Consultation

Statutory Consultation on extending the MSC and BAT beyond 31 March 2023

Publication date:	25 November 2022	**Contact:**	Maureen Paul, Deputy Director of Retail Market Policy
		Team:	Retail
Response deadline:	30 December 2022	**Email:**	retailpolicyinterventions@ofgem.gov.uk

On 26 August 2022 we published our Decision (the "**August 2022 Decision**") to extend the Market Stabilisation Charge ("**MSC**") and the Ban on Acquisition-Only Tariffs ("**BAT**") until 31 March 2023 following a period of consultation. Our Decision also invited comments from stakeholders on what action, if any, Ofgem should take in relation to the period after 31 March 2023, when the current licence conditions for the MSC and the BAT end.

In light of energy market conditions and stakeholder feedback from the August Decision, we are consulting on proposals to extend the MSC and the BAT until 31 March 2024, with new powers given to the Authority to enable both measures to be renewed on an annual basis, where required. The existing power for the Authority to end the MSC at an earlier date is proposed to be retained. We expect to publish our Decision in early February 2023, and the changes would go live from 1 April 2023.

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.

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Executive summary

Market context

Since Summer 2021, wholesale energy markets have experienced record high prices and volatility causing significant price rises for domestic consumers, both directly and as a result of the costs caused by a number of suppliers failing. This disruption arose because of a combination of factors including the recovery of worldwide energy demand following the Covid crisis, which put pressure on available supplies of gas, so starting the gas crisis. These challenges have intensified and are continuing because of the Russian invasion of Ukraine and related restrictions on the availability of Russian gas to Europe.

We introduced the Market Stabilisation Charge (**"MSC"**) and Ban on Acquisition-Only Tariffs (**"BAT"**) in April 2022 to help protect consumers from the risk to market stability posed by these pressures on energy supply markets. Both measures are designed to encourage domestic suppliers to hedge demand in accordance with the price cap indexation by providing a degree of protection against losses if these hedges are stranded by a wholesale price fall.

Substantial losses can arise when consumers switch supplier to take advantage of cheaper market prices, leaving their former supplier ("**Losing Supplier**") with the costs of the unused energy that was bought for them. This can have severe financial impacts on the Losing Supplier with consequent risks to the consumer if the supplier fails. The MSC works by requiring the supplier to which consumers switch ("**Acquiring Supplier**") to pay the Losing Supplier a proportion of that loss, calculated by reference to the price cap indexation. The BAT complements the MSC in protecting consumers from volatile markets by reducing the incentive for suppliers to make aggressively low-priced offerings in these circumstances (because their existing customers may take up the offer). Together, these measures help provide resilience for the GB domestic energy market against large wholesale price movements, whether up or down, for the benefit of consumers.

Previous extension

The MSC and the BAT were announced prior to Russia's invasion of Ukraine. They are temporary measures and as such were originally due to fall away from 30 September 2022. Following the invasion, which extended and deepened the gas crisis, we consulted in June 2022 and published our decision of 26 August 2022 (the "**August 2022 Decision**") to extend these measures until 31 March 2023. Our Decision to extend took account of stakeholder responses to our consultation as well as trends in the overall cost of energy hedges held by suppliers during the Extension Period (October 2022 to March 2023). We assessed overall hedge cost risks using our Value at Risk ("**VaR**") metric (see details in section 2) and modelled the impact on suppliers by reference to a hypothetical "notional" company designed to be representative of the actual suppliers.

In the August 2022 Decision, we drew attention to the fact that the VaR metric was projected to remain very high beyond March 2023 and invited stakeholders to comment on what actions we might take. In the light of that feedback and our own analysis to date, we are now consulting on proposals (described below) to further extend the MSC and the BAT.

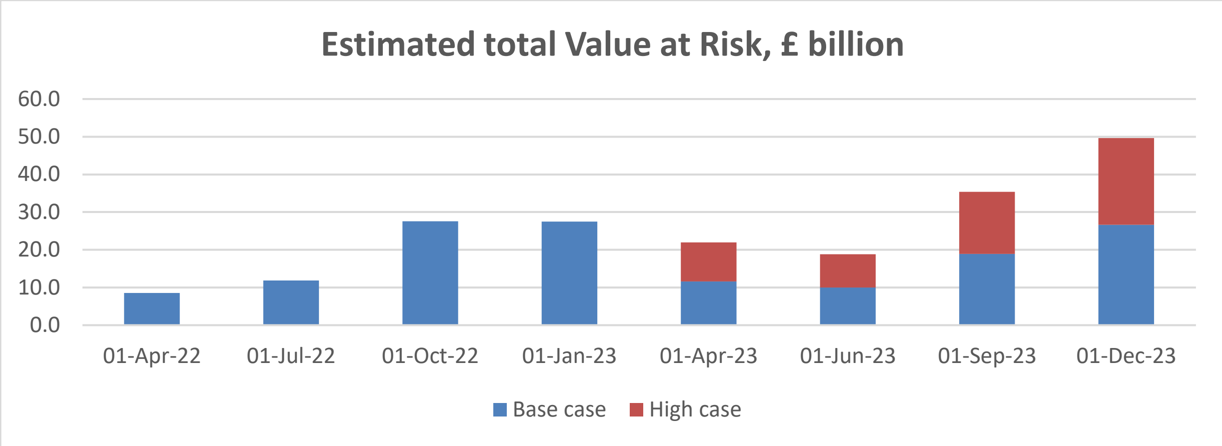
The Government's Energy Price Guarantee

We welcome the support provided by the Government's Energy Price Guarantee ("**EPG**") to customers. Since 1 October 2022, the EPG has reduced domestic energy prices to an average of £2,500 per year for a typical dual fuel customer. However, we consider that the MSC is still needed. As currently configured, the EPG interacts with the MSC by reducing the incentive for consumers to switch if wholesale prices fall but does not affect the value of the stranded hedge on each switch that does occur. On this basis we consider that the MSC remains in consumer interests, but that the EPG does affect the choice of parameters.

On 17 November 2022, the Chancellor of the Exchequer announced that the EPG would be retained for a year from April 2023, but that the price limit would be raised to £3,000 (with support proposed to be capped for consumers using very large volumes of energy). The higher price limit is expected to increase the amount of switching that takes place if wholesale prices fall and this will increase the role of the MSC in maintaining stability. Some design changes in the EPG could increase switching (and the role of the MSC) further. These uncertainties do not affect our view that the MSC and BAT remain in consumers' interests, but the final EPG design from April 2023 may well require changes to the MSC parameters.

Extension considerations

For this Consultation, we have updated our estimates of the VaR metric in the base case to take account of recent price movements, while maintaining the high case that we published in the August 2022 Decision, reflecting the risk that the current relatively high level of gas in storage across Europe this winter may not be replicated next year. In the base case, the estimates continue to indicate that VaR will be higher throughout 2023 than it was when the MSC was first decided.



The MSC assists all parties in managing the evolving crisis and it will only be retained for so long as it is necessary and in the interests of consumers. The MSC can be removed if market conditions reach a level of sufficient stability (for which the VaR metric is a useful indicator) or if other policy and market developments (including Government policy) mean that the risks can be appropriately managed in some other way. If, following this consultation, we proceed with the extension proposed, we would intend to review the position in summer 2023 so that any further changes could be made by October 2023.

Although the BAT is currently also being operated as a temporary measure, we wish to consider in due course whether it should be made enduring in order to promote fairness in the market. Any such consideration will be explored in a separate consultation.

We are aware of the impacts of both measures on competition in the market. These impacts include both short-term reduction in competition while the MSC is in operation, alongside the longer-term benefit from supporting the viability of the domestic supply market and therefore a healthy number of effective competitors. Overall, and taking into account the importance of providing further support to hedging in the sector, we consider that continuing the MSC past March 2023 is likely to be in the interests of consumers.

Our proposals

We are therefore consulting on our proposals to extend the MSC and the BAT until 31 March 2024, with powers given to the Authority to renew either or both measures beyond that date on an annual basis, where required, by publishing a statement to that effect.

Further extension beyond March 2024 is not envisaged unless in view of prevailing circumstances we consider it to be in consumers' interests. We propose to retain the existing power to terminate the MSC early by publishing a statement to that effect. We do not plan to include powers to extend the MSC once it has lapsed. If we did want to renew the MSC after that point, then we would consult on licence modification proposals to do so.

For the BAT provision, we are also consulting on proposals to extend the Market-Wide Derogation for Fixed Retention Tariffs until 31 March 2024. We consider that the reasons and justifications for this derogation continue to exist.

Licence modifications and derogations

We are consulting on draft licence modification notices for both the MSC and the BAT to implement these changes for electricity and gas domestic suppliers.

Simultaneously, we are also consulting on an updated direction on the Market-wide Derogation for fixed retention tariffs, reflecting our proposals to extend this Derogation alongside the BAT.

Next steps

We need to receive your responses to our proposals, together with any evidence where possible, by Friday 30 December 2022. We expect to publish our Decision in early February 2023, with the changes to go live from 1 April 2023. Any responses or other input should be sent to: retailpolicyinterventions@ofgem.gov.uk.

1. Introduction

What are we consulting on?

1.1. On 26 August 2022 we published our decision (the "**August 2022 Decision**")[1] to extend the Market Stabilisation Charge (MSC) and the Ban on Acquisition-Only Tariffs (BAT) until 31 March 2023. As part of that document, we also invited comments from stakeholders on what action, if any, Ofgem should take in relation to market stability, when the current licence conditions for the MSC and the BAT end on 31 March 2023.

1.1. In the light of stakeholder comments received and our own analysis to date, which we describe in this document, we are now consulting on proposals to extend the MSC and the BAT until 31 March 2024, with new powers given to the Authority to enable these measures to be renewed on an annual basis, where required. We propose to retain the Authority's existing power to end the MSC at an earlier date.

1.2. Accordingly, this Statutory Consultation is also accompanied by statutory notices of our intention to modify Standard Licence Conditions (SLC) 24A and 22B for the MSC and the BAT together with an updated direction on the Market-wide Derogation from SLC 22B for Fixed Retention Tariffs, reflecting our proposals to extend this Derogation alongside the BAT. These notices and other documents are listed in Appendix 1, together with appropriate links.

1.3. This document is split into three key sections:

- Section 2 sets out the case for our proposal to extend the MSC and the BAT post March 2023. This includes stakeholder feedback from our August 2022 Decision and the results from Ofgem's analysis to date (on which we would welcome observations).

- Section 3 sets out an initial draft impact assessment which includes consideration of the distributional and environmental impacts of our proposals. This is also subject to consultation.

[1] Decision on extending short-term interventions and adjusting MSC calculation, Ofgem (26 August 2022) https://www.ofgem.gov.uk/sites/default/files/2022-08/Decision%20on%20extending%20Short-Term%20Interventions%20and%20adjusting%20MSCcalculation.pdf

- Section 4 sets out our proposal to extend both the MSC and the BAT post March 2023, together with further proposals about the BAT and includes our consultation questions.

1.4. Further information is in the appendices:

- Appendix 1 sets out the website link to the main page on our website containing this Statutory Consultation, the licence modification notices for the MSC and the BAT and the Market-wide Derogation notice for Fixed Retention tariffs.

- Appendix 2 contains Ofgem's Privacy Notice on consultations.

Context

1.5. The MSC and BAT were introduced as temporary policy measures from April 2022 to help protect consumers from the risk to market stability posed by high and volatile gas prices.[2] These measures were originally due to fall away from 30 September 2022. However, developments since the original decision, especially the Russian invasion of Ukraine and the subsequent restriction of Russian gas exports to Europe, increased the intensity and duration of the gas crisis. Accordingly, in the August 2022 Decision, following a consultation in June 2022[3] (the "**June 2022 Consultation**"), we extended these measures until 31 March 2023.

1.6. The MSC supports the UK domestic retail supply industry by providing conditions to better manage the risks associated with purchasing energy on behalf of customers in order to supply it within the constraints of the price cap. These include the risk of hedging for energy at high prices, which cannot be recovered if consumers switch away in large numbers when wholesale prices fall. The MSC does this by providing an element of protection against the downside risk, so assisting suppliers in being able to continue hedging for consumers in accordance with the price cap. Without the MSC, suppliers would be likely to hedge insufficiently (so as to try to mitigate the risk in a falling market) but could then experience

[2] https://www.ofgem.gov.uk/publications/decision-short-term-interventions-address-risks-consumers-market-volatility
[3] https://www.ofgem.gov.uk/publications/consultation-extending-short-term-interventions-and-adjusting-msc-calculation

severe difficulties or fail if wholesale prices rose instead. The MSC is designed to make the market more resilient and protect consumers, whether prices rise or fall.

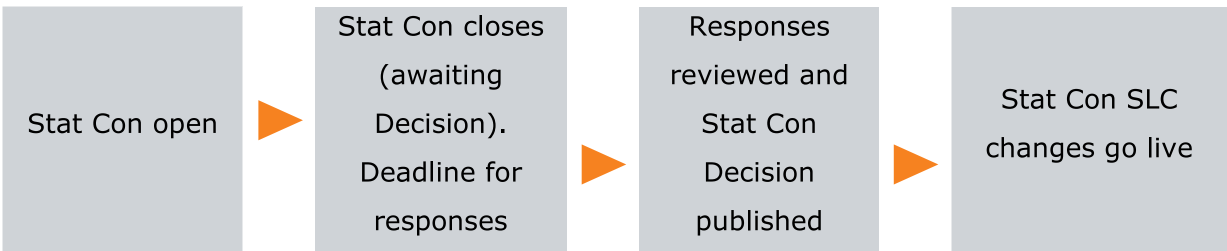
1.7. The BAT is a mechanism which prevents suppliers from offering potentially unsustainable fixed deals exclusively to new customers. The BAT was introduced alongside the MSC in April 2022 and augments the MSC by reducing the incentive for suppliers to offer very aggressive acquisition prices at a time of market turmoil because they would have to make the same offers available to their existing customers. This reduces the likelihood that deals would be offered that might increase the risks of financial stress and supplier exit and the resulting costs and disruption for consumers. It also ensures that any discounted deals are also available to existing customers, which improves fairness in the market. However, we do not consider that the BAT sufficiently achieves market stability on its own.

1.8. The Government's EPG, which was introduced on 1 October 2022, provides domestic customers some protection from high energy prices by limiting the amount they can be charged per unit of gas or electricity. The EPG in its current form means that a typical household in Great Britain will pay no more than £2,500 per annum. However, following the Government's Autumn Statement this month, the scheme will be extended from 1 April 2023 for a further 12 months and the price limit will be increased to £3,000 per annum. By reducing the incentives for customers to switch, the EPG has reduced but not eliminated the risk to market stability.

Consultation stages

1.9. We invite stakeholders to submit comments on any aspect of this consultation on or before 30 December 2022. This will give Ofgem, if it decides that it is in consumers' interests to maintain the MSC and/or BAT, the ability to make the changes to come into effect from 1 April 2023 so ensuring continuity of operation. We expect to publish our Decision in early February 2023, and the changes would go live from 1 April 2023. This would require a decision from Ofgem to be published by 4 February 2023.

Figure 1: Consultation Stages



25 November 2022	30 December 2022	4 February 2023	1 April 2023

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

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

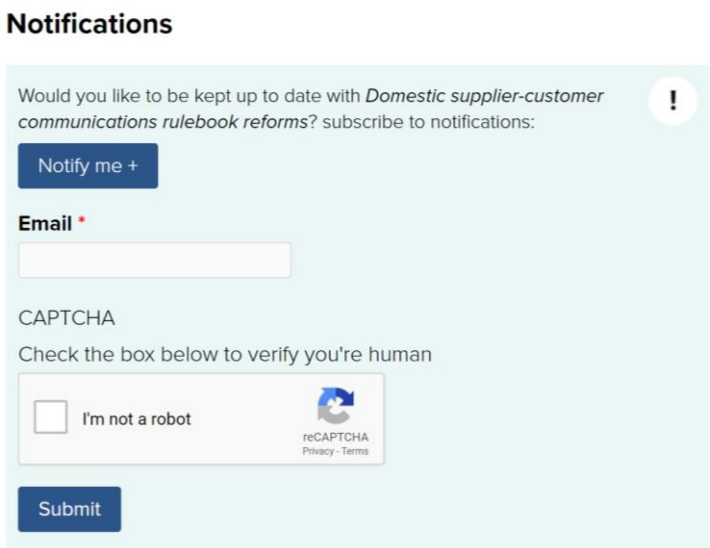
1.17. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

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?

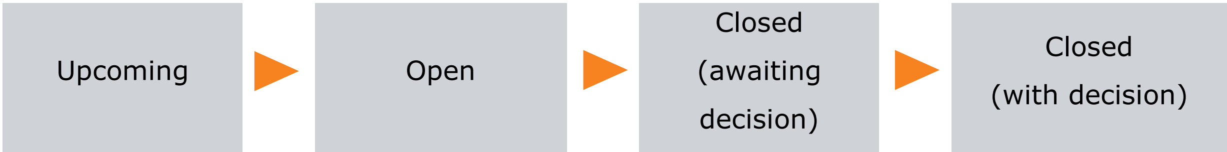
1.18. Please send any general feedback comments to stakeholders@ofgem.gov.uk.

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. The case to extend the Market Stabilisation Charge (MSC) and the Ban on Acquisition-only Tariffs (BAT) beyond 31 March 2023

Section summary

This section sets out the case for our proposal to extend the MSC and the BAT post March 2023 and includes feedback from the questions asked within our August 2022 Decision. It describes how Ofgem uses the Value at Risk (VaR) metric as an overall measure of potential stress in the market and provides our latest projections which indicate that intervention is still likely to be required. It discusses the impact of the Government's Energy Price Guarantee (EPG) and how this dampens, but does not eliminate, the risks to stability.

The section also confirms that the MSC is a temporary measure and describes our approach to ending it when it is in consumers' interests to do so.

Context

2.1. The MSC and BAT were introduced as temporary measures, ending on 30 September 2022 unless extended to no later than 31 March 2023. In the August 2022 Decision, we set out our reasons to extend both measures until 31 March 2023 based on stakeholder responses to the preceding consultation and our analysis.

2.2. The existing licence conditions for both measures expire on 31 March 2023 and it is not possible for Ofgem to extend the measures beyond that date without a licence condition modification. Below we have explored some of the key reasons which support our proposal to modify licence conditions in order to extend the MSC and the BAT post March 2023.

Supplier stability and security of supply

2.3. The MSC was introduced in the context of a high and volatile wholesale market to support the UK domestic retail supply industry in managing the risks associated with purchasing energy on behalf of customers in order to supply it within the constraints of the price cap. These include the risk of hedging for energy at high prices, which cannot be recovered if consumers switch away in large numbers when wholesale prices fall. The MSC does this by providing an element of protection against the downside risk, so assisting companies in being able to continue hedging for consumers in accordance with the price cap. It does this by requiring the Acquiring Supplier to pay to the Losing Supplier a proportion of the loss on the stranded hedge, set according to the MSC parameters.

2.4. In a scenario where falling wholesale prices lead to significant levels of switching, the MSC ensures that suppliers are compensated for a large portion of their losses from stranded hedges. This maintains the viability of efficient and well managed suppliers and in some scenarios could avert a market collapse. The modelling published in the August 2022 Decision which illustrates how this could work is described in section 3 of this document.

2.5. It it likely to be in consumers' interests for suppliers' efficient costs to be covered as failure to achieve this could lead to significant detriments. These could include costs incurred as a result of possible disorderly or unplanned exits from the market as well as more general problems of consolidation and continuing lack of competition, low or no investment, poor service, lack of innovation and ultimately failure to properly carry out the activity. Our view is that the costs associated with these risks for all customers would outweigh the short-term benefit of active customers being able to access lower prices more quickly.

2.6. In a scenario of continued high prices, where the MSC is not triggered,[4] the presence of the MSC still reduces the risk of supplier failure by providing suppliers with the confidence to adequately hedge. This is because adequately hedged suppliers are less exposed to further wholesale energy price rises. In our August 2022 Decision, we estimated that the MSC was likely in this way to have already saved over £1bn in avoided costs which would otherwise be passed to consumers. We maintain that estimate in section 3 below.

2.7. With continued market volatility, we are hearing near unanimous support among suppliers for the MSC to be extended to continue this level of protection. In the absence of such protection, suppliers would be likely to hedge insufficiently (so as to try to mitigate the risk in a falling market) and could then experience severe difficulties or fail if prices rose. While partial hedging might be a rational response in the absence of the MSC or a similar measure, it still leaves domestic suppliers exposed to a significant wholesale energy price movement in either direction. There is also a risk that reduced hedging could reduce UK

[4] Or only triggered at low levels and/or for short times, as a result of wholesale price fluctuations.

security of supply more generally as physical supplies may be secured by overseas buyers in forward markets.

2.8. In the light of these factors, our view is that extending the MSC is likely to increase resilience of the GB energy supply market for domestic consumers in the year starting April 2023, whether wholesale prices rise or fall.

2.9. Although we consider that extending the MSC is effective and appropriate for the expected situation of April 2023, it is clearly not the only route to resilience.

Value at risk analysis

2.10. As the MSC has evolved over recent months, Ofgem has developed the VaR measure to assist in making decisions on whether to intervene (or not) to maintain stability. VaR is the estimated total value of hedges held by all domestic suppliers (assumed to hedge 100% according to the price cap), less these hedges' value if prices reverted to historic norms. VaR is an estimate of potential not actual losses as only part of the VaR would ever be realised. However, it is a simple indicator that is proportional to the overall size of the problem that the MSC and BAT are intended to address.

2.11. Although the VaR indicator is a helpful tool, over time it needs to be looked at in the round together with other developments in Government and regulatory policy and supplier resilience which may affect how risk crystallises and how it can be managed. The level of VaR that can be tolerated (ie does not risk adverse consequences for consumers) will depend on these wider considerations.

2.12. In the August 2022 Decision, we explained how our VaR analysis indicated that (on the projections at the time), significant risks may remain in the market post March 2023. We made a preliminary estimate of VaR for that period, recognising that there are much greater uncertainties further into the future, and considered that if the high prices were maintained through 2023, VaR levels would be very high.

2.13. We have updated this analysis for the current Consultation, using as a base case estimates based on forward market data taken on 15 November 2022. These show a softening of wholesale prices (especially for gas) over the autumn in the light of expectations of the supply/demand balance in Europe this winter. However, the updated base case projections (which remain subject to very considerable uncertainty) continue to show high levels of VaR in 2023 which exceed the level when Ofgem originally decided to implement the MSC and BAT.

2.14. For the period April to December 2023, we have decided for this Consultation to maintain the high case for VaR that we published in the August 2022 Decision (that high case does not have separate values for before April 2023). This is because the current softening of prices for Winter 2022/23 does not necessarily imply that the situation will also be improved the following year, for example if demand is higher because of colder weather in Europe. Subject to views that we receive from consultees, and further analysis we may undertake, we currently consider it prudent to leave the high case unaltered.

2.15. The following tables give base and high case estimates for VaR per domestic customer for points within the period April 2023 to March 2024 (the "**Additional Period**") plus April 2022 and January 2023 for comparison.

Estimated Value At Risk (£ per domestic customer), Base Case	01 April 2022 (Decision)	01 Jan 2023 (Comparison)	01 April 2023	01 June 2023	01 Sept 2023	01 Dec 2023
Electricity	£210	£519	£294	£283	£374	£402
Gas	£250	£790	£244	£176	£522	£887
Total	**£460**	**£1,309**	**£538**	**£459**	**£896**	**£1,289**

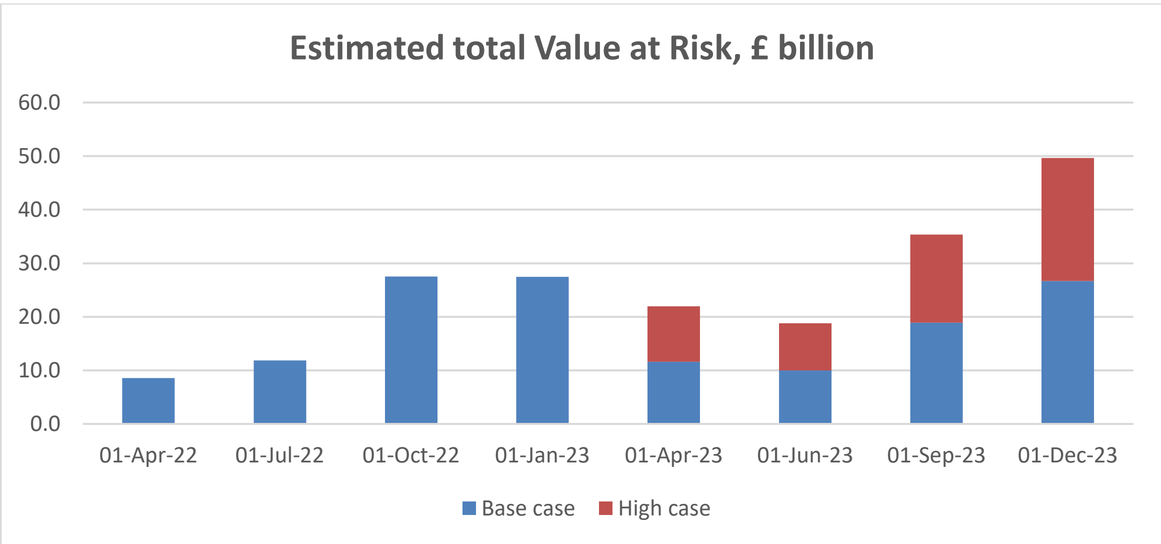
Estimated Value At Risk (£ per domestic customer), High Case	01 April 2022 (Decision)	01 Jan 2023 (Comparison)	01 April 2023	01 June 2023	01 Sept 2023	01 Dec 2023
Electricity	£210	£519	£558	£533	£702	£796
Gas	£250	£790	£462	£329	£975	£1,594
Total	**£460**	**£1,309**	**£1,020**	**£862**	**£1,677**	**£2,390**

2.16. As previously, we have used these VaR per customer numbers together with estimates of total SVT customer numbers for gas and electricity to derive overall VaR projections. We have maintained our previous SVT customer number estimates plateauing at 23.18 million for electricity and 19.55 million for gas from January 2023. The results are as below:

Estimated Value At Risk (total, £ billion) Base case	**01 April 2022 (Decision)**	**01 Jan 2023 (Comparison)**	**01 April 2023**	**01 June 2023**	**01 Sept 2023**	**01 Dec 2023**
Electricity SVT customers, million	20.31	23.18	23.18	23.18	23.18	23.18
Electricity VaR, £ billion	4.3	12.0	6.8	6.6	8.7	9.3
Gas SVT customers, Million	17.04	19.55	19.55	19.55	19.55	19.55
Gas VaR, £ billion	4.2	15.5	4.8	3.4	10.2	17.3
Total VaR, £ billion	**8.5**	**27.5**	**11.6**	**10.0**	**18.9**	**26.6**

Estimated Value At Risk (total, £ billion) High case	**01 April 2022 (Decision)**	**01 Jan 2023 (Comparison)**	**01 April 2023**	**01 June 2023**	**01 Sept 2023**	**01 Dec 2023**
Electricity SVT customers, million	20.31	23.18	23.18	23.18	23.18	23.18
Electricity VaR, £ billion	4.3	12.0	13.0	12.4	16.3	18.4
Gas SVT customers, Million	17.04	19.55	9.0	19.55	19.55	19.55
Gas VaR, £ billion	4.2	15.5	4.8	6.4	19.0	31.2
Total VaR, £ billion	**8.5**	**27.5**	**22.0**	**18.8**	**35.3**	**49.6**

2.17. These results (including additional 2022 data points) are depicted in the chart below.



2.18. The high estimated levels of VaR in late 2023 reflect projected wholesale prices as of late October 2023 and seasonal demand. Together, these factors on present estimates cancel out or exceed the reduction in VaR from the move to a quarterly price cap that was phased in during 2022. These preliminary projections indicate that there may continue to be significant threats to market stability beyond March 2023, at least until the end of that year.

2.19. When the decision to implement the MSC and BAT was taken in February 2022, the gas crisis appeared to be a short term supply/demand imbalance caused largely by the worldwide economic disruption and recovery related to Covid-19, as well as other market factors. The duration and intensity of the gas crisis has however significantly increased as a result of Russia's invasion of Ukraine on 24 February 2022 and the way that this conflict has developed, including restrictions in the supply of Russian gas to Europe.

2.20. Although the VaR analysis provides a simple indicator of the extent to which market conditions are likely to give rise to a stability issue, it is not the only factor in deciding whether the MSC is in consumers' interests. For example, further analysis is likely to be needed to assess the tolerable level of VaR (ie the level above which it is in consumers' interests to have market stabilisation policies of some form). For the present purposes, we have assumed that the tolerable level would not be more than the level at which Ofgem originally introduced the MSC (and could be less), but this view could be affected by future regulatory and Government policy developments.

Impact of the Government's Energy Price Guarantee

2.21. The Government's Energy Price Guarantee ("**EPG**"), introduced from 1 October 2022, provides domestic customers some protection from high energy prices by limiting the amount they can be charged per unit of gas or electricity. A side effect of this limitation is that (as currently configured) it reduces the incentives for customers to switch, though it does not reduce the Losing Supplier's loss on a stranded hedge when such a switch takes place. Accordingly, while it does not reduce the nominal level of VaR, the EPG is likely to reduce the actual realisation of VaR losses and could increase the level of VaR that is tolerable. We consider that the EPG is reducing but has not eliminated the risk to market stability from stranded hedges and this will be relevant to consideration of the future parameters and design of the MSC.

2.22. The reduction in switching incentives that arises from the EPG as it is currently configured also largely displaces the similar effect of the MSC. With the current EPG present, the MSC's dampening effect on competition is reduced because competition is already much reduced by the EPG.

2.23. The Government announced in the Autumn Statement on 17 November 2022 that the EPG will be retained for a further year from April 2023 until April 2024. From April 2023, the scheme will be set at a higher price than currently and support could be capped for those who use very large volumes of energy (with safeguards for vulnerable people). This means that a typical dual fuel household in Great Britain will pay no more than £3,000 per annum compared to the £2,500 they currently pay until 31 March 2023.

2.24. Much depends on the detail of the new scheme. For example, the current dampening effect on switching and competition comes from a rule which essentially means that new fixed term contracts do not attract the EPG subsidy. If that limitation were removed in the revised scheme, allowing the EPG to support price offers below £3,000 based on lower wholesale costs, the dampening effect of the EPG on market stability would be largely eliminated. Conversely, if the rules remain the same, there would still be a dampening effect but the higher price guarantee level of £3,000 would reduce it.

2.25. In practice, none of this affects our view that it would be prudent for Ofgem to have the powers to operate the MSC during the Additional Period to promote stability in consumers' interests, but the different scenarios for the EPG indicate different policies on the MSC parameters and we expect to review this shortly. More generally, we would expect to reassess the market situation 6 months after the implementation of our proposed measures to determine if they are still fit for purpose.

Temporary nature of the MSC; alternative policies

2.26. The MSC and the BAT were introduced as temporary measures and as such were originally due to fall away from 30 September 2022. However, in the light of the changing nature of the gas crisis and following the June 2022 consultation, we published the August 2022 Decision which extended these measures until 31 March 2023. Our Decision to extend took account of the VaR metric for the extension period (October 2022 to March 2023) and modelling of the finances for NoCo, together with stakeholder responses to our consultation.

2.27. The MSC assists all parties in addressing the evolving gas crisis but we do not consider it to be a suitable mechanism to be an enduring part of the regulatory framework. It will only be retained for so long as it is necessary in the interests of consumers. The MSC could be removed if market conditions reach a level of sufficient stability (for which the VaR metric is a useful, though not the only, indicator) or if other policy and market developments (including Government policy) meant that the risks could be appropriately managed in some other way.

2.28. These two conditions interact; a lower level of VaR could make alternative policies (such as price cap allowances or increased supplier resilience) more practicable. If, following this consultation, we proceed with the extension proposed, we would intend to review the position in summer 2023 so that any further changes could be made by October 2023.

2.29. Although the BAT is currently also being operated as a temporary measure, we wish to consider in due course whether it should be made enduring in order to promote fairness in the market. Any such consideration will be dealt with in a separate consultation.

2.30. We acknowledge the impacts on competition in the domestic energy market arising from the MSC. These include the short-term reduction in competition while the MSC is in operation, alongside the longer-term benefit from supporting the viability of the domestic supply market and so maintaining a healthy number of competitors.

2.31. As we stated in our August 2022 Decision, in the event that circumstances were to arise where the MSC was impacting consumers more (or for longer) than is necessary to achieve the objective of market stabilisation, Ofgem would be able to adjust the parameters (or indeed terminate the MSC) to deal with the issue. We will also take account of other policy developments, such as the success of Ofgem's measures to increase the financial resilience of suppliers and any relevant Government policies.

2.32. More generally, we see the ending of the MSC as being the product of the interplay of three factors, namely (a) market conditions including supplier resilience, (b) the development of alternative or supplementary policies that would promote market stability in a less intrusive way and (c) our monitoring of the effects of the policy on competition.

2.33. Obviously, if the gas crisis is resolved and prices revert to historic norms, there would be no need for the MSC. If the market developed such that stability risks were at a lower, but still significant, level that might indicate that it would be appropriate to replace the MSC with other, less intrusive, measures if we were satisfied that they were sufficiently effective. The more effective the alternatives, the higher the level of risk that they would be suitable to address. The VaR metric will be one indicator that will help us formulate a view on the future of the MSC alongside the policy and market developments at the time.

2.34. The work to date on alternatives has however not revealed anything that would be sufficiently effective in current market conditions without being more detrimental to consumers than the MSC. For example, suspension of switching would be effective, but has higher consumer detriments, both because it would prevent consumers exercising choice for non-price reasons, and because the MSC allows some consumer gains from switching. Similarly, allowing exit fees on SVT contracts could only be assured to be effective if those fees were at a similar level to the MSC. In addition, this option would involve consumers having to pay significant up front termination fees which would have the distributional issue that only consumers able to afford that (who probably have the least need for cheaper energy) would be able to access the cheaper deals.

2.35. Conversely, measures such as price cap allowances or relying on increased resilience do not appear to us to be sufficiently effective in current circumstances. Similarly, the BAT, without the MSC, only has a minor effect on the stability risks which would not be sufficient at present. However, the MSC is a temporary measure and will need to be retired when the appropriate mix of market conditions and policy actions (including any changes in Government policy) is in place so that it is in consumers' interests to bring it to an end. We are continuing to work on this and will keep stakeholders informed on progress.

Stakeholder feedback and conclusions

2.36. In response to our June 2022 Consultation, almost all supplier responses indicated a view that the MSC should be extended beyond March 2023 and most said that it was imperative to set out a clear direction of travel on this by November 2022, when suppliers who hedge according to the price cap will start buying energy for April 2023.

2.37. Further to this, our August 2022 Decision invited views and evidence on how Ofgem should respond to the projected high level of VaR beyond March 2023 in relation to the future of the MSC and BAT. It received 6 stakeholder responses. Suppliers generally said that the MSC remained fundamental to market stability especially while higher prices persist and were almost unanimous that it needed to be extended. They argued that other measures were unlikely to be strong enough or were insufficiently developed to be relied upon. Citizens Advice questioned whether the MSC was still needed as the EPG had reduced suppliers' risk. It argued that Ofgem had not been effective in setting out the trade-offs between the benefits to suppliers of the MSC and consumer costs. Most parties continued to support the continuation of the BAT, at least as a temporary measure.

Conclusions

2.38. We are grateful for the feedback that we received in response to the August 2022 Decision, which we have considered alongside our own analysis. Our view, subject to consultation, is that market stability risks remain and that the situation remains volatile. We consider that there is no assurance at this time that the risks will diminish over the Additional Period rather than intensifying.

2.39. Based on the current policy and market background, we think that continuing the combination of MSC and BAT is the least intrusive policy option currently available to maintain market stability in consumers' interests during the Additional Period. We consider that this conclusion applies even with the EPG in place. We note that the ability to alter the MSC parameters provides us with an option to fine tune the intervention so as to avoid over-correcting.

2.40. In reaching this view, we have had at the forefront of our minds the impacts on consumers – both positive and negative – from these interventions, as described in section 3. We are aware of the impacts of these measures on competition on the market. These include the short-term reduction in competition while the MSC is in operation, alongside the longer-term benefit from supporting the viability of the domestic supply market and the presence of a healthy number of strong competitors. Overall, and taking into account the importance of suppliers securing energy for consumers in good time to properly hedge the risks, we consider that continuing the MSC past March 2023 is likely to be in the interests of consumers.

2.41. We now welcome stakeholder views on this current consultation (see section 4 for specific questions).

3. Impact Assessment

Section summary

This section considers the impacts of the proposals on consumers and energy suppliers, as well as impacts on the environment and certain groups of consumers. It does this by reference to the modelled returns of a notional supply company ("**NoCo**") as published in the August 2022 Decision and indicates that the MSC continues to be in consumers' interests by helping ensure the viability of suppliers.

The precise impacts going forward will depend on the MSC parameters and other design issues, which we are planning to review shortly, as well as the interaction with the Government's EPG.

Assessment framework and methodology

Background to our approach

3.1. The impacts of the MSC on consumers arise in two phases:

- Before the MSC is triggered, when the impacts arise from the existence rather than the operation of the MSC ("**Initial Impacts**"). These impacts can also continue to arise when the MSC has been triggered by particular short term wholesale price movements and is therefore having only minor additional impacts from its operation;
- During the period where the MSC is operating in full and protecting significant hedge positions as they unwind following a major price fall ("**Operating Impacts**")

3.2. While it is possible in principle for there to be more than one significant period of Operating Impacts, we consider that the most likely evolution of the MSC is that there will be a relatively long period where the Initial Impacts are observed (including some periods where the MSC is triggered at a low level due to price fluctuations), followed by a relatively short period of the Operating Impacts, after which the market may have achieved more normal conditions and the MSC may no longer be required.

3.3. In the current circumstances, we have seen some softening of wholesale energy prices in the light of unusually mild October weather in Europe, which has increased confidence in the adequacy of gas supplies this winter. This has led to the forward market falling slightly below the price cap and some triggering of the MSC for gas at low levels of charge. Whether these conditions persist will depend on the weather over the winter period as well as other supply and demand factors, which could either reverse or intensify the recent falls. During this period, we are seeing elements of both the Initial Impacts and the Operating Impacts in play.

3.4. As respects the Initial Impacts, we have analysed the effects broadly qualitatively. This is made easier because the benefits are essentially the avoidance of under-hedging by suppliers, while there are no material direct costs because the charge is not triggered or not triggered at a material level of charge and/or duration.

3.5. In considering the Operating Impacts, we have decided at this stage to refer to the work we published in the August 2022 Decision on extending the MSC and BAT. In particular, we are continuing to apply price cap principles – that the consumer interest is best served by energy being priced at the efficient level, which is broadly the cheapest price consistent with a notional efficient and well-managed supplier being able to finance its business. In a well-functioning market, this price will be determined by competition – where a price cap is needed, it should deliver that result.

3.6. A market which is effectively constrained not to recover efficient costs is likely to lead to adverse consumer impacts. These could include disorderly or unplanned exits, with possibly large mutualisation costs; consolidation and the potential loss of competition; lack of investment or lower service quality; and ultimately failure to properly carry out the activity. In summary, a market which does not cover efficient costs is not sustainable and will leave consumers worse-off over time.

3.7. Of course, if the efficient level of costs is very high, for example due to geopolitical events, that level may cause hardship for consumers, especially vulnerable ones. This is not a problem that can be solved by creating a framework that does not allow the recovery of efficient costs as this would make for an unsustainable energy market which is itself contrary to consumers' interests. Instead, as the Government has recognised with the EPG, the social and economic impacts of exceptionally high energy costs driven by global gas prices must be a matter for wider Government policy.

Modelling approach and assumptions

Initial Impacts

3.8. In the case of the Initial Impacts, the MSC is likely to have increased the confidence of suppliers to hedge appropriately. This is because, in the absence of the MSC, suppliers would need to balance the risks of being under-hedged (and therefore risk selling energy at a loss if wholesale prices rise) with the risk that prices would fall and their hedge positions would be stranded by competition (and therefore have to be sold at a loss, potentially exceeding the value of the business). In such a case, a supplier would be likely to minimise the overall risk by hedging only a proportion of the expected requirements.

3.9. Such a strategy would, however, have led to difficulties as wholesale energy prices have risen unexpectedly twice since the MSC was decided upon – once in late February following the Russian invasion of Ukraine, and again from late June as Russia started progressively restricting gas exports to Europe. First quarter 2023 natural gas at the UK National Balancing Point, for example, was priced at around 190p/therm in February 2022 when we decided to introduce the MSC, around 250p/therm from March to early June 2022 and around 320p/therm (about six times historic prices) now.[5] This would have led to partially hedged suppliers having to buy their unhedged requirements at higher prices than allowed for in the price cap, with the risk of large losses or failure.

3.10. The cost of the Bulb Special Administration was estimated this month by the OBR to be £6.5 billion.[6] Many of the remaining companies in the market are significantly larger than Bulb and, had they significantly under-hedged, could be facing energy losses which could exceed the value of the business. This would put them at risk of their owners or financial backers declining to provide support leading to an insolvent or disorderly exit and a cost in excess of £1 billion.[7] An alternative methodology would be to estimate the cost based on

[5] Price estimate as at 22 November 2022

[6] Economic and Fiscal Outlook (Office of Budget Responsibility), November 2022 Page 9 https://obr.uk/docs/dlm_uploads/CCS0822661240-002_CCS001_SECURE_OBR_EFO_November_2022_BOOKMARK.pdf

[7] The actual cost would depend on the market conditions at the time of any failure and how big the failed company was. However it seems reasonable to believe that (a) significant under-hedging in the absence of the MSC would have been more likely than not to have led to a large supplier failure when prices rose and (b) such a failure would be likely to have a cost on a comparable scale to the Bulb failure. We therefore consider the £1 billion figure to be a conservative estimate of a cost that could have been much more, perhaps as much as £10 billion.

previous experience of mutualised costs from supplier exits, taking account of the size of the remaining companies. That would also result in a figure in excess of £1 billion.

3.11. It is therefore reasonable to assume that the benefits that could have accrued already to consumers from having the MSC and BAT in place to avoid an incentive to under-hedge may be in excess of £1 billion.

3.12. The costs to consumers of the MSC during this period are very limited. There has been some administrative cost in Ofgem and suppliers considering and operating the policy and implementing the payment mechanics; however, these are likely to be insignificant compared to the possible benefits mentioned above. It is possible that the MSC's existence may have deterred some companies from attempting to enter the market, but it is unclear if this is a real effect (since the MSC does not prevent efficient suppliers from profitably gaining customers). In any event, any impact on consumers is likely to be small.

3.13. The BAT has similar costs during the period of the Initial Impacts. In current market circumstances its main costs are administrative since fixed price contracts are generally not competitive with the capped SVT price. Meanwhile it contributes, to some extent, to the confidence of suppliers in hedging appropriately by reducing the incentive for very aggressive acquisition tariffs.

3.14. Looking forward to the Additional Period (starting April 2023), we can expect the Initial Impacts to follow a similar pattern. Although wholesale forward energy prices have softened somewhat at present (while remaining very high by historic standards), volatility remains high and prices are very susceptible to changes in the perceived forward supply/demand balance. We cannot exclude the possibility of significant rises, or falls, in price. In the absence of the MSC (augmented to some extent by the BAT), suppliers would face the same dilemma on hedging. Accordingly, the Initial Impacts during the Additional Period could be similar to those in the recent past.

Operating Impacts

3.15. Our primary tool for looking at the Operating Impacts of our policy has been to explore the characteristics of a notional company ("**NoCo**") which is a substantial energy supplier affected by these issues. However, the detail of the Operating Impacts depends on the parameters chosen, which are a separate question to whether the MSC powers are in place.

3.16. The modelling for NoCo is also affected by the EPG. As currently configured, the EPG does not apply to new contracts other than the SVT. As a result, the financial support is not available for price offers below the £2,500 benchmark for a typical customer. This has two effects:

- In the event of a wholesale price fall, suppliers will not have access to the EPG money for their fixed price contract offers, so any discounts that are offered are likely to be significantly smaller than the fall in wholesale prices. This leads to much reduced switching but the hedging loss to the Losing Supplier on each switch is not reduced by the EPG.
- Nevertheless, if wholesale prices fall, suppliers stand to make significant gains from acquiring customers onto their SVT and this is likely to be manifested in substantial marketing activities and incentives designed to achieve switching.

3.17. At some point, there is a tipping point where it is more advantageous for a supplier to forego the EPG subsidy and simply offer a discount. In setting parameters, it will be necessary for the model to optimise the behaviour of competing suppliers between the two strategies in order to assess the level of switching when the EPG is in place.

3.18. Following the Government's announcement of changes to the EPG to apply during the Additional Period, an analysis of parameters would need to consider three EPG cases:

- The current £2,500 EPG policy (this would verify whether the parameters remain appropriate in the current environment)
- A £3,000 EPG policy, assuming no change to the rules
- A £3,000 EPG policy with rule changes which remove the effect by which the EPG reduces switching (ie that it applies to all types of new contracts). For the purposes of MSC analysis, that is effectively the same as no EPG at all.

3.19. While this work is under way, we maintain the analysis set out in the August 2022 Decision as an indication of the likely effects. The actual impacts on NoCo will depend on the parameters chosen which we expect will be the subject of a separate consultation in the light of recent developments on the EPG.

3.20. The estimated effect on continuing the MSC was given in the August 2022 Decision in the following table:

	No MSC	MSC in Place
NoCo customers switching during Extension Period following price fall	2.34 million	1.87 million
Financial impact on NoCo of trading through Extension Period	-£2,038 million	-£312 million
Modelled NoCo EBIT on turnover during Extension Period	-29.82%	- 2.18%
Acquisitions Benefit	+0.75%	+0.75%
Net EBIT in Extension Period	-29.1%	-1.4%

3.21. To put these figures into context, a rough estimate of NoCo's ongoing value as a business can be obtained as follows. Take the price cap in "normal times" (we use the price cap for the period October 2021 to March 2022 to represent that) at mean consumption, scaling back the gas consumption for the reduced number of customers = £1,295. Multiply by 1.94% EBIT on turnover and by 5 million customers. This gives an annual EBIT of about £126m. Multiplying by a p/e ratio of ~7.5[8] indicates a possible value for NoCo of £945 million.

3.22. Based on the August 2022 Decision numbers, the losses incurred by NoCo in the absence of the MSC and BAT would be around double the value of the business or more. In such circumstances, it is unlikely that NoCo's owners or investors would support the business and it would be likely to fall into insolvency.

3.23. As noted in that Decision, the parameters are likely to require adjustment in order to get within the target range of 0-1.94% Underlying EBIT (subject to any adjustment that seems appropriate in the light of Ofgem's EBIT work). We remain of that view, subject to the impacts of the EPG, and expect to consult on the parameters and other design issues shortly.

[8] The acquisition of SSE's domestic business by Ovo, agreed on 13 September 2009, took place on a p/e ratio of about 6, based on the price of £500m and the earnings for the domestic segment of £84m. However these earnings were pre the price cap and involved a margin of c. 2.4%. Scaling the earnings to the 1.94% price cap level gets a p/e ratio of around 7.6. See: SSE segmentals https://www.sse.com/media/4zvkuj2y/sse-css-1819-published.pdf and Ovo announcement https://company.ovo.com/cma-approves-ovo-energy-acquisition-of-sse-energy-services/

3.24. For the purposes of this consultation, it is sufficient to note:

- Although the EPG has some effect in dampening switching in the event of a price fall, it does not remove the issue of stranded hedges;
- Absent the MSC, in a price fall scenario NoCo is likely to face very severe losses that could drive it into insolvency; and
- It is possible to set parameters and make design changes that address this and bring NoCo's Underlying EBIT within the target range.

3.25. It therefore remains the case that the MSC (alongside the BAT) is likely to be necessary in consumers' interests to maintain stability in the domestic energy supply market.

Consumer Impacts

3.26. As we have explained in previous documents and above, the consumer interest is best served over time by having a framework in which efficient costs can be covered by a notional supplier. To the extent that those efficient costs are likely to cause hardship for consumers (or any group of consumers), the most appropriate approach in the current exceptional circumstances is for Government to take special measures to mitigate the impacts. For these reasons we welcome the Government's decision to bring in the EPG and other support measures.

3.27. We have quantified the Initial Impacts of the MSC and BAT as being likely to be a gain in excess of £1 billion for consumers (also with large avoided losses for suppliers) by avoiding incentives for companies to under-hedge.

3.28. As regards the Operational Impacts, the short term effect of the MSC and BAT is to transfer resource to suppliers from consumers who switch (or who would have switched) during the period the MSC and BAT are active. This is to be set against the longer term benefit to all consumers of maintaining a viable market.

3.29. The level of these transfers depends on the VaR at the time of the price fall and the setting of the parameters. We intend to set out more detail on this in a future consultation on parameters. For the present purposes, we can illustrate this with the figures published in the August 2022 Decision.

3.30. In the case of NoCo's customers, that transfer could be estimated as the difference between the £2.038 billion and £312 million figures in the table above. That is a figure of

£1.726 billion. However, this is illusory as it is unlikely that NoCo could survive a loss on this scale. Moreover, in the absence of the MSC, NoCo would in all probability not have been able to take out the hedges projected and therefore would have been at risk of insolvency if wholesale prices rose (as they have several times this year already).

3.31. At an industry wide basis, the August 2022 Decision estimated that the total industry losses would be £9.311 billion. With the MSC, the figure came down to £1.497 billion. The difference is approximately £7.8 billion, but the same comments above apply – in reality the £7.8 billion is not available to consumers as it exceeds the means and value of the supply industry and the hedges would in all probability not have been taken out without the MSC.

3.32. In any event, if these losses and transfers did occur on this scale, they could be accompanied by insolvency of many or possibly all the remaining companies in the supply industry as supply companies with losses exceeding their value might be abandoned by their parents or investors. There would also be huge costs of any insolvencies. Bulb, with 1.6 million customers, accounted for approximately 6% of the industry and its special administration was estimated by OBR earlier this month to cost £6.5 billion, significantly more than the OBR's previous estimate in March 2022 of £2.2 billion. Scaling up the OBR's £6.5 billion estimated cost for Bulb for the whole industry would reach a total of around £108 billion. In practice, this is not an outcome that is feasible – regulatory or Government action such as the MSC would be necessary to prevent it.

3.33. We remain of the view that the appropriate focus for impact assessment in this area is to look to policies ensuring that efficient costs for energy supply can be covered, so ensuring that a sustainable market exists to the benefit of consumers. It is less useful to seek to weigh up costs and benefits in relation to scenarios which are not sustainable.

Environmental and Distributional impacts of proposals

Environmental

3.34. We have identified that continuation of the MSC may have environmental impact as follows:

- To the extent that the MSC reduces the overall costs to consumers of purchasing the energy they need (whether as a result of the Initial Impacts or the Operational Impacts), it could reduce the incentives for energy efficiency behaviours or measures.

- To the extent that the MSC prevents disorderly exits of suppliers from the market, it will reduce disruption to energy efficiency programmes such as those under the ECO4 scheme and other supplier-led initiatives with environmental benefits such as smart meter installation.

3.35. The first impact could be thought to be negative for the environment. However, Ofgem's primary objective is the interests of consumers, and this normally points towards reducing consumer costs through lower prices or well-designed energy efficiency schemes. While our primary duty to consumers includes their interest in the reduction of greenhouse gases, that interest is to be considered in the context of their overall interests. Front and centre of these overall interests is reducing the cost of energy for consumers.

3.36. The second impact is beneficial for the environment. Energy market instability can lead to disruption and under-delivery of energy efficiency schemes and/or smart meter installation. The MSC plays an important role in preventing this detriment, whether energy prices rise or fall.

Distributional

3.37. Distributional impacts can be considered in three ways:

- By reference to the statutory classes of consumers that Ofgem must have regard to (along with other descriptions of consumer) when making policy decisions (the "Statutory Groups"), namely:
    a. individuals who are disabled or chronically sick
    b. individuals of pensionable age
    c. individuals with low incomes
    d. individuals residing in rural areas
- By reference to the 13 archetypes of consumer developed for Ofgem by the Centre for Sustainable Energy (the "**Archetypes**")[9] and similar research carried out by the

[9] Ofgem energy consumer archetypes: Final report, Centre for Sustainable Energy (2020) https://www.ofgem.gov.uk/sites/default/files/docs/2020/05/ofgem_energy_consumer_archetypes_-_final_report_0.pdf

Competition and Markets Authority in the Energy Markets investigation of 2014 to 2016.[10] This approach is helpful where impacts differ by consumer behaviour.

- By reference to the duties in section 149(1) of the Equality Act 2010 in relation to the relevant protected characteristics set out in section 149(7) – namely age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex, or sexual orientation (the "**Protected Characteristics**").[11]

3.38. In looking at the distributional impacts, it is helpful to look separately at the Initial Impacts and the Operating Impacts (as defined above).

Initial Impacts

3.39. The Initial Impacts of the MSC have two aspects:

- Cost savings for all consumers by avoiding the costs of supplier exit or failure from under-hedging.
- Improvements in security of supply by reducing the extent that physical supplies are pre-empted by overseas customers and therefore not available in the shorter term market. (The fact that European security of supply concerns in the early part of this winter have been ameliorated by a mild October does not mean that they will not occur at other times.)

3.40. The cost savings apply to all consumers. However, such savings are more valuable to people with lower incomes than those who are more affluent. This is discussed in Ofgem's distributional impacts framework document,[12] which indicates that a particular cash saving is worth around 10 times more, on an equity weighted basis, for somebody in the lowest income decile than the highest. As respects the other Statutory Groups, the ONS data[13] indicates that

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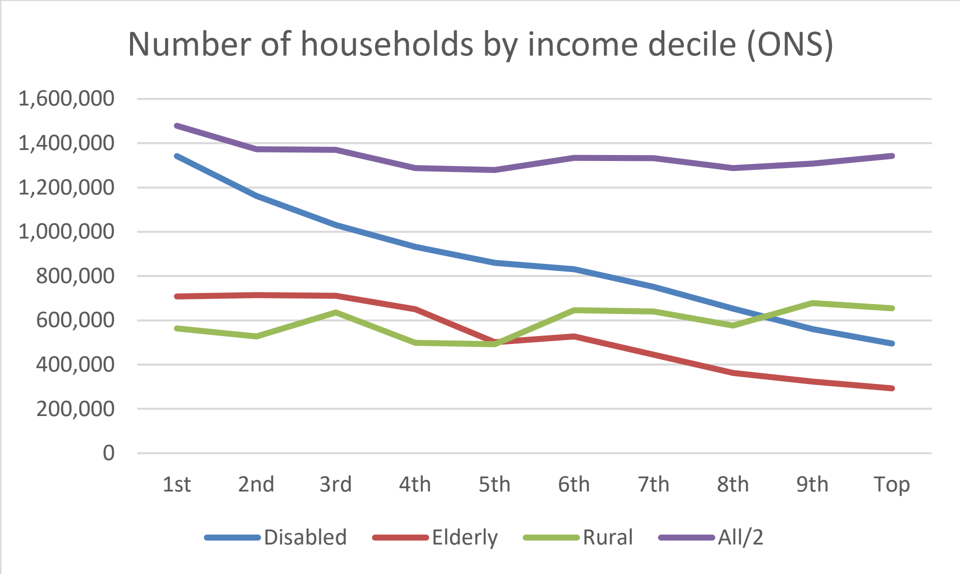
[10] Energy Market Investigation: Final Report, CMA (2016) https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf

[11] These protected characteristics are reflected in 13 Archetypes which we use in distributional analysis and overlap with the 4 Statutory Groups

[12] Ofgem, "Assessing the distributional impacts of economic regulation" (2020) https://www.ofgem.gov.uk/sites/default/files/docs/2020/05/assessing_the_distributional_impacts_of_economic_regulation_1.pdf

[13] ONS, "Disposable income and energy expenditure for different fuel type households and household types, UK, financial year ending 2018" (2020) https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/inco

there is an association between low incomes and disability, and between low incomes and pensionable age, but no association (or perhaps a small reverse one) between low income and rural location. See the graph below extracted from the ONS data:



3.41. Accordingly, the Statutory Groups a, b and c listed above gain more than average from the price element of the Initial Impacts, while group d (rural) has a similar, or slightly lower, impact to the generality of consumers.

3.42. As regards the security of supply element of the Initial Impacts, it is likely that the same three groups will be placed under more stress if there are security of supply difficulties because (in the case of low income) they may have fewer options to mitigate the problem and (in the case of disabled or pensionable age) they may be more susceptible to cold. We have not identified any obvious reasons why rural consumers would have more severe impact from security of supply issues than others; indeed some may have better arrangements to deal with supply failures if they are used to poorer than average security of supply due to network issues.

meandwealth/adhocs/11319disposableincomeandenergyexpenditurefordifferentfueltypehouseholdsandhouseholdtypesukfinancialyearending2018

3.43. For the Initial Impacts, there is no clear difference in impact by consumer behaviour, and it is not necessary to consider the archetypes or the corresponding CMA research.

3.44. As respects section 149 of the Equality Act, the impacts by age and disability are discussed above and do not amount to discrimination or a failure to advance equality of opportunity. To the extent that pregnancy and maternity imply a greater susceptibility to energy costs or insecurity, they will follow the analysis for age and disability. We have not identified any differential impact of the Initial Impacts on the other Protected Characteristics or any impact of this policy on the fostering of good relations between people with and without any of the Protected Characteristics.

Operating Impacts

3.45. A similar effect occurs in relation to the Operating Impacts, which are more complex but overall involve benefits to consumers from maintaining a sustainable energy supply market and avoiding additional market exit costs. These have similar distributional impacts to those set out above for the Initial Impacts.

3.46. However, there are additional distributional effects, set out below, which relate to differing propensity to switch. The benefits of maintaining the MSC and BAT, whether in terms of avoiding potential mutualised costs of failure, or more widely in having a viable energy supply sector, accrue to consumers generally. The costs of delayed savings through switching accrue only to active consumers.

3.47. We have therefore looked at two data sources which link the propensity of consumers to switch with markers of vulnerability and the Statutory Groups.

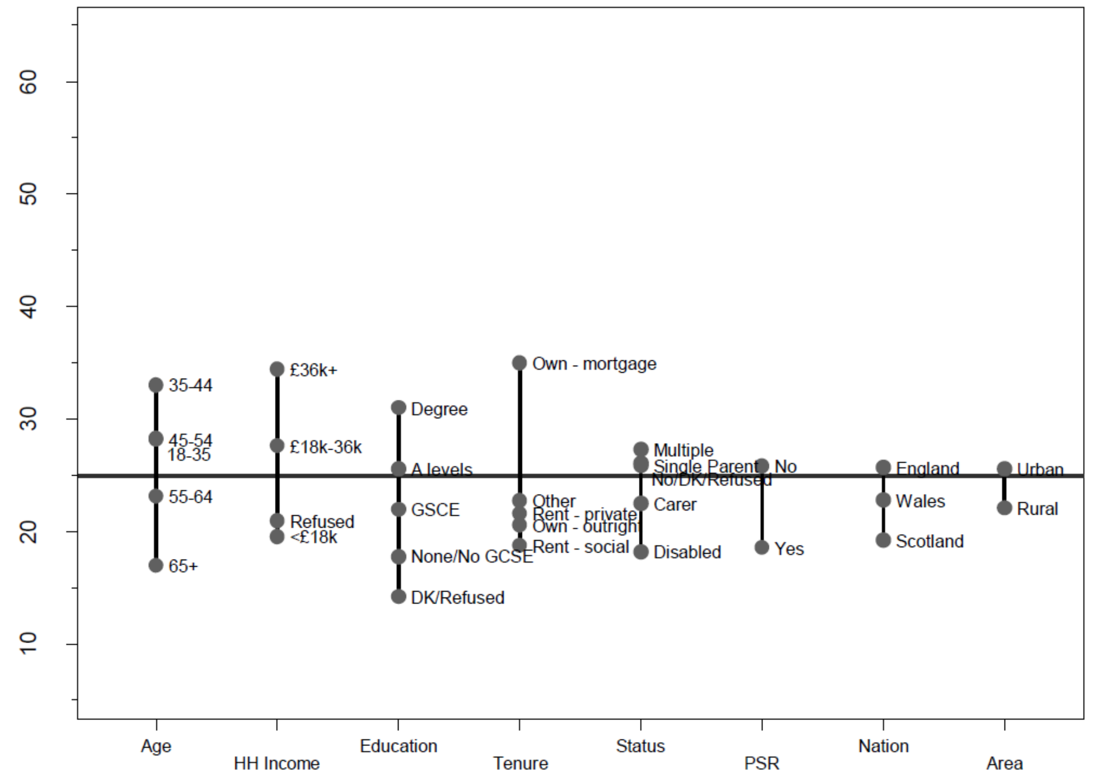
3.48. The first is the CMA which undertook a survey of domestic customers as part of its Energy Market Investigation. The key conclusions are set out in the Final Report[14] and the full

[14] CMA Energy Market Investigation, Final report (June 2016), pp 447-449 https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf

details of the survey are set out in Appendix 9.1 to that Report.[15] They find that a number of indicators of vulnerability were associated with being inactive in the energy market[16].

3.49. They illustrate these results with the graph reproduced below:

Figure 9.1: Proportion of supplier switching in the last three years by demographic and household characteristics



Source: CMA analysis of survey and supplier data.
Note: Derived from responses to questions K1, K3, K4, K5, K6 and records provided by supplier. PSR indicates whether respondent is on the Priority Services Register. Those who were unable to respond to relevant questions (ie answered 'do not know') have been excluded.
Base: age 6,901, income 6,999, education 6,665, tenure 6,999, status 6,999, PSR 6,990, nation 6,999, area 6,976.

3.50. This data suggests that all the Statutory Groups are associated with lower than average switching characteristics and are therefore more likely to gain from the upsides of

[15] https://assets.publishing.service.gov.uk/media/576bcbbc40f0b652dd0000b0/appendix-9-1-cma-domestic-customer-survey-results-fr.pdf

[16] "We find that the groups of respondents who are less likely to have switched supplier in the last three years are those with any of the following characteristics: household incomes under £18,000 a year; living in rented social housing; without qualifications; aged 65+; with a disability or registered on the PSR." CMA Final Report, June 2016, Paragraph 9.10, Page 448

the Operating Impacts and less likely to be affected by the downsides. The same result applies as respects the age and disability protected characteristics under the Equality Act. We have not identified any differential impact from the Statutory Groups analysis as respects people with the other Protected Characteristics.

3.51. We can repeat the analysis using the Consumer Archetypes, as an independently derived source. The Centre for Sustainable Energy ("**CSE**") explain (page 1 of report) that their data source is the ONS Living Costs and Food Survey, together with other external reports and Experian Mosiac data. A number of the archetypes list as a characteristic a low propensity to switch as summarised in the table below:

Archetype	Number of hholds (000's)	Hhold income % of GB average	Low switching	Age	Disability	Rural	BME
A1	2,761	141%					
A2	2,916	161%					
B3	3,674	84%	✓	✓			
B4	2,323	119%					
C5	1,922	48%	✓	✓			
D6	1,547	53%	✓		✓		✓
D7	1,205	100%		✓	✓		
E8	2,356	69%	✓				
E9	3,093	109%					
F10	1,912	113%		✓		✓	
G11	1,510	89%	✓				✓
H12	644	43%	✓	✓			
H13	525	65%	✓		✓		

3.52. This indicates:

- All the archetypes with income below the average are also associated as low switchers
- Of the archetypes with age as a characteristic, those associated with low switching contain 6.2 million households, those not associated with low switching contain 3.1 million households

- Of the archetypes with disability as a characteristic, those associated with low switching contain 2.1 million households, those not associated with low switching contain 1.2 million households
- The one archetype associated with rural locations (containing 1.9 million households) is not associated with low switching
- Both the archetypes that CSE describe as being associated with BME households are also associated with low switching.

3.53. Accordingly, for all the Statutory Groups except rural, the CSE archetypes indicate that the benefits of the Operating Impacts of the MSC disproportionately apply compared to the costs.

3.54. Turning to the protected characteristics under the Equality Act, this archetype analysis indicates the Operating Impacts have a similar positive impact (of the benefits applying more intensely than the costs) as respects age, disability and race. We have not identified evidence that people with the remaining protected characteristics are likely to be more, or less, active in the supply market than consumers generally and so this group is likely to be relatively neither advantaged nor disadvantaged by these proposals.

Conclusions

3.55. On current evidence we consider that the case for extending the MSC is very strong in both high and falling price scenarios. Accordingly, we consider that the reasons to extend the MSC are the same as when the MSC was first introduced, albeit the reasons are stronger now given the higher level of VaR and greater security of supply risk.

3.56. Similarly, we consider that the reasons to extend the BAT post March 2023 remain unchanged from when the BAT was first introduced. Furthermore, the BAT as a policy measure augments the MSC and its contribution to achieving stability is more valuable now due to higher VaR than when it was first introduced. We remain of the view that the BAT is insufficient in achieving market stability on its own.

3.57. We consider that our proposed approach to amend the existing standard licence conditions provide continuity of protection in the short term for consumers and suppliers from current energy market volatility, while allowing the flexibility to adapt the protection based on the evolving market situation.

4. Summary of Proposals and Questions

Section summary

This section summarises our proposal to modify the MSC and the BAT licence conditions so that they remain in place until 31 March 2024, subject to an annual power for the Authority to extend further (and, for the MSC, the existing power to terminate early). It also sets out some detailed proposals concerning the BAT and related derogations. Finally, it sets out the consultation questions.

Proposals for MSC

4.1. Further to the reasoning set out in section 2 and our draft impact assessment set out in section 3, we propose to extend the MSC until 31 March 2024. We also propose to give the Authority powers to extend the MSC for up to a year at a time beyond this date, where required, via publishing a written statement. The written statement would contain reasons for extending the MSC, such reasons for extension being the product of a thorough review which would include a consultation. The MSC remains a temporary provision and further extension beyond March 2024 is not envisaged unless in view of prevailing circumstances we consider it necessary in the interests of consumers.

4.2. We propose to retain the existing power to terminate the MSC early by publishing a notice to that effect.

4.3. We will consider the market situation at 6 months following the implementation of our proposed measures to ascertain if they are still fit for purpose.

Proposals for BAT

4.4. Further to the reasoning set out in section 2 and our draft impact assessment set out in section 3, we propose to extend the BAT in the same way as the MSC, until 31 March 2024, with powers given to the Authority to extend this annually, where required.

Market-wide Derogation for Fixed Retention tariffs

4.5. Alongside the introduction of the BAT from 14 April 2022, we introduced on 7 April 2022 a market-wide Derogation from SLC 22B for Fixed Retention tariffs.[17] This was to allow domestic suppliers to continue offering – or to offer new – Fixed Retention Tariffs to their existing customers only. The Direction under which this Derogation was issued will also come to an end on 31 March 2023.

4.6. Given that we are proposing to extend the BAT until 31 March 2024, and given that the reasons for allowing the Derogation for Fixed Retention Tariffs as set out in our Decision in April remain unchanged, we are proposing to also extend the Market-Wide Derogation from SLC 22B for Fixed Retention Tariffs until 31 March 2024.

4.7. We remain committed to ensuring a balance between protecting customers from price discrimination whilst also recognising the importance of certain tariff offerings in our transition to net zero. We aim to issue further guidance on the interactions between the BAT and the offering of other tariffs in early 2023.

Licence modifications

4.8. In our August 2022 Decision we noted that an extension of the existing licence conditions for MSC and BAT would require a licence condition modification. Accordingly, we are consulting on a set of notifications to modify the existing licence conditions for both the MSC and the BAT, to reflect the proposals to both measures as detailed above.

4.9. We are also proposing to issue a renewed Market-wide Derogation from SLC 22B for Fixed Retention Tariffs.

[17] https://www.ofgem.gov.uk/publications/decision-derogations-slc-22b-requirement-make-all-tariffs-available-new-and-existing-customers

4.10. The notices to modify the existing licence conditions and the draft market-wide BAT derogation are published alongside this document and links to them are provided in Appendix 1.

Questions

1) Do you agree that Ofgem should modify supply licence standard conditions SLC 24A and 22B so as to maintain powers to operate the MSC and the BAT until 31 March 2024, with powers given to the Authority to renew this annually?
2) Do you agree that this should continue to include, in the case of the MSC, the existing power for the Authority to terminate it early?
3) Do you have any comments on the proposed drafting of the changes to the supplier licence standard conditions?
4) Do you agree that we should extend the market-wide derogation from SLC 22B for fixed retention tariffs?
5) Do you have any comments on the analysis presented in section 2?
6) Do you have any comments on the draft impact assessment presented in section 3?

Appendix 1. Statutory Notices

This appendix lists and provides the link to the documents that we have published alongside this consultation, consisting of:

• Statutory notices of our intention to modify licences

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 link below:

https://www.ofgem.gov.uk/publications/statutory-consultation-extending-msc-and-bat-beyond-31-march-2023

• Statutory Consultation on proposal to extend the existing Market-wide Derogation from SLC 22B for Fixed Retention Tariffs

We are consulting on extending the existing Market-wide Derogation from SLC 22B for Fixed Retention Tariffs, and have accordingly proposed a revised notice. This is available on our website and can be accessed via the link below:

https://www.ofgem.gov.uk/publications/statutory-consultation-extending-msc-and-bat-beyond-31-march-2023

Appendix 2. 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

The details of the MSC payment mechanism will continue 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".