

## **Response to the consultation on updating the parameters in the Market Stabilisation Charge 14 April 2022**

**Please note that the highlighted figures are commercially sensitive and have been redacted**

### **Overview**

Thank you for moving quickly to propose an amendment to the parameters in the Market Stabilisation Charge.

In the light of the sustained high wholesale prices, we are supportive of moves to tighten the parameters so that the charge will be triggered more quickly when the wholesale market falls, and to increase the derating factor. This should make the MSC more effective in stabilising the market and in reducing customer exposure to the cost of further supplier failures.

However, to be fully effective in achieving its stated aims, it is imperative that Ofgem urgently commits to extending the MSC beyond this Autumn, when it is due to expire. The risk associated with a fall in the wholesale market extends well beyond the Summer and none of the price cap methodology changes Ofgem is considering for October would significantly mitigate this risk. A commitment from Ofgem to extend the duration of the MSC is needed as soon as possible to encourage responsible hedging for the coming Winter.

We would like Ofgem to consider replacing the trigger with an absolute amount rather than defining it as the percentage difference between the wholesale costs in the price cap and the market price. Ultimately what drives customers to switch is the amount of money they can save. As well as being more effective in stabilising the market, an absolute trigger would remove the need for Ofgem to update the trigger parameters as market conditions change. This would make the MSC more suitable as a longer term feature of the regulatory arrangements.

It is important that the MSC is proportionate and Ofgem can demonstrate that with the new parameters it remains in customers' interests overall, including that it does not overly constrain customer access to lower prices and competition. For this reason, we ask Ofgem to share further detail on its latest impact assessment of these new parameters. While we recognise the potential for further supplier failures and Ofgem's associated cost estimate of £1.2bn appears reasonable, we would like to see the analysis behind Ofgem's estimate of

customer gains foregone (in terms of lower prices) as a result of the proposed changes to the MSC parameters.

### ***The trigger***

In the light of sustained high wholesale prices, we support immediately lowering the MSC trigger below 30% and agree it will help to reduce the volume risk responsibly hedged suppliers face and the risk of supplier failures over the Summer. However, a sharper trigger without a commitment to extend the duration of the MSC beyond the Autumn will do little to change hedging behaviour underway for this Winter. A tighter trigger, combined with an extension of the MSC would help to encourage prudent hedging underway now and protect those retailers that are acting responsibly to manage the risk of wholesale market volatility. Our analysis suggests that even if the MSC is in operation over the Winter period, with the current 30% trigger, we would be exposed to revenue losses of over £1.5bn over the six month winter 2022/23 price cap period, significantly adding to our cash requirements for that period.

To reduce this volume risk exposure, we suggest a trigger set at an absolute value of around £1.5bn. This is the level of savings at which we have historically seen considerable customer churn. We note the difficulty of accurately predicting customer price sensitivity and recommend Ofgem seeks information from other retailers to calibrate this absolute level. In particular, the behaviour of our customers may be different from what we have seen historically given that the SVT cohort now contains many typically active customers and Avro customers, and energy bills are at unprecedented levels.

If the methodology continues to use a percentage trigger, we think a trigger set at 10% would be justifiable in today's market conditions, though our view would be different at lower (or much higher) wholesale prices. A lower percentage trigger is likely to be justifiable for the Winter 2022/23 period to encourage retailers to hedge fully, and we ask Ofgem to give urgent attention to the appropriate MSC parameters for the Winter period.

### ***Derating factor***

Increasing the derating factor is of lower financial importance to us, with analysis showing that a change of this factor from 75% to 100% would do little to ameliorate our cash losses if the trigger is too high.

We are keen to ensure that retailers continue to have an incentive to take steps to encourage customer retention through pricing keenly (including below the cap where they are able to do so) and providing good service. While we support an increase from the current 75% level we caution against increasing the derating factor beyond 90%, and would like more information on Ofgem's analysis before deciding on the relative merits of an 80% or 90% derating factor.

### ***Technical updates***

We have reviewed the detailed technical proposals to update the methodology for the new hedging profile in the price cap and to include losses/UIG. We agree with the intent of the proposed changes and that the changes as proposed will have the desired effect.

Like other retailers, we have now had further opportunity to consider the MSC design and how it might work in different circumstances. The effectiveness of the MSC could be diminished as a result of the mismatch between the wholesale cost index in the price cap and the wholesale costs that retailers actually carry for any price cap period. We encourage Ofgem to conduct analysis to assess the impact of the market being in contango or backwardation in season 2 and whether the MSC will work as intended. We note that the way to address this risk would be to introduce a price cap contract methodology and failing that to properly factor backwardation into the price cap on an ex ante basis.