CORNWALL INSIGHT

CREATING CLARITY

Alert - Ofgem consults on changes to price cap methodologies

Headline assessment	
Documents:	Benchmark consumption review Nuclear Regulated Asset Base (RAB) Backwardation deadband Contracts for Difference review Unidentified gas allowance review
Consultation dates:	**Benchmark and Backwardation:** 27/08/2025–25/09/2025 **Nuclear RAB:** 27/08/2025–26/09/2025 **CfD and UIG:** 27/08/2025–10/10/2025
Impact classification:	High: Domestic Supplier Medium: Consumers
Action if desired:	Respond to the consultations

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1 Assessment and recommendation

On 27 August, Ofgem announced the default tariff cap would be rising 2% to £1,755 per year on average for typical dual fuel direct debit customers in the next cap period. Alongside this, it has published five consultations, set out previously in the price cap programme of work 2025-26, looking at different allowances and methodologies within the cap. These are:

- Nuclear Regulatory Asset Base (RAB) allowance: Proposing to introduce an allowance for nuclear RAB, which will be updated on a six-monthly basis and recovered through the electricity unit rate.
- Benchmark consumption review: Proposing to update the benchmark consumption assumption to reflect current and future consumption patterns.
- Backwardation deadband: Proposing to remove the backwardation deadband and instead allow the costs and benefits to be recovered through the cap over a rolling 12-month period.
- Contracts for Difference (CfD) review: Seeking views and evidence on the case for introducing a reconciliation mechanism for the CfD allowance.
- Enduring Unidentified gas (UIG) allowance: Considering options for setting an enduring approach for the UIG allowance.

We recommend interested parties respond to the consultations, noting the differing closing dates for each.

Cornwall Insight comment: *The inclusion of a nuclear RAB allowance within the cap will be a welcome one for suppliers, providing clarity on the treatment of this anticipated cost. However, there will be a two-month delay between the introduction of the RAB and the allowance emerging in bills in January 2026 - necessitating an initial reconciliation of costs incurred for that period. Depending on the level at which it is set relative to the current interim rate, the potential enduring allowance for UIG would also add costs into the cap. The re-benchmarking of consumption to reflect current levels will lead to the cap being more representative of "typical" household consumption, with a corresponding impact on the level of the cap.*

Ofgem is also looking to improve cost reflectivity in the cap through removing the backwardation deadband and introducing an approach to update the consumption benchmark more frequently, allowing it to remain aligned with future consumption patterns.

2 Nuclear RAB

2.1 Background

Following the Government's Final Investment Decision on the funding of Sizewell C, recovery of the construction costs through the nuclear RAB can commence. In August 2025, the Low Carbon Contracts Company (LCCC) confirmed the first nuclear RAB interim levy rate and total reserve amount will be £3.455/MWh and £8,307,825.45 respectively for 1 November to 31 December 2025.

The costs will be applied to all electricity suppliers and recovered across all consumers (excluding Energy Intensive Industries). This consultation therefore looks to introduce an allowance in the cap to account for nuclear RAB.

2.2 Allowance

It is proposed that the allowance will be included in Annex 4 *Policy Cost Allowance Methodology* and updated on a six-monthly basis in February and August. It will be recovered on a volumetric basis through the electricity unit rate, in line with the policy intent and design of the nuclear RAB scheme to charge suppliers on a MWh basis.

In order to calculate a per annum allowance, the regulator proposes to use the interim levy rates published by the LCCC for each quarter of the financial year, and will account for the ongoing operational costs published by EMR Settlement. To calculate a £/MWh allowance, it proposes to take a seasonally adjusted average of the four interim levy rates using the Demand and Losses supplementary workbook, before adding the operational costs to the average.

Ofgem proposes for this to be implemented from January 2026, however, it notes that costs are expected to be incurred from November 2025. It therefore proposes to include the levy rate for costs incurred between November-December 2025 in the price cap from January 2026, allowing recovery to be spread over the first 12 months of the scheme.

It does not propose to include operational levy costs that suppliers have already incurred as its estimates equate this to approximately 4p per customer, and it considers this to be non-material. It also does not propose including any reserve funds in the allowance as they are not ongoing payments.

3 Benchmark consumption review

3.1 Background

The benchmark consumption is an input assumption included in the cap for the amount of energy a typical consumer uses. This has remained constant since 2019 and is based on the 2017 Typical Domestic Consumption Values (TDCV), which were in turn based on 2015 consumption data. Since then, two downward revisions have been made to the TDCVs, in 2019 and 2023 (Table 1), reflecting the longer-term trend of falling gas and electricity demand. This fall in demand has been based on a number of factors, at least some of which are expected to continue into the future, such as warmer weather and improved energy efficiency, though it is also likely electrification will mean increased electricity demand across consumers ahead of net zero 2050. Emerging evidence also suggests that consumption has fallen to a level where suppliers would be unable to recover their fixed costs, especially for gas.

3.2 Change of consumption benchmark

The consultation sets out three options for updating the benchmark consumption (Table 1). Option 1 is to update the benchmark using the latest TDCVs. Option 2 would use the median approach to DESNZ's 2023 subnational energy consumption data, while Option 3 would use the mean approach. Ofgem notes that Option 3 would represent a departure from the original cap methodology and may therefore have wider implications for other elements of the cap framework, including the existing headroom allowance.

Table 1: Benchmark options

	Addition to cap 14b level (average direct debit consumer)	EBIT margin increase
Option 1 – update using latest TDCVs	+£8.70	0.32%
Option 2 – update using DESNZ's 2023 data – median approach	+£17.10	0.63%
Option 3 - update using DESNZ's 2023 data – mean approach	+£0.80	0.03%

Ofgem's minded-to approach is to use Option 1, and it further proposes to update the benchmark consumption in the cap over time, as its view of the TDCV changes. This would allow the benchmark to continue to remain aligned with consumption patterns moving forward.

3.3 Payment method specific approach

The regulator is also seeking initial views on whether to introduce payment method specific benchmark consumption levels within the price cap. This would involve setting separate benchmark consumption values for direct debit, standard credit and prepayment meter (PPM) customers.

The main rationale is that this would improve cost reflectivity in the cap, as some fixed costs are recovered through the unit rate, meaning suppliers with a higher proportion of lower-consuming customers, such as PPM customers, may under-recover their costs relative to the benchmark.

However, it also notes this would result in higher cap levels for some customers, particularly PPM customers. Ofgem's analysis indicates that under it's minded-to option in Part A, dual fuel PPM customers would pay approximately £14.76 more per year under a payment specific approach, compared to a ~£3.64 increase for standard credit and a ~£6.10 decrease for direct debit customers. It would also introduce more complexity to the cap methodology, making it more difficult for stakeholders to understand. Ofgem is asking stakeholders if there is a case for introducing payment method specific benchmark consumption levels and what views are on the potential distributional and operational impacts of this.

4 Backwardation deadband

4.1 Background

The backwardation allowance covers the difference between buying energy for a full year and buying it only for the upcoming cap period. This results in a backwardation cost to suppliers when the costs for the upcoming cap period are higher than a full year, or a contango benefit where the costs are lower.

A deadband was put in place to ensure the cap does not capture backwardation costs when the market is broadly stable. This is set at £9 and means suppliers can only recover 'additional' backwardation costs above this threshold and vice versa for contango benefits. This was implemented with the intention of limiting seasonal variation in quarterly price cap levels. Ofgem considers that while this is important, the deadband introduces a degree of uncertainty and risk into the market and has potential to lead to periods of over- or under-recovery.

4.2 Proposals

This consultation proposes to remove the deadband and recover costs within the deadband range over 12 months. Ofgem considers this would enable a more complete and timely recovery of backwardation costs and contango benefits, reducing risk of systematic under- or over-recovery. It will also reduce potential of large swings in the headline cap level between cap periods that could occur if the deadband was removed altogether.

With the 12-month recovery approach, as a new quarter of backwardation or contango is added into the allowance, it will replace the equivalent quarter for the previous year, meaning it should retain a broadly equivalent degree of seasonality. Ofgem expects the removal of the deadband will typically be bill neutral for customers.

5 Contracts for Difference review

5.1 Background

There is currently an allowance in the cap for the CfD scheme, set using the best available information at the time on LCCC's expected levy payment for each quarter of the next financial year. During meetings in July 2025, suppliers have raised this allowance as an area of priority for review, stating that they have been under-recovering historic CfD costs, and they expect under-recovery risk to increase in the future due to growing penetration of renewable energy and increases in capacity and budget of the CfD scheme.

Suppliers suggested introducing a true-up mechanism to reconcile differences between the price cap allowance and outturn payments to the LCCC. Ofgem has previously rejected proposals for a reconciliation mechanism of the CfD allowance in 2022 and 2023 due to the issues underpinning suppliers' arguments not resulting in material and systematic impacts, however it remains open to considering new views and evidence.

5.2 Considerations

Ofgem is not putting forward a preferred policy proposal at this stage, and is welcoming evidence and views on the potential issues and remedies for setting the CfD price cap allowance.

On the analysis of the allowance vs outturn LCCC payments, Ofgem states that it does not currently have sufficient information of suppliers' outturn losses or benefits against the cap allowance and is welcoming evidence on this. It notes its analysis shows a large variation between the CfD price cap allowance and suppliers' outturn payments to or from the LCCC, particularly between 2021-22 and 2023-24, indicating that outturn payments are particularly susceptible to high wholesale energy price volatility.

Differences between the allowance and outturn occur because Ofgem uses wholesale prices with a lag in the CfD price cap allowance. It uses some outturn payments once they become available for the August and November cap updates, following LCCC's quarterly reconciliation, but will always use the latest information available. It stated that excluding the years affected by the gas crisis, the net difference between allowed and outturn payments is almost nil.

On generator delays to contract start dates, a few suppliers asserted that the CfD allowance may overestimate credits from generators, as the LCCC may assume generators begin generating under their CfD contract on their contracted start dates, while this is not always the case. The LCCC has confirmed it does not make this assumption and DESNZ have changed the CfD contract from Allocation Round 5 (AR5) to prevent generators delaying their CfD start date for commercial gain. Ofgem therefore does not expect this issue to reoccur for projects contracted under AR5 onwards.

Ofgem stated it does not currently have evidence on how many suppliers choose to hedge their CfD exposure, the methods they use, or the scale of their outturn losses or benefits relative to the cap allowance. The risk involved is attributed to two drivers: price risk and volume risk. The regulator is seeking evidence on the extent to which the difference between the allowance (based on forecasts) and the outturn payments is attributable to price variability vs volume variability. This will help it understand how much of the difference could potentially be mitigated through hedging.

5.3 Reconciliation

Ofgem stated it has not yet seen consistent and compelling evidence that a change to the price cap allowance approach is required. However, it invites detailed evidence from stakeholders explaining why the CfD allowance meets the material and systematic threshold on an ongoing basis once hedging is accounted for, and why this allowance is different to other allowances in the cap, such that a reconciliation mechanism would still be justified.

It also invites detailed evidence on whether a reconciliation mechanism would create additional or different risks for either suppliers or consumers. It is concerned that fully reflecting LCCC's outturn payments in the

cap allowance would shift the balance of risk entirely to customers, and therefore considers hedging to be prudent risk management behaviour, and shifting this risk may also disincentivise suppliers to hedge.

6 Unidentified gas allowance

6.1 Background

The current approach to setting the UIG allowance uses data on forecast domestic UIG from the Allocation of Unidentified Gas Expert's (AUGE's) annual statement. This is considered to no longer be reflective of suppliers' outturn costs.

In July 2025, Ofgem consulted on amending the UIG cost allowance from cap period 15a (October-December 2025), and proposed to use a new input to better reflect UIG volumes, such as Xoserve's estimation of post-reconciliation UIG as a percentage of throughput. A decision was published on 25 August to set a temporary UIG allowance at 3.17%, which is equivalent to around £5.40 per customer, using Xoserve's data. Ofgem decided to calculate this based on the average of the last two gas years' post-reconciliation UIG percentage figure.

6.2 Enduring approach

This call for input sets out Ofgem's main considerations for setting an enduring UIG allowance within the cap.

6.2.1 Data source

Ofgem considers that possible sources for an enduring allowance could include the average post-reconciliation UIG as a percentage of total throughput from Xoserve's chart. It notes that a different approach would be needed in the absence of update AUGE statements to reallocate total UIG to domestic consumers. It suggests one option could be to reuse the weighting factors and forecast assumptions from the 2025-26 AUGE statement to set the allowance in future years, while updating the post-reconciliation UIG figure.

It also suggests using bespoke analysis from Xoserve setting out the levels of post-reconciliation UIG for domestic consumers, and other data sources such as Xoserve's settlement data to calculate historic outturn UIG for domestic sites.

6.2.2 End user categories and profile classes

For the enduring allowance, Ofgem will need to identify which end user categories (EUCs) and profile classes UIG should be calculated on. The temporary allowance used the same EUCs and profile classes as have been used previously, which are EUC 1ND and 1PD (class 1 for domestic PPM and non-PPM meters, with consumption between 0-73.2MWh/year) and profile classes 3 and 4 (non-daily metered supply points, which represent smaller users, therefore approximating domestic consumers).

In response to the July 2025 scoping letter, it was suggested the UIG calculation could be extended to include EUC 2ND and 2PD, which represent large domestic sites with consumption of 73.2-293MWh/year. Consultation responses suggested only using profile class 4 in the calculation.

Ofgem is welcoming responses and evidence on the suitability of different EUCs and profile classes.

6.2.3 Frequency of updates

Ofgem considers keeping an annual review of the UIG allowance will be most appropriate, but it is open to views from stakeholders on whether the allowance should be updated more frequently. It is also seeking views on whether a fixed allowance would be appropriate.

While it understands that UIG costs are largely outside supplier control, the regulator is aware that setting an enduring allowance in the cap may affect the incentive to reduce UIG. It is therefore seeking views on the extent to which the level of UIG is within suppliers' control or the extent to which inaction may increase levels of UIG across the system.

7 Next steps

The consultation closing dates, alongside expected decision and implementation dates, where applicable, are set out in Table 2.

Table 2: Consultation close dates and next steps

Consultation	Close date	Decision date	Implementation date
Benchmarking considerations	25 September 2025	"Later this year"	1 January 2026
Backwardation deadband	25 September 2025	-	April 2026
Nuclear RAB	26 September 2025	November 2025	1 January 2026
CfD review	10 October 2025	-	-
UIG allowance	10 October 2025	-	-

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