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European Parliament Adopts Position on Climate Change Legislation Package, Including CBAM

Go-To Guide:

- European Parliament adopts position on three key EU climate draft laws to reduce greenhouse gas emissions by at least 55% by 2030
- Package relates to EU ETS, CBAM, and Social Climate Fund

The European Parliament (EP) has enacted significant change to the proposed Directive on revisions to the EU Emission Trading System (ETS) and the proposed Regulation for a Carbon Border Adjustment Mechanism (CBAM) that will have significant global trade implications.

On June 22, 2022, the EP adopted its **position** on three key aspects of the “**Fit for 55**” package. With a significant majority of votes, Members of the EP voted in favor of amendments to the (a) ETS, (b) CBAM, and (c) proposed Regulation on the establishment of a Social Climate Fund (SCF).

An earlier EP session had failed to adopt a favorable position on the EU climate change legislation. The voting was postponed then due to disagreements on, inter alia, the phase-out plan for free allowances for CO₂ emissions granted to certain industries in the EU, and the perceived dilution of key aspects of the EU climate ambitions.

ETS Reform

The ETS is a cornerstone of the EU climate policy. The ETS generally works as a “cap and trade” scheme where a limit is placed on the right to emit in the EEA, and companies can trade emission rights. To incentivize industries to reduce their emissions further and invest in low-carbon technologies to achieve this goal, the EP agreed on the following **amendments** to the revision of the ETS:

- **Phase-out of free allowances:** The free allowances in the ETS sectors covered by the CBAM should be phased out from 2027 and disappear by 2032. The free allowances should be reduced to 93% in 2027, 84% in 2028, 69% in 2029, 50% in 2030, 25% in 2031 and 0% in 2032.
- **Bonus-malus system:** A system in which the most effective installations in a sector are rewarded with additional free ETS allowances will be implemented starting in 2025. Manufacturers risk losing some or all of their ETS free allowances if they fail to implement suggestions from energy audits, certify their energy systems, or create a decarbonization plan for their installations.
- **ETS extension to maritime transport:** For ships above 5,000 gross tonnage, the ETS will cover 100% of emissions from *intra*-European routes and 50% of emissions from *extra*-European routes starting or ending outside the EU, and emissions from ships at berth in EU ports from 2024 until the end of 2026. From 2027, emissions from all routes should be 100% covered by ETS. There is a possibility of derogations for extra-European routes starting or ending outside the EU where coverage could be reduced to 50% subject to certain conditions.
- **Establishment of a new ETS II:** A separate ETS for fuel distribution for commercial road transport and buildings shall be established on Jan. 1, 2024. Residential buildings and private transport would be included in the new ETS not earlier than in 2029 and only after a thorough assessment by the European Commission (EC) and a new legislative proposal to be agreed upon by the Council and the EP.

CBAM Revisions

To prevent carbon leakage and raise global climate ambitions, the EP agreed to the following **amendments** to the CBAM text proposed by the EC – these amendments are largely in line with those proposed by the EP’s Committee on Environment, Public health and Food Safety, on which we reported in a **January 2022 GT Alert**:

- **Broader scope:** The EP has added organic chemicals, plastics, hydrogen, and ammonia to the original CBAM’s scope. However, the technical specificities of organic chemicals and polymers shall be subject to an EC assessment. Next to that, the scope will cover indirect emissions, i.e., emissions deriving from the electricity used by manufacturers.
- **Faster implementation:** The CBAM will have a transitional period from Jan. 1, 2023, until the end of 2026, whereby importers will be required to report emissions embedded in their goods without paying a financial adjustment. CBAM is forecasted to be implemented Jan. 1, 2027, with a phase-in until 2032. Amounts due under the CBAM are reduced mirroring the phase-out of the free ETS emissions.
- **Support for the least developed countries:** The EU budget should support the least developed countries through amounts equivalent to sums collected through the CBAM.

- **Centralised CBAM authority:** The EP believes that establishing one centralized CBAM authority instead of national authorities will be more efficient, transparent, and cost-effective. This would allegedly also help to prevent forum shopping from importers.

SCF Amendments

The SCF the EC proposed aims to help certain users that are vulnerable and particularly affected by the impact of the transition towards climate neutrality with the increased costs of the energy transition.

The EP agreed with the creation of the SCF, subject to some **amendments**, which include, inter alia, broadening the scope of the beneficiaries of the SCF.

Next Steps

The next step in the EU legislative process will be negotiations between the EP and the Council, consisting of EU Member State representatives. These negotiations may lead to further changes to the CBAM and the other instruments, but there now appears to be a substantive level of consensus on the package overall. These negotiations and consultations may take until the end of 2022.

Once the final texts are adopted, the package will impact across sourcing and distribution trade activities of companies globally. Moreover, the EU's package may also motivate other jurisdictions outside of the EU to implement similar measures.

Authors

This GT Alert was prepared by:

- **Edoardo Gambaro** | + (39) 02.77197205 | Edoardo.Gambaro@gtlaw.com
- **Dr. Martin Hamer** | +49 30.700.171.195 | martin.hamer@gtlaw.com
- **Dr. Robert Hardy** | +31 20 301 7327 | Robert.Hardy@gtlaw.com
- **Paul Schouten** | +31 20 301 7352 | Paul.Schouten@gtlaw.com
- **Jairo Keeldar** [~] | +31 20 301 7311 | Jairo.Keeldar@gtlaw.com
- **Zimei Fan** | +1 212.801.6725 | fanz@gtlaw.com

[~] Admitted to the Dutch Association of Tax Advisors Bar.

* Special thanks to Jenny Chen and Nataliia Chop for their valuable contributions to this GT Alert.

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