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for energy consumers

Consultation

Statutory Consultation on potential short-term interventions to address risks to consumers from market volatility

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Response deadline:	17 January 2022	**Email:**	retailpolicyinterventions@ofgem.gov.uk

Current wholesale market volatility means that energy suppliers face an increased challenge of managing risks in buying energy for their customers. This could increase costs for consumers if they lead to further significant supplier exits from the market.

We are consulting on a range of potential temporary measures to enable domestic suppliers to better manage these risks. Ofgem is only considering these measures due to the severe price volatility we are seeing in energy markets. There will be a high bar to intervention, and Ofgem will need to be satisfied that any measures are in the interests of consumers. Any measures would be time limited in advance of potential permanent adjustments to the price cap, on which we are setting out our thinking in parallel with this consultation.

We welcome views from energy consumers and others with an interest in the domestic retail energy supply market. We particularly welcome responses from energy suppliers and consumer groups.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at **Ofgem.gov.uk/consultations**. If you want your response – in whole or in part –

to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

Contents

Executive summary

High and volatile gas and electricity prices continue to put severe strain on energy markets. Ofgem's open letter dated 29 October set out the steps we are taking to manage this situation in the interests of energy consumers now and in the future.

We are now putting in place an enhanced regulatory approach to ensure energy suppliers pursue sustainable business models, minimising risks to customers and the market. And we are seeking views on potential adjustments to the price cap methodology to enable it to better handle market volatility, while continuing to protect consumers.

Risks to consumers from continuing volatility in energy markets

Adjustments to the price cap won't be in place until October 2022 at the earliest, which leaves considerable risks of consumer harm in the meantime. Markets remain volatile and there is significant uncertainty as to wholesale price movements over the next 6-12 months. In the face of such uncertainty, domestic suppliers are exposed to potentially significant losses if wholesale prices change significantly in either direction. When prices rise sharply, millions of domestic consumers who would normally take a fixed-term contract instead choose a standard variable tariff at the (cheaper) price cap level, which suppliers may not have anticipated or hedged for. When prices fall sharply, those consumers move off the standard variable tariff to now cheaper fixed-term contracts, leaving suppliers potentially facing losses on the energy they had purchased for those consumers. As set out below and in the accompanying discussion paper, this makes the task of managing these risks on behalf of consumers very challenging.

When wholesale prices fall, we want consumers to benefit from lower bills in a timely manner. We also want to avoid the risk that consumers could end up paying more in the longer run due to the costs involved if more suppliers fail due to being unable to recover costs that they have incurred in serving customers protected by the price cap. As such, there is a balance of costs and benefits to current and future consumers to be considered here.

Potential temporary interventions to address risks to consumers

The actions Ofgem is announcing today to improve financial resilience among new and growing suppliers will go some way to mitigating the risks identified. We remain to be convinced as to whether further action is warranted in the interests of consumers. Nevertheless, it is prudent for Ofgem to work up contingency options in case significant risks to consumers look likely to materialise.

This document sets out three temporary actions that Ofgem could take in response to the severe market risks identified:

1. Requiring suppliers to make all new tariffs available to existing customers
2. Allowing suppliers to charge exit fees on certain Standard Variable Tariffs
3. Requiring suppliers to pay a Market Stabilisation Charge when acquiring new customers.

These options could, in different ways, help suppliers to better manage, on behalf of consumers, the risks posed by severe energy price volatility and so mitigate the potential costs to consumers if wholesale prices rise or fall significantly. In the short term, they could also dampen competition and reduce the savings available to consumers.

While these options are intended to be targeted and proportionate, given the potential downsides to consumers, we are not attracted at this time to the more interventionist options of exit fees or customer acquisition charges. Ofgem continues to believe strongly in the benefits of competition, so there would be a high bar to any measures that put even modest and temporary constraints on switching. However, the unprecedented energy price volatility requires consideration of some temporary interventions that, due to the extreme market conditions, may be in consumer interests.

We welcome stakeholder views by 17 January 2022 on the potential scale and timing of the risks to consumers posed by current market volatility, the case for intervention to protect consumers' interests and the nature of any such intervention. Informed by these responses, we will take a decision by the start of February on whether and, if so, how to proceed.

1. Introduction

What are we consulting on?

1.1. This consultation document sets out a particular set of risks posed by current unprecedented wholesale energy market volatility, which could lead to poor outcomes for consumers – notably the challenge for suppliers of managing risks in buying energy for their domestic customers. The document then considers whether there is a case for intervention and, if so, how to address those risks in the best interests of consumers.

1.2. The focus of this consultation is on risks that may materialise before adjustments to the price cap methodology can be introduced and, hence, on options for near-term, temporary measures that could be implemented if needed to protect the interests of consumers.

1.3. This document is split into three chapters:

- Chapter 1 sets out the scope, purpose and context for this consultation, and outlines the key stages the consultation will progress through to get to a final decision.
- Chapter 2 sets out the nature, scale and timing of risks posed by current market volatility, asks whether we have correctly identified those risks and whether the potential harm to consumers is sufficient to warrant intervention.
- Chapter 3 sets out a range of possible short-term temporary interventions that could help to protect consumers' interests and asks which of these, if any, would be justified to mitigate the risks identified.

Context and related publications

1.4. The unprecedented and unexpected rise in gas and electricity prices over recent months has put energy markets under severe strain. Our open letter[1] dated 29 October set out the steps Ofgem is taking to manage this situation to protect the interests of consumers now and in the future. We have today published an open letter[2] updating

[1] https://www.ofgem.gov.uk/publications/rising-wholesale-energy-prices-and-implications-regulatory-framework
[2] https://www.ofgem.gov.uk/publications/building-energy-market-resilience

on the actions we've taken since then and on how we are now moving ahead with major reforms to increase retail market resilience:

- An enhanced approach to monitoring, compliance and enforcement of licence conditions to ensure energy suppliers pursue sustainable business models, minimising risks to customers and the market as a whole.
- Seeking stakeholder views on whether to make adjustments to the price cap methodology to ensure it continues to protect customers, while allowing suppliers to recover their efficient costs during times of increased energy price volatility.

1.5. These changes will establish more comprehensive risk management in the sector, protecting the interests of consumers, providing greater certainty for investors and strengthening the resilience of the sector.

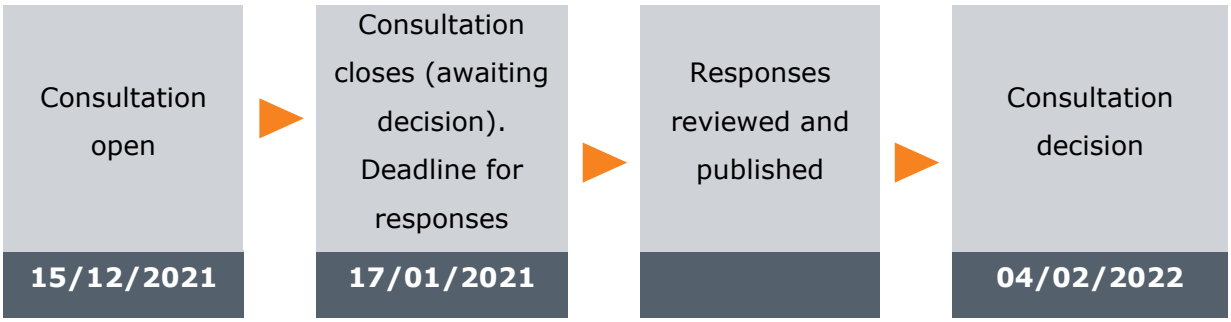
Consultation stages

1.6. This Statutory Consultation sets out further detail on the rationale for taking actions, and sets out the short-term interventions we are considering. This Statutory Consultation has not been preceded by a policy consultation, due to the urgency and pace required to implement any intervention deemed necessary following this consultation, to address the risks we have identified. It is accompanied by statutory notices of our intention to modify licences, with further details in Appendix 1.

1.7. We invite stakeholders to submit comments on any aspect of this consultation on or before 17 January 2022. This will give Ofgem, if persuaded of the need to act in consumer interests, the ability to implement measures that could come into effect from 1 April 2022. This would require a decision from Ofgem to be published early in February.

1.8. Industry stakeholders are invited to provide any relevant supporting material evidencing the nature, scale and timing of risks posed by current market volatility. To support our thinking, we would particularly welcome any evidence of this nature to be provided by 7 January 2022. However, we will consider all evidence provided by the consultation deadline.

Figure 1: Consultation Stages



Next steps

1.9. Following our consultation decision, should we proceed with any of the possible short-term intervention options listed in Chapter 3, Ofgem will take the steps, or similar, as set out in the implementation plan for each individual intervention measure. Dependent on the intervention, this may involve publishing licence modifications at the same time as the consultation decision, and further activity involving industry code modifications.

How to respond

1.10. We want to hear from anyone interested in this consultation. Responses to this consultation and any supporting evidence can be submitted to Ofgem by emailing retailpolicyinterventions@ofgem.gov.uk.

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

1.12. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

1.13. You can ask us to keep your response, or parts of your response, confidential. We'll 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.

1.14. 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 that you do not wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with 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.

1.15. 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 UK'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 3.

1.16. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't 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.

General feedback

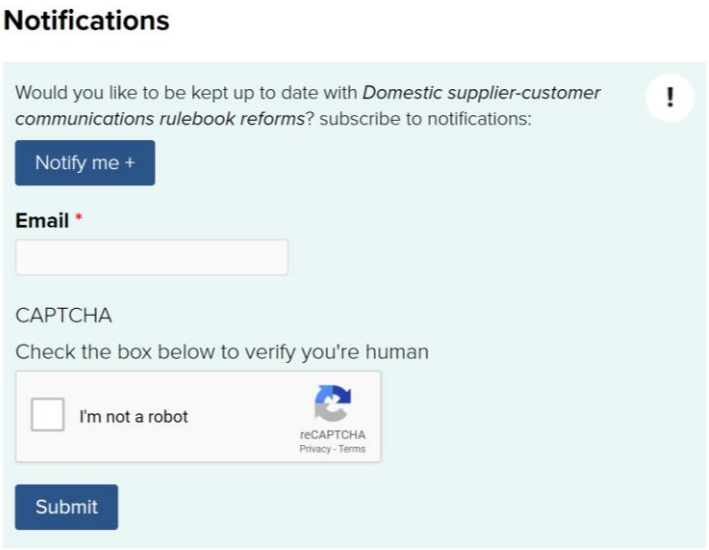
1.17. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Do you have any further comments?

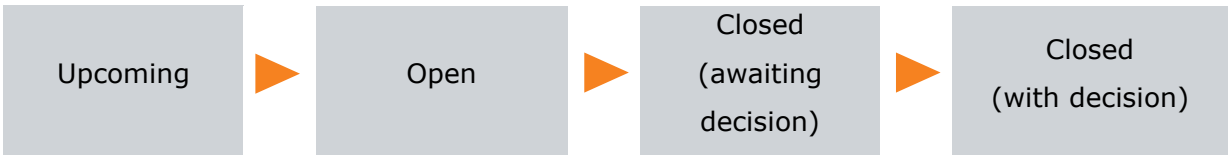
1.18. Please send any general feedback comments to stakeholders@ofgem.gov.uk.

How to track the progress of the consultation

1.19. You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Ofgem.gov.uk/consultations.



1.20. Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



2. Risks to consumers from continued wholesale market volatility

Section summary

The energy market continues to experience unprecedented volatility and wholesale prices for future seasons may yet rise or fall significantly. Active consumers stand to benefit most quickly from falling prices, but all consumers, including those were unable/unwilling to switch to a cheaper tariff, could suffer disbenefit if suppliers exit as a result of having to manage exceptionally high levels of uncertainty in both future demand and wholesale price exposure. The potential losses for suppliers pose significant risks to consumers. In more severe scenarios, we could see more suppliers being unable to finance their operations, which would lead to consumers incurring significant additional mutualised costs in the near term and reduce market competitiveness in the longer term.

Questions

Question 1: Have we correctly identified and assessed the risks to consumers from continued wholesale market volatility?

Question 2: Do you believe that intervention is warranted in the interests of consumers

2.1. The unprecedented rise in global energy prices this year has changed the costs, risks and uncertainties facing the supply companies we regulate. In this section, we set out the potential consumer harms from this severe market volatility.

The challenges of wholesale market volatility

2.2. Consumers have seen significant increases in their energy bills over the past 9 months as a result of the increase in wholesale costs, including the 12% increase in the price cap that many consumers experienced in October 2021. The price cap has protected domestic consumers from higher costs, delaying and smoothing the pass-through of unprecedented high commodity prices to households.

2.3. As new fixed-term contracts have become increasingly expensive, we have seen an increasing number of customers move from a fixed tariff and onto a 'capped' default tariff when their contracts expire. By October 2021, there were around 2 million more default tariff customers than in April 2021. Based on current forward wholesale prices, up to 2 million more consumers could move onto Standard Variable Tariffs (SVTs) as their fixed-term contracts expire over the winter.

2.4. Suppliers routinely manage price and volume risk using hedging and other strategies. This becomes more challenging and costly at times of severe market volatility. If suppliers do not hedge fully for next summer and prices rise, suppliers could face significant losses in having to supply additional SVT customers (e.g., active consumers who would normally have signed up to fixed tariffs), and at higher costs than covered by the price cap. Similarly, if suppliers seek to manage this risk by hedging fully, but prices then fall, they could see significant losses as active consumers move off the SVT tariff onto cheaper fixed deals. Whilst entirely rational for active consumers, this leaves suppliers with a set of risks that are hard to manage and could leave them with significant losses.

Expected impact on consumers

2.5. The default tariff price cap for April to October 2022 is expected to be significantly higher than the current level. If wholesale prices fall below these levels, then suppliers are likely to offer fixed tariffs significantly cheaper than the price cap level. There would be significant potential benefit for consumers who switch.

2.6. We would not expect all consumers on default tariffs to react in the same way. We have historically seen large numbers of consumers remain inactive even when considerable savings are available from switching. It is uncertain whether this would continue as the price cap reaches higher levels.

2.7. As we have seen in recent months, losses for suppliers can lead to significant costs for consumers. If suppliers exit the market because continued wholesale market volatility makes financing their operations unsustainable then all domestic consumers would be exposed to additional mutualised costs, including the recovery of Supplier of Last Resort (SoLR) payments and/or Special Administrative Regime (SAR) costs.

2.8. In addition, if some suppliers are unable to finance their activities and choose to voluntarily exit the market and/or high risks and losses deter further entry from new

investors, then there may be a decrease in competition in the market. This could harm consumers in the long-run due to a lower competition in prices/services and lower investment/innovation.

Quantification of consumer benefit/loss

2.9. Given the uncertainty over future wholesale market prices, we have developed three scenarios[3] to explore the impact of different prices on consumers:

- Prices fall to historic summer averages (~50p/therm for gas) over summer 2022.
- Prices outturn similar to recent expectations[4] (~110p/therm) over summer.
- Prices remain high (~250p/therm for gas) over summer 2022.

2.10. Under the falling prices scenario, we anticipate that several million domestic consumers could switch from SVTs to lower-priced, fixed-term tariffs in response to potential average savings of about £230 per year, up to a maximum of about £460. As shown in Table 1, under those conditions, domestic consumers who choose to switch would enjoy a total net benefit of £1.3-1.6bn, whereas others would only see £0.1-0.8bn disbenefit from additional mutualised costs. All consumers would incur mutualised costs if there were further supplier failures but for those that switch, these costs would be outweighed by the gains from switching. As noted in paragraph 2.8, there are additional disbenefits for all consumers that are hard to quantify but could be significant in the long run. Nevertheless, we see that just considering the falling price scenario suggests the case for intervention is currently relatively weak.

2.11. Under the rising prices scenario, we would expect more consumers to be on SVTs as there would be no price benefits from switching and others would default onto SVTs from fixed tariffs that come to an end. Given the additional costs that suppliers may face in this scenario, particularly where they are more exposed to rising wholesale prices, there is again a risk of supplier exits. The higher prevailing wholesale prices in this scenario mean that the mutualised costs incurred to protect affected consumers would be £1.8-2.6bn higher than those in the falling prices scenario.

[3] Our assumptions and approach to impact assessment are described in more detail in Appendix 4.
[4] Based on the price cap observation window up to 3rd December. We recognise that forward prices have increased significantly in recent weeks and remain volatile so there is significant uncertainty on future outturn.

Table 1: Quantified consumer benefit under different wholesale price scenarios

	Wholesale price scenario		
	Falling	**Steady**	**Rising**
Benefit for consumers switching[5] (£bn)	+1.3 – 1.6	-	-
Benefit for consumers unable/unwilling to switch (£bn)	(0.1) – (0.8)	0.0 – (0.1)	(1.8) – (2.6)
Total benefit for all consumers (£bn)	+0.6 – 1.5	0.0 – (0.1)	(1.8) – (2.6)

Note: Ranges indicate breadth of possible supplier hedging positions by summer 2022.

Distributional considerations

2.12. Low income and vulnerable consumers are less likely to switch tariff and are more likely to remain on SVTs. Assuming this continues, these consumers are less likely to immediately enjoy the full benefit should wholesale prices fall but would pay a share of the costs of any supplier failures/exits resulting from market volatility.

2.13. In the falling prices scenario, low-income consumers who do not switch would see an increase in their energy spend of around 0.3% of their disposable income. Higher income consumers that are also less likely to switch would see an increase of around 0.1%. If these same consumer archetypes were to switch, low-income consumers benefit from a higher saving in percentage of their disposable income (+1.6%) than higher-income consumers (+0.6%). In a rising prices scenario, low income and high-income consumers would see increased energy costs respectively equal to 0.5% and 0.2% of their disposable income respectively.

Impacts on suppliers

2.14. The impact of falling and rising prices on suppliers depends crucially on the operational choices of those businesses. As shown in the ranges given in Table 2, if suppliers seek to partially mitigate the downside price-volume risk by hedging only a fraction of their initial SVT demand, then losses under the falling price scenario would be reduced to

[5] Benefits for consumers switching in all tables are presented net of their share of additional mutualised costs.

about £60m (indicatively assuming 60% hedging on average), albeit opening up potential losses of £7.5bn under a rising prices scenario.

2.15. Conversely, if suppliers hedge more of their initial SVT demand, whilst mitigating the impact of the rising price scenario by 80%, their exposure to the falling price scenario would be £1.4bn.

Table 2: Domestic supplier market loss under different wholesale price scenarios

	Wholesale price scenario		
	Falling	**Steady**	**Rising**
Total supplier loss (£bn)	0.1 – 1.4	0.1 – 0.3	1.5 – 7.5

Note: Ranges indicate breadth of possible supplier hedging positions by summer 2022.

Conclusion

2.16. The analysis above suggests that active consumers are, as one would expect, likely to benefit significantly in the near-term in a falling prices scenario. But all consumers, including those who were unable/unwilling to switch to a cheaper tariff, could suffer disbenefit if suppliers exit as a result. They could all be impacted in the near-term by additional mutualised costs and in the long-run by lower levels of competition and innovation/investment. On the basis of the falling price scenario alone, the case for intervention is relatively weak.

2.17. In a rising prices scenario, there are significant disbenefits for consumers, depending on how suppliers have sought to manage those risks. Measures aimed at addressing the risks associated with falling prices could give suppliers greater confidence to hedge more fully (or otherwise manage risks from price volatility) for the summer 2022 period.

2.18. We are interested to get views from stakeholders on whether the risks identified in this chapter warrant any interventions in the interests of consumers. Ofgem's bar for intervention will be high. We expect to know more in January about the near-term outlook and have a clearer understanding of the risks that consumers are facing.

3. Options to mitigate risks to consumers

Section summary

This chapter sets out a range of possible short-term and temporary measures which could, if needed, be implemented to address the risks to consumers identified in the previous chapter, and asks which of these, if any, would be a reasonable and proportionate response to these risks. Given the potential downsides to consumers, we are not attracted at this time to the more interventionist options of exit fees or customer acquisition charges.

Questions

Question 3: Which of these possible interventions, if any, would be most effective and proportionate in addressing the risks identified in consumers' interests?

Question 4: For each option, are there particular benefits or risks for consumers, including those in vulnerable circumstances, that we have not identified?

Question 5: For each option, do you agree that we have identified the full range of expected impacts on suppliers, consumers and competition?

Question 6: Where applicable, do you agree that the draft Licence Condition text accurately implements the intervention as described?

3.1. This chapter sets out a number of options open to Ofgem in responding to the risks to consumers outlined in Chapter 2.

3.2. Based on our current analysis, it is possible that these risks could materialise in a way that the costs to consumers in the longer term outweigh any benefit to consumers, for example from cheaper prices in the short term. Nevertheless, there is considerable uncertainty around future wholesale prices and it is entirely possible that the risks do not materialise in a significant way.

3.3. When we come to take a decision on how to proceed here – by the start of February – the market situation may have evolved and, with it, our assessment of the likelihood and impact of any risks in this space.

3.4. We consider first the default option of taking no further action beyond the measures we have announced to adjust the price cap for April 2022 and improve financial

resilience among new and growing suppliers. We believe these measures will provide some modest mitigation of the potential risks to consumers.

3.5. Through engagement with stakeholders, we have identified a number of options that could be taken forward in the event that severe risks to consumers look likely to materialise.[6] These are as follows:

- Option 1: Requiring suppliers to make all new tariffs available to existing customers
- Option 2: Allowing suppliers to charge exit fees on certain Standard Variable Tariffs
- Option 3: Requiring suppliers to pay for a Market Stabilisation Charge when acquiring new customers.

3.6. For each option, we describe the nature of the intervention and how this would address the risks identified. We then assess the expected impacts for consumers, suppliers and the market as a whole. Finally, we set out how each measure would be implemented.

3.7. Our default position is not to implement these measures, but we nevertheless are consulting on these potential interventions in order to give ourselves the tools to intervene if we believe it is in consumers interests that we do so.

Our approach to Impact Assessment

3.8. The policy options set out in this document could result in 'significant impact' on the domestic supply of gas and electricity markets, as described under the criteria in s.5A of the Utilities Act 2000, therefore an Impact Assessment is required.

3.9. Due to the urgent nature of this consultation, we consider that a relatively simple Impact Assessment is proportionate in the time available. For this reason, we have

[6] Other suggestions made by stakeholders included a temporary ban on all switching and the introduction of a temporary price floor for new tariffs. We did not feel that these would be proportionate interventions, so have not developed them further for the purposes of this consultation.

included our assessment with the policy options in the consultation document and not a separate document.

3.10. We have supplemented our quantitative analysis with qualitative assessment of impacts for consumers, suppliers, and competition. We have assessed impacts against the 'Do nothing' option, set out in Chapter 2 and further below. We welcome further evidence in responses to this consultation.

'Do nothing' option

3.11. As set out in Chapter 1 and in accompanying documents, Ofgem is already taking actions to stabilise and reform the retail energy market. A number of these will help to mitigate the risks to consumers identified in Chapter 2. In particular:

- We are putting in place an enhanced approach to monitoring, compliance and enforcement of licence conditions to ensure energy suppliers pursue sustainable business models, minimising risks to customers and the market as a whole. This includes setting a higher bar for suppliers to demonstrate that they are on a sound financial footing, setting firmer expectations on the capital investment that suppliers should have in place and taking a more robust approach to assessing suppliers' operational capacity. As part of this, we are consulting in parallel with this document on licence modifications that strengthen our ability to assess the sustainability of growing suppliers and to scrutinise trade sales and significant commercial and personnel changes.

- While we put in place these enhanced measures to improve supplier financial resilience, and to help restore stability in the sector, in the interests of consumers, we are also extending our temporary 'pause' of the assessment of applications for new supply licences to a period of nine months.[7] We are also continuing to revoke unused or dormant supply licences as appropriate.[8]

[7] During this period, we are also disapplying the deemed authorisation mechanism.
[8] See associated links here:
https://www.ofgem.gov.uk/publications/building-energy-market-resilience

3.12. Taken together, these measures will reduce the likelihood of suppliers – new or existing – pursuing unsustainable business models and offering unsustainably low-priced tariffs in a way that could drive or even exacerbate the risks identified in a scenario of rapidly falling wholesale prices.

3.13. We are also consulting on proposals to modify supply licences to introduce an ability for us to amend the price cap outside of our routine six-month cycle, where exceptional circumstances occur that would have high impacts without urgent action.

3.14. These measures may be sufficient to limit the potential risks to consumers set out in Chapter 2. And would allow consumers that switch to save money in a scenario where wholesale prices fall. We will reserve judgement on whether this 'do nothing' approach is more appropriate until we have reviewed further evidence, considered how the market situation may have evolved, and responses to this consultation.

Option 1: Requiring suppliers to make all new tariffs available to existing customers

Description

3.15. Under this option, we would require domestic suppliers offering tariffs for the acquisition of new customers to make them available to existing customers as well.

3.16. The intention would be for this measure to be time limited until the end of September 2022.

Rationale

3.17. This measure would aim to mitigate the risks to consumers identified in Chapter 2 by reducing to some degree the incentives for suppliers to price significantly lower to acquire new customers and, in this way, reducing the potential losses caused by high levels of churn in scenarios with significant falls in wholesale prices.

3.18. By requiring all tariffs (subject to certain exclusions specified in the licence) to be available to existing customers, suppliers might be expected to reduce their acquisition pricing to some degree to avoid revenue losses from internal switching. In aggregate, this would reduce the intensity of price competition. And, in turn, this could reduce the amount of churn and, hence, potential supplier losses.

3.19. In parallel, we are undertaking actions to improve financial resilience among new entrants and growing suppliers that would be expected to reduce the likelihood of unsustainably low pricing in the market when wholesale prices fall. These actions would increase the potential effectiveness of this option by reducing the drive for suppliers to respond to any unsustainable pricing behaviour.

3.20. This measure would also serve to limit price discrimination by suppliers, with potential wider consumer benefits. It could mean that consumers are able to save money by staying with their supplier, which may tempt more of them to switch tariff when prices fall than would otherwise be the case.[9]

Expected impact on consumers, suppliers, and competition

Impact on consumers – energy bills

3.21. In the falling prices scenario, we would expect this option to lead to smaller differentials between suppliers' SVT and FTC prices compared to the 'Do nothing' option. This would reduce the potential savings that engaged consumers could achieve and, hence, lead to lower levels of customer switching between suppliers.

3.22. Nevertheless, we could also see a greater number of consumers able to benefit from cheaper tariffs if there was a significant fall in wholesale prices. This is because customers who would otherwise not wish to switch supplier being able to save money by switching to their own suppliers' acquisition tariffs. As such, we would expect to see an increase in internal switches, albeit less than the fall in external switches.

3.23. Overall, this option could reduce supplier losses and, hence, the risk of suppliers failing. As shown in Table 3, active consumers could still benefit by £0.2-0.3bn in the short term. That is £0.4-1.2bn lower compared to the 'Do nothing' option. Consumers not able or willing to switch could benefit from lower costs than they would have seen

[9] Such a provision was previously put in place by Ofgem's Retail Market Review reforms in 2013. The intention was to make the retail energy market simpler and fairer for all consumers. Ofgem revoked this requirement in 2016 following a recommendation by the Competition & Markets Authority (CMA) as part of its Energy Market Investigation. The CMA argued it could limit competitive pressure amongst suppliers. However, the CMA also acknowledged that removing the requirement could result in suppliers gaming the rules by directing cheaper tariffs only at new customers and hiding them from existing customers.

under the 'Do nothing' option. This is because of the reduction in supplier failures and the associated mutualised costs.

Table 3: Quantified consumer benefits from making tariffs available to existing and new customers under different wholesale price scenarios

	Wholesale price scenario		
	Falling	**Steady**	**Rising**
Benefit for consumers switching (£bn)	0.3 – 0.3	-	-
Difference vs. 'do nothing' (£bn)	*(1.0) – (1.2)*		
Benefit for consumers unable/unwilling to switch (£bn)	(0.1) - 0.0	(0.1) – 0.0	(1.8) – (2.6)
Difference vs. 'do nothing' (£bn)	*(0.7) – 0.0*	*0.0 – 0.0*	*0.0 – 0.0*
Total benefit for all consumers (£bn)	0.2 – 0.3	(0.1) – 0.0	(1.8) – (2.6)
Difference vs. 'Do nothing' (£bn)	*0.4 – 1.2*	*0.0 – 0.0*	*0.0 – 0.0*

Note: Ranges indicate breadth of possible supplier hedging positions by summer 2022.

Impact on consumers - distributional considerations

3.24. In a falling prices scenario, this option could mean lower-income consumers that are less likely to switch would see only a negligible increase in energy spend as a proportion of disposable income (up to 0.04%). This is an improved outcome compared to 'do nothing' in which these consumers are likely to see a larger increase in their energy bills. This is because under 'do nothing' there would be the costs of supplier failure added to these consumers' energy bills.

Impact on consumers – confidence and trust in the energy market

3.25. Consumers' trust in the market could increase if they know they can access offers from their existing supplier that are also open to new customers. They may feel the market is more transparent and that people are not being unfairly penalised for their loyalty.

Impact on suppliers

3.26. Suppliers' response would have a major bearing on the effectiveness of this policy. For example, some suppliers could focus in the short term on maximising revenue and

may not want to offer cheap tariffs whether to new or existing customers. They may prefer to mitigate the risk that existing customers switch to cheap tariffs by offering tariffs at a higher rate than would otherwise have been the case or not at all.

3.27. Nevertheless, some suppliers may be able to offer cheaper FTCs because they have hedged differently and/or may have a customer base that is proportionately less likely to switch. And other Ofgem measures to strengthen checks on market entry and growth would serve limit unsustainable competition on price. Ultimately, however, it is difficult to predict how suppliers will respond and this brings significant uncertainty to our assessment of impact.

3.28. The ranges of potential monetary impacts on suppliers are given in Table 4. These builds on the assumption that suppliers will not choose to offer the full extent of cheaper tariffs as a result of the proposed measure.

Table 4: Domestic supplier market loss from making tariffs available to existing and new customers under different wholesale price scenarios

	Wholesale price scenario		
	Falling	**Steady**	**Rising**
Total supplier loss (£bn)	0.0 - 0.3	0.1–0.3	1.5 – 7.5
Difference vs 'Do nothing' (£bn)	*(0.1) - (1.1)*	-	-

Note: Ranges indicate breadth of possible supplier hedging positions by summer 2022.

Impact on competition

3.29. We recognise that the measure could dampen competition. As there would be less incentive for rivalry and consequently less incentive for consumers to switch suppliers if the differential between an SVT and a fixed-price tariff is smaller. Any effect would be time limited as the measure is only intended to last for six months.

Implementation Plan

3.30. This proposal would require amending the supply licence. If we were to proceed with this measure, we expect the change to take effect 56 days after the Decision is published. It could be implemented by 1 April 2022. Further information and the relevant links to statutory notices are in Appendix 1.

3.31. If we were to implement this measure, it would be time limited, ceasing to have effect after 30 September 2022, unless the Authority decided to extend it by up to a further six months.

Option 2: Allowing suppliers to charge exit fees on some Standard Variable Tariffs

Description

3.32. Under this option, Ofgem would allow suppliers to temporarily introduce exit fees[10] for domestic customers on Standard Variable Tariffs (SVTs), other than deemed contracts[11]. Such fees are commonplace for fixed-term contracts but are currently not permitted for contracts of indefinite length, such as SVTs, by supply licence condition 24.3. The intention would be for this measure to be time limited until the end of September 2022.

3.33. As noted above, this measure would not apply to deemed contracts as the consumer would not have actively chosen to be with their current supplier. Examples of this include where a customer has moved into a new property or been transferred to a supplier of last resort.

3.34. We would require suppliers that choose to introduce exit fees in this way to follow the principles already set out in the licence relating to exit fees for fixed-term contracts. In particular, these require that any fee would need to be (a) proportionate, and (b) must not exceed the direct economic loss to the supplier.

Rationale

3.35. Suppliers will usually have hedged to supply the expected demand from customers on SVT tariffs. These customers are currently free to leave these contracts at any time without incurring an exit fee when cheaper prices are available. If market prices fall,

[10] We use the term 'exit fee' in this document, which has the same meaning as Termination Fee as defined in the licence.
[11] For the avoidance of doubt, exit fees would not be permitted on Deemed Contracts (as defined in the licence).

millions of SVT consumers may move to fixed tariffs, leaving suppliers unable to cover the costs of the energy they have committed to buy. Exit fees would enable the supplier to recover the legitimate hedging costs they have incurred on behalf of their SVT customers. Furthermore, supplier losses would also be reduced as some consumers who may otherwise have switched, would choose not to do so – or not be able to do so – because of the existence of an exit fee.

3.36. By reducing the potential losses to suppliers in a scenario of significantly falling wholesale prices, this measure could also give suppliers greater confidence to hedge more fully (or otherwise manage risks from price volatility) for the summer 2022 period. This, in turn, would also mitigate some of the risks to consumers in a scenario of significantly rising prices.

3.37. Exit fees are common in other sectors where firms take on price risk for consumers, for example, fixed-rate mortgages. However, we recognise that allowing exit fees on SVTs would be a departure from Ofgem's previous policy position. There will be a high bar for Ofgem to introduce such a policy, and Ofgem would need to be convinced that this intervention was in consumers' interests.

Expected impact on consumers, suppliers and competition

Impacts on consumers

- *Impact on consumers – energy bills*

3.38. Under the falling prices scenario, domestic consumers who choose to switch to a cheaper tariff would save less by virtue of having to pay an exit fee (and those deterred from switching due to the existence of an exit fee would not make any direct savings[12]). However, consumers overall would stand to benefit from the avoidance of significant mutualised costs from additional supplier failures.

3.39. Table **5** quantifies the net consumer benefits associated with allowing exit fees on some SVTs.

[12] We know from behavioural economics that consumers often prefer to avoid paying for something now even if it would provide for a larger gain in future.

Table 5: Quantified consumer benefits from allowing exit fees on some SVTs

	Wholesale price scenario		
	Falling	**Steady**	**Rising**
Benefit for consumers switching (£bn)	0.2 – 0.8	-	-
Difference vs. 'do nothing' (£bn)	*(0.8) - 0.7*	-	-
Benefit for consumers unable/unwilling to switch (£bn)	(0.1) - 0.0	0.0	(2.6) – 0.0
Difference vs. 'do nothing' (£bn)	*(0.1) - 0.1*	*0.0 - 0.1*	*0.0 – 1.8*
Total benefit for all consumers (£bn)	0.1 - 0.8	0.0	(2.6) - 0.0
Difference vs. 'do nothing' (£bn)	*(0.7) - 0.6*	*0.0 - 0.1*	*0.0 – 1.8*

3.40. Suppliers would be allowed to set exit fees at a level no higher than reflects the direct economic loss for them at the point a customer switched away. As a result, the level of any fees should be relatively low in situations where wholesale prices have not fallen significantly, though could be much higher where wholesale prices are low.

3.41. In a rising prices scenario, we estimate that there would be up to £1.8bn additional benefit for all consumers compared to the 'Do nothing' option due to the reduction in mutualised costs arising from the increased confidence that suppliers would have in their ability to manage their downside risks.

- *Impact on consumers – distributional considerations*

3.42. This option could have a negative distributional impact as an exit fee would likely be a stronger disincentive to switching for low-income consumers, for whom it would represent a greater proportion of their income. In this situation, low-income consumers would be more likely to miss out on the savings from switching to a cheaper tariff, despite standing to benefit most from being able to do so. This impact may be lessened by the fact that vulnerable consumers overall tend to switch less often than other customer segments.

3.43. In a falling prices scenario, low-income consumers that do not switch would see a negligible increase in energy costs as a percentage of disposable income (up to 0.04%). This is positive in comparison to the 'do nothing' option due to the lower costs

associated with supplier exits. High-income consumers that do not switch would see an increase of 0.01%, less than the 0.1% under 'do nothing' option.

- *Impact on consumers – confidence and trust*

3.44. Allowing exit fees on certain SVTs could undermine confidence in the market, for example where consumers have previously switched to an SVT without agreeing to an exit fee at that stage and, hence, had not factored in the fee when making their decision to switch. Consumers would be offered the opportunity to switch away from a supplier before any exit fee came into effect in their contract, but this may be of little help if there are no cheaper tariffs on the market at the time. Exit fees could also have a negative impact on those consumers that want to switch for non-financial reasons, such as poor customer service.

Impacts on suppliers

3.45. Exit fees would provide a mechanism for suppliers to recover economic losses from lost customers in a falling prices scenario, as shown in Table 6.

3.46. Suppliers wishing to impose exit fees would need to comply with existing licence conditions in respect of disadvantageous unilateral variations (SLC 31I) and therefore need to notify consumers that their contracts were changing so that consumers have time to make an informed decision about their actions before the change comes into effect. This notification could lead some consumers to leave ahead of the implementation of those fees, meaning that the suppliers which are intended to benefit from the fee do not actually receive it.

3.47. Some suppliers may choose not to impose exit fees to attract consumers. We do not believe this would reduce the effectiveness of the measure as the suppliers who are most at risk of exit would be most likely to utilise the exit fee option.

3.48. For suppliers, there is some anecdotal evidence that they may lack a way of enforcing payment of exit fees before their customer leaves them. Unpaid fees are only counted as debt after 28 days; during this time consumers would likely have switched away. We welcome further evidence on this issue from suppliers and consumer groups.

Table 6: Domestic energy market loss from allowing exit fees on some SVTs

	Wholesale price scenario		
	Falling	**Steady**	**Rising**
Total supplier loss (£bn)	0.0 – 0.8	0.0 – 0.2	0.0 – 6.2
Difference vs. 'do nothing' (£bn)	*(0.7) – (0.0)*	*(0.05) - (0.06)*	*(1.5) - (1.2)*

Note: Ranges indicate breadth of possible supplier hedging positions by summer 2022.

Impact on competition

3.49. Temporarily allowing exit fees on SVTs would reduce competition and switching in the market in the short term, although (as described above) may increase switching when consumers are first notified of their introduction.

3.50. In the longer term, by potentially preventing a number of supplier exits, there would be more suppliers in the market. It is likely that consumers would therefore benefit from increased competition compared to the 'do nothing' option.

Implementation plan

3.51. We would allow suppliers to introduce exit fees for SVTs (excluding Deemed Contracts as defined in the supply licence) by issuing a market-wide derogation from the prohibition of exit fees on all contracts of indeterminate length. As a condition of the derogation, such fees would be subject to the rules already set out in the licence relating to exit fees for FTCs. We consider that a market-wide derogation would be a more suitable option for a short-term intervention of this nature than seeking to modify licence conditions.

3.52. Suppliers wishing to impose exit fees would need to change the terms of their contracts with SVT customers. This would involve them sending a notification to customers of a Disadvantageous Unilateral Variation. In doing so, as set out in SLC 31I, suppliers must give sufficient information and time for the customer to make an informed decision before the variation takes effect. Customers could then choose to change tariff with their supplier, switch to another supplier or do nothing, thereby accepting the new contract terms.

3.53. We expect that suppliers would be able to have exit fees in place by the start of April if the Authority issued a market-wide derogation in early February. The derogation would

apply on a temporary basis until the end of September 2022, subject to any extension by the Authority.

3.54. Ofgem would observe the exit fees imposed by suppliers and would be prepared to take compliance or enforcement action if suppliers were found to be charging excessive exit fees, in line with our normal enforcement criteria.

Option 3: Requiring suppliers to pay a Market Stabilisation Charge when acquiring new customers

Questions

Question 7: Do you agree that the methodology outlined in Appendix 2 best delivers the charge described in this consultation document?

Question 8: Do you agree that an ex-ante publication of the charge delivers the best outcome for customers?

Question 9: Do you agree that a weekly publication represents an appropriate frequency of charge update?

Question 10: Do you agree that the payment mechanism described here is the most effective way of ensuring that charges are collected and paid?

Description

3.55. Under this option, we would require all suppliers acquiring a domestic customer to pay a 'Market Stabilisation Charge' to the losing supplier[13]. This charge would represent a proportion of the economic loss to the losing supplier applied when the switch occurs and would be based on a customer's estimated annual consumption.

3.56. We would set the charge such that it would only come into effect if wholesale prices were to fall significantly below the level assumed in the summer 2022 price cap (by somewhere between 30% and 50%, based on our current modelling and market outlook). Ofgem would calculate and publish the level of the charge on a regular basis in line with a transparent methodology, such that suppliers can factor this in when

[13] We believe that applying the Market Stabilisation Charge to all switches (including switches away from Fixed Term Contracts) would simplify and speed up implementation, as described in Appendix 2. The risk of overcompensation is mitigated as the charge only represents a portion of the economic costs incurred by a supplier.

setting their retail tariffs. Our proposed methodology for the calculation of the charge is set out in Appendix 2. To facilitate the payments and data flows, we would look for temporary industry code provisions to be introduced.

3.57. The intention would be, even if introduced, for this measure to be time limited; only applying during the period April to September 2022. As with exit fees, this measure will only be introduced if Ofgem consider market volatility to be sufficient to justify such an intervention, and that the measure would be in consumers interests.

Rationale

3.58. The Market Stabilisation Charge could, if introduced, potentially mitigate risks to consumers outlined in Chapter 2 by enabling suppliers to recover a portion of the efficient costs incurred on behalf of SVT customers when those customers choose to switch away as market prices fall.

3.59. We consider that this could be in consumers' interests because, in scenarios of more significant wholesale price falls, the benefits to those consumers who make savings from switching may be outweighed by the costs to consumers in the longer term from mutualised costs of failures. While the measure may dampen competition in the short term (resulting in the cheapest tariffs on the market being higher than in the 'do nothing' scenario), it could be justified in these exceptional circumstances, as the intervention is time-limited and only takes effect in more severe scenarios (where risks to consumers are greatest).

3.60. By reducing the potential losses to suppliers in a scenario of significantly falling wholesale prices, this measure could also give suppliers greater confidence to hedge more fully (or otherwise manage risks from price volatility) for the summer 2022 period. This, in turn, would also mitigate some of the risks to consumers in a scenario of significantly rising prices.

3.61. This charge would be designed to cover only a portion of incremental losses (the losses associated with further falls in the wholesale price) beyond the point at which consumers otherwise begin to be exposed to the risks described in Chapter 2. This progressive approach would mean that the charge, once introduced, grows steadily to limit customers' exposure to the minimum level necessary to stabilise the domestic retail market. Furthermore, this design would avoid a cliff edge whereby a small change in wholesale prices would result in the sudden introduction of a large charge.

Expected Impact on consumers, suppliers and competition

Impacts on consumers

3.62. Consumers would face little to no impact as a result of this charge if wholesale prices do not fall significantly, as the charge would not apply. In the event of wholesale prices falling significantly, this measure would likely have a dampening effect on some consumers' willingness to switch, as suppliers factoring in the charge to their pricing would reduce the levels of savings available compared to the 'do nothing' option. However, consumers would still benefit from switching and there would still be significant savings from doing so. We are conscious of the risk of a lasting impact on consumer engagement but think that is relatively small given the charge is not directly apparent to consumers and switching would bring similar benefits to consumers as it did in the past.

3.63. We would expect consumers that do not switch (through active choice or otherwise) not to be impacted directly by the costs of the Market Stabilisation Charge. Unlike the option of allowing exit fees on SVTs, consumers would not be exposed to any upfront costs as a result of a switch.

3.64. We expect this intervention would help mitigate consumers' exposure to up to £4.6bn of mutualised costs associated with supplier exits and unquantified disbenefits associated with potentially lower levels of competition and innovation; although this comes at the expense of expected lower levels of switching and bill savings in scenarios of significantly falling wholesale prices. In the longer term, we expect this intervention would provide benefits to future consumers through a larger and more diverse set of domestic suppliers. Table 7 quantifies the net consumer benefits associated with the Market Stabilisation Charge.

3.65. In a rising prices scenario, we estimate that there would be up to £1.8bn additional benefit for all consumers compared to the 'Do nothing' option due to the reduction in mutualised costs arising from the increased confidence that suppliers would have in their ability to manage their downside risks.

Table 7: Quantified consumer benefits from Market Stabilisation Charge

	Wholesale price scenario		
	Falling	**Steady**	**Rising**
Benefit for consumers switching (£bn)	0.2 - 0.7	n/a	n/a
Difference vs. 'do nothing' (£bn)	*(0.9) - 0.7*	-	-
Benefit for consumers unable/unwilling to switch (£bn)	(0.1) - 0.0	0.0	(2.6) - 0.0
Difference vs. 'do nothing' (£bn)	*(0.1) - 0.1*	*0.0 - 0.1*	*0.0 - 1.4*
Total benefit for all consumers (£bn)	0.6 - 0.7	0.0	(2.6) - 0.0
Difference vs. 'do nothing' (£bn)	*(0.8) - 0.6*	*0.0 - 0.1*	*0.0 - 1.4*

- *Impacts on consumers – distributional considerations*

3.66. It should be noted that whilst the net impacts are similar to the exit fees, this intervention is substantially more equitable as it does not require an upfront payment to switch, which could be an additional barrier for low-income households to access cheaper tariffs. The net expected impact on switching in the case of exit fees and the Market Stabilisation Charge are described in Appendix 4.

Impacts on suppliers

3.67. If wholesale prices were to fall sufficiently to trigger the charge (or that is expected to happen), we would expect suppliers to factor the charge into their acquisition tariff prices. As the charge is incurred at the point of switch (with payment due a short period thereafter), suppliers acquiring customers would need to ensure they have sufficient working capital to cover the charge.

3.68. The charge would apply to all switches so suppliers would not be obliged to inform competitors which tariff the consumer switched to or from. Nevertheless, suppliers would need to be ready to provide the necessary information and, where appropriate, payments once the Market Stabilisation Charge was triggered.

3.69. As shown in Table 8, suppliers that have hedged close to the strategy implied by the price cap methodology would see their potential losses reduced by up to £0.7bn in a scenario of significant falls in wholesale prices. Individual suppliers that hedged at much greater levels than this may suffer greater than market average losses while

those that have hedged less would face a correspondingly lower loss. Some risks associated with setting hedging strategies therefore still sit with suppliers rather than customers. Under a rising price scenario, potential supplier losses could be partially mitigated by £1.2-1.5bn were suppliers to have increased confidence that they could manage their downside risks.

Table 8: Quantified domestic supplier losses with Market Stabilisation charge

	Wholesale price scenario		
	Falling	**Steady**	**Rising**
Total supplier losses (£bn)	0.0 - 0.7	0.0 - 0.2	0.0 - 6.2
Difference vs. 'do nothing' (£bn)	*(0.7) - (0.1)*	*(0.1) - (0.1)*	*(1.5) - (1.2)*

Note: Ranges indicate breadth of possible supplier hedging positions by summer 2022.

Impacts on competition

3.70. If the charge were to come into effect due to a scenario of significantly falling prices then, by reducing the level of savings available to consumers switching, the charge would weaken the level of competition in the market in the short term. This impact upon competition would increase progressively as the wholesale price of gas and electricity falls further. Nevertheless, suppliers would still be able to compete on price, albeit to a lesser extent than if the charge was not in place, and those with a lower cost to serve, for example, would still be able to offer more competitive tariffs.

3.71. As the charge would be applied to all acquiring suppliers equally and would only cover a portion of losses, suppliers would still be incentivised to compete to acquire new customers. There is a theoretical risk that suppliers make a financial gain by losing individual customers, but given the Market Stabilisation Charge will only be set at a portion of the economic cost of a hedged consumer, we do not consider that suppliers would benefit from seeking to lose customers on a portfolio-wide basis.

3.72. In the longer term, by potentially preventing a number of supplier exits, there would be more suppliers in the market. It is likely that consumers would therefore benefit from increased competition compared to the 'do nothing' option.

Implementation Plan

3.73. The Market Stabilisation Charge would be introduced via a new licence condition. This would describe the principles of the charge and give effect to the charging

methodology, which would be published as Ofgem guidance which describes the calculation of the charge in detail (see Appendix 2). If we were to proceed with this measure, we expect the change to take effect 56 days after the Decision is published. In the event that Ofgem considers the severity of the market situation to justify introducing this measure in the interests of consumers, the most likely date by which Ofgem would seek to introduce this measure would be by 1 April 2022. This charge would expire on 30 September 2022, unless the Authority decided to extend it by up to a further six months. Further information and the relevant links to statutory notices are in Appendix 1.

3.74. For this measure to be operated effectively, we believe that it would need to be underpinned by a consistent set of industry arrangements. We envisage that the payment mechanism would be introduced through a modification to the Retail Energy Code. In order to implement this system, Ofgem would convene a Retail Energy Code Working Group to analyse and determine the best way of implementing the necessary modification to give effect to this system. Ahead of this, Ofgem will engage an informal Working Group in January to understand the likely form of these modifications.

3.75. We would expect a central body – such as RECCo – to manage the mechanism and calculate net credit and debts based on all switches across the market and the level of the charge announced by Ofgem. This body would need to be provided with sufficient data to calculate each supplier's net debt/credit and would inform suppliers as to their net position. The central body would issue invoices to suppliers with a net debt and would pay suppliers with net credit on a 'pay as paid' basis.

3.76. Establishing a centralised function would incur set-up costs, but is expected to be more efficient than a system where debts are settled on a bilateral basis with each supplier passing on the cost of setting up new commercial relationships with each other. In both cases, the administrative costs are expected to be low, and ultimately to be recovered from consumers. Suppliers would be expected to pay the charges they owe promptly; however, the precise regime used to ensure payment would be developed as part of the code modification process.

Conclusion

3.77. As set out in Chapter 1, Ofgem is already taking action to restore stability in the sector, including through a number of short-term measures to reduce the risk of existing and potential new suppliers pursuing unsustainable business models that lead to poor outcomes for consumers. These actions alone will mitigate some of the risks associated with volatile wholesale prices over the period to autumn 2022, when we intend for broader reforms to be in place to further improve supplier financial resilience and, potentially, to make the price cap better able to handle energy market volatility.

3.78. We have set out in this chapter three different temporary measures that we could introduce in the short term to further mitigate the risks to consumers identified in Chapter 2. These options are intended to be targeted and proportionate. The exit fees and Market Stabilisation Charge are mutually exclusive. There is no justification for implementing both. The requirement for suppliers to make acquisition tariffs available to existing as well as new customers, however, could be implemented on its own or with another measure.

3.79. The exit fees or Market Stabilisation Charge options would provide for stronger and more direct mitigation of the risks to consumers but could also have greater dampening effect on competition. The ban on acquisition-only tariffs would mitigate the risks to a lesser degree but would involve fewer potential downsides for consumers and could have some other positive effects.

3.80. These options could, in different ways, protect consumers' interests by enabling suppliers to better manage, on behalf of consumers, the risks posed by current market volatility, particularly the risks of a significant fall in market prices. We recognise that each of these options could also, in the short term, dampen competition and reduce the savings available to consumers.

3.81. Given the potential downsides to consumers, we are not attracted at this time to the more interventionist options of exit fees or a Market Stabilisation Charge. We are developing them as contingency options in case the market risks are severe enough to justify them. The intention is that, even if we were to implement one of the more interventionist options, they would be temporary measures to reflect the exceptional circumstances facing the energy market at this time.

3.82. In deciding whether to intervene to address the risks to consumers identified, we will need to weigh up, on the one hand, the potential benefits to current consumers from being able to save more money on their bills in a scenario of low wholesale prices and, on the other hand, the potential benefits to future consumers of avoiding higher prices as a result of significant mutualised costs from supplier failures in scenarios of very high or low wholesale prices. As a secondary consideration, we would need to choose whether to place greater emphasis in the short term on our duty to have regard to licence holders' financeability than our duty to have regard to the promotion of effective competition.

3.83. We welcome views on whether intervention would be justified in consumers' interests and, if so, which of these possible interventions would be most effective and proportionate in addressing the risks identified.

Appendices

Index

Appendix 1. Statutory Notices and Accompanying Documents

A1.1. This appendix lists the documents that we have published alongside this consultation, consisting of:

- Statutory notices of our intention to modify licences

Statutory notices

The statutory notices provided under 23(2) of the Gas Act 1986 and/or 11A(2) of the Electricity Act 1989 of our intention to modify the standard condition of all licences, have been published alongside this document. They are available on our website and can be accessed via the same webpage as this consultation: https://www.ofgem.gov.uk/publications/statutory-consultation-potential-short-term-interventions-address-risks-consumers-market-volatility

Appendix 2. Market Stabilisation Charge calculation methodology

Description

A2.1. This appendix describes the Charging Methodology for the Market Stabilisation Charge.

A2.2. The Market Stabilisation Charge (A) would be introduced with the aim of reducing consumer harm from supplier exits, resulting from significant financial losses in a severe falling prices scenario. The Market Stabilisation Charge is comprised of two sub-charges; one for gas and one for electricity. For the purposes of this methodology, references to wholesale prices should be read to mean one reference to the wholesale gas cost and another to the wholesale electricity cost.

A2.3. For the purposes of this methodology, supplier losses are assumed to be equal to the wholesale cost allowance under the price cap methodology minus the wholesale price at prevailing prices. The wholesale price (w) is calculated as the weighted average of contracts for the following 12-month period.

A2.4. The charge is therefore calculated as a function of the loss associated with a customer switching away at a given wholesale price, assuming that the losing supplier has followed the assumed hedging strategy in the price cap methodology. The charge would be published by Ofgem at regular intervals to ensure that it is not over- or under-valued during periods of volatility.

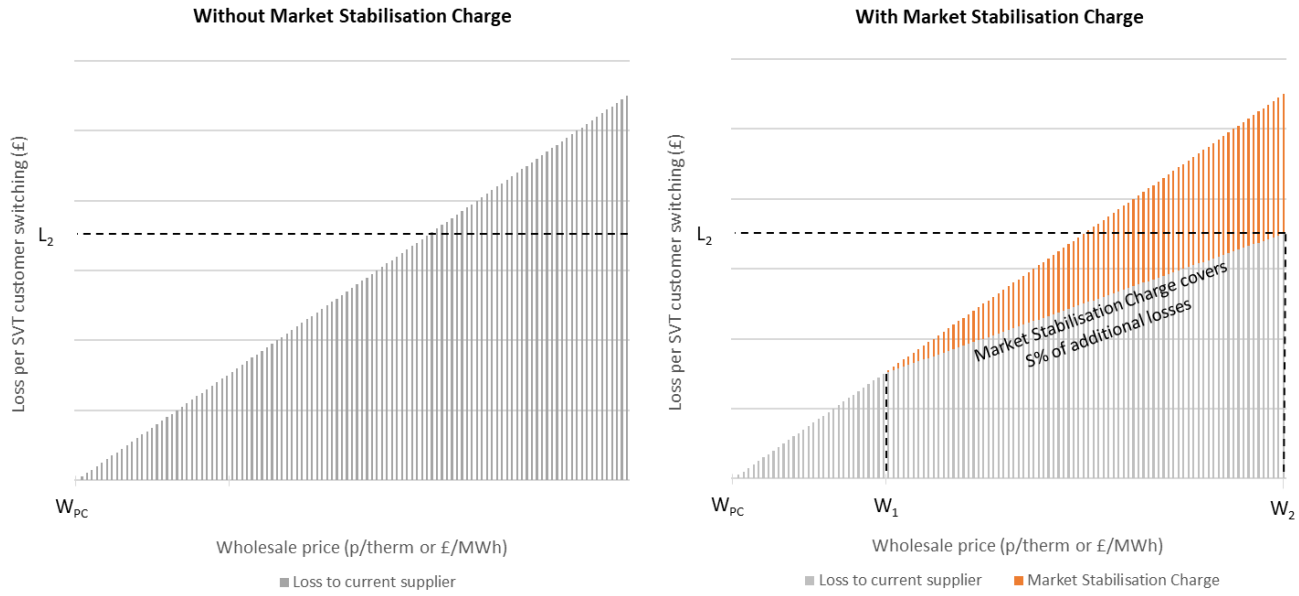
A2.5. The Market Stabilisation Charge is triggered once the wholesale price falls beyond a pre-determined trigger point, the Losing Supplier Loss Trigger. Based on our current modelling and market outlook, we expect this to be set between 50% and 70% of the price cap implied wholesale price.

Scope

A2.6. We believe that applying the Market Stabilisation Charge to all switches would simplify and speed up implementation, thereby saving implementation costs that would otherwise be passed on to consumers. This also mitigates the need for suppliers to possibly offer tariffs that depend upon a potential customer's current tariff, which could be confusing to consumers and harm engagement.

A2.7. We recognise that this would mean the 2 million customers on FTCs due to expire between April and October 2022 could indirectly have to pay the charge if they chose to switch to a new FTC upon expiry of their current tariff. Nevertheless, the inclusion of such switches within the scope of the fee is one reason why the fee represents only a portion of the potential full economic loss.

Figure 2: Illustration of the Market Stabilisation Charge



A2.8. The remainder of this appendix provides the proposed formulae underpinning the Market Stabilisation Charge.

The formula for the Market Stabilisation Charge

A2.9. The Market Stabilisation Charge (A) is calculated using the formula below:

$$A = x \cdot l \cdot c \cdot t$$

where:

x	The derating factor
l	Qualifying losses
c	Conversion factor
t	The hedge decay factor

Sharing factor (x)

A2.10. The sharing factor defines the level of the charge that the acquiring supplier would pay at a given point in time and at a given wholesale price. When the wholesale price is greater than W_1 the sharing factor is 0. From $W_1 \geq w$ the sharing factor is set at a defined level such that suppliers and consumers effectively share further losses.

A2.11. The definition of the sharing factor is:

$$w > W_1,\ x = 0$$
$$w \leq W_1,\ x = S$$

where:

W_1	The threshold at which the Market Stabilisation Charge starts to apply. Based on our current modelling and market outlook, we expect this to be set between 50% and 70% of the price cap implied wholesale price.
w	The wholesale price of the fuel.
S	The sharing factor, which we expect to be between 0.75 and 0.5.

Wholesale cost (w)

A2.12. For the purposes of this methodology, the wholesale cost is the price at which hedges are assumed to be unwound. It is assumed that the remainder of the hedge is sold back in the remaining futures markets. Wholesale prices are expressed in pence per therm for gas and £ per MWh for electricity.

A2.13. To calculate this value, Ofgem will consider the price of futures contracts for the following 12 months. The price will be the weighted average of the season ahead contract that covers this period, plus quarter ahead and month ahead contracts to cover the entirety of the period.

A2.14. This approach is intended to give a reasonable estimation of the value of the hedge that a losing supplier is forced to unwind at the time of the switch.

Qualifying losses ($\boldsymbol{l}$)

A2.15. The qualifying losses (l) to which the derating factor is applied are calculated using the formulae below:

$$w > W_1,\ l = 0$$
$$W_1 \geq w,\ l = W_1 - w$$

where: w and W_1 are as defined above.

Conversion factor (c)

A2.16. The conversion factor (c) converts the qualifying losses for from a pence per therm value for gas and £ per MWh for electricity into a £ per MWh value.

A2.17. The conversion factor for gas (c_{gas}) is equal to 0.3412 to four decimal places.

A2.18. The conversion factor for electricity (c_{elec}) is 1 as qualifying losses are expressed in pounds per MWh.

$$c_{gas} = 0.3412$$

$$c_{elec} = 1$$

Consumption weighting ($\boldsymbol{t}$)

A2.19. The consumption weighting (t) scales the Charge based on the forecast annual volume of gas or electricity consumption. It is expressed in MWh and is calculated by applying the typical domestic consumption values. This means that the Market Stabilisation Charge covers losses beyond the Summer 22 price cap period.

$$t = C_r$$

where:

C_r	Estimated consumption in MWh of the fuel by the SVT customer for one year.

Market Stabilisation charging period and publication

A2.20. The charge would be published on an ex-ante basis by Ofgem. The charging period would be one week, with the charge value published several days ahead of each weekly period; the precise notice to be given would be determined as the REC Working Group identifies the payment mechanism. Publishing the charge on a weekly basis would allow suppliers to understand their costs within a reasonable timeframe, whilst limiting the burden and volatility that a more frequent update would incur.

A2.21. For the purposes of this mechanism, a weekly period is the seven-day period beginning 00:00 on a Friday.

A2.22. We consider that a weekly period would be short enough to accurately reflect the losses faced by suppliers without being so frequent that it becomes unduly burdensome. A shorter frequency would give a more accurate value of the cost faced by a supplier in unwinding their hedges. However, this would be more burdensome for both Ofgem and suppliers to administer and would create a more volatile charge. A longer frequency would be simpler for both Ofgem and suppliers to administer. However, it increase the risk of switches of over/under compensation given the current high levels of volatility over short periods of time.

Appendix 3. Privacy notice on consultations

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 intend the details of the Stabilisation Charge payment mechanism to be set out in the Retail Energy Code. As the changes to the licenses are linked to what will be in the Retail Energy Code, we may require to share nonconfidential responses with RECCo and the REC Code Manager to enable us to develop mechanisms further in response to consultation responses but will redact your personal data before doing so.

We will not share personal data contained in confidential consultation responses with any organisation outside of Ofgem unless legally obligated to do so. Unless you indicate otherwise, we will make your response, as provided, available online.

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 as long as an audit trail on decision-making relating to the questions discussed in this document should reasonably be available.

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
- 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, click on the link to our "Ofgem privacy promise".

Appendix 4. Impact assessment approach and assumptions

Output	Assumption	Approach
'Do nothing' option		
Supplier impact	Wholesale price scenarios	Falling Prices Scenario Wholesale prices fall to historical seasonal levels for Summer 2022, to c.50p/therm (and equivalent for electricity) over a period of five months. Steady Prices Scenario Wholesale prices follow the levels of the forward curve as of 3/12/2021. Rising Prices Scenario Wholesale prices rise to c.250p/therm for Summer 2022 (and equivalent for electricity).
	Supplier hedging	Due to increased uncertainty we find it credible that suppliers may choose not to hedge for the full range of their SVT customers. We have provided an indicative range to reflect suppliers' ongoing approach to hedging up to an assumed 90% of their SVT demand.
	Switching rates	Falling Prices Scenario Historical switching rates for SVT customers, qualitative consumer engagement evidence, and quantitative survey evidence on consumer preferences were used as evidence to develop assumed switching rates under this scenario of: • SVT customers (long-term disengaged): 16% • SVT customers engaged (who have recently switched to a small or medium supplier): 49% • Customers who have or will come to end of fixed-term tariffs in April 2022: 78% • Customers who have recently gone through the SoLR process: 83% We have reflected the indicative constraints in the current switching systems of about 2m switches per month, recognising that the introduction of new systems will relieve this constraint. Steady and Rising Prices Scenarios Negligible switching away from SVT is assumed when FTCs are likely to be priced at or above the price cap. We have taken in consideration customers whose fixed tariffs expire over summer 2022 and we have assumed they will roll onto SVTs.
Consumer impact	Consumer saving by switching from SVT	We have estimated the level of the wholesale allowance for the Summer 2022 default tariff cap, and use this to forecast SVT prices.

	to fixed term tariff	Fixed-term tariff prices are estimated based on the prevailing wholesale market prices.
	SoLR costs	We have estimated the costs consumers will pay through mutualisation of SoLR/SAR costsunder each of the price scenarios. These costs include credit balances, working capital costs, customer onboarding costs and wholesale costs.
	Credit balances	We have estimated supplier Summer and Winter credit balances and range consumer benefit that reflects this variation.
Option 1 – Making tariffs available to existing and new customers		
Supplier impact	Wholesale price scenarios	As per 'Do nothing' option
	Supplier hedging	As per 'Do nothing' option
	Switching rates	<u>Falling Prices Scenario</u> The 'Do nothing' switching rates were reduced to reflect the consumer response to lower potential savings based on the our quantitative survey of consumer preferences. We assumed that more engaged customers would be more sensitive to price changes so the fall in switching rate is proportional to the starting rate. This allowed us to calculate following switching rates, to reflect different consumer engagement levels: • SVT customers (long-term disengaged): 6% • SVT customers engaged (who have switched to a small or medium supplier in the past years): 20% • Customers who have or will come to end of fixed term tariffs in April 2022: 31% • Customers who have recently gone through SoLR process: 33% <u>Steady and Rising Prices Scenarios</u> As per 'Do nothing' option
Consumer impact	Consumer saving by switching from SVT to fixed term tariff	Similar to the 'Do nothing' option, except we have used historical Summer price differentials between the default tariff cap and cheapest tariff (large suppliers) to inform our option onsuppliers pricing behaviour.
	SoLR costs	As per 'Do nothing' option
	Credit balances	As per 'Do nothing' option
Option 2 – Exit fees on Standard Variable Tariffs		
Supplier impact	Wholesale price scenario	As per 'Do nothing' option
	Supplier hedging	Similar to the 'Do nothing' option, due to increased uncertainty, we have assumed a range for supplier hedging. We have provided an indicative range to reflect suppliers' ongoing approach to hedging and up to an assumed 100% of their SVT

		demand. We have assumed a higher level of hedging under this option compared to the 'Do nothing', as suppliers will be more incentivised to hedge given downside risk has reduced due to the presence of the exit fee.
	Switching rates	<u>Falling Prices Scenario</u> Similar to the 'Do nothing' option, except that we account for the impact of potentially smaller savings on offer for consumers accounting for the exit fee. We have assumed that consumers exhibit a level of present bias and are deterred by exit fees more than proportionally compared to a Market Stabilisation Charge and so switching rates would be lower for an equivalent fee. We account for the time inconsistent nature of consumers (quasi-hyperbolic discounters). The effect of an exit fee being amplified as consumers seek to delay immediate costs: • SVT customers (long-term disengaged): 14% • SVT customers engaged (who have switched to a small or medium supplier in the past years): 44% • Customers who have or will have come to end of fixed-term tariffs in April 2022: 70% • Customers who have recently gone through SoLR process 75% <u>Steady and Rising Prices Scenarios</u> As per 'Do nothing' option
Consumer impact	Exit fee level	For illustration we have assumed that suppliers set exit fees in a manner similar to the Market Stabilisation Charge methodology outlined in this document.
	Consumer saving by switching from SVT to fixed term tariff	Similar to the 'Do nothing' option except for an adjustment to account for exit fees.
	SoLR costs	As per 'Do nothing' option
	Credit balances	As per 'Do nothing' option
Option 3 –Market Stabilisation Charge		
Supplier impact	Wholesale price scenarios	As per 'Do nothing' option
	Supplier hedging	Similar to the 'Do nothing' option, due to increased uncertainty, we have assumed a range for supplier hedging. We have provided an indicative range to reflect suppliers' ongoing approach to hedging and up to an assumed 100% of their SVT demand. We have assumed a higher level of hedging under this option compared to the 'Do nothing', as suppliers will be more incentivised to hedge given downside risk has reduced due to the presence of the Market Stabilisation Charge.

	Switching rates	<u>Falling Prices Scenario</u> Similar to option 1, reflecting different consumer engagement levels: • SVT customers (long-term disengaged): 14% • SVT customers engaged (who have switched to a small or medium supplier in the past years): 44% • Customers who have or will have come off fixed term tariffs in April 2022: 70% • Customers who have recently gone through SoLR process: 75% The stabilisation charge decreases the potential losses for suppliers, which in turn increases the potential cost to consumers compared to those under the 'Do nothing' option. The switching rates are therefore lower than under the 'Do nothing' option. <u>Steady and Rising Prices Scenarios</u> As per 'Do nothing' option
Consumer impact	Consumer saving by switching from SVT to fixed term tariff	As per 'Do nothing' option, with an adjustment for the Market Stabilisation Charge.
	SoLR costs	As per 'Do nothing' option
	Credit balances	As per 'Do nothing' option