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Stephen Davies  
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Dear Maureen,

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

We agree that MSC should be extended to the end of March 2024, alongside an extension of the ban on acquisition only tariffs (BAT) and the market-wide derogation from SLC 22B for fixed retention tariffs.

We remain concerned that the MSC provides limited mitigation, with current parameters resulting in suppliers still being exposed to significant losses (from wholesale costs and under-recovery of allowances) before the MSC takes effect and providing only partial recovery of losses thereafter. We have consistently highlighted to Ofgem that the MSC design, with these parameters, does not address risk as effectively as Ofgem seems to think it does. This is particularly important when considering the level of risk mitigation MSC provides in Ofgem's analysis on EBIT and the level of risk capital suppliers need to hold. We are concerned Ofgem will overstate the value of MSC in mitigating risk in its modelling of risk capital for the notional supplier; we will elaborate further on this point in our response to Ofgem's consultation on amending the EBIT methodology.

Ofgem must take action to review and consult on an updated set of MSC parameters, ensuring they effectively mitigate the risks they are intended to manage. We agree with Ofgem that the intervention will need to be reviewed to ensure it aligns with other policy and market developments such as the Energy Price Guarantee (EPG). In particular, the MSC needs to account for the additional (subsidised) incentive for switching that EPG on new fixed contracts would introduce and the effect this would have on losing suppliers, both in terms of wholesale losses and other costs (such as unrecovered allowances).

MSC is intended to partially address one side of the risk of the free option that the price cap forces suppliers to provide. MSC focuses on the potential wholesale losses of providing that free option, but there are other costs too. Most notably, various allowances in the price cap are recovered ex post, if a customer switches, these allowances may not be recovered. Some of these allowances are based on costs of ✂ (e.g. backwardation), MSC must be amended to address these unrecovered allowances.

We are also concerned by the lack of clarity provided on how Ofgem will use its powers to withdraw these temporary mechanisms. A predictable framework including clearly defined market conditions and benchmarks alongside a notice period that avoids withdrawal in periods where a supplier who hedged in line with the price cap will have built positions are required in order to avoid unnecessarily increasing the risks that suppliers face.

Finally, Ofgem must recognise that the need for MSC, and many other measures that have been introduced over the last 18 months, are a result of a flawed price cap design. There needs to be a much more fundamental review of the role of price regulation in the retail market to ensure consumers receive relevant protection that offers value for money. The current price cap introduces additional costs for consumers because of the unmanageable risks it exposes suppliers to, the need for MSC is just one illustration of that.

We set out more detailed thoughts on the issues raised in the consultation in Appendix 1.

Yours sincerely,  
Steve Davies  
Head of Regulation

## **Appendix 1**

### *Extension of MSC and BAT*

***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?***

#### *Market Stabilisation Charge*

Market volatility continues to pose significant risks to suppliers. Given the design of the price cap drives many of the risks which suppliers are exposed to, mechanisms such as BAT and MSC which aim to mitigate these risks continue to be necessary. We continue to be concerned that Ofgem overstates the mitigation that MSC offers, changes to MSC parameters are required to ensure it delivers the expected benefits.

The element of protection that MSC offers against the downside risk in accordance with the most up to date MSC parameters from May 2022 is still insufficient. Ofgem must consult on further updates to the thresholds to ensure the scheme is fit for purpose and prevent further supplier failure.

We do not believe the MSC ranges go far enough to protect suppliers from otherwise unmanageable volume risk. Ofgem should implement an MSC with a 0% price fall trigger (i.e. any price fall) and a 100% sharing factor. If a 0% trigger is not acceptable, then Ofgem should ensure that the wholesale cost trigger is an absolute £ number, not a percentage, based on the minimum saving a customer would need to see to encourage switching.

MSC and BAT continue to be required in the context of EPG being in place. At the same time as improving MSC's effectiveness through a review of its parameters Ofgem must also ensure the mechanism is aligned with the updated features of the EPG, including adjusting the trigger to account for a subsidised switching incentive (i.e. recognising that the falls in the wholesale market may no longer be the trigger for significant losses that suppliers may incur).

Ofgem must react quickly if this happens in order to help maintain the resilience of the market and address the likelihood of significantly increased switching.

### *Ban on acquisition tariffs*

Given the continuing volatility, existence of unmanageable risks imposed by the price cap continuing risk of supplier failure, an extension of BAT continues to be required alongside MSC, ensuring suppliers are not able to offer unsustainably low prices for a subset of customers, risking market stability for all other customers.

When considering an enduring implementation of BAT Ofgem must carry out a full consultation process and impact assessment to avoid potential unintended consequences. This needs to be analysed together with a potential enduring extension of the market-wide derogation from SLC 22B for fixed retention tariffs.

### ***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?***

We are concerned by the lack of clarity and confidence Ofgem gives suppliers on how it will use its powers to withdraw these temporary mechanisms. Ofgem must commit to a consultation process to ensure an appropriate methodology for termination is implemented when the market conditions are appropriate. The methodology should determine clearly defined market conditions and benchmarks and include a notice period which factors in the timing of when prudent suppliers hedge in line with the price cap methodology to avoid unnecessarily increasing risks.

Further details are also needed on the operational aspects of terminating the MSC. Suppliers need more clarity on how the final invoicing and payments process with RECCo would be carried out at the time of the scheme termination.

### ***3) Do you have any comments on the proposed drafting of the changes to the supplier licence standard conditions?***

We have no comments on the proposed drafting of the changes to supplier license conditions.

### ***4) Do you agree that we should extend the market-wide derogation from SLC 22B for fixed retention tariffs?***

We agree with the extension to the market-wide derogation from SLC 22B for fixed retention tariffs. This derogation allows suppliers to develop and offer innovative tariffs tailored to individual groups of customers which will be crucial in our transition to net zero.

Alongside the extension, further updates are needed to the conditions for relying on the market-wide Derogation from SLC 22B.

The current process of obtaining a derogation from Ofgem for each individual fixed retention tariff is creating unnecessary administrative burden for suppliers. Ofgem need to use a more efficient and pragmatic approach, providing a set of clear conditions and constraints in which a licensee can benefit from this exemption. Suppliers need clear guidance to be issued which would enable a self-assessment of whether a new retention tariff adheres to the derogation in lieu of the existing individual notification requirement. This approach would not increase the risk of detriment to consumers.

**5) Do you have any comments on the analysis presented in section 2?**

Further clarity is required on the market stability indicators (VaR alongside market and policy developments) aimed at assisting Ofgem in making decisions on whether to intervene, or withdraw intervention, in order to allow us to prepare for upcoming changes. Ofgem needs to provide more detail on which market environment will be used as a benchmark going forward (i.e. the level at which Ofgem originally introduced the MSC or an updated one) and how policy developments will be considered.

**6) Do you have any comments on the draft impact assessment presented in section 3?**

No comment.

**Additional point: MSC needs to be extended to include unrecovered price cap allowances**

Suppliers continue to face significant unmanageable risks due to the design of the price cap. Various allowances have been introduced by Ofgem to allow suppliers to recover some of these risks, changes in MSC are needed in order to provide suppliers sufficient confidence that costs can be recovered.

As an example, backwardation carries a high cost for Q1 2023. ✂. Backwardation costs are recovered over 2 price cap periods, so we expect another significant allowance in Q2 23 to allow suppliers to recover costs incurred in Q1 2023. Should a significant number of consumers switch to a fixed tariff in Q2 23 it would be impossible for suppliers to sufficiently recover the associated costs through existing mechanisms. We also note that some other price cap allowances are recovered over longer periods (up to 12 months).

We have consistently communicated to Ofgem that we are concerned with the principle of recovering exceptional costs via adjustments to the price cap alone, often sometime after those costs have been incurred, which means non-switching customers who remain on SVT tariffs will be subsidising active customers who save by switching. MSC could be used to address this risk, we would be happy to discuss with Ofgem further thoughts on how to do this.