The voice of the energy industry

Sent via email to: cbampolicyteam@hmrc.gov.uk
13 June 2024

Dear CBAM Policy Team,

We would like to thank HMT and HMRC for their publication of their consultation on the introduction of a UK Carbon Border Adjustment Mechanism (CBAM), as this is an important way of protecting the UK against carbon leakage. The consultation questions are focused on the implementation of the initial UK CBAM in 2027, which will not have electricity in scope, and as such we are only providing a high-level industry view on the issues raised by HMT and HMRC. Energy UK members support the introduction of a UK CBAM as this will reduce the risk of carbon leakage, whilst also creating an incentive for other countries to implement robust carbon pricing schemes to maintain international competitiveness. However, when considering jurisdictions with similar Net Zero ambitions, a CBAM is a barrier to trade – both via non-tariff barriers and, when there is a carbon price differential, a tariff barrier. It is therefore important that the UK CBAM is designed in such a way as to accurately reflect the carbon price differential in the tariff and minimise the administrative burden on industry.

To remove the need for CBAMs between Great Britain and EU or European Economic Area countries, Energy UK strongly supports an agreement between the UK and EU to link their respective emissions trading schemes. As this will take time to negotiate we would urge the Government to pursue bilateral engagement with the EU on a bespoke EU-UK CBAM agreement as soon as possible and ahead of the EU's CBAM implementation date of 1 January 2026 – this could take the form of an exemption via electricity market coupling or a recognition of the equivalence of the two ETS. This would result in reciprocal exemption from both UK and EU CBAMs of products where carbon leakage risk is low, or where there are particular challenges in applying a CBAM. Such reciprocal exemptions could be conditional on criteria that indicate carbon leakage risk is low, could be time-limited or subject to periodic review. Most members agree with the minded-to position on the scope of the UK CBAM in this consultation. A minority of members believe that the inclusion of electricity in the UK CBAM could be considered as an interim measure to address asymmetric risks for GB electricity generators caused by differences in scope between the UK and EU CBAMs. Including electricity in the scope of the UK CBAM could also be considered to prevent carbon leakage should there be electricity interconnection between GB and non-EU or non-EEA countries without their own carbon pricing regimes in future.

Whilst we support the UK CBAM's introduction, the Government must also recognise it will lead to higher prices for clean energy projects by raising the cost of procurement for low-carbon generation and infrastructure, which should be reflected in wider policy and regulatory frameworks. The UK must learn lessons from the implementation of the EU CBAM to avoid creating uncertainty for industry. It is also unclear how the UK and EU CBAMs will impact the Single Electricity Market (SEM) between Ireland and Northern Ireland, and how it will apply to the two electricity interconnectors between GB and the SEM – one of which connects with Northern Ireland and one with the Republic of Ireland. The UK Government should work closely with the Irish Government to seek immediate clarity about how the European Commission intends to apply the EU CBAM on electricity trade between GB and the SEM, and whether the market coupling exemption can apply to individual interconnectors that are either coupled between day ahead markets or intraday markets.

Finally, Energy UK is concerned by media reporting of potential CBAM exemptions for jurisdictions with high carbon intensity. Any decisions to exempt countries from the UK CBAM must be evidence-based and fully justified on carbon leakage grounds.

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Prioritising linking the UK and EU ETS
Linking both ETS regimes has strong support from across industry and wider stakeholders and is key to mitigating the barriers to trade between the UK and EU that a CBAM will inevitably create by avoiding having a carbon price differential in the UK and EU.

CBAMs between the UK and the EU represent a trade barrier between two jurisdictions with similar emissions trading schemes and climate policies. The presence of CBAMs strengthens the case for linkage of the two trading schemes, which would remove any potential tariff barrier (created by both the regulatory burden and carbon price differentials) on CBAM goods traded between the UK and EU. The UK ETS is relatively small compared to other emissions trading schemes globally, with the linked EU and Swiss ETS roughly ten times the size of the UK scheme. Linking schemes would greatly increase price stability in UK carbon pricing markets - there has been a sustained price decrease in the UK ETS from Spring 2023 onwards, and further price volatility could be expected as the market tightens as carbon budgets tighten. The low UK carbon price has undermined investment in decarbonisation in the UK, as higher carbon prices make lower-carbon technologies more attractive and generate additional revenues for HMT. Indeed, Energy UK analysis shows that in 2023, ETS auctions raised £1.7bn less than they would have done had there been a linking agreement in place between the UK and EU carbon markets. This revenue could have been used to support clean power and the decarbonisation of industry.

Whilst an ETS linkage agreement would ultimately be a negotiation, similarities between the UK and EU ETS, including the scope of the respective schemes, and alignment on decarbonisation goals, mean that any agreement should be relatively simpler than previous EU linkage negotiations. Nonetheless, it is likely that there will likely be a number of years between a linkage agreement being signed and coming into place. Energy UK would strongly support the UK Government's pursuit of a bilateral agreement between the UK and EU ahead of the EU CBAM implementation date of 1 January 2026. We would encourage the UK Government to state an aim to link the UK and EU ETS at the next fiscal event in Autumn 2024 and initiate linking negotiations by Spring 2025.

Scope of a UK CBAM
The majority of Energy UK members believe that the minded-to position in this consultation on the initial scope of the UK CBAM is appropriate, as the inclusion of electricity into the UK CBAM would come at a risk. The technical implementation of a CBAM for electricity would likely be very complex and additional distortions to cross-border trading would result from its implementation, with implications for costs to consumers and decarbonisation. Authorities in the UK and EU must recognise that both the UK and EU are on a similar decarbonisation pathway and have similar carbon pricing regimes, and therefore as stated earlier linking the EU and UK ETS should be pursued as a matter of priority.

There are some concerns about the interaction between the UK and EU CBAMs when considering the electricity sector, given that the EU CBAM has electricity in scope and the minded-to position on the UK CBAM does not. This could create a misalignment in arrangements and the creation of market inefficiencies. Further analysis could be undertaken when considering a UK CBAM with electricity in scope of the risks to trade, the challenges and whether these can be overcome, as well as the positives in further detail; for example, the benefits could include the introduction of carbon pricing schemes in future where none currently exist. This may also be an option to prevent carbon leakage should interconnection between GB and non-EEA countries without their own carbon pricing arrangements be considered in future.

A minority of members believe that the inclusion of electricity in the scope of the UK CBAM would be an interim solution to avoid market distortions whilst a bilateral CBAM agreement, and subsequent ETS linking arrangements, are finalised.

Knock-on impacts of a CBAM on procurement
Energy UK's members are helping to deliver Net Zero through investment in infrastructure, such as low carbon generation, electricity interconnection, and technologies with complex global supply chains such as electric vehicles and heat pumps. Many of these technologies already face higher procurement costs as a result of global competition, and a UK CBAM will inevitably further increase the cost of project delivery. A streamlined administrative process with evidence requirements that are

rigorous but not unnecessarily onerous will, however, help to mitigate the cost impact of the CBAM. HMT and HMRC could consider indicating relevant and accepted carbon price data for key jurisdictions, the reporting requirements when no CBAM charge is due and the proposed use of default values. Ongoing uncertainty regarding market reform, for example, the REMA process, is further impacting the cost of procurement. The Government must recognise the impact that a UK CBAM will have on new and existing projects and factor this into existing funding mechanisms, for example future allocation rounds of the Contracts for Difference scheme.

Administration of a UK CBAM

Our members welcome many of the simplifications to CBAM administration as proposed in this consultation. These changes will help to ensure that industry has confidence in a UK CBAM regime.

Energy UK does not believe a quarterly accounting period for declaring returns is the most appropriate option for a UK CBAM. We deem it more appropriate to have an annual declaration that accounts for both embedded emissions imported as well as the CBAM rate at this time, in line with the EU CBAM. A one-month lead time to complete the previous quarter's return could be insufficient. We also suggest that declarants are able to amend declarations following the deadlines in case of any errors or oversight.

Having a CBAM with seven different rates – one per sector in scope – based on a quarterly ETS price, rather than a certificate-based scheme, may mean that the CBAM is open to challenge under WTO rules, as the CBAM price paid may not be consistent with the domestic price paid. Domestic producers can purchase their ETS allowances throughout the calendar year of production, and indeed hold on to allowances purchased in previous years to surrender in their year of choice. Allowing a shorter pricing period for CBAM, such as fortnightly, means importers can fairly manage their costs in the same way this is permitted for UK industry. Further to this, the presence of separate prices for each sector complicates the ability of importers to aggregate and manage their CBAM exposure.

From an operational perspective, the liable person should be able to appoint any entity, for example, another entity within the same organisation, to manage its CBAM returns, not only a tax agent. Many large organisations may wish to appoint an internal entity to manage its CBAM returns to consolidate and reduce costs, therefore this should be permitted in the regulation.

The UK CBAM proposes a single go-live date, unlike other CBAMs which have included a transitional phase where penalties are not imposed for incorrect or late reporting. The latter allows parties to become familiar with CBAM compliance and the identification of unintended consequences or scheme weaknesses. A transitional period where HMRC would not levy penalties for unintended errors would likely be beneficial for all parties, whilst educational/training opportunities must be provided to ensure that companies understand, and are comfortable with, the process before being subject to any penalties.

Hydrogen in the UK CBAM

Hydrogen's inclusion in the UK CBAM is welcome and will help to ensure the viability of the UK's low-carbon hydrogen generation. However, this should also be paired with a robust certification mechanism that is interoperable with other countries and jurisdictions. Options for this must be explored further by the UK Government. Indirect emissions methodology for hydrogen under the CBAM should also accurately reflect the emissions in production.

Thank you for providing us with the opportunity to respond to this consultation.

Yours sincerely,

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About Energy UK

Energy UK is the trade association for the energy industry with over 100 members - from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat and technology.

Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses.

The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors - and supports over 700,000 jobs in every corner of the country.

The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources.

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