EXPLANATORY MEMORANDUM TO

THE GREENHOUSE GAS EMISSIONS TRADING SCHEME AUCTIONING (AMENDMENT) REGULATIONS 2026

2026 No. 214

1. Introduction

1.1 This Explanatory Memorandum has been prepared by HM Treasury (HMT) and is laid before the House of Commons by Command of His Majesty.

2. Declaration

2.1 Daniel Tomlinson, Exchequer Secretary to the Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Juliet Palfrey, Deputy Director for Energy and Transport Tax at the Treasury confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Samuel Deaner at the Treasury, at samuel.deaner@hmtreasury.gov.uk or +44 7977 910056 can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument makes amendments to the legislation which provides for the auctioning of emissions allowances to emit 1 tonne of carbon dioxide equivalent under the UK Emissions Trading Scheme (the "UK ETS") and associated mechanisms to support market stability.

4.2 This instrument will update the Auction Reserve Price (ARP), which is the minimum price at which emission allowances can be sold at auction. It will uplift the ARP from £22 to £28 per tonne of CO_2 equivalent from 8 April 2026. This is designed to address price erosion of the ARP, in real terms, since the UK ETS was introduced in 2021.

4.3 This instrument will also introduce a mechanism for annual inflation-based adjustments from 1 January 2027 onwards, using the GDP deflator published by the Office for National Statistics. This is designed to protect the ARP from future price erosion.

Where does the legislation extend to, and apply?

4.4 The extent of this instrument is the whole of the United Kingdom.

4.5 The territorial application of this instrument is the whole of the United Kingdom.

5. Policy Context

What is being done and why?

5.1 The UK ETS is a UK-wide greenhouse gas emissions trading system designed to incentivise emissions reductions in line with the UK's net zero targets. The UK ETS

replaced the UK's participation in the EU Emissions Trading System from 1st January 2021.

5.2 The scheme is governed by the UK ETS Authority, comprising UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs in Northern Ireland, hereinafter "the Authority". The UK ETS is regulated by the Environment Agency, the Scottish Environment Protection Agency, Natural Resources Wales, the Northern Ireland Environment Agency and the Secretary of State (Offshore Petroleum Regulator for Environment and Decommissioning), hereinafter "the Regulators".

5.3 The UK ETS operates on a 'cap and trade' principle, where a cap is set on the total amount of certain greenhouse gases that can be emitted by sectors covered by the scheme. Within the cap, participants receive or buy emission allowances which they can trade with one another as needed. This cap is reduced over time, relative to emissions covered, so that total emissions fall. The carbon price is determined by the market.

5.4 The ARP was introduced as a temporary measure when the UK ETS commenced in 2021. The ARP is the price below which auction bids will not be accepted. When the UK ETS commenced, the ARP was set at £22 per tonne of CO_2 equivalent, before trading began.

5.5 Since its introduction, the real value of the ARP has eroded due to inflation, reducing its effectiveness as a safeguard. This instrument addresses this issue in two ways. Firstly, there will be an immediate uplift to the ARP from £22 to £28 from 8 April 2026. Secondly, the price will be updated annually on 1st January (at the start of the scheme year), from 2027. The annual price uplift will be made using the most recent annual GDP deflator figure (published by the Office for National Statistics) as at the preceding 31st July. Each year, the Authority will publish the automatically updated price for the following year, alongside the publication of the auction calendar.

5.6 Following stakeholder consultation, the Authority has decided to retain and uplift the ARP following strong stakeholder support, which remains an effective mechanism for managing sudden, significant and sustained price decreases. Stakeholders also supported the retention of the ARP as an effective long-term minimum price signal in the market.

What was the previous policy, how is this different?

5.7 Under the previous policy, the ARP was set at £22 per tonne of CO_2 equivalent, or such other sum as may be specified by the Treasury by direction. This mechanism provided a fixed minimum bid price at auction to ensure price continuity and market stability during the early years of the UK ETS. The ARP was not indexed to inflation, and the direction-making power was limited to specifying a single sum rather than establishing a formula for annual adjustment.

5.8 The new policy implemented by this instrument updates the ARP and provides for an annual adjustment mechanism to maintain its effectiveness. Legislation is required to enact this policy change, because the current direction-making power in Regulation 6(9) cannot be used to establish a new mechanism for indexation.

6. Legislative and Legal Context

How has the law changed?

6.1 The UK ETS was established under the Climate Change Act 2008 by the Greenhouse Gas Emissions Trading Scheme Order 2020 (the "2020 Order"). Under the power in section 96 of the Finance Act 2020, Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 (the "Auctioning Regulations 2021") set out the rules for auctioning emission allowances created under the 2020 Order.

6.2 Regulation 6(9) of the Auctioning Regulations 2021 set the ARP at £22 per tonne of CO_2 equivalent "or such other sum as may be specified by the Treasury by direction." This wording allows the Treasury to change the ARP by specifying a new fixed sum but does not provide for any mechanism to incorporate an annual adjustment to account for inflation.

6.3 This instrument amends Regulation 6(9) to uplift the ARP from £22 to £28 from 8 April 2026 and introduce new provisions to establish a rolling annual uplift from 2027 onwards. The annual adjustment will be calculated using the most recent annual GDP deflator published by the Office for National Statistics and applied automatically each year. The instrument also provides clarity that, should the GDP deflator read 0 or a negative number, the ARP would remain unchanged.

6.4 This instrument amends Regulation 6(9) to set out where an auction reserve price calculated in accordance with paragraph (9A) includes a fraction of a penny, it is to be rounded up to the nearest whole penny.

6.5 The annual adjustment of the ARP refers to the GDP deflator published by the Office for National Statistics. As the ONS figure is independently determined and the instrument applies it automatically, this is considered to be in line with comparable legislative applications of the RPI.

6.6 This instrument changes the current price of the ARP and how it is calculated in future. There are no legislative changes to how the ARP is applied and there are no legislative changes to how the annual carbon price is calculated per the 2020 Order, section 46(4) to 46(6).

Why was this approach taken to change the law?

6.7 This is the only possible approach to make the necessary changes.

7. Consultation

Summary of consultation outcome and methodology

7.1 The Authority jointly consulted on the approach to future markets policy, including the ARP, from December 2023 to March 2024.[1] . The consultation received responses from 58 stakeholders. The consultation responses are summarised in the Authority Response.[2]

[1] https://assets.publishing.service.gov.uk/media/657c5e3983ba38000de1b622/uk-ets-future-markets-policy-consultation.pdf

[2] https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-future-markets-policy/outcome/uk-emissions-trading-scheme-main-authority-response-to-the-future-markets-policy-consultation-accessible-webpage

7.2 The consultation sought views on whether the ARP should be retained and amended. It also asked stakeholders about whether the ARP should evolve over time, and if so, how.

7.3 87% of respondents supported retaining the ARP, 66% advocated for an increased ARP, and 67% wanted the ARP to be an evolving value rather than static. Stakeholders emphasised the importance of maintaining the minimum price signal to support investment in decarbonisation and to mitigate risks of sudden, sustained price decreases.

7.4 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, as a matter of best practice.

8. Applicable Guidance

8.1 General guidance on participating in the UK ETS is published on GOV.UK.[3]

8.2 Guidance on how to take part in auctions and trade on the secondary market is also published on GOV.UK.[4] This guidance explains how the ARP applies to auctions and how the annual adjustment will be calculated using the GDP deflator published by the Office for National Statistics[5].

8.3 The annual ARP will be communicated through the publication of the auction calendar circular by ICE Futures Europe, on behalf of UK Department for Energy Security and Net Zero.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

Impact on businesses, charities and voluntary bodies

9.2 The impact on business, charities or voluntary bodies has been published in an impact assessment alongside the Authority Response to the Future Markets Consultation. This assessment illustrates traded carbon values for modelling purposes compared with current and proposed ARP. This provides an indication that a £28 minimum bid would have no or limited impact. Relevant risks and assumptions are set out in the impact assessment.

9.3 The instrument does impact small or micro businesses. The instrument impacts all market participants consistently and equally and therefore there is no difference for any group, including whether they are small or micro businesses. There is no administrative burden change on any market participants.

9.4 Overall, the scheme is designed to minimise any disproportionate impact of UK ETS requirements on small and micro businesses, as well as the public sector; those with relatively low levels of emissions are either not caught by the scheme or can take

[3] https://www.gov.uk/government/publications/participating-in-the-uk-ets/participating-in-the-uk-ets
[4] https://www.gov.uk/government/publications/taking-part-in-the-uk-emissions-trading-scheme-markets/taking-part-in-the-uk-emissions-trading-scheme-markets
[5] https://www.ons.gov.uk/economy/grossdomesticproductgdp/datasets/uksecondestimateofgdpdatatables

advantage of derogations provided through the 2020 Order and, or applicable exemptions provided through legislation expanding the scope of the scheme.

9.5 Policy options to exempt small or micro businesses were judged not to be appropriate, given the need for clear and consistent rules governing the market and auctions. Further, some small businesses who participate in the scheme are not small emitters; any exemption for such businesses could create a loophole through which shell companies could manipulate scheme function.

9.6 The impact on the public sector is indirect, and there is expected to be limited or no impact. The UK ETS has opt-out schemes for Hospital and Small Emitter ("HSE") installations and Ultra Small Emitter ("USE") installations, as they either provide services to hospitals or are installations emitting less than 25,000 and 2,500 tonnes respectively of carbon dioxide equivalent (CO2eq) per year. Installations eligible for these schemes do not have to surrender allowances in respect of their emissions, and have lower compliance burdens than the main UK ETS[6].

9.7 This instrument indirectly impacts civil penalties for the HSE scheme, through the change to the ARP. Civil penalties are calculated using the carbon price, which is defined in accordance with the criteria in article 46(4) to 46(6) of the 2020 Order. However, in line with the rationale set out in section 9.2, modelling indicates that there will be no or limited impact on carbon price.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is set out in the 2020 Order. Article 17 of the 2020 Order requires the Authority to review the operation of the UK ETS in 2023 and in 2028. The Authority published the 2023 scheme review in December 2023.[7]

10.2 The instrument does not include a statutory review clause. The requirement under section 28(2) of the Small Business, Enterprise, and Employment Act 2015 to make provision for review does not apply to this instrument as it falls within an exception in section 28(3) of that Act.

[6] https://www.gov.uk/guidance/opt-out-of-the-uk-ets-if-your-installation-is-a-hospital-or-small-emitter
[7] https://www.gov.uk/government/publications/uk-emissions-trading-scheme-review-2023

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 As the instrument is subject to negative procedure and does not amend primary legislation, no statement is required.

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"). [It does however relate to the withdrawal of the United Kingdom from the European Union because the UK ETS is a policy replacement for the UK's participation in the EU ETS].