

# COMMUNICATION IS KEY: COOPERATION BETWEEN CANADIAN EXPORTERS AND EUROPEAN UNION IMPORTERS WILL BE ESSENTIAL TO OPERATE UNDER THE CARBON BORDER ADJUSTMENT MECHANISM REGULATION

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The European Union (“**EU**”)’s pathbreaking Carbon Border Adjustment Mechanism (“**CBAM**”) will require Canadian exporters to closely monitor and calculate the amount and cost of carbon embedded in exported goods to their EU importing counterparts. On August 17, 2023, the EU adopted the *Implementing Regulation* (the “**Regulation**”), imposing reporting obligations on EU importers of carbon-intensive goods in the six sectors currently covered by the CBAM (iron and steel, aluminum, cement, fertilizer, electricity and hydrogen).<sup>[1]</sup> The Regulation prescribes new reporting obligations for EU importers that began on October 1, 2023.

Practically speaking, this means that EU importers will be requiring Canadian exporters of carbon-intensive goods to implement monitoring and reporting methodologies that comply with these new requirements to ensure the importers themselves have the information they need to satisfy their regulatory obligations. Emissions reports will be due quarterly from October 1, 2023, through December 31, 2025 (“**Transitional Period**”). The purpose of this Transitional Period is to collect emissions data and information on calculation methodologies to facilitate a smooth roll out of the CBAM. In 2026, the CBAM will enter its Definitive Phase, in which importers will have to begin paying for CBAM certificates based on the reported quantity and value of carbon emissions embedded in the goods they bring into the EU.

## **New Reporting and Data Collection Responsibilities for Importers and Exporters**

Throughout the Transitional Period, and in the subsequent Definitive Phase, EU importers are responsible for reporting the information about carbon-intensive goods that is needed to determine the magnitude of the border carbon adjustment. Such adjustments will place the imported goods on a level playing field with goods produced in the EU that are subject to the EU’s carbon emissions regulatory and pricing regime.

The required reporting information includes details on the country of origin, the exporting company’s name and address, the production routes, and the direct and indirect embedded emissions, alongside other

factors.<sup>[2]</sup> Importantly, exporters are not directly subject to the CBAM or the Regulation. However, they will have to provide the embedded emissions in their exported goods and communicate that data, along with information about their production facilities, to enable their EU importing counterparties to comply with obligations under the Regulation.

The first reporting period will cover emissions related to imported CBAM goods from October 1, 2023, to December 31, 2023, and the first report on such emissions will be due at the end of January 2024. The European Commission has developed an “emissions data communication” template<sup>[3]</sup> to assist exporters in compiling the necessary embedded carbon emissions data. The template covers all necessary embedded emissions information that exporters must share for their importers’ CBAM reports, as well as recommended information that will provide greater transparency of the shared data.

An electronic database called the CBAM Transitional Registry (the “**Registry**”) will be accessible only to EU importers, the European Commission, and competent authorities (including national authorities, central CBAM authorities and customs authorities). The CBAM Trader Portal (the “**Portal**”) will act as the entry point to the Registry.<sup>[4]</sup> The Registry is intended to ease the administrative burden on both importers and exporters as it will allow importers to store information about exporting partners and their embedded emissions, enabling re-use of the information during later reporting periods.

### **Carbon Pricing Policies in Export Jurisdictions Have a Key Role to Play**

The CBAM seeks to ensure that imported products have incurred the same level of carbon costs as comparable EU products. In the EU, the cost is based on the price per unit of emissions under the EU’s emission trading system – currently about EUR €82 per tonne.<sup>[5]</sup>

Presently, the EU’s carbon emissions regime provides free allocations designed to mitigate the risk of “carbon leakage” prior to the CBAM’s implementation. Carbon leakage happens when companies move production abroad, often to countries with less stringent or no environmental policies. However, as the CBAM is introduced, the European Commission will be phasing out the free allocations in line with the EU’s increasing climate ambition and carbon prices. The phase out also aligns with efforts to level the playing field between EU producers and third-country producers. These allocations will cease entirely in 2026 after the Transitional Period concludes.<sup>[6]</sup>

The CBAM recognizes that some countries have their own carbon pricing systems in place.<sup>[7]</sup> Importers must report specific information where exporting jurisdictions have domestic carbon pricing schemes,<sup>[8]</sup> including the type of product and carbon price, the country and law providing for the carbon price, and whether there are rebates available, among other factors. Exporters must monitor and communicate to importers the actual price per tonne of CO<sub>2</sub> emissions that has already been paid. If the price paid in the exporter’s jurisdiction

equals or exceeds the EU price, no border carbon adjustment would be payable.<sup>[9]</sup>

In implementing this principle, the CBAM and the Regulation require adjustments for rebates, free allocations or other forms of compensation that would ultimately reduce the carbon price paid in the exporter's jurisdiction. Any rebates or other reductions of the exporter's carbon costs must be reported by the EU importer in order to properly calculate the difference between EU carbon pricing and the exporting jurisdiction costs.<sup>[10]</sup>

Canadian producers and exporters are subject to a domestic carbon pricing regime through the output-based pricing system ("OBPS").<sup>[11]</sup> The current posted price under the OBPS is CAD \$65 per tonne. In an effort to accelerate a shift towards a low carbon economy, it is scheduled to increase annually by CAD \$15 per tonne from 2023 to 2030.<sup>[12]</sup> The OBPS requires specific industries and large emitters to pay this carbon price after they exceed their applicable emissions limit (analogous to the free allocations in the EU).<sup>[13]</sup>

Companies that emit less than their regulated limit will in most circumstances earn credits that they can trade with other companies to meet their compliance obligation under the OBPS for the following year or bank for future use.<sup>[14]</sup> These reductions in domestic carbon costs are required to be reported under the Regulation in order to ensure that the importer will purchase CBAM certificates that fully reflect the difference between the actual amounts paid under the OBPS (or more stringent Canadian provincial) regime relative to the EU's carbon price level.

### **Carbon Emissions Data Calculation Methodologies for EU Importers**

Since CBAM reporting obligations have commenced quickly, the Regulation provides for temporary alternative monitoring and reporting methods, so long as full and accurate emissions data are maintained.<sup>[15]</sup>

The Regulation contemplates the following two available methods to determine embedded emissions:

- Calculations-based method: This method determines emissions from source streams based on activity data gathered from measurements and calculation factors, either from laboratory analyses or standard values.<sup>[16]</sup> Source streams are a specific fuel type, raw material, or product that either contain carbon or generate carbon emissions during production.<sup>[17]</sup> Activity data refers to data from the materials consumed or produced by a carbon-emitting process.<sup>[18]</sup>
- Measurements-based method: This method involves continuously<sup>[19]</sup> measuring the concentration of carbon emitted in the site-specific composed mixed gases at exported production facilities.

Where an eligible monitoring, reporting, and verification system is already established for the purpose of a carbon pricing scheme or compulsory emission monitoring scheme ("EMS") in the exporting jurisdiction, there are three alternative methodologies contemplated under the Regulation.<sup>[20]</sup> Importers can use data collected

within any of the following systems by their exporting counterparties to fulfill their reporting requirements until December 31, 2024:

- *Carbon pricing scheme*: This methodology generally refers to any pricing mechanism that is directly charged to the source emitting carbon.[\[21\]](#)
- *Compulsory EMS*: This methodology monitors, analyzes, and quantifies the amount of carbon emitted over a specified period.
- *EMS with verification*: This methodology operates using an independent third party who has been verified in accordance with CBAM Regulations[\[22\]](#) to issue a report confirming the data obtained by the EMS.

After December 31, 2024, EU importers will have to calculate emissions using either the calculations-based method or the measurements-based method, highlighted above.[\[23\]](#)

### **Penalties for Non-compliance During the Transitional Period**

Even though importers are not required to make CBAM payments during the Transitional Period, they are required to comply with the data reporting obligations. The Regulation prescribes penalties for importers that do not take the necessary steps to comply, including where a quarterly report is incorrect or incomplete, and for failure to remedy such reporting inaccuracies.[\[24\]](#) The penalties range between EUR €10 and EUR €50 per tonne of improperly reported or unreported emissions.[\[25\]](#)

While exporters are not directly subject to the penalty regime in the Regulation, they will want to accurately communicate their embedded emissions to avoid their importing counterparties being penalized. It is likely that importers will seek representations and warranties, cooperation covenants and indemnification provisions in supply agreements that effectively transfer these responsibilities and risks in large part to the exporters.

### **Key Takeaways**

While Canadian exporters do not have a formal reporting onus, they should be aware of their EU counterparties' reporting obligations to provide complete and accurate emissions reports. The Regulation effectively creates a parallel expectation that exporters will closely monitor and communicate the production cycle, embedded emissions, and carbon costs of their carbon-intensive goods to their EU importers.[\[26\]](#) Canadian exporters should also use the Transitional Period to ensure they understand how their OBPS or provincial carbon emissions regime obligations in Canada will interact with the EU regime once payments start to be required under the CBAM and the Regulation.

Notwithstanding the increased compliance burdens, the CBAM could also provide opportunities for Canadian companies in certain circumstances. In particular, Canadian companies that are competing in Europe with



goods exported from the US or numerous other countries that have no or lower carbon regulatory costs than are imposed under Canada's OBPS (or a more stringent Canadian provincial regime) may have a valuable cost advantage once the Definitive Phase of the CBAM kicks in.

[1] For more information on the CBAM, please refer to McMillan's bulletin [The EU's New Carbon Border Adjustment Mechanism in Action: Impacts on Canada and Beyond](#).

[2] Implementing Regulation (EU) 2023/956 at article 3(2).

[3] The European Commission, *Guidance Document on CBAM Implementation for Imports of Goods into the EU*, [online](#) at page 76.

[4] Implementing Regulation (EU) 2023/956 at article 22.

[5] The price of emissions allowances in the EU and UK, Ember [online](#). Note that EUR €82 would equal approximately CAD \$117 using the October 1, 2023, exchange rate of 1.4304 from the Bank of Canada.

[6] The European Commission, *Guidance Document on CBAM Implementation for Imports of Goods into the EU*, [online](#) at page 18.

[7] Almost 40 countries worldwide have some form of domestic carbon pricing system in place including Australia, South Africa, Argentina, Brazil and New Zealand in addition to Canada. The United States does not currently have a federal carbon pricing scheme, although some states have implemented carbon-pricing mechanisms or cap-and-trade programs including California, Connecticut, New Hampshire, New York, Washington and other Northeast states. China has a national carbon emissions cap and trade market that sets a limit on the amount of carbon emitted for each unit of power generated.

[8] Implementing Regulation (EU) 2023/956 at article 7.

[9] For a discussion on border carbon adjustments and trade law compliance, see Neil Campbell, William Pellerin and Tayler Farrell, "[A Roadmap for Trade-Law-Compliant Border Carbon Adjustments](#)" 10 *Energy Regulation Quarterly* (no. 2) (July 2022).

[10] Implementing Regulation (EU) 2023/956 at article 7.

[11] Note that where provincial carbon pricing regimes apply within Canada, a Canadian producer or exporter's carbon pricing obligations may be more stringent than what is set out in the OBPS, but will at minimum meet these federal standards.

[12] "The federal carbon pollution pricing benchmark" *Government of Canada*. [Online](#).

[13] Where a province has enacted a local carbon emissions program, the applicable emissions limits will at least meet the OBPS benchmark, but can be more stringent. British Columbia, Quebec, and the Northwest Territories have implemented provincial or territorial systems that meet the federal stringency requirements. British Columbia has a provincial carbon tax, transitioning to a provincial carbon tax and OBPS in 2024. Quebec has a provincial cap-and-trade program. The Northwest Territories have a territorial carbon tax. The federal backstop applies in full or in part to all other provinces and territories. For more information, see [online](#).

[14] For more information on the OBPS, please refer to McMillan’s bulletin [Transition to Emissions Performance Standards \(EPS\) Program Underway for Greenhouse Gas Emitters in Ontario](#).

[15] Implementing Regulation (EU) 2023/956 at articles 4(2) and 4(3).

[16] Implementing Regulation (EU) 2023/956 at article 4(1)(a).

[17] As previously defined by the European Commission in Regulation (EU) 2018/2066 at article 3(4). See also Regulation (EU) 2018/2066 at article 21.

[18] As previously defined by the European Commission in Regulation (EU) 2018/2066 at article 3(1).

[19] As previously defined by the European Commission in Regulation (EU) 2018/2066 at article 3(40); note: “continuously” refers to using periodic measurements to determine the value of a quantity.

[20] Implementing Regulation (EU) 2023/956 at article 4(2). See generally the CBAM description in our previous [Bulletin](#).

[21] The Implementing Regulation states, “a carbon pricing scheme where the installation is located” (e.g. the OBPS, and any provincial carbon pricing mechanism applied in Canada) can be used by importers up until December 31, 2024, to calculate embedded emissions.

[22] See *also* Regulation (EU) 765/2008 and Regulation (EU) 2018/2067.

[23] Implementing Regulation (EU) 2023/956 at article 4(2).

[24] Implementing Regulation (EU) 2023/956 at article 16(1).

[25] Implementing Regulation (EU) 2023/956 at article 16(2).

[26] See also: the European Commission has published three guidance documents for EU importers and non-EU installation operators on the practical implementation of the Regulation. These guidance documents contain provisional methodology for calculating embedded emissions, [online](#).

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### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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