Decision

Backwardation wholesale allowance in the default tariff cap

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In this document, we outline our decision to remove the deadband from the backwardation allowance in the energy price cap, having considered stakeholder feedback to our August 2025 consultation. We will allow the costs and benefits currently subject to the deadband to be recovered through the cap on a rolling 12-month period. We will implement the change from price cap 16b (July – September 2026).

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Executive summary

On 1 January 2019 we introduced the default tariff cap ('the cap'), in accordance with the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('the Act'), which protects households on standard variable and default tariffs. The cap ensures that default tariff and standard variable tariff customers (jointly referred to as default tariff customers) pay a fair price for their energy that reflects the efficient underlying cost to supply that energy. The cap includes a number of allowances for the costs a supplier faces, such as wholesale costs, network costs, policy costs and operating costs.

The cap includes an allowance for the difference between purchasing energy for a full year and purchasing it only for the upcoming cap period (ie one quarter). This difference is a cost to suppliers (known as 'backwardation') when the costs for the upcoming cap period are higher than the cost for a full year. In the opposite direction, the difference is a benefit to suppliers (known as 'contango'). We refer to the allowance as the backwardation allowance.

In the cap, these costs or benefits are subject to a threshold ('deadband') of £9, below which they are not passed through to customers. This deadband was implemented with the intention of limiting seasonal variation in quarterly price cap levels – an objective we still consider important. However, it also introduces a degree of uncertainty and risk into the market. In addition, it has the potential in certain circumstances to lead to periods of under- or over-recovery of costs.

In August 2025, we consulted on options to reduce this risk without negatively impacting customers through greater seasonality or higher prices in aggregate. We proposed to remove the deadband from the backwardation allowance in the cap and instead allow the costs and benefits currently subject to the deadband to be recovered through the cap over a rolling 12-month period. We proposed to implement the policy change no earlier than April 2026.

Stakeholders broadly agreed with the removal of the deadband, with a rolling 12-month cost recovery period for costs and benefits up to the deadband. However, several respondents asked for the change to be implemented at the earliest opportunity (January 2026) to reduce risk exposure and potential losses.

We have decided to proceed with our consultation proposal of removing the deadband from the backwardation allowance and allowing costs currently subject to the deadband to be recovered over a rolling 12-month period. We consider this will reduce unnecessary risk and uncertainty, without the detriment of higher bill seasonality. This risk reduction will help support a more stable and investable energy supply market, which will ultimately benefit existing and future default tariff customers.

Following stakeholder feedback, we have decided to implement this change in cap period 16b (July – September 2026). We consider this date to achieve an appropriate balance for both customers and suppliers compared to other options, as it will avoid an immediate short-term increase to the cap over this coming winter, while allowing for

greater certainty on cost recovery going forward. Additionally, we expect the change to result in a balanced cumulative recovery of costs and benefits currently subject to the deadband, based on current shape of the forward curve.

We recognise that the precise cumulative recovery position at the point of July implementation is subject to change due to movements in the forward curve. We retain the ability to make changes to the cap methodology in the event of material and systematic issues. If a concerning level of under- or over-recovery emerges then we may reconsider the removal date. However, we would not do so lightly given the regulatory uncertainty and additional process it would bring.

1. Introduction

In this chapter, we set out the purpose of this decision and overview of the decision-making stages.

Context

1.1 In summer 2022, we moved from setting the cap every six months to every quarter in response to the high and volatile wholesale prices during the energy crisis. To set the wholesale cost allowance for the quarterly cap, we seek to estimate the costs a notional supplier would face in buying energy to serve its customers in any given quarterly cap period.

1.2 We calculate the allowance in two steps. Firstly, we calculate the annualised wholesale index, which provides the cost of delivering energy across a 12-month period. Secondly, we calculate the cost of delivering energy for the quarter ahead. The difference between these two calculation steps can be positive or negative, typically depending on the time of year. We refer to this difference as 'backwardation' when the cost for the quarter ahead is above the annualised wholesale index. We refer to the difference in the opposite direction as 'contango'.

1.3 We set the wholesale allowance as a combination of the first step (12-month energy delivery) and an allowance for covering the difference between the two steps (ie the cost or benefit from backwardation). However, including an allowance for backwardation in the cap can create greater volatility for customers, driven by large swings in the cap level between cap periods.

1.4 To reduce the bill volatility for customers, we introduced a threshold under which we do not apply the backwardation allowance.[1] We refer to this threshold as a 'deadband'. The deadband is £9 in both directions. This means the first £9 of costs or benefits does not pass through to customers' bills. For example, if the backwardation cost is £15, only £6 is passed through to bills. The opposite would be true for contango (ie £6 benefit would be passed on to customers for a £15 contango benefit).

1.5 Typically, we expect that the long-run impact of the deadband should be neutral. The £9 is applied to both costs and benefits and so customers or suppliers should not see a net gain or loss. However, in the short-term these may not net out, meaning the deadband introduces the risk of under- or over-recovery. This can be for sustained periods depending on market trends.

[1] Ofgem (2022), Price cap – Decision on changes to the wholesale methodology. https://www.ofgem.gov.uk/decision/price-cap-decision-changes-wholesale-methodology

1.6 Where suppliers face uncertainty and risks, this can lead to costs which are ultimately borne by customers. Reducing uncertainty can therefore be in the interests of customers, where this can be accomplished without negative impacts on them.

Purpose of this document

1.7 In August 2025, we consulted on removing the backwardation allowance deadband, setting out our considerations for whether the inclusion of a deadband remained appropriate. We considered the mitigations required in removing the deadband to mitigate any negative impacts for customers, such as increased seasonality of bills.

1.8 We have undertaken the review as a risk-reduction measure to address the uncertainty the deadband introduces in cost-recovery, which stems from the less certain pattern of seasonality caused by the energy crisis and broader macroeconomic trends in the forward market. This is in line with the cap's overarching objective of protecting customers who pay standard variable and default rates, while having regard, amongst other things, to the ability of an efficient supplier to finance its licensed activities. We consider reducing unnecessary uncertainty to be in customers' interest as an important enabler of a more stable and investable market.

1.9 This document sets out our decision on the August 2025 consultation, having considered responses received to the consultation.

Related publications

1.10 The key documents relating to this publication are:

- August 2022: Price cap – Decision to introduce a backwardation allowance with a deadband. https://www.ofgem.gov.uk/decision/price-cap-decision-changes-wholesale-methodology
- August 2025: Energy price cap methodology – Consultation on removing the deadband from the backwardation allowance. https://www.ofgem.gov.uk/consultation/energy-price-cap-methodology-backwardation-deadband

Decision-making stages

Stage 1 Consultation open: 27 August 2025

Stage 2 Consultation closes (awaiting decision). Deadline for responses: 25 September 2025

Stage 3 Responses reviewed and published: 21 November 2025

Stage 4 Consultation outcome (decision): 21 November 2025

2. Wholesale methodology – backwardation

This chapter sets out the case for change and our decision to proceed with removing the deadband, recovery period and implementation date of the changes. We also include our consideration of responses received to the consultation.

Background

What are backwardation costs and how do they arise?

2.1 In the context of the cap, backwardation costs refer to the difference between the price of buying energy for a full year (the cap index) and the price of buying it for just the upcoming cap period (the actual costs suppliers incur purchasing energy for their SVT customers).

2.1 We set up the cap to calculate the wholesale index based on a 12 month forward view of gas and electricity prices. This means the cap reflects an average of prices over the year ahead, not just the cap period itself. We adopted this approach to smooth seasonal fluctuations in prices for customers.

2.2 Suppliers, however, typically hedge their energy over shorter timeframes, usually around three months, to align with the cap period and manage their risks more effectively. This can result in a mismatch between suppliers' costs and the cap allowance.

2.3 This misalignment creates 'basis risk', where the forward prices used to set the cap are different to the forward prices based on the period a notional efficient supplier would use for its hedging. As a result, the cap allowance may not accurately reflect the costs suppliers incur when purchasing energy. Moreover, hedging the full 12 months in advance would not eliminate this risk, as the cap is calculated every quarter using a new 12 month forward view and suppliers' costs would still diverge from cap allowances.

2.4 When the market is in backwardation, forward prices decline into the future – the forward prices in the latter nine months are lower than in the first three (the actual cap period). This results in backwardation costs where the costs suppliers incur purchasing energy for customers are greater than the cap wholesale index allowance. Contango benefits happen when the opposite is true.

2.5 Backwardation costs and contango benefits are conceptually symmetrical but have opposite effects. Backwardation leads to a cost for suppliers when longer-term (forward) prices are lower than short-term prices. Contango results in a benefit where forward prices are higher than short-term prices. For simplicity, we refer primarily to backwardation (which is the name we have given to the allowance for these costs and benefits) unless drawing a view on differences between the two. For the avoidance of doubt, referring to backwardation for

simplicity does not mean that we are only concerned with impacts in one direction.

2.6 Backwardation costs and contango benefits in the cap are primarily driven by two factors:

- seasonal fluctuations: driven by the cost of energy typically being higher in winter than in the summer due to supply and demand;
- macroeconomic trends: a trend in the forward curve for a persistent period. A downward trend would lead to backwardation costs, while an upward trend would lead to contango benefits.

2.7 Both drivers influence the shape of the forward curve and therefore how closely the cap aligns with suppliers' actual costs.

What is a deadband?

2.8 The deadband was intended to ensure the cap does not capture backwardation costs when the market is broadly stable, and seasonal backwardation is largely offset by seasonal contango. The deadband contributes to seasonal smoothing by allowing backwardation and contango to net out over the period of 12 months, rather than being passed through immediately (though only when seasonality is low).

2.9 We set the deadband at a fixed level of £9 (£4 for electricity and £5 for gas in £/customer/quarter, symmetrically around zero).[2] In practise this means suppliers recover only the 'additional' backwardation costs above this threshold and vice versa for contango benefits. The £9 deadband was calculated by looking at what backwardation would have been historically during pre-crisis cap periods one to six (January 2019 – September 2021). £9 was found to be the standard deviation of this historical data (centred around zero).

2.10 This has the effect of, in 'normal' market conditions, setting the backwardation allowance to zero, while ensuring that in more volatile conditions the cap is able to capture at least some of the costs or benefits of that volatility. Without the deadband, we would expect much larger swings in the headline cap level between cap periods. The deadband is a quarterly figure and we set the cap on an annualised basis. Due to the demand being higher in winter, the summer impacts on the headline cap level are generally larger when scaling the £9 figure by demand for the given quarter. As the differences between quarters demonstrate, when the deadband is met, there would be large differences between each cap period purely driven by the backwardation and contango that sits within the deadband currently.

[2] Ofgem (2022), Price cap - Decision on changes to the wholesale methodology, Chapter 5. https://www.ofgem.gov.uk/decision/price-cap-decision-changes-wholesale-methodology

2.11 The annualised figure does not reflect the impact on the bill. However, volatility in the headline cap level would affect the apparent savings available on other tariffs. This could distort customers' choices between tariffs.

Case for change

2.12 While the deadband plays a role in reducing volatility between cap periods, it also has its drawbacks. The deadband introduces additional uncertainty into suppliers' cost recovery. This is exacerbated by the continued uncertainty and volatility of forward wholesale prices, where the level of over- or under-recovery is very dependent on the shape of the forward curve.

2.13 Originally, the deadband was intended as a buffer to smooth seasonal volatility in bills based on the assumption that backwardation and contango would broadly net out over time. It was designed to mitigate normal seasonal backwardation, rather than persistent structural imbalances.

2.14 In practice, however, the deadband adds a further layer of uncertainty - suppliers cannot know in advance whether their costs will exceed the threshold for recovery. While the deadband has helped smooth seasonal fluctuations, it can also introduce cash flow pressures and risks that are difficult to hedge against. We generally consider it in consumers' interests to decrease risk in the market where it can be done without creating other costs or disbenefits for consumers.

2.15 Beyond cashflow uncertainty, suppliers are exposed to a risk where there is increased uncertainty (relative to a counterfactual with no deadband) on whether backwardation and contango will balance out over time. In a more constrained and geopolitically influenced gas market, the risks of sustained periods of either are higher – which could mean periods of time where the deadband results in bills that are higher or lower than they need to be.

2.16 Following the energy crisis and increased market volatility, the pattern of seasonality has looked less certain. This is also driven by structural market changes such as the increasing share of renewable generation and the increased need to replenish European gas storage during the summer.

2.17 Additionally, macro trends in the forward market are now likely to be more prevalent as future expectations of changes in supply and demand balances are influenced by more complex factors such as the availability of LNG and global competition for it.

2.18 Both of these factors increase uncertainty and make it harder to be confident that a historical pattern of costs and benefits netting out in a reasonable period of time will be maintained in the future. Uncertainty of whether costs will fall above or below the deadband can increase the risk of under- or over-recovery of costs over extended periods, making it more difficult for suppliers to plan their business activities.

Decision

2.19 We have decided to proceed with our consultation proposals to remove the deadband from the backwardation allowance in the cap and recover costs within the deadband range over 12 months (as opposed to the 6-month period over which costs above the deadband are recovered).[3]

2.20 We have also decided to proceed with our consultation proposal of implementing the changes not earlier than April 2026. We will implement the changes in price cap period 16b (July – September 2026).

2.21 Alongside this document, we have published a version of the price cap model 'Wholesale cost allowance methodology (Annex 2)' which reflects the policy changes set out in this document.

Rationale

2.22 The removal of the backwardation deadband will ensure more complete and timely recovery of backwardation costs and contango benefits. This will reduce unnecessary risk of systematic under- or over-recovery, particularly in the context of volatile and unpredictable forward prices, helping to ensure that suppliers who operate efficiently are able to finance their licensed activities. In turn, this will contribute to protecting existing (and future) customers who pay standard variable and default rates from costs of supplier failure and help contribute to the conditions for longer-term investment that benefits customers.

2.23 Without a 12-month recovery period, customers would see large differences in bills between quarters, which we consider would be an unreasonable outcome. Therefore, a 12-month recovery period for costs within the deadband is key to protecting customers.

2.24 We consider that implementation in July 2026 achieves an appropriate balance for both customers and suppliers in terms of impact on cumulative recovery and short-term bill increases, compared to other options. Based on the current shape of the forward curve, removing the deadband in July 2026 is forecast to see a balanced cumulative recovery of costs and benefits currently subject to the deadband. On this basis, we consider July 2026 to be the most appropriate implementation date, as the impact on cumulative recovery would be expected to be materially higher if the deadband was removed in April 2026. Implementing the change in July will also avoid an immediate short-term increase in the cap compared to implementing it over this coming winter. We expect the deadband removal to be bill neutral in the long term.

[3] Ofgem (2025), Energy price cap methodology: backwardation deadband, paragraph 2.20. https://www.ofgem.gov.uk/consultation/energy-price-cap-methodology-backwardation-deadband

Stakeholder response summary

2.25 In response to our consultation, we received nine responses from suppliers, one response from a consumer group and one from a consumer. We have published non-confidential responses on the consultation page.[4]

Deadband removal

2.26 Most respondents were in favour of the removal of the deadband from the backwardation allowance to ensure cost reflectivity, provide cashflow predictability and eliminate unnecessary risk to suppliers which will reduce risk of supplier failure.

2.27 One supplier disagreed with removing the deadband and said the backwardation allowance should be removed altogether, to encourage more long-term hedging strategies.

Recovery period

2.28 Five suppliers and one stakeholder supported the proposed recovery period of 12 months for costs up to the deadband to prevent seasonal fluctuations in bills, while maintaining the current recovery period of 6 months for costs outside the deadband.

2.29 However, one supplier said that 12-month recovery could bring risk of over- or under-recovery due to customer churn, changes in portfolio composition and seasonal demand variation. It also said it would create complications for forecasting and cashflow management due to timing mismatches in financial reporting.

2.30 Two suppliers said all backwardation costs could be recovered on a 12-month basis, with one supplier saying this would simplify the approach and the other suggesting this as part of a January 2026 implementation, as doing so would offset the bill impact of removing the deadband in January.

Implementation date

2.31 Most suppliers expressed concerns over the expected cumulative under-recovery of costs if the deadband was removed in the April 2026 cap, due to the deadband having been in place for more winter than summer periods. Three suppliers said that implementation in April 2026 would need to be complemented by an additional uplift to the allowance.

2.32 Five suppliers supported implementation of the deadband removal at the earliest opportunity (January 2026) to reduce risk exposure and potential losses, albeit

[4] Ofgem (2025), Energy price cap methodology: backwardation deadband. https://www.ofgem.gov.uk/consultation/energy-price-cap-methodology-backwardation-deadband

acknowledging that it would lead to a short-term increase in customer bills. One supplier said implementation in January 2026 should be combined with an adjustment to recover the costs exceeding the deadband in Q4 2025, which could be phased over multiple quarters to smooth out the impact.

2.33 One supplier supported the removal of the deadband in October 2026 and two suppliers supported it as an alternative to January 2026, as it would allow for an equal number of winter and summer cap periods given the deadband was first introduced in October 2022, mitigating the effects of seasonality. However, they said it could leave open the risk of under-recovery if summer 2026 was in backwardation, and Ofgem should commit to relooking at the cumulative position and make an adjustment if there was a material deviation in the cumulative recovery.

2.34 One supplier said implementation in July 2026 could be an alternative to their preferred option of January 2026, although it could still carry a risk of under-recovery if summer 2026 was in backwardation.

2.35 One supplier proposed a retrospective implementation in October 2025, as a second-best alternative to implementation in January or October 2026.

Considerations

Deadband removal

2.36 Our proposal to remove the deadband from the backwardation allowance got broad support in stakeholder responses.[5] Stakeholders said that the policy change would lead to greater cost reflectivity of the wholesale component of the cap; that it would provide greater certainty over cashflow; and that it would eliminate unnecessary risk of unexpected losses, including the risk of long-term cumulative backwardation. Stakeholders said that this would reduce the risk of supplier failure and increase investor confidence.

2.37 We consider that removing the deadband from the backwardation allowance will be beneficial for both customers and suppliers. It will reduce risk of under- or over- recovery of costs, providing suppliers with greater cashflow stability and helping to protect existing (and future) customers who pay standard variable and default rates from the costs associated with supplier failure. By reducing risk and uncertainty, it will also support the conditions needed for longer-term investment that benefits customers.

[5] Ofgem (2025), Energy price cap methodology: backwardation deadband, paragraph 2.20. https://www.ofgem.gov.uk/consultation/energy-price-cap-methodology-backwardation-deadband

2.38 We consider this can be achieved without leaving customers worse off, given our decision to implement a 12-month recovery period. This will smooth out the short-term bill impact and avoid increasing the expected seasonality of the cap.

2.39 One stakeholder suggested that the risk reduction should be reflected in a reduced profit margin (ie the EBIT allowance) for suppliers. We recognise that the financial risks and capital requirements facing suppliers fluctuate frequently due to a variety of factors. Adjusting the EBIT allowance in isolation would not necessarily improve the accuracy of the allowance and could potentially undermine regulatory stability. While there is no planned review of the EBIT allowance at this time (given that a review was recently completed),[6] when updating the cap methodology, we are mindful of supplier financeability and the role this plays in protecting customers through the avoided cost of supplier exits, which are born by customers. It is also worth noting that, on average, suppliers' returns have been lower than the notional allowance.

2.40 One supplier said the backwardation allowance should be removed altogether, to encourage more long-term hedging strategies. However, we consider the frequency of price cap updates as the key factor influencing suppliers' hedging strategies, rather than the backwardation allowance. Removing the backwardation allowance would leave suppliers exposed to basis risk due to the mismatch between the frequency of the cap updates (3 months) and length of the index used to set the wholesale allowance (12 months).

Recovery period

2.41 We have decided to proceed with our consultation proposal of a 12-month recovery period for costs up to the deadband.[7] The proposal received broad stakeholder support. A 12-month recovery period will avoid large swings in the cap compared to a recovery period of 6 months, which could be challenging for customer budgeting, market trust and supplier communication.

2.42 With the 12-month recovery approach, we expect the removal of the deadband to typically be bill-neutral for customers. As a new quarter of backwardation or contango is added to the allowance, it will replace the equivalent quarter for the previous year. This means that the 12-month average should retain a broadly equivalent degree of seasonality. Quarterly values may still vary due to changes in macro backwardation or contango, or due to noise in the input data.

[6] Ofgem (2023), Amending price cap methodology for Earnings Before Interest and Tax (EBIT) allowance decision
https://www.ofgem.gov.uk/decision/amending-price-cap-methodology-earnings-interest-and-tax-ebit-allowance-decision

[7] Ofgem (2025), Energy price cap methodology: backwardation deadband, paragraph 2.20.
https://www.ofgem.gov.uk/consultation/energy-price-cap-methodology-backwardation-deadband

2.43 If we did not recover the amount within the deadband over 12 months, the process of annualising the allowance to match how we announce the cap level would give a presentational increase in the impact of removing the deadband. To illustrate the materiality of this consideration, when applying £9 cost recovery over 6 months, on an annualised basis the impact on any given quarterly cap rate may be up to £50 depending on the demand share for that cap period.

2.44 Increased volatility in the headline cap level could make it harder for customers to budget and manage costs throughout the year. This may be particularly relevant for financially vulnerable customers. Moreover, it would affect the headline savings available from switching to fixed tariffs, making it harder for customers to compare deals and distorting consumer choices. This in turn could have a knock-on impact on consumer trust in the market, if consumers did not realise the savings they were expecting. Increasing the degree of seasonality in the headline cap level would make it more important for suppliers to communicate appropriately to consumers about their tariff choices.

2.45 During the transition to capturing the full 12 months of costs, there will be some impact on bills between each cap period until the full year of costs is in the cap. If the deadband is reached for each cap period, we would expect this to result in two £9 increases and two £9 decreases, which would net out at the end of the year once a full year of costs and benefits is captured. In practice, it is less likely the deadband will be met and therefore the impact in each cap period is likely to be small.

2.46 One supplier flagged that the 12-month recovery period could lead to under- or over-recovery due to customer churn, changes in market portfolio and seasonal variation, as well as cashflow complications due to timing mismatches in financial reporting. We consider that our decision strikes the appropriate balance between fair and timely cost recovery and bill stability. Timelier (6-month) cost recovery will be maintained for costs above the deadband, which can be material during periods of volatile energy prices. However, a 6-month recovery for costs also within the deadband would have led to a greater seasonal volatility in energy bills and larger differences between cap periods on an annualised bill. On balance, we consider that removing the deadband would not have been in customers' interest if we retained a 6-month recovery period for the costs and benefits captured within the deadband. We consider managing seasonal variation is part of a supplier's core business of activities, and suppliers are better placed to manage it than customers.

2.47 We recognise that a longer recovery period increases the potential for changes in a supplier's default tariff customer numbers or their consumption, relative to the period when backwardation costs were incurred. This could lead to over- or under-recovery for individual suppliers. However, we do not regard this factor as decisive when weighed against the considerations outlined above. Overall, as we

expect the removal of the deadband to be typically bill neutral, we do not expect the fluctuations in the allowance for costs within the deadband to be material.

2.48 Two suppliers said that the 12-month recovery could be applied to all costs, including costs above the deadband. One supplier said this would simplify the approach and the other suggested this as part of a January 2026 implementation, as doing so would offset the bill impact of removing the deadband in January. Six-month recovery of costs above the deadband is a measure to mitigate against cashflow risk from high volatility periods, by allowing for speedier recovery of costs. Costs outside the deadband have shown high volatility in the past during periods of energy crisis. We therefore consider it is important to ensure timelier recovery of these costs, to reduce the risk of supplier exit and support our objectives on market stability, financial resilience and capital adequacy for suppliers. We also note that the 6-month recovery period already smooths out costs compared with a 3-month pass-through recovery period, therefore achieving an appropriate balance of considerations.

2.49 Additionally, if we were to move to a 12-month recovery period for costs above the deadband and then witnessed another wholesale price event similar to the energy crisis, we would likely have to move back to a shorter recovery period to manage market resilience. Implementing such a change would take time, particularly in circumstances where moving at pace may be crucial for market resilience. Therefore, we consider it appropriate to retain the 6-month recovery period for costs and benefits above the deadband to help manage future risks.

Implementation date

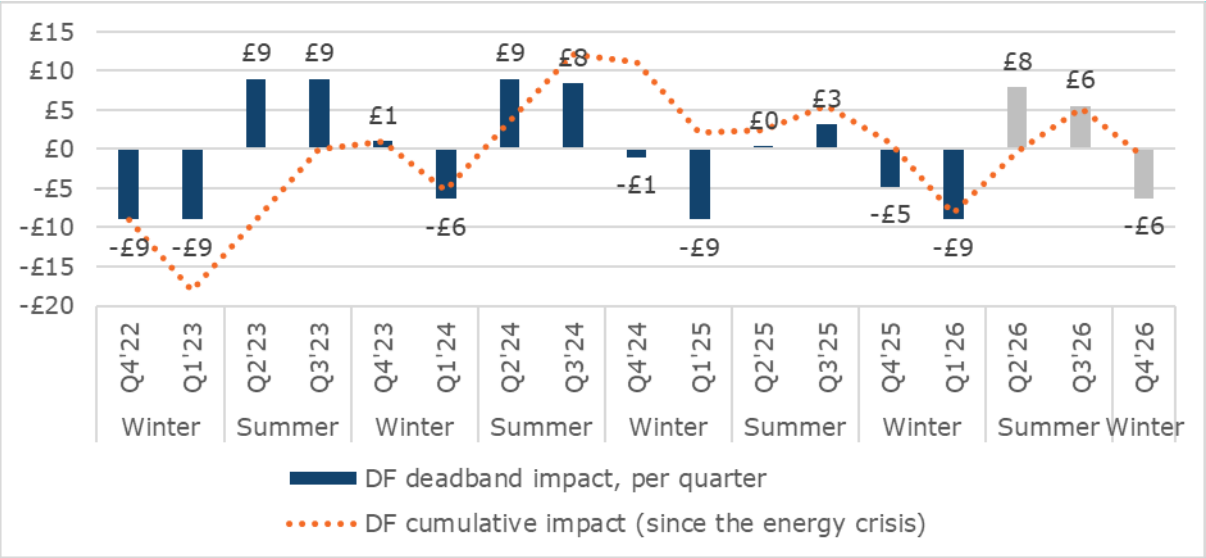
2.50 While we expect the removal of the deadband to be bill-neutral in the long term, we note its timing could result in an immediate short-term increase in the cap compared to implementing it over this coming winter. Therefore, we do not see an urgent need to remove the deadband. Instead, the timing of implementation should be carefully considered to ensure alignment with customer interests.

2.51 We note stakeholder concerns regarding the cumulative under-recovery of costs if the policy change was implemented in April 2026 and have decided to implement the removal of the deadband from the backwardation allowance effective from price cap 16b (July – September 2026). Although this alternative was not put forward by many stakeholders, we consider that it offers a balanced outcome overall for both customers and suppliers, appropriately weighing the need to mitigate an immediate short-term bill increase over this coming winter against the impacts on suppliers' cumulative cost recovery.

2.52 We expect the change to result in a balanced cumulative recovery of costs and benefits currently subject to the deadband, based on current shape of the forward curve. The impact would be equivalent to a loss to suppliers of £0.28 per dual fuel

(DF) customer (Figure 1).[8] This is considerably lower than the forecast cumulative impact on suppliers in either April 2026 (-£8) or October 2026 (+£5). Taking this into account, we consider July 2026 to be the more appropriate option, in light of our statutory duty under the Domestic Gas and Electricity (Tariff Cap) Act 2018 to exercise our functions under that Act with a view to protecting existing and future domestic customers who pay standard variable and default rates – whilst also having regard (amongst other things) to the need to ensure that suppliers who operate efficiently are able to finance their licensed activities.

Figure 1: Impact deadband has had on cost-recovery (benchmark consumption)



Accessible format: A chart showing the dual fuel deadband impact per quarter from Q4 2022 to Q4 2026, with forecast values starting from Q1 2026. Negative values are a loss to suppliers. Positive values are a benefit to suppliers. Grey bars (Q1'26 to Q4'26) are based on forecast data. The cumulative impact is the position at the end of each quarter. Benchmark consumption values reflect those at cap 15a (October-December 2025).

2.53 We do not consider it essential for the cumulative impact of the backwardation deadband to be zero at the point of its removal. The introduction of the deadband was a policy decision that explicitly allowed for some divergence between costs and allowances to achieve lower price seasonality. We are not proposing to reverse that decision retrospectively (for example by implementing the changes retrospectively in October 2025), but rather to implement a new proposal on a prospective basis.

[8] The orange dotted line in Figure 1 (ie the dual fuel cumulative impact) shows the cumulative cost/benefit of implementing the removal of the backwardation deadband in any cap period. This corresponds to the value of the line at the cap period before the implementation of the policy change. For example, the cumulative impact of removing the deadband in July 2026 (ie Q3'26) corresponds to the value of the line in Q2'26.

2.54 We do, however, recognise that the deadband was introduced on the understanding that any over- or under-recovery arising from seasonal factors would broadly net out over the course of full years. As such, implementing the change from July (or any date that did not result in the lifetime of the deadband being full years) does carry some risk that if a cumulative under or over-recovery emerges it may be the result of incomplete seasonality rather than chance.

2.55 We also recognise that the precise cumulative recovery position at that point remains sensitive to movements in the forward curve. As always, we retain the ability to amend the cap should material and systematic issues arise. Accordingly, if there is a significant change in the forecast that would result in a material level of over – or under- recovery, then we may consider changing the timing of when the deadband is removed. However, such a change would not be made lightly given the associated regulatory uncertainty, the potential interaction with suppliers' hedged positions, and the potential additional process required to change the implementation date, such as a further consultation process.

2.56 In addition to the expected balanced impact on suppliers' cumulative recovery, removing the deadband in July 2026 will also avoid an immediate short-term increase to the cap compared to implementing it over this coming winter, while remaining bill-neutral in the long term. Implementation in January 2026 would lead to a short-term increase of £9 per dual fuel customer in the January to March 2026 price cap. Retrospective implementation in October 2025 would also lead to an increase in this coming winter cap.

2.57 Overall, we consider that July 2026 is the most appropriate option to protect existing and future customers whilst also having regard to the financeability of suppliers, appropriately weighing the need to mitigate an immediate short-term bill increase over this coming winter against the impacts on suppliers' cumulative recovery.

2.58 One supplier said that the impact on cumulative recovery should also be assessed by fuel, as a better reflection of the impact on supplier revenues. According to the current shape of the forward curve, the cumulative recovery impact of July 2026 implementation would be almost symmetrical, with a £6.2 loss per electricity customer and a £5.9 benefit per gas customer. On a dual fuel basis, the impact is almost zero. The majority of suppliers' customers are dual fuel, therefore we do not consider residual impacts on single fuel customers to be material enough to drive the choice of implementation period or a different implementation period for each fuel. And similarly to the above argument, we do not consider these impacts to be the result of incomplete seasonality but rather the coincidental trend in the forward curve, for which we do not consider it necessary or appropriate to ensure net out to zero. Additionally, we note that the forecasted impact by fuel in July 2026 is consistent with recent trends, as electricity has generally been in backwardation and gas in contango over the past few quarters.

2.59 Usually there is backwardation in the winter (October and January caps) and contango in the summer (April and July caps). Assuming we observe normal trends in seasonality, we expect the implementation in July 2026 to lead to a reduction in the level of the cap in July 2026 (compared to the current approach). From October 2026, the impact (relative to the current approach) would depend on the balance between the contango and backwardation across the year to date.

Other issues

2.60 One supplier commented that the deadband amount (currently £4 for electricity and £5 for gas customers) should be reviewed in future price cap periods to ensure a more accurate immediate pass-through of wholesale basis risk costs or benefits, given that it was calculated using data from before the energy crisis. Changing the deadband now would only have implications for the speed of recovery of any costs or benefit, rather than for the total amount suppliers would recover. Additionally, preliminary analysis indicates that the deadband change would be small. We also note that there is limited post-crisis data to set a revised deadband. Overall, we do not consider there is a case for reviewing the deadband amount.

2.61 One stakeholder proposed that the deadband should be amended from static to dynamic, to allow it to expand in volatile periods, with an enhanced monitoring and reporting framework. It also proposed that the deadband should differentiate for supplier size, reflecting the hedging capacity and risk tolerance of smaller vs bigger suppliers. We consider that a deadband that expanded during periods of high volatility would increase the risk of under-recovery for suppliers. Additionally, the Act requires us to only set one cap across the market,[9] therefore we cannot set different allowances by supplier size.

[9] Domestic Gas and Electricity (Tariff Cap) Act 2018. https://www.legislation.gov.uk/ukpga/2018/21/enacted

Appendix 1. Technical changes to 'Annex 2: Wholesale cost allowance methodology' model

In this appendix, we summarise the changes to the 'Wholesale cost allowance methodology (Annex 2)' reflecting the decision to remove the backwardation deadband.

Summary of changes

A1.1 We have published a version of the 'Wholesale cost allowance methodology (Annex 2)' at cap 15a (October to December 2025) on the consultation page, amended to reflect the decisions set out in this document.[10] We have also published a separate version of Annex 2 for the November 2026 price cap update, which reflects both the outcome of the decisions in this document and the outcome of other decisions across the price cap (eg benchmark consumption review).[11] We note the model published on our consultation page does not include the cap allowances from the November 2026 cap update, but has been published for illustrative purposes.

A1.2 All changes are shown in the model from cap period 16b (July – September 2026). We set out below a summary of the changes. All changes refer to worksheet '8a(i) Backwardation' in Annex 2.

- **New table to calculate the backwardation costs and benefits up to the deadband (Table 3)** – This table calculates the backwardation costs up to the deadband as the difference between the total backwardation costs (Table 1) and the costs above the deadband (Table 2).
- **New table to smooth the recovery of the backwardation costs and benefits up to the deadband over 12 months (Table 6)** – This table takes the costs and benefits calculated up to the deadband for each quarter in Table 3, and spreads the recovery over 12 months. Costs and benefits are not weighted by seasonal demand (unlike costs and benefits recovered over 6 months in Table 5), given they are recovered over 12 months. There is a transitional formula in place for the first three quarters of implementation (rows 237-266, columns T, U and V), due to not having 12 months of costs to recover until the fourth quarter.
- **New table to calculate the total backwardation allowance recovered in each quarter (Table 7)** – This table takes the costs and benefits recovered in each quarter both above the deadband (Table 5) and up to the deadband

[10] Ofgem (2025), Energy price cap methodology: backwardation deadband. https://www.ofgem.gov.uk/consultation/energy-price-cap-methodology-backwardation-deadband
[11] Ofgem (2025), Energy price cap (default tariff) levels. https://www.ofgem.gov.uk/energy-regulation/domestic-and-non-domestic/energy-pricing-rules/energy-price-cap/energy-price-cap-default-tariff-levels

(Table 6), and sums them up to calculate the total amount recovered in each quarter.

- **Amended formula in existing Table 8 to re-link from Table 5 to Table 7** – This is an existing table setting the final backwardation allowance. The formula has been amended to re-link from Table 5 to the new Table 7, which calculates the new total backwardation allowance.

Send us your feedback

We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this decision. We would also like to get your answers to these questions:

- Do you have any comments about the quality of this document?
- Do you have any comments about its tone and content?
- Was it easy to read and understand? Or could it have been better written?
- Are its conclusions balanced?
- Did it make reasoned recommendations?
- Do you have any further comments?

Please send your feedback to stakeholders@ofgem.gov.uk.