The voice of the energy industry

Response to Ofgem: LDES Window 1 Cap and Floor regime: Financial Framework (July 2025)

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members – from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat and technology. Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses. The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors. The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources. The energy sector supports 700,000 jobs in every corner of the country. Energy UK plays a key role in ensuring we attract and retain a diverse workforce. In addition to our Young Energy Professionals Forum, we are a founding member of TIDE, an industry-wide taskforce to tackle Inclusion and Diversity.

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The consultation

Ofgem's Financial Framework consultation invites views (by 17th July 2025) on the detailed design of the financial parameters that will support the regime. This includes how C&F levels are set, how capital and operational costs are treated, and how incentives and protections are built into the regime to ensure good value for consumers while enabling investment.

The consultation covers the following key areas:

- How cap and floor levels are set, role of competition, choice between administrative and competitive approaches, plus risk management and project investability.
- How the floor works (downside protection via minimum revenue to support bankability and financing).
- How the cap works, (ensuring consumers take a share of the upside).
- How capital and operating costs are treated, including development costs, spares, decommissioning, and interest during construction.
- Incentives for cost control and timely delivery.
- Financial resilience measures
- What happens at the end of the regime, including how any residual value is handled.
- The Cap and Floor Financial Model (CFFM), and its accompanying handbook, which explain how revenue levels are calculated and how project bids are assessed.

Next Steps:

- Final version of Financial Framework published in Q3 2025
- Final version of Project Assessment MCA framework published Q3 2025

Energy UK response: summary

We thank the Ofgem and NESO for their work in this space and for delivering at pace.

Risk: our central comment in relation to these proposals is the treatment of risk. Whilst we support the intent to ensure value for consumers, the additional proposals increase risk for developers (risk that is often unquantified until Q3, 2025). As a package, the scheme now feels unbalanced – with too much downside and insufficient upside. If not addressed, the scheme may not secure enough capacity in time and on budget.

Competition: The focus on competition (throughout these new proposals) introduces new delivery risk by incentivising developers to minimise costs or inflate returns to increase their chance of being selected or securing enhanced profit-sharing. Whilst the objective of the *previous* project assessment stage was to get the maximum benefit for system and most competitive projects, the objective now should be on investibility. These proposals with their (over) focus on competition seem to conflate these two objectives of value and investibility.

Late delivery penalty - The proposals still include the 2-year cliff edge risk. If developers miss their delivery date of 2030 or 2033 by 2 years, it suggests they could face a hard cut-off of floor support. This is too much risk for pumped storage hydro (PSH). Whilst the consultation states that further detail will come with the Q3 licensing consultation, developers in Window 1 will need more comfort ahead of Q3 to proceed with the scheme.

Clawback / penalty incentives schemes - the scheme needs to ensure that any clawback is balanced. It is difficult to forecast how to run an asset so any clawback risk needs to be quantified and included in the developers' forecast/ risk assessment. Developers will not proceed if there is a risk of projects with negative revenue. Mooting the potential for clawback but not providing full detail until Q3 creates risk and uncertainty for Window 1 applicants. A further risk is the lack of inflation protection. No other carbon support scheme caps inflation at 2 percent leaving developers to bear additional costs of both higher inflation and tax increases. These are factors beyond the developers control.

Soft-cap: The proposal for 10 percent profit-sharing above the cap is too low. 10 percent is not high enough to support investment into improving the efficiency/ life/ availability of the asset. We recommend that Ofgem look at the LTESA scheme's fifty percent profit-sharing.

Higher risk LDES: the CEPA analysis and Ofgem publication note the higher risk profile of LDES as a class compared with interconnectors, and yet the scheme does not adequately account for these risks. This makes it less attractive to investors than the interconnector scheme. Moreover, the scheme does not adequately account for the higher risks that some types of LDES face. *Where investors are taking on more risks (as opposed to just servicing debt), more upside is needed.*

Signalling future intent: It is important that Ofgem is as transparent as possible at each stage of the process so that developers looking to enter future rounds understand the feasibility of doing so. By developing projects in GB, developers will be foregoing opportunities elsewhere). A Window 2 announcement will ensure that these developers continue to invest in the UK.

Approach to C&F levels setting for LDES

Q1. Views on proposal to move beyond focus on project return rates at C&F levels, to more flexible approach that allows projects to tailor key parameters for archetype?

Under competitive approach, projects will submit a bid package that includes 5 key parameters:

a) Target rate of return at both C&F (RoR for Regulatory Asset Value (RAV). Inc costs of building, maintaining, and decommissioning project recoverable through C&F revenue
Floor sets min. revenue, Cap sets max. Propose - Cap is 7.31% CPIH-real Floor is 4.47% CPIH-real.
b) Proposed residual value of project at end of regime (expressed as proportion of upfront capex). This would be excluded from the RAV. Ofgem's benchmark here will be zero.
c) Regime length of at least 20 years. If <25 yrs, explain how remain financeable.
d) Target Interest During Construction (IDC) rate (%real). Ofgem's benchmark IDC rate will vary depending on the length of the construction period, rather than being fixed for all projects.
e) Estimated decommissioning cost (as percentage of capex). Benchmarked by Ofgem

Energy UK supports the approach and note that the five parameters are similar to interconnector scheme. Ofgem's proposed benchmark for Cap is 7.31% CPIH-real and Floor is 4.47% CPIH-real. We note the importance of Ofgem setting workable administrative cap and floor levels.

Members agree that it provides more flexibility for the LDES heterogeneity than the previous approach. It will mean, for example, that projects with a higher-risk profile (e.g. capex-intensive like pumped storage hydro [PSH] or less mature as with Stream 2 technologies) could apply for a higher floor than the administratively-set Ofgem floor to limit some risk.

Developers opting for a competitive C&F (lower floor, lower cap) than the administratively-set levels, will get offered this (if successful). The approach incentivises developers to bid more competitively than the administrative cap to increase their likelihood of securing a C&F contract. If they are amongst the top 25 most competitive projects, applicants could secure enhanced profit-sharing (to retain 20 [rather than 10] percent of profit earnt above the cap).

Q2. How well does proposed competitive framework accommodate differing risk profiles of various tech? Any tech-specific considerations?

We agree that the competitive framework provides more scope to tailor the C&F levels than previously. This allows developers to structure bids based on the elements/ risks most relevant to their project (e.g. decommissioning costs are less relevant for PSH).

The option to choose a regime longer than the 25-year standard (up to 40 years) provides some additional support for long-lived, capex-intensive projects. However, it is not sufficient redress for the additional risk that PSH faces (capex, construction risk and not built in the UK for over 40 years).

In all, the LDES C&F scheme is less attractive to developers than the equivalent scheme for interconnectors. This applies for all LDES but is especially relevant to PSH and Stream 2. The treatment of Weighted Average Capital (WAC), based on the administrative C&F is around 5 percent is lower than for the interconnector scheme despite the interconnector development in the UK being an established business with fewer risks.

Ofgem notes the higher risk for LDES projects but suggests that these are adequately mitigated in the LDES C&F via the following measures:

i) providing a higher floor rate of return
ii) ten percent profit-sharing above the cap
iii) by revenue being assessed cumulatively on an NPV neutral basis (so short-term revenue spikes not immediately capped - increasing the effective cap level)

Members do not agree that these mitigations are sufficient to offset the increased risk that LDES projects face. Instead, the cumulative impact of the new proposals is to increase the overall risk for applicants. To offset this, we recommend that Ofgem consider a slightly higher administrative floor for LDES types with higher risk profiles (in line with the policy objective to support less mature technologies).

For this reason, some members however disagree with the competitive approach proposed. The view here is that it is not possible to have effective competition on a technology-neutral basis, with an inconsistent set of assumptions based on incomplete information.

All members agree that there is now too much focus on competition in the scheme and that this risks impacting the quality of the outputs and effectiveness of the overall scheme.

We recommend that Ofgem reconsider the use of competition in parts of the scheme where it is still working through the detail. These aspects are increasing risks for developers that have already bid into the scheme.

Q3. How can Ofgem best ensure comparability between bids given bespoke nature of proposed parameters? Specific normalisation techniques or benchmarks?

We support the proposed approach of comparing bids within asset classes (but note that alternative approach may be needed for Stream 2 projects with no comparator projects).

There are still a large number of uncertainties on the detail of the scheme (the level of Minimum Availability Time [MAT] previously mooted as 80 percent; treatment of pass-through tax, and claw-back).

This means that developers will be constructing their bids with different set of starting assumptions – without a level-playing field. This makes the competitive aspects less useful and introduces risks (including on deliverability).

Q4. Views on proposed truth-telling incentives? Discourage inflated/ strategic bidding?

Truth telling - strong incentives to encourage honest bidding. Propose framework based on 2 principles:

a) Enhanced revenue sharing for most competitive bids: Projects in the top 25% of bids (based on biggest percentage cut from administrative C&F levels), to receive an enhanced sharing rate (potentially 20%)
b) Bid evaluation: Competitiveness assessed as part of Financial Assessment under Project Assessment framework. The most competitive projects likely to score higher.

Mitigating risk of strategic bidding: Robust evidence required for all bid parameters (third-party validation from supply chain partners and potential debt and equity advisers) and like-for-like comparisons.

Approach to selection - administrative vs. competitive

- If a project's bid exceeds admin. C&F levels, admin. levels will act as a ceiling.
- If all project bids fall below the administrative levels, the competitive bids will be used.

Recap of general approach to C&F levels calculation - four cost building blocks

i. Operating expenditure (opex) and decommissioning costs estimated as annual operating costs and end-of-life decommissioning costs, common to both C&F levels.
ii. Depreciation of the Regulatory Asset Value (RAV) represents the run-off of the RAV, built from devEx, capex, IDC, spares, and transaction costs, and adjusted for replacement expenditure during operations.
iii. Return on the RAV will be tailored to the returns suitable at the C&F
iv. Tax calculated on nominal, notional pre-tax revenue ex-ante, then deflated to real terms

Minded-to: adopt a fully nominal regime where initial C&F levels are estimated in real terms, nominal cashflows are converted to real cashflows using inflation assumption of 2%; C&F levels then adjusted each year by 2%

We support the use of like-for-like comparators and third-party validation from supply-chain partners as sensible approaches to reduce the risk of parties understating costs or

overstating performance. As noted previously, the C&F scheme feels unbalanced – with developers exposed to too many risks with insufficient reward.

We do not support the enhanced profit-sharing proposal since:

i) Greater upside is needed for *all* projects where they can demonstrate efficient operation and value to the system – *not just the top 25 percent.*
ii) The 25 percent threshold feels arbitrary. Whilst a developer in the top 25 percent of competitive projects will get 20 percent profit sharing above the cap, another only marginally-less competitive project will get half the level of profit sharing.
iii) The proposal could increase delivery risk by incentivising developers to bid with costs that prove unfeasible to deliver against.
iv) Gaming risk – the readiness requirements of the scheme means that it may be possible for developers to estimate and seek to undercut rival projects. The enhanced incentive increases the incentive here.

Alternative: As an alternative option, we urge Ofgem to consider increasing the profit-sharing above the cap for *all* projects. This would provide the same incentive to all developers to operate their projects efficiently, contributing to the system and remain available after they have met the MAT/ cap.

If developers can only recoup 10 percent of profit above the cap, certain actions or investments (investing in the efficiency of the unit/ refurbishments/ bidding into a new balancing or ancillary service) may not be economically viable or attractive. We note that the original purpose of the cap was to incentivise availability not incentivise competition.

10 percent of profit sharing is very low in comparison to other schemes. The Australian Long term Energy Sharing Agreement (LTESA) scheme, for example, is set at fifty percent. We recommend that Ofgem/ CEPA examine the impact this has had, and whether the GB scheme could benefit from a similar approach.

LTESA profit sharing (p8)

Net Revenue Threshold	The Net Revenue Threshold is a bid variable. As a Project's Net Operational Revenue increases toward the Net Revenue Threshold, the annuity payment from SFV reduces below the Annuity Cap. If Net Operational Revenue exceeds the Net Revenue Threshold, a 50% revenue sharing percentage applies and a repayment to the SFV may apply. Repayments are capped at Historical Net Payments. A lower Net Revenue Threshold may reduce the Forecast LTESA Cost, all else being equal, but it had a lesser impact on Forecast LTESA Cost than minimising an Annuity Cap.

Downside protection – designing the floor mechanism

TDD proposed two approaches to setting floor: Administrative floor & Actual cost of debt (ACOD).
Now considering competitive approach. Projects using limited/ non-recourse project finance, will have two floors:

i. The competitive floor (from the project's bid), which limits how much consumers are exposed to.
ii. The ACOD floor, which helps the project secure debt financing.

Administrative floor: Minded to (same as interconnector) to set RoR using the iBoxx index of BBB rated GBP non-financial corporate bond yields of 15+ years remaining maturity. Cost of debt benchmark will be the average yield over the 20 trading days up to 8 April 2025. This floor RoR will apply to the entire RAV.

ACOD: will covers only project's debt obligations. If higher than administratively set (or competitive) floor, project must repay difference before equity distributions. Minded to: set to match debt obligations to lenders.

Q5. What are your views on our proposed approach to floor setting?

As noted in our response for Q2, t all LDES projects face a higher degree of risk in the LDES C&F compared with the interconnector equivalent. We recommend that Ofgem consider a higher floor that adequately reflects this risk.

We further recommend that Ofgem consider whether LDES technology facing a higher degree of risk, merit additional protection. This could include a risk premium for i) construction risk and ii) FOAK risk. Since PSH has not been built in the UK for over 40 years, we would class both PSH and Stream projects as FOAK here.

Q6. What are your views on our proposed performance-linked measures to access the floor and incentives below floor?

Minimum Availability Target (MAT) - To ensure floor payments are linked to operational performance, projects must meet a MAT set individually for that project (reasonable level of technical availability - independent expert or reference to system stress events). Will exclude planned outages and force majeure events. Detail - Q3 2025

Energy UK supports the proposal for a Minimum Availability Target (MAT) – if reasonable. However, the lack of a firm figure for the MAT at this stage leaves too much risk for Window 1 developers (We note that a previous consultation mooted an 80 percent MAT).

Designing the cap mechanism

Administrative cap - set using benchmark return assumptions evaluated at a notional capital structure. Competitive process to capture heterogeneity. using same building blocks as floor, except for return on RAV. Minded to: set cap based on a notional cost of equity calculated using CAPM applied to 100% of the RAV.

- Equity beta (β): Measures how volatile the asset is vs. the overall market.
- Risk-free rate (RFR): Typically based on the return of government bonds.
- Equity risk premium (ERP): The expected return of the market above the risk-free rate (calculated as the Total Market Return (TMR) minus the RFR).

These inputs are combined using the following formula: $Benchmark\ return = RFR + \beta(TMR - RFR)$
Propose CAPM inputs aligned with Window 3 interconnector C&F regime, using a reference date of 8 April 2025.
Competitive cap - Allows projects to optimise cap using 5 competitive bid parameters if below admin. cap ceiling
Soft cap': Minded to: 10% of revenues above cap. (and marginal cycling costs e.g. variable maintenance).

Q7. Does proposed cap design provide right balance between incentivising efficient operation and sharing upside with consumer?

No – as previously noted, the proposals outlined in this publication allocate too much risk to the developer for not enough 'upside'. Please see our response to Q4.

We recommend significantly increasing the percentage of profit-sharing above the cap to address this. The Australia LDES scheme, LTESA includes a fifty percentage sharing agreement. We recommend Ofgem look at the impact this is having and whether a similar approach would benefit the GB scheme.

Q8. Views on the use of CAPM and proposed input assumptions (e.g. equity beta, RFR, TMR) for calculating cost of equity? Refinements or alternatives?

Ofgem accept LDES face higher risk profile but use same benchmark for cap RoR since:

a) Unlike interconnector regime, LDES revenues above cap are shared
b) Revenue is assessed cumulatively on an NPV neutral basis, so short-term revenue spikes not immediately capped, which increases the effective cap level.
c) Proposing a higher floor RoR for LDES projects than for P2P interconnectors

TMR is a market-wide parameter so propose to align with Ofgem's latest RIIO methodology - 6.5% to 7.0% with the midpoint of 6.75%. Propose to confirm two of the parameters – beta and TMR now. On 8 April, the 20-day average yield on 20-year ILGs was 1.99%. Combined with current estimate of inflation wedge of 26 bps – a RFR estimate of 2.26%. Combined with our beta and TMR estimates, this would give an estimate of 7.31% for the cap rate of return in CPIH real terms. The competitively set cap level will follow the same process

As noted before we do not agree that the three mitigations outlined above mitigate the higher risk that LDES projects face compared to interconnectors.

In addition, some LDES technologies face higher risk than others. These need reasonable support to address this increased risk. We recommend that Ofgem consider adjustments for

technologies that are acknowledged to have higher risk profiles (for example using a different beta for these so differentiate the weighted average cost of capital [WAC]).

Capital costs

Q9. Views on the proposed capital cost components for determining the RAV and C&F levels, including the equity and debt transaction cost allowances?

The capital cost base for LDES projects includes the following components Costs a) to d) included in the RAV:

a) Development expenditure (devex) –including planning, design, and permitting.
b) Construction capital expenditure (capex) –including equipment, installation, and commissioning.
c) Spares – strategic spare parts required to ensure operational resilience.
d) Replacement expenditure (repex) – Anticipated mid-life replacements or refurbishments.
e) Decommissioning cost – End-of-life costs for safely dismantling the asset.
f) Interest During Construction (IDC) – Financing costs incurred during the construction period.
g) Transaction costs – Costs associated with raising debt and equity finance.

Decommissioning: full costs not included, especially for projects likely to keep running after regime. Minded to: projects estimate full decommissioning cost as a percentage of capex. Projects bid to recover any proportion (from 0% to 100%), through C&F levels. Propose using capex (excluding devex), as submitted for C&F level setting closer to Q2 2026, as the basis for estimating and assessing decommissioning costs.

Interest During Construction (IDC): (interconnector IDC methodology, yield on the cost of debt is set based on A-rated and BBB-rated iBoxx GBP bond indices). Minded to: may differ from interconnector. Propose to refer to an index of comparable tenor to the construction duration for each type of project but will not 'fine-tune'. Developers have flexibility to propose own IDC assumptions as one of the five bid parameters. Each project will receive IDC rate it bids (if competitive). If not, the administrative IDC rate will apply.

Transaction costs - propose including allowances associated with raising both equity and debt finance. Welcome views. For equity transaction cost, propose an allowance of 5% of the opening RAV at start of operational period to reflect the costs incurred in raising equity finance, such as legal and advisory fees. For debt transaction cost, propose allowance of 2.5% of opening RAV to reflect costs such as arrangement fees, legal and due diligence.

Treatment of opex

Annual opex added to depreciated RAV. Must be forecasted realistically, with expectations for efficiency gains:

a) Controllable opex – regular operational and maintenance costs.
b) Baseline uncontrollable opex / Pass-through costs – defined as a very limited set of cost elements outside the project's control, such as GB licence fees and property fees, where applicable.
c) Corporation tax – provided separately as an ex-ante allowance.

Yes - in general, Energy UK supports the minded-to positions. We note the importance of using appropriate third parties to validate submitted costs and recommend rechecking the applicants financial resilience at this stage.

If not already considered within DevEx, time spent to develop the proposals could be included in some way.

Q10. Do you agree with limiting reopeners during the operational phase to opex (after 10 years) and decommissioning (if there's a legal change)?

Reopeners only allowed in limited cases, mainly for decommissioning cost and opex, to keep the regime stable:

a) For opex, a reopener may be triggered by either Ofgem or the project, but not earlier than 10 years and no more than once every 10 years. Any changes would remain until next reopener is triggered.
b) For decommissioning, a reopener may be triggered if change in law that affects decommissioning cost.

(Proposed approach differs from the interconnector regime, where only a single opex reopener is allowed)

No - Energy UK does not support the ten-year delay between possible OpEx reopeners.

The main difficulty we see with this is the lack of inflation protection. The current proposals assume 2 percent inflation and that any tax changes sit with the developer. We do not

support this approach - it is not aligned with other carbon schemes (such as the Contracts for Difference scheme) and is an unnecessary extra risk to put on investors.

Without inflation protection, the developer is exposed. If inflation increases by more than 2 percent then the project OpEx will increase by more than 2 percent too. Unless there is inflation protection, there will need to be reopeners more regularly than every ten years. Our preference here would be for inflation protection.

We note that that the 2 percent fixed inflation approach will not benefit energy bill payers. If outturn inflation is lower than 2 percent, then the developer could make gains at a cost to consumers but if inflation is higher, then the additional costs will either need to be recovered through the OpEx reopeners - or else the project could fail – with the associated risk that this implies for all bill payers.

Q11. What are your views on the treatment of decommissioning costs and IDC - particularly around timing of recovery, project delays, and legislative changes?
We support this proposal. Very long lived assets such as PSH, with 100 year life may not need to recover decommissioning costs via the C&F.

Q12. What are your views on the proposed IDC rate approach and the option for projects to bid their own rate? Should riskier technologies receive a different rate?
IDC rate approach: Developers typically have higher risk-profile, and projects using Special Purpose Vehicles (SPVs) and project financing, will not have access to the parent company' debt rating. Benchmarking to AAA and BBB debt costs as proposed, could dissuade or increase the costs of the parties willing to undertake LDES projects, especially those with a higher risk profile.

The proposal is to use an amended approach to that used for interconnectors but not to 'fine tune' it. This suggests that it could be less suited to LDES projects with higher-risk profiles (higher construction, revenue or technology risk). We suggest that the approach (and overall scheme approach) takes sufficient account of and offsets the risk profile of different types of LDES projects.

Cost and delivery incentives

Q13. What are your views on the types of cost efficiency and delivery performance incentives included in the regime?
Option 1 - RAV adjustment approach: adjust C&F levels by modifying the RAV either upwards or downwards. The benchmark may be the midpoint or upper end of cost range submitted by project at Project Assessment stage. If final costs are lower, the RAV, will be reduced at Post Construction Review stage. If final costs are higher, the RAV may be increased, but only if additional costs are efficient– and will be subject to a 50:50 cost-sharing.
Option 2 - Outturn cost comparison approach: Cost increases beyond those submitted at Project Assessment, can be added to the RAV if deemed efficient. If a project receives floor payments, these may be subject to repayment at the end.

Since the scheme is a C&F rather than a RAB-type scheme, there is already a significant incentive to deliver on time and on cost (no C&F payment until the project is operational). The impact of these additional measures could be to further increase risk for the developer.

RAV Adjustment: We agree that it is reasonable for a project to have the RAV reduced if outturns and costs are significantly lower than forecast. However, if a developer can justify the additional costs, then these should be covered. The 50:50 sharing approach adds a new risk – that reasonable costs may not be fully covered by the floor. Whilst this could be a

tolerable risk for lower CapEx technologies, this may not be for PSH groundwork related construction risks.

Q14. What is your preferred approach to cost incentives (e.g. cost sharing vs. outturn comparison), and how should these be appropriately calibrated?

Propose two additional incentives:

1. Graduated levers: Direct adjustment to IDC rate (+/- 25 basis points per year, pro-rated for partial years)
   a) If a project delivered on time/ ahead, IDC rate would increase. If delayed, IDC rate would decrease.
   b) The increase / decrease in IDC would apply to the whole construction phase.
   c) Initial view - incentive should be symmetric - same reward or penalty applying to early or late delivery.

2. Alternative approach: Clawback - if delayed project receives floor payments, may need to be repaid after regime. Significant delays may trigger a new Project Assessment to see if support remains appropriate.

Treatment of delays and force majeure plan: Coming Q3 2025 - to inc. both pre-operational & operational phase. During pre-op, may request deadline extensions to 2032/ 2035, if delays caused by FM events and evidence. For operational period, projects will have FM provisions similar to interconnector regime covering events and circumstances beyond reasonable control (interconnectors may trigger the Income Adjusting Event mechanism and Exceptional Event mechanism).

As previously, the inherent delivery incentives in the C&F are sufficient. Introducing additional risk at this stage is not helpful. We agree that it is reasonable for the RAV to be adjusted at the post-construction review but highlight that it is important for all reasonable costs to be covered and that we do not support clawback of floor payments here.

Financial resilience

The LDES sector has unique characteristics that require a tailored regulatory approach:

a) Circularity between debt and floor: The C&F regime, particularly the ACOD variation, introduces a direct link between cost of debt and the floor. So need care of gearing caps to prevent inflated floor payments.
b) Limited additional capex requirement: LDES projects typically involve substantial capex followed by low ongoing capex. This limits need for continuous debt financing (bar refinancing or replacement capex).
c) No direct exposure to consumer:

Propose proportionate controls - on how much debt a project can take on. Minded to - gearing cap of 80%
Asset ringfencing provisions Without appropriate safeguards, risk equity holders could extract hidden value so:

a) Restriction on asset disposal without written approval from the regulator
b) Restriction on granting charges, liens, or other forms of security over regulated assets unless approved
c) Prohibition of inclusion of cross-default clauses in financing arrangements unless written consent

To support this, we propose to introduce regular financial reporting requirements.

a) Key financial metrics such as cash flow, profitability, and liquidity;
b) Gearing levels and their forecasts;
c) Details of financing arrangements and anticipated refinancing events;
d) Dividend payments and equity movements, with justifications;

A narrative explanation of financial risks and how they are being managed

Q15. Does proposed mix of gearing caps, ringfencing, and financial reporting strike right balance between financial resilience and flexibility? What would you change?

No comments received

C&F payments and charging mechanisms (p45)

Q16. Which charges - TNUoS or BSUoS - do you consider more appropriate for funding cap and floor payments and receipts, and why?

Unlike TNUoS, BSUoS recovered via volumetric usage (reflect consumption, don't fall on standing charges).
Payment flow timings: payments reconciled annually, with settlement aligned to BSUoS charging periods.
Timing will reflect actual performance, with adjustments made through future BSUoS charges.
If a floor payment due, NESO will collect BSUoS charges (suppliers and transmission demand customers)
If cap payment triggered, projects return surplus to NESO to credit suppliers and customers.
Flows reconciled annually to align with BSUoS charging periods. NESO may adjust BSUoS tariffs mid-year if C&F payments differ from forecasts. Any under/ over-recovery is reconciled in future charging periods.

Whilst we agree that recovering the cost via BSUoS would be more reflective, our strong preference is for TNUoS since this would provide more stability for energy retailers.

There is a risk of in-year adjustment with BSUoS whereas TNUoS is fixed and cannot be adjusted in-year. This means that where there is a need for reconciliation, it will be carried by the network companies until the following year.

When energy retailers offer fixed tariffs to the market, they need to make an estimate of the network charges. Where these could be subject to sudden unanticipated changes during the fixed term (due to LDES floor payments), that risks the supplier under-recovering (or over-recovering) monies from the customer and financial risk to a supplier. This translates into a risk premium in the tariff to cover the eventuality that the charges are higher than expected.

Regardless of the charge type used, it is essential that floor payments are not exposed to under-recovery risk. To mitigate this, we recommend prioritising LDES floor payments over other distributions, and/or holding payments in a ringfenced pot to ensure security. This will help ensure bankability, maintain investor confidence and protect project viability.

End of regime arrangements

Q17. What are your views on including a residual value at the end of the cap and floor period, and how should this affect depreciation and investor returns?

Since projects can recover their full investment within 25 years, may seem unfair if continue to earn high returns, especially if received floor payments. So considering recovering a portion of post-regime revenues:

a) When incentives linked to cost and delivery are triggered; or
b) When a project operated below the floor for much of the regime and relied on consumer support.

To address this, considering applying a soft cap beyond year 25 especially for projects bidding at administrative levels. We do not expect that a floor would apply after the regime ends or any residual value would be regulated.

Energy UK does not support a soft cap at the end of the regime since this could deter investors from engaging with the scheme.

Q18. What policy mechanisms should be introduced to support investability now and post regime or recovery of residual value beyond the C&F period?

Minded-to: to continue assuming a residual value of zero at the end of the 25- year regime. Will rely on the competitive approach, where projects bid including their proposed depreciation profile and residual value. Ofgem may benchmark proposed depreciation and residual value assumptions on a like-for-like basis

Cost and delivery incentives - if a project incurs cost overruns that push final costs beyond the range submitted at the Project Assessment stage, or faces delivery delays beyond 2032 for Track 1 and 2035 for Track 2, there may be a case for recovering floor payments received by the project.

Post-regime arrangements - for assets with a technical life under 25 years, decisions on detail post-regime arrangements will be deferred until closer to potential refurbishment or decommissioning. High level principles:

a) Consumers should face similar risk across long- and short-lived projects;
b) Post-regime rules should not reintroduce investment risks the C&F regime is designed to reduce
c) Rules should not discourage further LDES investment, including refurbishment, where that makes sense;
d) Project lifetime returns should not be capped below C&F return at floor return over asset's full economic life.

Cost and delivery incentives – Energy UK does not support the proposal for clawback of floor payments where projects face reasonable cost overruns (where these can be evidenced as unavoidable) and reasonable delays. As noted in response to previous questions, this is another new (and as yet undefined quantified), which may be introduced *after* developers have bid into the scheme.

The point of the scheme is to derisk necessary investment. Whilst the transitioning energy system needs these projects online by the early 2030s, the revenues streams, especially in

the early years of operation, are uncertain. The purpose of the floor is to reduce the risk of these investments. As with other new proposals in this document, this feels like a lot of open-ended risk for a developer to sign up to. It's a risk on equity that could discourage investment and which seems to work against the point of the floor - to limit the downside risk.

Cap and floor financial model (CFFM)

Q19. What are your views on our proposed financial model and handbook? Do you have any suggestions for simplifying it while keeping it clear and robust?

Approach to financial calculations - the key elements of the CFFM are as follows:

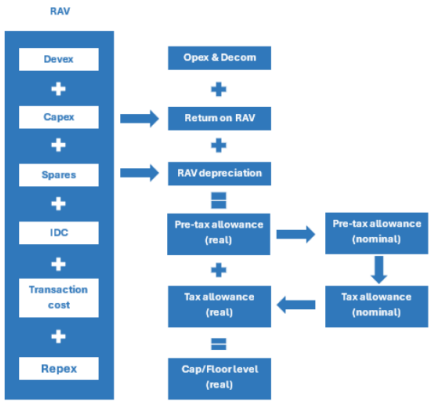
a) Regulatory Asset Value (RAV):
   i) Pre-operational RAV: DevEx and capex before the asset becomes operational
   ii) Operational RAV: Tracks value during life, inc depreciation, replacement capex, decommissioning, indexation.

b) Allowed C&F building blocks: used to calculate the annual revenue requirement under both C&F:
   i) Return on RAV: Based on allowed cost of capital.
   ii) Depreciation: Recovery of capital over the asset's life.
   iii) Operational expenditure (opex): Forecasted and actual costs of running the LDES asset.
   iv) Tax allowance: Based on taxable profits and applicable tax rates.

c) C&F levels: a. Cap level: The maximum allowed revenue, including incentives and adjustments.

d) Floor level: The minimum allowed revenue, ensuring financial viability.

Figure 1: Building blocks of the CFFM



No comments received.

Annex – Previous Energy UK LDES responses

- Energy UK response to project assessment (June 2025)
- Energy UK Response to Ofgem's Open Letter (January 2025)
- Energy UK response (March 2024) to Designing a policy framework to enable investment in long duration electricity storage (DESNZ, 2024)
- Energy UK response (September 2023) to the House of Science and Technology Committee inquiry Long-duration energy storage.
- Energy UK response to Government Call for Evidence into Facilitating the deployment of large-scale long duration energy storage , BEIS (2021)