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#### NOTE

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From:	Presidency
To:	Permanent Representatives Committee (Part 2)
Subject:	Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism - Preparation for the trilogue

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#### I. STATE OF PLAY

1. The Commission proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism<sup>1</sup> (CBAM) was published on 14 July 2021 as part of the ‘Fit for 55’ package.
2. The principal objective of the Commission proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism<sup>2</sup> CBAM (as an environmental measure) is to address the risk of carbon leakage, caused by asymmetrical climate policies of non-EU countries (where policies applied to fight climate change are less ambitious than those of the EU). The application of CBAM would prevent that the emissions reduction efforts of the Union are offset by increasing emissions outside

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<sup>1</sup> Doc. ST 10871/21 + ADD 1 to 6; (2021/0214 (COD)).

<sup>2</sup> Doc. ST 10871/21 + ADD1-ADD6; (2021/0214 (COD)).

the Union through relocation of production to non-EU countries or increased imports of carbon-intensive products. Without such a carbon border adjustment mechanism, carbon leakage is likely to result in an overall increase in global emissions.

3. The Commission proposes that CBAM initially covers a number of specific products in some of the most carbon-intensive sectors: iron and steel, cement, fertilisers, aluminium and electricity.
4. CBAM would function in parallel with the EU's Emissions Trading System ("EU ETS"), to mirror and complement its functioning on imported goods. It will gradually replace the existing EU mechanisms to address the risk of carbon leakage, in particular the free allocation of EU ETS allowances.
5. Ensuring full compatibility of the CBAM with international obligations of the EU, including in the area of international trade, remains of fundamental importance.
6. On 15 March 2022, the Council of the EU reached agreement on a general approach on the draft CBAM Regulation (doc. ST 7226/22). The Council also took note of the Annex to doc. ST 6978/22, which contains a list of issues that are of significance to the implementation of the CBAM.
7. On 22 June 2022, the European Parliament (EP) adopted a number of amendments to the CBAM legislative proposal by the European Commission, which constitute the position of the EP in the negotiations with the Council on this file.<sup>3</sup>
8. On 13 July 2022 the Committee of the Permanent Representatives (Part 2) took note that work in the Council on the matters outside of CBAM Regulation but important to its functioning (Annex to doc. ST 6978/22) has progressed to a sufficient degree, which enabled the Presidency to begin negotiations with the European Parliament on the CBAM Regulation.

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<sup>3</sup> [https://www.europarl.europa.eu/doceo/document/TA-9-2022-0248\\_EN.html](https://www.europarl.europa.eu/doceo/document/TA-9-2022-0248_EN.html)

9. The negotiations between the co-legislators are now ongoing. While good progress has been made, technical work on the legislative text continues. The Presidency expects to conduct further rounds of technical negotiations on the CBAM Regulation, where it will further clarify the positions of co-legislators. None of the constitutive parts of the CBAM Regulation can be considered as finally agreed until an overall accord on the text is reached.
10. Necessary preparatory work for the interinstitutional negotiations is carried out at the meetings of the Ad Hoc Working Party on CBAM (AHWP CBAM). The political objective of reaching an agreement on CBAM by the end of this year is maintained. However, if this objective is to be achieved, substantive progress in these negotiations is required within the next days or weeks on a number of key issues (set out in Part II of this note).

## **II. KEY ISSUES**

### **II.A. GOVERNANCE OF THE CBAM**

#### ***a) Governance structure of the CBAM***

11. The Commission has initially proposed a decentralised model of CBAM, where most of the CBAM-related tasks are carried out at the national level. The Council in its general approach opted for centralising a number of those tasks, leaving at the Member State level, in particular: the authorisation of CBAM declarants, buying (re-purchase) and selling of CBAM certificates, oversight and review of CBAM declarations and emission reports, on-site inspections, application of penalties, customs controls, litigation and recovery as well as financial responsibility oversight. The EP has favoured even broader centralisation, seeking among other to strengthen the role of the EU level and avoid alleged forum shopping or unequal treatment across the EU.

12. The main objective of the interinstitutional negotiations is to establish an effective, practical and resource efficient CBAM, which would not result in excessive administrative burden to businesses or public authorities. Therefore, it has become clear that full centralisation of all CBAM tasks at EU level is not possible at this stage. This means that it is necessary to find an appropriate balance between the tasks allocated to national authorities and tasks that will have to be carried out centrally (at the level of the EU).
13. While the European Commission continues to support its proposal for a decentralised CBAM model, it has issued a non-paper (doc. ST 13508/22), outlining a task allocation with further elements of centralisation, in addition to those in the Council general approach. This option suggests, in particular, to:
- i) centralise oversight and review of CBAM declarations and emission reports, as well as of assessment of unsubmitted CBAM certificates;
  - ii) handle buying (re-purchase) and selling of CBAM certificates through a central platform (set up under a joint procurement agreement), with clear delineation of roles of the Member States and the Commission, as regards oversight of that platform and calculation of price of CBAM certificates;
  - iii) submit under shared Member State/Commission responsibility (also with clear delineation of roles) the tasks concerning the authorisation of CBAM declarants, penalties, litigation and recovery as well as financial responsibility oversight.
14. The discussions at the AHWP CBAM have shown that the non-paper by the Commission is a good basis for further work. Nevertheless, it is necessary to find an appropriate balance and resolve the concerns of Member States which prefer to maintain competence in the areas of oversight and review of CBAM declarations and emission reports, on-site inspections, application of penalties, customs controls, litigation and recovery as well as financial responsibility oversight.

15. Under current circumstances, also due to the costs linked to such a solution, it does not seem necessary to establish a new EU-level CBAM authority with legal personality, and administrative or financial autonomy. Given that the transitional period of CBAM will last a few years and consist of reporting obligations only (the “dry-run”), it seems feasible and attainable that a number of centralised CBAM tasks could be efficiently carried out by the European Commission, which could also handle any necessary administrative adjustments within its current structure as a basis. To be noted that the governance structure of CBAM should be subject to a review once the CBAM Regulation is operational.

***b) Financing of the governance structure of the CBAM***

16. Negotiations on the CBAM Regulation are likely to lead to a more centralised governance model than the one proposed by the Commission, as Member States prefer centralising a number of CBAM tasks instead of carrying them out at a national level. This will require additional administrative expenses (for the IT system and staff) at the EU level.
17. In its non-paper on more or less centralised variants of CBAM governance (doc. 13508/22) the Commission informally indicates, among other points:
- i) CBAM costs under Council governance model, as well as the EP governance proposal, would range between 28-35 million EUR/year during the transitional period;
  - ii) during the definitive CBAM period, costs under the Council governance proposal would range between 30-35 million EUR/year, and that of the EP between 35-40 million EUR/year;
  - iii) from 2026, CBAM model set out in the Council general approach will require total staff of 101, and the model designed by the European Parliament – 139.

18. While the issue of financing CBAM is of key importance, it is to be noted, that the political decision on the need to establish CBAM as such has been taken already, as also noted by the European Council in its conclusions of 10-11 December 2020<sup>4</sup> and its conclusions of 17-21 July 2020<sup>5</sup>. This means that, as the first priority, the efforts in the interinstitutional negotiations on CBAM should now focus on designing a functioning CBAM. Work in this area is also the principal task in the mandate of the AHWP CBAM. Once the design of CBAM governance is clarified in the interinstitutional negotiations, the additional financial need of the European Commission has to be acknowledged accordingly, pending the necessary specifications and without prejudice to discussions on budgetary aspects by the competent Council preparatory bodies, as appropriate.

## **II.B. SCOPE OF CBAM**

*a) List of products within the scope (Article 2, Annex I); inclusion of downstream products; extension of CBAM scope to all EU ETS sectors*

19. The Commission proposes that CBAM initially covers a list of specific products in some of the most carbon-intensive sectors: iron and steel, cement, fertilisers, aluminium and electricity. The Council in its general approach has maintained the scope set out in the Commission proposal and added a number of goods (CN codes) to the Annex I of the draft CBAM Regulation, essentially to prevent possible avoidance of CBAM through imports of products that could easily replace in-scope products.

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<sup>4</sup> See doc. EUCO 22/20, points 14 and 17.

<sup>5</sup> See doc. EUCO 10/20, point A29.

20. The EP suggests that:
- i) from the beginning of the application of the CBAM Regulation its scope includes a number of chemicals (hydrogen in particular) and polymers (plastics and articles thereof);
  - ii) by 1 January 2030 the CBAM Regulation applies to all sectors covered by the EU ETS Directive (Directive 2003/87/EC);
  - iii) in three years after the entry into force of the CBAM Regulation its scope is extended to downstream products (products, which are made of products in Annex I).
  - iv) the timeline of inclusion of all EU ETS sectors into CBAM and any extension of the scope to downstream products has to be defined by way of a delegated act by the Commission.
21. Neither of the co-legislators question the policy objectives underlying CBAM. However, the extension of scope to the range of sectors in the way suggested by the EP, and the suggested use of delegated acts, does not seem to be a viable option due to several reasons. There is a number of technical and practical limitations (such as lack of clear or available methodology, impossibility to exercise compliance control, disproportionate administrative costs). Moreover, such a broad extension, as well as the method thereof proposed by the EP, raise a number of concerns, such as the lack of clarity of impact of such an extension, WTO compatibility (also regarding products not produced in the EU) or legal uncertainty related to defining any delegation of powers to extend the scope of CBAM Regulation.
22. To facilitate negotiations on this matter, the Commission undertook to identify, by the end of November 2022, a number of goods (CN codes), which could potentially be included in the Annex I of the CBAM Regulation. A large majority of Member States maintain that any extension of the scope of CBAM can only be made on the basis of a study containing an impact assessment of what such an extension of the CBAM scope would entail in practice.

23. It is therefore suggested to continue the discussion on the extension of product-scope of CBAM once such a study is available. Although this puts additional stretches in terms of timing, it seems reasonable to proceed on the basis of this study and working on reaching a compromise that the initial scope of CBAM will have to be regularly reviewed. Any extension of the scope would have to include carbon intensive and actively traded goods, and would have to be gradual, strictly based on impact assessment, technical feasibility and cost effectiveness thereof.

***b) Inclusion of indirect emissions into calculation of embedded emissions***

24. The European Parliament position so far has been that indirect emissions should be included into the calculation of embedded emissions from the beginning of application of the CBAM Regulation, and that the Commission should adopt a delegated act regarding the definition of a method to calculate embedded indirect emissions for simple and complex products and relevant default values, as well as a method to determine the CBAM price of indirect embedded emissions.
25. In its general approach the Council holds the view that an inclusion of indirect emissions into the calculations of the embedded emissions should take place as soon as possible, but only when the CBAM Regulation is reviewed and the Commission has collected the information necessary with a view to the extension of the scope of this Regulation, to indirect emissions, to goods further down the value chain, and goods other than those listed in Annex I.
26. Further technical and political discussions are required to resolve this issue and the Presidency is continuing to defend the general approach of the Council. During the trilogues it has been argued that the question of including indirect emissions is linked to the planned revision of the EU electricity market reform, as well as to the indirect costs compensations schemes, which are in place in some Member States.



## **II.C. SPEED OF PHASE-IN OF CBAM (LINK WITH EU ETS) AND CARBON LEAKAGE ON EXPORTS**

27. One of the issues of key significance to the implementation of the CBAM is the rate at which the obligation to surrender CBAM certificates becomes more extensive ('phase-in') under Article 31 of the draft CBAM Regulation. . The Council in its general approach on CBAM indicated that the rate of 'phase-in' is determined by the rate of the 'phase-out' of the free allowances established by the EU Emissions Trading System (EU ETS) Directive and allocated to industry sectors covered by the CBAM.
28. On 28 June 2022, the Council reached agreement on a general approach on the draft Directive amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union (EU ETS; doc. ST 10796/22).
29. Among other issues, the general approach on the EU ETS addresses the duration of the phase-out period for free allocations to sectors covered by the CBAM and identifies provisions on carbon leakage in relation to exports. It sets out the rate at which free allowances are allocated to industry sectors covered by the CBAM, over a 10-year period, with a progressive reduction of free allowances, slower at the beginning of the period, and faster towards the end (Article 10a(1a)). This, in turn, automatically will determine the rate at which the obligation to surrender CBAM certificates becomes more extensive under Article 31 of the draft CBAM Regulation.
30. The Council general approach on the text of the draft EU ETS Directive also provides more detail on the 'special attention' to be paid in the context of the Innovation Fund to CBAM sectors, setting out the aim that over the 2021-2030 period, projects in those sectors are awarded a significant share of the equivalence in financial value of CBAM sectors-related allowances, and indicating that the Commission may launch before 2027 calls for proposals dedicated to the sectors (Article 10a(8)).

31. Finally, it expands on the review clause of the ETS in relation to CBAM sectors (Article 30), providing that the measures applicable to CBAM sectors shall be kept under review in light of the application of the CBAM Regulation, and that before 1 January 2026 and every two years thereafter as part of its reports to the European Parliament and the Council pursuant to Article 30 of the CBAM regulation, the Commission shall assess the impact of the mechanism on the risk of carbon leakage, including in relation to exports and make legislative proposals as appropriate.
32. On the point of the CBAM ‘phase-in’, it seems that the most practical and technically admissible solution would be to maintain a link with the EU ETS Directive in the way it is designed in the Council general approach.
33. The pace and dates of ‘phase-in’/‘phase-out’ will remain an important matter for decision in the interinstitutional negotiations on the revision of the EU ETS Directive. The Presidency will strive to resolve the differences between the Council and the Parliament on the phase-out of the free allowances under EU ETS Directive in the ongoing interinstitutional negotiations on that dossier, and the eventual solution would be part of the overall package agreement on the interlinked dossiers of the ‘Fit for 55’ package.
34. As regards limiting carbon leakage from exports, this remains a crucial issue for the functioning of CBAM, though this issue can not be resolved in the text of the CBAM Regulation. This issue needs to be addressed fully and appropriately, to ensure economic efficiency, environmental integrity and WTO compatibility.

## II.D. CBAM REVENUES

### *a) Ownership of receipts from sale of CBAM certificates*

35. The EP allocates the task of selling CBAM certificates to a central (EU) CBAM authority.
36. As one of the most important points, a number of Member States indicate that Member States should maintain the ownership of the receipts from the sale of CBAM certificates. In accordance with the general approach of the Council (Article 24(0)), Member States would sell CBAM certificates to authorised CBAM declarants established in their Member State through a central platform, which would be established by the Commission following a joint procurement procedure with the Member States.
37. The Presidency considers that this approach is in line with the mandate of the AHWP CBAM and reflects the ongoing discussions in the Working Party on Own Resources on the Commission proposal for amending Council Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union (doc. ST 15260/21). This Commission proposal includes a new EU own resource based on revenue from the sale of CBAM certificates and foresees that a share of the revenues from the sale of CBAM certificates is to be transferred to the EU budget as own resources in the form of a national contribution.
38. Work on the CBAM is also referred to in the “Roadmap towards the introduction of new own resources”, which is part of the Interinstitutional Agreement between the European Parliament, the Council of the European Union and the European Commission of 16 December 2020.<sup>6</sup>
39. Against this background, and in line with the Council general approach, it seems appropriate that the issues related to a new EU own resource based on CBAM are resolved in the negotiations on the new EU own resources, and not in the text of the CBAM Regulation.

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<sup>6</sup> OJ L 433I , 22.12.2020, p. 28.

***b) support to LDCs (Article 24a of the EP position) / use of CBAM receipts***

40. The Council in its general approach recognises the need to engage, in an even-handed manner and in line with the international obligations of the EU, with the third countries whose trade to the EU would be affected by the CBAM Regulation. The Council also points out the necessity that the EU should provide technical assistance to developing countries and Least Developed Countries, in order to contribute to ensuring their adaptation to the new obligations established by CBAM Regulation.
41. Moreover, the Council calls for the development of bilateral, multilateral and international cooperation with third countries, including through the parallel setting up of an alliance of countries with carbon pricing instruments or other comparable instruments ('climate club'), in order to promote the implementation of ambitious climate policies in all countries and pave the way for global carbon pricing.
42. The Council also states that the EU is committed to work with and support low and middle-income countries towards decarbonisation of their manufacturing industries as part of the external dimension of the Green Deal and in line with its international obligations under the Paris Agreement.
43. The European Parliament wishes to foresee a binding obligation in the CBAM Regulation, to ensure that Union financial support is provided to support climate mitigation and adaptation in least developed countries. Such funding would have to be made available through the Union budget in order to contribute to international climate finance by facilitating the adaptation of the industries concerned to the new CBAM obligations and complemented by technical assistance, subject to the full implementation and enforcement of internationally recognised labour and social rights such as the ILO core labour standards in the recipient country.

44. In addition, the EP wishes to foresee that the new financial support from the Union budget should be provided under the relevant geographic and thematic programme of the Neighbourhood, Development and International Cooperation Instrument established by Regulation (EU) 2021/947 and an amount determined on a yearly basis, which should correspond at least to the level of revenues generated by the sale of CBAM certificates.
45. Further technical and political discussions are required to resolve this issue. While the Council already recognised that the EU should provide technical assistance to developing countries and the Least Developed Countries, it should be decided whether it is feasible and appropriate to define the attribution and use of CBAM receipts in the text of the CBAM Regulation, instead of setting these aspects out in other relevant EU legislation.

## **II.E. OTHER KEY ISSUES**

46. In addition, it is appropriate to recall that it remains of particular importance for the delegations to monitor, discuss, further clarify and agree, by the end of negotiations on this dossier:
- the relevant operational aspects of the applicability of CBAM towards trading partners of the Union, in particular those having ambitious and progressive environmental policies in place;
  - the criteria, as part of the essential characteristics of the CBAM Regulation, for any exemptions from the CBAM, and
  - the principles under which the CBAM will correlate with ongoing international work on the ‘climate club’, as well as addressing risks of carbon leakage for emission intensive goods, while complying with international rules.
47. As agreed in the Committee of Permanent Representatives (Part 2) on 13 July 2022, in order to facilitate the assessment by delegations, the European Commission should regularly update on all contacts with relevant non-EU countries relating to the ongoing work on CBAM in the EU.

### III. WAY FORWARD

48. In the forthcoming rounds of negotiations with the European Parliament, the Presidency will take into account and follow the guidance (mandate) on the issues outlined above, bearing in mind the comments made by the delegations, in relation to the EP position, as appropriate.
49. Against this background, the Committee of Permanent Representatives is invited to exchange views on the way forward in the interinstitutional negotiations on this dossier, with a view to further advance negotiations to be conducted by the Presidency on the basis of this note.
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