

By email: priceprotectionpolicy@ofgem.gov.uk

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RECCo response to: Market Stabilisation Charge licence condition

We welcome the opportunity to respond to this consultation. Our non-confidential response represents the views of the Retail Energy Code Company Ltd (RECCo) and is based on our role as operator of the Retail Energy Code (REC). RECCo is a not-for-profit, corporate vehicle ensuring the proper, effective, and efficient implementation and ongoing management of the REC arrangements. We seek to promote trust, innovation and competition, whilst maintaining focus on positive consumer outcomes. We are committed to ensuring that RECCo is an “*intelligent customer*”, ensuring efficacy and value-for-money of the services we procure and manage on behalf of REC Parties, including those which constitute the REC Code Manager and the earlier application of the Market Stabilisation Charge (MSC).

Our response is informed by our practical experience of implementing and operating the previous MSC arrangements under the REC. Working closely with Ofgem, the REC Code Manager and service providers, RECCo established the necessary governance, charging, invoicing and payment arrangements within a tight four-month timeframe, and administered the distribution of more than £80 million between suppliers over the life of the scheme. The previous operation of the MSC demonstrated that such arrangements can be delivered efficiently and pragmatically, including where unexpected issues arise. However, it also highlighted the importance of sufficient mobilisation time, clear operational governance, robust data assurance, timely communications with REC Parties and transparency over the data used to support calculations. Those lessons inform our comments on the proposed licence condition and, in particular, the importance of early engagement with RECCo and industry before any future activation of the MSC.

We have set out our response to each of the consultation questions in the appendix to this letter, but would like to highlight the following point:

- **Timing and process:** While we remain concerned about the potential consumer, competition and engagement impacts of the MSC, we recognise that it may have a role as an exceptional contingency measure. If the MSC is reintroduced, we would support a process that is responsive but structured: early engagement with RECCo and industry, transparent activation criteria, a clear operational timetable, appropriate notice to market participants, and a regularly updated dashboard or equivalent mechanism for publishing the MSC value once activated. This would help preserve Ofgem’s ability to act quickly in exceptional circumstances, while reducing uncertainty and the risk of avoidable disruption.
- **Data:** MSC previously relied upon estimates of gas and electricity consumption sourced from Xoserve and Electralink respectively. However, the implementation of Market-Wide Half-Hourly Settlement (MHHS) in electricity has changed the nature of various industry flows and specifically where and how estimated Annual Consumption will be communicated and stored. Whilst the Electricity Enquiry Service (EES) will over time be populated with the Annual Consumption data for MHHS-migrated MPANs, RECCo may in the meantime be reliant upon the provision of data from Elexon and/or Electralink if the MSC is to be activated. We are in discussions with both organisations on how this

could be best achieved and whether the Smart Data Repository (SDR) would provide part of the enduring solution once available.

A further lesson from the previous MSC arrangements concerns the quality and use of industry data to determine scheme scope. During implementation, Xoserve highlighted issues with the accuracy of the Domestic Premises Indicator, which in turn required a pragmatic operational approach where suppliers that considered themselves to be wholly non-domestic could opt out of the scheme. If the MSC is reintroduced, there may therefore be a need to consider how the accuracy of this data is assured, and whether any arrangements for supplier self-exclusion should be reflected more explicitly in the supporting REC arrangements.

- **System cost and lead time:** As noted in the consultation, it is proposed that the MSC would operate in substantively the same manner as the scheme which operated April 2022 to March 2024. The legacy development and know-how from that scheme would therefore reasonably be expected to be lower than any wholly new scheme depending on the nature of the scheme and the data sources required. However, as previously confirmed, the systems infrastructure was re-purposed following the closure of the scheme and would therefore need to be rebuilt. On current assumptions, and subject to a detailed impact assessment, RECCo would expect to require approximately four months to re-establish the necessary system, data, governance, assurance and operational arrangements before the MSC could be administered effectively. We would be happy to share further analysis with Ofgem in due course.

We are happy to discuss any of the points raised in this response.

Yours sincerely,

Jon Dixon
Director, Strategy and Development

Appendix: RECCo response to consultation questions

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 to manage the impact of rapidly changing wholesale prices that cannot be immediately reflected in retail tariffs due to the default tariff cap, which has a significant influence on suppliers purchasing decisions and therefore creates distortions in both a rising and falling market. An MSC can ameliorate those impacts by compensating losing suppliers for part of the cost of unwinding hedges and by reducing the risk that sharp movements in wholesale prices translate into wider market instability or mutualised costs for consumers. However, as expanded upon in our response to Q2, the consumer benefits of the MSC must be balanced against its acknowledged trade-offs, including reduced switching savings, weaker competitive pressure and the potential to dampen consumer engagement.

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

We recognise that this is a complicated area involving important and difficult trade-offs impacting consumers. Ofgem has acknowledged that an active MSC would likely be reflected in fixed tariff pricing, reduce the savings available to consumers who switch, and temporarily reduce switching and competitive pressure in the market. We are concerned about those anti-competitive effects, particularly where the MSC may further dampen incentives for consumers to engage in the market and seek a better offer. At a time when rebuilding trust, engagement and effective competition remains important, any measure that weakens the consumer price signal risks undermining both retail competition and the broader transition to a more flexible, low-carbon energy system. Ofgem's previous decision to allow the MSC to lapse also recognised that the measure could reduce incentives for suppliers to compete, deter new entry, make fixed-term contracts less competitive against the price cap, and delay consumers from seeing the full benefit of falling wholesale prices. Similar concerns have been raised by consumer representatives, including that the MSC may operate as a tax on competition.

Against that, we recognise that an MSC may benefit consumers indirectly where it reduces the risk of supplier failure and associated mutualised costs, including through the Supplier of Last Resort levy. There is a separate question as to whether recent changes to supplier financial resilience requirements have appropriately rebalanced the risk of failure between consumers and investors. We also recognise that the MSC may support prudent hedging and wider market resilience in exceptional circumstances, although that benefit depends on suppliers having sufficient confidence that the MSC would be activated when relevant conditions arise.

More fundamentally, these issues arise because the default tariff cap itself creates distortions during periods of rapid wholesale price movement in either direction. In a sustained period of rising prices, wholesale costs may outstrip even a prudent hedging strategy, particularly where the cap prevents suppliers from passing through efficiently incurred costs until a later cap period. While this may insulate consumers from immediate wholesale price increases, that is arguably an unintended benefit of the cap rather than its original policy purpose. Where suppliers are expected or encouraged to absorb costs in the short term, it is reasonable that efficiently incurred costs may subsequently be reflected in later cap periods.

That can create further distortions if wholesale prices then fall rapidly. If the cap continues to reflect historic costs or under-recoveries from an earlier rising-price period, it may sit above prevailing wholesale costs. This can increase the risk of incumbent suppliers being undercut by new entrants or other suppliers pricing fixed tariffs

against current market conditions, while also creating distributional effects between consumers who remain on SVTs and those able to access fixed term offers, as referenced in the consultation.

On that basis, while we remain concerned about the MSC's impact on competition and consumer engagement, we recognise that it may be a reasonable tool in exceptional circumstances where the risks created by the interaction of wholesale volatility and the tariff cap cannot be more appropriately accommodated through a more dynamic price cap methodology, existing financial resilience requirements, or other less distortive interventions. We therefore support the availability of the MSC as a contingency measure, but would expect any activation to be evidence-based, time-limited, and subject to a clear assessment that the consumer benefits of avoiding disorderly supplier failure outweigh the consumer harms from reduced switching, weaker competition and delayed access to lower tariffs.

Q3: Do you agree with our proposed licence drafting?

We agree that the proposed licence drafting is broadly consistent with the policy intent set out in the consultation. In particular, proposed paragraph 24A.2A appears to give the Authority flexibility to determine whether and when Condition 24A should take effect, rather than the MSC applying automatically when the licence modification comes into force. We recognise the rationale for this approach, including Ofgem's desire to retain optionality and respond quickly to fast-moving wholesale market conditions, and to ensure that any activation is aligned with the necessary REC arrangements for administering payments between suppliers. This is consistent with the consultation's stated intent that the MSC should remain an exceptional tool for managing market stability risks, rather than becoming a normal feature of the market.

However, while the statutory consultation notices state that any licence modification would take effect no earlier than 56 days after the decision is published, the proposed drafting of 24A.2A does not appear to provide for any minimum notice period between the Authority publishing a written statement and the MSC taking effect. We recognise that the purpose of the drafting is to allow the Authority to respond quickly to unforeseen impacts on the wholesale market. Nevertheless, we are concerned that the absence of any minimum notice period could itself create uncertainty and, in some circumstances, have the unintended effect of creating or amplifying a price shock.

In particular, suppliers will need sufficient notice to reflect the prospective activation of the MSC in pricing, risk management, operational planning and hedging decisions. A very short notice period could make it more difficult for suppliers to take orderly commercial decisions and may also create uncertainty for consumers and third-party intermediaries if tariffs are withdrawn or repriced quickly in response to an MSC notice. This would be undesirable in circumstances where the MSC is intended to support market stability and consumer confidence. We therefore consider that Ofgem should consider inserting a minimum notice period into paragraph 24A.2A. This would reduce uncertainty, support better planning and hedging decisions, and provide greater predictability to market participants. In our view, this would be consistent with Ofgem's previous recognition that industry raised concerns about having sufficient notice before changes to the MSC were made.

We also consider that there may be merit in aligning MSC activation periods with the quarterly default tariff cap periods. The need for the MSC is closely linked to the existence and design of the default tariff cap, and the constraints it places on normal commercial decision-making. The MSC is only likely to be effective in the specific circumstances where wholesale prices fall materially below those assumed in standard variable tariffs, rather than while wholesale prices are rising as a result of an unforeseen event. Ofgem itself notes that the quarterly cap reduces both the value of suppliers' hedges and the period over which consumers may switch away before the cap resets.

On that basis, it may be sensible for Ofgem to notify the market of its intention to activate the MSC as part of the relevant price cap adjustment process before the relevant cap period takes effect. That would provide a clear and predictable decision point, while still allowing Ofgem to determine the value of the MSC dynamically by reference to prevailing wholesale market movements.

We accept that the charge itself must be capable of being calculated and updated more dynamically, as was the case during the previous period of the scheme. The MSC value could therefore continue to be notified through a regularly updated dashboard or equivalent mechanism, supported by guidance and operational arrangements under the REC. RECCo's previous experience of administering the MSC demonstrates that such arrangements can be delivered, but also that transparency of the underlying data and timely communication with suppliers are important to the effective operation of the scheme.

Subject to those points, and there being sufficient notice for RECCo to impellent the system, we agree that the proposed licence drafting appears to achieve the stated policy intent. Our recommendation is that Ofgem amends paragraph 24A.2A to include a minimum notice period before the MSC can take effect, and considers whether MSC activation periods should be aligned, so far as practicable, with the quarterly default tariff cap timetable.

Q4: Do you have any comments on our intended process?

We welcome Ofgem's confirmation that any decision to activate the MSC would be subject to a separate consultation on the case for doing so, and that Ofgem would also consult on the guidance and parameters before activation. Our understanding is that such consultation would be practicable given that the MSC deals with the aftermath of an energy cost crisis, and therefore not part of the immediate response to ameliorate the cost shock. That said, and as noted in our response to Q3, we consider that the policy will be most effective if suppliers have confidence that the MSC will be activated, so it may be possible to provide further certainty by clarifying the conditions such as the extent or acceleration of any wholesale price rise that would be likely to trigger the intervention. Any further consultation could therefore focus objectively on whether those circumstances have been met, rather than reopen wider considerations. This would also be true of the conditions for deactivation of the scheme, rather than having to extend it further than necessary (though we appreciate that much of the practical effect could be achieved by setting the MSC charge to zero).

Also as set out in Q3, we consider that the process would benefit from clarify on timing. We recognise the need for Ofgem to remain responsive to fast-moving wholesale market conditions, but suppliers, third-party intermediaries, and consumers will all benefit from a predictable process.

From a REC perspective, early and detailed engagement with RECCo will be essential. The MSC relies on the availability of REC infrastructure and arrangements to support calculation, invoicing, payment, dispute and assurance processes. Although RECCo has previous experience of implementing and administering the MSC, mobilisation will still require appropriate time for governance, service provider engagement, data assurance, testing and communications with REC Parties. The previous operation of the MSC also highlighted the importance of transparency over the data used to support calculations, and we would expect that to be built into any future process from the outset.