Decision

Extending the MSC and BAT beyond 31 March 2023	
Publication date:	3 February 2023
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From 25 November to 30 December 2022, we consulted on proposals to extend the Market-Stabilisation Charge ("**MSC**") and the Ban on Acquisition-only Tariffs ("**BAT**") until 31 March 2024, with the licence mechanism amended to enable both measures to be renewed on an annual basis ("**November 2022 Consultation**").

We have carefully considered stakeholder feedback and ongoing energy market conditions, and this document sets out the reasons for our Decision to go ahead with the proposals as above.

Changes to SLC 24A for the MSC and SLC 22B for the BAT will take effect from 1 April 2023, as will the renewed Market-wide Derogation from SLC 22B for fixed retention tariffs.

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Executive Summary

Context

Wholesale energy markets remain volatile, with prices well above historic norms, and continue to face a wide range of external pressures and shocks. We introduced the Market Stabilisation Charge ("MSC") and Ban on Acquisition-Only Tariffs ("BAT") in April 2022 as temporary measures to help protect consumers against these. So far, we believe they have achieved their intended purpose, helping to provide stability at a time of extreme price volatility.

The current licence conditions for the MSC and BAT are due to end on 31 March 2023. Our view is that retaining both measures beyond March 2023 will maintain the resilience of the GB energy sector and is in the interests of consumers. While we welcome the recent fall in wholesale prices, we remain mindful that there is a reasonable risk of further, sustained price shocks and resulting consumer detriment. The MSC remains a valuable tool to have available to increase market stability and consumer protection in such circumstances.

However, we are clear that the MSC is a temporary measure designed to improve market stability during an exceptional time. We acknowledge that the MSC in its current form is likely to have some impact on market competition. At a time of such price volatility, this needs to be balanced against the much-reduced risk of expensive, disorderly or unplanned exits from the market in the absence of any stabilising measures which can result in consumer detriment through increased bills. We consider that on balance, the MSC's benefits in providing that improved stability and greater security of supply remain in consumers' interests.

Our intention is to remove or replace the MSC when market conditions reach a level of sufficient stability, taking into account the balance of consumer interests in enabling more competition, or if we consider that the risks that it helps to mitigate could be managed in an alternative way. We are actively considering options for this and will keep stakeholders informed of progress. We also retain the ability to either remove the MSC entirely before April 2024, or to change its parameters to lessen its impact, if conditions allow.

Similarly, we believe that the BAT has complemented the MSC and helped to achieve market stability at a difficult time, although we remain of the view that the BAT would be insufficient to do so on its own. We are mindful of the suggestion, made by some consultation respondents, that the BAT should be made a permanent feature. We will consider this issue in the coming months.

Our decision

Further to stakeholder responses to our November 2022 Consultation and in light of ongoing energy market conditions, we are extending the MSC and the BAT until 31 March 2024, with the licence mechanism amended to enable both measures to be renewed on an annual basis, by publishing a statement to that effect. We will also retain the existing power to terminate the MSC early by publishing a statement to that effect. If we want to renew the MSC after March 2024, then we would consult on proposals to do so.

To give effect to the decision to extend the MSC we will also be publishing a consultation on the proposed technical changes to the MSC model to extend the MSC beyond 31 March 2023. It outlines the changes we propose to implement in the MSC model which will facilitate its operation from April 2023 – March 2024. The proposed changes and any subsequent alterations arising from this consultation will be incorporated in the MSC guidance as set out in 24A.2 of the supply licence.

For the BAT provision, we have also extended 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

Alongside this document we have issued Licence Modification Notices for both the MSC and the BAT to implement these changes for electricity and gas domestic suppliers. Simultaneously, we have also issued an updated direction on the Market-wide Derogation for fixed retention tariffs, reflecting our decision to extend this Derogation alongside the BAT.

Next steps

Changes to SLC 24A for the MSC and SLC 22B for the BAT will go live from 1 April 2023.

1. Introduction

Section summary

This section sets out the context of this Decision alongside the Consultation and Decision documents that have led to the introduction of the MSC and the BAT, as well as subsequent changes to how the MSC operates. It also details the structure and overall headings for the remainder of this Decision Document.

Subject of this Decision

1.1. The existing provisions for the MSC and the BAT end on 31 March 2023. From 25 November to 30 December 2022 we consulted on proposals to extend both measures until 31 March 2024 ("**November 2022 Consultation**") with the licence mechanism amended to enable both measures to be renewed on an annual basis, by publishing a statement to that effect.

1.2. This document sets out our decision to proceed with our proposed changes to the MSC and the BAT. We have decided to make these changes in light of ongoing energy market conditions and stakeholder responses to our November 2022 Consultation.

Structure of this Decision Document

1.3. This document is split into 6 chapters:

- Chapter 1 provides the context for this Decision;
- Chapter 2 sets out our updated case for change;
- Chapter 3 provides an updated Impact Assessment based on current market conditions;
- Chapter 4 sets out our proposals, stakeholder responses and Final Decision on extending the MSC;
- Chapter 5 sets out our proposals, stakeholder responses and Final Decision on extending the BAT;
- Chapter 6 (Appendix) sets out the link to the main page on our website containing this Decision, the licence modification notices for the MSC and the

BAT, the Market-wide Derogation notice for Fixed Retention tariffs and non-confidential consultation responses.

1.4. Alongside this document we are publishing the following:

- The final licence modification notices setting out changes to the Gas and Electricity Licenses to implement our changes to the MSC and the BAT;
- The Market-wide Derogation notice for Fixed Retention Tariffs, updated to reflect our changes to the BAT; and
- Non-confidential consultation responses.

Context

1.5. We introduced the MSC and BAT as temporary policy measures in April 2022 to help protect consumers from the risk to market stability posed by high and volatile gas prices. 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 (the "June 2022 Consultation"), we extended these measures until 31 March 2023.

1.6. Further to stakeholder feedback we consulted on further extension of the MSC and the BAT post 31 March 2023 when current licence provisions end (November 2022 Consultation).

1.7. 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 in accordance with the price cap methodology (so as to try to mitigate the risk in a falling market) but could then experience severe difficulties or fail if wholesale prices rose instead, leading to higher costs for consumers. The MSC is designed to make the market more resilient and protect consumers, whether prices rise or fall.

1.8. 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 promotes fairness in the market. However, we do not consider that the BAT sufficiently achieves market stability on its own.

1.9. Since the introduction of our measures, we note the recent significant fall in wholesale prices. However, we remain mindful that there is a reasonable risk of further, sustained price shocks and resulting consumer detriment.

1.10. Our analysis in Chapters 2 and 3 sets out our view that retaining both measures beyond March 2023 will maintain the resilience of the GB energy sector and is in the interests of consumers.

Our decision-making process

Consultation stages

December 2021 Consultation

1.11. On 17 December 2021, we consulted on a range of potential short-term interventions to address risks to consumers from market volatility, setting out three temporary measures that Ofgem could take in response, if we considered them to be warranted in the interests of consumers (December 2021 Consultation).

February 2022 Decision

1.12. Following responses to our consultation, on 16 February 2022 we published our Decision to introduce two measures to manage wholesale market volatility: a requirement for suppliers to make all tariffs available to new and existing customers (the BAT); and a requirement for suppliers to pay a Market Stabilisation Charge when acquiring new customers (the MSC). We also stated our intention for both of these measures to come into effect on 14 April 2022 (February 2022 Decision).

March 2022 Consultation

1.13. On 31 March 2022, we consulted on changes to the MSC's parameters, with the intention of making the charge more robust to ongoing and sustained levels of volatility in the market. We also consulted on technical changes to the MSC calculation methodology, to reflect both (a) updated guidance to domestic suppliers related to the price indexation methodology in the default tariff cap, and (b) electricity losses and unidentified gas (March 2022 Consultation).

May 2022 Decision

1.14. Following responses to our consultation, on 16 May 2022 we set out our decision to alter the MSC's parameters. These changes included reducing the price-change threshold at which the MSC was engaged from 30% to 10%, and increasing the derating factor (the percentage of incremental hedging losses covered by the MSC) from 75% to 85%. We also adjusted the MSC calculation to take account of the 15 March Indexation Guidance letter, and to take account of electricity losses and unidentified gas ("UIG") (May 2022 Decision).

June 2022 Consultation

1.15. On 28 June 2022, we consulted on extending the MSC until 31 March 2023 and invited comments on extending the BAT to the same date (June 2022 Consultation). We also consulted on changes to the MSC calculation methodology to reflect our announcement of 16 May 2022 relating to price indexation in the default tariff cap (the "Second Indexation Guidance Letter").

August 2022 Decision

1.16. Following stakeholder feedback and an assessment of the state of the energy market, on 26 August 2022 we published our Decision (August 2022 Decision) to extend the MSC and the BAT until 31 March 2023. 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.

November 2022 Consultation

1.17. In light of stakeholder feedback from our August 2022 Decision and ongoing market conditions, on 25 November 2022 we consulted on proposals to extend the MSC and the BAT until 31 March 2024, with the licence mechanism amended to enable both measures to be renewed on an annual basis. (November 2022 Consultation). We proposed to retain the existing power for the Authority to end the MSC at an earlier date. Alongside this we published draft licence modification notices to amend the MSC and the BAT and an updated Direction on the Market-wide Derogation for fixed retention tariffs, reflecting our proposal to extend this Derogation alongside the BAT.

1.18. We received 16 responses from stakeholders – 12 suppliers, 2 consumer groups, 1 supplier trade body and 1 non-profit independent organisation. 13 responses were marked as non-confidential and these can be found on the following page of our website: https://www.ofgem.gov.uk/publications/statutory-consultation-extending-msc-and-bat-beyond-31-march-2023

1.19. We have carefully reviewed these responses and used them to inform our decisions. This document sets out our decisions, rationale and consideration of responses.

Related publications

1.20. The main documents related to this Decision are:

1.21. June 2022 Consultation - Consultation on extending short-term interventions and adjusting MSC calculation | Ofgem

1.22. August 2022 Decision - Decision on extending Short-Term Interventions and adjusting MSC calculation | Ofgem

1.23. November 2022 Consultation - Statutory Consultation on extending the MSC and BAT beyond 31 March 2023 | Ofgem

General feedback

1.24. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

- Do you have any comments about the overall quality of this document?
- Do you have any comments about its tone and content?
- Was it easy to read and understand? Or could it have been better written?
- Are its conclusions balanced?

- Did it make reasoned recommendations?
- Any further comments

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

2. Case for change

Section summary

This section provides an updated analysis of the reasons for extending the MSC and the BAT beyond 31 March 2023, including consideration of the impact of the Value at Risk (VaR) metric and the Government's Energy Price Guarantee (EPG), and provides an update on our work on developing alternative policies to the MSC.

Context

2.1. In our November 2022 Consultation we set out the key reasons which supported our proposal to modify licence conditions in order to extend the MSC and the BAT post March 2023, when the current licence conditions end.

2.2. In the sections below we have provided further considerations on these reasons in light of recent market activity.

Supplier security and security of supply

2.3. We note the significant fall in wholesale prices since the launch of our consultation in November 2022 but note that prices remain both volatile and still significantly above historic norms. As a result, continued volatile and high prices continue to represent a risk to the resilience of the market and underline the need to maintain powers to operate the MSC.

2.4. In a scenario where prices fall significantly, stranded hedges can imperil the viability of efficient and well managed suppliers for reasons that may be far beyond suppliers' control. We consider that the MSC helps to avert this by reducing the impact of those stranded hedges, as explained in our November 2022 Consultation.

2.5. We continue to believe that the short-term benefit of accessing lower prices more quickly once prices begin to fall is more than offset by the increased resilience of suppliers against price shocks and the much-reduced risk for consumers of expensive disorderly or unplanned exits from the market as a result.

2.6. Our position, therefore, remains that extending the MSC is likely to increase resilience within the GB energy supply market and to keep costs low for domestic consumers in the year starting April 2023.

Value at Risk analysis

2.7. As the MSC has evolved over recent months, Ofgem has developed the Value at Risk (VaR) measure to assist in making decisions on whether to intervene (or not) to maintain stability in the energy market.

2.8. VaR is the estimated total value of hedges held by all domestic suppliers (assumed to hedge 100% SVT customers according to the price cap indexation strategy), 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.

2.9. 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, market conditions and supplier resilience which may affect how risk crystallises and how it can be managed. The level of VaR that can be tolerated (i.e. does not present adverse consequences for consumers) will depend on these wider considerations.

2.10. In the August 2022 Decision, we explained how our VaR analysis indicated that, based on 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.

2.11. We have updated our analysis for this Decision, using observed data as of 9 January 2023 and unobserved data based on internal price scenarios updated as of 13 January 2023 as a base case.

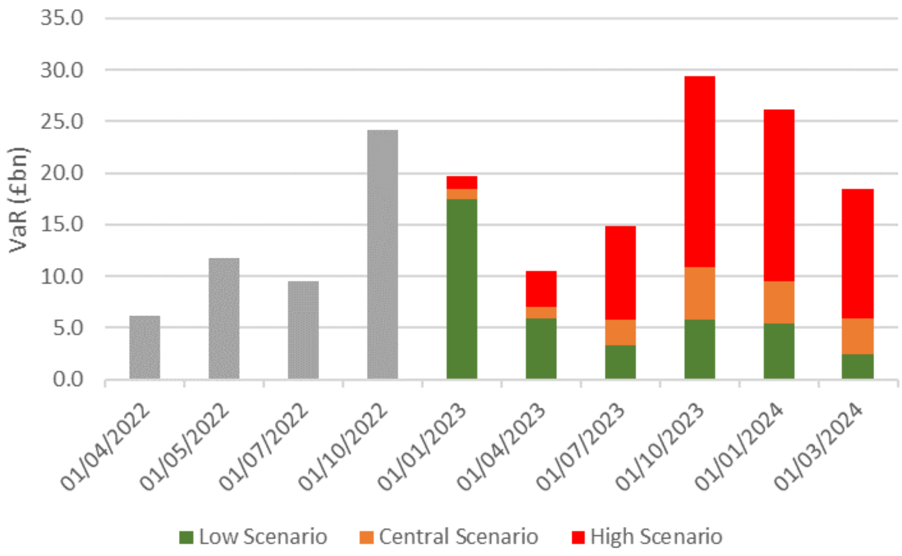
2.12. Whilst the data shows a significant softening of wholesale prices since the consultation was launched, these are still significantly above historic norms.

2.13. The updated base case projections (which remain subject to very considerable uncertainty) continue to show high levels of VaR until at least June 2023 which are almost as high as or exceed the level when Ofgem originally decided to implement the MSC and BAT.

2.14. Under the low and medium case there is a significant decline in VaR from around June 2023. This may indicate that there is potential for MSC parameters to be "looser" than they are currently set.

2.15. **Figure 1** shows updated VaR estimates from January 2023 to March 2023 using low, central and high case price scenarios. The central case price scenario is represented by the orange bar and shows the total level of risk in addition to the low price scenario. The high case price scenario is represented by the red bar and shows the total level of risk in addition to the central price scenario. These estimates are shown alongside previous VaR estimates that have already been published (April 2022 to October 2022), which are shown in grey.

Figure 1: Total estimated Value At Risk with no MSC in place, in £bn



2.16. We assume that wholesale prices remain above the EPG level for the high case price scenario. Due to the continued low levels of switching we have maintained our previous estimates of 23.18 and 19.55 million SVT customers for electricity and gas from January 2023 onwards when calculating the VaR for this scenario. We assume that wholesale prices fall below the EPG level for our low and central case price scenarios which we expect would lead to increased levels of switching away from SVTs as cheaper fixed deals become available. On this basis we have estimated lower SVT customer numbers, depending on the different level of savings available in the low and central case price scenarios, which also contributes to lower VaR figures.

2.17. 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 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.

2.18. 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 will be needed to assess the precise market conditions in which market stabilisation policies of some form are no longer in consumers' interests. Using VaR as a proxy for those conditions, it is clear that VaR will remain at an intolerable level at least through to June 2023. In all scenarios VaR projections for April 2023 remain higher than VaR when the MSC and BAT were introduced.

Impact of EPG

2.19. Our overarching assessment of the impact of the Government's Energy Price Guarantee (EPG) has not changed since the launch of our consultation. The existing support for domestic customers reduces overall competition across the market, as well as individual incentives for customers to switch. This largely displaces any dampening effect which the MSC may have on competition.

2.20. From April 2023, the price level for EPG support will increase. A typical dual fuel household in Great Britain will pay no more than £3,000 per annum, compared to the £2,500 maximum they currently pay under the EPG until 31 March 2023. This increase will reduce the dampening effect of the EPG on competition but will not eliminate it. The higher price limit is also 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.

2.21. This does not alter our view that Ofgem should retain its powers to extend the MSC beyond March 2023. We will, however, take account of the future EPG level, as well as subsequent Government announcements on support for consumers, when considering any changes to the ongoing operation of the MSC, in particular the MSC calculation and parameters.

Future of the MSC and alternative policies

2.22. Our Decision to extend Ofgem's powers to operate the MSC until 31 March 2024 reflects our view that the risk of price volatility remains, and that the MSC is well-placed to manage any such circumstances.

2.23. However we reiterate the point made in our November 2022 Consultation that the MSC is a temporary measure and will be removed or replaced when the appropriate mix of market conditions and policy actions enable this to be the case.

2.24. We continue to see the future of the MSC as being contingent on 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.

2.25. We are proceeding with our work to develop and consider alternative policy options that may be better placed to provide the right balance of support to consumers and suppliers in different market conditions, taking account of the three factors set out above, and will keep stakeholders informed of progress.

2.26. The case for the MSC is also inextricably linked to that of the price cap. The MSC is designed to address the primary risk inherent in the price cap, namely that it creates commercial conditions which require suppliers to hedge leaving them exposed if these hedges are stranded by a wholesale price fall. Similarly, if suppliers have not adequately hedged and wholesale prices subsequently rise during the price cap period, they are unable to recover their higher costs by pricing above the price cap level.

2.27. In the Autumn Statement in November 2022, the Government committed to developing a new approach to consumer protection in energy markets which will apply from April 2024 onwards. It said it would work with consumer groups and industry to consider the best approach, including options such as social tariffs, as part of wider retail market reforms. This has clear implications for the price cap in its current form. Ofgem expects to feed into the Government's work to develop a new approach to consumer protection and will carefully consider how this impacts the case for the MSC and our development of alternative policies.

Conclusions

2.28. Further to our assessment of contributing factors as above, our view remains that despite changes to VaR levels since our November 2022 Consultation, market stability risks remain and the situation remains volatile. We consider that this represents a risk to the resilience of the market and underlines the need to maintain powers to operate the MSC until March 2024, for the protection of consumers.

2.29. In reaching this view, we have continued to have 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 these measures may have on competition in 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.

2.30. Overall, and taking into account the importance of security of supply of suppliers securing energy for consumers in good time, we continue to consider that continuing the MSC past March 2023 is likely to be in the interests of consumers.

2.31. In considering the future of the MSC, we will take into account the recent softening of wholesale prices, policy changes to the EPG and other future Government support for consumers, including any new approach to price protection, alongside supplier risk management capabilities.

2.32. To this end Ofgem is also currently undertaking analysis to support a parameter review. We will consult on new parameters in the early spring.

2.33. We do not envisage the MSC to be an enduring part of the energy market. To this end we will continue our work to develop and consider alternative policy options that may be better placed to provide the right balance of support to consumers and suppliers in different market conditions, including the possibility of removing the MSC altogether, taking account of the factors set out above as well as Government's wider work on retail market reforms. We will keep stakeholders informed of progress.

3. Impact Assessment

Section summary

This section considers an assessment of the impacts of our decision to extend the MSC and BAT 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. Our assessment here is based on our draft Impact Assessment, which we published alongside our November 2022 Consultation, and has been updated following recent price movements.

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, the impacts arise from the existence rather than the operation of the MSC ("**Initial Impacts**") by incentivising prudent behaviour on the part of suppliers. 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 as a result of its operation;

- During the period where the MSC is operating in full, the impacts arise by 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 a significant softening of wholesale energy prices. This has led to the forward market falling below the price cap and some triggering of the MSC. However only a relatively small amount of MSC payments have been made, as the impact of the EPG is to depress switching rates. Forward wholesale prices have fallen below the price cap but have largely remained above the level currently implied by the EPG. Factoring in the cost of the MSC payment which would be owed by a supplier from gaining a customer, suppliers have not yet priced any fixed price contracts below £2,500 which could result in a significant increase in switching and amount of MSC payments made.

3.4. In relation to 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 due to the impact of the EPG.

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. 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 ("NoCo"). 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 for consumers; 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. Wholesale energy prices have risen unexpectedly on two occasions since the original decision to introduce the MSC was made – once in late February 2022 following the Russian invasion of Ukraine, and again from late June 2022 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 at the beginning of 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[1].

[1] Price estimate as at 22 November 2022

Had there been no MSC in place, this may have led to partially hedged suppliers buying 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 in November 2022 by the OBR to be £6.5 billion[2]. Many of the remaining companies in the market are significantly larger than Bulb and, had they significantly under-hedged, may have faced energy losses exceeding the value of the business. This would put them at risk of their owners or financial backers declining to provide support, potentially leading to an insolvent or disorderly exit and a cost in excess of £5 billion. An alternative methodology would be to estimate the cost based on previous experience of mutualised costs from supplier exits, taking account of the size of the remaining companies. This, too, would result in a figure in excess of £5 billion[3].

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 £5 billion.

3.12. The costs to consumers of the MSC have, until recently, been very limited. During the first quarter of 2023 these costs have increased. It is not yet clear what impact the MSC has had on potential tariffs. This is difficult to establish given the impact of historic costs, the EPG and the pricing of risk in the market. The recency of this data and the volatility of the market also mean that it is too early to quantify direct consumer impacts of this change. It should be noted that the consumer impact is directly proportional to the MSC parameters, and that both the parameters and

[2] 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

[3] The actual cost would depend on the market conditions at the time of any failure and the failed company's size. 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 have a cost on a comparable scale to the Bulb failure. We therefore consider the £5 billion figure to be a conservative estimate of a cost that could have been much higher, perhaps as high as £10 billion.

the price background during the extension period are yet to be confirmed. Our approach to the Impact Assessment is therefore focused on the impact of the powers to operate the MSC.

3.13. There have been some administrative costs for Ofgem and for suppliers in considering and operating the MSC policy and implementing the associated payment mechanics. These are likely to be insignificant compared to the possible benefits mentioned above. The MSC's existence may have deterred some companies from attempting to enter the market, but it is unclear if this has been a significant deterrent (since the MSC does not prevent efficient suppliers from profitably gaining customers). In any event, any impact on consumers is likely to have been small.

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

3.15. 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 significantly in recent weeks (while remaining very high by historic standards), volatility remains high and prices are highly susceptible to changes in the perceived forward supply/demand balance. We cannot exclude the possibility of significant rises or falls in prices. 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

3.16. 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 modelling for NoCo is affected by the parameters chosen.

3.17. 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 related financial support is not available for fixed price contract offers below the £2,500 benchmark for a typical customer. This has two effects:

- In the event of a wholesale price fall below the level implied by the EPG (currently £2,500), 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 on each switch for a supplier which loses a customer is not reduced by the EPG.

- Nevertheless, if wholesale prices continue to fall significantly, suppliers stand to make significant gains from acquiring customers onto their SVT where they can still claim for the EPG. This is likely to be manifested in substantial marketing activities and incentives designed to achieve switching.

3.18. At some point, as wholesale prices continue to fall further then there will be a tipping point where it is more advantageous for a supplier to forego the EPG subsidy and simply offer a discount. It will be important for the model's parameters 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.

3.19. 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 such as fixed price contract offers). For the purposes of MSC analysis, that is effectively the same as no EPG at all.

3.20. 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 is a separate consideration and not the subject of this consultation.

Consumer Impacts

3.21. 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 in the short term. For these reasons we welcome the Government's decision to bring in the EPG and other support measures.

3.22. 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.

3.23. As regards the Operational Impacts, the short-term effect of the MSC and BAT is to compensate suppliers for the losses incurred from consumers who switch (or who would have switched) during the period the MSC and BAT are active. Although this may result in a short delay for consumers to benefit from a fall in prices, this needs to be set against the larger long-term benefit to all consumers of maintaining a viable market.

3.24. For the present purposes, we can illustrate this with the figures published in the August 2022 Decision. While wholesale prices and impacts have fallen since then, these figures provide a useful illustration of the potential impact of the MSC on the market and reflect the continued market volatility and uncertainty around prices.

3.25. On an industry wide basis, the August 2022 Decision document set out Ofgem's estimate that total industry losses could be £9.311 billion for the P9 price cap period (1 October 2022 to 30 March 2023) in the event of a significant fall in wholesale prices if there was no MSC. In reality, if losses and transfers occurred on a scale approaching this level, they are likely to be accompanied by market exits or insolvencies for a high number of remaining companies in the supply industry, as supply companies with losses exceeding their value might have been abandoned by their parent companies or investors.

3.26. The costs to consumers would be primarily based on the wholesale cost of re-hedging by new suppliers in order to serve customers of failed suppliers. This cost depends on the level of prices as well as the point in time of supplier failure. In a market of continuously falling prices, we expect the cost to consumers to be lower than the total industry losses because the cost to re-hedge is likely to be lower than the cost at which failed suppliers had hedged. For illustration purposes, without the MSC in place we can estimate this cost to consumers at up to £9.311 billion (this overlooks other SoLR costs such as credit balances and on-boarding costs). This amount reflects a maximum cost to consumers in a volatile market.

3.27. With the MSC in place, the total industry losses are estimated to be reduced to £1.497 billon. Therefore, if we assume that £9.311 billion is causing supplier failures, and that £1.497 billion is no longer causing supplier failures, the MSC would allow suppliers to recover £7.8 billion, the cost of which we assume suppliers would pass onto the price of fixed price contracts. Therefore, we expect the net savings of consumers of MSC to be the difference between the cost of supplier failure and the cost of the MSC (ie, £1.497 billion).

3.28. The recent significant fall in wholesale prices means that under this scenario losses today would be lower. However, the estimates underline that while wholesale prices remain volatile and significantly above historic norms, the market continues to face circumstances where losses may be unsustainable for many suppliers and the risk of multiple insolvencies remains credible.

3.29. 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, enabling a sustainable market to exist, to the benefit of consumers.

Environmental and Distributional impacts of proposals

Environmental

3.30. We have identified that continuation of the MSC may have environmental impacts as follows:

- To the extent that the MSC reduces 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 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.

3.31. 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 must be weighed against wider interests, including reducing the cost of energy for consumers.

3.32. 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

3.33. 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**")[4], and similar research carried out by the Competition and Markets Authority in the

[4] 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

Energy Markets investigation of 2014 to 2016[5]. 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**")[6].

3.34. 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

3.35. 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.

3.36. 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[7], which indicates that a particular cash saving is worth around ten times more, on an equity weighted basis, for somebody in the lowest income

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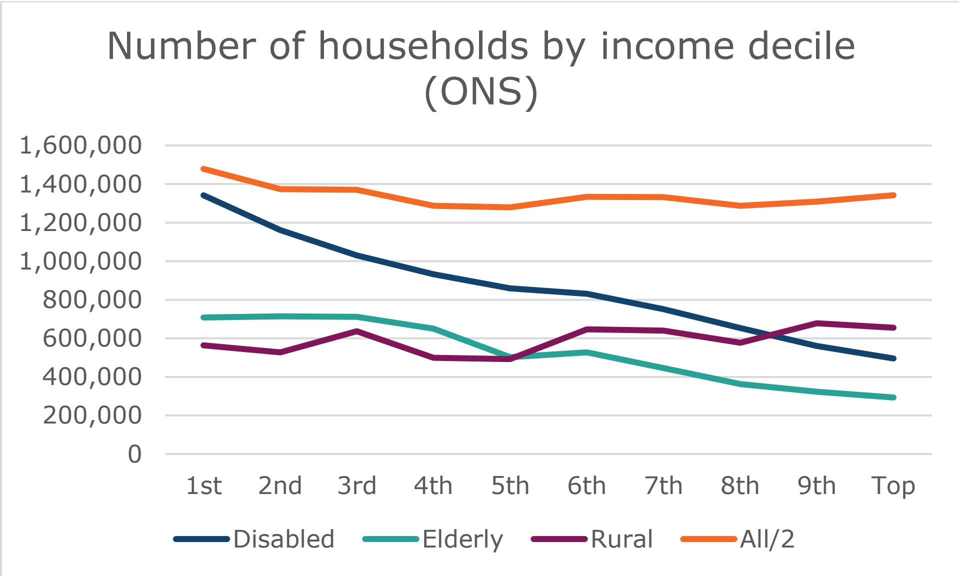
[5] Energy Market Investigation: Final Report, CMA (2016) https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf

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

[7] 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

decile than the highest. For other Statutory Groups, ONS data[8] indicates that there is an association between low incomes and disability, and between low incomes and pensionable age, but no association (or perhaps a small inverse one) between low income and rural location. See the graph below extracted from the ONS data:



3.37. 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.

3.38. 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. This is because (in the case of those on low incomes) they may have fewer options to mitigate the problem or (in the case of those who are disabled or of pensionable age) 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

[8] 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/incomeandwealth/adhocs/11319disposableincomeandenergyexpenditurefordifferentfueltypehouseholdsandhouseholdtypesukfinancialyearending2018usehold types, UK: financial year ending 2018 - Office for National Statistics (ons.gov.uk)

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.

3.39. 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.

3.40. 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 which are not already covered by the distributional impact analysis.

Operating Impacts

3.41. 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.

3.42. 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.

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

3.44. 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[9] and the full details of the survey are set out in Appendix 9.1 to that Report[10]. They find that several indicators of vulnerability were associated with being inactive in the energy market[11].

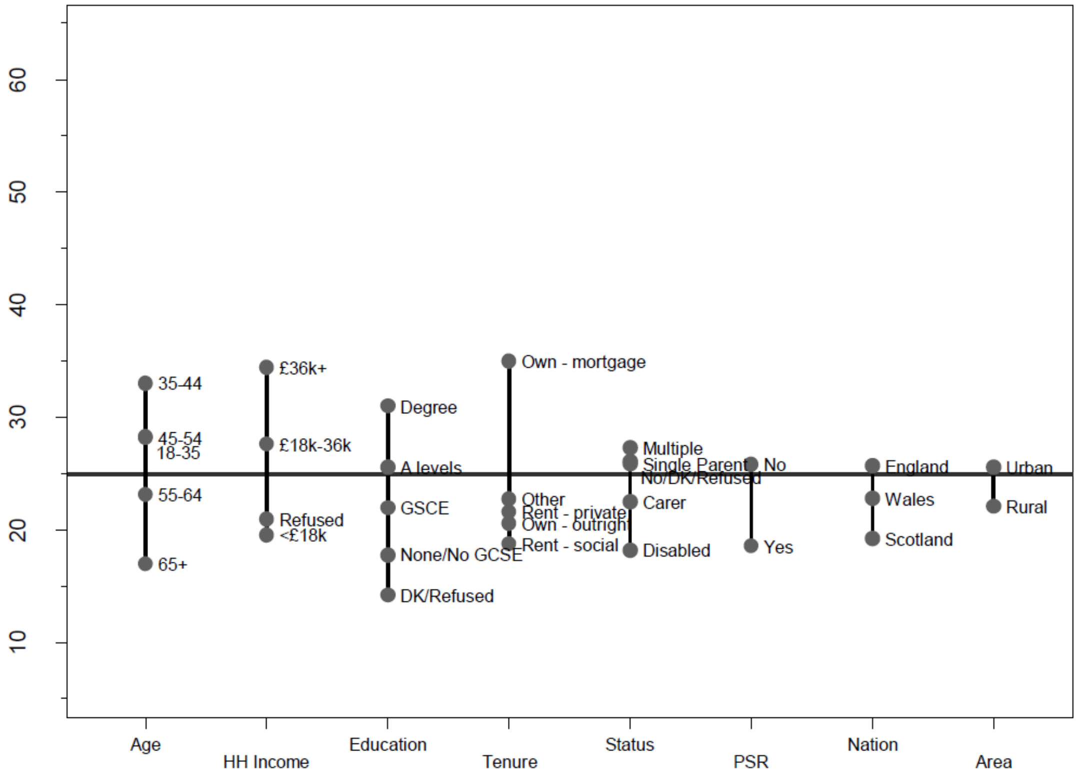
3.45. They illustrate these results with the graph reproduced below:

[9] 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

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

[11] "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

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.

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

3.47. 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

Mosaic 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%	✓		✓		

3.48. 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.

3.49. 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.

3.50. 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) with respect to 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, so this group is likely to be relatively neither advantaged nor disadvantaged by these proposals. In any event, we consider that all groups will benefit from more stable markets.

Conclusions

3.51. On current evidence we consider that the case for extending the MSC is 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. Although VaR has decreased, the risk to market stability remains high.

3.52. 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 remains valuable when both measures are implemented together. We remain of the view that the BAT is insufficient in achieving market stability on its own.

3.53. 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. We believe that the benefits of maintaining a robust retail energy market will have medium and long-term benefits for all consumers and groups of consumers.

4. Extending the MSC

Section summary

This section summarises the stakeholder feedback we received from our November 2022 Consultation proposals, together with our response, and outlines our final decision on extending the MSC post 31 March 2023.

Our proposals

4.1. In our November 2022 Consultation we outlined our proposals to extend the MSC until 31 March 2024 with the licence mechanism amended to enable it, along with the BAT, to be renewed on an annual basis, by publishing a written statement. We specified that 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.

4.2. We proposed to retain the existing power to terminate the MSC early by publishing a notice to that effect. We added that we would consider the market situation 6 months following the implementation of our proposed measures to ascertain if they are still fit for purpose or whether to terminate the MSC early.

Stakeholder feedback

Suppliers and supplier trade body

4.3. The majority of suppliers agreed that the MSC should be extended until 31 March 2024. Their collective view was that the extension was necessary in the midst of ongoing wholesale market volatility in order to continue providing some stability to suppliers by enabling them to effectively hedge for forecasted demand, ultimately in consumers' interests. Two suppliers were strongly against the extension of the MSC until 31 March 2024 or beyond, considering it to be intrusive and anti-competitive, resulting in harmful outcomes for consumers.

4.4. Aside from the two suppliers who were strongly against the extension of the MSC beyond March 2024, two other suppliers expressed their reservations about extending the MSC beyond this date. They considered this would move further away from the original policy intent for the MSC to be part of a package of short-term interventions to help stabilise the domestic energy retail market.

4.5. Six suppliers expressed concerns about Ofgem’s intention to assess the market situation 6 months following the implementation of our proposed measures, to ascertain if they are still fit for purpose. In addition, they raised concerns over Ofgem’s proposal to retain the ability to terminate the MSC early. Some suppliers argued that the uncertainty over the longevity of the MSC posed hedging risks to suppliers. Furthermore, two suppliers went on to suggest that Ofgem should give a minimum of four months’ notice for any extension or abolition of the MSC in order for suppliers to be able to effectively factor this into their forecasting, trading and hedging strategies. There was also a strong suggestion that Ofgem should consult early, prior to any decision to terminate the MSC ahead of March 2024.

4.6. One supplier suggested that any extension beyond 31 March 2024 should be subject to a separate consultation and decision, rather than an indefinite power for the Authority to annually renew. Furthermore, ten suppliers stated that Ofgem should commit to simultaneously reforming the design of the MSC to make it more effective in meeting its primary objective. This included looking at factors such as the MSC methodology to account for switching, backwardation, unexpected SVT numbers and BSUoS transition.

4.7. The supplier trade body shared the views of the majority of suppliers in supporting the extension of the MSC until 31 March 2024 and beyond, with similar concerns around the possibility of terminating the MSC early and suggestions to improve its design.

Consumer groups and independent non-profit organisation

4.8. Consumer groups were unanimous in their concerns over the dampening effects of the MSC on competition in the market and the resulting impact on consumer outcomes in the immediate term. One consumer group made suggestions for revised implementation of our proposals if we decided to extend the MSC, including providing clearer trigger points or circumstances where we may choose to remove the MSC at a later point. They also suggested that the licence conditions should only allow a single one-off amendment until 31 March 2024, with any further extensions beyond that point being subject to a new consultation, and therefore subject to a higher level of scrutiny.

4.9. The independent non-profit organisation was happy with extending the MSC to 2024 if no other, less interventionist policies are feasible. They expressed similar concerns over the prospect of the MSC becoming a longer-term policy intervention and suggested more frequent reviews of the measure to ensure the MSC is removed as soon as conditions allow.

Ofgem response

Competition

4.10. We appreciate that the MSC in its current form has impacts on competition in the market. Whilst in the short term we see a reduction in competition while the MSC is in operation, this needs to be balanced against the longer-term benefit from supporting the viability of the domestic supply market and therefore a healthy number of effective competitors. Overall, taking into account the importance of providing further support to hedging in accordance with the price cap methodology and despite VAR reducing, we continue to consider that continuing the MSC past March 2023 is likely to be in the interests of consumers.

Future of the MSC

4.11. We acknowledge stakeholder feedback commenting on the temporary nature of the MSC and to that extent, seeking clarity on the trigger points for its removal or indeed replacement. The MSC has been designed as a temporary 'corrective' measure which we have stated will only be retained for so long as it is in the interests of consumers. Furthermore, we maintain the view that the MSC should not be considered an enduring part of the regulatory framework in its current form, for reasons described in Chapter 2. We consider 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.

4.12. In relation to the suggestion to implement a single one-off extension of the licence conditions until 31 March 2024, where any future extensions would be subject to a new licence modification and open to new scrutiny, our view is that our current proposal to give the Authority said powers provides the requisite flexibility to act swiftly in light of fast changing and unpredictable market conditions. A requirement to raise a new licence modification would not necessarily allow for this and would therefore be unfavourable in a volatile energy market.

4.13. Furthermore, it is important to emphasise that any subsequent renewals of the MSC post 31 March 2024 would only be decided following a thorough review which would include a consultation inviting stakeholder engagement.

4.14. Moreover, considering the volatility of the energy market and as noted in our November 2022 Consultation, we will consider the market situation at 6 months following the implementation of our proposed MSC measures to ascertain if they are still fit for purpose. We acknowledge concerns around giving stakeholders enough notice prior to making any changes to the MSC and will take this into account at that stage.

Alternative options to MSC

4.15. We note the differing opinions on how quickly the MSC should be terminated. As noted in Chapter 2 (Case for Change), the MSC is a useful tool to provide stability and reliability for consumers and suppliers at a time of price volatility but we acknowledge that the MSC is not intended to be a long-term intervention. We are proceeding with our work to develop and consider alternative policy options. We appreciate the need for advance notice of any alternatives that will be implemented and will keep stakeholders updated on significant progress with this work.

Final decision

4.16. Upon considering stakeholder feedback and in light of our updated analysis on the case for proceeding with our proposals (Chapter 2) and our updated impact assessment (Chapter 3), we have decided to proceed with our proposal to extend the MSC until 31 March 2024.

4.17. We have also decided to proceed with our proposal to amend the licence mechanism to enable both measures to be renewed on an annual basis, via publishing a written statement. This written statement will contain reasons for extending the MSC, such reasons for extension being the product of a thorough review which would include a consultation.

4.18. We will retain the existing power to terminate the MSC early by publishing a notice to that effect and we will consider the market situation 6 months following the implementation of our proposed measures to ascertain if they are still fit for purpose.

4.19. We consider that the arguments presented as above together with the existing market volatility strengthen the case to extend the MSC for another year.

4.20. We consider that there is no assurance at this time that the risks will diminish over the Additional Period rather than intensifying, despite the recent significant fall in wholesale prices. Accordingly, while we note the lower VaR, we also consider that market volatility is ongoing and that the reasons to extend the MSC are the same as when the MSC was first introduced.

Next steps

4.21. Changes to SLC 24A for the MSC, for both gas and electricity licensed suppliers, will take effect from 1 April 2023.

4.22. The MSC payment mechanism will continue to be set out in the Retail Energy Code for the extension period. Furthermore, we will engage with RECCo, which owns responsibility for the Retail Energy Code, to allow changes to the licence conditions to be reflected therein.

Parameter review

4.23. We acknowledge and are grateful for stakeholder feedback on the MSC design including parameters.

4.24. Ofgem is currently undertaking analysis to support a parameter review, taking into account the recent softening of wholesale prices, the wider market context and policy changes to the EPG. We will consult on new parameters in the early spring.

5. Extending the BAT

Section summary

This section summarises the stakeholder feedback we received from our November 2022 Consultation proposals together with our response, and outlines our final decision on extending the BAT post 31 March 2023.

Our proposals

5.1. In our November 2022 Consultation we outlined our proposals to extend the BAT, in the same way as the MSC, until 31 March 2024, with the licence mechanism amended to enable the BAT to be renewed on an annual basis.

5.2. We also proposed to extend the Market-wide Derogation from SLC 22B for Fixed Retention Tariffs until 31 March 2024. This was to account for the proposal 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 remained unchanged.

Stakeholder feedback

Suppliers and supplier trade body

5.3. All but one supplier agreed that the BAT would help to augment the MSC in effectively stabilising the energy market and should be extended until 31 March 2024.

5.4. There was a split between those suppliers who considered that the BAT should be made an enduring policy measure and those who didn’t. Six suppliers considered that making BAT an enduring measure in the energy market would help to promote fairness in the market. However, three suppliers suggested that we should conduct a fuller review to ensure that there are no unintended consequences in making BAT a permanent feature. Three suppliers also suggested that the Market-wide Derogation process is burdensome and should be incorporated as part of a renewed set of licence conditions for the BAT, with one of these suppliers suggesting this takes a principles-based approach.

5.5. The supplier trade body shared the views of the majority of suppliers in supporting the extension of the BAT until 31 March 2024.

Consumer groups and independent non-profit organisation

5.6. One consumer group was strongly in favour of extending the BAT until 31 March 2024 and supported a permanent application of the BAT thereafter.

5.7. The independent non-profit organisation supported the extension of the BAT until 31 March 2024 in the absence of other viable policy interventions, however they suggested that we proceed with the permanent application of BAT with careful consideration.

Ofgem response

Future of the BAT

5.8. Aside from the BAT taking a market stabilisation role for which it was initially introduced, we acknowledge that the BAT also promotes fairness in the market by ensuring that any discounted deals are also available to existing customers.

5.9. For this reason, and further to stakeholder comments, in our November 2022 Consultation we noted that there is merit in considering whether the BAT should be made an enduring measure in the energy market in due course.

5.1. In doing so, however, we acknowledge that careful consideration needs to be given to ensure that we have fully explored any unintended consequences both in the short term and long term and how any enduring measure would align with wider policy changes.

5.2. Further to stakeholder feedback, we will ensure that we review the approach to derogations during any such exercise, including the existing Market-wide Derogation, to streamline the process of its application where possible.

Final decision

5.3. In light of current market volatility together with consideration of stakeholder feedback and our updated analysis in Chapter 2, we have decided to proceed with our proposal to extend the BAT until 31 March 2024.

5.4. In the same way as for the MSC, we have also decided to proceed with our proposal to amend the licence mechanism to enable the BAT to be renewed on an annual basis, via publishing a written statement. This written statement will contain reasons for extending the BAT, such reasons for extension being the product of a thorough review which would include a consultation.

5.5. We have also decided to extend the Market-wide Derogation from SLC 22B for fixed retention tariffs until 31 March 2024.

5.6. We consider that the reasons to extend the BAT 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 still valuable now, despite lower VaR, owing to higher levels compared to the historic norm. We remain of the view that the BAT is insufficient in achieving market stability on its own.

Next steps

5.7. Changes to SLC 22B for the BAT, for both gas and electricity licenced suppliers, will take effect from 1 April 2023, as will the renewed Market-wide Derogation from SLC 22B for fixed retention tariffs.

Interaction of BAT with certain tariff offerings

5.8. We have considered the interaction of the BAT with certain tariff offerings and business models which support the transition to net zero.

5.9. Ofgem is working to develop an enduring solution which ensures that the BAT does not jeopardise the business models of green tariffs and green suppliers. Ofgem will set out its plans in the coming weeks.

6. Appendix 1: Final Notices and consultation responses

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

- **Final Notices to modify all gas and electricity supply licences under 23(2) of the Gas Act 1986 and 11A(2) of the Electricity Act 1989**

- **Decision to extend the existing Market-wide Derogation from SLC 22B for fixed retention tariffs**

    - **Non-confidential stakeholder responses to our November 2022 Statutory Consultation**

These are all available on our website and can be accessed via the links below:

- **Decision and Final Notices** - https://www.ofgem.gov.uk/publications/decision-extend-msc-and-bat-beyond-31-march-2023

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