Consultation: Extending the UK ETS Cap Beyond 2030

Closing date: 9 April 2025

February 2025

Any enquiries regarding this publication should be sent to us at:
emissions.trading@energysecurity.gov.uk

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Foreword

The UK Emissions Trading Scheme (ETS) is a cap-and-trade scheme that sets an overall limit on emissions for the sectors covered by the scheme. The downward trajectory of the cap drives emissions reductions in the covered sectors towards UK-wide climate targets.

The UK ETS is jointly run by the UK ETS Authority, made up of the UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland (DAERA).

Phase I of the ETS runs from 1 January 2021 until 31 December 2030. The long-term pathway for the UK Emissions Trading Scheme was published on 18 December 2023, setting out the Authority's continuing commitment to the long-term future of the UK ETS. The long-term pathway announced the Authority's intention, subject to consultation, to continue the UK ETS beyond 2030 until at least 2050.

To ensure that the UK ETS continues to operate after 2030, the Authority is seeking input on proposals for extending the UK ETS beyond the end of Phase I. This consultation therefore seeks views on:

- Extending the UK ETS into a second phase from 1 January 2031 onward.
- The length of a post-2030 Phase II.
- Whether to allow banking of emissions allowances (UKAs) between Phase I and a post-2030 Phase II of the Scheme.

General information

Why we are consulting

The UK Emissions Trading Scheme (ETS) Authority is seeking input on proposals for extending the UK ETS beyond the end of Phase I at midnight on 31 December 2030. This fulfils the commitment made in December 2023 within the UK Emissions Trading Scheme long-term pathway[1] to consult on the extension of the Scheme. This consultation proposes options and seeks views on:

- Extending the UK ETS into a second phase from 1 January 2031 onward.
- The length of a post-2030 Phase II.
- Whether to allow banking of emissions allowances (UKAs) between Phase I and a post-2030 Phase II of the Scheme.

Consultation details

Issued: 12 February 2025

Respond by: 9 April 2025

Enquiries to:

Emissions Trading, Department for Energy Security and Net Zero 3rd Floor
3-8 Whitehall Place
London
SW1A 2EG

Email: emissions.trading@energysecurity.gov.uk

Consultation reference: Extending the UK ETS Cap Beyond 2030

Audiences: This consultation is expected to be of most interest to non-governmental organisations (NGOs), academics, thinktanks, as well as the industrial, power and aviation sectors with obligations under the UK ETS. This consultation is not limited to these stakeholders; any organisation or individual is welcome to respond.

Territorial extent: This consultation relates to the UK ETS, which operates across England, Scotland, Wales and Northern Ireland. This is a joint consultation, published by the UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland.

[1] https://www.gov.uk/government/publications/uk-emissions-trading-scheme-long-term-pathway

How to respond

Respond online at: https://energygovuk.citizenspace.com/energy-markets/extending-ukets-cap-beyond-2030

or

Email to: ukets.consultationresponses@energysecurity.gov.uk

Write to:

Emissions Trading, Department for Energy Security and Net Zero 3rd Floor
3-8 Whitehall Place
London
SW1A 2EG

When responding, please state whether you are responding as an individual or representing the views of an organisation.

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome.

Confidentiality and data protection

Information you provide in response to this consultation, including personal information, may be disclosed in accordance with UK legislation (the Freedom of Information Act 2000, the Data Protection Act 2018 and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential please tell us, but be aware that we cannot guarantee confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not be regarded by us as a confidentiality request.

We will process your personal data in accordance with all applicable data protection laws. See our privacy policy.

Consultation responses will be shared across the UK ETS Authority.

We will summarise all responses and publish this summary on GOV.UK. The summary will include a list of names or organisations that responded, but not people's personal names, addresses or other contact details.

Quality assurance

This consultation has been carried out in accordance with the government's consultation principles.

If you have any complaints about the way this consultation has been conducted, please email: bru@energysecurity.gov.uk.

Introduction

The UK ETS is jointly run by the UK ETS Authority (hereafter 'the Authority') made up of the UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland (DAERA).

In July 2023, the Authority announced significant changes to the UK ETS cap for 2024-2030 to bring it in line with climate targets across the UK, following the Developing the UK ETS consultation[2]. However, the Authority recognises that ambitious climate action will be required beyond 2030, including in the traded sector.

In December 2023, the Authority published a long-term pathway for the UK ETS beyond 2030, confirming the intent to legislate for continuing the Scheme until at least 2050, subject to consultation. We committed to ensuring the Scheme remains aligned with a net zero trajectory and providing participants with long-term certainty to support much needed investments in decarbonisation.

This consultation seeks views on the continuation of the Scheme post 2030 and sets out the Authority's process for setting the cap for the next phase of the Scheme.

This consultation proposes options and seeks views on:

- Extending the UK ETS into a second phase from 1 January 2031 onward.
- The length of a post-2030 Phase II.
- Whether to allow banking of emissions allowances (UKAs) between Phase I and Phase II.

Net Zero across the UK

Decarbonisation sits at the heart of industrial policy across all four nations within the UK. As set out in the Climate Change Act 2008, the UK as a whole is committed to the legally binding target of reducing the net UK carbon account by 100% of the 1990 baseline by 2050[3]. This is referred to as the net zero target. On this basis, England, Wales and Northern Ireland are each targeting net zero emissions across their economies by 2050, and Scotland has set its own target[4] of reaching net zero by 2045.

Under Section 4 of the Climate Change Act[5], the UK Government must set and adhere to five-yearly carbon budgets, which place a limit on the total greenhouse gas emissions for the UK economy in a given five-year period. These carbon budgets reduce the UK's emissions to net

[2] https://www.gov.uk/government/consultations/developing-the-uk-emissions-trading-scheme-uk-ets
[3] https://www.legislation.gov.uk/ukpga/2008/27/contents
[4] https://www.legislation.gov.uk/asp/2009/12/contents
[5] https://www.legislation.gov.uk/ukpga/2008/27/section/4

zero over the period between 2008 to 2050, and each five-year carbon budget must be set twelve years in advance.

On 17 December, the UK Government published *Accelerating to Net Zero: Responding to the CCC Progress Report and delivering the Clean Energy Superpower Mission*[6]. This sets out the opportunities of accelerating to net zero, including protecting families from future price shocks and creating hundreds of thousands of jobs across the country. The UK Government will also publish a revised Carbon Budget Delivery Plan by May 2025 and set Carbon Budget 7 (2038-2042) by the statutory deadline of 30 June 2026, setting out the long-term decarbonisation pathway for the UK economy.

In Scotland, following changes made by the Climate Change (Emissions Reduction Targets) (Scotland) Act 2024, the Scottish Government are implementing a carbon budget target framework to set a trajectory to net zero emissions by 2045. All of Scotland's targets include a fair share of emissions from international aviation and shipping activity. Carbon budget levels will be set by secondary legislation once Scottish Government receive the latest advice from the Climate Change Committee. Once carbon budgets have been set, an updated draft Climate Change Plan, covering the period up to 2040, will be published.

The Senedd legislated for the net zero target for 2050 in March 2021 (the Environment (Wales) Act 2016 (Amendment of 2050 Emissions Target) Regulations 2021)[7], following advice from the Climate Change Committee (CCC) to Welsh Ministers in December 2020. Interim targets for 2030 (63% reduction) and 2040 (89% reduction) have also been set in legislation (the Climate Change (Interim Emissions Targets) (Wales) Regulations 2018, as amended) as well as carbon budget periods including Carbon Budget 2 (37% average reduction, 2021-25) and Carbon Budget 3 (58% average reduction, 2026-30) (the Climate Change (Carbon Budgets) (Wales) Regulations 2018, as amended). The Welsh Government subsequently published Net Zero Wales 2021-25 – Carbon Budget 2 on 28 October 2021[8]. Net Zero Wales focuses on achieving Wales's second carbon budget, but also looks beyond to start building the foundations for Carbon Budget 3 and the 2030 target, as well as net zero by 2050[9].

The Climate Change Act (Northern Ireland) 2022 (Act)[10] received Royal Assent on 6 June 2022. It sets a target of at least 100% reduction in greenhouse gas (GHG) emissions by 2050 and an interim target of at least 48% reduction in net emissions by 2030. In December 2024 the NI Assembly legislated for the first 3 Carbon Budgets for Northern Ireland in line with advice from the Climate Change Committee. In addition to the 2030 Target a new statutory 2040 Target was agreed at a 77% reduction in net emissions. This reaffirms Northern Ireland's commitment a net zero pathway. The Carbon Budgets will be delivered through a series of Climate Action Plans (CAP). The CAP will set out government's collective approach to delivering the emissions reductions required by all sectors to achieve Northern Ireland's first

[6] https://www.gov.uk/government/publications/committee-on-climate-change-2024-progress-report-government-response/accelerating-to-net-zero-responding-to-the-ccc-progress-report-and-delivering-the-clean-energy-superpower-mission-accessible-webpage
[7] https://www.legislation.gov.uk/wsi/2021/332/contents/made
[8] https://www.gov.wales/net-zero-wales-carbon-budget-2-2021-2025
[9] https://www.gov.wales/net-zero-wales-carbon-budget-2-2021-2025
[10] https://www.legislation.gov.uk/nia/2022/31/contents/enacted

carbon budget and longer-term emissions reduction targets. In addition, the Northern Ireland Executive's multi-decade draft Green Growth Strategy has been developed and sets out a long-term vision for tackling the climate challenge by balancing climate action with the environment and the economy in a way that benefits all the people of Northern Ireland[11]. The Energy Strategy for Northern Ireland was launched in December 2021[12], followed by the publication of an Energy Strategy Action Plan in January 2022 that sets out the actions that will be taken by central government and delivery partners towards a 56% reduction in energy-related emissions by 2030 on the pathway to deliver the 2050 vision of net zero carbon and affordable energy[13]. The Energy Strategy Action Plan is updated annually, with the most recent edition published on 28 March 2024[14].

UK Emissions Trading and the UK ETS Cap

The UK ETS came into operation on 1 January 2021, putting carbon pricing at the heart of an economy-wide approach to decarbonisation. It is key to building a decarbonised economy across the UK, delivering an economically efficient transition to net zero, and demonstrating the UK's leadership on carbon pricing. It gives businesses covered by the Scheme the certainty and flexibility to decide how to decarbonise most effectively at least cost, incentivising decarbonisation and green innovation.

The UK ETS is a cap-and-trade scheme that sets an overall limit on emissions (the cap) and establishes a market for allowances. The downward trajectory of the cap drives emissions reductions in the covered sectors towards ambitious climate targets. The market determines the price of allowances and allows participants to decarbonise where it is cheapest to do so.[15]

Since the launch of the UK ETS in 2021, the Authority has worked to develop and expand the Scheme in line with net zero commitments across the UK and the long-term drive towards a decarbonised economy. In July 2023, the Authority response to the 'Developing the UK Emissions Trading Scheme' consultation confirmed the decision to set a net zero consistent UK ETS cap[16]. The Authority set the cap at the top of the net zero consistent range and smoothed the transition to this new cap by releasing previously unallocated allowances from the industry cap into auctions. This approach ensured that the UK ETS continues to drive ambitious decarbonisation within the covered sectors, while allowing the market and participants time to adapt.

The Authority launched further consultations on future markets policy[17] and free allocation[18] in December 2023. In May 2024 the Authority consulted on how to integrate energy from waste

[11] https://www.daera-ni.gov.uk/consultations/consultation-draft-green-growth-strategy-northern-ireland
[12] https://www.economy-ni.gov.uk/publications/energy-strategy-path-net-zero-energy
[13] https://www.economy-ni.gov.uk/publications/energy-strategy-path-net-zero-energy-action-plan
[14] https://www.economy-ni.gov.uk/publications/energy-strategy-action-plan-2024
[15] For more information on the current design of the UK ETS, please visit our 'Participating in the UK ETS' page: https://www.gov.uk/government/publications/participating-in-the-uk-ets/participating-in-the-uk-ets
[16] https://www.gov.uk/government/consultations/developing-the-uk-emissions-trading-scheme-uk-ets.
[17] https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-future-markets-policy
[18] https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review

and waste incineration[19], as well as including engineered greenhouse gas removals into the Scheme[20], and sought views on including nature-based greenhouse gas removals. This was followed by further consultations on domestic maritime and non-pipeline transportation of CO2 in November 2024.

The first phase of the Authority's UK ETS evaluation report highlighted the crucial role of the UK ETS in supporting decarbonisation while underlining the importance of long-term certainty for participants[21]. The long-term pathway for the UK Emissions Trading Scheme[22] was published on 18 December 2023, setting out the Authority's continuing commitment to the long-term future of the UK ETS. The long-term pathway announced the Authority's intention, subject to consultation, to continue the UK ETS beyond 2030 until at least 2050.

[19] https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-scope-expansion-waste
[20] https://www.gov.uk/government/consultations/integrating-greenhouse-gas-removals-in-the-uk-emissions-trading-scheme
[21] https://www.gov.uk/government/publications/evaluation-of-the-uk-emissions-trading-scheme-phase-1 - see p. 102 on importance of certainty beyond 2030.
[22] https://www.gov.uk/government/publications/uk-emissions-trading-scheme-long-term-pathway/the-long-term-pathway-for-the-uk-emissions-trading-scheme

Section 1: Extending the UK ETS

Context

The Greenhouse Gas Emissions Trading Scheme Order 2020 currently provides for the UK ETS to operate until the end of the current trading period (starting 1 January 2021 and ending on 31 December 2030), which we refer to in this consultation as Phase I. The Authority intends for the Scheme to be a cornerstone of decarbonisation in the coming decades. To ensure that the UK ETS continues to operate after 2030, a post-2030 Phase II would need to be provided for in legislation.

The UK ETS after 2030

Legislating to extend the UK ETS from 2031 onward will ensure that participants within the Scheme continue to be subject to their compliance obligations, that greenhouse gas emissions covered by the Scheme remain capped, and that emissions allowances can continue to be traded. This will maintain the incentive to the covered sectors to decarbonise their operations by investing in sustainable technologies.

On this basis, the Authority is strongly minded to legislate for a Phase II of the Scheme that continues the operation of the UK ETS from 1 January 2031 when Parliamentary time allows, as outlined in the December 2023 UK Emissions Trading Scheme long-term pathway document[23]. This will ensure that the UK ETS can continue to play its vital role in driving economically efficient decarbonisation and meeting legally binding net zero targets across the UK.

Extending the Scheme beyond 2030 will enable the Authority to continue fulfilling its commitments on expanding the scope of the UK ETS, further developing Scheme design to ensure ambitious and cost-effective decarbonisation. Subject to the outcome of this consultation, the Authority will subsequently consult on the specifics of a detailed Phase II cap profile (see the timelines section at the end of this document).

Questions:

Q.1.1) Do you agree with the Authority's minded to position, as presented above, that the UK Emissions Trading Scheme should be extended into a Phase II to follow directly on from Phase I? (Y/N) Please explain your answer.

[23] https://www.gov.uk/government/publications/uk-emissions-trading-scheme-long-term-pathway/the-long-term-pathway-for-the-uk-emissions-trading-scheme

Section 2: The length of the post 2030 phase (Phase II)

Context

Emissions trading systems typically operate on a series of phases. A phase is a period of time defined in the legislation, over which the cap on emissions has been set and the overall framework of the Scheme will stay broadly the same. Organising the operation of the Scheme into predefined phases provides much needed market certainty whilst ensuring opportunities to evolve the design of the Scheme. The length of the phase determines the long-term signal to the market to decarbonise.

Phase Lengths and Emissions Trading

The UK ETS Phase I runs from 2021-2030, matching the length of the EU Emissions Trading System (EU ETS) Phase IV. However, a post-2030 Phase II of the UK ETS has not been provided for in current legislation. Setting the length of a post-2030 phase provides an opportunity to continue to ensure that the UK ETS phase length appropriately reflects the ambition and long-term priorities of the Scheme.

Long-term certainty over the cap ensures a clear signal to the covered sectors to decarbonise and facilitates more effective long-term abatement planning by businesses covered by the Scheme. However, the further into the future the cap is set, the greater the uncertainty over decarbonisation technologies and their associated costs. This means that there is greater uncertainty associated with the emissions pathway modelling outputs that facilitate decision making on the cap trajectory.

The length of Phase II would need to provide the right balance between:

- Clarity for participants on the long-term cap and the ambition of the Scheme.
- The certainty with which we can predict emissions trajectories for the sectors covered by the Scheme over the course of the phase.
- The flexibility to adjust the design of the Scheme to ensure that it continues to function effectively.

Phase Length: Options

The UK ETS compliance cycle functions on an annual basis and as such the length of a phase is operationally limited to whole year increments. Thus, Phase II could theoretically be set to end on 31 December in any subsequent year up to 2050. However, the Authority has identified potential minimum and maximum phase lengths.

Crucially, responses to the 2023 UK ETS evaluation highlighted the importance of long-term certainty within the Scheme, given the long-term investment planning required for large-scale abatement interventions[24]. The Authority has provided long-term context for the Scheme by committing to extend the Scheme until at least 2050, subject to consultation[25].

A shorter Phase II of 1-6 years would in theory allow more frequent opportunities to make significant changes to the UK ETS cap during the 2030s. However, this shorter phase would provide very limited certainty to participants in the primary and secondary markets, and correspondingly a weaker signal to the covered sectors to decarbonise. As this signal to decarbonise is key to the functioning of the UK ETS, we recommend that Phase II of the UK ETS should extend at least to the end of 2037 (the end of Carbon Budget 6).

Decarbonisation investment lead times will vary between sectors and individual businesses, but a minimum phase length of at least 7 years would facilitate a greater range of decarbonisation investments across covered sectors like power, aviation and heavy industry (see Fig. 1 below).

Figure 1: Sectoral Planning and Construction Timelines

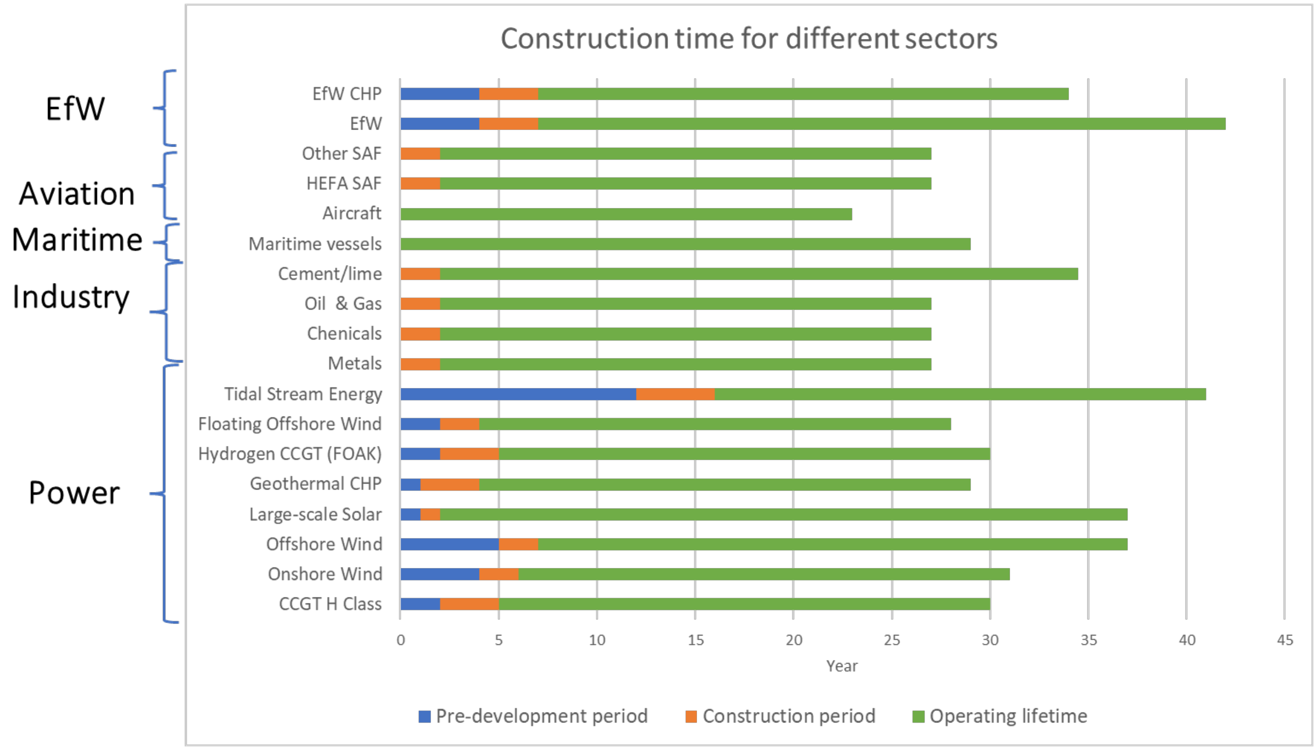

Fig. 1 shows estimated pre-development, construction and operational timelines relating to the key decarbonisation investment options for the main three sectors covered by the UK ETS.

[24] https://www.gov.uk/government/publications/evaluation-of-the-uk-emissions-trading-scheme-phase-1 - see p. 102 on importance of certainty beyond 2030.
[25] https://www.gov.uk/government/publications/uk-emissions-trading-scheme-long-term-pathway/the-long-term-pathway-for-the-uk-emissions-trading-scheme.

This graph demonstrates that decarbonisation investments have very long time horizons[26]. This demonstrates the potential visibility and certainty benefits of longer phase lengths but needs to be balanced against the confidence with which we can model long term emissions pathways, as noted above.

As noted above, the UK Government, Scottish Government, Welsh Government and Northern Ireland Executive must set and adhere to emissions targets. Given that the UK ETS is a UK-wide policy, the cap has previously been set in line with the UK-wide Net Zero Strategy to ensure policy consistency across the UK. In line with this, our recommendations focus on the relationship between potential phase length and UK-wide Carbon Budgets.

Specific policies and processes to support delivery of the UK's sectoral decarbonisation trajectories are set out for each carbon budget period. If the length of Phase II extends beyond the point for which Carbon Budgets have been set, then the cap trajectory would need to be set beyond the period for which these policies and processes are defined in carbon budgets and delivery plans. As such, we recommend that Phase II of the UK ETS should not extend beyond the last year for which UK-wide Carbon Budgets have been defined (at the point of cap-setting). As we currently plan to consult on the Phase II cap profile following the publication of Carbon Budget 7, this last year would be 2042, meaning that the maximum phase length under this approach would be 12 years. This would ensure that the decarbonisation trajectory required of the covered sectors (as determined by the Phase II cap) is underpinned by the policies and processes required to support abatement in the covered sectors.

We propose three options for phase length within these minimum and maximum bounds and outline these options below. We welcome views on the relative merits of each, and whether there are alternative options that should be considered. We are not currently minded to recommend one specific option over the others.

Within these options, the Authority could seek to align UK ETS phase length more closely with the 5-year timeline of UK-wide carbon budgets (via a 7 or 12 year phase length). Alternatively, the Authority could continue with the 10-year-length of Phase I, providing continuity for participants.

[26] The data and evidence for this graph comes from several sources. Power sector timelines come from https://www.gov.uk/government/publications/electricity-generation-costs-2023 Annex A Technical and cost assumptions (medium scenario). For aviation sustainable fuel development timelines see https://publications.jrc.ec.europa.eu/repository/handle/JRC118309. Industry timelines come from a collection of UK government sources such as the Net Zero Industrial Pathways (NZIP) model and industry analysis. The lifetime of a vessel is typically somewhere between 20 and 30 years, with data from Clarksons suggesting the average age at demolition in 2024 was 29 years for bulk carriers and containerships -DfT analysis of data from Clarksons' SIN data.

Option 1 – 2031-2037, UK-wide Carbon Budgets aligned until end of Carbon Budget 6 (7-year phase)

Phase II of the UK ETS could be set to cover the period between 1 January 2031 and 31 December 2037. This would represent a departure from the 10-year length of Phase I, aligning the end of Phase II with the end of Carbon Budget 6 and bringing the UK ETS phase cycle into closer alignment with the 5-year UK-wide Carbon Budget cycle.

This would provide less long-term certainty for participants than the current 10-year phase approach. However, emissions trajectories for the sectors covered by the Scheme could be predicted with greater certainty over a 7-year phase when compared to a 10- or 12-year phase.

Subject to later consultations on the future of the UK ETS, subsequent phases (from Phase III onwards) could be 5 years each to maintain direct alignment with the Carbon Budget cycle.

Option 2 – 2031-2040, continue with 10-year phases

Phase II of the UK ETS could be set to cover the period between 1 of January 2031 and 31 of December 2040.

A 10-year Phase II would set out the cap trajectory for a longer period than a 7-year phase, providing greater certainty for stakeholders. However, the degree of certainty associated with emissions pathway modelling outputs to support decision-making would be slightly lower in the final years of a 10-year phase when compared to a 7-year phase.

A 10-year Phase II would align with the UK ETS' Phase I approach.

Option 3 – 2031-2042, UK-wide Carbon Budgets aligned until end of Carbon Budget 7 (12-year phase)

Phase II of the UK ETS could also be set to cover the period between 1 of January 2031 and 31 of December 2042.

As with a 7-year phase, this would represent a departure from the 10-year length of Phase I. A 12-year phase would align the end of Phase II with the end of Carbon Budget 7 and bring the UK ETS phase cycle into closer alignment with the 5-year Carbon Budget cycle.

A 12-year Phase II would set out the cap trajectory for a longer period than a 7- or 10-year phase, providing greater certainty for stakeholders. Correspondingly, the degree of certainty associated with emissions pathway modelling outputs to support decision-making would be slightly lower over a 12-year phase when compared to a 7-year or a 10-year phase.

Questions:

Q.2.1) Do you have a preference regarding the length of the post 2030-phase? (Y/N) Please explain your answer.

Q.2.2) Beside the options outlined above, are there other possible durations that should be considered for the length of Phase II? (Y/N) Please explain your answer.

Section 3: Inter-Phase Banking of UKAs

Context

Banking refers to the practice of purchasing an allowance in a given year for surrender in subsequent years and is permitted within Phase I of the UK ETS. This ensures that emissions abatement can happen at least cost, by supporting participants to meet their purchase and surrender obligations under the Scheme while decarbonising their operations when it is cheapest to do so.

Correspondingly, interphase banking refers to the practice of holding allowances purchased during a given Phase of an ETS to be surrendered or traded in a subsequent phase. Banking of allowances between phases is built into most mature emission trading schemes, including the EU ETS transition from Phase III (2013-2020) to Phase IV (2021-2030).

Interphase banking gives participants greater flexibility to plan for unexpected economic circumstances or technological developments and to decarbonise when it is most cost-effective to do so, regardless of phase lengths. This builds resilience in the sectors covered by the Scheme and within the ETS market itself.

Interphase banking also allows participants in the market to make decisions on a longer timeline, incentivising the uptake of longer-term emissions abatement options. In facilitating longer-term planning by participants, banking between phases also allows market behaviour to more effectively determine an appropriate price on emissions.

Inter-phase Banking and Emissions Trading

Inter-phase banking would extend the Scheme’s existing flexibility provisions by allowing participants to carry over allowances from a previous phase for surrender in a future phase. Overall emissions would remain under the cap, while at the same time businesses covered by the Scheme would be able to more effectively plan during Phase I for meeting their compliance obligations into Phase II, and consequently to take advantage of longer-term emissions abatement options.

If participants are not able to carry held allowances over between Phase I and Phase II, then UKAs purchased during Phase I would lose their value after the 31 of December 2030, as they could not be used to meet compliance obligations during Phase II. This in turn would limit participants’ ability to plan for market fluctuations and technological developments in their own planning cycles.

Inter-phase banking could result in increased emissions during Phase II, as participants could bank Phase I allowances to surrender during Phase II in anticipation of more challenging emissions abatement targets during the 2030s and early 2040s. However, in practice the cap will tighten significantly during Phase I, limiting the allowances that could be carried over between phases. A planned second-stage consultation on a detailed cap trajectory will also allow the Authority to further mitigate residual risks by accounting for interphase banking when the Phase II cap is set.

CASE STUDY

During the transition between Phase I and Phase II of the EU ETS, interphase banking was not permitted. Consequently, the market price of EU emissions allowances (EUAs) fell dramatically at the end of Phase I in anticipation of Phase I EUAs imminently losing their value (*see Figure 2, below).* The EUA price then bounced back rapidly over the early part of Phase II as participants were able to purchase Phase II allowances to cover their purchase and surrender obligations. In subsequent phases the EU ETS has successfully addressed this price shock risk by allowing interphase banking.

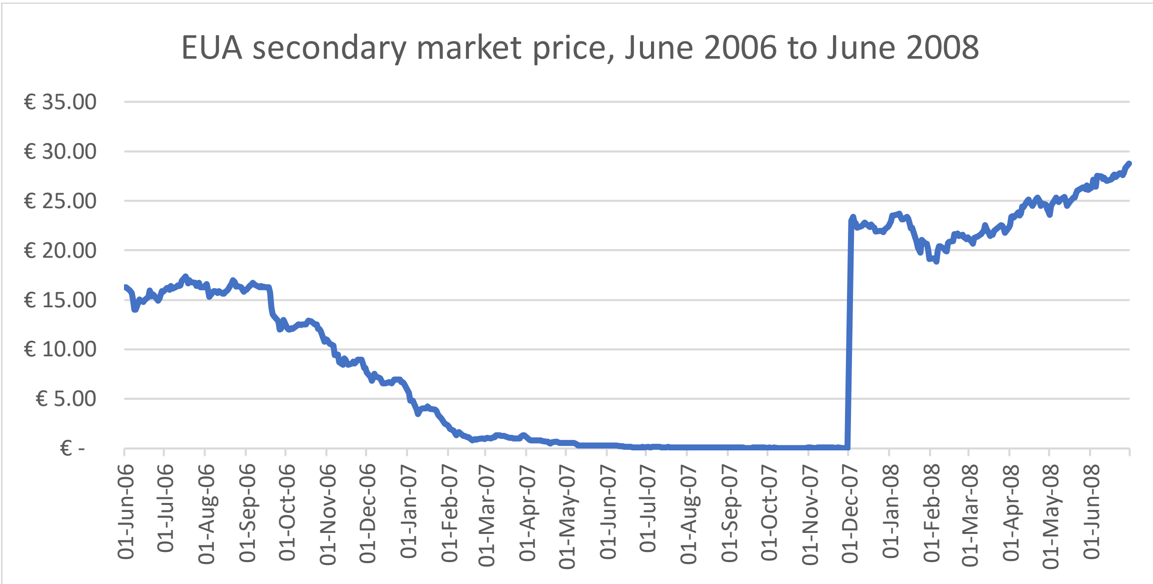

Fig. 2: EUA price movements over the transition between Phase I and Phase II of the EU ETS.

Data Sources - ICE connect

Crucially, not allowing interphase banking would significantly undermine the benefits delivered by the UK ETS, and pose significant risks to market stability within the Scheme (see case study below). Not allowing interphase banking could also incentivise increased emissions in the late 2020s, as participants could increase emissions in the late 2020s and 2030 to use their Phase I allowances before they become invalid. This would increase delivery risks to interim net zero targets across the UK.

On this basis, we are strongly minded to allow banking of allowances between Phase I and Phase II of the Scheme. This would maintain the benefits of a UK ETS, ensuring that participants have the flexibility to take advantage of longer-term emissions abatement options, effectively plan during Phase I for meeting their compliance obligations into Phase II and decarbonise their operations at least cost. The Authority will continue to monitor interactions with UK emissions targets, and consider whether there is evidence of carbon budget risks from banking in Phase II cap-setting.

Questions:

Q.3.1) Do you agree with the Authority's minded to position to allow banking of allowances between phases of the Scheme? (Y/N) Please explain your answer.

Consultation questions

1.1.) Do you agree with the Authority's minded to position, as presented above, that the UK Emissions Trading Scheme should be extended into a Phase II to follow directly on from Phase I? (Y/N) Please explain your answer.

2.1) Do you have a preference regarding the length of the post 2030-phase? (Y/N) Please explain your answer.

2.2) Beside the options outlined, are there other durations that should be considered for the length of Phase II? (Y/N) Please explain your answer.

Q.3.1) Do you agree with the Authority's minded to position to allow banking of allowances between phases of the Scheme? (Y/N) Please explain your answer.

4. Next Steps and Timelines for Future Publications on Phase II

Given the importance of confirmed policy positions for participant planning and investment decisions, we aim to provide an Authority response to this consultation by the end of 2025. We recognise that there are important policy questions beyond this consultation's proposals for the foundations of a UK ETS Phase II. Subject to the response to this consultation, we would seek to consult on the post-2030 cap profile as soon as possible to address the need to provide certainty and a long-term decarbonisation signal for participants.

Consulting on any proposed cap trajectory beyond 2030 would need to be coordinated with cross-economy decarbonisation plans across all four nations. For setting the post-2030 cap, the UK-wide Carbon Budgets and Net Zero Strategy will be important to consider given the UK-wide nature of the cap and their role in how the Phase I cap was set. Given the range of phase lengths outlined in this consultation, the period for which we set the post-2030 cap may overlap with UK-wide Carbon Budget 7 (2038-2042). The statutory deadline for setting Carbon Budget 7 is 30 June 2026.

Subject to the result of this consultation, we would aim to consult on the post-2030 cap profile alongside or soon after Carbon Budget 7's publication. This would allow us to take the traded sector trajectory from the Carbon Budget 7 setting process into account in our proposals. In the case of a seven-year phase, we would consult as soon as practicable after the first-stage response. We would aim to provide an Authority response within 12 months of this second-stage consultation and, subject to consultation, legislate for any decisions as soon as Parliamentary time allows after that Authority response. We would also consult on other aspects of Phase II scheme design where required after the cap consultation but sufficiently ahead of the beginning of a proposed Phase II on 1 January 2031 to provide the required certainty for participants.

As part of the future consultations and government responses on Phase II of the UK ETS we will seek to include additional analysis to support consultation responses and a final decision on a UK ETS Phase II cap. For a second stage consultation outlining the options that we are considering for the cap, we would look to include a separate analytical annex outlining which caps we are considering and the emerging impacts of those trajectories. For a final government response on the UK ETS cap, we would complete an impact assessment to outline the benefits of the chosen option compared to the short list of options considered.

This publication is available from: www.gov.uk/government/consultations/extending-the-uk-emissions-trading-scheme-cap-beyond-2030

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