EXPLANATORY MEMORANDUM TO

THE CLIMATE CHANGE ACT 2008 (CREDIT LIMIT) ORDER 2026

2026 No. 694

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Energy Security and Net Zero and is laid before Parliament by Command of His Majesty.

1.2 This memorandum contains information for the Secondary Legislation Scrutiny Committee.

2. Declaration

2.1 Ed Miliband, Secretary of State at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

2.2 Sonia Krylova, Deputy Director, Net Zero Strategy, at the Department for Energy Security and Net Zero, confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Helen Parker at the Department for Energy Security and Net Zero can be contacted by email at the following address with any queries regarding the instrument: SI_order@energysecurity.gov.uk.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This legislation relates to the maximum level of UK greenhouse gas emissions for the years 2028 to 2032, known as the fifth carbon budget, which was set in 2016. The legislation sets a limit (of zero) on the amount of overseas reductions, or avoidance, of greenhouse gases that are allowed to count towards meeting the fifth carbon budget. The legislation also exempts the EU Emissions Trading System from the limit. This is to avoid restricting any future approaches to linking the EU Emissions Trading System and the UK Emissions Trading Scheme.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the United Kingdom.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. Policy Context

What is being done and why?

Net zero, carbon budgets and carbon units from overseas

5.1 The Climate Change Act 2008 ("the Act") requires the Secretary of State for Energy Security and Net Zero to reduce UK net greenhouse gas emissions to zero by 2050. This is known as the net zero target.

5.2 With a view to meeting that target, the Secretary of State must set five year "carbon budgets'' representing the maximum level of the net UK greenhouse gas emissions, (known as the net carbon account).

5.3 Initially the Act was based on a reduction of at least 80% emissions by 2050 against the 1990 baseline, and the first five carbon budgets, covering the 2008-2032 period, were set against this 80% reduction target. The Act was amended in 2019 to require net zero by 2050, and the sixth carbon budget was set on this trajectory, covering the 2033-2037 period.

5.4 The level of the seventh carbon budget, covering 2038-2042 must be set by 30 June 2026.

5.5 The Act allows the net zero target and the carbon budgets to be met partly through action overseas, under specific circumstances. In the Act, carbon units refer to the reduction, or avoidance, of greenhouse gas emissions overseas. Each unit represents one tonne of carbon dioxide equivalent.

Limit on carbon units

5.6 The Act places a requirement on the Secretary of State to set a limit on the net amount of carbon units that can be used towards each carbon budget (section 11). The limit must be set 18 months before each carbon budget period begins.

5.7 When setting this limit, the Secretary of State must have regard to the need for UK domestic action on climate change (section 15). The UK has met all carbon budgets so far, without using carbon units from overseas. Based on this, and the Carbon Budget and Growth Delivery Plan[1] published in October 2025, the Secretary of State has sufficient flexibility to deliver the fifth carbon budget through domestic action alone. Article 2(1) of this instrument therefore sets the limit on the use of carbon units for the fifth carbon budget at zero.

Units from the European Union Emissions Trading System

5.8 Article 2(2) of this instrument excludes from this limit any net use of carbon units in connection with the European Union Emissions Trading System ("the EU ETS"). The United Kingdom Emissions Trading Scheme ("the UK ETS") replaced the UK's participation in the EU ETS on 1 January 2021. In May 2025, the UK-EU Summit Common Understanding[2] set out that the United Kingdom and the European Commission should work towards establishing a link between carbon markets by way of a European Union-United Kingdom agreement linking the UK ETS and the EU ETS. The link and associated accounting mechanisms have not been agreed. The intention behind excluding these units from the zero-carbon unit limit set by this

[1] https://www.gov.uk/government/publications/carbon-budget-and-growth-delivery-plan
[2] https://www.gov.uk/government/publications/ukeu-summit-key-documentation/uk-eu-summit-common-understanding-html

instrument is to ensure that the instrument does not restrict any approaches the UK and EU may take in future towards establishing a link between the two ETS markets.

What was the previous policy, how is this different?

5.9 A credit limit is required to be set by order every five years and is unique to each carbon budget. Earlier Credit Limit Orders set the credit limit for the first carbon budget (covering the 2008-2012 budgetary period) at zero and the credit limit for each of the second, third and fourth carbon budgets (covering 2013-2027) at 55 million units.

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument does not amend the Act but exercises the duty under section 11(1) to set a limit on the net amount of carbon units that can be credited to the net UK carbon account for each budgetary period. Earlier Credit Limit Orders set the limits for the first four carbon budgets. This instrument sets the limit for the fifth carbon budget. No new powers or obligations are created beyond those already in the Act.

6.2 Section 26 and 27 of the Act allow the Secretary of State to determine what carbon units should be added to and subtracted from the UK carbon account and how carbon accounting for the relevant period will work. The accounting treatment for the period covered by the fifth carbon budget (2028 to 2032) will be determined in due course.

Why was this approach taken to change the law?

6.3 This is the only possible approach because the Act requires the Secretary of State to set the credit limit by order.

7. Consultation

Summary of consultation outcome and methodology

7.1 The Act does not require public consultation on the issue of setting the credit limit for the fifth carbon budget.

7.2 However, there are some specific consultation requirements contained in the Act. The Secretary of State must take into account the Committee on Climate Change's advice provided under section 34(1)(b) of the Act in relation to the budgetary period and must consult the Devolved Administrations before laying the draft Order proposing the credit limit for each budgetary period.

7.3 The Secretary of State has taken into account the views of the Committee on Climate Change. The Committee has confirmed that its advice on the Fifth Carbon Budget remains unchanged and that the budget should be achieved without reliance on international carbon units. The Committee has further confirmed that, consistent with previous Credit Limit Orders, the limit should exclude any units attributed to the fifth carbon budget that arise from the trading of allowances between the EU ETS and the UK ETS, in the event that the two systems are linked during the fifth carbon budget period (2028–2032), and provided that both the EU and the UK apply equivalent accounting rules so as to ensure that no double counting of emissions reductions occurs.

7.4 The government consulted the Devolved Administrations, and their views align with the position set out in this legislation.

8. Applicable Guidance

8.1 No guidance has been published in relation to the matters contained in the Order, because no guidance is considered to be required in addition to this memorandum.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 The setting of a zero credit limit through this instrument will not itself lead to any costs to government, business or consumers. The Government's plans for meeting the fifth carbon budget are set out in the Carbon Budget and Growth Delivery Plan. A zero credit limit will provide investors with a clear signal that the government will deliver emissions reductions required for the fifth carbon budget through domestic action. This could encourage investment in low-carbon infrastructure and supply chains in the UK.

9.2 The zero credit limit does not itself prohibit the purchase of credits where these are purchased for purposes beyond meeting the fifth carbon budget. The costs and benefits of any potential future purchases of credits would be captured as part of future Impact Assessment(s).

9.3 On this basis, a full Impact Assessment has not been prepared for this instrument given that there are no, or no significant, impacts on business associated with this instrument.

Impact on businesses, charities and voluntary bodies

9.4 In line with the above, there are no, or no significant, impacts on business, charities or voluntary bodies.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 We will continue to track emission projections against the fifth carbon budget, and to update our published emission projections annually.

10.2 The instrument does not include a statutory review clause.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 The Government has stated in its plans that it does not intend to use carbon units to meet the fifth carbon budget and this SI does not represent a change in emissions reductions plans.

12. European Convention on Human Rights

12.1 The Secretary of State at the Department for Energy Security and Net Zero has made the following statement regarding Human Rights: "In my view the provisions of the Climate Change Act 2008 (Credit Limit) Order 2026 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").