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# UK Emissions Trading Scheme: Moving the Second UK ETS Free Allocation Period Authority Response

A joint response from the UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland

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# Introduction

This document sets out the UK ETS Authority's response to the targeted consultation<sup>1</sup> seeking views on moving the start of the second allocation period for stationary installations from 2026 to 2027 and extending the current allocation period to include 2026.

Our current approach to Free Allocations for stationary installations under the UK ETS prioritised continuity for operators and largely carried over methodology from the EU ETS Phase IV. The Authority launched a review into Free Allocation policy in 2021 with a call for evidence<sup>2</sup>, with the aim to ensure Free Allocation policy is working effectively in the UK context to both incentivise emissions reduction and protect energy intensive, trade exposed industries from the risk of carbon leakage. We have carried out this review in a phased approach:

- The first phase focused on the share of Free Allocations under the cap available to be given out for free<sup>3</sup>.
- The second phase focused on the methodology for calculating, and distributing, Free Allocations.

The first phase concluded in June 2023 with agreement of the overall pot of allowances available to be distributed for free until 2030. In the second phase, the UK ETS Authority published the [Free Allocation Review consultation](#), which sought views on how Free Allocation policy could be adjusted to better target free allocations for sectors most at risk of carbon leakage. The aim was to implement any changes ahead of the second allocation period in 2026.

The Authority has not proposed to change any of the structural features of the UK ETS that set overall ambition. In 2024 we implemented a net zero aligned cap, which constituted a 30% reduction on the previously legislated cap out to 2030. Overall allowances available under the cap will reduce from 156m in 2021 to approximately 50m in 2030.

Free allocation policy is currently the primary mitigation for carbon leakage. In December 2023 HM Treasury announced the introduction of a UK Carbon Border Adjustment Mechanism (CBAM) in 2027. CBAMs are another mitigation to carbon leakage. They address carbon leakage risk by applying an effective carbon price to products being imported into the UK. A UK CBAM will be applied to several sectors covered by the UK ETS. Of 47 respondents to the Free Allocation Review consultation who expressed a view on the overall approach to carbon leakage, 41

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<sup>1</sup> This consultation was sent to operators from their Regulatory body on 26<sup>th</sup> September 2024 and closed on 11<sup>th</sup> October 2024.

<sup>2</sup> <https://assets.publishing.service.gov.uk/media/60507ae48fa8f505bfdac4d6/uk-ets-call-for-evidence.pdf>

<sup>3</sup> Developing the UK Emissions Trading Scheme (UK ETS), <https://www.gov.uk/government/consultations/developing-the-uk-emissions-trading-scheme-uk-ets>, published 25 March 2022

(87%) made clear that they want changes to free allocation policy to align with introduction of the UK CBAM.

## Authority Response

### Summary of Proposal

Having heard stakeholder views and recognising concerns over the potential misalignment of industrial decarbonisation and carbon leakage policy, the UK ETS Authority consulted existing operators in the scheme on a proposal to move the start of the second allocation period from 2026 to 2027. This will enable us to align the implementation of the Free Allocation Review with the introduction of the UK CBAM, ensuring a holistic policy approach to carbon leakage.

Given the depth and breadth of developments across the scheme, a move to 2027 will also provide additional time for careful consideration of stakeholder views and policy development in what is a complex and challenging area, which we do not believe would be possible for implementation in 2026. It would ensure that changes to free allocation resulting from the review, and any changes to adjust free allocation for CBAM covered sectors, will all take place at the same time, minimising uncertainty for business.

The Authority proposed that:

1. For the purposes of determining free allocation for stationary installations, 2026 will be treated as an extension of the current allocation period.
2. The baseline data reporting exercise will continue as planned from 1 April to 30 June 2025.
3. Applications for the 2027-2030 free allocation period will be confirmed in 2026, following the publication of any changes to the free allocation rules resulting from the Free Allocation Review.
4. Updated lists of installations with hospital or small emitter (HSE) and ultra-small emitter (USE) status for the years 2026-2030 will come into effect from 2026, with the application window for inclusion on these lists open from 1 April to 30 June 2025.
5. Changes to the current rules regarding the electricity generator classification will come into effect in 2026, as previously announced in the [Authority Response to the Developing the UK ETS consultation](#).
6. In the unlikely instance that a cross-sectoral correction factor (CSCF) is triggered in 2026, we will mitigate its application through use of our reserves.

## Summary of Responses

### **Question: Do you agree with the proposal to move the start of the next allocation period to 2027 and treat 2026 as an extension of the current allocation period?**

The UK ETS Authority received 26 responses to the consultation. Twenty (77%) respondents agreed with the proposal, three (11.5%) disagreed, and three (11.5%) expressed neither agreement or disagreement.

Of the 20 who agreed, 13 (65%) gave alignment of changes to free allocation with the introduction of the UK CBAM in 2027 as their main reason. Eleven (55%) also urged the Authority to communicate the results of the Free Allocation review as soon as possible. Three (15%) stated their wish for free allocation to remain at the same level. Three (15%) asked that the baseline years for the second allocation period should remain the same as before, rather than being shifted forward a year.

Of the three who disagreed, two gave negative impact on investment in carbon capture and storage and other decarbonisation technologies as a reason. One respondent did not want there to be a delay to implementation of any changes resulting from the Free Allocation review.

Of the three who neither agreed or disagreed, two stated that they wanted both changes to free allocation and the UK CBAM to be implemented in 2026. One respondent stated that delay in changes to benchmarks could impact investment in decarbonisation technologies.

## Authority Response

The UK ETS Authority has decided to implement the proposed changes. The start of the second UK ETS free allocation period will be moved from 2026 to 2027. The 2026 scheme year will be treated as an extension of the current allocation period and free allocation for the 2026 scheme year will be determined on the basis of the same rules as the years 2021-2025, as set out below.

The Authority has considered all of the responses to the consultation, and the benefits and risks of moving the start of the second allocation period by one year. A large majority of respondents agreed with the proposal, and we have heard the concerns of scheme participants regarding alignment with the implementation timeline of the UK CBAM to ensure a consistent approach to carbon leakage mitigation.

We have also considered concerns regarding the delay including the impact on policy certainty and ambition. The changes laid out below will only affect the technical rules regarding how free allocation is distributed to participants and will not impact the overall ambition of the scheme.

The changes below will not impact either the overall cap or the Industry Cap which set the net zero aligned limit on allowances available to be given out for free. The move of the second allocation period will not impact the auction share, which was also reset following the announcement of the net zero cap last year.

### Free Allocation for the 2026 Scheme Year

No changes to benchmarks or the carbon leakage list will be introduced in 2026. For the purposes of determining free allocation for stationary installations, 2026 will be treated as an extension of the current allocation period. Free allocation for stationary installations for the 2026 scheme year therefore will be determined according to the benchmarks, carbon leakage list, reduction factors and other rules currently in legislation. It will be calculated according to current rules, using the same historical activity level (HAL) data as used for 2025. Once free allocation for 2026 has been calculated, the UK ETS Authority will add the 2026 scheme year to the 2021-2025 allocation table and distribute free allowances to operators by 28 February 2026.

Note that existing rules for activity level changes (ALCs) will continue to apply, and free allocation for the 2026 scheme year may be subject to revision if an ALC occurs in 2026, as per current legislation (i.e., on the basis of the activity level reports (ALRs) submitted to regulators in 2025 and 2026).

### Free Allocation Application Process for the 2027-2030 Allocation Period

The free allocation application process for the 2027-2030 allocation period will be amended to become a two-stage process.

1. The first stage, the baseline data reporting (BDR) exercise, will take place from 1 April to 30 June 2025 as planned. Operators of all installations that wish to apply for free allocation in the 2027-2030 allocation period should submit a complete BDR at this time. The indicative free allocation values produced by the BDR template may be subject to revision following the publication of any changes to the free allocation rules resulting from the Free Allocation Review.

Note that free allocation for the 2026 scheme year will not be determined using data from the BDR. See section above for more information.

2. The second stage will take place in 2026, after any changes resulting from the Free Allocation Review have been announced. From 1 April to 30 June 2026, operators will confirm their intention to continue their application for free allocation. This will allow operators to confirm or withdraw their application following the publication of any changes to the free allocation rules resulting from the Free Allocation Review. Some operators may have to resubmit some data at this point (for example, if a change in the carbon leakage list resulted in a heat or fuel sub-installation needing to be split into carbon leakage exposed and non-carbon exposed sub-installations). We will provide information to impacted operators in advance of the second stage window.

Once free allocation for the 2027-2030 allocation period has been calculated, the UK ETS Authority will publish the preliminary allocation and distribute free allowances to operators by 28 February 2027 at the latest.

## Hospital or small emitter (HSE) and Ultra-Small Emitter Lists

The Authority understands that some operators may have planned on applying for hospital or small emitter (HSE) or ultra-small emitter (USE) status for the years 2026-2030. We will not be making any changes to the HSE/USE application process for the 2026-2030 HSE/USE lists. Although, note that we have separately consulted<sup>4</sup> on changing the eligibility criteria for USE status during the years 2026-2030 to enable operators who commenced a regulated activity after 1 January 2021 to apply with at least one scheme year of data. We will confirm the outcome of this consultation shortly.

The application window for HSE/USE status in 2026-2030 will remain 1 April to 30 June 2025. This means that operators wishing to apply for either status for the years 2026-2030 can still do so.

Operators of eligible installations that have HSE/USE status in 2026 will have the opportunity to apply to rejoin the UK ETS from 2027 for the 2027-2030 free allocation period. This will allow operators to make an informed decision as to their preferred status following the publication of any changes to the free allocation rules resulting from the Free Allocation Review.

Operators that are applying for HSE or USE status in 2026 and intend to simultaneously apply for free allocation for the 2027-2030 free allocation period, should submit a full BDR and monitoring methodology plan (MMP) in the first stage of the free allocation application process from 1 April to 30 June 2025. If they subsequently choose to apply to re-enter the main UK ETS, and are eligible for free allocation, they will then be able to complete their application for free allocation during the second stage of the free allocation application process from 1 April to 30 June 2026.

Additionally, if an HSE/USE loses their HSE/USE status during the 2027-2030 allocation period, provided that they submitted a BDR in the first stage of the free allocation application process, they may be able to obtain free allocation upon joining the full scheme under Schedule 8A to the Order. We will not be making any changes to this process.

If an eligible installation on the HSE or USE lists is planning or expecting to be removed from either list in 2025 or 2026 and wishes to be able to apply for free allocation for the 2026 scheme year, the operator should submit a full BDR and MMP during the upcoming 1 April to 30 June 2025 window. The 2023 activity data from the BDR will be used to determine free allocation for 2026. This will be allocated in 2026.

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<sup>4</sup> [UK ETS Authority - Technical consultation September 2024.pdf](#)



Free allocation for the 2027-2030 allocation period will be determined using baseline period data from the BDR as normal.

If the operator of an installation on the HSE list applies for an increased emissions target in the 2026 scheme year, then the increased target for that year will be calculated with reference to the benchmarks in legislation (i.e., the same benchmarks as the 2021-2025 allocation period). However, the target for the years 2027-2030 will be recalculated to take account of any changes to benchmarks resulting from the Free Allocation Review.

### Electricity Generator Classification

In the [Authority Response to the Developing the UK ETS consultation](#), the UK ETS Authority announced changes to the electricity generator classification that would come into effect in 2026. These changes will come into effect in 2026 as planned and may result in some installations currently classed as electricity generators becoming eligible for free allocation, or for additional free allowances, in 2026.

Operators of installations currently classed as electricity generators, but that meet the criteria laid out in legislation and wish to apply for free allocation for 2026 and/or the 2027-2030 allocation period, should submit a full BDR and MMP during the 1 April to 30 June 2025 window, which must include any activity newly eligible for free allocation due to these changes to the electricity generator classification. If eligible, the 2023 activity data from the BDR will be used to determine free allocation for these installations/sub-installations for the 2026 scheme year. This will be allocated in 2026. Historical activity levels for the 2027-2030 allocation period will be updated using baseline data from the BDR as normal.

### Cross-Sectoral Correction Factor

As proposed in the consultation, in the unlikely instance that a cross-sectoral correction factor (CSCF) is triggered in 2026, the UK ETS Authority will mitigate its application through use of our reserves.