

CBAM's impact on the Defence & Security Industry

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As announced mid-January, BLOMSTEIN is publishing a series of briefings introducing into European and German legal defence matters. In our last briefing, we discussed the relevance of merger control in the European consolidation of the defense industry.

The Carbon Border Adjustment Mechanism (CBAM) represents a pivotal shift in the European Union's approach to mitigating climate change by imposing a carbon price on imports of certain goods from outside the EU. It aims to prevent carbon leakage by ensuring that ambitious climate efforts within the EU do not lead to the relocation of carbon-intensive production to countries with less stringent emissions standards. The CBAM is designed to complement the EU's Emissions Trading System (ETS) by applying a similar carbon cost to imports, thus leveling the playing field for EU producers.

The Challenge of Emissions Data in Defence

The obligation to accurately report emissions data under CBAM poses a significant challenge, particularly within the Defence & Security sector. This industry's reliance on highly specialized components and materials for example from iron and steel or aluminium, often procured from a global network of suppliers, complicates the collection of reliable emissions data. Given the sector's stringent confidentiality requirements and the proprietary nature of many defence-related products, obtaining detailed emissions information from suppliers can be particularly challenging.

This complexity is exacerbated by the fact that many defence suppliers may not have the necessary systems in place to accurately track and report emissions data, further complicating compliance efforts for importers in the defence industry. For now, importers can rely on default values published by the European Commission. This possibility will end 31 July 2024. During the transitional period ending on 31 December 2025, importers are tasked with collecting data and adjusting to the reporting requirements of CBAM without the immediate pressure of financial adjustments. However, it's crucial for companies in the Defence & Security sector to view this period as a window of opportunity to develop more robust mechanisms for collecting and reporting emissions data from their supply chains, in preparation for the stricter reporting requirements that will commence from 1 January 2026.

The Broader European Defence Sector Challenge

Across Europe, the defence sector is undergoing significant transformations in response to shifting geopolitical dynamics, mirroring the essence of Germany's "Zeitenwende" but on a continental scale. This period of profound change, characterized by increased security concerns and defence investments, highlights the critical need for regulatory frameworks that accommodate the strategic imperatives of national defence while pursuing environmental objectives. The CBAM, by imposing additional reporting and compliance burdens without sector-specific exceptions, poses a challenge to the agility and adaptability that are crucial for defence industries across the EU. CBAM, while aimed at advancing the green transition, risk constraining the operational flexibility of defence.

Balancing Green Transition and Operational Readiness

However, CBAM is here to stay and companies in the defence sector must comply when imports are made from the relevant sectors. While the green transition is a global imperative, the Defence & Security industry must balance environmental responsibilities with the non-negotiable priority of national security. The sector is indeed moving towards sustainability, with increased investment in green technologies and energy-efficient systems. However, the path to green transition must acknowledge the unique operational, confidentiality, and security considerations inherent to the defence industry.

What should companies in the Defence sector do?

- It is necessary to develop a comprehensive compliance strategy that minimizes legal risks and aligns with the operational realities of the defence industry. This includes interpreting CBAM regulations in the context of defence, advising on the applicability of default emissions values, and planning for the transition to full compliance post-2025.
- Furthermore, another task will be negotiating and drafting supplier agreements that include provisions for emissions reporting, ensuring that contracts are aligned with CBAM requirements. This will touch on the legal aspects of data sharing and confidentiality.
- Companies will need to prepare accurate and compliant CBAM reports. This includes documenting emissions data, using default values where necessary, and ensuring that all reporting obligations are met in a timely and efficient manner.

BLOMSTEIN is constantly advising its clients in the defence industry in all aspects on the practical implementation as well as on the scope of application of CBAM. Please do not hesitate to contact Roland Stein, Florian Wolf, Christopher Wolters, Pia Hesse and Leonard von Rummel.

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Stay tuned: In our next defence briefing - to be published on 13 March - we will provide some insight into the Bundestag's ominous requirement (and its legality) to separately approve any defense procurement with a volume above EUR 25 Mio.