

Company Name or Organisation:	Fuels Industry UK
Please briefly describe your organisation and interest in this process	We are a trade association representing the UK’s six large refineries as well as large scale importers of fuel. Refineries are within the scope of the UK Emissions Trading Scheme and that we believe that fuel products should be within the scope of the UK CBAM.
If you are responding on behalf of a representative organisation, how many members do you have and how did you obtain the views of your members:	The trade association has 8 board member companies who have been asked to input to this response.
If you would like your response or personal details to be treated <b>confidentially</b> , please explain why:	Not applicable

## 1. Overview

The Commission for Carbon Competitiveness was founded in 2023, as a cross-party and cross-industry effort to explore how the UK can reach net zero without undermining the competitiveness of British industry.

Following the launch of our first report, *Fixing the Carbon Leak*, which successfully advocated for the introduction of a Carbon Border Adjustment Mechanism (CBAM) in the UK, the Commission is looking to understand the views of industry and trade experts on carbon leakage in the export market.

The Commission would welcome written evidence from interested parties, with the intention of summarising the findings in a short report for Ministers later this year. Respondents are also welcome to submit for the record any existing position papers, legal opinion or economic analyses that may be of relevance to the Commission’s enquiry.

## **Your views of the UK Government’s existing approach to carbon leakage, including the current proposals for a Carbon Border Adjustment Mechanism (CBAM).**

### *Current approach to carbon leakage*

Fuels Industry UK supports the principles behind carbon pricing to drive decarbonisation at the lowest possible cost, with the EU and UK ETS forming the cornerstone energy and climate policy since 2008. However, existing carbon leakage measures (free allocation and indirect costs compensation) mitigate carbon costs only partially in practice, and variably across industrial sectors. The CCC’s 2024 progress report to Parliament suggests that the current approach to carbon leakage is not working; “... whilst UK territorial emissions fell 47% from 1990–2021, imported emissions increased by 21% over the same period, resulting in a reduction of UK consumption emissions of only 24%.”

The UK’s implementation of carbon leakage policies sees an increasing gap between free allowances and verified emissions for refining coupled with the increasing cost of allowances – increasing the risk of carbon leakage. UK refineries are not adequately protected from carbon leakage, with the announcement that the Grangemouth refinery will be turned into an import terminal after Q2 of 2025 directly referencing its inability to compete with other sites globally among its reasons for ceasing refining operations.

The gradual loss of refining capacity, if allowed to happen, reduces the UK’s fuel security of supply alongside our domestic industrial capability. Refineries offer a ‘natural hedge’ by their availability to supply fuels both by refining of crude oils – which offer a large global market from which to access oils – as well as being able to import finished products. Import terminals are only able to do the latter, and access only the smaller product market. Given refineries are a foundation sector of the economy – supplying fuels, chemical feedstocks, lower carbon fuels, other (non-fuel) products and have important roles in industrial clusters given their scale and expertise in hydrogen and carbon capture – there is also the threat to UK economic growth if they are lost due to carbon leakage.

The reasons for the growing cost of compliance is, in part, deliberate – with carbon prices expected to rise over time and act as incentive for decarbonisation activity – however, the UK system itself has principles which are not delivered in practice and do not fairly treat UK refineries which further pushes up their costs against global competitors and the current carbon price effectively acts as a tax on UK production:

- ETS free allowance allocations (FAA) are based on performance benchmarks set at the level of the average best 10% installations, however, the UK inherited its benchmarks from the EU system which we believe disadvantages UK refineries. In the most recent data, the refining sector received around 60% of verified emissions as free allocations, considerably lower than other sectors in the UK which are less exposed to carbon leakage risk. This is also lower than it would be if

the benchmarks used were more reflective of the UK refining sector itself, which has some operational setups seen rarely in the EU and which were not therefore fully considered in the development of the EU benchmark. However, we note that the free allowance allocations policy addresses carbon leakage for all processing outputs, so it is a mitigation that seeks to address carbon leakage for production whether products are used in the UK or exported.

- The UK's policy of compensation for indirect costs on ETS cannot be claimed by UK refineries, despite the fact that refiners in the EU are eligible for the equivalent scheme. Fuels Industry UK believes the data used to assess eligibility by the Department for Business and Trade is incorrect but despite the concerns being raised, the assessment of eligibility has not been revised.
- Furthermore, there is an expectation that free allocation levels will come down and that the free allocation trajectory may be changed at short notice and, crucially, not in line with the trajectory of other policies for decarbonisation in the UK (for example the CBAM, but also the introduction of CCUS and Hydrogen business models which have been pushed back beyond expected reductions in free allowance allocations from 2026).

#### *Proposals for a Carbon Border Adjustment Mechanism (CBAM):*

Given that the refining sector is at a high risk of carbon leakage and with the prospect of FAA levels reducing still further, we view that the refining sector should be brought within scope of the UK CBAM regime. If it is well designed – we believe it can offer a more effective carbon leakage mitigation than current policies. Nonetheless, at this point, the fuels sector is out of scope of the UK (and EU) CBAM proposals as there is not a suitable methodology for the sector to deliver a CBAM. Fuels Industry UK is working on a proposal which we will share with Treasury in 2025.

In terms of the proposed CBAM itself it is essential that the CBAM both consider and seek to address exports as well as imports (noting that FAA does this already). Many industries (for example the car industry) can only successfully operate in the UK if they have viable export routes, as well the indigenous UK market. Refiners also operate on the same basis, with a need for exports to maintain viable UK operations – in 2023, the value of refined oil exports was £13.18 billion according to the ONS. Refineries are co-production facilities of multiple products – all of which vary in demand and supply over time – operating in an environment where the UK (and EU) is long on gasoline and short on diesel and jet fuel, meaning that exports are an essential component of our industry to balance demand with supply. Continuation of free allowance allocation under the UK ETS must therefore continue to support exports and investment in UK manufacturing industries to avoid deindustrialisation at this point.

On a point of detail: we note that the retention of FAAs on total production may reduce the CBAM liability on imports, and therefore the 'effectiveness' of the CBAM. Because of

this, any FAAs intended to address providing relief for UK ETS on exports needs to be considered export (only) protection. And, therefore, not included in the calculation of the CBAM liability that would be applied on imports.

**Your view of how carbon leakage in the export market will impact your business/sector, as well as the UK more widely.**

As noted in our response to question 1, export markets are essential to both the fuels supply chain and to refineries themselves as a means of balancing demand for products with their supply and ensuring that all refinery products are able to find a market. For this reason we view that carbon leakage policy, if well designed, must address carbon leakage risk on exported products as well as products supplied into the domestic market.

As the diagram below shows, the UK refined petroleum products sector is among the most carbon leakage exposed sectors in the UK by Government’s own assessment. Adequately addressing carbon leakage is therefore highly important for our sector.

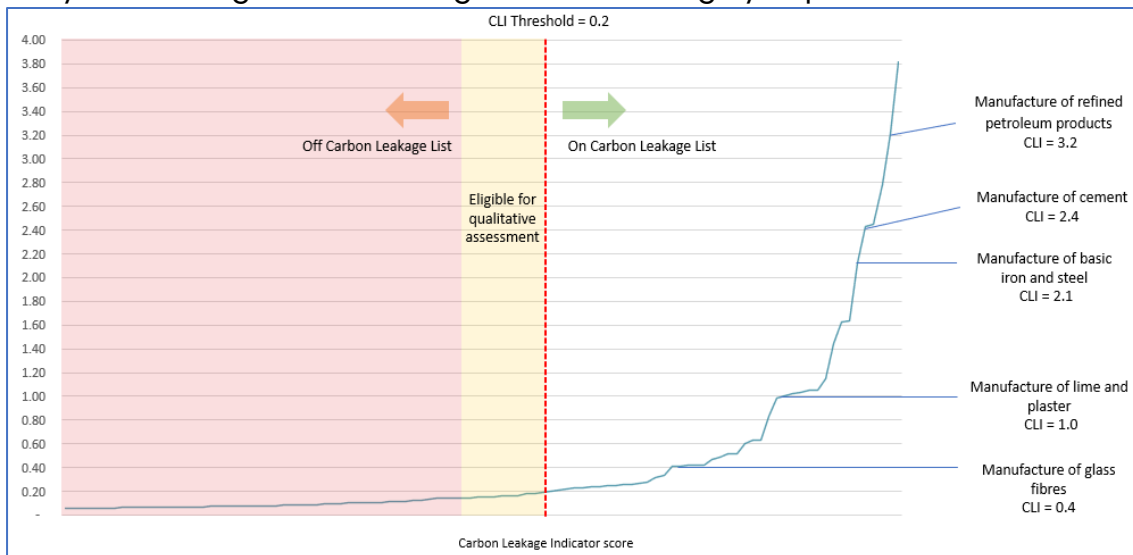
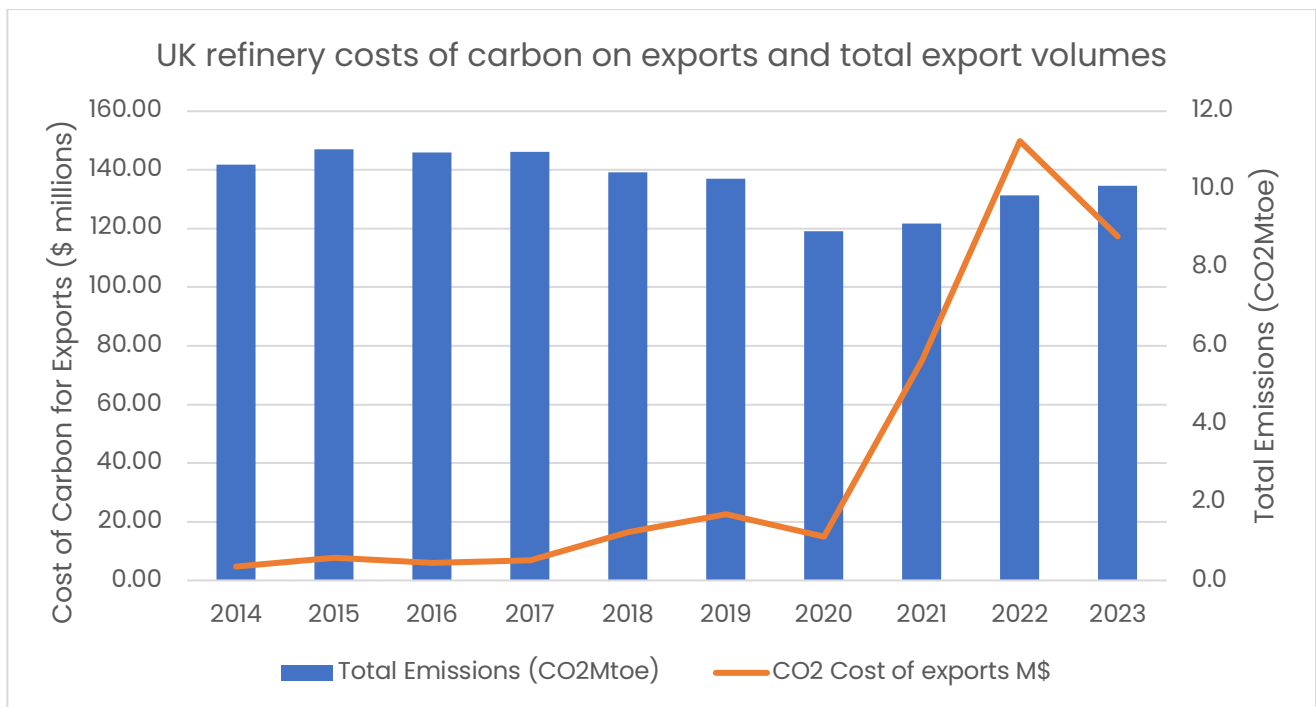


Diagram: Carbon leakage risk for the UK refining sector based on carbon leakage indicator score; source [Analytical Annex](#) to the Free Allocation Review, December 2023

In terms of how the fuels sector will be impacted by carbon leakage in the export market, we have quantified the approximate carbon costs which are paid by UK refiners on their current exports by using (publicly available) ETS data on verified emissions and free allowances and taking a pro-rata value of total compliance costs based on exports (results on next page). Over the last decade, with costs rising rapidly from 2017 in line with stark rises in ETS (both EU and then UK) prices during that period, we see a peak estimated costs of over £149m for the six refineries in 2022. This is effectively the carbon leakage ‘policy gap’ that companies are forced to pay for at present on exports.



\*To note, given that the Grangemouth refinery has announced it will cease refining operations in 2025, data shown is for the other UK refineries only.

It is important to note that the numbers above are calculated in what we consider to be an imperfect carbon leakage environment, so the number itself reflects that imperfection. If carbon leakage risk were to be fully addressed for exports of UK refineries then we would expect the UK sites to be more competitive globally and able to export more product should they wish to so the value is likely an underestimate. It is acknowledged that exports will generally be the ‘second choice’ of companies, after wishing to deliver domestically (and as noted earlier in our submission exports are an essential outlet for refineries as co-production manufacturing facilities), however, we view that if companies were more competitive in the wider market – both UK and rest of world – that our utilisation rates (indicatively 91% over the last decade) could increase.

**Your view on potential mechanisms to address carbon leakage in the export market, and their compatibility with our international trade obligations.**

We would encourage UK policymakers to prioritise providing sufficient carbon leakage protection for their industry and the people working to manufacture the things that the nation and the economy depends upon over concerns about a potential WTO challenge (so long as we are confident in our arguments and justifications for such intervention). Fuels Industry UK does not have trade law expertise, however, it is essential for policy certainty that carbon leakage mitigation policies have a solid legal and trade policy grounding so they are not subject to challenge and eventual change. Given that consideration, we would encourage policymakers to proactively engage international partners to seek alignment and common agreement of the compliance with WTO (and

other) rules surrounding trade both to avoid the volatility from later policy changes but also to ensure a high degree of compliance – particularly in the case of a CBAM.

FAAs as a policy mitigation may – for now – have advantages over a CBAM as it is well established and understood in international markets and not being directly challenged at the WTO for example.

The introduction of the EU CBAM has and continues to be questioned by countries under World Trade Organisation (WTO) rules, most notably the [non-discrimination rules](#) (Most Favoured Nation and National Treatment). However, a CBAM addressing exports is, in our view, WTO compliant as it is not a subsidy and is an environmental measure (rather than a trade measure). We would also note that while there has been some consideration of a CBAM against global trade rules, the export component of a CBAM has not yet been tested at the WTO.

UK ETS is a unilateral policy choice of the UK Government. Any future decision to remove a unilateral policy choice cannot be considered a subsidy or other benefit gifted to domestic industry. Also, by only seeking to alleviate carbon leakage protection for imports (through a CBAM) and not taking action on exports, the Government may increase the grounds for a WTO complaint, as it could reasonably be accused of only looking to protect its internal market against imports. If CBAM/ETS policy is truly meant to be an environmental measure, then it should be addressing both given emissions occur domestically and overseas.