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Call for Evidence for an Impact Assessment

Carbon Border Adjustment Mechanism (CBAM) – downstream extension, anti-circumvention, and rules on electricity emissions

The International Tracking Standard Foundation (I-TRACK Foundation) welcomes the adoption of the European Commission's Carbon Border Adjustment Mechanism (Regulation (EU) 2023/956) in May 2023. Pulling together this world-first legislation is a complex and commendable feat, and we fully support the Commission's intent to both protect the European economy and industry from carbon leakage and to accelerate the decarbonisation of global supply chains.

Protecting European industry from carbon leakage while pushing for more renewable energy and carbon pricing in Europe's trading partners provides simultaneous protection for European value chains and provides incentives to make them more sustainable. Pricing embedded carbon strengthens the case for Clean Trade and Investment Partnerships under the Clean Industrial Deal and grants European industry better access to more sustainable materials in often complex value chains. However, as currently proposed, the CBAM threatens the goal of encouraging local renewable energy use in non-European countries. If a CBAM adherent product's embedded emissions are calculated based on national averages (default values), the CBAM would end up treating producers the same regardless of their efforts to reduce their climate impact by using onsite or offsite renewable energy as a production input. Indeed, producers of goods covered by the CBAM would pay twice. Once for the renewable energy they contract to purchase and a second time for emissions based on national averages (default values) for which they are not accountable due to their explicit procurement of renewable energy. This will undermine the motivation for producers outside of the EU to proactively use, and invest in, renewable energy.

Treating all commodity producers identically by using default values, irrespective of their efforts to reduce the emissions related to their production processes, reduces the incentive to invest in low-carbon technologies in their home countries. In addition, it entails exporting this investment from local low-carbon technologies to the European market in the form of mandatory CBAM certificates. In this way, the payment for CBAM certificates constitutes an opportunity cost that could have been invested locally in low-carbon solutions like renewable electricity. This would weaken the ongoing transition to carbon-free commodity production and the development of low-carbon technologies. It would also increase global CO2 emissions by reducing the demand, and revenue, for locally produced renewables and low-carbon technologies. This opportunity cost will also affect European companies with production or suppliers

outside of Europe, reducing their incentives to run extra-European facilities on renewable energy.

The best way to encourage these commodity producers to purchase more renewable energy or low-carbon technologies is to require them to substantiate their products' actual embedded emissions based on contractually defined emission rights such as energy attribute certificates (EACs). Making use of these internationally recognized and implemented certification standards will allow for clarity as to the use of renewable electricity, CCUS, renewable gases, and other decarbonizing technologies.

The issuance, ownership, and cancellation of tradable EACs provide proof of the emissions related to a given product. The protocols and infrastructure for allowing consumers to claim the use of renewable energy already exist in the EU—as defined in the REDIII—in the US and in many other countries in the world. Most global EAC systems are local or regional adoptions of the system of Guarantees of Origin first designed by the EU. These tools can be used to verify the amount of carbon embedded in a volume of products imported into Europe at any given time, and as a basis to understand the total embedded emissions in each product.

We are pleased to see that the Commission incorporated stakeholder feedback (such as our previous guidance) into the final design of the CBAM mechanism to include contractually defined emissions ownership for embedded emissions claims. In simpler terms, the Commission has now made it clear that CBAM-adherent commodity producers (declarants) will have the option of either using default emissions factors for electricity emissions (Annex IV, point 4.3) or applying actual indirect emissions if they can prove a direct physical link or power purchase agreement (PPA) with a renewable electricity producer for an equivalent amount of electricity used in their commodity's production (Annex IV, point 5 & 6).

In practice, we believe the Commission's definition of PPA provided in Annex IV point 1(f) will be interpreted broadly to include any contractually defined emissions ownership agreements between energy producers and users. It is useful to note that the term 'PPA' is not always applied consistently across the world. What is clear however is that all PPAs rely on energy attribute certificates (EACs) to provide their renewable claims. These EACs provide the basis of the contractually defined emission ownership required by CBAM and can be utilized to support the implementation of the CBAM. The vast difference in specificity between the requirements of PPAs for electricity as a CBAM good and PPAs for electricity used in the production process of CBAM goods also risks creating great uncertainty among CBAM reporters as to the currently valid methodology for reporting actual indirect emissions from electricity consumption in the latter case.

Broadening the interpretation of PPAs to include EACs is not only logical but also supports the transparency and robustness of the CBAM. EACs have already been implemented in the EU—as defined in the Renewable Energy Directive—in the US and in many other countries in the world (such as the 60+ countries adherent to the I-TRACK Foundation's I-REC for Electricity market). These existing mechanisms *can* and *should* be leveraged by CBAM declarants as complementary tools to verify the embedded emissions of each product imported into Europe. Moreover, EACs can ease adherence for both declarants and verification bodies, by providing a trustworthy foundation for claims of renewable electricity usage, as well as other production inputs such as hydrogen, biomethane, and durable carbon dioxide removal credits.

Our guidance to the Commission for future implementing acts

Whilst the CBAM regulation is highly prescriptive in some areas, other elements require further attention and clarification through implementing acts and the establishment of best practices during the CBAM's transitional period. We highly recommend that the Commission considers the following key principles to ensure the CBAM's successful implementation:

Principle 1: Pursue clarity, simplicity, and consistency between key pieces of EU legislation

Unlike previous EU climate and energy legislation, the CBAM has a global reach, which means that new audiences will be introduced to several pieces of European legislation, such as the REDIII and the RFNBO delegated acts. With the source of electricity as a key component of indirect emissions for most CBAM-impacted sectors, the Commission needs to use implementing acts to clearly and simply articulate what best-practice adherence looks like for reporting electricity usage emissions. As a first step, the Commission's provided definition of PPAs in the CBAM regulation can be strengthened to encourage the use of voluntary EAC schemes (as has been done in Recital 15 of the RFNBO delegated acts). Creating stronger interlinkages between these two pieces of legislation (and other relevant acts for different commodities) will provide clearer, more consistent regulatory guidance for Europe's trading partners. In turn, this will accelerate the understanding and acceptance of best-practice renewable energy procurement in exporting nations.

Principle 2: Encourage actual emissions accounting over default emissions to drive decarbonization

As explained in our previous position paper, an over-reliance on default emission factors may have perverse impacts on developing renewable energy markets. If

imported products' electricity usage emissions are calculated based on default values, the CBAM would end up treating producers the same regardless of their efforts to reduce their climate impact by using onsite or offsite renewable energy as a production input. When it comes to implementing the CBAM and achieving its policy intent, the best way to encourage commodity producers to purchase more renewable energy or to adopt low-carbon technologies is to require them to substantiate their products' actual embedded emissions with contractually defined emission ownership agreements such as EACs.

Principle 3: Work with national governments to define default residual mix emission factors

With two CBAM calculation methodologies for indirect emissions (default factors and actual values) it is critical that double counting of renewable electricity is avoided. Default country emission factors of electricity grids will need to exclude renewables that have already been claimed and procured by consumers through PPAs and the associated EACs (as acknowledged in Annex IV point 5). This is quite a complex undertaking, but it has been successfully achieved before in markets with robust voluntary EAC mechanisms (such as the Guarantee of Origin in Europe). From our experience, the national governments of commodity-exporting countries are best positioned to define default residual mix emissions factors together with standard-setting bodies, such as the I-TRACK Foundation. Creating a renewable market that is aligned to robust, international standards is a critical first step in this direction for countries that do not already have these processes in place.

Principle 4: Leverage existing voluntary mechanisms to reduce the administrative burden for CBAM declarants and verification bodies

Lastly, additional implementing acts should aim to reduce the administrative burden on CBAM declarants by leveraging existing mechanisms of best practice. In this context, EACs, and explicit recognition of the Guarantee of Origin, US Renewable Energy Certificate and the I-REC for Electricity are well-suited to support CBAM declarants with their actual emissions claims and record-keeping requirements, whilst also easing the verification process for accredited verifiers. Moreover, the to-be-developed CBAM registry should allow for efficient integration with existing EAC registries to accelerate and authenticate the declaration and verification process for relevant parties.

Closing remarks

The I-TRACK Foundation looks forward to working closely with the Commission and our global network of stakeholders to help standardise emissions reporting through EACs to help support the implementation of the CBAM.

Given that PPAs (and by extension reliable EACs such as Guarantees of Origin, Renewable Energy Certificates, and I-REC for electricity) now have a clear place within CBAM, we believe these instruments will help increase the value of renewable energy in Europe's trading partners and create market-based pressure for renewable energy expansion. As always, the I-TRACK Foundation will continue to work hard to get the principles of ex-post, fact-based certification –as a basis for contractually defined emission ownership – embedded in the national regulatory policy of Europe's trading partners to ensure demand-driven, market-based renewable electricity and low-carbon technology growth is supported.