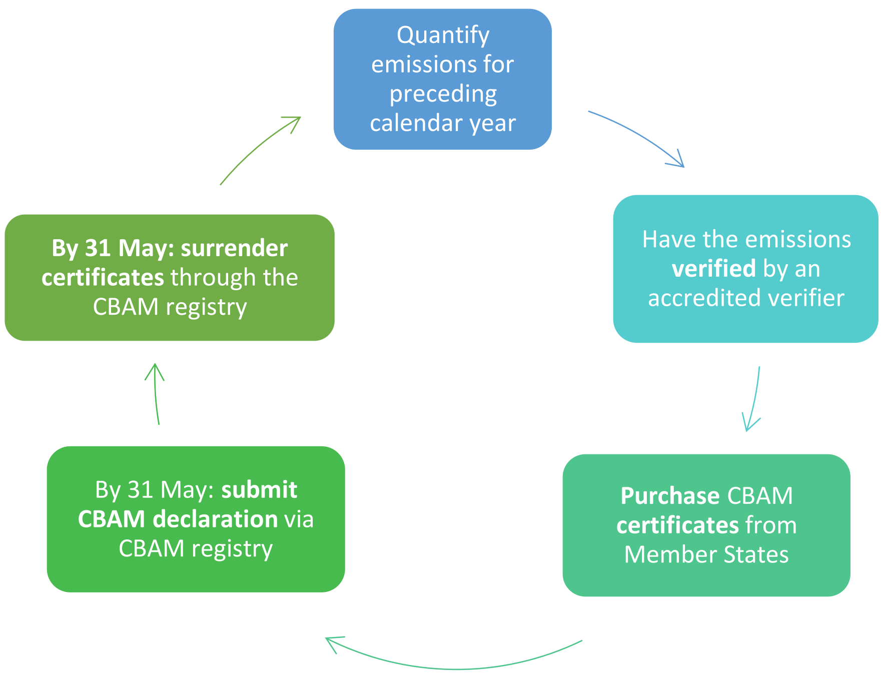

Figure 3: Compliance cycle during definitive period

2.5 Reports and Assessments

During the transitional period, the Commission is mandated with conducting several reviews and assessments. Before the end of the transitional period, a comprehensive report must be submitted, evaluating the implementation of the CBAM Regulation. This report should consider the potential extension of the CBAM's scope to include emissions from transport of CBAM goods and transportation services, as well as goods not yet listed but at risk of carbon leakage, and the possibility of extending the scope to cover indirect emissions from additional sectors. The governance system of the CBAM and progress in international climate discussions also need to be assessed.

Additionally, a separate report, presented at least one year before the transitional period ends, should propose products further down the value chain for potential inclusion in the regulation's scope. These reports must be accompanied by legislative proposals if necessary. Subsequently, the Commission is required to assess every two years the effectiveness of the CBAM Regulation in addressing carbon leakage risks for EU-produced goods exported to countries without an equivalent pricing mechanism. Furthermore, before 1 January 2028, and every two years thereafter, the Commission must provide a report on the application and functioning of the CBAM. In exceptional circumstances with destructive consequences on the economic and industrial infrastructure of CBAM countries, the Commission must produce a report and potentially propose provisional measures to address such situations.

3 Analysis of the Draft Implementing Regulation

The draft Implementing Regulation has a number of welcome elements in terms of its substance and approach, and also some elements that warrant caution or concern. Here we briefly summarize the most noteworthy of these.

3.1 Strengths of the Draft Implementing Regulation

3.1.1 Mirroring the ETS

In its accounting for emissions by foreign producers, the draft regulation does an excellent job of cleaving closely to the approach used under the EU ETS:

- It provides a clear mapping of the CN codes used for EU ETS reporting to the covered goods;
- its specifications of system boundaries for direct emissions are in line with EU ETS rules under the Monitoring and Reporting Regulation, the only exception being the treatment of scrap
- it uses the same conversion factors and equations for calculating the emissions from fuel combustion; and so on.

This is desirable most significantly for legal and political reasons. Legally, the CBAM is a legislative act that attempts to mirror the domestic requirements of the EU ETS for imported goods, and any extra requirements imposed on imported goods will risk violating the non-discrimination obligations set out in World Trade Organization (WTO) law, notably the General Agreement on Tariffs and Trade (GATT). In the same vein, any perceived inequity in treatment for foreign producers will be seen by trading partners as a sign that the CBAM is more about protecting domestic producers than it is about protecting the environment, and may give rise to push-back.

As discussed below, however, there is a tension between precise mirroring of the ETS and the goal of the CBAM in preventing leakage. For example, unlike the CBAM, the ETS does not require allowances to be purchased to cover indirect emissions or the embodied emissions in precursors. Domestic producers nonetheless do pay for at least some of those emissions – the exact amount depends on how much costs are passed through – when they purchase electricity or input goods that have already been assessed a carbon cost under the ETS. It is an open question whether that arrangement qualifies as equal treatment under trade law – it would depend on how one defined the boundaries of the measures being compared.

3.1.2 Pragmatic Flexibility

The draft Implementing Regulation only sets out the reporting obligations for the CBAM transitional period, and during that period it lays out a flexible approach to compliance. Declarants that are subject to existing reporting requirements in their home countries can, for example, use a wide variety of methods to calculate and report their embedded direct emissions up until the end of 2024, and any declarants can choose to use either a calculation method or a measurement method of accounting (see Section 2.3 above and Article 4 of the draft Implementing Regulation). If the declarant does not have the requisite data, until 31 July 2024 they can even use unspecified "other methods" (respecting the monitoring principles spelled out in Annex III A.3) to determine direct emissions embedded in imports. For the first two quarters of reporting, declarants are granted an extended period of time – right up until the third reporting period – to modify or correct their CBAM reports as submitted.

These sorts of flexibilities are welcome. Foreign producers will have very little time between the release of the final regulation and the onset of reporting obligations in October 2023, and even those that have existing reporting obligations in their home countries will have difficulties adjusting their accounting regimes to comply with CBAM requirements. Those with no existing regimes for carbon accounting will struggle. A flexible approach is an acknowledgement of those difficulties, and reflects a desire not to unduly impair the ability of existing imports to contest EU markets.

3.1.3 A Learning Approach

As appropriate for a transitional period, the CBAM requirements during that period are geared toward allowing the EU to better understand how the regime will work in practice, with a view to helping inform the crafting of the final requirements to be imposed in the definitive period starting in 2026. As the draft Implementing Regulation itself states: "The assessment of data collected will in particular inform the Commission work in view of adjusting the applicable reporting rules and finalising the applicable methodologies after the transitional period in further implementing acts" (Recital 5 of the draft Implementing Regulation).

Requirements for reporting of embedded indirect emissions, for example, are kept flexible explicitly in order to provide data that will allow the Commission to eventually choose among the three possible options for defaults it has described in the CBAM legislation: the emission factor of the EU electricity grid, the emission factor of the country of origin electricity grid, or the emission factor of price-setting sources in the country of origin.

3.2 Areas of Concern in the Draft Implementing Regulation

3.2.1 Flexibilities

The flexibilities described above are welcome and pragmatic given the timelines, but they must strike a fine balance. If they are too permissive, they will lead to widespread reporting of poor or inexact data, which will defeat one of the key objectives of the transitional period: having accurate data in order to inform the crafting of final obligations to be imposed during the definitive period.

For example, widespread use of default values for reporting and the acceptance of a variety of different reporting protocols may result in under-reporting of actual emissions, and in turn amount to underestimating the risk of leakage. Risk of leakage is one of the guiding criteria to be used in the setting of important parameters, such as for example the mark-up added to default values for direct emissions reporting (Article 4.1 of the CBAM Regulation). Moreover, data from the transitional period will be used in the assessment of impacts by 2026 that will inform other important design choices, such as whether to include coverage for indirect emissions in sectors such as aluminum and steel (per Article 30.2(a)(i) of the CBAM Regulation).

3.2.2 Verification in the Transitional Period

During the transitional period, emission reports submitted by declarants do not have to be verified by an independent accredited verifier, as will be the case during the definitive period starting in 2026. Instead, during the transitional period, the Commission “may check CBAM reports to assess compliance” (Article 11.1 of the draft Implementing Regulation). It is hard to assess what this will mean in practice; such checks may be relatively infrequent, or may be regular occurrences. The more infrequent they are, the more risk there is that the data garnered in the transition period will be insufficiently robust as a basis for the decisions they are supposed to inform, as described above.

3.2.3 The Bubble Approach

The draft Implementing Regulation allows for aggregated reporting of emissions from integrated facilities where a number of covered production processes take place – a so-called bubble approach (draft regulation Annex II, 2.1). An integrated steel mill, for example, may comprise several different steps, or production processes, in the value chain that transforms iron ore into finished steel, and such a facility is allowed to report the embedded emissions of just the final good, as opposed to separately reporting the emissions from each separate production process.

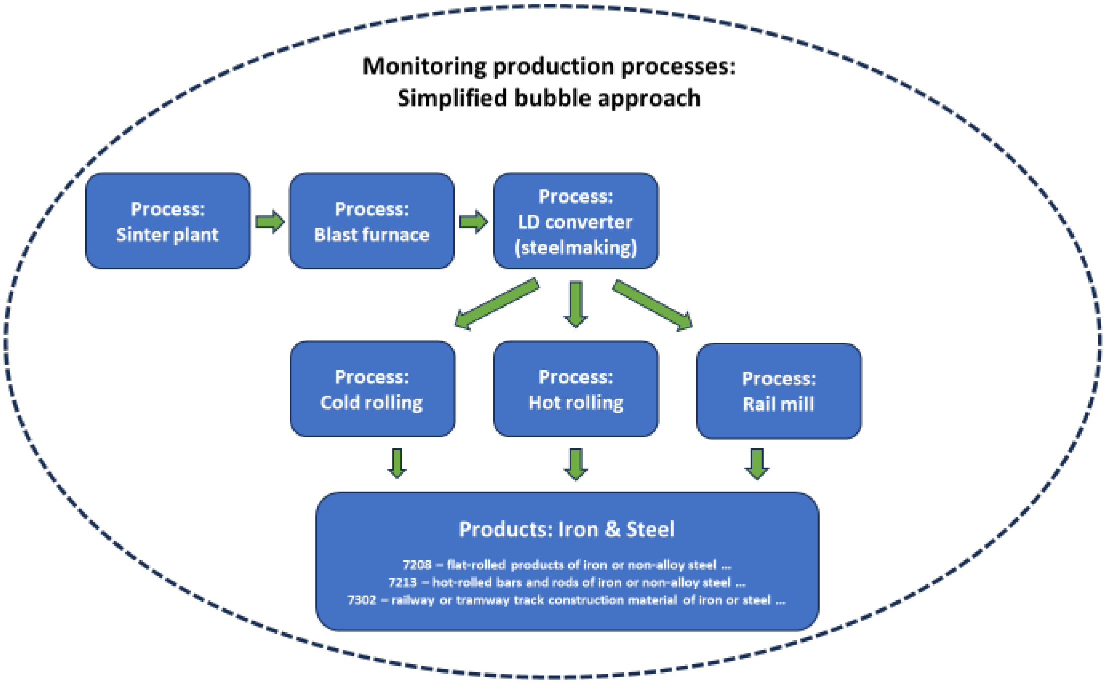

Figure 4: The Bubble Approach applied to steelmaking – an illustration

This is a welcome accommodation of the realities of integrated production, but it also gives rise to a caution: the use of facilities-wide average emissions data in such facilities will degrade the quality of the data the Commission receives during the transitional period for those specific production processes.

3.2.4 The Need for Capacity

An effective regime of verification, both in the transitional period and in the definitive period that follows, will require significant resources to build up requisite capacity in the Commission and the Member States. This may in fact be the intent, but it is worth raising this concern given the critical importance of ensuring compliance with the CBAM's obligations if its objectives are to be achieved. An indication of the level of effort needed can be gleaned from the resources currently devoted to the more straightforward challenge of ensuring compliance with the ETS.

3.2.5 Exemption for scrap inputs

Waste and scrap products, for example those yielded during the production of iron and steel or aluminum (pre-consumer scrap), are assigned a zero value for embedded emissions, even if they are returned into the production processes (Annex III, F.2 of the draft Implementing Regulation). But it is technically impossible to know by inspecting steel or aluminium at the border how much scrap of this type was used in the manufacturing process.

The draft regulation limits the exemption to material that is not sold, but it seems to nonetheless include scrap that can be transferred (i.e. sold) from one installation to another. If this broader interpretation of the exemption is accurate, then it represents a significant opportunity for circumvention by foreign secondary producers of steel and aluminium.

The scrap market is significant; more than 25% of all primary aluminium will become industrial process scrap at some point before remelted and turned into products. If all inputs of scrap are assumed to have zero embedded emissions, importers will likely skew their purchases to producers that report high use of such inputs, and there will be incentives for those producers to game the system to report high scrap inputs. The result would be aluminum and steel imports to the EU that may have paid no carbon price, but which pay very low CBAM charges. Given that the majority of emissions in the steel and aluminium value chains are upstream in primary production, this could be a significant advantage for such producers over their EU counterparts, and a high risk of leakage. Scrap produced within an EU installation or purchased from an EU installation will already have paid for its embodied emissions under the ETS.

It is true that producing steel and aluminium from scrap creates much lower emissions than primary production. Within the EU, however, the primary production that leads to that scrap –whether post-consumer or pre-consumer–will have already been assigned a carbon price. That is not necessarily the case for foreign primary production, meaning an exemption for scrap is inconsistent with the principle of leveling the playing field. It should be noted the same inconsistency exists in the coverage of the CBAM, which does not include scrap aluminium or iron and steel.

4 Concluding Thoughts and Next Steps

As our preceding analysis underscores, the draft Implementing Regulation extends the pragmatic and generally measured approach already pursued with the design of the CBAM in the parent Regulation (EU) 2023/956. It proposes a phased approach and affords reporting declarants a number of flexibilities, especially in the first full year, to reduce the compliance burden and buy time for all affected parties – declarants, third country operators, Member State authorities and the Commission itself – to develop fluency with the rules, processes and institutions of CBAM-related emissions reporting.

Such accommodation can go a long way to dampen the intensity of diplomatic – and potentially even legal – opposition from trade partners struggling to build the necessary capabilities and support structures for their domestic producers to successfully comply. In a world in which successfully addressing climate change and meeting committed temperature stabilization targets still depends on global cooperation, such aspects matter.

Also clearly evident is the commendable objective of using the transitional period to collect data and experience in order to optimize the CBAM and its regulatory framework. Key components of the future CBAM regime, such as the default values that will be applied once payment obligations phase in from 2026, will be elaborated on the basis of data collected and preparatory work conducted during the transitional period.

As the hurried process since the CBAM was initially announced has shown, the transitional period will go by fast, and with it the opportunity for learning and optimization before the financial compliance obligations kick in. It is, in other words, a critically important phase, and needs to be utilized to the fullest. Given the already crowded docket and strained resources of the European Commission as it implements all elements of the 'Fit for 55' package, in addition to the announced increase in outreach efforts to third countries on the CBAM and the potential disruptions to day-to-day operations as the EU progresses through elections and a new political cycle, with possible changes in political direction and leadership, this may prove challenging.

Like its parent legislation, the draft Implementing Regulation also has to balance some competing objectives and stakeholder interests. Domestic producers relying on the CBAM to address the risk of emissions leakage and competitive distortions from the ambitious pace of industrial decarbonization under the European Green Deal understandably expect foreign covered goods to bear the same compliance burden their own domestically produced goods face, and that not only includes the carbon price itself, but also the administrative cost of complying with technically complex emissions accounting provisions.

While the aforementioned flexibilities are justified to buy time for declarants and foreign producers to prepare and avoid unnecessary hardship, as the previous section also cautioned it would not level the competitive playing field if foreign goods benefitted from excessive or open-ended concessions, nor would it advance the objective of ensuring a robust information base for the further operationalization of the CBAM. Such concessions and flexibilities have to eventually end if the CBAM is to meet its objective, and the real question therefore is how to strike the right balance between the degree of accommodation for importers and foreign producers, and the comparability to the domestic burden imposed on domestic producers under the EU ETS.

There is reason to assume that this balance, as currently struck in the draft Implementing Regulation, will not unduly favor foreign producers. The minimum penalty level for unreported emissions in imported goods – a non-trivial 10 EUR per ton – already indicates that, for all the willingness to afford initial flexibility, the EU is serious about robust implementation and ensuring it will collect the necessary data to fully operationalize the CBAM before the end of the transitional period.

Various elements of the proposed Implementing Regulation also highlight the complexities raised by product-level emissions reporting, which in some ways exceed those faced by domestic producers only required to carry out facility-level reporting. The need to apply inherently ambiguous facility boundaries and consider upstream emissions embedded in relevant precursors adds a layer of information requirements for reporting declarants that is not easy to meet, not least since the declarants themselves will typically not have that information themselves and have to rely on producers for its provision.

Similarly, once indirect emissions reporting expands to all products covered by the CBAM, so will the associated challenges. As noted above, EU producers are not directly subject to such charges and reporting requirements on input goods and electricity, although they do pay indirectly for the carbon costs of inputs that have been assessed a carbon price under the EU ETS.

Perhaps the greatest burden potentially facing foreign producers under the proposed Implementing Regulation is the possibility that they will face reporting obligations under multiple emissions accounting standards. The structure and substantive approach reflected in the draft Implementing Regulation clearly builds on the compliance cycle set out in the Monitoring and Reporting Regulation under the EU ETS,[3] and while fundamental principles and calculation methods tend to be similar across emissions accounting standards, this link to the EU ETS also results in important particularities.

Where foreign producers already are required to report emissions under domestic monitoring, reporting and verification systems, they will – at least beyond 2024 and the initial flexibility afforded under the draft Implementing Regulation – potentially have to apply various accounting procedures and methodologies in parallel, increasing their administrative burden. The same applies where producers have voluntarily introduced an emissions accounting system under international standards such as ISO 14064 Part 1 for facility-level reporting, or ISO 14067 on the carbon footprint of products. In the same vein, foreign producers may fear the need to report under yet another set of distinct accounting and reporting regimes adopted by other countries that follow the EU's lead in introducing some form of border carbon adjustment, such as Canada, the United Kingdom or the United States.

That may also mark one of the only missed opportunities in the draft Implementing Regulation or the parent CBAM Regulation: any provision that would provide direction and open the door to cooperation with other national or international actors to develop an international standard that addresses the risk of a proliferation of similar, but still distinct standards, resulting in a global patchwork of varying calculation methodologies, reporting procedures, timelines and formats, and accreditation and verification structures.

From the perspective of foreign companies already challenged by the need to implement their own rapidly evolving domestic climate policies, every additional foreign standard for which unique capacities, responsibilities and workflows have to be introduced marks a burden, and any opportunity to harmonize and streamline the growing body of relevant rules and procedures must appear an important cause that has not been advanced with the regulatory framework of the CBAM so far.

As the European Commission proceeds to engage in outreach and capacity building efforts, defines the verification process in a separate implementing act, and advances its work on the remaining implementing and delegated acts, this important goal should not be forgotten amidst the incredibly tight timeline faced to operationalize the CBAM by October.

Likewise, existing platforms for bi- or multilateral negotiation – such as the Global Arrangement on Sustainable Steel and Aluminium, the G7 Climate Club, or the sustainable development elements of Free Trade Agreements – should be used to prioritize the definition of common minimum standards and best practices before other jurisdictions such as the U.S. introduce their own, and almost certainly again

[3] Commission Implementing Regulation (EU) 2018/2066 of 19 December 2018 on the monitoring and reporting of greenhouse gas emissions pursuant to Directive 2003/87/EC of the European Parliament and of the Council and amending Commission Regulation (EU) No 601/2012, OJ L334/1 (31 December 2018), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02018R2066-20220101>.

distinct, emissions reporting obligations – and before it ultimately becomes too late to avoid an increasingly complex and costly patchwork of national or regional standards.

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