Net Zero, Energy and Transport Committee
Tuesday 27 January 2026
4th Meeting, 2026 (Session 6)

Note by the Clerk on the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2026 (draft)

Overview

1. At this meeting, the Committee will take evidence from the Cabinet Secretary for Climate Action and Energy and officials on the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2026 (draft) before debating a motion in the name of the Cabinet Secretary inviting the Committee to recommend approval of the instrument.

2. This is a draft Statutory Instrument (SI), which requires approval by resolution of the Parliament before it can become law. More information about the instrument is summarised below:

Title of instrument: the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2026 (draft)

Laid under: sections 44, 54 and 90(3) of, and Schedule 2 and paragraph 9 of Schedule 3 to, the Climate Change Act 2008

Laid on: 17 December 2025

Procedure: Affirmative

Lead committee to report by: 10 February 2026

Commencement: If approved, the instrument comes into force on the day after the day on which it is made.

Procedure

3. Under the affirmative procedure, an instrument must be laid in draft and cannot be made (or come into force) unless it is approved by resolution of the Parliament. In this case, the instrument also requires approval by resolution of Senedd Cymru, the Northern Ireland Assembly and both Houses of the UK Parliament.

4. Once laid, the instrument is referred to:

- the Delegated Powers and Law Reform (DPLR) Committee, for scrutiny on various technical grounds, and

- a lead committee, whose remit includes the subject-matter of the instrument, for scrutiny on policy grounds.

5. The lead committee, taking account of any recommendations made by the DPLR Committee (or any other committee), must report within 40 days of the instrument being laid.

6. The normal practice is to have two agenda items when an affirmative instrument is considered by the lead committee:

    - an evidence session with the Minister and officials, followed by

    - a formal debate on a motion, lodged by the Minister, inviting the lead committee to recommend approval of the instrument.

7. Only MSPs may participate in the debate, which may not last for more than 90 minutes. If there is a division on the motion, only committee members may vote. If the motion is agreed to, it is for the Chamber to decide, at a later date, whether to approve the instrument

Delegated Powers and Law Reform Committee consideration

8. The DPLR Committee considered the instrument on 13 January 2026 and reported on it in its 6th report 2026. The DPLR Committee made no recommendations in relation to the instrument but noted that this draft instrument has been withdrawn and re-laid twice: first due to errors identified by the responsible Minister and subsequently following questions raised by the DPLR Committee with the Scottish Government.

Purpose of the instrument

9. This instrument makes various changes to the UK Emissions Trading Scheme (the “UK ETS”).

10. The UK ETS was established under the Climate Change Act 2008 by the 2020 Order as a UK-wide greenhouse gas emissions trading scheme to encourage cost-effective emissions reductions, which will contribute to the UK’s emissions reduction targets and net zero goal.

11. Under the UK ETS, participants are required to monitor, report on, and surrender allowances in respect of their greenhouse gas emissions. Participating operators at risk of carbon leakage are given a certain number of UK ETS allowances for free, to manage their exposure to the carbon price and the risk that business’s decarbonisation efforts could be undermined by higher-carbon imports. Participants can also buy emission allowances at auction and in secondary markets.

12. This instrument is part of a package of legislation to implement the policy decisions in the main joint Authority Response to the ‘Free Allocation Review’ consultation, which was published in November 2025. The policy note states that overall, this instrument aligns with EU ETS policy on free allocations, matching policies for the treatment of HAL (Historical activity level) and CBAM (Carbon Border Adjustment Mechanism) sector receiving free allocations. According to the

policy note, this instrument also ensures that the UK ETS continues to use the EU ETS benchmarks, ensuring that treatment of free allocations for both ETSs remains aligned. Therefore, this is not expected to have any impact on any wider interactions with the EU.

13. This instrument will make changes to the free allocation policy in the UK ETS. The main changes made by this instrument relate to the following areas:

14. **Historical activity level (HAL)**: The instrument amends the 2020 Order to enable operators of incumbent installations to notify their regulator that they wish to have their activity data for the 2020, or 2020 and 2021, scheme year(s) excluded from the calculation of their HAL for the 2027-2030 allocation period in order to mitigate the impacts of the COVID-19 pandemic. The policy note explains that the impact of COVID-19 during the baseline period could result in operators' HAL being unrepresentative of normal activity. Operators will be able to notify their regulator during the second stage of the 2027-2030 free allocation application (1 April – 30 June 2026) that they wish to have their activity data for 2020, or 2020 and 2021, excluded. This, according to the policy note, ensures that an operators' HAL is representative even where activity in 2020 or 2020 and 2021 was lower than normal due to the COVID-19 measures.

15. **Benchmarks**: The instrument amends the 2020 Order to use current benchmarks for the purpose of calculating free allocation ("FA") for stationary installations for the 2027 scheme year and to provide for the ability to update the benchmark values used to calculate FA for the years 2028, 2029 and 2030 of the 2027-2030 allocation period. The intent, as set out in the policy note, is to use the updated EU ETS Phase IV benchmarks in the 2028, 2029 and 2030 scheme years to reflect emissions efficiency improvements available to production processes that are carried out by UK installations. This is to ensure that free allocation continues to reward installations that reduce emissions and incentivise decarbonisation by covering a higher proportion of emissions from installations close to the benchmarks.

16. **Free allocation for sectors covered by the UK CBAM**: The instrument makes provision to start to phase out free allocation for sectors covered by the UK CBAM over the 2027-2030 allocation period. This phase out will be implemented through applying a UK CBAM reduction factor to the calculation of free allocation and will apply at sub-installation level. To do this, operators will be required to report which of their sub-installations serve the production of UK CBAM goods. This will enable regulators to apply the UK CBAM reduction factor. The instrument provides for the ability to update the UK CBAM reduction factors during the 2027-2030 allocation period, enabling regulators to recalculate final free allocation entitlement in accordance, for those sub-installations producing UK CBAM goods.

17. **Permanent cessation reporting requirement**: The instrument amends the Activity Level Changes Regulation to clarify that the reporting requirement that applies to installations who receive free allocation and who have permanently ceased their activities.

18. The Policy Note accompanying the instrument is included in the annexe. It includes a summary of consultation undertaken on the instrument and the anticipated financial effects. The following impact assessments have been carried out:

- Free Allocation Review – Final Impact Assessment

Report

19. The Convener may invite the Committee to delegate to him authority for considering and approving a draft report prepared by the clerks after the meeting. In relation to any report finalised in this way, Committee Members may ask to see the draft and comment on it before the Convener authorises it for publication.

Clerks to the Committee
January 2026

Annexe: Scottish Government Policy Note

THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (AMENDMENT) ORDER 2026

SI 2026/XXXX

The above instrument is to be made in exercise of the powers conferred by sections 44, 54 and 90(3) of, and Schedule 2 and paragraph 9 of Schedule 3 to, the Climate Change Act 2008. The instrument is subject to affirmative procedure.

Summary Box

This instrument makes various changes to the UK Emissions Trading Scheme (the "UK ETS") including provisions enabling incumbent installations to have their 2020, or 2020 and 2021, scheme year(s) data excluded from the calculation of their historical activity level ("HAL") for the 2027-2030 allocation period. The primary aim of these provisions is to mitigate the impact of the COVID-19 pandemic on HALs for the 2027-2030 allocation period.

This instrument also includes provisions to retain current UK ETS free allocation benchmarks used in the free allocation calculation for the 2027 scheme year and adopt updated benchmarks in the free allocation calculation for the years 2028, 2029 and 2030 of the 2027-2030 allocation period to continue to reward efficient installations and incentivise decarbonisation.

This instrument enables the reduction of free allocation annually during the period 2027-2030 for sub-installations operating in one of the five sectors covered by the UK Carbon Border Adjustment Mechanism (the "UK CBAM"). To do this, operators will be required to inform the regulator which of their sub-installations serve the production of UK CBAM goods and a UK CBAM reduction factor will be applied to those sub-installations in each of the 2027-2030 scheme years.

This instrument also makes a clarification to the annual reporting requirement that applies to installations that receive free allocation and permanently cease their activities.

For further information on the UK ETS, see the Policy Note accompanying the Greenhouse Gas Emissions Trading Scheme Order 2020 ("the 2020 Order")[1].

Policy Objectives

The UK ETS was established under the Climate Change Act 2008 by the 2020 Order as a UK-wide greenhouse gas emissions trading scheme to encourage cost-effective emissions reductions which will contribute to the UK's emissions reduction targets and net zero goal. The UK ETS is operated by the UK ETS Authority, comprising the UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland. The scheme is regulated by the Environment Agency, the Scottish Environment Protection Agency, Natural Resources Wales, the Northern Ireland Environment Agency, and the Offshore

[1] Draft Greenhouse Gas Emissions Trading Scheme Order (legislation.gov.uk)

Petroleum Regulator for Environment and Decommissioning. This scheme replaced the UK's participation in the EU Emissions Trading System ("EU ETS"), and the 2020 Order applied EU ETS rules on the monitoring, reporting and verification of emissions with modifications to ensure that they work for the UK ETS.

Under the UK ETS, participants are required to monitor, report on, and surrender allowances in respect of their greenhouse gas emissions. Participating operators at risk of carbon leakage[2] are given a certain number of UK ETS allowances for free, to manage their exposure to the carbon price and the risk that business' decarbonisation efforts could be undermined by higher-carbon imports. Participants can also buy emission allowances at auction and in secondary markets.

This instrument will make changes to free allocation policy in the UK ETS. The main changes made by this instrument relate to the following areas:

- Historical activity level (HAL): The instrument amends the 2020 Order to enable operators of incumbent installations to notify their regulator that they wish to have their activity data for the 2020, or 2020 and 2021, scheme year(s) excluded from the calculation of their HAL for the 2027-2030 allocation period in order to mitigate the impacts of the COVID-19 pandemic. The impact of COVID-19 during the baseline period could result in operators' HAL being unrepresentative of normal activity. These operators will be able to notify their regulator during the second stage of the 2027-2030 free allocation application (1 April – 30 June 2026) that they wish to have their activity data for 2020, or 2020 and 2021, excluded. This ensures that an operators' HAL is representative even where activity in 2020 or 2020 and 2021 was lower than normal due to the COVID-19 measures.

- Benchmarks: The instrument amends the 2020 Order to use current benchmarks for the purpose of calculating free allocation ("FA") for stationary installations for the 2027 scheme year and to provide for the ability to update the benchmark values used to calculate FA for the years 2028, 2029 and 2030 of the 2027-2030 allocation period. The intent is to use the updated EU ETS Phase IV benchmarks in the 2028, 2029 and 2030 scheme years to reflect emissions efficiency improvements available to production processes that are carried out by UK installations. This is to ensure that free allocation continues to reward installations that reduce emissions and incentivise decarbonisation by covering a higher proportion of emissions from installations close to the benchmarks.

- <u>Free allocation for sectors covered by the UK CBAM</u>: The instrument makes provision to start to phase out free allocation for sectors covered by the UK CBAM over the 2027-2030 allocation period. This phase out will be implemented through applying a UK CBAM reduction factor to the calculation of free allocation and will apply at sub-installation level. To do this, operators will be required to report which of their sub-installations serve the production

[2] Carbon leakage is 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.

of UK CBAM goods. This will enable regulators to apply the UK CBAM reduction factor. The instrument provides for the ability to update the UK CBAM reduction factors during the 2027-2030 allocation period, enabling regulators to recalculate final free allocation entitlement in accordance, for those sub-installations producing UK CBAM goods.

- Permanent cessation reporting requirement: to the instrument amends the Activity Level Changes Regulation to clarify that the reporting requirement that applies to installations who receive free allocation and who have permanently ceased their activities.

EU Alignment Consideration

The purpose of the UK ETS is to encourage cost-effective emissions reductions which will contribute to the UK's emissions reduction targets and net zero goal. The UK ETS is operated by the UK ETS Authority, comprising the UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs in Northern Ireland. The UK ETS replaces the UK membership of the EU Emissions Trading Scheme following the UK's exit from the EU. Directive 2003/87/EC (as amended) established the EU Emissions Trading System (EU ETS), which created a European Union market in greenhouse gas emissions allowances. The 2020 Order applied EU ETS rules on the monitoring, reporting and verification of emissions with modifications to ensure that they work for the UK ETS.

This instrument is part of a package of legislation to implement the policy decisions in the main joint Authority Response to the 'Free Allocation Review' consultation, which was published in November 2025. Overall, this instrument aligns with EU ETS policy on free allocations, matching policies for the treatment of HAL and CBAM sector receiving free allocations. This instrument also ensures that the UK ETS continues to use the EU ETS benchmarks. All of this ensures that treatment of free allocations for both ETSs remains aligned. Therefore, this is not expected to have any impact on any wider interactions with the EU.

Consultation

Paragraph 3 of schedule 10 of the Climate Change Act 2008 provides that no recommendation may be made to His Majesty in Council to make an order under paragraph 9 of that schedule unless a consultation has taken place with such persons likely to be affected by the legislation as appropriate. The UK ETS Authority –formed by the Scottish Government, together with the UK Government, Welsh Government and the Department for Agriculture, Environment and Rural Affairs for Norther Ireland– ran the 2023 Free Allocation Review Consultation[3] and the 2024 Free Allocation Review Carbon Leakage consultation.
The 2023 Free Allocation Review consultation ran from 18th December 2023 to 11th March 2024 and received responses from over 66 organisations. The 2024 Free Allocation Review Carbon Leakage consultation ran from 16th December 2024 to 10th March 2025 and received responses from over 54 organisations.

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[3] https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review

The Authority has reported on the findings from this consultation in the Authority Response: UK Emissions Trading Scheme: free allocation review - GOV.UK. Following the consultation, the advice of the Climate Change Committee (CCC) on the associated policy proposals in this instrument was sought and taken into account, which is a further statutory requirement in the Climate Change Act 2008. The CCC reviewed these proposals and had no comments.

Impact Assessments

The Authority Response to the consultation has a UK-wide impact assessment on the decisions made by the Authority - which includes Scottish analysts – outlined in the Authority Response: UK Emissions Trading Scheme: free allocation review - GOV.UK. The Scottish Government has completed a Business and Regulatory Impact Assessment (BRIA) on all the changes the UK ETS Authority agreed on and which were published in the Authority Response.

Officials screened the following Scottish impact assessments and determined they were not required for this SI:

1. Islands Communities Impact Assessment
2. Child Rights and Wellbeing Impact Assessment
3. Equalities Impact Assessment
4. Strategic Environmental Assessment
5. Fairer Scotland Duty
6. Data Protection Impact Assessment

Financial Effects

A Business and Regulatory Impact Assessment (BRIA) has been completed. The BRIA analyses the different policy options that were explored to assess their potential impacts on businesses.

In summary, all options considered are projected to result in lower free allocations when compared to the counterfactual of do nothing. This is in line with the UK ETS decarbonisation ambitions.

It is possible, although not certain, that 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 support our ambitious climate targets.

It is possible that while free allocation lowers carbon costs for UK production regardless of destination, as a UK CBAM levied on imports only supports competitiveness for items covered by the UK CBAM and bought in the domestic market, it does not necessarily protect UK producers competing on export markets. As such, there is potential impact for export leakage risk for these sectors specifically. The decision aligns with the EU and the Authority believes this will be beneficial for linking negotiations. The Authority and UK Government will keep this under review to monitor potential impacts.

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. Decisions also maintain alignment with the EU, which stakeholders fed back as important during the consultation process. All decisions will be kept under review ahead of the subsequent allocation period post-2030.

Scottish Government
Energy and Climate Change Directorate

2 December 2025