

Energy price cap: Proposed changes to the Contracts for Difference cost allowance

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In this consultation, we set out our proposals and considerations regarding the introduction of a volume reconciliation in the Contracts for Difference (CfD) price cap allowance. The proposed reconciliation would capture differences between forecast and actual CfD payments arising from changes in CfD volume generation.

We also seek views on a potential simplification of the CfD allowance methodology.

We welcome responses from stakeholders to help inform our decision.

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Executive summary

Last year, we set out our vision for the energy retail market in our [Markets Regulatory Strategy and Vision to 2030](#). As part of this strategy, we outlined our vision for energy markets that work for all consumers, through regulation which provides confidence and protections to consumers whilst enabling innovation and investability, supporting Clean Power 2030 (CP2030) targets and economic growth.

Retail market investability is a core pillar for achieving this vision. We consider it is in consumers' interest that suppliers are able to raise sufficient investment, at a reasonable cost, to provide quality services and innovation.

The default tariff cap ('cap') was introduced in 2019 to protect consumers and ensure they are charged fair prices. It is a major feature of the retail market and has a significant bearing on the investability of the retail market.

Broadly, investability is about risk and return. Investors must feel that the returns available for investing are sufficient to compensate the risks of putting capital into the market. This means in improving investability we have two options: (1) increase the level of return that suppliers expect to achieve; or (2) reduce the risks that suppliers face.

We consider it in consumers' interests to focus on the latter. The proposals set out in this consultation seek to reduce risks associated with the Contracts for Difference (CfD) allowance. We consider this approach can support a resilient and investable market while maintaining appropriate protections for consumers.

Issue under consideration

The CfD scheme is a government scheme that supports the production of low carbon electricity by providing eligible generators with a fixed price for the electricity they generate. The scheme is expected to play a key part in reaching CP2030 targets, and the capacity and budget of the scheme is expected to substantially increase over the next five years.

We generally set the cap on a forward-looking basis, which means we need to estimate the costs suppliers face for the upcoming cap period. For many costs this is relatively straightforward – for example network costs are fixed charges, and wholesale costs can largely be locked in through hedging. However, for some costs it is uncertain – meaning the level at which costs are capped may subsequently prove to be either too high or too low.

The risk of deviations between forecast and outturn costs is particularly acute for the CfD scheme. CfD costs are driven by a combination of market prices and low carbon generation, both of which are inherently uncertain in advance. In setting an ex-ante cap

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allowance we use forecasts of expected CfD payments (with limited use of outturn data where available). Suppliers, however, incur the outturn costs. Where forecasts and outturn deviate, suppliers can over- or under-recover their costs.

Suppliers can hedge part of this risk exposure, as price uncertainty can be hedged through buying and selling of wholesale contracts. This helps support market liquidity and reduces cost uncertainty for consumers. We do not want to undermine incentives for suppliers to risk manage through hedging in this way.

However, some elements of this risk exposure that are harder to mitigate. Changes in the volume of renewable generation (volume risk) and how changes in renewable generation affect market reference prices (capture price risk) are more difficult to hedge effectively.

The cost of this risk is currently modest, although it was significantly elevated during the previous energy crisis. As the CfD scheme grows, the potential scale of differences between forecast and outturn CfD costs may also increase. While differences between forecast and outturn costs can arise across a range of cost categories within the cap, we consider the CfD scheme presents a distinct set of challenges.

Proposal

We therefore propose to introduce a reconciliation for CfD risks that driven by changes in CfD volume generation (volume risk and capture price risk). This would leave suppliers to continue managing price risk, which we consider they are better placed to manage through hedging, while providing mitigation against risks that may be more difficult to hedge effectively.

The reconciliation would apply in both directions, meaning the reconciled CfD costs could be either positive or negative depending on whether outturn costs were higher or lower than the forecast costs that set the allowance.

While a reconciliation mechanism would have an impact on the cap level for any given cap period, we do not consider it to have a positive or negative overall bill impact. Rather, it is a mechanism for ensuring that the overall volume of CfD generation is accurately reflected in the cap. Given the ongoing development of the forecasting methodology of the Low Carbon Contracts Company (LCCC), we would not expect forecasts to systematically over- or under-estimate CfD volumes going forward.

In order to balance the impact on bills and the cashflow risk from extended delays in cost recovery, we propose that any costs recovered, or benefits returned, through the reconciliation would be spread over a rolling six-month period.

Subject to consultation responses, we expect any changes to take effect from the April 2027 cap period.

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Further considerations

We have considered two alternative approaches: (i) a full reconciliation (covering both price and volume risk) which would reduce incentives for suppliers to manage price risk through hedging – something we consider suppliers should continue doing as it provides value to consumers by helping to mitigate CfD related price risk; and (ii) a risk allowance which would increase bills for all default tariff customers upfront, regardless of whether higher CfD costs actually materialise.

We are also seeking feedback on a potential simplification of the CfD allowance from using a weighted average of four quarters of payments to set the cap, to using only one quarter of CfD payments. While we are not making a minded-to proposal on this at this stage, we are consulting on potential options for simplification, and may decide to adopt one option, or a variation of it, following consideration of responses.

Finally, we note that during our engagement some stakeholders have expressed views regarding the length of the observation window for forward market reference prices used by the LCCC to calculate its forecast of CfD cap payments. We summarise in this consultation the feedback received, and suggest that stakeholders share their views directly with LCCC for consideration.

1. Introduction

This chapter explains how our review of the Contracts for Difference price cap allowance supports the Markets Strategy and Vision to 2030 through better alignment of the allowance with outturn costs. It sets out our proposal for a volume reconciliation with a six-month recovery period and one additional area on which we are seeking feedback.

Context

- 1.1 Our [Markets Strategy and Vision to 2030](#) outlines how we expect the retail market to operate by the end of the decade. Central to this vision is supporting an investable retail market that fosters innovation, supports economic growth, and ultimately delivers better outcomes for consumers.
- 1.2 The default tariff cap ('cap') plays a key role in the retail market. It was introduced on 1 January 2019 through the [Domestic Gas and Electricity \(Tariff Cap\) Act 2018](#) and protects customers on standard variable and default tariffs (referred to collectively as default tariff customers). The cap ensures that default tariff customers pay a fair price for their energy that reflects the efficient underlying costs to supply that energy.
- 1.3 Within the cap framework, risk could be addressed in two ways: by increasing the level of allowed returns for energy suppliers, or by reducing risk through closer alignment between allowances and the efficient costs suppliers are expected to incur.
- 1.4 Our review of the Contracts for Difference (CfD) allowance in the energy price cap is focused on the latter approach, in line with the objectives set out in the Markets Strategy and Vision. In August 2025, we published a [call for input on the CfD allowance](#) ('our August 2025 call for input') to better understand the risks suppliers face under the current methodology and to explore potential options for mitigating those risks. Following the call for input, we engaged extensively with suppliers to explore the technical issues raised.
- 1.5 The feedback we received, together with our subsequent analysis, has informed our view that there is a case to consider changes to the current methodology. The reasons for this are discussed below.
- 1.6 The proposals set out in this paper aim to reduce risks associated with the CfD allowance, by improving the alignment of allowances with actual ('outturn') costs. We consider this can help support a resilient and investable retail market while maintaining appropriate protection for consumers.

Case for change

Background

- 1.7 We set an ex-ante CfD cap allowance, using the best available information at the time on the expected cost of the CfD scheme for the next financial year. We use forecasts of CfD payments calculated by the Low Carbon Contracts Company (LCCC), which are based on forecasts of the CfD generation and market prices for each CfD quarter. We make limited use of outturn data to set the allowance as this becomes available during the financial year.
- 1.8 The LCCC recovers CfD costs from suppliers using a forecast of CfD payments ahead of every CfD quarter, followed by a reconciliation against outturn CfD payments at the end of each quarter. Changes in outturn CfD generation and market prices can lead to deviations between forecast and outturn payments.
- 1.9 Suppliers can generally hedge against price risk, ie deviations between forecast and outturn market prices. However, suppliers have consistently reported that risks arising from changes in CfD generation (volume risk) are more difficult to hedge against, given the cost and complexity of available products.
- 1.10 Suppliers have also reported being unable to find products to hedge against the impact of volume changes on market prices. This is known as capture price risk, and it arises from the negative correlation between intermittent renewable generation (mostly wind and solar) and market prices. A high volume of intermittent generation can depress market prices, and vice versa. Further details on these risks are covered in Chapter 2.

Increasing risk on the CfD price cap allowance

- 1.11 Historically, deviations between forecast and outturn costs have been modest outside of periods of market instability, and have broadly netted out over time. Suppliers have also been able to mitigate part of the risk exposure through price hedging, although this is difficult to quantify.
- 1.12 However, the risk exposure suppliers face on the CfD cap allowance is expected to significantly increase over the next few years, due to an increase in the size of the scheme to support the government's Clean Power 2030 targets, and due to the associated greater volatility in CfD payments. Installed capacity is expected to more than double up to 2030 according to [LCCC projections](#). A substantial pipeline of contracted capacity is already expected to come online over the next few years, providing greater certainty over future deployment.
- 1.13 As the scheme grows, the scale of forecast-to-outturn deviations and associated supplier exposure on both price and volume deviations may increase. This could

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increase suppliers' exposure to both hedgeable risks (such as price risk) and risks that may be more difficult to hedge effectively (such as volume risk and capture price risk).

- 1.14 Additionally, the majority of newly installed capacity will be intermittent generation. As the share of intermittent generation in the market increases, capture price risk is expected to grow. It is expected that CfD generation could account for over 60% of total generation by 2030 (up from currently around 20%), with the majority of this being intermittent CfD generation. The growth in the share of CfD-supported generation is expected to continue beyond 2030. In turn, this could lead to significant swings in day-ahead market prices, depending on the level of intermittent generation.
- 1.15 Overall, suppliers' costs and revenues are likely to face a two-fold impact: CfD payments will increase as the scheme grows, and those payments may become more volatile as intermittent generation becomes more closely correlated with market prices. This could materially impact the size of any differences between the CfD cap allowances (mostly set using forecast payments) and outturn CfD costs.
- 1.16 Volatile gas prices can also make forecasting CfD payments harder, and lead to changes in generator behaviours which can also affect the variance between forecast and outturn CfD payments.
- 1.17 Overall, as CfD payment volumes increase, there is merit in considering whether the current cap methodology remains appropriate.
- 1.18 While differences between forecast and outturn costs can arise across a range of cost categories within the cap, the CfD scheme is different to other policy schemes in structure, risk profile and expected scale of growth, which warrants a separate consideration and treatment. CfD costs are driven by market prices and are subject to volatility in both volume generation and price, which differs from more predictable schemes such as the Capacity Market and Renewable Obligation schemes. In addition, the expected growth trajectory of the CfD scheme is likely to increase suppliers' exposure to volume and price-related risks over time.
- 1.19 Our concern is therefore not simply that outturn costs may differ from forecasts, but that suppliers are exposed to a growing source of risk that may be more difficult to manage effectively. We consider this supports a targeted intervention on CfD costs, focused on volume risk and capture price risk. This should not be interpreted as establishing a general principle that deviations from forecasts or other cost categories would justify similar reconciliation mechanisms or regulatory intervention.

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- 1.20 We previously rejected a reconciliation mechanism due to the lack of material and systematic evidence, as set out in our [2022 decision](#) and in our [2023 decision](#). At the time, we considered that a reconciliation would not be proportionate due to the size of the CfD scheme. However, given the expected development of the scheme and the potential scale of impact on suppliers' costs, we consider it appropriate to revisit whether targeted risk mitigation measures may be warranted on a forward-looking basis. In particular, we are considering whether a more targeted approach focused on risks that may be difficult to hedge effectively could be appropriate, whilst preserving incentives for suppliers to continue managing price risk.
- 1.21 As discussed above, our Markets Strategy and Vision supports reconsidering the level of risk suppliers are exposed to in the retail market, with the aim of supporting investability of the market and driving better outcomes for consumers.

Purpose of this consultation

1.22 In this consultation (see Chapter 2), we propose to:

- introduce a reconciliation on volume of CfD generation. This is a mechanism to adjust for some of the differences between our CfD allowance (primarily based on forecast CfD payments) and the actual payments. We would adjust for changes in how much renewable energy is generated, relative to expectations (ie volume risk). We would assess the cost of these volume changes using outturn prices, which would take into account the impact of changes in renewable volumes on market prices (ie capture price risk).
- recover the volume reconciliation over six months; and
- implement this change in the April to June 2027 cap period.

1.23 We are also seeking views on an additional technical area, set out in Chapter 3: a simplification of the CfD allowance from using four quarters of payments to set the allowance in any cap period, to using one quarter of CfD payments only (recovered over 12 months). This change would support simplification of how suppliers hedge for CfD costs under the cap, and simplify the implementation of a volume reconciliation. While we are not making a minded-to proposal at this stage, we are consulting on potential options for simplification, and may decide to adopt one option, or a variation of it, following consideration of responses.

1.24 Alongside this consultation, we have also published:

- a draft version of 'Wholesale cost allowance methodology (Annex 2)', which incorporates our minded-to proposal of a volume reconciliation with a six-month recovery period – for guidance on this model, see Appendix 4;

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- an alternative version of Annex 2, incorporating a volume reconciliation with a six-month recovery period on the simplified CfD allowance with a 12-month recovery period – for guidance on this model, see Appendix 5.

A1.1 We note that, in response to our call for input, some stakeholders have expressed views on the length of the LCCC's observation window for CfD price cap payments. This change relates to LCCC's internal methodology. We summarise feedback received in Chapter 3, and invite stakeholders to share views directly with the LCCC for consideration.

Questions included in this consultation

Questions

- Q1. **Volume reconciliation (Chapter 2).** Do you support the introduction of a volume reconciliation in the CfD cap allowance, covering both volume and capture price risk?
- Q2. **Volume reconciliation (Chapter 2).** Do you support a six-month recovery period on the volume reconciliation? If you consider an alternative recovery period to be more appropriate, please explain how this would balance cashflow risk and bill impacts.
- Q3. **Volume reconciliation (Chapter 2).** Do you have any comments on the proposed calculation of the volume reconciliation (including the proposed LCCC methodology in Appendix 3)?
- Q4. **Volume reconciliation (Chapter 2).** Do you support the proposal to introduce this change from cap period April to June 2027?
- Q5. **Simplification of CfD allowance (Chapter 3).** Should we pursue simplification of the CfD allowance with a 12-month recovery period?
- Q6. **Simplification of CfD allowance (Chapter 3).** Do you have other suggestions for how the cost recovery of the simplified CfD allowance could be set? Please provide an Excel example of how your proposal would work.

Related publications

1.25 The main document relating to this publication is:

- [Contracts for difference allowance in the default tariff cap: call for input - August 2025](#). In this document we sought input from stakeholders on any issues with the way we currently set the default tariff cap allowance for Contracts for Difference scheme costs, and views on potential remedies.

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1.26 The main documents relating to the CfD allowance are:

- [Decision on amending the methodology for setting the Contracts for Difference \(CfD\) cap allowance – June 2022](#). In this document we set out a decision to remove the £0/MWh floor from the CfD allowance and a decision not to introduce a reconciliation for variations of the CfD allowance from outturn costs.
- [Decision on technical changes to the price cap methodology – August 2023](#). In this document we set out a decision to include in the CfD allowance any before period adjustments made available at least 30 working days prior to the start of the cap period. We also set out a decision not to include in-period adjustments and not to introduce a reconciliation mechanism.

Consultation stages

- **Stage 1** Consultation opens: 30 July 2026
- **Stage 2** Consultation closes (awaiting decision). Deadline for responses: 10 September 2026
- **Stage 3** Responses reviewed and published: TBC
- **Stage 4** Consultation outcome (decision or policy statement): TBC

How to respond

1.27 We want to hear from anyone interested in this consultation. Please send your response to the person or team named on the front page of this document.

1.28 We have asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.29 We will publish non-confidential responses on our website.

Your response, data, and confidentiality

1.30 You can ask us to keep your response, or parts of your response, confidential. We will respect this, subject to obligations to disclose information. For example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations, or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.31 If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you do wish to be kept confidential and those

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that you do not wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we will contact you to discuss which parts of the information in your response should be kept confidential and which can be published. We might ask for reasons why.

- 1.32 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the United Kingdom's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 6.
- 1.33 If you wish to respond confidentially, we will keep your response confidential, but we will publish the number, but not the names, of confidential responses we receive. We will not link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

How to track the progress of a consultation

1. Find the web page for the call for input you would like to receive updates on.
2. Click 'Get emails about this page', enter your email address and click 'Submit'.
3. You will receive an email to notify you when it has changed status.

A consultation has three stages: 'Open', 'Closed (awaiting decision)', and 'Closed (with decision)'.

2. Volume reconciliation

In this chapter we set out our proposal to introduce a volume reconciliation for differences between forecast and outturn CfD payments driven by a change in CfD generated volumes. We also explain our considerations on other policy options stakeholders proposed in response to our August 2025 call for input.

Background

Overview of the CfD scheme and the cap allowance

- 2.1 The CfD scheme is the government's main scheme for supporting the generation of low carbon electricity in the UK. It is a private law contract between a developer of a new renewables project and the LCCC.
- 2.2 CfD contracts are awarded through auctions. The successful renewable generators are guaranteed a set price ('strike price'), indexed to inflation, per unit of renewable electricity generated, for the years of the contract's duration. If the market price for electricity is below the strike price, the generator receives a top-up payment from the LCCC to make up the difference. If the market price is above the strike price, the generator pays back the difference to the LCCC. This system provides revenue stability for developers, while protecting consumers from high electricity prices.
- 2.3 The LCCC forecasts and collects an Interim Levy Rate (ILR) from energy suppliers under the Supplier Obligation, and uses it to fund payments to CfD generators. At high level, the LCCC calculates the ILR by dividing expected CfD payments, which depend on forecast generated volumes and wholesale prices, by total forecast eligible demand:

$$\frac{\text{CfD Payments}}{\text{National Eligible Demand}} = \frac{(\text{CfD Generation}) * (\text{Strike Price} - \text{Market Reference Price})}{\text{National Eligible Demand}}$$

- 2.4 where:

- national eligible demand is the total volume of electricity supply liable for the CfD Supplier Obligation across Great Britain, net of applicable exemptions; and
- the market reference price is the relevant forecast reference price for the electricity generated, ie the forecast intermittent reference price for

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intermittent CfD generation (eg wind, solar) and the forecast baseload reference price for dispatchable baseload CfD generation (eg nuclear).

- 2.5 The LCCC recovers costs from each supplier based on the supplier's share of national eligible demand.
- 2.6 Suppliers' payments to the LCCC are initially based on a forecast of the ILR for the following quarter. At the end of each quarter, the LCCC undertakes a reconciliation of suppliers' interim payments against actual payments to (or from) CfD generators during the period. The reconciliation is offset against the value of the Total Reserve Amount for the next quarter.
- 2.7 The cap includes an allowance to account for suppliers' CfD costs (or benefits). We set an ex-ante allowance using the best available information at the time on LCCC's expected levy payment for each quarter of the next financial year. Rather than using LCCC's published ILR, we calculate an expected levy payment using LCCC's forecast payments and forecast eligible demand. This is so that the calculated levy can take negative values, as set out in our [2023 decision](#).
- 2.8 We base our cost estimates on an annualised view of the costs of the scheme, to avoid the risk of the cap systematically varying between winter and summer as a result of seasonal trends in wholesale prices or CfD generation volumes. In addition, using the annualised approach helps reduce volatility within individual payment quarters.
- 2.9 At the beginning of the financial year, we use LCCC's forecast of the payments to generators to set the allowance. As quarterly levy periods are reconciled, we use this outturn data to update the allowance for the remainder of the CfD year (Table 1).

Table 1: Annualised CfD price cap allowance update process for a CfD year (April to March)

CfD quarter	Apr-Jun cap	Jul-Sep cap	Oct-Dec cap	Jan-Mar cap
Apr-Jun	Forecast	Forecast	Outturn	Outturn
Jul-Sep	Forecast	Forecast	Forecast	Outturn
Oct-Dec	Forecast	Forecast	Forecast	Forecast
Jan-Mar	Forecast	Forecast	Forecast	Forecast

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2.10 We do not solely rely on quarterly outturn data to set the allowance as we set the cap allowance ex-ante for each quarter. We do not set a lagged allowance and do not include a true-up for differences in costs between the CfD cap allowance and outturn CfD payments.

Types of risks energy suppliers face on the price cap CfD allowance

2.11 There are three key drivers of change between forecast and outturn CfD payments: price risk, volume risk and the correlation between volume and price (capture price risk). We define each in turn below.

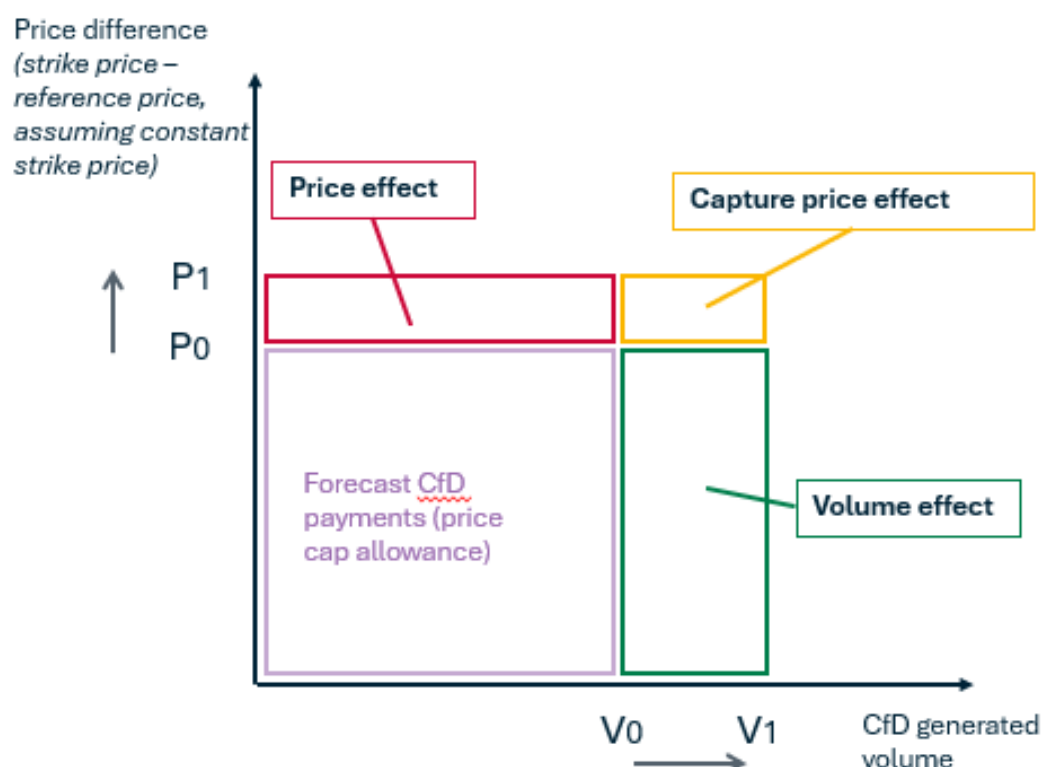
2.12 In the notation used below and throughout the rest of the consultation, P stands for the difference between strike and market reference price (where strike price is assumed constant, to focus on changes in market reference prices), V stands for generated volume, subscript $_0$ indicates a forecast, and subscript $_1$ indicates outturn.

- Price risk $(P_1 - P_0) * V_0$: The risk of a change between forecast and outturn CfD payments due to a change in the market reference price (intermittent or baseload).
- Volume risk $(V_1 - V_0) * P_0$: The risk of a change between forecast and outturn CfD payments due to a change in CfD generated volume.
- Capture price risk $(P_1 - P_0) * (V_1 - V_0)$: The risk of a change between forecast and outturn CfD payments due to the impact of a change in generated volumes on the market reference prices (ie the correlation between volume and price). Outturn prices may differ from expectations for various reasons, including changes in gas prices. However, one key factor is the change in CfD generation itself. Typically, higher than expected CfD generation leads to a decrease in reference prices, and vice versa (negative correlation).

2.13 Figure 1 provides a visual representation of the risks and how they interact with the CfD cap allowance, in the event of an increase in outturn generated volumes and a decrease in the outturn market reference price (ie an increase in the difference between CfD strike and reference price).

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Figure 1: Illustration of key risks on CfD payments (assuming an increase in outturn generated volume and a decrease in outturn reference price)



- 2.14 Suppliers have consistently reported that, while price risk can be hedged, volume risk is harder to hedge effectively. Suppliers said available products are complex, costly, and currently not covered under the cap allowance. Suppliers have also reported being unable to find products to hedge capture price effects.
- 2.15 Suppliers said that volume risk can be material, due to weather fluctuations, uncertainty around the start date of new CfD contracts (driven by technical and market factors) and due to changes in the running regime of baseload generators (usually market driven).
- 2.16 Capture price risk is also expected to increase in the future as the share of renewable generation in the market strengthens the correlation between CfD volume generation and reference price.
- 2.17 Suppliers are exposed to some residual risk arising from differences between forecast and outturn ILR, primarily through strike price risk and demand risk. However, these risks are not the focus of this consultation. Strike price risk is relatively limited in magnitude, as it arises only from differences between forecast and outturn inflation. Demand risk is also outside the scope of this consultation, consistent with our approach across the cap of not providing a reconciliation for demand-related deviations.

Proposals

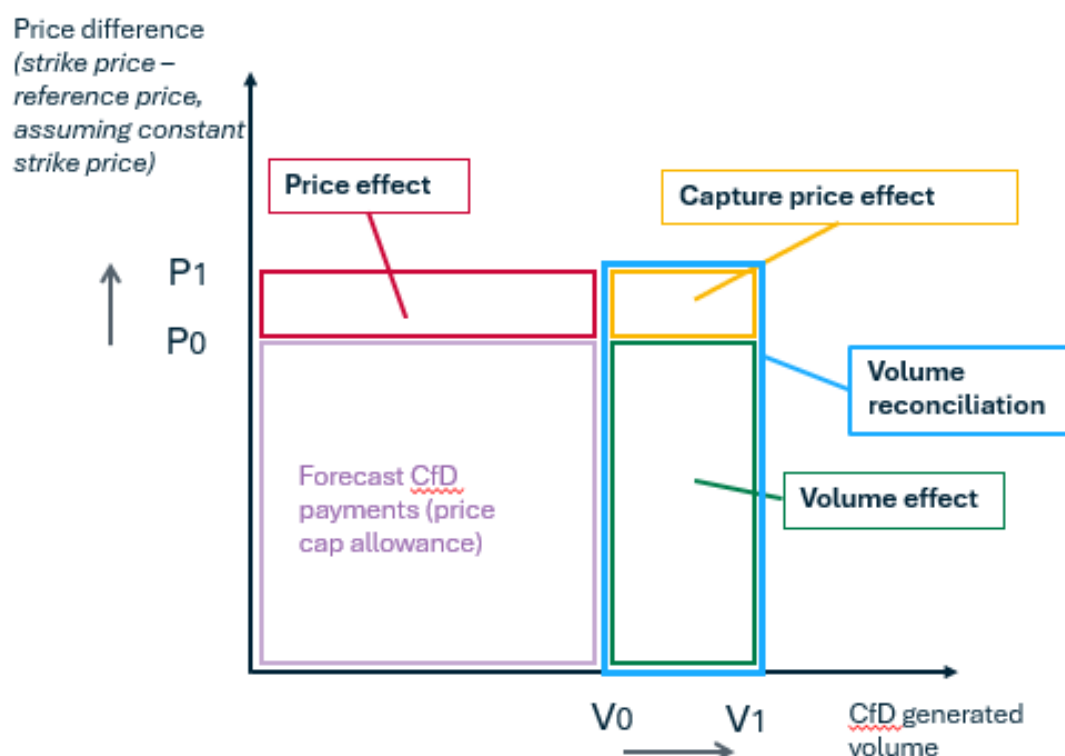
- 2.18 We propose to implement a volume reconciliation in the CfD cap allowance. This would reconcile for differences between the CfD forecast generation implied in the cap allowance and outturn generation (volume risk). This approach would also capture differences in CfD outturn payments arising from capture price effects.
- 2.19 Appendix 1 includes a graphical illustration of the effect of a volume reconciliation on the CfD cap allowance.
- 2.20 The reconciliation would apply in both directions, meaning the allowance could be either positive or negative depending on if outturn costs were higher or lower than the forecast costs that set the allowance, resulting in an increase or decrease in the allowance respectively.
- 2.21 We propose to recover the volume reconciliation over a 6-month period, to smooth out any volatility in amounts and its impact on customer bills.
- 2.22 Should we decide to proceed, we aim to introduce the reconciliation by April 2027 (cap period 18a). Specifically, this would reconcile CfD payments for half of the current CfD year (October 2026 onwards). Our proposal is to implement the reconciliation from a particular point in time, rather than to only apply the reconciliation to entire CfD years. Taking the latter approach would imply starting to reconcile at a later date (October 2027).
- 2.23 Depending on the responses we receive and confirmation that an earlier implementation wouldn't impact hedging decisions within the cap observation window, we may seek to implement changes sooner (January 2027). In this case, we would reconcile CfD payments from July 2026 onwards.

Calculation of a volume reconciliation

- 2.24 We propose to calculate the reconciliation as a difference between forecast and outturn CfD generation, multiplied by the difference between outturn strike price and outturn reference price. Using the notation in Figure 1, the calculation would be $(V_1 - V_0) * P_1$. This is illustrated below in Figure 2.
- 2.25 Appendix 1 expands on Figure 2 by providing a graphical illustration of the potential scenarios of interaction between volume and market reference price changes, and the impact on the volume reconciliation.

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Figure 2: Illustration of volume reconciliation, in case of an increase in CfD generated volume and a decrease in market reference price



2.26 We note the use of outturn strike and reference price ensures any capture price effect is included in the reconciliation. This is opposed to using the forecast strike and reference price (P_0), which would exclude the impact of capture price effects from the reconciliation.

2.27 The LCCC would calculate and publish the value of the volume reconciliation on their website, in line with the methodology we are consulting on. Appendix 3 sets out the proposed methodology the LCCC would use to calculate the volume reconciliation, which we have developed in collaboration with the LCCC.

Implementation of a volume reconciliation

2.28 The volume reconciliation would be implemented on a 'Q+2' basis, meaning it would be applied two quarters after the relevant CfD quarter. This is because outturn payment information becomes available after the end of every CfD quarter. For example, for the April to June CfD quarter, outturn CfD payments would be available in July. A volume reconciliation could therefore be calculated and applied on the August cap update (ie the October to December cap).

2.29 Under the current annualised set up of the CfD cap allowance, the cap uses 13 different forecast payment values to set the CfD allowance in any CfD year (April to March), in line with the process set out in Table 1. As forecast CfD payment

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values are updated at each cap update using the latest information available at that point in time, the forecast value for the same CfD quarter may change across successive cap updates. The volume reconciliation would reconcile the 13 distinct differences from forecast payments, as they become available.

2.30 Table 2 sets out this process. In Chapter 3, we compare this to how the reconciliation would work under a simplified CfD allowance.

Table 2: Update process of the CfD volume reconciliation applied two cap periods later (Q+2) under annualised CfD allowance

CfD quarter	Year 1 Apr-Jun cap	Year 1 Jul-Sep cap	Year 1 Oct-Dec cap	Year 1 Jan-Mar cap	Year 2 Apr-Jun cap	Year 2 Jul-Sep cap
Apr-Jun	A	Ax	0	0		
Jul-Sep	B	Bx	Bxy	0		
Oct-Dec	C	Cx	Cxy	Cxyz		
Jan-Mar	D	Dx	Dxy	Dxyz		
Apply reconciliation			A+Ax	B+Bx+Bxy	C+Cx+Cxy +Cxyz	D+Dx+Dxy +Dxyz

Note: Letters indicate distinct volume reconciliation values. Zeros indicate that volume reconciliation would not be applied where outturn values were used to set the CfD allowance.

2.31 For example, in the October-December cap period, we would reconcile April to June CfD payments against the forecast values used when setting both the April to June and July to September cap allowances (ie A and Ax respectively).

2.32 In the January-March cap period, we would include a reconciliation for the July-September CfD quarter, calculated against the forecast payments for that quarter included in the April-June, July-September and October-December caps (ie B, Bx and Bxy respectively).

Rationale

- 2.33 A volume reconciliation would provide targeted protection against risks that suppliers may be less able to hedge effectively and which may not be fully reflected in the current cap methodology, ie volume risk and capture price risk. This approach would preserve incentives for suppliers to continue managing risks that remain within their control.
- 2.34 This approach strikes an appropriate balance between the risks borne by consumers and suppliers, helping to support a resilient and investable retail market while maintaining appropriate protection for consumers.

Considerations on a volume reconciliation

Risk mitigation

- 2.35 Energy suppliers face CfD price, volume and capture price risks both on fixed tariffs and standard variable tariffs.
- 2.36 Through our engagement with suppliers, our understanding is that, for fixed tariffs, suppliers price in differing levels of risk premia to mitigate CfD risk and often carry out CfD hedging in line with their own internal CfD forecasts. This suggests that, on fixed tariffs, suppliers have more control over CfD forecast assumptions and over the level of risk premium incorporated to account for CfD risk.
- 2.37 In the cap, the assumptions implied in the forecasts of CfD payments are set by the LCCC, and the allowances (including those for risks) incorporated in standard variable tariffs are set by Ofgem.
- 2.38 We do not consider that the price cap headroom allowance was designed to specifically address deviations between forecast and outturn CfD payments, particularly as the scheme grows. We consider that there is a case for improving the accuracy of the CfD allowance, to mitigate the risk of material variations between cap allowances and outturn CfD costs. This would support an investable retail market, in line with our Markets Strategy and Vision to 2030, and deliver positive outcomes for consumers.
- 2.39 A volume reconciliation would increase accuracy of the CfD allowance and provide targeted mitigation from risks that suppliers may be less able to mitigate effectively, or that may not be fully reflected in the current methodology – ie volume and capture price risk. The volume reconciliation would seek to ensure that such costs are recovered on the basis of actual CfD generation volumes, whilst preserving incentives for suppliers to continue managing risks that remain within their control (price risk).

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- 2.40 The reconciliation would not include any adjustment for price risk, as we do not consider it appropriate to pass this risk on to consumers. Price hedging is a standard and prudent risk mitigation activity across both fixed and standard variable tariffs, which provides value to consumers through more stable prices. We consider that suppliers are better placed to manage this risk on behalf of customers. Additionally, if suppliers stopped hedging price risk, the subsequent removal of demand from the day-ahead market may lead to unintended consequences, at least temporarily. We discuss these points in more detail in the section on total reconciliation below.
- 2.41 Five suppliers said in our engagement that a volume reconciliation would be an improvement on the current methodology, although some queried whether the reconciliation would account for capture price risk. One individual also said there was a case for building a reconciliation mechanism in the CfD cap allowance, indicating that renewable generation volume risk, and its impact on wholesale prices, are the largest source of risk in the CfD scheme.
- 2.42 One supplier said that a volume reconciliation would exacerbate suppliers' gains (or losses) on their price hedges where strike prices are below reference prices. Appendix 1 shows that in the case of strike prices being below reference prices, the volume reconciliation would have an opposite sign, ie would be negative in case of higher generation and positive in case of lower generation. This would neutralise rather than exacerbate the effect of price hedges on the additional volumes.

Cost recovery of a volume reconciliation

- 2.43 We considered three options for the recovery period on the reconciled amounts: 3-month, 6-month and 12-month. A 3-month recovery would align the recovery to the period in which the reconciled amount is available for calculation, with immediate cost recovery. At the other end, a 12-month allowance would spread the recovery across a full year or four cap periods.
- 2.44 We consider a 6-month recovery period strikes an appropriate balance between timely recovery and mitigating volatility. It reduces the lag of cost recovery compared to the 12-month recovery option but mitigates the risk of unusually large quarterly reconciliation values having a greater impact on customer bills.
- 2.45 By comparison, a 12-month recovery period would increase the delay between the allowance and recovery of the final outturn cost. As the size of the CfD scheme grows, this could increase cashflow pressure on suppliers. Additionally, while a 12-month smoothing of costs is beneficial on the initial CfD cap allowance to mitigate any risk of seasonality, we do not expect deviations from LCCC's forecasts to be systematically driven by seasonality.

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- 2.46 Conversely, a 3-month recovery period would mean that fluctuations in the amount to reconcile would be passed on immediately. This could lead to more volatility in the size of the CfD reconciliation allowance, which would have a negative impact on bill stability for consumers. The cap is set as an annualised number. Therefore, the reconciled amount would need to be scaled up to ensure the correct revenue is collected within a quarter. For example, for a given annualised cap level, recovering £2 on an annualised basis would be a £2 increase on the cap (lasting for four cap periods), whereas the same amount recovered within three months would be an annualised figure of £8 (lasting for one cap period).
- 2.47 We have adopted a similar approach in other allowances within the cap. For example, when setting [recovery of the backwardation element of the wholesale allowance](#), we set a 6-month recovery window for any costs that fall outside the deadband level.

Impact of a volume reconciliation

- 2.48 While a reconciliation mechanism would affect the cap level in any given cap period, we do not consider it would have a positive or negative impact on bills overall. Rather, it is intended to ensure that the actual volume of CfD generation is more accurately reflected in the cap over time. To the extent that the proposed reconciliation resulted in net payments to suppliers, this would reflect the mitigation of a risk that suppliers may be less able to manage efficiently.
- 2.49 Overall, the rationale for a reconciliation depends on the nature of the risk and does not require the reconciliation to net out precisely over time. In this case, we consider that a reconciliation is in consumers' interest, including by supporting market resilience and investability. Given the ongoing development of the LCCC's forecasting methodology, we would not expect forecasts to systematically over- or under-estimate CfD volumes.
- 2.50 Historic estimates of a volume reconciliation in normal market conditions indicate that the value of a volume reconciliation with a 6-month recovery period could range between +/- £2 per customer per year. However, we note that historical estimates may not be a reliable indicator of future outcomes, given the ongoing changes to LCCC's forecast methodology and the expected growth of the CfD scheme.

Considerations of other options

Total reconciliation

- 2.51 A total reconciliation would reconcile the full difference between the forecast payments used in the CfD allowance and outturn CfD payments. This could alternatively be set as a form of lagged allowance, though this would introduce a longer lag than a reconciliation approach.
- 2.52 Four suppliers suggested we should adopt a total reconciliation in response to our August 2025 call for input. They said this option would have the advantage of greater financial resilience, cost recovery alignment and transparency.
- 2.53 Three stakeholders, including two suppliers, said that it would not be appropriate to transfer all the risk from suppliers to customers, and one stakeholder said there would need to be clear evidence for such change.
- 2.54 We do not consider that transferring total CfD risk to consumers would be appropriate.
- 2.55 A total reconciliation would significantly reduce suppliers' exposure to differences between forecast and outturn CfD costs, including risks that suppliers are generally able to manage through hedging. While we recognise that not having to hedge for CfD costs may be simpler for suppliers and provide a greater degree of protection, we consider suppliers are better placed than consumers to manage price risk and should continue to retain incentives to do so.
- 2.56 Managing these risks on behalf of customers is a core part of the service suppliers should provide to their customers. Additionally, suppliers manage the risk of price deviations on the fixed tariff market too. Removing this risk on the standard variable tariff market would provide greater de-risking than in the competitive segment of the market.
- 2.57 A total reconciliation could therefore shift an excessive proportion of risk onto consumers and weaken incentives for suppliers to manage risks that remain within their control. By contrast, a targeted reconciliation focused on volume risk and capture price risk allows suppliers to continue managing price risk whilst providing protection against risks that may be more difficult to hedge effectively.
- 2.58 Therefore, we consider that this more targeted approach to risk mitigation strikes a more appropriate balance between the interests of consumers and suppliers.
- 2.59 Respondents acknowledged a total reconciliation would disincentivise hedging. Suppliers would receive the full difference between forecast and outturn cost, removing the benefit from hedging their exposure between the allowance and

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outturn cost. This could lead to consumers bearing higher costs than necessary for a risk that is within suppliers' ability to mitigate.

- 2.60 Moreover, if suppliers stopped hedging price risk, this would remove some demand from the day-ahead market. This may affect market prices and lead to unintended consequences that could temporarily increase the cost of the CfD scheme for customers.

Risk premium

- 2.61 Two suppliers supported setting a separate risk premium to account for higher CfD risk. They said this would be a simpler approach than reconciliation. Another supplier said that, in the absence of a reconciliation mechanism, consideration would need to be given to an additional risk allowance and an increase to the Earnings Before Interest and Tax (EBIT) margin.
- 2.62 We recognise that customers continue to face significant cost-of-living pressures and broader economic uncertainty. In this context, any increase to the cap should be approached with caution and only where clearly justified, given the direct implications for customer bills and affordability.
- 2.63 While a risk premium would align with the approach suppliers take in the fixed tariff market, we do not consider it would be an appropriate mechanism and consider a volume reconciliation to be a more appropriate option for both suppliers and customers.
- 2.64 A risk premium would not provide targeted risk mitigation, potentially leaving suppliers exposed if volatility in CfD payments was higher than implied in the level of the risk premium. The level of risk is also expected to change over time as the CfD scheme grows, meaning any risk premium could quickly become outdated and require regular revision. One supplier noted similar concerns.
- 2.65 A risk premium is also a one-sided measure, increasing the level of the cap allowance regardless of whether higher CfD costs actually materialise, and without capturing instances of reduced CfD costs to suppliers (where outturn CfD payments are lower than forecasted). This would mean that customers may end up over-paying for CfD costs.

Rolling weighted average

- 2.66 One supplier suggested setting a rolling weighted average allowance. Instead of setting the CfD allowance with forecast data at the beginning of the CfD year and updating it with outturn data as it becomes available, the allowance would always be set using two quarters of forecast and two quarters of outturn CfD payments (akin to the current approach for the January to March cap period in Table 1).

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2.67 The supplier suggested this approach would have the advantage of not removing the incentive to price hedge, while providing a partial reconciliation for CfD costs.

2.68 We consider this option would provide untargeted risk protection, as it would reconcile two out of four quarters of payments in every cap period. This would make it difficult to determine how much of the risk being offset relates to risks that suppliers may be less able to hedge effectively, as opposed to risks that suppliers are generally better placed to manage through their own commercial and hedging activities. By providing protection irrespective of the nature of the underlying risk, the approach could also reduce incentives for efficient price hedging. We therefore consider this option less favourable than a targeted volume reconciliation focused on volume risk and capture price risk.

Other comments

2.69 We have included in Appendix 2 other minor additional comments related to the CfD allowance methodology and our response to them.

Questions

- Q1. **Volume reconciliation.** Do you support the introduction of a volume reconciliation in the CfD cap allowance, covering both volume and capture price risk?
- Q2. **Volume reconciliation.** Do you support a six-month recovery period on the volume reconciliation? If you consider an alternative recovery period to be more appropriate, please explain how this would balance cashflow risk and bill impacts.
- Q3. **Volume reconciliation.** Do you have any comments on the proposed calculation of the volume reconciliation (including the proposed LCCC methodology in Appendix 3)?
- Q4. **Volume reconciliation.** Do you support the proposal to introduce this change from cap period April to June 2027?

3. Other issues

This chapter discusses two other technical areas raised in response to our call for input. The first area relates to the annualised set up of the CfD cap allowance, where we are not making a minded-to proposal but are consulting on potential options for simplification, and may decide to adopt one following consideration of responses. The second area relates to the length of LCCC's observation window for the CfD price cap forecast payments, where we summarise the feedback we received to our call for input and suggest stakeholders share their views directly with the LCCC.

- 3.1 In this chapter, we cover proposals on two technical areas of feedback raised by stakeholders. Our proposal to introduce a volumetric reconciliation is not dependent on changes across these two areas.

Simplification of the CfD price cap allowance

Background

- 3.2 As explained in Chapter 2, we base our cost estimates of the CfD scheme on an annualised view of the cost. This mitigates against the risk of both seasonality in CfD payments resulting from seasonal trends in wholesale prices and volatility within any individual quarter of payments. Smoothing out seasonal swings and short-term spikes gives customers a more stable and manageable cost.
- 3.3 Another consequence of the annualised CfD allowance is that some cost recovery happens in advance of the quarter when payments are incurred, and some happens in arrears. For example, in the July to September cap, forecast CfD costs for the following October to March are passed through the allowance in advance of the cost being incurred, and costs for the previous April to June are passed through in arrears. Such an annualised approach reduces cashflow risk for suppliers and allows the allowance to keep pace with the growing size of the scheme over time compared to an allowance set fully in arrears.
- 3.4 During our engagement, some suppliers said that the annualised CfD allowance increases the complexity of hedging CfD costs for the quarter ahead. Because the allowance is based on a weighted average of four separate quarters of payments, suppliers may need to adopt more complex hedging approaches to manage price risk effectively. They said this involves higher operational costs and risks due to having to 'reverse engineer' the exposures and, depending on the hedging strategy, place multiple separate hedges for one cap period.

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Alternative option

- 3.5 A simpler way of calculating the CfD allowance could be to use only the upcoming quarter of CfD payments rather than an average of four CfD quarters. For example, using just the July to September 2026 forecast of CfD payments to set the allowance in the July to September 2026 cap period. This process is set out in Table 3 below (as opposed to the process for the annualised allowance set out in Table 1).

Table 3: Simplified CfD price cap allowance update process for a CfD year (April to March)

CfD quarter	Apr-Jun cap	Jul-Sep cap	Oct-Dec cap	Jan-Mar cap
Apr-Jun	Forecast			
Jul-Sep		Forecast		
Oct-Dec			Forecast	
Jan-Mar				Forecast

Considerations

Applying the simplified approach

- 3.6 For the avoidance of doubt, at this stage we are not proposing to simplify the methodology of the CfD cap allowance as described above. However, we welcome views from stakeholders on the potential advantages or disadvantages of the approach, including views on alternative approaches to set the recovery of the simplified allowance. We may decide to adopt this option, or a variation of it, following consideration of responses.
- 3.7 We consider there would be some advantages to setting a simplified CfD allowance using only one quarter of CfD payments, namely:
- It would simplify hedging CfD costs for cap customers for suppliers and reduce the associated price risk.
 - Depending on the hedging approach, it would reduce the operational cost of setting multiple separate hedges for one cap period.

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- It would simplify the implementation of the volume reconciliation for both Ofgem and the LCCC, as the design of the allowance and reconciliation would be simpler in Annex 2, and thus the LCCC would only need to calculate 4 reconciled payment values per CfD year, instead of 13 (as shown in Table 4 below).

3.8 We have set out the reconciliation process under the simplified allowance in Table 4 below. This compares to Table 2, which sets out the reconciliation under the annualised allowance.

Table 4: Update process of the CfD volume reconciliation applied two cap periods later (Q+2) under the simplified CfD allowance

CfD quarter	Year 1 Apr-Jun cap	Year 1 Jul-Sep cap	Year 1 Oct-Dec cap	Year 1 Jan-Mar cap	Year 2 Apr-Jun cap	Year 2 Jul-Sep cap
Apr-Jun	A					
Jul-Sep		B				
Oct-Dec			C			
Jan-Mar				D		
Apply reconciliation			A	B	C	D

Note: Letters indicate distinct volume reconciliation values.

Recovery period

3.9 As discussed earlier, the reason for averaging across four CfD quarters is to smooth impacts of any given quarter, whilst maintaining a forward-looking allowance. If applying a simplified approach, we would lose the smoothing benefits the current approach has. In general, when setting the cap, we seek to avoid introducing seasonality in consumer bills.

3.10 An equivalent approach when applying the simplified allowance would be to recover costs over a 12-month period. This would provide a similar smoothing effect for seasonal fluctuations, as well as for outlier quarters.

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- 3.11 However, a 12-month recovery period, while mitigating for the risk of seasonality and volatility, could lead to undesirable outcomes as it would make the allowance fully recovered in arrears. This is unlike the current annualised approach where part of the cost is recovered in advance and part in arrears. With the growing size of the scheme, we consider that a delayed cost recovery could create an ongoing working capital pressure. This could at some point affect the EBIT allowance required under the cap. Delayed recovery could also have a negative impact on supplier financial resilience than more timely recovery.
- 3.12 A shorter recovery period may mitigate against cashflow pressures. However, we do not consider that a 3-month or 6-month cost recovery would provide adequate protection against seasonality of payments and volatility of any outlier CfD quarterly payments. The latter in particular is a growing risk, with the increasing size of the scheme and consequent expected increase in volatility of CfD price and volume. Conversely, we consider a 6-month recovery appropriate for volume reconciliation as we do not expect this to be systematically driven by seasonality in payments.
- 3.13 There may be alternative approaches to a 12-month cost recovery. For example, setting a moving threshold that allows 'normal' cost recovery under a 6-month recovery period and allowing cost recovery of payments outside of the normal threshold under a 12-month period. We welcome feedback on this or any other alternative proposals.
- 3.14 For reference, we have published a second version of Annex 2, incorporating the volume reconciliation with a 6-month recovery on the simplified allowance with a 12-month recovery. Guidance for this second version of Annex 2 is included in Appendix 5 in this document. For the avoidance of doubt this is not our minded-to proposal.

Options for the introduction of the CfD volume reconciliation under the simplified allowance approach

- 3.15 If a simplified CfD allowance was introduced in April 2027 alongside a CfD volume reconciliation, there would be a two-quarter delay between the introduction of the simplified CfD allowance and the point at which the relevant volume reconciliation can be calculated.
- 3.16 One option would be to have a transitional approach to calculating the reconciliation for the first two cap periods (April to June 2027 and July to September 2027), where the reconciliation would be calculated based on the annualised CfD allowance following the approach described in Chapter 2. From October 2027 onwards, the reconciliation would be calculated based on the simplified CfD allowance. While this would allow the reconciliation to be

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implemented in April 2027, this option would be more complex as it would require two different reconciliation methodologies to be applied.

- 3.17 An alternative option would be to introduce the simplified CfD allowance from April 2027 but defer the volume reconciliation until October 2027, when the necessary data is available to calculate the reconciliation under the new approach. This would be simpler and clearer to implement, as only one reconciliation methodology would be used, but it would delay the introduction of the volume reconciliation by two quarters.
- 3.18 The second version of Annex 2 we have published illustrates the former approach.
- 3.19 We note that implementing the simplified approach before April 2027 could interfere with suppliers' hedging for the CfD year 2026/27, including hedging already in place for the January to March 2027 CfD quarter. If we were to introduce the simplified approach, it may therefore be preferable to do so from the start of the new CfD year in April 2027.

Observation window of the LCCC cap payment forecasts

- 3.20 In response to our August 2025 call for input, some stakeholders expressed views regarding the way CfD payment forecasts are calculated by LCCC.
- 3.21 Internal LCCC methodologies are a matter for the LCCC, and views should be shared directly with them.
- 3.22 However, we wish to briefly summarise the views expressed by stakeholders for completeness and also because it is relevant to the way suppliers hedge against the price cap allowance. We invite stakeholders to share their thoughts directly with the LCCC.
- 3.23 To set the CfD cap allowance, we use forecast CfD payments as published by the LCCC in its [Price Cap Inputs Dashboard](#). To calculate these payments, the LCCC observes forward market prices on specific days, set out for price cap inputs in its [Key Dates Dashboard](#).
- 3.24 To minimise price risk when hedging, suppliers generally seek to replicate the LCCC methodology used to derive the forecast payments included in the CfD allowance, including the relevant market observation dates.
- 3.25 In our engagement, a few suppliers said that it is difficult to find enough liquidity to hedge for CfD costs on the individual market dates that the LCCC observes forward prices on. Suppliers reported having to place hedging positions over multiple market dates to find sufficient liquidity. Suppliers said this does not allow them to reflect the forward prices the LCCC uses to set the forecast payments, making it difficult to follow the allowance and thus leading to increased price risk.

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- 3.26 Suppliers also said that using individual market dates could capture peaks or troughs in forward prices, leading to higher volatility in the forecasts of CfD payments and therefore in costs to customers. Suppliers also said that artificially concentrating hedging over a few dates during the year could lead to suppression of market prices on those dates, leading to higher volatility in the level of wholesale prices.
- 3.27 Suppliers do not face this issue when hedging for fixed tariff customers as they do not follow LCCC market dates, generally hedging costs when a new customer is signed up to the fixed tariff instead.
- 3.28 A few suppliers suggested extending the LCCC observation window of CfD price cap forecast payments to multiple dates rather than a single market date, which they said could mitigate the risk of lack of liquidity and risk of capturing volatility in prices.
- 3.29 A few suggested aligning the LCCC market dates for CfD price cap inputs to the three-month observation window used to calculate the price cap wholesale allowance. They said not only would the three-month window reduce the liquidity issue and smooth market prices over a longer period, but it would also allow suppliers to align their CfD cap allowance and wholesale index hedging, allowing them to streamline their processes (by placing a net buy position instead of separate buy and sell positions for the wholesale index and CfD allowance respectively).
- 3.30 As mentioned earlier, any views on internal LCCC methodologies should be communicated directly to the LCCC.

Questions

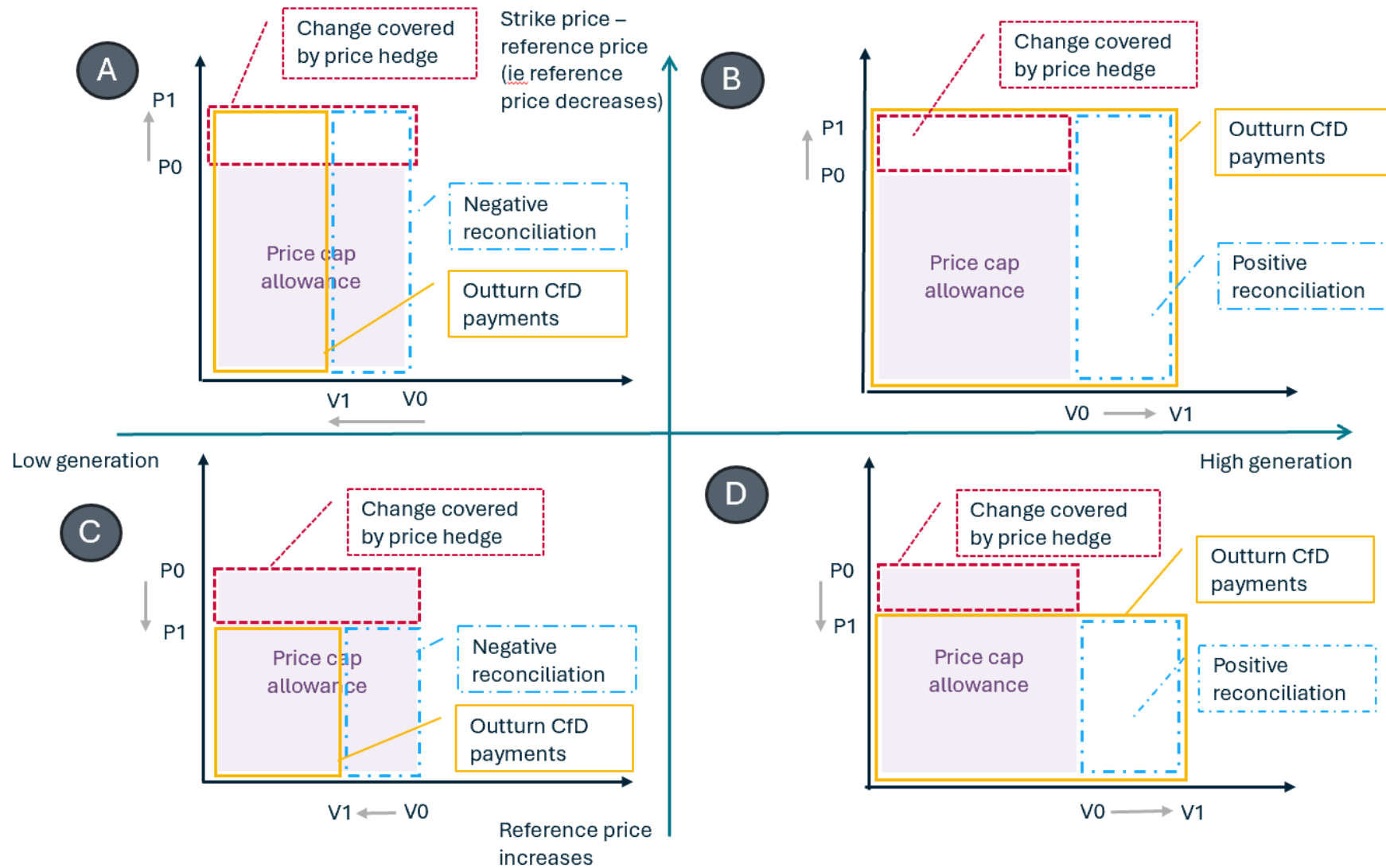
- Q5. **Simplification of CfD allowance.** Should we pursue simplification of the CfD allowance with a 12-month recovery period?
- Q6. **Simplification of CfD allowance.** Do you have other suggestions for how the cost recovery of the simplified CfD allowance could be set? Please provide an Excel example of how your proposal would work.

Appendix 1. Illustration of effects of a volume reconciliation

- A1.1 Figure A1 and A2 illustrate how the reconciliation mechanism would operate under a range of price and volume variations. Prices and volumes shown are for illustration purposes only.
- A1.2 Figure A1 presents four scenarios where the reference price is below the strike price and Figure A2 presents four scenarios where the reference price is above the strike price.
- A1.3 Both figures show how differences between the CfD cap allowance and actual ('outturn') CfD payments would be mitigated either through suppliers' price hedging or the proposed volume reconciliation mechanism.
- A1.4 The notation used in the figures is the same as in Chapter 2, ie:
- P stands for the difference between strike and market reference price, where strike price is assumed constant, to focus on changes in market reference prices. As a result, a decrease in the reference price causes P to increase, while an increase in the reference price causes P to decrease;
 - V stands for CfD generated volume;
 - subscript $_0$ indicates a forecast; and
 - subscript $_1$ indicates outturn.

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Figure A1: Interaction of CfD price cap allowance, price hedging and volume reconciliation if reference price is below strike price

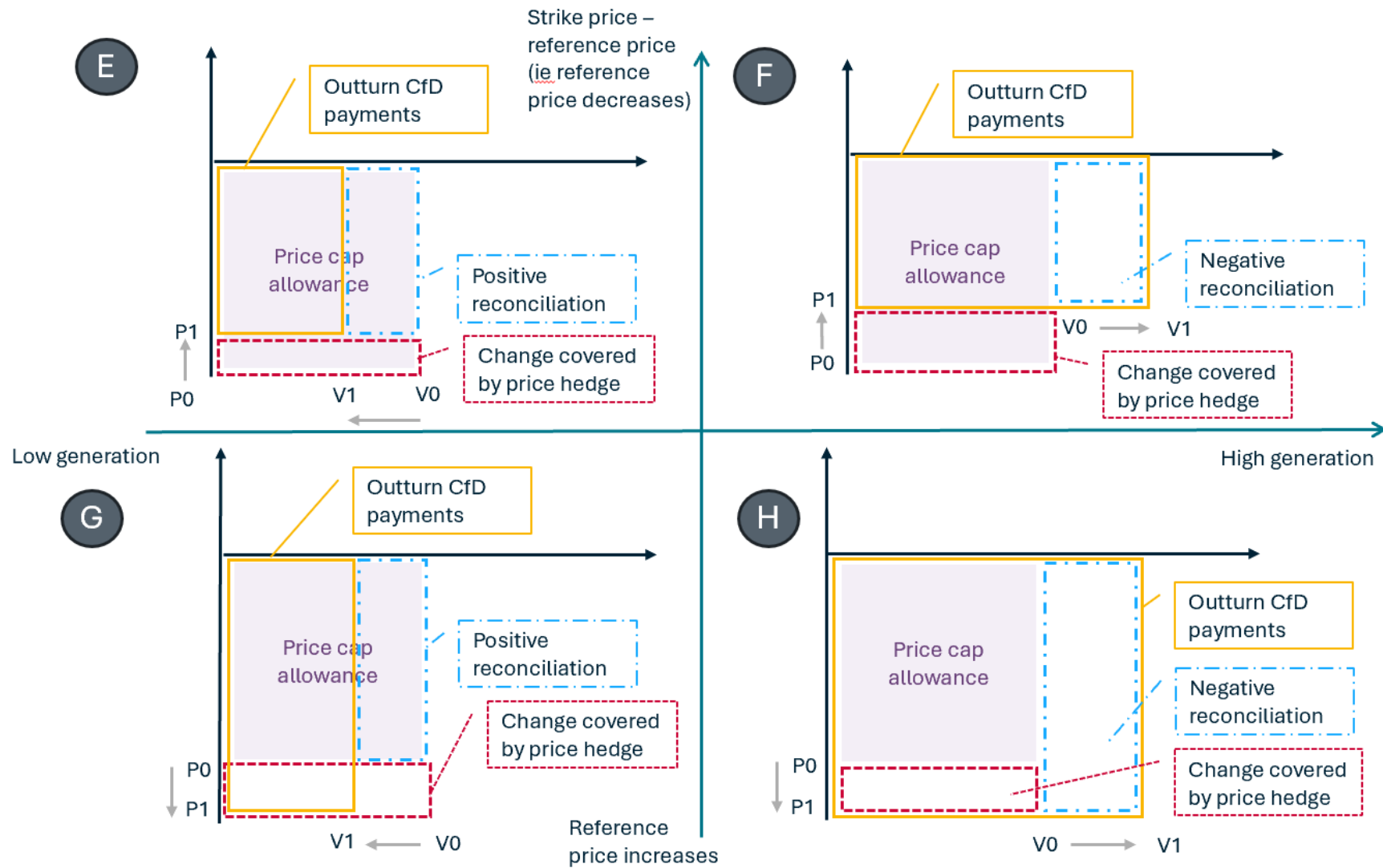


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- A1.5 Figure A1 assumes that the strike price is fixed and exceeds the reference price in all scenarios shown. Accordingly, CfD payments are positive (ie a cost to suppliers), which is represented by the positive initial cap allowance above the x-axis in each quadrant. Note: the figure focuses on the change between strike and reference prices, rather than the absolute level of the strike price – the strike price is therefore not shown separately in the diagram.
- A1.6 The x-axis shows changes in CfD generation, indicated by the notation V . V_0 is the forecast of CfD generation and V_1 is outturn CfD generation.
- A1.7 The y-axis represents the difference between the strike price and the reference price (P), assuming a constant strike price. P_0 represents the forecast difference, while P_1 represents the outturn difference. As P is defined as strike price minus reference price, a decrease in the reference price results in a larger value of P ($P_1 > P_0$), whereas an increase in the reference price results in a smaller value of P ($P_1 < P_0$).
- A1.8 On the right-hand side of the graph (scenarios B and D), higher-than-expected CfD generation leads to an increase in outturn CfD payments for suppliers (yellow box) compared to the initial price cap allowance (purple area). The difference between V_0 and V_1 at outturn price P_1 is covered by the volume reconciliation. This difference is positive in both cases (reflecting the higher CfD cost). The change in reference price P_0 to P_1 (whether that be a decrease or increase compared to the initial forecast P_0) is covered by the price hedge at the initial volume forecast V_0 .
- A1.9 On the left-hand side of the graph (scenarios A and C), lower-than-expected CfD generation leads to a decrease in outturn CfD payments (yellow box) compared to the initial price cap allowance (purple area). The difference between V_0 and V_1 at outturn price P_1 is covered by the volume reconciliation, which is negative in both cases (reflecting the lower CfD cost). The change in reference price P_0 to P_1 (whether that be a decrease or increase compared to the initial forecast P_0) is covered by the price hedge at the initial volume forecast V_0 .

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Figure A2: Interaction of CfD allowance, price hedging and volume reconciliation if reference price is above strike price



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- A1.10 Figure A2 assumes that the strike price is fixed and is lower than the reference price in all scenarios shown. Accordingly, CfD payments are negative (ie a revenue stream for suppliers), which is represented by the negative initial cap allowance below the x-axis in each quadrant. Note: the figure focuses on the change between strike and reference prices, rather than the absolute level of the strike price – the strike price is therefore not shown separately in the diagram.
- A1.11 Notation P and V is the same as in Figure A1.
- A1.12 On the right-hand side of the graph (scenarios F and H), higher-than-expected CfD generation leads to an increase in the negative outturn CfD payments (yellow box) compared to the initial price cap allowance (purple area) – ie an even higher revenue stream for suppliers compared to the initial forecast. The volume reconciliation (the difference between V_0 and V_1 at outturn prices P_1) would be negative, reflecting that the additional revenue stream would be returned to customers. The change in reference price P_0 to P_1 (whether that be a decrease or increase compared to the initial forecast P_0) is covered by the price hedge at the initial volume forecast V_0 .
- A1.13 On the left-hand side of the graph (scenarios A and C), lower-than-expected CfD generation leads to a decrease in the negative outturn CfD payments (yellow box) compared to the initial price cap allowance (purple area) – ie a lower-than-expected revenue stream. In this case, the volume reconciliation would be positive, reflecting that suppliers received a lower revenue stream compared to the initial forecast. The change in reference price P_0 to P_1 (whether that be a decrease or increase compared to the initial forecast P_0) is covered by the price hedge at the initial volume forecast V_0 .

Appendix 2. Additional stakeholder comments

Generator delays and capture prices

- A2.1 A few suppliers provided comments on the LCCC inputs used to calculate the forecast payments we use to set the CfD cap allowance. While we have responded to the key comments below, we would like to note that comments related to internal LCCC methodologies are a matter for the LCCC, and views should be shared directly with them.
- A2.2 A few suppliers provided comments on the start dates of new generators, saying that suppliers lack visibility of whether generators will adjust their start date and the LCCC should be more transparent in its assumptions. Another supplier said that Ofgem should ensure generators are not assumed to start on their expected date when they have option to delay.
- A2.3 The LCCC incorporates the best available information on project status into its forecasts of CfD payments. As generator start dates are commercially sensitive, the LCCC cannot disclose this information. The LCCC is also best placed, given its technical expertise and access to project information, to develop the assumptions used to calculate forecast payments. Delaying start dates for commercial gain is no longer allowed from Allocation Round 5.
- A2.4 We note that our proposal of a volume reconciliation would cover the impact of a change in generated volumes from delays in generator start dates.
- A2.5 Two suppliers also provided comments on the level of capture prices implied in the LCCC forecasts. They said that capture price discount rates are too low, that there is no information provided to validate LCCC's forecast of capture prices, and the issue is expected to increase substantially as more renewables are sold in the day-ahead market.
- A2.6 While capture prices are not a direct input of LCCC's forecast model, the LCCC uses capture prices as one of the metrics to assess the effectiveness of its model.
- A2.7 We also note that the volume reconciliation we propose to introduce would capture the impact of any differences between forecast and outturn CfD payments arising from changes in capture price effects.

Reduction in supplier returns

- A2.8 One consumer group said that while amendments to reduce risk for suppliers could be in the interest of consumers, the lower risk would need to be reflected in lower returns.
- A2.9 We do not consider it would be appropriate to lower supplier returns. Our proposal of a volume reconciliation aims at reducing risk that is not currently compensated in the cap allowance, particularly in consideration of the low margins currently observed in the retail market and the future expansion of the CfD scheme, which could expose suppliers to significant levels of risk. This is consistent with our Markets Vision and Strategy to 2030, which emphasizes supporting investability across the retail market.

Transaction costs

- A2.10 One supplier noted that Ofgem should include explicit consideration of the transaction costs of hedging in any assessment of efficient cost recovery.
- A2.11 Transaction costs are not in the scope of this review of the CfD allowance. This review is focused on mitigating risk related to the variation between forecast and outturn CfD costs in the cap allowance, as set out in earlier sections of this consultation.

Before-period and in-period adjustments

- A2.12 One supplier said that before-period adjustments and in-period adjustments are likely to ramp up with the size of the CfD scheme, reducing suppliers' effectiveness in hedging. Another supplier said Ofgem should incorporate an additional forecast in the cap, timed to ensure all available information about future CfD is incorporated in the price cap.
- A2.13 The current CfD cap allowance methodology already reflects the impact of any before-period adjustments before LCCC's price cap inputs publication date. We note the timeline of publication of LCCC's price cap inputs is typically close to the end of the price cap observation window (as set out in the LCCC [Key Dates Dashboard](#)), allowing for updated forecasts to be incorporated in the cap.
- A2.14 While we do not include the impact of in-period adjustments in the CfD allowance, the proposed volume reconciliation would reconcile differences in payments due to a change between the forecast of CfD generated volumes included in the cap allowance, and outturn generated volumes.

Dispatchable Power Agreements and Clean Industry Bonus

- A2.15 One supplier said that Ofgem should ensure that the cap methodology will account for material future costs such as Dispatchable Power Agreements (a support mechanism for low-carbon dispatchable power generation technologies) and the Clean Industry Bonus (a scheme providing additional financial support to offshore wind developers that invest in sustainable supply chains), without requiring retrospective allowances.
- A2.16 Dispatchable Power Agreements and the Clean Industry Bonus are not currently incorporated in the CfD interim levy rate, as forecasts for these schemes are not yet included. Once forecasting for these schemes begins and the associated costs are reflected in the levy rate calculation, the CfD cap allowance will automatically incorporate these costs.

Appendix 3. Methodology for the LCCC's calculation of the volume reconciliation

Standard reconciliation calculation

A3.1 We have worked with the LCCC to establish a calculation of the volume reconciliation. This methodology would mirror the proposed calculation set out in Chapter 2, ie $(V_1 - V_0) * P_1$.

A3.2 The calculation of reconciled payments would use hourly price and volume information, as follows:

$$\frac{[(\text{Outturn CfD Generation}) - (\text{Forecast CfD Generation})]}{[(\text{Outturn Strike Price}) - (\text{Outturn Reference Price})]} *$$

A3.3 CfD volumes are also adjusted by the relevant volume multipliers the LCCC uses in the calculation of CfD payments, before being used in the calculation of the reconciliation.

A3.4 The resulting volume reconciliation aligns with the illustrations in Appendix 1:

- the reconciliation would be positive if outturn generation was higher than forecast, unless outturn reference prices were higher than outturn strike prices; and
- the reconciliation would be negative if forecast generation was higher than outturn, unless outturn reference prices were higher than outturn strike prices.

A3.5 The results at hourly level would be added together to calculate the total volume reconciliation payments for the quarter.

Reconciliation calculation for unmatched payments

A3.6 In the case of unmatched payments (ie where there was a forecast of generation, but the generator does not start producing due to delays to the start date), the LCCC does not hold information on outturn strike and reference prices in their system. In this case, the calculation would use the closest information to outturn strike and reference prices, ie:

$$\frac{[(0) - (\text{Forecast CfD Generation})]}{[(\text{Forecast Strike Price}) - (\text{Relevant Reference Price})]} *$$

A3.7 The relevant reference price would be the intermittent or baseload market reference price for the hour where the outturn generation was originally expected to take place.

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- A3.8 The use of the forecast strike price in the case of unmatched payments is an approximation. However, we consider this to be a reasonable approximation as outturn strike prices are only subject to the impact of outturn inflation, which is generally small.

Appendix 4. Guidance for changes to the proposed ‘Wholesale cost allowance methodology (Annex 2)’ for consultation

- A4.1 Alongside this consultation we have published an updated version of ‘Wholesale cost allowance methodology (Annex 2)’ for consultation, named ‘Wholesale cost allowance methodology (Annex 2) v1.29.1 – minded-to position’. Changes in the model reflect the implementation of our proposal to introduce a volume reconciliation with a six-month recovery period in the CfD cap allowance.
- A4.2 All proposed changes are shown in the draft Annex 2 from cap period April to June 2027 (cap period 18a). The inputs in the tables have been left blank, but formulas have been included to test the functionality of the model.
- A4.3 To support the understanding and the review of the volume reconciliation, we describe the calculation steps below and summarise the model changes in Table A1. There is also a flow chart of the calculation process included in the Annex 2 model published alongside this consultation.

Part A

- A4.4 The volume reconciliation payments would be calculated and published by the LCCC following the methodology proposed in Appendix 3. These payments would be an input in tab ‘7e CFD volume reconciliation’, Table 1.
- A4.5 The calculations set out in Tables 1, 2 and 3 of tab ‘7e CFD volume reconciliation’ calculate what the adjustment to the CfD allowance would have been, if the additional volume reconciliation payments were known upfront.
- A4.6 We therefore apply the relevant total eligible demand, demand weights, losses factors and benchmark consumption from the cap period where the historical allowance was calculated, to work out the additional volume-related contributions to the Expected Levy Payment. These calculations mirror how the CfD allowance is calculated in tab ‘7c CFD input’.
- A4.7 The inputs are added in the column corresponding to the upcoming cap period. However, rows 20-23 in tab ‘7e CFD volume reconciliation’ transpose the inputs so that they align with the cap period in which the historical allowance was calculated. This allows the relevant total eligible demand, demand weights, loss factors and benchmark consumption values from that period to be applied consistently.

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- A4.8 As the reconciliation is not intended to reflect actual demand, forecast values for eligible demand and demand weights are therefore used instead of actuals, ensuring consistency with the original allowance calculation.
- A4.9 The application of regional loss factors from an early stage leads to tables with a large number of lines (Tables 2, 3 and 4).
- A4.10 The values in Table 3 are in pounds per customer per year. This is equivalent to the additional allowance that we would have set.

Part B

- A4.11 To aggregate contributions across different cap periods (in Part C), it is first necessary to express them as cashflow values. This is because demand levels vary between cap periods, meaning the contributions are not directly comparable. Converting them into cashflow terms allows us to take into account the effects of differing demand levels.
- A4.12 Therefore, once the additional volume-related contributions have been calculated, we estimate the equivalent cashflow suppliers would have received had the volume reconciliation payments been known upfront (Table 4 in the '7e CFD volume reconciliation' tab). The cashflow is calculated using the proportion of demand in the historical cap period.
- A4.13 Across Part A and Part B, we first multiply by benchmark consumption (in Part A) and then multiply by a demand weight for the cap period (in Part B). In combination, this is equivalent to multiplying by assumed consumption per typical customer in a quarter.

Part C

- A4.14 Once the cashflow associated with the additional volume-related adjustments has been determined for the historical cap period, the amounts relating to the same CfD quarter are aggregated to calculate the volume reconciliation for that quarter (Table 5 in tab '7e CFD volume reconciliation').
- A4.15 Outturn information becomes available one CfD quarter at a time, reflecting the Q+2 reconciliation process. However, because allowances are set on an annualised basis, a single CfD quarter may have contributed to allowances across multiple cap periods. The reconciliation must therefore capture all cap periods in which forecasts for that CfD quarter were included. To do this, we identify the quarter's contribution to each relevant allowance and aggregate these amounts (Table 5 in the '7e CFD volume reconciliation' tab). This approach is illustrated in Table 2 of this consultation.

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- A4.16 Overall, the process to calculate the volume reconciliation first requires calculating what the allowance would have been had the additional volumetric reconciliation payments been known upfront (in Part A), and then reconcile payments across multiple cap periods for the same CfD quarter (in Part C). This requires a two-stage approach: first, looking ‘down’ to determine the volume-related adjustment in each cap period, and second, looking ‘across’ to account for information spanning multiple cap periods for a given CfD quarter.
- A4.17 Note that this means we do not reconcile the entire CfD allowance for a particular cap period at the same time, as different CfD quarters are reconciled at different points in time (in line with the process set out in Table 2 of this consultation).
- A4.18 As we are taking into account values for different combinations of price cap quarters and CfD generation quarters, this means that the weight accorded to each individual value is reduced. For example, the contribution in price cap quarter April-June for generation in Q1 is only part of the April-June allowance (so needs to be multiplied by a demand weight in Part A) and is only part of the CfD allowance over the course of the year (so again needs to be multiplied by the relevant demand weight in Part C).

Part D

- A4.19 Once the relevant cashflow contributions for the same CfD quarter have been added together, recovery is spread over six months, in line with our proposal. This would produce the cashflow recovery for the upcoming cap period related to the volume reconciliation.
- A4.20 The formulas used in Table 6 of tab ‘7e CFD volume reconciliation’ are consistent with the six-month recovery calculation in the backwardation tab 8a (Table 4).

Part E

- A4.21 Once cashflow recovery for a CfD quarter has been spread over a six-month period, the allowance needs to be expressed in pounds per customer per year, in line with how the rest of the cap allowances are set. Therefore, the cashflow amount we have calculated in Part D for the volume reconciliation for the upcoming cap period is divided by demand in the upcoming cap period. This calculation is also consistent with the approach used for six-month recovery in the backwardation tab 8a (Table 5). The resulting figure represents the final volume reconciliation allowance.

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A4.22 Values from Part E are then added to the baseline CfD allowance in tab ‘7a CFD allowance’, to calculate a total CfD allowance.

Table A1: Summary of changes to “Wholesale cost allowance methodology (Annex 2)” for calculation of CfD volume reconciliation

Worksheet	Change	Description
Notes	Updated list of tabs.	Updated description of row 52 and added description of new tabs in row 56 and 57.
1a Wholesale allowance	Changed formulas of CfD table.	Amended links in rows 85-112 to link to new Table 3 in tab ‘7a CFD allowance’, to import the total CfD allowance including volume reconciliation.
7a CFD allowance	New Tables 2 and 3 for the calculation of CfD allowance including volume reconciliation.	Two new tables have been added, ie Table 2 and 3. Table 2 links to the final volume reconciliation allowance from tab ‘7e CFD volume reconciliation’. Table 3 sums up the CfD allowance in Table 1 to the volume reconciliation allowance in Table 2, to calculate a total CfD allowance.
CFD reconciliation overview	Tab showing step-by-step calculation of the volume reconciliation.	This tab has been included to support the review of the volume reconciliation. It should be read in conjunction with the guidance set out in this Appendix.
7e CFD volume reconciliation	Created new worksheet for the calculation of the CfD volume reconciliation.	This tab calculates the volume reconciliation, using inputs from tab ‘7c CFD input’, ‘7d losses’ and ‘3b Demand’. A step-by-step description of the calculation is provided earlier in this Appendix and in tab ‘CFD reconciliation overview’.

Appendix 5. Guidance for changes to second version of ‘Wholesale cost allowance methodology (Annex 2)’ reflecting simplified CfD allowance

- A5.1 Alongside this consultation, we have published a second version of Annex 2 that calculates the volume reconciliation using the simplified CfD allowance discussed in Chapter 3. This model is named ‘Wholesale cost allowance methodology (Annex 2) v1.29.2 – additional methodology change’. We have summarised changes in Table A2 below.
- A5.2 As discussed in Chapter 3, there is a lag of two quarters between when the CfD cap allowance is incurred, and when the volume reconciliation would be applied. If both changes were implemented in April 2027, the volume reconciliation would initially need to be calculated using the annualised CfD allowance. This would apply for the April-June 2027 and July-September 2027 cap periods, before moving to the simplified allowance from October 2027.
- A5.3 An alternative approach would be to start the reconciliation from October 2027, which would reduce complexity but delay implementation of the reconciliation.
- A5.4 For illustrative purposes, we have reflected the former approach in the additional version of Annex 2 we have published, with a transitional approach to calculating the reconciliation for the first two quarters. This is reflected in the tabs:
- tab ‘7e CFD volume rec – transitional’ calculates the volume reconciliation for the two cap periods April to June 2027 and July to September 2027 (transitional approach);
 - tab ‘7f CFD volume reconciliation’ calculates the volume reconciliation on the simplified CfD allowance from October 2027.
- A5.5 The approach to calculating the volume reconciliation in tab ‘7e CFD volume rec – transitional’ is the same described in Appendix 4.
- A5.6 The approach to calculating the volume reconciliation in tab ‘7f CFD volume reconciliation’ is similar to the approach described in Appendix 4, except for the following differences:
- In Part A, we do not multiply by demand weights (given we would no longer be setting the CfD allowance using multiple quarters of CfD payments that would have been weighted);

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- In Part C, we do not add together contributions to the same CfD quarter, given we would no longer be setting the CfD allowance using multiple quarters of CfD payments that would need to be summed together to calculate the reconciliation against a CfD quarter.

A5.7 Tab '7a CFD allowance' Table 2 also calculates a recovery of the CfD allowance over 12 months, in line with the discussion in Chapter 3.

A5.8 Table A2 below summarises changes to the second version of Annex 2.

Table A2: Summary of changes to second version of “Wholesale cost allowance methodology (Annex 2)”, calculating the volume reconciliation on the simplified CfD allowance

Worksheet	Change	Description
Notes	Updated list of tabs.	Updated description of row 52 and added description of new tabs in row 56, 57 and 58.
1a Wholesale allowance	Changed formulas of CfD table.	Amended links in rows 85-112 to link to new Table 4 in tab '7a CFD allowance', to import the total CfD allowance including volume reconciliation.
7a CFD allowance	New Table 2 for the recovery of simplified CfD allowance over 12 months, and new Tables 3 and 4 for the calculation of CfD allowance including volume reconciliation.	Three new tables have been added, ie Table 2, 3 and 4. Table 2 calculates the recovery of the simplified CfD allowance over 12 months from April 2027. Table 3 imports data on the final volume reconciliation allowance from tab '7e CFD volume rec – transitional' and '7f CFD volume reconciliation'. Table 4 combines the CfD allowance in Table 1 and 2 with the volume reconciliation allowance from Table 3, to calculate a total CfD allowance.

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7c CFD inputs	New rows and formulas for calculation of simplified CfD allowance from April 2027.	Added new rows 21 and 36 with simplified inputs for the calculation of simplified CfD allowance from April 2027. Amended formulas in rows 40 and 41 to reflect simplified inputs. Blanked rows with inputs for annualised CfD allowance calculation (ie quarterly CfD payments and demand weights).
CFD volume rec overview	Tab showing step-by-step calculation of the volume reconciliation.	This tab has been included to support the review of the volume reconciliation (under both the annualised and simplified approach). It should be read in conjunction with the guidance set out in Appendix 4 and Appendix 5 in this document.
7e CFD volume rec – transitional	New worksheet for the calculation of the CfD volume reconciliation on the annualised CfD allowance (temporary approach for April to June 2027 and July to September 2027).	This tab calculates the volume reconciliation, using inputs from tab '7c CFD input', '7d losses' and '3b Demand'. A step-by-step description of the calculation is provided in Appendix 4 and in tab 'CFD volume rec overview'.
7f CFD volume reconciliation	New worksheet for the calculation of the CfD volume reconciliation on the simplified CfD allowance, from October 2027.	This tab calculates the volume reconciliation, using inputs from tab '7c CFD input', '7d losses' and '3b Demand'. A step-by-step description of the calculation is provided in this Appendix and in tab 'CFD volume rec overview'.

Appendix 6. Privacy policy

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name, address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, “Ofgem”). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

We may share your responses, including any personal data within them, with the Department for Energy Security and Net Zero.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for six months after the project, including subsequent projects or legal proceedings regarding a decision based on this consultation, is closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data

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- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
 - to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/> or telephone 0303 123 1113.

7. Your personal data will not be sent overseas.

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information For more information on how Ofgem processes your data, view our [Ofgem privacy policy](#).

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 consultation. 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.