

# Aldersgate Group response to the UK ETS Free Allocation Review: Approach to Carbon Leakage consultation

**March 2025**

## Introduction

The Aldersgate Group is an alliance of major businesses, academic institutions and civil society organisations which drives action for a competitive and environmentally sustainable UK economy.<sup>1</sup> Our corporate members represent all major sectors of the economy and include Associated British Ports, Aviva Investors, BT, CEMEX, the John Lewis Partnership, Michelin, Nestlé, Siemens, SUEZ, Tesco, and Willmott Dixon. Aldersgate Group members believe that ambitious environmental policies make clear economic sense for the UK, and we work closely with members when developing our independent policy positions.

The consultation, including a full list of questions, can be found [here](#).

## Questions

**1. Do you agree with the data sets used to calculate emissions intensity and trade intensity? If you do not, please explain why and suggest alternative data sets.**

It will be important for the Authority to consider alignment with the EU ETS approach to their carbon leakage list. The EU is the UK's biggest trade partner and working to minimise any unintended trade consequences caused by deviating from the EU ETS scheme is vital.

**4. Do you agree with the Authority's preliminary list of Carbon Leakage Indicator (CLI) values?**

We are broadly supportive of the Authority creating a UK-specific carbon leakage list, formulated with UK-specific data, for the UK ETS to best fulfil its purpose to incentivise industrial decarbonisation. This new approach must also ensure UK businesses' competitiveness is supported.

The impact of the Carbon Leakage Indicator Values depends on the Authority's approach to benchmarking, tiering and other additional methodologies discussed in the previous consultation, Free Allocation Review (March 2024). We support a tiering or similar approach to the carbon leakage list to ensure support is targeted based on risk level.

The Authority may need to undertake further consultation or stakeholder engagement on the approach to carbon leakage and free allocation following the publication of the Authority's response to the Free Allocation Review consultation later this year. Businesses have found the multi-consultation approach fragmented. Without a full view of the approach to free allocation and how it will align with the introduction of a UK CBAM, responses to the existing consultations

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<sup>1</sup> Individual recommendations cannot be attributed to any single member and the Aldersgate Group takes full responsibility for the views expressed.

may not have effectively identified the challenges to address or potential unintended consequences.

The Authority must ensure changes are communicated clearly and ahead of time to allow participants to prepare.

**6. Do you agree with the Authority's minded to position to take an 'additive' approach to the Carbon Leakage List, should new data provided through this consultation change the current CLI values? If you do not agree, please explain why and suggest an alternative approach.**

We support the Authority's position to take an 'additive' approach to the Carbon Leakage List. Maintaining flexibility and altering the list based on robust new data is sensible. Only sectors with a genuine carbon leakage risk should be added to the list. The Authority should be open to considering further evidence and should maintain an up-to-date understanding of carbon leakage risks.

Regular review of the Carbon Leakage List must be balanced with the need to provide certainty to ETS participants and maintain the functionality of the scheme. The environmental integrity of the scheme must be maintained as trade and carbon intensity factors change domestically and internationally.

Changes to the carbon leakage list must reflect and be aligned with the approach for new free allowances entering the market.

**7. Are there any other facts or matters that you would like the Authority to take into account before making a final decision on the Carbon Leakage List?**

The Authority should consider the possibility of future linkage of the UK ETS and CBAM to those in the EU. The government has indicated its openness to ETS and CBAM linkage.<sup>2</sup> The UK ETS free allocation regime must be designed in a manner that maintains ease of linkage with the EU ETS. The Authority should seek to reduce the disruption that linkage would cause to businesses by maximising alignment with the EU scheme in terms of design while still ensuring the UK ETS fulfils its intended policy role in the UK context.

The Aldersgate Group supports linking the UK ETS and CBAM with those in the EU, taking an ambitious approach to ETS reform. A considered approach to linkage will ease compliance for UK companies exporting to the EU, who would not have to produce new documentation of compliance with EU rules. Reducing trade friction with the EU is a growth opportunity for the UK, particularly as the EU is the UK's largest trading partner, accounting for 41% of UK exports.<sup>3</sup> Linkage would also improve liquidity in the UK ETS, as a larger market increases the opportunity

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<sup>2</sup> Nick Thomas-Symonds, Cabinet Office Minister, told the House of Commons business and trade committee: "Linking our respective systems is absolutely what the ambition is."

<sup>3</sup> <https://commonslibrary.parliament.uk/research-briefings/sn02815/#:~:text=The%20EU%20accounted%20for%2041,it%20runs%20a%20trade%20deficit>

for allowance trading. This would enable more efficient financial risk management for UK businesses, aiding competitiveness.

Moreover, both the UK and the EU net zero strategies include the use of carbon capture and storage to tackle residual emissions and achieve their net zero goals. Access to carbon storage sites before 2030 remains a barrier for capture projects in the EU, and the UK's exit from the EU has meant that the UK's storage capacity can no longer be used for CO<sub>2</sub> emissions from EU-based sources. This is a commercial opportunity for the UK and could help develop the CCUS sector. Linking the UK ETS with the EU ETS could help address this barrier to cross-border transport and storage of CO<sub>2</sub>.<sup>4</sup>

The UK renewable energy sector, one of the growth-driving sectors highlighted in the Modern Industrial Strategy Green Paper, would also benefit from linkage. At present, electricity is in the scope of the EU CBAM. EU regulators have decided to base CBAM rates for electricity on the average historical carbon intensity of the UK grid. This approach does not reflect the UK grid's increasingly lower carbon intensity. As UK electricity to the EU would face a CBAM charge, it may deter renewable energy exports to the EU, negatively affecting the sector.<sup>5</sup>

**8. On the basis of the information presented in this Chapter do you think we should update the Carbon Leakage List to be based on UK data or do you have a preference to continue to use the existing Carbon Leakage List? Please explain your answer.**

We are broadly supportive of creating a UK-specific carbon leakage list, formulated with UK-specific data. There is a strong case to maintain an up-to-date UK-specific carbon leakage list that reflects the make-up of UK ETS participants and their relative share of the market. The Authority should be mindful of contrasting the risk of carbon leakage with the effect of delayed decarbonisation. As the UK moves further towards its net zero targets for 2030 and 2050, the corresponding reduction of emissions allowances could increase the risk of carbon leakage and offshoring, especially as carbon prices increase. The CBAM must be introduced and operated effectively to protect the UK market from high-carbon goods, with free allocations phased out as the CBAM is introduced.

To ensure that decarbonisation continues at pace, alongside the decarbonisation incentive provided by ETS, it will be important to implement complementary policy instruments that support industries investing in low-carbon solutions and increase the demand for low-carbon products. Alignment across industrial decarbonisation policies should be considered as the government reviews its Industrial Decarbonisation Strategy this year.

The Authority's final decision on the approach to carbon leakage and free allocation must consider potential linkage with the EU ETS and EU CBAM. Businesses need policy clarity so that they can prepare to comply with the schemes and make investment decisions in decarbonisation.

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<sup>4</sup> <https://www.catf.us/resource/relationship-reset-eu-uk-collaboration-on-climate-and-energy/>

<sup>5</sup> <https://www.lse.ac.uk/granthaminstitute/news/what-is-the-effect-of-border-carbon-adjustments-on-britains-electricity-flows/>

**9. Do you agree with the Authority's minded to position to not take forward the 'do nothing' option? If you do not agree, please explain your reasoning.**

Yes. We agree the Authority should take action and support the approach to adjust free allocations for CBAM sectors.

Free allocations for CBAM sectors should be phased out with a clear roadmap outlining the trajectory for the reduction in free allocations. The 'do nothing' approach described in the consultation document would somewhat defeat the administrative effort and cost of introducing a CBAM in the first place. The aim of CBAM is to provide an improved carbon leakage mitigation policy. The UK ETS and CBAM policies must work together to drive forward industrial decarbonisation while not unduly risking industrial competitiveness. Moreover, WTO compatibility would be a significant risk of the 'do nothing' approach. Adjusting free allocations for CBAM sectors will allow CBAM to be more effective and increase the effectiveness of the UK ETS decarbonisation incentive.

Alongside free allocation and CBAM, other forms of policy and financial support are needed to support decarbonisation (e.g. business models, innovation support, competitive electricity pricing, access to grid connections, efficiency planning and permitting). Effective delivery of these policies at pace will be necessary not just to avoid carbon leakage but also to ensure fairness in the ETS, so that participants have adequate support measures and incentives to decarbonise. In this sense, enabling policies such as compensation and support are needed to prevent the carbon price from being merely an added cost rather than an incentive to decarbonise, especially when abatement opportunities are not currently available.

Alignment between the UK ETS and CBAM is vital to best support businesses and reduce the compliance burden. The instruments should follow the same model for emissions reporting and verification and should seek to align as closely as possible on pricing. This will enable smoother implementation and administration of CBAM and changes to the ETS free allocation for CBAM sectors.

**10. Do you agree with the parameters of adjustment that have been identified by the Authority? If not, please explain your reasoning and any other parameters which should be considered.**

We broadly agree with the parameters of adjustment.

We also support a phased approach to adjusting free allocation. A phased approach will support the implementation of changes to the ETS and the introduction of the CBAM for both the Authority and businesses. It should reduce risks, costs and disruption. This is particularly important as no transition phase is planned for the introduction of the UK CBAM. The Authority and HMRC should seek to learn lessons from the implementation of the EU CBAM to apply in the UK context.

It will be important to review the effectiveness of CBAM as it is introduced to inform the authorities' approach to free allocation phase out. The Authority may want to consult on a framework by which the effectiveness of CBAM is assessed. The European Commission is

required to assess the impact of the EU's CBAM and the parallel removal of free allocation in the late 2020s and early 2030s. It would be sensible for the UK government to commit to monitoring the CBAM for trade distortions and reserve the powers to intervene where the policy is not having the intended effect. Close engagement with businesses will be needed to evaluate the impact of the UK CBAM and, if needed, to improve its application.

We support alignment with the EU's approach to phasing out free allocation for CBAM sectors. Misalignment could create unintended consequences for businesses operating and trading across both jurisdictions. The Authority should seek to better understand potential risks from misalignment with the EU's approach and how these can be mitigated.

**11. Do you have a preference for the start year, adjustment length or trajectory? Please explain your reasoning for each preference.**

We support a gradual approach to adjustment, similar to the approach taken in the EU (phase out between 2026 and 2034). A gradual approach would balance feasibility, business competitiveness and maintaining the environmental integrity of the policy.

A trajectory that is too slow will not provide a sufficiently high incentive to drive decarbonisation, which is vital for the UK to reach its net zero goals and to capture the green growth opportunity for early adopters of low carbon production. A trajectory that is too steep could introduce risks and costs to businesses which damage their competitiveness.

Overall, we support the Authority implementing a phase out trajectory that is aligned with the EU (s-shaped 2027-2034). The UK's phase out would start a year later, and the Authority must seek to understand what the implications of a similar trajectory with a one-year lag would be and to what extent the UK should align with the exact trajectory of the EU scheme. Misalignment could lead to unintended trade and operational consequences for UK businesses. The alignment would have the benefit of aligning CBAM rates, reducing the risk of UK exporters to the EU facing a CBAM charge by aligning the approach to carbon leakage mitigation sooner. Additionally, alignment would also support ease of linkage in future.

As free allocation adjustment progresses, the Authority should review the impact on businesses and be open to policy adjustment if needed. Any adjustments to the approach must be communicated clearly and in a timely manner.

To support the success of ETS and CBAM for driving decarbonisation while maintaining competitiveness, the government has a responsibility to ensure that businesses can access the infrastructure they need and a wider enabling environment for investment to decarbonise.

**12. Do you agree with the rationale that has been presented for consideration within each of the parameters of the adjustment? If not please explain your reasoning and any other considerations the Authority should take into account.**

Yes, we agree with the rationale presented for consideration within each parameter.

**13. Do you agree with the considerations the Authority will take into account when determining the extent of the adjustment to free allocations? If not, please explain your answer.**

We broadly support the considerations being taken into account by the Authority.

Export carbon leakage is a concern. However, the risk of export leakage varies by sector and will also likely change over time. It is also important to recognise that products may gain a competitive advantage due to their lower carbon nature, which could mitigate export leakage risk. The Authority needs to seek a robust and detailed understanding of export leakage and how it might impact sectors or products (within a sector) differently. As more countries introduce decarbonisation policies, export leakage risk will reduce. For example, the EU is the UK's biggest trading partner and is introducing a CBAM, which will reduce the export risk for the UK.

We support the consideration of export carbon leakage through the design of the ETS; however, we would caution the Authority about the risk of introducing additional complexity to the scheme unless its need is justified, and the effectiveness can be demonstrated. The international trading environment is influenced by many factors and is constantly changing. The ETS may not be well suited to continuously adapt to changing export risk and to ensure fairness across sectors. Policy measures outside of the ETS and CBAM may be better suited to mitigate export risk and target specific cases with agility.

To address export carbon leakage, the Authority could introduce an export adjustment mechanism, which would provide rebates or compensation for exported goods from CBAM-covered sectors to maintain a level playing field. For example, this could take the form of a rebate at the end of the allocation period, with free allocations provided for the proportion of goods exported that are subject to export leakage risk. Design of such a mechanism and implementation must be carefully considered to ensure feasibility for both the Authority and businesses, compliance with WTO rules, fairness and environmental robustness. An export market leakage list may be needed to identify markets in scope and those that are not. For example, if a business is exporting to a jurisdiction that is covered by an ETS and CBAM, like the EU, the UK producer should not receive free allowances for this export.

Another option to address export carbon leakage is additional financial support to help industries decarbonise faster and maintain global competitiveness. The UK also has a role to play in encouraging decarbonisation globally, including the adoption of carbon pricing. Greater decarbonisation globally will reduce import and export carbon leakage risk.

**14. Do you have a preference on whether the adjustment should be to zero or a non zero amount? Please explain your answer.**

We support an ambitious approach to adjustment that provides a strong incentive for decarbonisation and supports the UK's ability to maximise low-carbon growth opportunities. This must be balanced with feasibility for business and government. The adjustment amount should be evidence-based, with a non-zero amount only maintained if necessary.

**16. Do you agree with the Authority’s minded to position that free allocations should only be adjusted for goods covered by the UK CBAM? If not, please explain your answer.**

The UK CBAM and ETS need to work together to drive an ambitious decarbonisation agenda while supporting business competitiveness. We support the Authority’s minded to position to focus on adjusting the free allocations for sectors covered by CBAM. We recommend that the government takes an ambitious approach to CBAM and considers expansion to further sectors, in which case free allocations would also need to be adjusted for additional sectors.

Over time, free allocation must be phased out for all sectors to ensure the carbon price rises to a level that is high enough to end polluting activities and remove any subsidies on greenhouse gas (GHG) emissions. Alongside free allocation, other forms of policy and financial support are needed to support decarbonisation.

The Aldersgate Group recommends that the Authority considers introducing conditionality. To encourage low carbon investment, the Authority should consider implementing a requirement for both new and incumbent installations to provide a transition plan. This will ensure that the UK ETS is not designed in a way that hampers decarbonisation efforts, contrary to its purpose. The EU ETS has introduced conditionality to access free allocations, with energy audits and climate neutrality plans for certain sectors. The Authority should seek to maximise consistency between the UK and EU ETS and ensure the burden is minimised for participants subject to conditionality in both schemes.

**17. Do you have any other factors that you would like to flag to the Authority for consideration in how CBAM and non-CBAM good free allocations should be disaggregated? Please provide an explanation of how you think this methodology could be implemented.**

The environmental integrity of the policy is paramount. However, the cost and ease of compliance for businesses must be considered. Methodologies must be developed to be as easy to adopt as possible. The Authority should review how the methodology is working and resolve any issues identified.

**18. Do you agree with the assessment criteria that has been put forward for consideration by the Authority? If not, please explain your answer and provide other assessment criteria for consideration.**

We agree broadly with the assessment criteria; these are some of the most important factors to consider. The ‘technical feasibility of the free allocation adjustment methodology’ criterion should incorporate consideration of the impact on businesses and compliance. Businesses have limited capacity; an approach that is mindful of ease of compliance would be beneficial.

One additional significant consideration should be the potential future linkage with the EU ETS and CBAM. A test should be included to ensure linkage remains possible and the implications of misalignment for future linkage are considered in decision-making. Policy uncertainty and

frequent changes create an additional burden on businesses and a less attractive investment environment. Beyond the risk to future linkage, alignment with the EU is desirable as many companies work across both jurisdictions and must comply with both schemes.

**19. Please rank the assessment criteria in order of most important to least important.**

1. Mitigating carbon leakage risk for imports (most important)
2. Impact of a Free Allocation adjustment on ETS effectiveness
3. Technical feasibility of the free allocation adjustment methodology
4. Mitigating carbon leakage risk for exports
5. Affordability to government of the final policy choice. (Least important)

The UK imports more industrial goods than it exports.<sup>6</sup> The aim of the UK CBAM is not only to prevent carbon leakage but also to encourage carbon pricing and decarbonisation action internationally. A UK CBAM will discourage the import of higher carbon goods into the UK market, putting lower carbon goods on an equal footing with higher carbon goods economically, and supporting UK businesses to meet their net zero commitments. The UK domestic market is a significant opportunity for low carbon goods; mitigating carbon leakage risk for imports is economically important.

Ensuring the effectiveness of the ETS is vital. The role of the ETS is to incentivise decarbonisation efficiently. The Authority's approach to free allocation must support this role.

Affordability for the government is an important consideration, particularly in the current fiscal context and to ensure the long-term functionality of the policy. The government must ensure that overall benefits are considered, including wider decarbonisation ambitions and industrial competitiveness as part of any cost-benefit analysis. The effectiveness of the policy is essential, and the additional costs which enable this may reduce public spending in other areas and in the longer term.

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<sup>6</sup> [Trade and investment core statistics book - GOV.UK](#)