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## **E.ON response to Ofgem's statutory consultation on a Market Stabilisation Charge licence condition**

Dear Price Protection team,

Thank you for the opportunity to respond to Ofgem's statutory consultation on a Market Stabilisation Charge (MSC) licence condition (SLC 24A).

**E.ON supports Ofgem taking prudent steps to ensure it has the necessary regulatory flexibility to respond at pace in genuinely exceptional market circumstances. We agree in principle that an MSC can be a useful tool to manage the risks created by an extreme fall in wholesale prices where suppliers have responsibly hedged for default tariff customers, and where the resulting losses could create wider risks to market stability and consumers.**

**Our view is that Ofgem should:**

1. Set a **high bar for future activation** of the MSC.
2. Ensure the MSC parameters reflect **closer to the full value of the hedge** under the price cap.
3. Consider whether the **trigger should be in £/MWh** rather than a percentage which has different severity depending on the original prices.

The MSC is a significant intervention and should therefore be reserved for extreme market conditions where there is clear evidence that the risks to market stability and consumers outweigh the adverse impacts on competition, switching incentives, and consumer access to falling wholesale prices.

**Ofgem should also take account of the extent to which the wider regulatory framework has been strengthened** since the MSC was originally introduced. The Financial Resilience & Controls (FRC) regime, quarterly price cap updates, and other measures all reduce the likelihood that MSC activation should be necessary. These changes shift the case for any possible future activation towards more extreme market conditions than those that might previously have justified intervention. We describe this further in Annex 1, along with other steps that Ofgem can take to mitigate the need for MSC.

If such exceptional circumstances do arise, we believe the **MSC parameters should be calibrated to reflect the full efficient value of the lost wholesale hedge**. In our view, if the market circumstances are sufficiently severe to justify activation of the MSC, the mechanism should provide effective protection against the specific risk it is designed to address. Where there is uncertainty about

whether the full value of the hedge should apply (e.g., to a departing FTC customer), Ofgem should seek to mitigate that uncertainty separately. **We recommend that Ofgem undertake the necessary analysis on the updated parameters and consult on the guidance as soon as possible**, as it should not be left until compressed timescales that will arise close to the point of activation.

We provide our responses to the specific questions in the consultation in Annex 2. We hope these comments are helpful and would be pleased to discuss any aspect of this response further.

Yours sincerely,

James Doig

## Annex 1: E.ON view of market context

### *Context of MSC*

We understand that Ofgem intends to set out the conditions that will determine when it may activate the MSC. Even in the acute conditions of 2021/22, the introduction of the MSC required a difficult balance between the interests of existing and future consumers, competition, and market stability. Hence, we suggest that Ofgem should consider whether the same range and severity of risks are appropriate.

We remind the Price Protection team that the MSC was originally conceived in September 2021 in a very different environment to the one currently experienced:

- **Wholesale prices were extremely high**, with daily gas prices reaching nearly 350p/therm in 2021 and over 600p/therm in 2022, compared to c.150p/therm in recent months.
- **Many suppliers had weak levels of financial resilience**, with many having significant net liabilities<sup>1</sup>.
- **Most consumers were on default tariffs** or likely to roll onto default tariffs in the coming months (and so the distortion of MSC applying to FTC customers was more acceptable).
- **Suppliers were facing significant risks** if they continued to buy energy in advance for their existing default tariff customers over the winter.

The severity and likelihood of risks for suppliers depends on the wider regulatory framework. Ofgem should consider how it has significantly strengthened that framework since 2021/22:

- **Price cap** is updated quarterly, reducing the duration and scale of exposure to hedging losses.
- **Financial Resilience and Controls (FRC)** framework has been significantly strengthened with the introduction of capitalisation thresholds, monitoring of supplier risk management (inc. stress-testing), market entry requirements, and other measures, although there is potentially more for Ofgem to consider doing (see next section).
- **Ban on Acquisition-only Tariffs (BAT)** was introduced alongside MSC and has been regularly extended.

Given the stronger framework now in place, Ofgem should only activate the MSC where the evidence shows risks of comparable seriousness. The MSC guidance was last updated in March 2023 (v4.0), notably before the introduction of the FRC regime, so we believe it warrants careful review. We would support MSC being reserved for the most extreme market circumstances, but at that point, the parameters should reflect the extreme situation.

### *Mitigating the need for MSC activation*

We believe Ofgem should continue to use its existing regulatory tools to reduce the likelihood that MSC activation becomes necessary:

- **Timely and robust application of the FRC regime.** All suppliers should maintain appropriate capital and liquidity, and any capitalisation plans should be credible, sufficiently ambitious and time-limited. Prolonged under-capitalisation increases the risk that future wholesale market volatility creates instability for consumers and the wider market.

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<sup>1</sup> [Policy Consultation: Strengthening Financial Resilience | Ofgem](#) (June 2022), in particular section 6.

- **Clearer compliance action on BAT and rules relating to win-back activity.** Ofgem should intervene quickly to clamp down on practices that risk destabilising the market or undermining fair competition.
- **Ofgem should be clear that the MSC is not a substitute for prudent supplier risk management.** Suppliers should remain responsible for forecasting demand, managing wholesale exposure and maintaining appropriate financial resilience. The MSC should only address losses arising from exceptional market-wide circumstances where suppliers have acted efficiently and responsibly.

## Annex 2: Responses to questions in the consultation

### Q1. Do you agree that an MSC could help to manage the impact of falling wholesale prices?

Yes. We agree that **an MSC could help manage the impact of sharply falling wholesale prices in exceptional circumstances.** Those can create a specific risk for suppliers that have responsibly purchased energy in advance for their default tariff customers in line with the price cap methodology.

Ofgem has already taken a view, through the FRC regime<sup>2</sup> and methodology for setting the EBIT allowance in the price cap<sup>3</sup>, on the level of risk that an efficient and resilient supplier should be expected to withstand. It would not be in consumers' interests to fund suppliers to be robust against every conceivable extreme risk through normal market allowances. However, where risks move materially beyond those that suppliers are expected to manage under the existing framework, an MSC may be an appropriate targeted intervention to protect consumers from the wider costs of market instability.

Hence, particularly considering the existing pressure on consumer bills and affordability, we believe that it is in consumers' interests for MSC to help manage this risk by transferring some of the cost associated with switching in those circumstances. It can also support confidence that suppliers should continue to hedge responsibly in volatile market conditions.

However, the MSC should not be treated as a normal feature of the retail market. It affects competitive dynamics by increasing the cost of customer acquisition and reducing the savings available to customers who switch. **It should therefore only be activated where there is clear evidence that the risks to market stability are material and cannot be addressed adequately through existing regulatory tools or supplier financial resilience.**

We suggest that, when reviewing the MSC guidance, Ofgem should consider whether the trigger should be in absolute terms, such as £/MWh, rather than solely as a percentage fall, given that the same percentage movement can represent very different levels of financial exposure depending on the starting wholesale price.

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<sup>2</sup> In particular, the target credit rating assumed for the notional efficient supplier.

<sup>3</sup> In particular, in the wholesale market volatility assumptions within the uncertainty model (aka 'the NERA model') that provided inputs to the notional supplier financial model.

## Q2. Do you have any comments on the consumer impacts of an MSC?

**The consumer impacts of an MSC are finely balanced.**

On the one hand, an MSC can protect consumers by reducing the risk of supplier failure and the associated costs that may otherwise be mutualised. It can also support responsible hedging and market stability, both of which are ultimately in consumers' interests. An MSC allows consumers to exercise their choice of supplier, even during a period of extreme wholesale market volatility, while reducing the risk that significant costs are socialised as a consequence of switching activity in exceptional market conditions.

On the other hand, an MSC can reduce the immediate savings available to customers from switching to cheaper fixed tariffs in a falling wholesale price environment. It may also reduce switching and dampen competitive pressure, particularly where suppliers seeking to grow are required to price in the expected cost of MSC payments.

For that reason, we consider that the **consumer interest is best served by Ofgem continuing to set a deliberately high threshold for activation**. Ofgem should only activate the MSC where the likely consumer detriment from market instability would clearly exceed the detriment from reduced switching incentives and delayed access to falling wholesale prices.

If activation is justified, the MSC should be designed to be effective. In our view, that means **setting parameters that reflect closer to the full efficient value of the lost wholesale hedge** under the price cap methodology. If Ofgem concludes that circumstances are sufficiently extreme to warrant intervention, then a mechanism that only partially mitigates the relevant loss may not provide adequate protection for consumers or the market.

Where Ofgem considers that specific customer segments, such as departing fixed-term contract (FTC) customers, raise separate calibration issues, those should be addressed transparently rather than by applying a general discount to the MSC value. There are other connected reasons (e.g., setting a default tariff-only demand profile for a future single-rate price cap) for Ofgem to consider how tariff status information should flow from suppliers to industry.

## Q3. Do you agree with our proposed licence drafting?

We broadly agree with the proposed licence drafting insofar as it gives Ofgem flexibility to activate the MSC only when required.

However, we recommend that Ofgem provides additional clarity, either in the decision document or accompanying guidance, on the **circumstances in which it would expect to activate, maintain, or deactivate the MSC**. This should include the evidence Ofgem would consider, the threshold for intervention, and the expected exit criteria.

We also recommend that Ofgem provides clarity in the decision document or accompanying guidance on its considerations for setting the date in 24A.2A relative to the date of publishing the required statement. These should include the time required by suppliers to update the prices of their competitive offers and for the market arrangements to be activated.

#### Q4. Do you have any comments on our intended process?

We welcome Ofgem's confirmation that activation of the MSC would be subject to a separate consultation. That is important given the significance of the intervention and the potential impacts on competition and consumers.

**Ofgem should consult on the MSC guidance as soon as possible.** Whilst Ofgem has stated that it would consult on the MSC guidance "before any decision to activate the MSC",<sup>4</sup> it should not wait until near or at the time of consulting on the case for activating the MSC licence condition. Evaluation of appropriate parameters under the new regulatory framework is likely to be a detailed exercise that is not suitable to be undertaken during compressed timescales when there are pressures on the sector. Ofgem should establish this within the energy price cap programme of work for 2026/27.

**Ofgem should provide as much notice as possible between any decision to activate the MSC and the mechanism taking effect,** while recognising that responsiveness may be necessary in fast-moving market conditions. Suppliers and RECCo will need sufficient operational clarity to implement the mechanism effectively. We would expect a minimum implementation period of about 24 hours following any publication notice unless Ofgem can clearly demonstrate that a short period is necessary to protect consumers or market stability.

Finally, **Ofgem should be transparent about the evidence base for activation.** It is important to maintain confidence that MSC is being used only where justified and proportionate. Ofgem should consider whether all the indicators can be published on its Data Portal<sup>5</sup> and/or state of the market reports.

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<sup>4</sup> Consultation, paragraph 3.11.

<sup>5</sup> [Retail market indicators | Ofgem](#)