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Making a positive difference for energy consumers

To – all stakeholders

Email: Retailpolicyinterventions@ofgem.gov.uk

Date: 20 March 2023

Dear stakeholders,

Decision on technical changes to the Market Stabilisation Charge (MSC) model to reflect the decision to extend the MSC beyond 31 March 2023

In April 2022 we[1] introduced the MSC[2] as a temporary measure aimed at managing the risk to market stability of efficiently run suppliers exiting the market in a falling price scenario. It ensures that energy companies who have taken a prudent approach to hedging, by purchasing energy for their customers in advance are not unduly penalised for doing so. This charge, payable by suppliers gaining new customers to suppliers losing them, only takes effect if wholesale prices fall significantly below the level used to set the price cap.

On 3 February 2023, we consulted on proposed technical changes to the MSC[3] to give effect to our February decision on extending the MSC and Ban on Acquisition only Tariffs (BAT) beyond 31 March 2023[4]. The scope of the proposed changes was limited to the technical changes required for the continued operation of the MSC beyond 31 March 2023 based on the current MSC design. We also sought views on our treatment of prices in the calculation of the wholesale cost of energy during the current cap period (the term known as *Wn*) which we set out in our clarificatory letter to suppliers[5] on 25 November 2022.

Decision

We have decided to implement the algebra as proposed in our consultation and we have published a worked example of the MSC model (Version 6) and updated MSC guidance (Version 4) alongside this decision.

The rationale for this decision reflects the fact that we have moved beyond the temporary transitional indexation arrangements required to facilitate the transition to quarterly cap updates, which has now concluded. We consider that the algebra consulted on provides an appropriate means to calculate the MSC charge from April 2023 until March 2024, based on

[1] The terms "we", "us", "our", "Ofgem" and "the Authority" are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.
[2] Ofgem (2022), Decision on short-term interventions to address the risks to consumers from market volatility
[3] Ofgem (2023), Consultation on technical changes to the Market stabilisation charge (MSC) model indexation methodology to reflect our decision to extend the MSC beyond 31 March 2023
[4] Ofgem (2023), Decision to extend the MSC and BAT beyond 31 March 2023
[5] Ofgem (2022), Letter to suppliers on the use of monthly contract prices in calculating the market stabilisation charge

the enduring quarterly (3-1.5-3) indexation methodology which we expect to have effect while the MSC remains in place, which, subject to an earlier or later cessation date being specified, will be until 31 March 2024.

On the use of prices for the calculation of the 'current period' cost of energy (*Wn*), we have decided to maintain the approach as set out in our clarificatory letter on the use of monthly contract data as a proxy for more granular within-month prices. We consider this approach maintains the balance we have sought to achieve between simplicity for the purposes of transparency, and accuracy. On balance, we consider the use of monthly prices is a robust and accurate proxy, and the use of more granular prices is unlikely to materially impact the level of the charge in the long term, so the current approach fits the policy objective of the MSC.

Responses to our consultation

We received two supplier responses to our consultation. One of the suppliers that responded indicated broad support for our proposals, but noting our intention to maintain alignment with the inputs from the price cap model, recommended that we bring the relevant electricity losses inputs into line with the price cap model published on 27 February 2023. The other respondent suggested that the use of more reflective prices for the calculation of the current period cost of energy (*Wn*), such as balance of month for gas and Week+1, Week+2, .., Week+4 for electricity, would make the MSC methodology more accurate.

In response to the feedback on alignment with the price cap model, we have updated the MSC to reflect the recent update to the electricity loss factors. This was the only price cap input relevant to the MSC to change in the February 2023 price cap update. As we set out in the consultation, we will continue to maintain alignment of the MSC with relevant input changes in the price cap model at the point each cap update takes effect.

We have considered a suggestion from one respondent to use more granular price data for the calculation of *Wn*. We maintain our view that the use of M+1 as a proxy for more granular price data remains appropriate. As we have set out previously, we have sought to strike a balance between simplicity for the purposes of transparency, and accuracy for the avoidance of uncertainty. We consider the use of the monthly contract data, particularly in the final month of the cap period, achieves this balance. We think that M+1 contract data is a suitable proxy for more granular contracts in the final month of the cap period, particularly, given the impact of this simplification decreases though the month as the weightings on *Wn* diminish to zero. This view is supported by our analysis which demonstrates that there is no material difference in the charge level, in the long run, in using monthly data as a proxy for more granular data, compared with using the value calculated using Balance of Month (BoM) for gas and Week+1 to Week+4 for electricity.

However, we will continue to keep our treatment of prices in the MSC model under review and may consider alternative methods in the future should evidence emerge to suggest the current approach is no longer appropriate.

Implementation

The updated model (Version 6), based on the enduring indexation, will be implemented in the model run undertaken on Monday 3 April 2023, effective from Wednesday 5 April 2023. It is intended to remain in effect until the model run of Monday 25 March 2024, effective until Sunday 31 March 2024.

The updated MSC model has been developed to run until the expiry date currently envisaged at the date of this decision of 31 March 2024, as set out in standard license condition 24A. In the event of changes to wider MSC policy or the duration of the MSC, where necessary, we will update the published worked example and guidance to reflect this, consulting stakeholders where appropriate.

Yours Sincerely,

Dan Norton

Deputy Director, Retail Price Protection