

To all licensed energy suppliers,
consumer groups and other
interested parties

Date: 27 April 2022

Email: retailpriceregulation@ofgem.gov.uk

Dear colleagues,

Price Cap and Market Stabilisation Charge update

We are aware of the current challenges faced by suppliers and the negative effect supplier exits can have on customers and the bills they pay. As such, we have decided to publish this letter to provide additional context and clarity on our pipeline of proposed policy changes, to better enable suppliers to manage risk and reduce costs for customers.

Furthermore, this letter is to reassure suppliers, consumer groups and other interested parties that, more specifically, we are aware of the challenges facing suppliers and others in relation to backwardation costs and the risk of market prices falling over winter 2022/23.

As we set out in our February consultation on Medium Term Reforms for the Price Cap,¹ we recognise that the changes in the market mean that the assumptions that backwardation costs and contango gains may net out in a reasonable period of time may no longer stand. Given that backwardation costs are a cost that suppliers face in supplying energy to consumers on the price cap tariff, we remain committed to ensuring that they are addressed. This will either be through designing out backwardation by matching the cap period and underlying hedge, or by providing an allowance.

In February, we stated that, if there were an allowance for backwardation costs, our preference was for an *ex post* approach based on weighted actual costs. Our position has changed, and our current minded to position is that any allowance would be based on an *ex ante* modelled approach with a deadband.

We continue to undertake analysis of the options to address backwardation including how a deadband would be applied. We intend to publish a statutory consultation in early May, enabling us to make a decision in August to make changes to the price cap methodology ahead of the October price cap period.

We have consulted on changes to the Market Stabilisation Charge (**MSC**) parameters to make the charge more robust to ongoing and sustained levels of volatility observed in the recent months.² We expect to publish our final decision mid-May.

This summer, we will assess whether there is a case for extending the MSC in the context of market developments and any changes to the default tariff cap methodology.

¹ [Consultation on Medium Term Changes to the Price Cap Methodology | Ofgem](#)

² [Consultation on changes to market stabilisation charge | Ofgem](#)

In May, we will also be setting out our next steps, having collected data from suppliers, on wholesale costs following further market volatility.

Below, please find overview tables with further elaboration on our current minded-to positions along with an indicative timeline of next steps for consultations and decisions.

Topic	Direction of travel	Next steps
Changes to the default tariff cap	<ol style="list-style-type: none"> 'Medium term changes' to the price cap methodology being consulted on to reduce volume risk and to address backwardation, including a reduction in the notice period. Other changes being consulted on are: <ol style="list-style-type: none"> the removal of the £0 floor in the Contracts for Difference (CfD) allowance to allow customer savings when wholesale costs are high; a 'true-up' of costs suppliers have incurred due to Covid-19 compared to the float set in previous cap periods; updates as part of the annual review of smart metering costs. 	<ol style="list-style-type: none"> Continue analysis of options to address backwardation Consult on proposed changes in May 2022 Publish decisions in August 2022 Intended to come into effect for the next update in October 2022 for cap period nine
Market Stabilisation Charge	<p>Changes to the Market Stabilisation Charge (MSC) parameters to make the charge more robust in protecting the interest of consumers against ongoing and sustained levels of volatility observed in the recent months.</p> <ol style="list-style-type: none"> We have already consulted on changes to parameters, UIG and indexation (consultation opened 31 March, closed 14 April) In Summer we will assess the case for further indexation and parameter changes and an extension to the MSC in the context of the prevailing state of the retail market and including any changes to the default tariff cap methodology. 	<ol style="list-style-type: none"> Publish decision in May 2022 Publish consultation and subsequent decision in Summer 2022
Bad Debt	Ensure the cap reflects the efficient costs incurred by suppliers due to bad debt and other debt-related costs as result of the recent sharp increase in gas prices.	<ol style="list-style-type: none"> Complete data collection and if required consult in Autumn 2022. Publish consultations & RFIs with a view to implementation in April 23 (if required)

	April - May	June - July	August - September	October - December
Price Cap	<i>Spring 22 Price Cap in effect</i>	<i>GEMA decisions for October Price Cap</i>	<i>October Price Cap announced – August</i>	<i>October Price Cap change - October</i>
Changes to the default tariff cap	<i>Consult on proposed changes - May</i>	<i>Consultation responses, analysis and GEMA decisions</i>	<i>Publish decisions - August</i>	<i>Effective from October 2022 for cap period nine</i>
Market Stabilisation Charge	<i>Publish parameters decision</i>	<i>Publish consultation (and subsequent decision) on indexation changes, extension & parameter review</i>		
Bad Debt	<i>Data collection</i>	<i>Analysis</i>	<i>Publish consultations & RFIs with a view to implementation in April 23 (if required)</i>	

We trust that this letter provides comfort that we recognise the challenge and intend on addressing it. Should you wish to discuss any of the above, please contact us for a bi-lateral discussion.

Neil Lawrence
Director of Retail