

UK ETS Free Allocation Review – Final Business and Regulatory Impact Assessment

This Business and Regulatory Impact Assessment (BRIA) covers the potential impacts on Scottish businesses following proposed changes to the UK Emissions Trading Scheme (ETS) Free Allocation policy.

Introduction

This Business and Regulatory Impact Assessment (BRIA) has been completed to assess the potential impacts on Scottish businesses of the announced changes to the UK Emissions Trading Scheme (ETS) Free Allocation policy. This is a final BRIA. It should be read in conjunction with the main Authority Response¹ and Authority Impact Assessment.² This Impact Assessment specifically covers the analytical assessment of the Authority's final policy position on Scottish businesses.

¹ [UK Emissions Trading Scheme: free allocation review - GOV.UK](#)

² [UK Emissions Trading Scheme: free allocation review - GOV.UK](#)

Executive summary

The UK Emissions Trading Scheme (UK ETS) was established on 1 January 2021 by the UK ETS Authority (the “Authority”) – formed by the Scottish, UK and Welsh Governments and the Department of Agriculture, Environment and Rural Affairs in Northern Ireland (DAERA) for Northern Ireland. When it was established, the Authority committed to increasing the climate ambition of the scheme and the Authority consulted on a number of proposals to strengthen the UK ETS and align it with net zero targets across the UK.

Following extensive engagement with stakeholders through the Free Allocation Review (FAR) Consultation (December 2023 – March 2024)³ and the Carbon Leakage Consultation (December 2024 – March 2025)⁴, the UK ETS Authority Response, published on 26 November 2025, sets out the Authority’s final policy decisions on reforms to free allocation rules. In summary, the Authority’s proposed changes to the UK ETS include:

- An option for operators to choose to have activity data for either the scheme years 2020 only, or 2020 and 2021, excluded for the purpose of determining historical activity level (HAL) for the 2027-2030 allocation period.
- The retention of current benchmarks for 2027, with the in-principle intent to adopt updated EU benchmark values from 2028-2030.
- A decision to retain the current carbon leakage list, with no introduction of tiering of free allocation for sectors at risk of carbon leakage, and no early phase out of free allocations of allowances for sectors not on the carbon leakage list.
- No additional methodologies to be introduced in 2027, which would introduce conditions on the provision of free allocation, with a pathway set out to reconsider their introduction for future allocation periods, and
- A gradual phase out of free allocations for sectors covered by the UK Carbon Border Adjustment Mechanisms (CBAM) from 2027, with an indicative trajectory of 9 years.

These changes are set out in detail in the Authority Response. Changes will be legislated for via the statutory instrument the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2026.

³ [UK Emissions Trading Scheme: free allocation review - GOV.UK](#)

⁴ [UK Emissions Trading Scheme: free allocation review - carbon leakage - GOV.UK](#)

Section 1: Background, aims and options

Background to policy issue

Free Allocation of UK ETS allowances is the primary policy instrument through which carbon leakage risk is currently addressed in the UK. The Authority defines 'carbon leakage' as the movement of production and associated emissions from one country to another due to different levels of decarbonisation effort, through carbon pricing and climate regulation.

The Free Allocation Review considered how the Authority can use free allocations to better target carbon leakage mitigation and incentivise further decarbonisation across the next allocation period (2027-2030). The objective of the Free Allocation Review was to focus on changes to the methodology for distributing free allocations, ensuring that support is better targeted for sectors most at risk of carbon leakage, in the context of UK industry and within the bounds of the new net zero consistent industry cap.

Purpose

If the Authority does not intervene with changes to free allocation rules, there are notable implications:

- Incentives to decarbonise industrial production may not be sufficient to promote investments in green technologies, particularly in hard-to-abate sectors.
- Free allocation levels remain at current levels, resulting in a greater risk of exceeding the industry cap⁵ and drawing on the flexible reserve⁶ to avoid triggering a reduction in each sector's share of free allocation through the Cross Sectoral Correction Factor (CSCF)⁷. This would reduce production and investment certainty for industry.
- For those sectors covered by the UK CBAM, retaining free allocation at current levels would render the UK CBAM significantly less effective.
- As announced as part of the UK-EU Summit on 19 May 2025, and then set out in the shared Common Understanding⁸, the UK and EU have agreed to work towards linking their respective Emissions Trading Systems. As stated, any agreement should include dynamic alignment with European Union rules where relevant. Maintaining the status quo would likely be inconsistent with this position.

The Authority consulted stakeholders on a number of proposals to improve its approach to free allocations ahead of the next allocation period.

⁵ A proportion of allowances that are set aside to be distributed for free in each scheme year.

⁶ A reserve of allowances that can be used if the industry cap is breached, which may be allocated until the reserve is exhausted. A flexible reserve of allowances for maintains market stability and sufficient carbon leakage mitigation

⁷ The CSCF is applied when the total amount of free allowances exceeds the scheme's industry cap, i.e. the proportion of the total cap set aside for free allocations. If the CSCF is triggered in 2026, the UK ETS Authority will mitigate its application through the use of its allowance reserves.

⁸ [UK-EU Summit - Common Understanding \(HTML\) - GOV.UK](#)

Options considered

The Authority examined a range of options for each of the policy proposals set out in the consultation. Below is an outline of the policy proposals consulted on. The Authority Response and the Authority Impact Assessment sets out in detail stakeholder views, assessment and rationale for options proposed and discounted, and all final decisions that will inform the calculation of free allocations in the next allocation period from 2027-2030.

Historical Activity Level (HAL)

Historical Activity Level (HAL) refers to the level of production or activity at an installation during a defined past period, which is used to determine how many free allowances that installation should receive.

The Authority consulted on 3 options in relation to HAL:

- i. Option 1: Do nothing.
- ii. Option 2: Dynamic allocation. Change to a dynamic allocation approach, with free allocation distributed on a provisional basis at the start of each scheme year and updated after the end of each scheme year to reflect actual reported activity.
- iii. Option 3: Consider reducing the activity level changes (ALC) threshold. Maintain current HAL and ALC rules but lower the threshold at which ALCs are triggered (currently ALCs are triggered if activity increases or decreases by 15% or more in any two year period).

The Authority has decided to maintain the current approach to HAL and ALC and not to implement a dynamic approach or reduce the ALC threshold. This will provide continuity and certainty for operators and avoid increased administrative burden. Following assessment of all options, the Authority concluded that the current approach (Option 1) offers a reasonable balance between accuracy in reflecting activity, certainty to industry, and administrative burden.

Having heard stakeholder concerns about the impact of COVID-19 on activity levels during the baseline period, the Authority has decided that operators of UK ETS installations will be able to choose to exclude activity data for the scheme year 2020 only, or 2020 and 2021, for the purposes of determining HAL for the 2027-2030 allocation period. Operators will be able to indicate whether they wish to exclude 2020 only, or 2020 and 2021, activity from HAL at sub-installation level during the second stage of the free allocation application process (1 April – 30 June 2026). Guidance on how to do this will be made available before the second stage window opens on 1 April 2026.

Benchmarks

Benchmarks are reference values that reflect the efficiency of specific sectors covered by the UK ETS. They are used to calculate the number of free allowances

allocated to installations. The closer an installation's performance is to the benchmark, the more efficient its processes are considered to be, and the higher the proportion of its emissions that will be covered by free allocations.

The Authority consulted on 3 options in relation to Benchmarks:

- i. Option 1: No change to benchmarks
- ii. Option 2: Use updated 2026 EU benchmarks
- iii. Option 3: UK focused benchmark update

The Authority has decided to use updated 2026 EU benchmarks in the Free Allocation calculation for the 2027-2030 allocation period. Current benchmarks will be retained for 2027, with the in-principle intent to adopt updated EU benchmarks from 2028-2030. Following assessment of the options, the Authority has concluded that the EU ETS benchmarking methodology remains the most robust and representative framework for reflecting efficiency improvements made by industry and incentivising decarbonisation.

Carbon Leakage List

The carbon leakage list identifies sectors and sub-sectors that are deemed at significant risk of carbon leakage. Those sectors in the list are eligible to a higher level of free allowances.

The Authority consulted on 3 options in relation to the Carbon Leakage List:

- i. The Authority presented two options for determining the Carbon Leakage List from the second allocation period:
 1. A revised list based on updated UK-specific data and a new Carbon Leakage Indicator (CLI) methodology.
 2. Retention of the existing list, based on historic EU wide data.
- ii. Whether to introduce tiering of the Carbon Leakage Emissions Factor (CLEF)⁹ or CSCF.
- iii. Bringing forward the phase out date for free allocation to sectors deemed not at risk of carbon leakage.

The Authority has decided to retain the EU ETS Phase IV Carbon Leakage List for the second UK ETS allocation period (2027–2030). This decision reflects a balanced judgement across policy intent, data robustness, stakeholder confidence, deliverability, and strategic alignment with wider decarbonisation objectives.

The Authority has decided not to pursue any of the tiering options consulted upon. Modelling indicates that free allocation will remain below the industry cap through to 2030, and the decision to retain the EU list avoids the increase in allocation volumes

⁹ The CLEF is used to adjust the number of free allowances an operator receives under the UK ETS, based on their sector's exposure to carbon leakage risk. If a sector is deemed at high risk, the CLEF is set at 1, meaning the operator receives 100% of their calculated free allocation. For sectors not on the carbon leakage list, the CLEF is set at 0.3, resulting in only 30% of the calculated free allocations being provided.

that would have resulted from adopting the UK list. Tiering of the CLEF is therefore unnecessary.

As the likelihood of levels of free allocation exceeding the industry cap in the next allocation period from 2027 is deemed very low, the CSCF is unlikely to be triggered, and any changes to the CSCF process would increase complexity without any of the benefits of better targeting free allocations. Therefore, the Authority will not be introducing tiering of the CSCF.

The Authority has decided that it will maintain the existing trajectory for phasing out free allocation to sectors not deemed at risk of carbon leakage, as defined by the EU ETS Phase IV Carbon Leakage List. Under this approach, installations operating in sectors not on the carbon leakage list will continue to receive a reduced level of free allocation until 2030, at which point it will be fully phased out. The Authority recognises that decarbonisation through the UK ETS requires long-term investment and that policy stability is essential to enable operators to make informed decisions. Maintaining the current phase out timeline provides the necessary certainty for sectors to prepare for the full exposure to the carbon price.

Additional Factors for Free Allocation Calculation – Access to Decarbonisation Technologies

The Authority consulted on 2 methods that could be used to consider any discrepancies in availability of decarbonisation technologies:

- i. Option 1: disaggregate benchmarks on the basis of whether a sub-installation has access to large-scale decarbonisation technologies, putting installations with different access to decarbonisation technologies on different benchmarks so they would not be measured against each other.
- ii. Option 2: Including low/no carbon production processes in benchmark calculations

The UK ETS Authority has decided not to disaggregate free allocation benchmarks or amend benchmark definitions to include low or no carbon production processes. This means that access to decarbonisation technologies will not be used for benchmark calculations for the 2027-2030 allocation period.

The Authority's assessment concluded that there is no evidence of widespread deployment of large-scale decarbonisation technologies at UK industrial sites that could significantly affect benchmark values. Therefore, there would be no risk of early adopters setting unattainable benchmarks on the basis of use of UK data for the next allocation period.

Additional Factors for Free Allocation Calculation – Conditionality

The Authority consulted on 3 proposed designs of conditionality:

- i. Option 1: Reducing free allocation to an installation by a pre-determined amount (for example 10%) if an installation has not made any emissions reductions or resource efficiencies over a certain period of time.

- ii. Option 2: Exclude the most efficient installations from any potential application of a CSCF. This option could define most efficient installations as those who are operating at the benchmark level and then ensure that these installations would not see a reduction in their free allocation from a CSCF.
- iii. Option 3: Require installations to have a decarbonisation plan in place or they will have their free allocations reduced by a pre-determined amount (e.g. 10%).

The Authority took on board feedback on the three conditionality options presented in the consultation as part of its assessment. The Authority is mindful of not increasing complexity or administrative burden as part of free allocation changes and therefore took account of the benefit of introducing conditionality in comparison to the burden and cost that would be imposed on operators and regulators to facilitate its introduction.

As a result of this assessment process, and stakeholder feedback, the Authority has resolved not to introduce conditionality for the upcoming free allocation period. The Authority notes the potential benefits of introducing conditionality and will continue to consider its merits for the future.

Free Allocation for Sectors Covered by the UK Carbon Border Adjustment Mechanism (CBAM)

The UK Government has signalled its intention to introduce a CBAM from 1 January 2027. As this measure is designed to address the risk of carbon leakage, the Authority has assessed how free allocations should be treated for sectors that will fall within the scope of the UK CBAM.

The Authority therefore consulted on 3 options for adjusting free allocations for sectors covered by the UK CBAM from 2027:

- i. The adjustment of free allocation for UK CBAM sectors
- ii. Parameters for adjustment
- iii. Extent of adjustment i.e. a phase out or a phase down to account for export leakage

The Authority has decided to gradually phase out free allocations for sectors covered by the UK CBAM, the trajectory for this has been presented for 2027-2030, giving certainty on operator's free allocations for the next allocation period. In order to provide further clarity, the Authority has also set out an indicative trajectory beyond 2030. This phase out will occur at sub-installation level to ensure only free allocations corresponding to products where a UK CBAM will be applied are affected. This phase out of free allocation will ensure a gradual transition for industries across the UK from free allocations to the UK CBAM as the primary carbon leakage mitigation.

The approach taken also mirrors the EU's pace and scale of phase out for sectors covered by the EU CBAM. This will ensure consistency in the transition for UK and EU businesses, minimising competitive distortions.

Technical Changes

The Authority consulted on 5 technical changes:

- i. Technical Change Three: Updating minimum content of the monitoring methodology plan
- ii. Technical Change Four: Changes to Heat Metering Measurement Hierarchies
- iii. Technical Change Five: Adjustment to Monitoring Principles with relation to Hierarchy.
- iv. Technical Change Six: Updating the Unreasonable Cost Calculation
- v. Technical Change Seven: Requirement of control system checks to be made at yearly intervals.

The Authority has decided not to introduce the changes proposed in the consultation.

In relation to technical changes three and five, the Authority considers that current legislation reflects the proposed changes.

In relation to technical change four, the Authority concluded that, based on the available evidence, there is insufficient confidence that the proposed equivalent accuracy of Non-automatic Weighing Instruments Regulations 2016 or Measuring Instruments Regulations 2016 compliant metering (e.g. for measurable heat $\pm 3\%$ of actual reads) is currently achievable by industries across the UK.

In relation to technical change six, the Authority has decided not to update the reference price figure used in the unreasonable cost calculation at this time. The Authority recognises that the current reference UK Allowances (UKA) price does not reflect recent UKA prices, which have been higher than the reference price throughout the current allocation period. However, given the scope of planned and possible changes across the scheme, the Authority considers that it would be prudent to wait until those changes have been finalised before determining any update to the reference price. The Authority may update the unreasonable cost calculation in future.

In relation to technical change seven, the Authority considers that the current industry practice of conducting regular checks in line with manufacturer guidance is sufficient to ensure measuring equipment continues to perform to the required standard.

Sectors/ Groups affected

In preparing this BRIA, we have conducted an assessment of the sectors which are expected to be affected by the policy.

The proposed changes to the UK ETS will primarily affect the sites and businesses which are covered by the UK ETS. On this basis, this BRIA focuses on the potential impacts of the policy for sectors covered by the UK ETS who receive free allocations.

By design, the UK ETS legislation applies across the whole of the UK to the same sectors (except for power in Northern Ireland which remains under the EU ETS). This means that there is no specific Scottish cap, or specific cap for any of the four nations in the UK.

This presents challenges when assessing the impact and costs of the UK ETS changes at the regional level. Abatement opportunities, such as access to decarbonisation technologies, carbon capture and storage and fuel switching, will vary across and within sectors and regions and depend on often site-specific key infrastructure and technological solutions being available. In addition, Scotland's industrial profile is different from the UK when taken as a whole and, as a result, the solutions required in Scotland may be different from those in the rest of the UK. Abatement solutions may not be available or not delivered symmetrically across all parts of the UK. Overall, the rate of decarbonisation is therefore likely to differ across the UK nations. While we can draw some high level and aggregate conclusions around likely impacts, business responses to the proposed changes will be made on site or organisation-specific commercial decisions, which are difficult to predict on the basis of national or sector-level data and targets.

As the Authority agrees a shared approach to UK ETS changes, it is appropriate for the costs and benefits to affected sectors of this policy to be examined at a UK-level. This analysis was undertaken by the Department of Energy Security and Net Zero (DESNZ) with oversight and involvement from the Devolved Governments, and full details can be found in the Authority Impact Assessment attached to the Authority Response. The Authority Impact Assessment provides the overall economic impact across the UK of these changes.

Further detail is set out in section 3 (Costs, Impacts and Benefits).

Section 2: Engagement and information gathering

Engagement approach

Below is a summary of the engagement undertaken by the Authority between 2021 and 2025 to inform the free allocation review.

Internal SG engagement/ engagement with wider Public Sector

Within Governments

The UK ETS free allocation policy is delivered jointly between all members of the Authority - comprising the UK Government, Scottish Government, Welsh Government, and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland.

The following government agencies and departments have been consulted by the Scottish Government in the Authority consultation and the preparation of this BRIA:

- The International Trade Policy & Subsidy Control Division has provided advice on proposals related to the traded sector;
- The Scottish Government Office of the Chief Economic Adviser has provided analysis and advice on the economic impacts;
- The Authority members (Welsh Government and the Department for Agriculture, Environment and Rural Affairs for Northern Ireland) and UK Government departments (Department for Energy and Net Zero, His Majesty's Treasury and Department for Transport); and
- Scottish Environment Protection Agency (SEPA).

Public consultation

The Authority consulted extensively with stakeholders across the UK, including with Scottish stakeholders, during this period.

The Authority launched a review into free allocation policy in 2021 with a call for evidence¹⁰, aiming to ensure free allocation policy was working effectively in the UK context to both incentivise emissions reduction and protect energy intensive, trade exposed industries from the risk of carbon leakage.

The Authority consulted further through the Free Allocation Review Consultation (December 2023 – March 2024)¹¹ and the Carbon Leakage Consultation (December 2024 – March 2025).¹²

¹⁰ [UK ETS free allocation review: call for evidence](#)

¹¹ [UK Emissions Trading Scheme: free allocation review - GOV.UK](#)

¹² [UK Emissions Trading Scheme: free allocation review - carbon leakage - GOV.UK](#)

As part of these consultation processes, and aiming to gather as much feedback as possible, the Authority carried out UK-wide stakeholder engagement sessions. The Authority received 113 registrations for the 2023 consultation workshops, and 140 for the 2024 consultation workshops, with UK ETS participants, including Scottish stakeholders, from cross-sector business groups, trade associations, thinktanks, academics and eNGOs. These sessions included high-level summaries of the consultation and topic-specific workshops on specific areas of the consultations.

Businesses were primarily consulted through the public consultations set out above. Scottish Government officials identified responses most relevant to Scotland – including all UK ETS operators in Scotland who responded to the consultation. Scottish businesses and UK ETS operators also participated in the workshops and roundtables hosted by the Authority during the consultations.

In total, 66 written responses were received as part of the Free Allocation Review Consultation, 24 of which held a Scottish interest. For the Carbon Leakage Consultation, 54 responses were received in total, 11 of which held a Scottish interest.

The feedback received via these consultations has been instrumental in shaping the final policy decisions. The Authority Response responds to these consultations and sets out the Authority's final policy position for the second allocation period, covering 2027 to 2030, and the phase-out of free allocations for UK CBAM covered sectors beyond 2030.

Section 3: Costs, impacts and benefits

Quantified costs to businesses

In line with UK ETS Authority Impact Assessment analysis¹³, six different options were explored to assess the possible quantified costs to businesses. These are detailed in table 3A below, with package F highlighted as the preferred policy option.

The key differences between options are:

- The timing of the use of EU benchmarks.
- The timing of the phase out of free allocations (FAs) for UK ETS installations not on the carbon leakage list.
- Whether conditionality is considered, where conditionality refers to making the receipt of free carbon allowances dependent on an operator's efforts to decarbonise.
- Timing and how quickly free allocations are phased out for sectors affected by the introduction of the UK CBAM)¹⁴.

¹³ [UK Emissions Trading Scheme: free allocation review - GOV.UK](#)

¹⁴ [Factsheet: Carbon border adjustment mechanism - GOV.UK](#)

Table 3A: Shortlist of Policy Options

Table 3A	Package A	Package B	Package C	Package D	Package E	Package F
Changes to Activity Level Changes (ALCs)	COVID mitigation for calculating HAL	COVID mitigation for calculating HAL	COVID mitigation for calculating HAL	COVID mitigation for calculating HAL	COVID mitigation for calculating HAL	COVID mitigation for calculating HAL
Changes to benchmarks	Updated EU benchmarks ¹⁵	Updated EU benchmarks	Updated EU benchmarks	Updated EU benchmarks	Updated EU benchmarks	Updated EU benchmarks from 2028 ¹⁶
Changes to Carbon Leakage List (CLL) and Carbon Leakage Exposure Factor (CLEF)	Current CLL, early non-CL phase-out from '27	Current CLL, no early non-CL phase-out from '27	Current CLL, no early non-CL phase-out from '27	Current CLL, early non-CL phase-out from '27	Current CLL, no early non-CL phase-out from '27	Current CLL, no early non-CL phase-out from '27
Consideration of access to decarbonisation technologies	No consideration	No consideration	No consideration	No consideration	No consideration	No consideration
Consideration of conditionality	20% reduction to those within EU 80th percentile	No conditionality	20% reduction to those within EU 80th percentile	No conditionality	No conditionality	No conditionality
Introducing phase-out / down of FAs for CBAM sectors	Steep phase-out	Delayed phase-out	EU aligned phase-out, 1-year delay	EU aligned phase-out, 1-year delay	EU aligned phase-out, 1-year delay	EU aligned phase-out, 1-year delay

As outlined in the UK ETS Authority's Impact Assessment, each package was identified to align with a particular theme with a clear rationale for each:

- Package A: Most ambitious option with free allocations quickly phased out for sectors not at risk of carbon leakage due to not being on the carbon leakage list or being protected through the introduction of the UK CBAM.

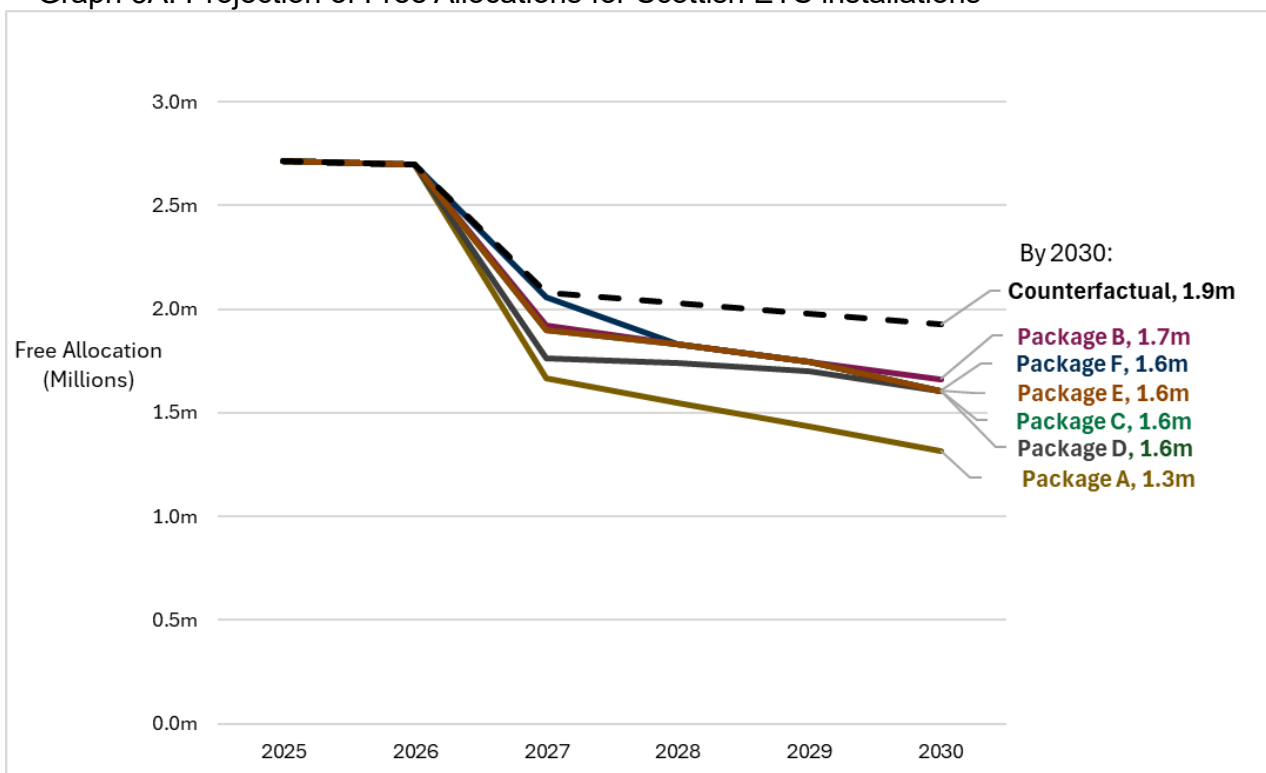
¹⁵ At the time of completing the analysis for this impact assessment, updated EU benchmarks were not publicly available. For this reason, UK benchmarks have been used as a proxy. We test the potential implications of this proxy in Section **Error! Reference source not found.**

¹⁶ The UK ETS Authority has an intent to use updated 2026 EU benchmarks in the free allocation calculation over 2028-2030, however will continue to use current benchmarks for the 2027 scheme year as the updated 2026 EU benchmark values were not available at the point of decision making.

- Package B: Least ambitious option which takes a cautious approach to reducing free allowances, with the attempt to provide as much protection from carbon leakage regardless the size of the risk.
- Package C: Move towards closer alignment with EU ETS free allocation policy with due regards to UK-EU linking negotiations¹⁷.
- Package D: Similar to package C but without the introduction of conditionality, and with the early phase-out of free allocations for sectors not at risk of carbon leakage.
- Package E: Middle option between C and D, with no introduction of conditionality and no early phase-out of free allocations for sectors not at risk of carbon leakage.
- Package F: Nearly identical to package E apart from the use of EU benchmarks from 2028, with current benchmarks retained for 2027. This reflects the unavailability of published EU benchmarks at the time of decision making.

In preparation for the UK ETS Authority’s Impact Assessment, free allocation modelling was carried out for each package as set out in table 3A¹⁸. Based on this analysis, graph 3A illustrates projections of free allocations for Scottish ETS installations under each package from the modelling.

Graph 3A: Projection of Free Allocations for Scottish ETS installations



Alt Text: Package A represents the largest nominal reductions in free allocations by 2030 compared to the counterfactual, followed by package D, C, E, F then B.

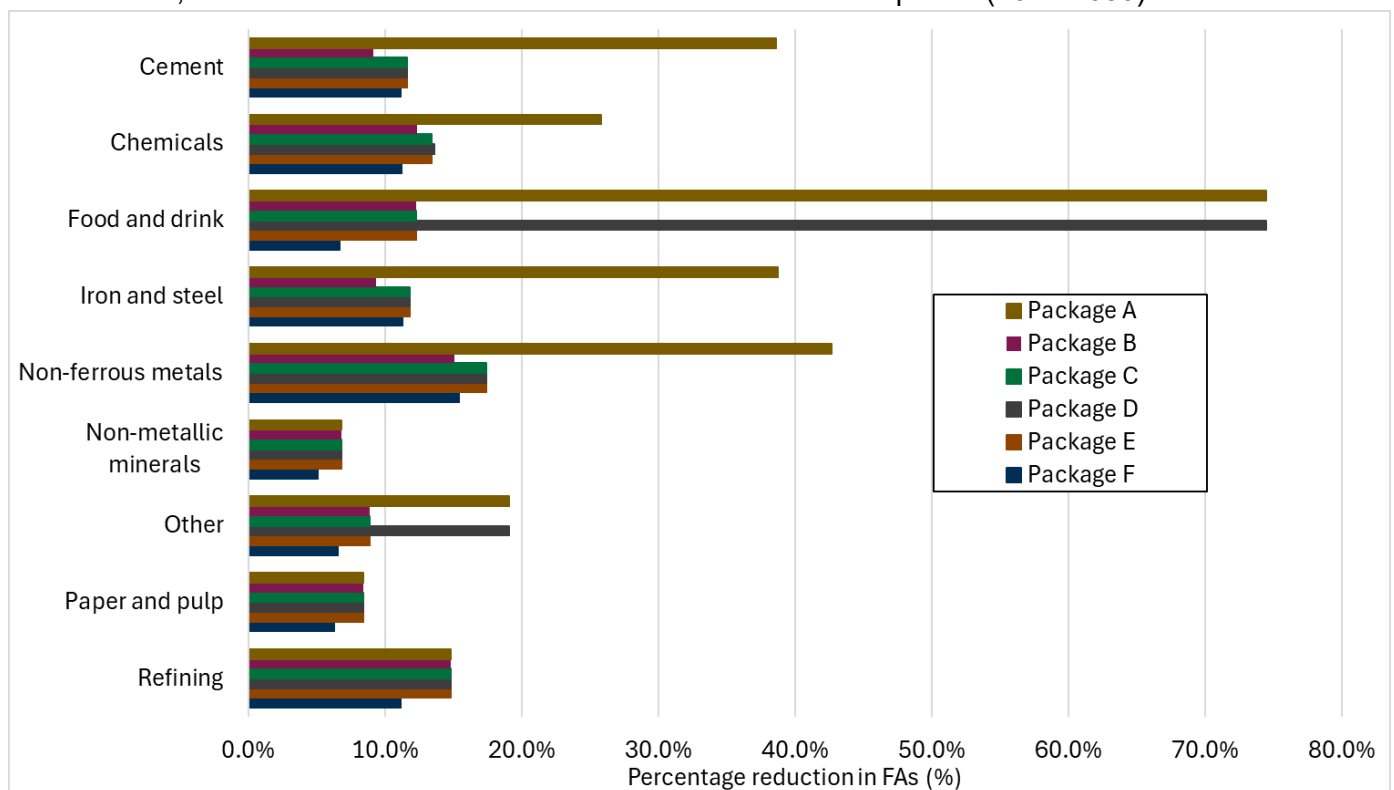
¹⁷ [UK-EU Summit - Common Understanding \(HTML\) - GOV.UK](#)

¹⁸ Details can be found in Chapter 12 of the Authority Impact Assessment: [UK Emissions Trading Scheme: free allocation review - GOV.UK](#)

Given the high level of ambition, package A represents an option with the most significant projected reduction in free allocations at around 1.3 million in 2030, with around 0.6 million lower free allocations than in the counterfactual of ‘do-nothing’. Conversely, package B represents a much more cautious option with only around 0.2 million lower free allocations when compared to the counterfactual. Packages B, C, D, E & F all sit in between the aforementioned packages, with projections of free allocations following slightly different pathways throughout the remainder of the 2020s. The preferred package F projects around 1.6 million free allocations in 2030, sitting closer to package B than package A. This provides a balance between implementing changes to reflect the introduction of the UK CBAM and potential future EU linking, while also trying to ensure a gradual phase out to support industrial decarbonisation.

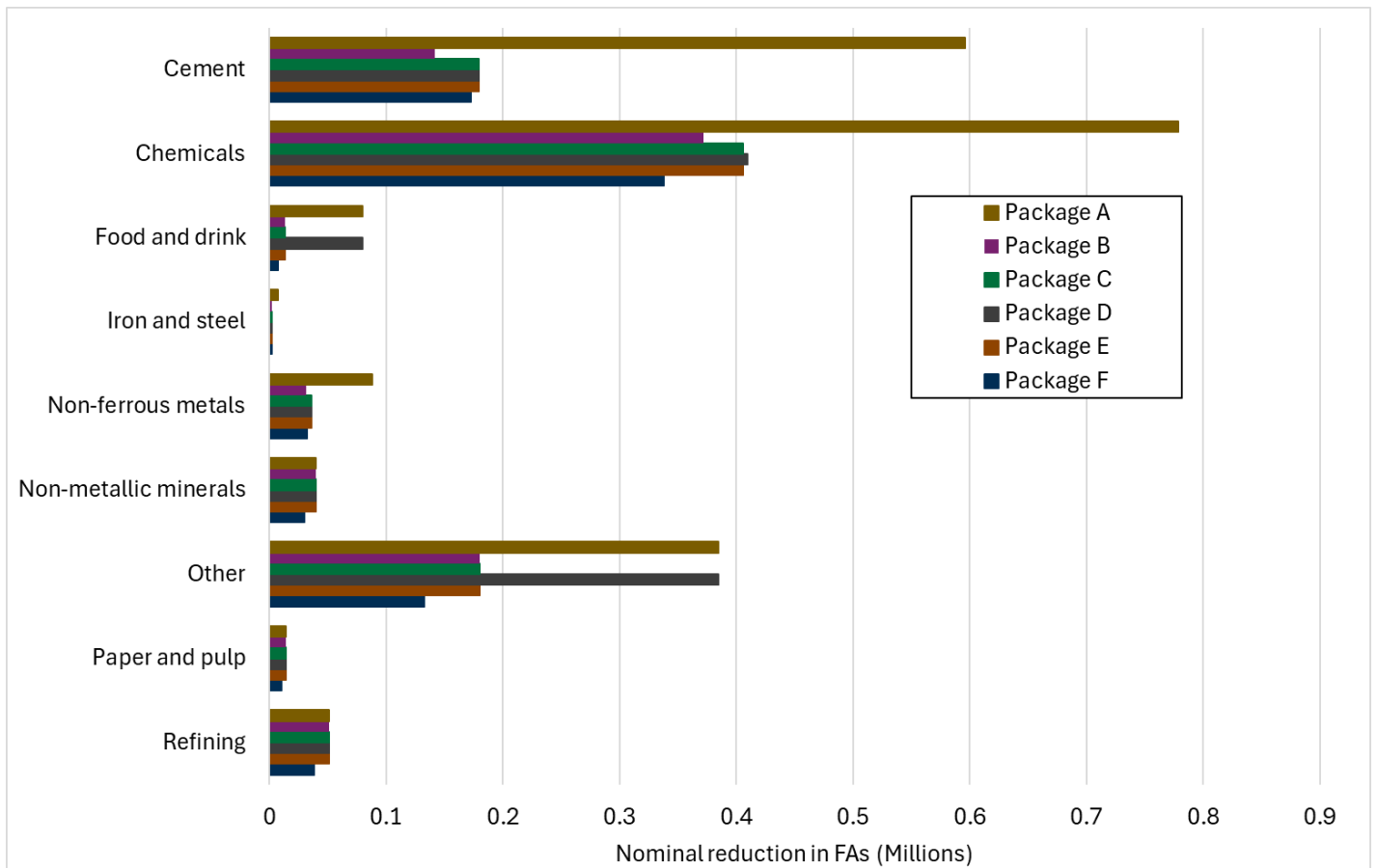
While graph 3A illustrates the total number of free allocations estimated under each package option, the impacts across sectors will be heterogeneous and dependent on whether the policy changes are significant for that sector. Graphs 3B and 3C below illustrate the estimated percentage and nominal impacts of each package across ETS sectors in Scotland for the second allocation period 2027-2030.

Graph 3B: Percentage reduction in free allocations under each package for each Scottish sector, relative to the counterfactual for the second allocation period (2027-2030)



Alt Text: Package A represents the largest percentage reduction in free allocations for most sectors across the second allocation period compared to the counterfactual, followed by package D, C, E, F then B.

Graph 3C: Nominal reduction in free allocations under each package for each Scottish sector, relative to the counterfactual for the second allocation period (2027-2030)



Alt Text: Package A represents the largest nominal reduction in free allocations for most sectors across the second allocation period compared to the counterfactual, followed by package D, C, E, F then B.

Comparison of Policy Package Impacts

When comparing across policy packages A-E, the reductions in free allocations are most similar for refining, paper and pulp and non-metallic minerals, with policy impacts largely being driven by identical changes in benchmarks and Activity Level Changes (ALCs). The exception to this is package F which sees lower projected reductions in free allocations due to the delay in the adoption of EU benchmarks.

Non-ferrous metals, iron & steel and cement all see larger reductions in free allocations under package A compared to other packages, due to the steep phase-out of free allocations for CBAM sectors. Likewise, these same sectors all see lower reductions in free allocations under package B due to a delayed phase-out of free allocations for CBAM sectors.

Food and drink see a stark reduction in free allocations under package A and D, driven by early phase out of free allocations for sectors not on the carbon leakage list.

For chemicals, option A sees a significant reduction in free allocations due to the phase-out of free allocations for CBAM sectors. While the broader chemicals sector is not currently on the list of UK CBAM sectors at the time of writing, the modelling of

the chemicals sector included sub-installations who produce hydrogen which is included.

Preferred Policy Package F

In percentage terms, non-ferrous metals see the largest reduction at 15% lower free allocations under package F compared to the counterfactual. This compares to around 43% lower free allocations under the most ambitious policy package A.

Iron and steel, cement, refining and chemicals all see modest percentage reductions with around 11% lower free allocations compared to the counterfactual. This is considerably lower than package A which sees a nearly 40% reduction in free allocations for iron and steel, cement, and chemicals compared to the counterfactual.

Food and drink along with paper and pulp both see some of the smallest reductions in free allocations under package F, at around 6-7% lower free allocations compared to the counterfactual.

When looking at absolute changes, chemicals and cement see the largest reductions in free allocations. This occurs given the significant proportion of total free allocations that are projected for these sectors under the counterfactual, with around 60% allocated to these sectors over the period 2027-2030.

Overall policy package F provides an appropriate balance between implementing changes to reflect the introduction of the UK CBAM and potential future EU linking, while also trying to ensure a gradual phase out of free allocations to support industrial decarbonisation, in line with the UK ETS objectives. Policy package A has a higher risk of deindustrialisation instead of industrial decarbonisation. On the other hand, policy package B may have risked the opposite, with the reduction in free allocations too gradual thereby limiting industrial effort to decarbonise.

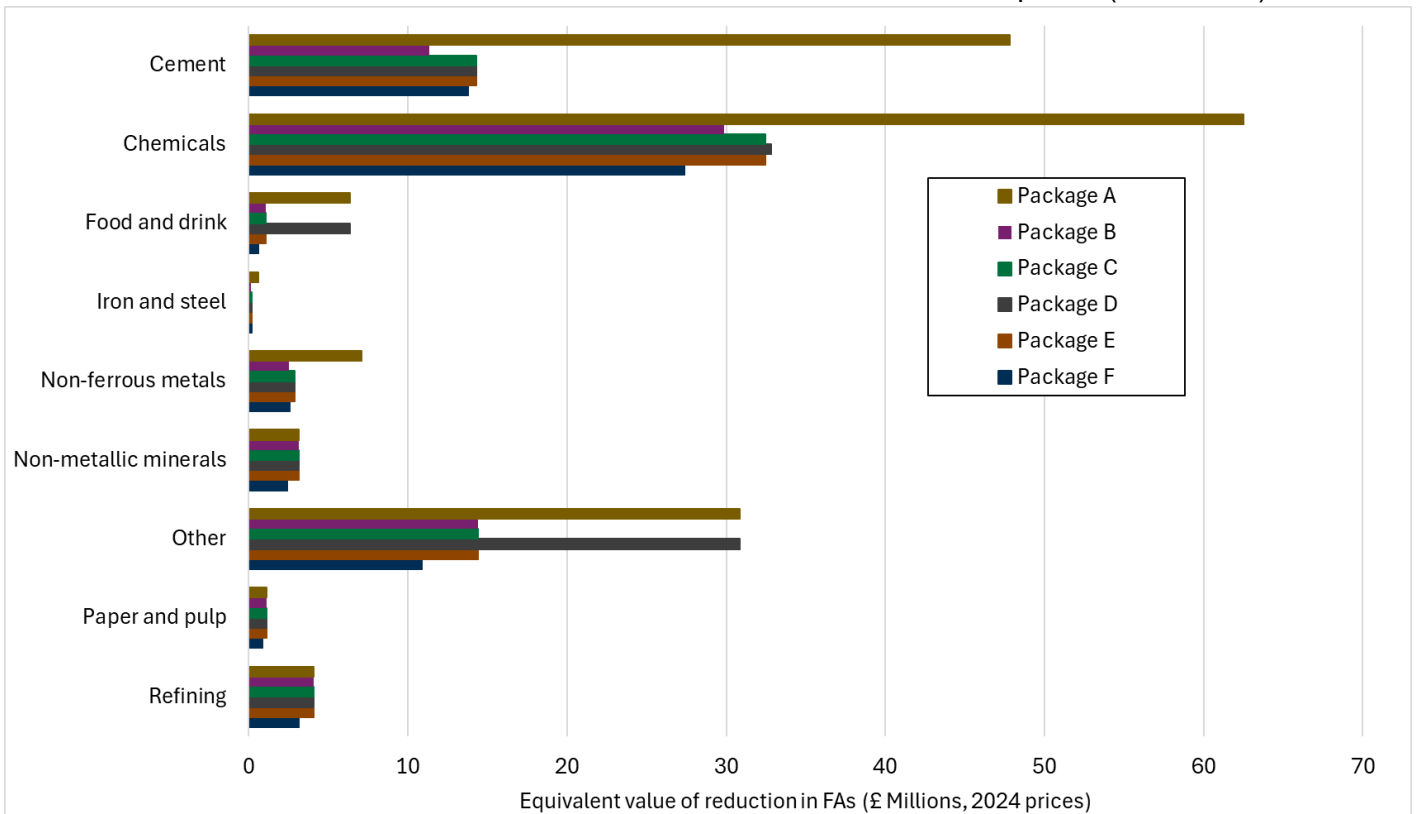
While a reduction in free allocations received may represent an opportunity cost¹⁹, as installations will receive fewer free allocations than they would have previously, the true financial impact of the policy options will depend on how installations respond to the change. If it encourages more decarbonisation effort, then installations will not be required to purchase the equivalent of free allocations foregone. However, if installations do not decarbonise further in response to the policy change, they may be required to purchase allowances up to their foregone free allocations depending on support ratios. Support ratios are defined as the proportion of emissions which are covered by free allocations calculated as total free allocations received divided by total emissions for each sector. A support ratio above 100% indicates sectors, on average, have received more free allocations than have been needed, with free allocations received exceeding total emissions. This suggests operators wouldn't need to purchase any additional ETS allowances if support ratios remained at or above 100% due to the policy change. Conversely, any sector with a historic support ratio of less than 100% suggests additional allowances have had to be purchased up to 100% of emissions to cover ETS liabilities. Any reduction in free allocations in the

¹⁹ Opportunity cost refers to the economic concept of foregone value when a choice is made. In this context, it is the foregone financial value of the FAs which would have been received under the counterfactual but not under the policy option.

future would require additional allowances to be purchased unless there is additional decarbonisation effort.

The maximum opportunity cost under each package is presented in graph 3D below, where nominal reductions in free allocations have been converted into equivalent 2024 monetary values based on projected market traded carbon values in the years 2027-2030²⁰.

Graph 3D: Equivalent value of reduction in free allocations under each package for each Scottish sector, relative to the counterfactual for the second allocation period (2027-2030)



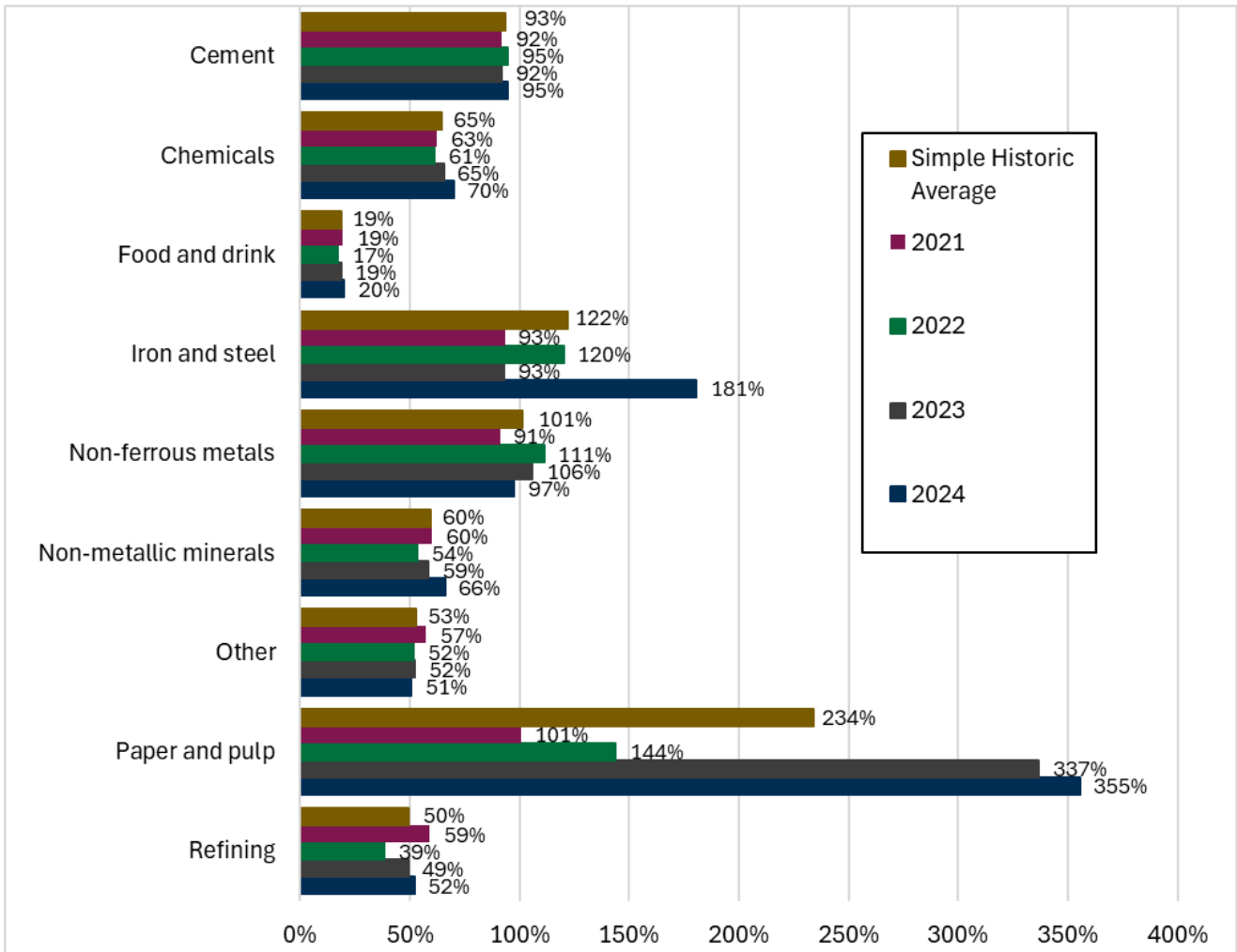
Alt Text: Package A represents the largest value reduction in free allocations for most sectors across the second allocation period compared to the counterfactual, followed by package D, C, E, F then B.

When comparing across policy packages, preferred policy package F appears to provide a suitable balance between reducing free allocations to support policy objectives, while also helping provide a gradual reduction in free allocations to promote industrial decarbonisation and reduce the risk of deindustrialisation. This contrasts policy packages A and B which represent options with more significant risks of deindustrialisation or too little additional decarbonisation effort.

Unsurprisingly graph 3D largely mirrors graph 3C, reflecting that market carbon values are projected to be largely similar over the period 2027-2030. Reductions in the volume of free allocations across the different policy packages reflect an opportunity cost and don't necessarily translate into additional costs to Scottish sectors due to the interaction with support ratios. Historic support ratios for sectors across Scotland are illustrated in graph 3E below.

²⁰ [Traded carbon values used for modelling purposes, 2024 - GOV.UK](#)

Graph 3E: Historic Support Ratios of Scottish ETS Sectors



Alt Text: Historically the paper and pulp sector has seen the largest support ratios, followed by the iron and steel sector, non-ferrous metals, cement, chemicals, non-metallic minerals, other, refining, and food and drink.

While having seen some variability over time, paper and pulp, cement, non-ferrous metals and iron & steel have all seen support ratios of at least 90% historically. This indicates these sectors have relied significantly on free allocations for their ETS compliance obligations in the past. Conversely, food and drink have seen some of the lowest support ratios at an average of 19% over historic years. Chemicals, non-metallic metals and other have historically seen support ratios between 50% and 70%.

When focussing on simple historic averages, only iron and steel, non-ferrous metals and paper and pulp have seen support ratios greater than 100%. This implies that the maximum financial cost for all other sectors could be as high as the opportunity cost presented in graph 3D if sectors do not decarbonise further. Table 3B below represents the maximum additional financial cost Scottish sectors could face under each policy package. This assumes that historic support ratios would have remained constant over the 2027-2030 period under the counterfactual, and that sectors have to purchase the equivalent of free allocations foregone up to a support ratio of 100%

over the 2027-2030 period to fulfil their ETS compliance obligations²¹. This extreme scenario assumes that sectors do not decarbonise further and represents an **upper estimate** of additional financial costs.

Table 3B: Maximum additional ETS Cost to Scottish Sectors under each policy package, relative to the counterfactual for the second allocation period (2027-2030)

Sector	Package A	Package B	Package C	Package D	Package E	Package F
Cement	£47.8m	£11.4m	£14.3m	£14.3m	£14.3m	£13.8m
Chemicals	£62.5m	£29.9m	£32.4m	£32.8m	£32.4m	£27.4m
Food and drink	£6.4m	£1.1m	£1.1m	£6.4m	£1.1m	£0.6m
Iron and steel	£0.5m	£0.1m	£0.1m	£0.1m	£0.1m	£0.1m
Non-ferrous metals	£7.0m	£2.5m	£2.8m	£2.8m	£2.8m	£2.5m
Non-metallic minerals	£3.2m	£3.2m	£3.2m	£3.2m	£3.2m	£2.4m
Other	£30.9m	£14.4m	£14.4m	£30.9m	£14.4m	£10.9m
Paper and pulp	£0.5m	£0.5m	£0.5m	£0.5m	£0.5m	£0.4m
Refining	£4.1m	£4.1m	£4.1m	£4.1m	£4.1m	£3.1m
Total	£162.8m	£67.0m	£72.9m	£95.1m	£72.9m	£67.0m

Under the assumption of no additional decarbonisation effort, package A represents the costliest option with around £163m projected as additional ETS compliance costs for Scottish ETS sectors. This represents an upper estimate of costs, with operators having to purchase all foregone free allocations up to 100% of their compliance obligation due to no change in decarbonisation effort.

The preferred policy package F represents one of the least costly options with around £67m projected as additional ETS compliance costs over the period 2027-2030, similar to the least ambitious option package B. Under package F, costs are concentrated in the chemicals and cement sectors making up around 61% of total additional Scottish ETS sector costs. This occurs due to the significant proportion of total free allocations that are projected for these sectors under the counterfactual, with around 60% originally allocated to these sectors over the period 2027-2030. As is illustrated in graph 3B, neither sectors are disproportionately impacted by the policy changes compared to other sectors. Overall policy package F provides a suitable balance between implementing changes to reflect the introduction of the UK CBAM and potential future EU linking, while also trying to ensure a gradual phase out of free allocations to support industrial decarbonisation. Policy package A may have provided a too ambitious option, threatening deindustrialisation instead of

²¹ For sectors with support ratios greater than 100%, financial costs have been constrained to only consider possible ETS compliance costs and do not include the opportunity cost of reduced free allocations above estimated emissions.

industrial decarbonisation. On the other hand, policy package B may have provided the alternative extreme with the reduction in free allocations too gradual limiting additional industrial effort to decarbonise.

While table 3B illustrates projected maximum costs from each policy package, true costs to businesses could be lower through additional decarbonisation effort. This would occur where it is more cost effective to invest in decarbonisation technologies to reduce carbon emissions and consequently reduce ETS compliance costs. Estimates of additional decarbonisation effort and abatement costs are presented in Chapter 15 of the UK ETS Authority's Impact Assessment²². In the regional impacts section, net present social values are calculated by region when assuming emissions and population shares of abatement costs and emissions savings respectively. As noted, while this approach is useful for providing an indication of aggregate distributional impacts, regions with a higher concentration of sectors with relatively low-cost abatement options will see the greatest emissions reductions and cost savings. Consequently, estimates of regional abatement costs will not be reflective of the true abatement costs and opportunities for Scottish ETS sectors. Due to this, no estimates of abatement costs have been attempted with table 3B representing an upper limit of Scottish sectoral costs.

Considering all the above policy package comparisons, package F appears to provide a strong balance between implementing changes to free allocations in light of the introduction of a new UK CBAM from 2027, ensuring businesses are supported with a smooth transition without excessive cost, and providing a policy landscape consistent with potential future EU ETS linking²³. Changes to ALCs would include COVID mitigations to avoid including abnormal historic years, while EU benchmarks would be used from 2028. The phase-out of free allocations for CBAM sectors would be aligned with the EU's phase-out, with a 1-year delay reflecting that the UK CBAM is expected to be introduced one year after the EU's CBAM. There would be no early non-carbon leakage phase-out from 2027, and no consideration of conditionality. Consequently, while less ambitious than option package A, package F provides a balance across the different policy packages considered while also bearing the joint least maximum additional ETS costs, similar to option package B, but with more ambitious projections.

As illustrated in graph 3B and table 3B, preferred policy package F represents the best option for sectors overall while trying to provide a suitable balance between achieving the policy intent of the change and continuing to support industrial decarbonisation and minimise the risk of deindustrialisation.

Other impacts

Furthermore, businesses may face a one-off familiarisation cost due to a change in the regulatory environment. While this is a possibility, these costs are likely to be negligible when compared to the aforementioned monetised impacts given the magnitude of the proposed policy changes.

²² [UK Emissions Trading Scheme: free allocation review - GOV.UK](#)

²³ [UK Emissions Trading Scheme \(UK ETS\): a policy overview - GOV.UK](#)

Scottish firms' international competitiveness

The measures covered by this BRIA aim to incentivise business to decarbonise in a cost-efficient way, including by improving efficiency which could result in increased competitiveness in global markets. Where companies are deemed at risk of carbon leakage, they receive a proportion of their allowances for free.

To ensure the UK CBAM applies an effective cost on imports and to maintain the carbon price signal to drive decarbonisation, the phase-out of free allocations must be coordinated with the phased introduction of the UK CBAM from 2027 to ensure parity between domestic and import pricing.

The UK's CBAM phase out will begin one year after the EU's to align with the introduction of the UK CBAM. While the decision has been made to align with the EU's phase-out trajectory of free allocation for CBAM sectors, the one-year delay between the EU and UK start date for implementation may pose a cross-border competitiveness risk, the extent of which remains unknown. During this one-year delay, UK producers could receive higher free allocation than their EU counterparts, further inflating the price differential paid domestically between both the UK and EU ETS markets. The CBAM cost is calculated as the difference between the domestic ETS price and the carbon price paid in the exporting country, adjusted for any free allocation. Due to market volatility and differing timelines for phasing out free allocations, actual EU CBAM costs remain uncertain and subject to change. Therefore, the impact on Scottish export competitiveness in the short-term remains unknown. However, by aligning the start of the phase out with the implementation of the UK CBAM, the Authority ensures that domestic producers are not exposed to carbon leakage risks before border measures are in place. This phase out will occur at sub-installation level to ensure only free allocations corresponding to products where a UK CBAM will be applied are affected.

For those sectors covered by the UK CBAM, a reduction in free allocation will support the transition toward the UK CBAM becoming the principal mechanism for mitigating carbon leakage. This will incentivise low-carbon imports and disincentivise high-carbon imports. For those sectors not covered by the UK CBAM, a reduction in free allocation could reduce the international competitiveness of UK firms, resulting in greater quantities of imports. The sectoral scope of the UK CBAM will be kept under review beyond 2027, as new evidence comes to light to reflect changes to carbon leakage risk, as well as methodological and technological advances. This is required to ensure the CBAM continues to effectively mitigate carbon leakage risks as the UK decarbonises. The UK ETS Authority will continue to carefully consider interactions between CBAM sectoral scope and UK ETS free allocation.

Stakeholders have consistently called for a cautious approach that avoids premature reductions in free allocation before the UK CBAM is proven to function effectively. The Authority has taken this feedback into account and designed a trajectory that provides certainty to operators while maintaining flexibility to respond to future developments. The approach taken mirrors the pace and scale of phase out of free allocation in the EU ETS for sectors covered by the EU CBAM. This will support consistency in the transition for UK and EU businesses.

Benefits to business

Policy packages have been created with potential future EU linking in mind, where businesses may experience benefits that could come from any potential future EU linking agreement. These could include benefits such as improved market liquidity, lower overall compliance costs, and improved price stability and convergence. Combining emissions trading schemes has been found to increase liquidity due to the creation of a larger ETS market with reduced transaction costs for businesses buying and selling allowances²⁴. Moreover, a larger ETS market allows for greater abatement options, where those with the lowest costs are able to reduce their emissions and lower the overall cost of compliance for businesses within the UK ETS. Lastly, linking ETS markets allows for convergence of a single carbon price across a greater number of regions, providing lower price volatility and creating a more stable price signal for businesses making long-term decarbonisation investment decisions.

Small business impacts

Participation in the UK ETS for industry and power generation businesses is only required for installations sites where combustion units with a total rated thermal input exceeding 20MW are operated²⁵. As a result, it is unlikely that small businesses will be disproportionately affected.

Investment

The impact of the proposed policy change on investment is highly uncertain due to mixed implications. On the one hand, the reduction in free allocations for CBAM sectors is a direct result of the anticipated introduction of the UK CBAM. The UK CBAM would introduce carbon costs for imports from outside of the UK, effectively reducing the relative cost of domestically produced industrial goods. However, this will correspond with a reduction in free allocations for CBAM sectors which could introduce higher UK ETS compliance obligations. The net effect impact on investment in Scotland is highly uncertain as it depends on whether the domestic benefits of the UK CBAM outweigh the costs of receiving lower free allocations. Therefore it is not currently known what, if any, material impact the change will have on the potential to make Scotland a more, or less, attractive place for global investment. The Authority will continue to assess any impacts to ensure evidence feeds into future UK ETS policy decisions.

Workforce and Fair Work

The policy is not anticipated to have any specific impacts on the ability of businesses to meet the Fair Work First principles.

The proposed changes apply specifically to sectors most at risk of carbon leakage who receive free allocations. Any indirect effects on the workforce will depend on the

²⁴ [Energy UK explains: Linking the UK and EU Emissions Trading Schemes - Energy UK](#)

²⁵ [Participating in the UK ETS - GOV.UK](#)

commercial decisions made by these sectors. The Scottish Government does not collect information on the commercial choices of businesses or the factors influencing them and therefore cannot predict or confirm how sectors may respond to changes in the UK ETS.

Climate change/ Circular Economy

Both the UK Government and the Scottish Government have legislated ambitious net zero targets. Scotland's greenhouse gas emissions reduction targets are set out in the Climate Change (Scotland) Act 2009²⁶. Scotland's net zero target is consistent with the overall UK target and is based on advice from the CCC.

The UK ETS aids the Scottish Government's priority of tackling the climate emergency and is generally seen as the most economically efficient way of driving decarbonisation. The UK ETS operates under a cap-and-trade system, where a fixed number of emissions allowances are issued every year. Over time, the cap is reduced to drive emissions down and increase the carbon price, thereby encouraging investment in decarbonisation technologies.

Free allocation of UK ETS allowances is the primary policy instrument through which carbon leakage risk is currently addressed in the UK. The UK ETS Authority defines 'carbon leakage' as the movement of production and associated emissions from one country to another due to different levels of decarbonisation effort, through carbon pricing and climate regulation. The proposed changes mark a significant step in the evolution of the UK ETS. By updating the free allocation rules to reflect a large data pool of latest emissions efficiencies taken by industry to drive decarbonisation, the Authority is ensuring that the scheme remains environmentally robust and aligned with the net zero ambitions across the UK. The adoption of updated EU benchmark values, the retention of a robust Carbon Leakage List, and the gradual phase out of free allocation for UK CBAM sectors all contribute to a more targeted and effective scheme. These changes maintain the incentive for installations to decarbonise—ensuring that efficient operators are rewarded and that the scheme continues to drive emissions reductions for industries across the UK.

This policy supports Scotland's Environment National Outcome as it directly contributes to the reduction of greenhouse gas emissions sectors at risk of carbon leakage. This aligns with Scotland's commitment to tackle climate action.

Competition Assessment

The proposed changes apply specifically to sectors most at risk of carbon leakage who receive free allocations and do not directly affect consumers. The impact of these changes on business competitiveness is hard to quantify as free allocation is just one factor of many impacting on competitiveness. It is not thought that these measures will directly impact competition in terms of limiting the range or numbers of businesses operating in the market. None of the wider proposals are deemed to risk limiting the range or numbers of suppliers. We have not identified any impact on competition associated with these changes.

²⁶ [Climate Change \(Scotland\) Act 2009](#)

The proposed changes to the UK ETS are not expected to:

- directly or indirectly limit the number or range of supplier,
- limit the ability of suppliers to compete or limit suppliers' incentives to compete,
- affect consumers' ability to engage with the market and make choices that align with their preferences, or
- affect suppliers' ability and/or incentive to introduce new technologies, products or business models.

Any unexpected effects on consumers or suppliers will depend on the commercial decisions made by these sectors. The Scottish Government does not collect information on the commercial choices of businesses or the factors influencing them and therefore cannot predict or confirm how sectors may respond to changes in the UK ETS.

Consumer Duty

The Consumer Scotland Act 2020 ('the 2020 Act') introduced a duty on public authorities in Scotland, when making decisions of a strategic nature in relation to the exercise of its functions, to have regard to the impact of those decisions on consumers (individuals or small businesses) of goods and services in Scotland that are supplied by a public authority or body.

The proposed changes to the UK ETS will primarily affect the sites and businesses which are covered by the UK ETS. These are primarily high-emitting sectors with large energy intensive operators. Changes aim to incentivise business to decarbonise in a cost-efficient way, with those deemed most at risk of carbon leakage receiving a proportion of their allowances for free. Therefore, the measures covered in this BRIA are not expected to have an impact on consumers as they do not involve the supply of goods or services by the Scottish Government or another public authority to individuals and small businesses. The impact on consumers more widely has been considered, with no direct negative impacts identified. The proposed changes apply specifically to sectors most at risk of carbon leakage who receive free allocations and do not directly affect consumers. Any indirect effects on consumers as a result of any cost implications will depend on the commercial decisions made by these sectors. The Scottish Government does not collect information on the commercial choices of businesses or the factors influencing them and therefore cannot predict or confirm how sectors may respond to changes in the UK ETS.

Section 4: Additional implementation considerations

Enforcement/ compliance

This policy does not change the current enforcement, sanctions or monitoring processes already in place for the UK ETS. These processes are built on top of existing practices and procedures, and it is a matter for SEPA to make operational.

SEPA are responsible for the regulation of all Scottish installations affected by the proposals and will implement relevant changes that may be required. This includes the periodic Baseline Data Collection and annual Activity Level reporting processes for which installations in receipt of free allocation participate in.

SEPA will continue to support operators in meeting their regulatory obligations in terms of free allocation and will communicate any changes as a result of this policy. The monitoring, reporting and verification system METS (Manage your Emissions Trading Scheme) will be utilised and is in the process of being updated to support this policy.

Non-compliance may result in financial penalties as outlined in the Greenhouse Gas Emissions Trading Scheme Order 2020. SEPA engages closely with operators to ensure compliance however and overall compliance with the current free allocation policy remains high.

UK, EU and International Regulatory Alignment and Obligations

We do not expect these policy changes to impact on intra-UK trade as it has been developed and agreed on a UK-wide basis, in conjunction with the UK Government and other Devolved Governments.

International Trade Implications

As outlined above in Section 3's *Scottish Firms' International Competitiveness*, the measures covered by this BRIA aim to incentivise business to decarbonise in a cost-efficient way, including by improving efficiency which could result in increased competitiveness in global markets. Where companies are deemed at risk of carbon leakage, they receive a proportion of their allowances for free.

To ensure the UK CBAM applies an effective cost on imports and to maintain the carbon price signal to drive decarbonisation, the phase-out of free allocations must be coordinated with the phased introduction of the CBAM to ensure parity between domestic and import pricing. The Authority has decided to gradually phase out free allocations for sectors covered by the UK CBAM from 2027, with a trajectory that mirrors the EU's phase out period, ensuring a gradual and coordinated transition to the UK CBAM as the primary carbon leakage mitigation measures. By aligning the

start of the phase out with the implementation of the UK CBAM, the Authority ensures that domestic producers are not exposed to carbon leakage risks before border measures are in place. This phase out will occur at sub-installation level to ensure only free allocations corresponding to products where a UK CBAM will be applied are affected.

EU Alignment consideration

As announced as part of the UK-EU Summit on 19 May 2025, and then set out in the shared Common Understanding, the UK and EU have agreed to work towards linking their respective Emissions Trading Systems.

The positions set out in the Authority Response, Authority Impact Assessment and this document will be implemented in the UK ETS from 1 January 2027 but it should be noted that the UK's free allocation policy in a linked market may be subject to change, in particular where these would avoid creating competitive distortions, as recognised in the Summit text²⁷. Further updates related to linking negotiations will be provided by UK Government at the appropriate times.

Legal Aid

Not applicable.

Digital impact

All UK ETS operators make use of the online platform METS in their interaction with the scheme. In terms of free allocation, the system is used by operators and regulators to submit and process relevant reports.

METS will be used to implement aspects of this policy, including the application of the COVID mitigation and association of CBAM with the 2025 Baseline Data Report, used to set the baseline for free allocation over the 2027-2030 period. Development of METS for this purpose is ongoing.

Operators are familiar with the METS platform in general, however, SEPA will provide clear instruction to operators on any new components arising from this policy.

Business forms

This process does not require new forms as it is built on top of existing practices and procedures and is a matter for SEPA to make operational.

No new standalone business forms will be introduced as part of the implementation of this policy, however, amendments to existing forms will be required – namely the Baseline Data Report and going forward the Activity Level Change Report for the 2027-2030 period. Operators are familiar with these report templates and will be provided instruction and support with any amendments.

²⁷ [UK-EU Summit - Common Understanding \(HTML\) - GOV.UK](#)

All compliance and reporting obligations will be managed through existing digital platforms, primarily the METS system and the UK ETS Registry.

Section 5: Next steps and implementation

Recommendations/ preferred options

The final policy positions of the Free Allocation Review can be found in the Authority Response to the consultation. In summary, the Authority's proposed changes in the UK, including Scotland, are:

- An option for operators to choose to have activity data for either the scheme years 2020 only, or 2020 and 2021, excluded for the purpose of determining historical activity level (HAL) for the 2027-2030 allocation period.
- The retention of current benchmarks for 2027, with the in-principle intent to adopt updated EU benchmark values from 2028-2030.
- A decision to retain the current carbon leakage list, with no introduction of tiering of free allocation for sectors at risk of carbon leakage, and no early phase out of free allocations of allowances for sectors not on the carbon leakage list.
- No additional methodologies to be introduced in 2027, which would introduce conditions on the provision of free allocation, with a pathway set out to reconsider their introduction for future allocation periods, and
- A gradual phase out of free allocations for sectors covered by the UK Carbon Border Adjustment Mechanisms (CBAM) from 2027, with an indicative trajectory of 9 years.

Considering all the policy package comparisons, as detailed in Section 3, package F appears to provide a strong balance between implementing changes to free allocations in light of the introduction of a new UK CBAM from 2027, ensuring businesses face a smooth transition without excessive cost, and providing a policy landscape consistent with potential future EU ETS linking²⁸. Changes to ALCs would include COVID mitigations to avoid including abnormal historic years, while EU benchmarks would be used from 2028. The phase-out of free allocations for CBAM sectors would be aligned with the EU's phase-out, with a 1 year delay reflecting that the UK CBAM is expected to be introduced 1 year after the EU's CBAM. There would be no early non-carbon leakage phase-out from 2027, and no consideration of conditionality. Consequently, package F provides a balance across the different policy packages considered while being slightly closer to the least ambitious option package B than the most ambitious option package A.

Changes to the UK ETS may increase costs for participating businesses through the costs associated with investment in decarbonisation technologies and the costs associated with purchasing of allowances. However, these costs are associated with reductions in emissions and will therefore support our ambitious climate targets. The proposed changes presented in the Authority Response and resulting costs to businesses are deemed to be proportionate given the importance of our national climate targets.

Implementation considerations/ plan

²⁸ [UK Emissions Trading Scheme \(UK ETS\): a policy overview - GOV.UK](#)

This policy does not change the current implementation or delivery processes already in place for the UK ETS for the second free allocation period (2027-2030). These processes are built on top of existing practices and procedures.

The second stage of the application for free allocation for 2027-2030 will take place between 1 April and 30 June 2026. During this window, operators will be required to confirm or withdraw their initial applications for free allocation made in 2025, now that the free allocation review has concluded. In addition, some operators who are impacted by the UK CBAM will need to resubmit information relating to their affected sub-installations. Operators will also have the opportunity during the second stage to state whether their 2020, or 2020 and 2021, scheme year data should be excluded from the calculation of their HAL. Further guidance on how to comply with the requirements of this second stage application will be published in advance of the window. Regulators will notify operators when this is available.

The Authority will continue to engage with stakeholders on the implementation of these changes in the lead up to 2027.

Post implementation review

Under Article 17 of The Greenhouse Gas Emissions Trading Scheme Order 2020, the UK ETS Authority has a statutory requirement to undertake and publish a review by 31st December 2028 on the operation of the UK ETS and make appropriate recommendations for future operations. Further information on the UK ETS monitoring and evaluation plan can be found in the Authority Impact Assessment.

Declaration

I have read the Business and Regulatory Impact Assessment and I am satisfied that it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and that these have been taken into account when making the policy decision. I am satisfied that business impact has been assessed with the support of businesses in Scotland.

I am also satisfied that officials have considered the impact on consumers as required by the [Consumer Scotland Act 2020](#) in completion of the Consumer Duty section of this BRIA.

Signed:

A handwritten signature in black ink, appearing to read 'Gillian Martin', written in a cursive style.

Date: 12/01/2026

Minister's name: Gillian Martin

Minister's title: Cabinet Secretary for Climate Action and Energy

Scottish Government Contact point: emissions.trading@gov.scot



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