

**To - Domestic gas and
electricity suppliers**

Email: Retailpolicyinterventions@ofgem.gov.uk

Date: 25 November 2022

Dear Colleagues,

**Market Stabilisation Charge (MSC) - Use of monthly contract prices for the
calculation of the current period cost of energy (W_n)**

We are writing to clarify the use of monthly contract prices in the calculation of W_n within the MSC model.

The original MSC guidance set out that we would “use seasonal prices where they exist, followed by quarterly, then monthly if the seasons/quarters have broken down into quarters/months”¹. We updated this to reflect the change to quarterly cap updates and stated that we would “[use] quarterly prices, followed by monthly prices from 6 June 2022”². We realise that the guidance did not specify what combination of monthly products we would use and when we would use them, and this may consequently lead to confusion surrounding how we calculate the MSC charge itself.

This letter is intended to clarify the use of contract data within the MSC model for the calculation of W_n to assist stakeholders’ model likely MSC charges should they choose to do so.

When developing the MSC, we specifically excluded the use of granular contract data below monthly products. This was to prevent unnecessarily overcomplicating the calculation (i.e. beyond the level of accuracy needed to fulfil the policy intent). However, the MSC is calculated throughout the cap period, including during the last month, when there is less than a month’s worth of energy to be unwound in the calculation of W_n . Consequently, to ensure consistency in our modelling, we are required to attribute a value to the cost of this energy. The way in which we use monthly price data in determining the value for W_n is shown in *table 1* below.

Table 1 – Prices used for the calculation of W_n

Length of cap period remaining	Prices used
<3 months but greater than or equal to 2 months	Average of M+1 and M+2

¹ Ofgem 2022, MSC Guidance (version 1), <https://www.ofgem.gov.uk/sites/default/files/2022-02/MSc%20Guidance.pdf>

² Ofgem 2022, MSC Guidance (version 3), <https://www.ofgem.gov.uk/sites/default/files/2022-08/MSc%20Guidance%20%28Version%203%29.pdf>

Less than 2 months but greater than or equal to 1 month	M+1
Less than 1 month	M+1 as a proxy for more granular price data

As we have set out in our publications on the MSC to date, we have sought to strike a balance between simplicity for the purposes of transparency, and accuracy for the avoidance of uncertainty. We consider the use of the monthly contract data in this way, particularly in the final month of the cap period, strikes a proportionate balance. We think that M+1 contract data is a suitable proxy for more granular contracts in the final month of the cap period, particularly, given the impact of this simplification decreases though the month as the weightings on W_n diminish to zero. On the basis that the MSC's objective is to reduce the risk to market stability in the event of a sudden price drop we consider this simplification appropriate and we will incorporate this clarification in any future update to the MSC guidance.

However, we keep our treatment of prices in the MSC under review and may consider alternative methods in future cap periods should evidence emerge to suggest the current approach is no longer appropriate. In such a case, we would include any proposals to alter our treatment of prices used in calculating W_n alongside any other policy changes in future consultations on the MSC, to provide stakeholders the opportunity to provide views.

We hope this clarifies to industry how we are treating prices for the purposes of calculating W_n . If you have any further questions please e-mail them to retailpolicyinterventions@ofgem.gov.uk

Yours Sincerely,

Dan Norton
Deputy Director