

Consultation: Moving the UK ETS Second Free Allocation Period

The UK Emissions Trading Scheme (UK ETS) Authority is 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.

This consultation is open until 23:59 on Friday 11 October. Please send responses to ukets.consultationresponses@energysecurity.gov.uk

Background

As part of significant developments to the scheme, we are currently conducting a review into the methodology for distributing free allocation for stationary installations. In the Free Allocation Review consultation¹, the UK ETS Authority sought views on how free allocation policy could be adjusted to better target free allocations for sectors most at risk of carbon leakage, with final decisions to be published by the end of 2024 and implemented at the start of the second allocation period in 2026. Free allocation policy is currently the only existing 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 ETS².

Respondents to the Free Allocation Review consultation made clear that they want the UK Government and UK ETS Authority to ensure that free allocation policy is closely aligned with other carbon leakage mitigation measures. Of 47 respondents who expressed a view on the overall approach to carbon leakage, 41 (87%) stated a preference for changes to free allocation to align with the introduction of the UK CBAM (currently planned for 2027).

¹ <https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review>

² From 2027, UK CBAM will cover aluminium, cement, ceramics, fertiliser, glass, hydrogen, iron and steel sectors.

UK ETS Authority proposal

The UK ETS Authority proposes to move the start of the second free allocation period from 2026 to 2027. Under this proposal, the current allocation period will be extended to include 2026. Any changes made to the free allocation rules for stationary installations following the completion of the Free Allocation Review will not come into effect until 2027.

A move to 2027 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. Recognising the depth and breadth of ongoing 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.

We have heard stakeholder views and recognise concerns over the potential misalignment of industrial decarbonisation and carbon leakage policy. This proposal will also 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.

We hope that these proposed changes will ensure a consistent and joined up approach to decision making and will ensure there is no gap in protection. These are important decisions which will impact the future of business and industry and we want to get them right.

Proposed Implementation

We propose the following approach to implementation:

- i.) The current allocation period for stationary installations will be extended to include 2026. Individual installations will receive the same level of free allocation as in 2025 (except in cases where changes are due under existing rules, such as where an Activity Level Change occurs). Under this proposal, no changes to benchmarks or the carbon leakage list will come into effect in 2026. Any changes to the free allocation rules resulting from the Free Allocation Review will be published by the end of 2025 (instead of 2024) and implemented for the new start of the second allocation period, in 2027 (instead of 2026). The final year of the second allocation period will remain 2030 as before.
- ii.) The baseline data reporting exercise will continue to take place from 1 April to 30 June 2025 as planned, avoiding disruption to UK ETS operators who may already have begun preparations.
- iii.) Applications for free allocation for the second allocation period will be made in 2026 (instead of 2025). This means that they will be made separately from the baseline data reporting exercise. The indicative free allocation values

produced by the baseline data report may be subject to revision following the publication of changes to the free allocation rules. Some operators may have to resubmit activity data alongside their free allocation application, although we expect this will only affect a small minority of sub-installations. We will provide information to impacted operators ahead of the window to apply for free allocation.

- iv.) The start date of the lists of operators with hospital or small emitter (HSE) and ultra-small emitter (USE) status for the years 2026-2030 will remain 2026, as currently planned. The window to apply for HSE/USE status will continue to be the same as the baseline data reporting exercise (1 April – 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 for the 2027-2030 allocation period. If they choose to apply to rejoin, they will be able to apply for free allocation for the 2027-2030 allocation period, if eligible.
- v.) Changes to the current rules regarding the electricity generator classification, which were announced in the Government Response to the Developing the UK ETS Consultation, will come into effect in the 2026 scheme year as planned.
- vi.) The UK ETS Authority does not anticipate that levels of free allocation in 2026 will be above the level of the industry cap, and so there should be no requirement for a cross-sectoral correction factor (CSCF). However, in the unlikely instance that a CSCF is triggered in 2026, we will continue our guarantee of free allocations at current levels (subject to changes in activity) and mitigate its application through use of our reserves.

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? Please explain your answer.

Please send your response to this consultation to ukets.consultationresponses@energysecurity.gov.uk.