Baker McKenzie.

Legal Update

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EMEA: United Kingdom and European Union Agree to Link ETS

Linked carbon markets from 2028 and early UK CBAM exemption.

In brief

At the EU-UK Summit on 20 November 2026, the UK and the EU concluded negotiations to link the UK Emissions Trading Scheme (UK ETS) with the EU Emissions Trading System (EU ETS). Both parties have committed to apply the agreement from 1 January 2028, subject to ratification. The link will also provide the basis for mutual exemptions from the UK and EU carbon border adjustment mechanisms (CBAMs).

The UK published draft legislation on 23 November 2026 under which goods originating in the EU, the European Economic Area (EEA) and Switzerland will be exempt from UK CBAM from 1 January 2027, the date UK CBAM takes effect. UK-origin goods will remain subject to EU CBAM until the EU amends its CBAM Regulation.

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- From 1 January 2028, carbon allowances issued under either scheme are intended to be usable for compliance across both schemes.
- The agreement includes dynamic alignment. The UK will apply the same ETS rules as the EU on an ongoing basis and will have an early decision-shaping role on EU rules in development, although it will have no vote or veto over EU legislation.
- UK CBAM will not apply to goods of EU, EEA or Swiss origin imported from 1 January 2027. The exemption is based on origin under the UK non-preferential rules of origin, not on the country of dispatch.
- Exempt goods do not count towards the GBP 50,000 UK CBAM registration threshold and are not reported in the UK CBAM return. Record-keeping obligations continue to apply.
- On the EU side, the UK will be added to Annex III of Regulation (EU) 2023/956 by delegated act once the linking agreement enters into force.

In more detail

1. **The ETS linking agreement**

The intention to link the two systems was announced at the first EU-UK Summit in May 2025, and negotiations concluded on 20 November 2026. The UK Government has published a detailed explainer on the agreement, and the legal text will follow. The main features are set out below.

- **Scope of the link.** The link concerns the main EU ETS, which covers power, industry, aviation and maritime. The UK has no equivalent of the separate EU ETS2 for buildings, road transport and additional sectors, and the published materials do not extend the link to ETS2.
- **Mutual recognition of allowances.** From 1 January 2028, UK and EU allowances are intended to be usable for compliance across either scheme.
- **Dynamic alignment.** "The UK will apply the relevant EU ETS rules listed in Annex I at the same time and on an ongoing basis, subject to agreed UK-specific adaptations. The UK will have an early decision-shaping role, but no vote or veto

over EU legislation. Any extension to a sector outside the agreement's existing scope requires approval by the Partnership Council, the joint UK-EU body overseeing the bilateral relationship. If no agreement is reached, the EU may, after at least eight months, take necessary and proportionate temporary measures to address carbon leakage or competitive distortions."

- **UK ETS Authority**. The UK ETS Authority remains institutionally responsible for the UK ETS, including key decisions on the UK cap and allowance distribution. Its substantive policy autonomy will, however, be narrower in areas governed by the linking agreement. It will administer and develop the UK ETS within a framework of dynamic alignment, agreed ambition requirements and mutual market access.
- **Suspension.** Either party may temporarily suspend the mutual recognition of allowances or the reciprocal CBAM exemption, following written notice and consultation in the Joint Committee. Trading would remain possible, but allowances would cease to be eligible for compliance in the other system.
- **Expanded UK ETS scope.** The UK will expand its ETS, including to aviation and maritime. The European Commission estimates that this will bring over 10 million tonnes of additional CO2 emissions into the system. Both schemes will monitor the non-CO2 climate effects of aviation.
- **Aviation.** The UK and EU have committed to a one-stop shop for aircraft operators, who currently deal with two schemes covering different legs of UK-EEA return flights.
- **Carbon storage.** Under the EU ETS, captured CO2 is only treated as not emitted where it is transferred for permanent storage at a site permitted under the EU carbon capture and storage (CCS) Directive. Storage sites in the UK, being outside the EEA, do not currently qualify. Under the agreement, CO2 captured at an installation in one scheme and permanently stored in the other will no longer be excluded for that reason alone. This opens a cross-border market for CO2 transport and storage services, particularly in the North Sea.
- **Switzerland.** The existing link between the EU ETS and the Swiss ETS, in place since 1 January 2020, will continue.

The UK Government estimates that the link will exempt around GBP 6.5 billion of UK exports from EU CBAM and add up to GBP 3.8 billion a year to the UK economy by 2040.

2. **Timing risk**

The ETS agreement forms part of a wider package agreed at the Summit, which also covers a sanitary and phytosanitary (SPS) agreement and a youth experience scheme. According to press reports, EU Member States have indicated that the Council will not adopt the decisions on signing the ETS, SPS and youth agreements until negotiations on equal treatment for EU students on tuition fees are concluded. EU officials have referred to a six-month timeframe. Any delay in these negotiations could affect the 1 January 2028 target date.

3. **EU CBAM and UK-origin goods**

EU CBAM does not apply to goods originating in countries that participate in, or have linked their own ETS to, the EU ETS. These countries are listed in Annex III of the EU CBAM Regulation. The Commission will add the UK to Annex III by delegated act under Article 2(11) once the linking agreement enters into force and the necessary legal steps are completed. The Commission is set to launch the relevant procedures as soon as possible.

Until then, UK-origin goods remain subject to EU CBAM as usual.

4. **UK CBAM and the early exemption**

UK CBAM was introduced by the Finance Act 2026 and applies from 1 January 2027 across the whole of the UK, including Northern Ireland. It covers specified goods, identified by commodity code, in the aluminium, cement, fertiliser, hydrogen, and iron and steel sectors. Certain scrap products are excluded. The liable person is the importer of the CBAM goods. The CBAM rate and carbon price relief are set by the Carbon Border Adjustment Mechanism (Calculation of CBAM Rate and Determination of Carbon Price Relief) Regulations 2026 (SI 2026/809). The inclusion of indirect emissions has been deferred until 2029 at the earliest.

The UK expects the mutual CBAM exemptions to apply from 1 January 2028. To reduce administrative burdens for UK importers, however, it will exempt EU, EEA and Swiss-origin goods from UK CBAM from 1 January 2027. The main points are set out below.

- **Origin-based test.** The exemption applies to CBAM goods originating in the EU, the EEA and Switzerland, determined under the UK non-preferential rules of origin. It does not depend on the country from which the goods are shipped. For example, steel produced in Germany can still qualify for the exemption, whatever the route it takes to the UK.

- **Goods routed through the EU.** Goods originating in a third country remain within UK CBAM when imported into the UK from the EU, even where EU CBAM has already been paid. For example, steel produced in Turkey and shipped to the UK from a warehouse in Rotterdam remains within UK CBAM. Carbon price relief may be available for a qualifying carbon price already paid, including an EU CBAM charge.
- **Automatic application.** The exemption applies automatically to qualifying goods.
- **Registration threshold.** Exempt goods do not count towards the GBP 50,000 threshold. The threshold is tested in two ways, through a monthly look-back over the previous 12 months and a forward-looking test of expected imports over the next 30 days. HM Revenue & Customs (HMRC) has confirmed that registration will open on 1 January 2028 and that penalties may apply for failure to notify.
- **Records and evidence.** Importers must keep records for all CBAM goods from 1 January 2027, even where no liability arises. They should also retain evidence of origin to support the exemption.

5. **Legislative process**

The exemption will be legislated in the Finance Bill. Subject to Parliament, it will apply retrospectively from 1 January 2027 once the Bill receives Royal Assent. Until then, importers should keep the records required for CBAM goods and retain evidence of origin for goods they expect to qualify.

Recommended actions

Importers into the UK

- Map in-scope imports by commodity code and origin, and confirm which goods qualify under the UK non-preferential rules of origin.
- Update supplier contracts and onboarding processes so that suppliers provide reliable origin evidence.
- Reassess the registration position once exempt goods are excluded from both threshold tests.
- For third-country goods routed through the EU, collect evidence of any EU CBAM paid to support a claim for carbon price relief.
- Maintain CBAM records for all in-scope goods from 1 January 2027, including goods expected to be exempt.

UK exporters to the EU

- Continue to meet EU CBAM data and reporting expectations from EU customers until the UK is added to Annex III.
- Review the contractual allocation of CBAM costs and data obligations with EU customers, taking account of the expected exemption.

UK ETS participants and other affected businesses

- Assess the effect of a linked market on allowance prices, hedging strategies and long-term procurement of allowances.
- Address the risk of suspension in long-term contracts through allowance-substitution, change-in-law and CBAM cost-allocation provisions.
- Aviation and maritime operators should monitor the expansion of the UK ETS and the design of the one-stop shop.

For specific advice on how the ETS link and the UK CBAM exemption affect your business, please contact the authors listed above or your usual Baker McKenzie contact.

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