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# UFE's position paper on the implementation of CBAM on electricity

## Linking the EU ETS with the UK ETS to address the negative consequences of the implementation of CBAM on electricity.

The Carbon Border Adjustment Mechanism (CBAM) is a European regulatory framework designed to impose on imported goods the same carbon costs borne by EU industries in producing equivalent products. It applies to imports of iron, steel, cement, fertilisers, aluminium, hydrogen, and electricity.

Given the context of strengthening climate ambition at the European level, the objective of CBAM is to preserve the competitiveness of European industry and to prevent carbon leakage. **UFE therefore supports the principle underlying CBAM**.

However, in a study published in March 2024 (commissioned by TSOs - including RTE - and interconnection companies) assessing the impact of the EU's CBAM on electricity imports from Great Britain, AFRY Management Consulting identifies two problems:

1. **A significant risk of overestimating the assumed emissions for electricity imports from Great Britain. Indeed, the emission factor values are likely average values calculated based on the carbon intensity of historical fossil production (default calculation method)**: the method thus notably neglects the fact that mixes tend to decarbonise by calculating emission factors from past data and applying them to a future period. It also only considers carbonised electricity volumes without taking into account the overall electricity mix of the exporting country.

2. **An excessive exposure to the carbon price for imports from Great Britain, linked to operational obstacles in demonstrating that a carbon price has been paid in Great Britain by the emitting plant**. Indeed, if the regulation provides for the possibility for actors importing electricity to deduct the tax already paid in the United Kingdom from the CBAM tax paid in Europe, it could be very difficult in practice to trace an import back to the original installation, which could ultimately result in double taxation without the possibility of deduction. Moreover, even with a deduction, renewable production - which is exempt from carbon taxation in the United Kingdom - would end up being taxed more than carbon-intensive production.

AFRY Management Consulting therefore emphasises that the implementation of CBAM on electricity imports from Great Britain would lead to the following negative consequences:

- **Hindering the proper functioning of the market by blocking flows that would otherwise be economically viable**: the application of CBAM indeed leads to an increase in import costs, resulting in a reduction of these imports as soon as the price spread is lower than the tax paid on these imports, ultimately leading to an increase in prices;

- **Restraining the development of interconnection projects between Great Britain and the European Union**, as well as hybrid offshore projects in the North Sea and renewable projects in the United Kingdom.

- **Increasing $CO_2$ emissions in the European Union**: the decrease in low-carbon electricity imports from the United Kingdom is indeed offset by an increase in electricity production in Europe, partly carbonised by CCGTs and coal-fired power plants.

The implementation of CBAM in the United Kingdom starting from January 1, 2027, could resolve part of the $CO_2$ price gap. Moreover, analysts' projections see a gradual convergence of ETS quota prices and British quotas. However, this does not resolve the issue of inefficiencies induced in the use of interconnections as each mechanism does not recognize the other's ETS.

**In this context, to remedy the negative consequences of the application of carbon borders between Great Britain and the European Union, UFE calls for further exploration of the idea "of a link between the United Kingdom's emissions trading system and that of the European Union" as mentioned in the 2020 Trade and Cooperation Agreement (TCA) between the UK and the EU (art 392, paragraph 6).**

Electricity contracts have already been concluded on futures markets, with delivery beyond the start of the final CBAM period (January 2026). The uncertainty related to the lack of visibility on the treatment of the carbon price paid in a third country (delayed secondary legislation) can negatively affect these market horizons, leading to a decrease in liquidity.

Therefore, **in order to avoid a negative impact on electricity prices for EU consumers, including industry, UFE urges the European Commission to publish the remaining legislation to improve visibility for market players by reviewing the rules related to the calculation of the default emission factor for electricity imports**. Electricity has very specific characteristics (such as frequent and anonymous trading on electricity exchanges, consumption at the time of production, etc.) and is subject to physical infrastructure and management constraints (interconnection/cross-border capacity, transport of physically balanced flows, etc.). It is necessary to take them into account in order to :

- **Ensure appropriate default emission values** that reflect emission factors as close to real-time as possible (instead of the average $CO_2$ emissions from fossil plants over 5 years) and consider the rapid decarbonisation of electricity mixes (including in the UK);
- **Design solid, simple, and pragmatic requirements to demonstrate the actual emissions of electricity imported into the EU.**

The inclusion of electricity within the scope of the CBAM should follow the principle of proportionality, ensuring that the expected (climate) benefits outweigh the administrative burden and implementation costs for importers and third countries.

**Therefore, UFE emphasises that, to ensure better visibility on the already negotiated time horizons, the only short-term solution is to improve the implementation of a default emission factor. Furthermore, UFE calls for a rapid coupling of the EU-ETS with third countries that have one, in order to limit the inefficiencies related to the application of CBAM and to ensure a level playing field in the case of wholesale electricity markets coupling.**