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Usage Notes

to the

UK ETS ALLOWANCES APPENDIX (POWER)

to the

EFET General Agreement

Concerning the Delivery and Acceptance of Electricity

Version 2.1/December 20, 2000 and Version 2.1(a)/September 21, 2007

(the "Allowances Appendix")

(Version 1.0/July 29, 2021)

I. Introduction: EFET's form of United Kingdom Emissions Trading System ("UK ETS") Allowances Appendix (Power) (version 1.0/July 29, 2021) as published on the EFET web page on 29 July 2021 ("**UKA Appendix**") was developed by a working group comprised of EFET member company representatives and EFET's counsel. A number of usage notes of which users of the UKA Appendix should be aware are detailed below. Please note that this document is not intended as a user's guide to the UKA Appendix.

Unless otherwise expressly set forth in these usage notes, capitalised terms used throughout these usage notes shall have the meanings attributed to those terms in the UKA Appendix.

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PLEASE NOTE: These Usage Notes were prepared by EFET exercising all reasonable care and as a general guide only for the purposes of assisting users of the UKA Appendix. EFET, the EFET members, representatives and counsel involved in the preparation of these Usage Notes shall not be liable or otherwise responsible for their use and any damages or losses resulting out of their use and in whatever jurisdiction. It is the responsibility of each Party wishing to use the UKA Appendix to ensure that the terms and conditions set forth therein are legally binding, valid and enforceable and best serve to protect the user's legal interest, and are suitably brought to the attention of a counterparty. Users of the UKA Appendix and/or Usage Notes are urged to consult their own legal counsel.

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II. Amendments to the Phase IV Appendix: The UKA Appendix is materially based on the EFET EUA Allowances Appendix (Power) (Version 5.0/February 28, 2021) ("**Phase IV Appendix**") and makes minor changes to align its provisions with the UK ETS which commenced operation in 2021. To the extent the UK ETS does not deviate from the EU ETS, the mechanisms of the Phase IV Appendix remain applicable.

III. Legal basis: At the date of these Usage Notes, the primary legislation governing the establishment and operation of the UK ETS is the UK statutory instrument is the Greenhouse Gas Emissions Trading Scheme Order 2020, as amended by the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2020 ("**ETS Order**"). More generally, the UK ETS relies on various statutes, statutory instruments and EU legislation "onshored" into UK domestic law, including but not limited to: (i) Climate Change Act 2008; (ii) the Finance Act 2020; (iii) the Commission Implementing Regulation (EU) 2018/2066 (the Monitoring and Reporting Regulation), as it forms part of UK domestic law; (iv) the Commission Implementing Regulation (EU) 2018/2067 of 19 December 2018 on the verification of data and on the accreditation of verifiers pursuant to Directive 2003/87/EC of the European Parliament and of the Council, as it forms part of UK domestic law; (v) the Commission Delegated Regulation (EU) 2019/331 (the Free Allocation Regulation), as it forms part of UK domestic law; and (vi) the Commission Implementing Regulation (EU) 2019/1842 (the Activity Level Changes Regulation), as it forms part of UK domestic law.

IV. General operation of the UK ETS: The UK ETS largely reflects the structure and operation of the EU ETS with some changes, as highlighted in point V (*Key amendments*) below. Similar to the EU ETS, the UK ETS uses a cap-and-trade mechanism, allowing for free trade between market participants on the secondary market, as well as retaining the annual compliance cycle, including the annual verification deadline of 31 March and the compliance deadline of 30 April each calendar year.

V. Geographical application of the UK ETS: At the date of these Usage Notes, Northern Ireland remains part of the EU ETS. As such, the UK ETS applies only to Great Britain, comprised of England, Scotland and Wales.

VI. Key amendments: In response to the differences between the EU ETS and the UK ETS, the UKA Appendix makes the following key changes to the position established by the EUA Appendix. This should not be understood as an exhaustive list but a demonstrative list of key amendments:

1. **Allowances:** In contrast to the EU ETS, only one type of allowance is foreseen by the UK ETS, which may be equally used by operators and aircraft operators. References to and conditions regarding different allowance types have therefore been removed. At the date of these Usage Notes, no validity period or other limitation is placed on Allowances, and accordingly the term of the Trading Period is decisive with respect to the Parties' obligations.
2. **Accounts:** The UK ETS established four types of account: operator holding account, aircraft operator holding account, trading account, and personal account. The first two are intended for compliance purposes, the third for trading, and the fourth for the import of non-UKAs. The UKA Appendix therefore expressly references the first three types of account.
3. **Exempt entities:** At the date of these Usage Notes, several classes of entities are exempt from the compliance obligations. These entities are there carved-out from the definition of Operator, specifically Hospital Related Installations, Small Emitting Installations, and Ultra-Small Emitting Installations.
4. **Registry:** In contrast with the EU ETS, which involves the establishment of multiple interconnected national EUA Registries, the UK ETS has only one national Registry to which all users have access. References to multiple Registries or the Registry Pairs have therefore been removed. Due to the inherent simplification of the trading process, references to Transfer Point as used in the Phase IV Appendix have been removed, with the UKA Appendix instead relying only on the Delivery Point concept.
5. **Trading Period:** The Phase system established under the EU ETS has been replaced by a single Trading Period which extends from 2021 until 2030. Subject to the success of the UK ETS, it is anticipated that a second Trading Period will be introduced after 2030, however it is possible that this may be subject to material amendments, similar to the transition from one EU ETS Phase to another. The Trading Period consists of two Allocation Periods, the first from 2021 until 2025, and the second from 2026 to 2030. It is currently not anticipated that there will be any restriction in trading or issuance of UKAs will occur from the first to the second Allocation Period. For this reason, references to Phases from the Phase IV Appendix have been replaced by the Trading Period in the UKA Appendix.
6. **Relevant Authority:** Three types of authorities are relevant to the operation of the UK ETS, which have been collectively defined in the UKA Appendix as the Relevant Authority. The competences are devolved and as such different authorities apply for each nation. At the date of these Usage Notes, the authorities include:
 - a. the national authority (the Secretary of State, Scottish Ministers, Welsh Ministers, and the Department of Agriculture, Environment and Rural Affairs);
 - b. the regulator (Environment Agency, Scottish Environmental Protection Agency, Natural Resources Wales, and Chief Inspector¹); and
 - c. the registry administrator (the Environment Agency, which has been nominated to act for the whole of the United Kingdom).

Due to the inherent risk of evolving competences of the Relevant Authorities over the term of the first Trading Period, the UKA Appendix makes reference to the relevant definitions in the ETS Order rather than expressly listing these entities. Upon execution of the UKA Appendix, Users are recommended to familiarise themselves with the applicable Relevant Authorities.

We note that, whilst the UK ETS applies solely to Great Britain and not to Northern Ireland, the relevant authorities for Northern Ireland have nevertheless been expressly listed in the ETS Order.

7. **Excess Emissions Penalty:** In contrast to the EU ETS, the penalty regime in the UK ETS has been expanded to include a civil penalty as well as the excess emissions penalty as used in the EU ETS. To ensure continuity between the Phase IV Appendix, the UKA Appendix retains the defined terms "Emissions Excess Penalty" or "EEP". The concept of "Excess Emissions Penalty Equivalent" or "EEP Equivalent" has therefore been retained, however as set out in the definitions, the UKA Appendix reflects the new UK ETS penalty position. The penalty type depends upon whether the Buyer is an Operator or an Aircraft Operator. Where the Buyer is an Operator, the following penalties are applicable:
 - a. an excess emissions penalty payable pursuant to Article 52(2) of the ETS Order for failure to surrender sufficient Allowances contrary to its obligations under the ETS Order; or
 - b. a civil penalty payable pursuant to Article 52(4) of the ETS Order for reportable emissions exceeding the verified reportable emissions and subsequent failure to surrender Allowances equal to such difference.

Where the Buyer is an Aircraft Operator, the following penalties are applicable:

- c. an excess emissions penalty payable pursuant to Article 52(2) of the ETS Order for failure to surrender sufficient Allowances contrary to its obligations under the ETS Order; or
 - d. a civil penalty payable pursuant to Article 52(7) of the ETS Order for aviation emissions exceeding the verified aviation emissions and subsequent failure to surrender Allowances equal to such difference.
8. **Currency:** The default currency of the UKA Appendix has been amended to GBP Sterling, and provisions on applicable currency for payments and currency conversion have been introduced in §§4.5 and 4.6.
9. **Interest Rate:** In light of the usage of GBP Sterling as the default currency, the Base Rate and Cost of Carry Rate have been aligned with the UK index applicable at the date of these Usage Notes, the GBP-SONIA-COMPOUND. Users may wish to review this and additionally amend the Cost of Carry Rate to more closely reflect the applicable rate.

VII. Inherent risks of the UK ETS: Users should be aware that at the date of these Usage Notes, the UK ETS is in its early stages of development and therefore may be subject to amendment during the Trading Period. These may include without limitation general legislative changes through statute and statutory instruments, changes to the number of Allowances issued, a validity period being introduced on Allowances, and the entities subject to the compliance obligation. Such material amendments may be made in the transition from the current Allocation Period to the second Allocation Period. Initial changes to the scheme will be implemented by 2026. Further changes may be introduced at the end of 2030 before the start of the second Trading Period.

¹ As constituted under regulation 8(3) of the Pollution Prevention and Control (Industrial Emissions) Regulations (Northern Ireland) 2013.

The risk of operational issues of the UK ETS in its first years is additionally comparably higher than for the established EU ETS. The risk of such occurrences should be considered in respect of the continued performance of the Parties' obligations. For additional comfort, Parties may wish to amend the standard position of the UKA Appendix in its Part II through the introduction of appropriate clauses, such as change in law or scheme abandonment.

In light of such risks during the Trading Period, Users are therefore strongly recommended to consult legal counsel with respect to the negotiations of the UKA Appendix.

III. Amendments to the UKA Appendix: In executing the UKA Appendix, parties may wish to consider additional amendments in Part II of the Election Sheet to vary the position of the UK Appendix beyond those available in Part I (*General Terms*), further tailoring it to the nature of the UKA transaction. Points which may be considered include but are not limited to (i) the application of physical settlement netting, (ii) Force Majeure termination payment, (iii) the application of the EEP and/or the EEP Equivalent, (iv) the applicable payment cycle, (v) additional representations and warranties concerning the status of the User as an Operator or an Aircraft Operator with respect to the EEP.

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