

# Statutory consultation: Estimated annual costs for domestic consumers

## Consultation

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### Overview:

We are seeing increasing innovation in the types of tariffs that are offered to domestic consumers, following the removal of rules restricting their number and structure. This is likely to continue, and accelerate, in future as smart meters enable increasingly dynamic and tailored tariffs. We want to make sure that domestic consumers have the necessary tools to be able to understand their current circumstances, budget effectively and to compare their current tariff with others – and that these tools remain fit-for-purpose as the market evolves.

Building on our enforceable Standards of Conduct and new requirements for suppliers to enable their customers to make informed choices, we are now reviewing the methodology for estimating consumers' annual costs (the Personal Projection) to make sure that it supports, rather than constrains, innovation. We want to establish a framework within which suppliers and comparison sites have room to adapt the projection to consumer preferences and innovative tariffs, while putting in place controls to ensure consumers are able to choose a tariff that is appropriate to their circumstances and are not misled. We want consumers to be confident that the projected costs they are provided with will enable them to effectively budget, compare and switch tariffs.

This paper sets out our final proposal for how we intend to build on the existing principles by amending the Personal Projection rules so they remain fit-for-purpose in a rapidly changing market.

## Context

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We are committed to relying more on enforceable principles in the way we regulate the retail energy market, rather than detailed, prescriptive rules. We believe this approach will better protect consumers in a rapidly evolving market, promote innovation and place responsibility firmly on suppliers to understand and deliver good outcomes for consumers.

In 2016, we implemented changes to the rules governing the number and types of tariffs that domestic suppliers can offer, following the recommendation of the Competition and Markets Authority as part of their energy market investigation. These changes mean we now need to update requirements relating to the estimated annual cost methodology.

In this paper we set out our proposal to amend the estimated annual cost methodology by removing prescriptive requirements and replacing them with principles-based rules.

## Associated documents

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Ofgem, [Personal Projection: Updated thinking on the way forward](#), July 2017

Ofgem, [Final Decision: Enabling consumers to make informed choices](#), April 2017

Ofgem, [Modification of electricity and gas supply licences to remove certain RMR Simpler Tariff Choices rules](#), September 2016

Ofgem, [Helping consumers make informed choices – proposed changes to rules around tariff comparability and marketing](#), August 2016

Ofgem, [Retail Market Review – Statutory consultation on the RMR domestic proposals](#), June 2013

CMA, [Energy market investigation: Final report](#), June 2016

Ofgem, [CMA provisional remedies: removal of certain RMR 'simpler choices' rules](#), April 2016

Ofgem, [Decision: Default tariffs for domestic customers at the end of fixed-term contracts](#), October 2017

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## Executive Summary

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Ofgem's objective is for consumers to receive projections of the costs of their electricity and gas tariffs that are both transparent and accurate. This will enable them to budget and to compare and switch tariffs with confidence.

We require suppliers and Confidence Code-accredited price comparison sites to provide domestic consumers with their 'Estimated Annual Cost' – an estimate of a consumer's costs for the next 12 months on a given tariff. The projection must be included on bills and other communications, as well as during sales and marketing activities.

The methodology that suppliers and sites are required to follow is prescriptive – it sets out in detail how they should factor in standing charges, unit rates, discounts and charges for bundled products. We think that consumers will be better-served by enabling suppliers and comparison sites to tailor the cost estimates they provide.

The removal of certain tariff restrictions, our recent changes to the rules relating to default tariffs for customers at the end of fixed-term contracts, and increasing tariff innovation mean that the existing methodology needs to change to keep pace with current market rules and tariff offerings. We want to future-proof the methodology as far as possible so that it can accurately reflect the cost of tariffs that are on the market now and in future.

Stakeholders have acknowledged the challenges involved in designing a methodology that works for all circumstances. There has not been a clear consensus among them on the methodology they would like to see. Some prefer a prescriptive one-size-fits-all approach for all industry parties. Others would prefer a more principles-based approach that sets certain high-level parameters, and leaves flexibility for suppliers and comparison sites to structure the calculation how they choose within them.

### *Our proposal*

Following engagement with stakeholders and consideration of responses to our July working paper, we propose to amend the current Estimated Annual Cost definition to require suppliers and Confidence Code-accredited price comparison sites to provide consumers with an estimate of their costs for the next 12 months that:

- Is personalised to the consumer, based on information that is reasonably available to the supplier or comparison site, and reasonable assumptions where actual data is not available;
- Is based on actual historic consumption wherever this is available (and a best estimate of actual consumption where it is not);
- Includes non-contingent discounts and non-optional bundled charges, and excludes contingent discounts and optional bundled charges;
- When used to provide the consumer with a comparison of different tariffs, is applied consistently, such that the same assumptions, where relevant, should be made for all tariffs that are being compared; and
- Is transparent, and accompanied by a description for the projection that makes clear to the consumer what it is, what it can be used for, and any assumptions that have been made in its calculation.

We expect suppliers and comparison sites to use the opportunity provided by this proposed rule change and new technologies, eg online calculators, to make it as easy as possible for consumers to make an informed choice of tariff for them.

We do not propose wider changes, for example to when or in what format the estimated annual cost should be provided to consumers. We will consider any changes to these requirements as part of our broader review of the rules relating to customer communications like bills and annual statements.

*Balancing increased flexibility with the right parameters to protect consumers*

Any methodology we choose will have strengths and weaknesses. However, we do not think that the benefits of a highly prescriptive approach outweigh the potential risks, particularly in light of the tariff innovation we expect to see over the coming years. Smart meters and changes to settlement arrangements are likely to lead to an increase in the number and diversity of time-of-use or demand-side response tariffs. As we do not yet know what types of tariffs will be offered in future, a prescriptive approach may act to stifle innovation or lead directly to poor consumer outcomes.

Nevertheless, it is also important to have strong parameters in place to ensure the estimates provided to consumers are sufficiently accurate, and to avoid some of the poor practices we observed in past mis-selling cases. For example, we want to ensure consistent treatment of discounts and charges so that consumers are clear on what is included in and excluded from their projection.

Currently, the rules require that the estimated annual cost is based on a consumer's actual usage where this is available. Some suppliers have suggested that they should have room to assume that their consumption over the next year may be different than that just passed. This may be particularly relevant for time-of-use tariffs, as any savings the consumer may be able to make may depend on their ability to change their behaviour or usage patterns in future.

We recognise the potential benefits of providing this flexibility. However, we think there is a significant risk that consumers may be misled as to whether and how much they could save. Actual historic usage may not be the best predictor of future consumption in all cases, but it provides a clear and transparent basis for estimating annual costs. We consider, in the absence of any evidence to the contrary, that suppliers and comparison sites should base the estimated annual cost on actual historic consumption wherever this is available. This would not prevent suppliers or sites providing additional estimates to highlight the potential benefits of time-of-use tariffs. We intend to keep this part of our proposed rules under review should evidence suggest that a change would deliver better outcomes for consumers.

These changes we are making are in keeping with the informed choices principles we introduced recently, and are aimed at ensuring that consumers receive information that is complete, accurate and not misleading.

*Next steps*

We welcome stakeholder views on the proposals set out in this consultation by 29 November 2017. Subject to responses, we intend to move quickly to make a decision on the way forward. We expect to issue this decision around the end of the year.

# 1. Introduction

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- 1.1. For domestic consumers to engage effectively in the retail energy market, they need to have the tools to be able to understand their current circumstances, budget effectively and to compare their current tariffs with others.
- 1.2. To help support this aim, suppliers and price comparison sites should provide consumers with an estimate of the annual costs of their gas and electricity tariffs that is personalised and transparent, so that consumers can confidently make the right tariff choice for them. We want consumers to be able to understand what the estimate is and what it can be used for, and for it to be clear to the consumers where assumptions have been made in its calculation, so they can understand how their consumption or behaviour may affect their bill.
- 1.3. The current estimated annual cost requirements need to updating to reflect recent changes in the market and other regulatory rules, and feedback from stakeholders.
- 1.4. We intend to replace the existing prescriptive methodology with one that is more principles-based. This will help to ensure that the new methodology remains fit-for-purpose in future, when we expect initiatives such as smart meters and settlement changes to facilitate greater tariff innovation by suppliers.
- 1.5. Below we set out some background to why we are reviewing the estimated annual cost rules, and summarise some of the links between this work and other important initiatives in the energy market. In the following chapter, we set out the key issues and options we have considered, the stakeholder feedback we received to our July working paper, our proposed changes and the next steps.

## Background and why we are reviewing these rules

- 1.6. In 2014, we introduced the ‘Personal Projection’ – a personalised calculation of the cost a domestic consumer is likely to pay over the next year on a given tariff.<sup>1</sup> The Personal Projection replaced a high-level requirement for suppliers to provide an illustrative projection of annual costs to each consumer.<sup>2</sup>

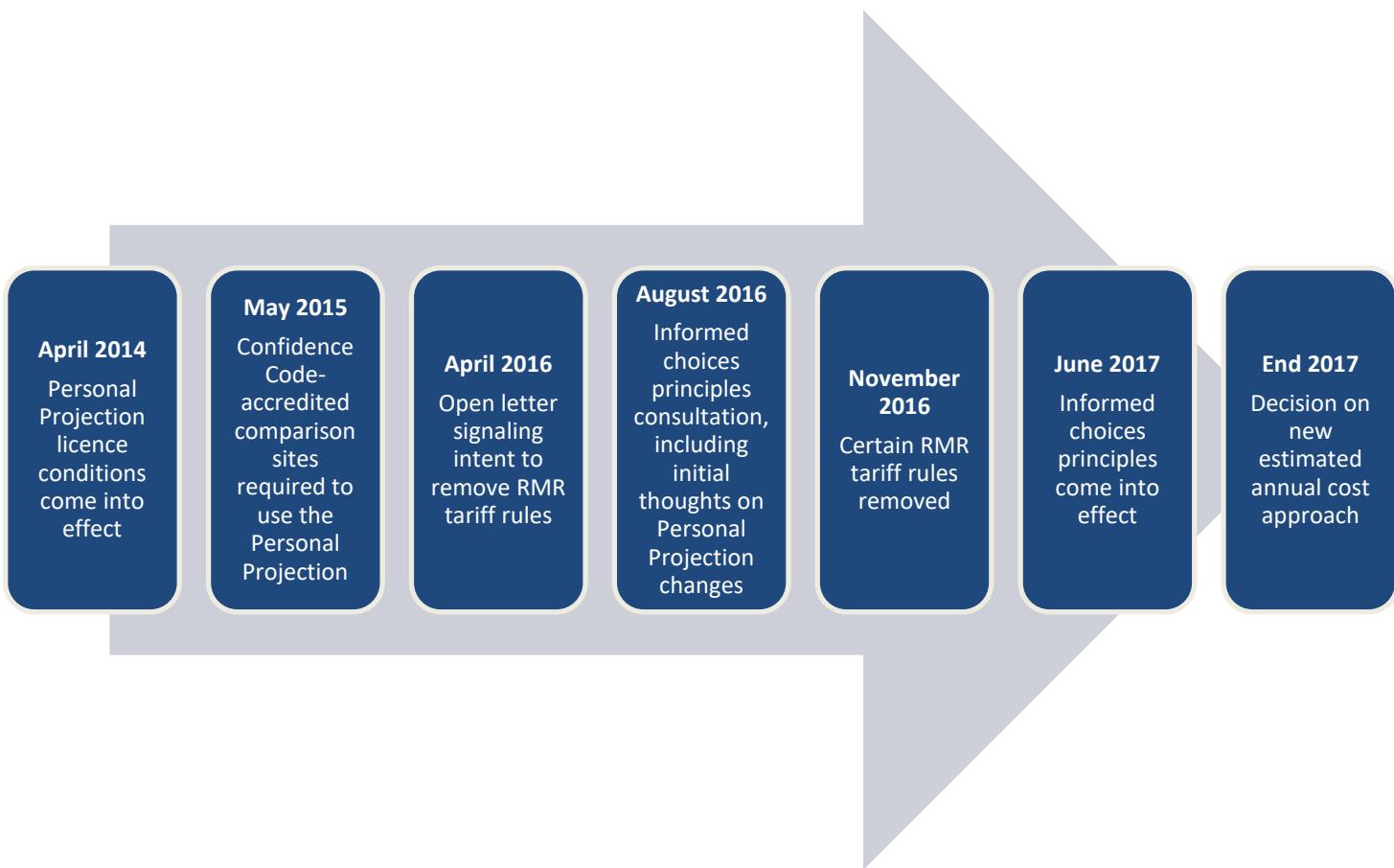
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<sup>1</sup> Ofgem, [Retail Market Review – Statutory consultation on the RMR domestic proposals](#), June 2013

<sup>2</sup> Prior to the introduction of the Personal Projection, suppliers were required to provide consumers with “an illustrative projection of the costs in pounds sterling of the quantity of [electricity/gas] supplied to the [consumer] for the forthcoming 12 months assuming those premises are supplied with the same quantity of [electricity/gas] as during the previous 12 months.”

1.7. We introduced the Personal Projection to help consumers understand how much they are paying for their energy so that they can budget effectively and to enable them to compare their deal with others on the market. It was introduced, in part, to prevent some of the poor practices that had been adopted around the industry, including inconsistent approaches to the inclusion of certain discounts and charges, and the provision of heavily caveated statements to consumers describing what may or could be included in cost projections.

**Figure 1:** Timeline of changes relating to the Personal Projection



*Current rules*

1.8. The Personal Projection is a prescriptive methodology, set out in standard supply licence condition 1 under 'Estimated Annual Cost', for suppliers to use to calculate the cost a domestic consumer would pay on a given tariff.

1.9. It is based on a consumer's actual historic consumption (or a best estimate of their consumption if actual readings are not available). It sets out in detail how we expect suppliers to factor unit rates, standing charges and different types of discounts and bundled products into an annual cost calculation. Suppliers are

required to provide consumers with their Personal Projection on a regular basis, including on bills, annual statements and at the point of sale of a new contract.

1.10. Domestic suppliers are required to consistently name this estimate the 'Personal Projection' when providing it to consumers (eg on energy bills), and to accompany the figure with a description of what charges and discounts it includes.

1.11. We subsequently changed our Confidence Code, a voluntary code of practice for domestic energy price comparison websites, to require accredited sites to use the Personal Projection methodology, as a default, when comparing the price of different tariffs. Accredited sites had previously been required to follow Code rules setting out the types of discounts and charges that should be included in, and excluded from, the calculation. We made this change in order to provide consumers with a degree of consistency in the tariff prices they see in different forums. We allowed accredited sites to provide different methodologies should they choose, but required that they use the Personal Projection as the default means of calculating the price of different tariffs.

#### *Why we are reviewing these rules*

1.12. Following its energy market investigation, the Competition and Markets Authority (CMA) recommended that, to allow greater room for innovation, we remove some of the prescriptive tariff rules that were in place at that time.<sup>3</sup> After consulting with stakeholders, we removed these tariff rules in November 2016. At that time, we signalled that there were likely to be some knock-on consequences for consumer information-based rules, including the estimate of annual costs. We set our expectation that until enduring amendments to the information tools were made, suppliers should adapt their approach to complying with the information requirements in a way that ensures consumers continue to receive appropriate prompts to engage, are not misled and are able to make properly-informed decisions.<sup>4</sup>

1.13. More recently, we changed the rules relating to default tariffs for domestic customers at the end of fixed-term contracts.<sup>5</sup> Suppliers are now able, as a default, to roll a customer onto a further fixed-term tariff at the end of their existing deal, as long as that further tariff meets certain criteria.

1.14. Both of these changes may have an impact on how a consumer's annual costs should be calculated. We want to refresh the methodology to ensure it stays in step with current market rules.

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<sup>3</sup> Competition and Markets Authority, [Energy market investigation: Final report](#), June 2016

<sup>4</sup> Ofgem, [CMA provisional remedies: removal of certain RMR 'simpler choices' rules](#), April 2016

<sup>5</sup> Ofgem, [Decision: Default tariffs for domestic customers at the end of fixed-term contracts](#), October 2017

1.15. Additionally, we are seeing increasing tariff innovation, and we want to make sure that the estimated annual cost methodology is sufficiently future-proofed to provide a realistic reflection of the costs a consumer will pay on a given tariff. Smart meters and changes to settlement arrangements are likely to lay the groundwork for an increase in the number and diversity of time-of-use and demand-side response tariffs. We do not yet know what tariff types will be offered in future, so we want to make sure that the estimated annual cost methodology is flexible enough to adapt to different tariff types.

1.16. More broadly, the level of prescription used in the current methodology is not in keeping with our general direction of travel towards greater use of principles in how we regulate. We want suppliers to deliver good outcomes for consumers without us necessarily having to specify in detail exactly how suppliers should go about doing so. We want to remove most of the prescription from the current requirements and replace with a simpler set of conditions, and in so doing make sure that it aligns with the overarching principles we have set out in the licence. In particular, we want to make sure that the changes we make are in keeping with our recently-introduced 'informed choices' principles, and help to ensure consumers have information that is complete, accurate and not misleading.

## Related initiatives

### *Confidence Code*

1.17. The Confidence Code is a voluntary code of practice for domestic energy price comparison websites. We oversee the Code, auditing accredited sites to ensure that they provide an independent, transparent, accurate and reliable service for consumers.

1.18. The Code currently requires accredited sites to use the existing Personal Projection methodology, as a default, when calculating the savings a consumer could make by switching tariffs.

1.19. We do not want to introduce multiple different sets of price calculation requirements for different industry parties. We intend that any changes we make to the licence requirements would also apply to the Confidence Code via inclusion by reference of the definition of Estimated Annual Costs in the licence.

1.20. We have included our envisaged Confidence Code drafting to reflect our proposed changes in appendix 3.

### *Cheapest tariff message and prompts to engage*

1.21. On bills and other communications, consumers receive messages informing them of how much they could save by moving to a cheaper tariff with their current supplier. This is to raise awareness among consumers of the savings available and to encourage them to engage and consider switching tariff. The calculation of the cheapest tariff is based on the current Personal Projection methodology.

1.22. The new methodology we introduce should continue to support the calculation of the cheapest tariff message. We do not intend to consider wider issues relating to the cheapest tariff message within the scope of our work on estimated annual costs.

1.23. We have launched a separate programme for suppliers to trial new prompts to engage. We have worked with a number of suppliers to participate in randomised control trials to test certain prompts.<sup>6</sup> The aim of these trials is to identify, test and implement measures to provide consumers with information to encourage them to engage. Any changes we make to the cheapest tariff message in future will be driven by the findings of this work. In general, the estimated annual cost methodology is likely to be an important input into this work.

#### *Customer communications*

1.24. We are in the process of reviewing the rules relating to supplier-customer communications, such as bills and annual statements.<sup>7</sup> Our aim is to remove unnecessary prescription from the rules and rely more on principles-based requirements. This will help make communications more engaging for consumers by allowing room for suppliers to innovate, while continuing to ensure consumers receive the information they need to effectively engage with their energy supply.

1.25. The estimated annual cost is an important piece of content on these communications. The proposals we outline in this consultation relate to the estimated annual cost methodology, name and description. We do not consider broader issues, eg relating to any placement or formatting requirements of the projection. Any changes to these rules will be taken forward as part of our broader work on customer communications.

#### *Automatic rollovers*

1.26. We have recently made changes to the rules regarding default tariffs for customers at the end of fixed-term contracts.<sup>8</sup> Suppliers can now, as a default, roll customers onto further fixed-term tariffs at the end of their existing deals, subject to certain conditions.

1.27. This change may have an impact on the assumptions suppliers need to use to estimate a consumer's annual costs. Our proposed changes to the estimated annual cost methodology will ensure it keeps pace with wider policy changes.

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<sup>6</sup> Ofgem, [Open letter: Finding ways to unlock consumer engagement through supplier trials](#), August 2017

<sup>7</sup> Ofgem, [Open letter: Reforming our rules related to domestic supplier-customer communications](#), September 2017

<sup>8</sup> Ofgem, [Decision: Default tariffs for domestic customers at the end of fixed-term contracts](#), October 2017

## 2. Policy issues and our proposal

### Chapter Summary

We set out our analysis of the key policy issues considered as part of our redesign of the Estimated Annual Cost, the options for reform and our recommendation.

**Question 1:** Do you agree with the changes we propose to make to the Estimated Annual Cost requirements?

**Question 2:** Do you agree that we should require that the Estimated Annual Cost is always based, as a default, on actual historic consumption where this is available? Please provide supporting reasons for your answer.

**Question 3:** Do you agree that we should aim to deliver within-channel consistency of results rather than full cross-market consistency? Please provide supporting reasons for your answer.

2.1. We want domestic customers to be provided with a projection of the costs of their electricity and gas tariffs that is both transparent and accurate. This will enable them to confidently budget, compare and switch.

2.2. We have considered a number of issues in developing our proposal to best meet this objective. These issues include:

- Consumption assumptions
- Consistency of estimates and level of prescription
- Treatment of different types of discounts and bundled products
- Assumptions at the end of a fixed-term tariff
- Name and description of the estimated annual cost
- Period covered by the projection
- Use of the methodology by suppliers and price comparison websites

2.3. We outline our considerations in relation to each of these key issues below, as well as some of the key feedback from stakeholders. We then briefly set out the high-level options for reforming the Personal Projection and our recommendation.

### Key policy issues

#### Consumption assumptions

2.4. With the rollout of smart meters and the move to half-hourly settlement there are greater opportunities for suppliers to innovate in the tariffs they offer to consumers. It is likely that in future we will see a much greater number of smart time of use and dynamically-priced tariffs.

2.5. This has the potential to be positive for consumers and the market. For instance, suppliers will be able to use smart technology to offer more tariffs that reward consumers who change when they use energy. This can help to make the system more efficient as consumption and supply are more flexible and responsive. Increasing the flexibility within the system in this way can reduce the need for expensive peaking plants, and can reduce network costs by avoiding or deferring reinforcement. This can ultimately help to reduce consumer bills.

2.6. Many consumers could benefit significantly from time of use tariffs. For instance, those with night storage heating (common in council and ex-council housing) installed in their homes are able to consume energy overnight (when it is relatively) cheap, and use it for heating throughout the day. By moving to a time-of-use tariff they may be able to reduce their energy costs without any change in their consumption patterns. Other consumers may be able to take advantage of time-of-use tariffs by adapting their behaviour – some may be able to use energy-intensive appliances such as washing machines or clothes dryers overnight or during the day.

2.7. Time-of-use and dynamically-priced tariffs are unlikely to benefit everyone, however. Not all consumers will have the ability, appliances or infrastructure necessary to shift their peak consumption to different parts of the day, or to lower their consumption in response to a price signal.

2.8. We want to enable consumers to easily compare and select the appropriate tariff for them. The estimate of annual costs, provided to consumers on bills and when comparing tariffs, has a key role to play in enabling consumers to make the right choice of tariff for them. A realistic projection of costs will help consumers to determine whether a time of use or dynamically-priced tariff is right for them.

2.9. In order to realistically project the costs a consumer will pay in future, a supplier must understand what their consumption is likely to be. If the consumption figure used by a supplier is wrong, this presents a risk that a consumer is given a misleading picture of the savings they may or may not achieve by choosing a given tariff.

2.10. For time-of-use or dynamically-priced tariffs this risk is particularly acute. If a cost projection does not take into account that a consumer's current peak consumption is relatively high then the consumer may be misled into thinking they can save money on a time-of-use tariff when in fact they will pay significantly more.

2.11. Past consumption is generally seen as the best predictor of future energy use – our current rules reflect this by requiring suppliers to use actual historic consumption wherever it is available. Where suppliers don't have actual readings, or have only partial readings, they are required to form a best estimate of what a consumer will use in a 12 month period.

2.12. However, consumption levels can change over time. Even for non-time of use consumers, the number of occupants, type and number of appliances, and any energy efficiency measures installed in a home, among other factors, can all change over time, leading to changes in household energy consumption.

2.13. Some suppliers have suggested that, even where they have actual readings, they should have room to assume that a consumer's usage over the next year may be different than that just passed. They say it is appropriate to use actual readings as the default, but where they have strong evidence to suggest that the actual historic consumption is likely to change in future they should be able to build this into the default cost calculations provided to consumers.

2.14. For time-of-use and dynamically-priced tariffs this suggestion is particularly pertinent, and raises two opposing risks. Many consumers will need to change their consumption patterns to get good value out of these tariffs. If a supplier assumes that a consumer's behaviour will change in future, but does so inappropriately (eg where the consumer has high consumption at peak times and little or no ability to shift it to different parts of the day), then this could mislead the consumer into thinking they will make savings when they may have to pay substantially more. Additionally, when presented with the savings figure consumers themselves may not understand that they need to change their behaviour to obtain those savings.

2.15. Conversely, if a supplier does not assume that a consumer's behaviour will change in future, even where they have strong evidence to suggest that it will, then the consumer may stay on a flat rate tariff and miss out on savings they could make by moving to a time-of-use tariff. If this were a widespread issue, this could ultimately mean that there is a lower take-up of time-of-use tariffs among consumers.

2.16. Neither of the above outcomes is optimal. However, we consider the risks associated with the former – eg misleading a consumer into thinking the savings they will make are greater than they are likely to see in practice – outweigh the potential benefits. Consumer trust is more likely to be harmed where they inadvertently switch to a tariff that makes them worse off than if they were to miss out on savings. This could hamper wider take-up of time-of-use tariffs.

2.17. Furthermore, past compliance and enforcement activities have shown that this area is one which can be prone to poor consumer outcomes. In light of this, it may be sensible to limit the ability of suppliers and price comparison sites to assume that household behaviour or consumption will change in future. Using historic consumption provides a transparent means of projecting costs, that is likely to be clear and understandable to consumers. Suppliers and comparison sites would then be free to provide further projections showing how much the consumer could gain by changing their behaviour or consumption in future.

### **Consistency of estimates and level of prescription**

2.18. Some stakeholders have argued in favour of us maintaining (or even increasing) the level of prescription of the current methodology. They say that consumers should see the same results wherever they look for tariff information, and the best way of providing this consistency is to prescribe a common way for all suppliers and comparison sites to estimate annual costs.

2.19. We agree that there could be benefit in us setting a methodology that would provide consistent results on an industry-wide basis. We know that consumers can find it confusing when they see one 'answer' in one place, and a different one somewhere else, and that this confusion can discourage them from engaging further.

2.20. However, we do not think it would be desirable or easily achievable to deliver full cross-market consistency by adopting a highly prescriptive methodology. There are two main reasons for this.

2.21. The first is that we do not know what types of tariffs may be offered by suppliers in future. Until now, tariffs have been relatively straightforward in their structure – a substantial majority of consumers are on single unit rate tariffs. Estimating the annual costs for these tariffs is relatively straightforward, and there is little room for differentiation in how one would go about the calculation. In future, this may not remain the case. Smart meters and changes to settlement arrangements will facilitate tariff innovation by suppliers. Complex time-of-use or innovative tariffs may pose challenges for a one-size-fits-all methodology – what works for one tariff may be misleading for another. We want to make sure that whatever approach we put in place works for different tariff types now and in the future.

2.22. The second reason is that to achieve truly consistent results across the industry at this stage we would need to prescribe the means by which suppliers and comparison sites estimate consumption. Currently, where a consumer does not know their annual consumption or where actual readings are not available, suppliers and comparison sites may ask questions about household characteristics such as the number of occupants, number of rooms, type of property, number and type of electrical appliances. Both the questions asked and the resulting consumption figure may differ. Different consumption estimates will ultimately lead to different cost projections.

2.23. Furthermore, where the cost projection is for a time-of-use tariff, or a tariff with prices that differ on a seasonal basis for example, the daily or seasonal consumption pattern is as important as the annual total. This creates more opportunities for results to differ across suppliers and comparison sites.

2.24. We don't currently prescribe how suppliers or comparison sites should go about estimating consumption amounts or patterns where they don't have actual readings.

2.25. Setting the 'bar' at the right level would be a difficult task. We would obviously want to ensure that the consumption figures provided to consumers are as accurate as possible. Not all market participants may have the resources at their disposal to adopt the newest or most sophisticated tools – the list of factors that could potentially be considered is substantial, and includes not just those outlined above but also other factors such as expected weather patterns, insulation, and working hours. Attempting to take too many factors into consideration and increasing the number of questions consumers must answer may turn consumers off engaging. Adopting a shorter, simpler set of factors, on the other hand, may prevent

some market participants from making their own estimation tools more accurate and sophisticated.

2.26. We do not think that we are best-placed to determine a single approach to consumption estimation, and consider there may be unintended consequences to us doing so. This is better left to those directly interacting with the consumer – ie suppliers and comparison sites.

2.27. We do, however, want to ensure that consumers receive fair comparisons *within* each supplier or comparison site (ie that comparisons of tariffs are like-for-like on a given comparison site, though they may not be exactly the same between sites). Giving suppliers and comparison sites more flexibility over which approach to use may incentivise them to choose a way of calculating the costs of tariffs that either maximises or minimises the savings presented to a consumer (depending on their objective).

2.28. In line with the overarching principles for suppliers to treat customers fairly and to make sure that the information provided to consumers is complete, accurate and not misleading, we expect that where the projection is used for the purposes of comparing tariffs, this comparison is made on a like-for-like basis. Any assumptions used to calculate the cost for one tariff should also apply to others within a supplier's portfolio or for all tariffs on a comparison site.

2.29. In the longer term, as smart meters are rolled out we expect that cost projections will be based increasingly on actual meter readings. So we would expect that any inconsistencies in the results provided to consumers across different channels will decrease over time.

### **Treatment of different types of discounts and bundled products**

2.30. The current estimated annual cost methodology requires suppliers and comparison sites to exclude one-off and 'contingent' discounts (those discounts which require a consumer has to behave a certain way to receive, eg prompt pay) and includes other 'non-contingent' discounts (eg online or dual fuel discounts which are applied automatically). The methodology also specifies how discounts should be factored into the calculation of costs when they are accrued either over time or on a per kWh basis. However, this doesn't currently cover discounts that might be accrued in other ways, such as percentage discounts. These types of discounts were previously banned but can now be offered to consumers following the removal of certain tariff restrictions.

2.31. Some suppliers have suggested that they should be able to include contingent discounts in cost projections where they have evidence to support it (eg where they know that a customer tends to pay on time and is thus likely to receive the prompt pay discount). They say that this will mean that consumers are provided with a more accurate reflection of the cost they are likely to pay.

2.32. Other suppliers have argued that they should be able to include one-off discounts, in order to better reflect the cost a consumer will pay over the year.

2.33. As we have outlined in relation to consumption assumptions above, we are concerned that consumers could be misled as to how much they will save if contingent discounts are included in the estimate of annual costs.

2.34. In relation to contingent discounts, by their nature a consumer has to behave a certain way (eg paying on time, submitting meter readings) to receive them. They may not always meet the criteria for this, so a savings claim that is based in part on a consumer obtaining this discount may be misleading.

2.35. Similarly, one-off discounts may also mislead consumers as to the cost they will pay. For example, loyalty discounts may be time-bound, so a consumer has to remain with a supplier for a certain amount of time to receive them. If a consumer switches before a certain time they will not get the discount. Other types of one-off discount can be paid up front. If these discounts are included, even where the estimate of annual costs are being calculated for a consumer's current tariff and the discount has already been paid, this may mislead the consumer into thinking they are on a better deal than they actually are.

2.36. We do not propose to allow one-off or contingent discounts to be included in the estimate of annual costs. Suppliers and comparison sites would, however, be free to provide additional projections where they want to convey the potential benefits of these discounts to consumers.

2.37. In relation to bundled products or services<sup>9</sup>, the current methodology specifies that the cost of optional bundles should be excluded from the estimate of annual costs. The cost of 'tied' bundles (ie those that are not optional) should be included wherever they can be expressed in £/year or p/kWh.

2.38. Some suppliers have suggested that consumers may prefer to be provided with separate itemised projections – one covering energy-related costs and the other covering other products and services.

2.39. We continue to believe that the costs of tied bundles should be included in a consumer's estimated annual costs. If this were not the case, we are concerned that a consumer may get a misleading impression of how much they are likely to have to pay. As an illustration, a tariff that had a relatively low unit rate and standing charge, but which required a consumer to pay a significant monthly insurance charge, for example, would appear relatively high up a comparison site's results

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<sup>9</sup> We use 'bundles' to refer to products or services that can be bundled together with an energy tariff, but which are unconnected to the supply of energy. Bundles can include things such as boiler cover, other utilities such as telecoms, or physical products.

table if tied bundles were excluded. We do not believe that this would result in good outcomes for consumers.

2.40. We therefore propose to retain the spirit of the current rules regarding bundles and the estimated annual cost.

### **Assumptions at the end of a fixed-term tariff**

2.41. The methodology is currently set up to project a consumer's costs on a given tariff assuming they take no action over the next 12 months. For instance, if a consumer is on a fixed-term tariff with 6 months remaining their projection will be based on that 6 months, plus a further 6 months on the tariff they would roll onto if they didn't switch at the end of their current contract. Suppliers and comparison sites are currently required to assume that this rollover tariff will be the relevant cheapest standard variable tariff for that consumer. This reflects what would, until recently, happen in practice.

2.42. In October, we amended the rules in relation to default tariffs for customers at the end of fixed-term contracts. We now allow suppliers to roll customers, as a default, onto further fixed-term tariffs at the end of their existing contracts, as long as the further tariff meets certain criteria.

2.43. This may mean that the rollover tariff for the customer is not always clear. Suppliers may not specify the exact tariff that a customer will be rolled onto until near the end of their existing contract, for example. Or, instead of using a single tariff for customer rollovers they may use multiple different contracts. This will have an impact on the assumptions to be used when estimating annual costs.

2.44. Even without this recent policy change, we recognise that certain consumers may feel that a projection that assumes they will roll onto another tariff is confusing. Some consumers may, for instance, prefer a projection that calculates an annual total of their current tariff's rates. Several stakeholders have argued that some of the calculation assumptions about consumer behaviour at the end of fixed-term tariffs do not align with what their users expect to see, or how they often behave in practice.

2.45. We intend to remove the requirement for the estimated annual cost to always be forward-looking. This will mean that suppliers and comparison sites can, if they choose, provide an estimate of annual costs that is an annualised total based on the consumer's current tariff rates. Where the tariff in question is a 'staggered price' or tracker tariff<sup>10</sup>, for instance, we would expect suppliers and comparison sites to carefully consider how they take seasonal consumption variations into account to

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<sup>10</sup> By 'staggered price tariff' we mean a tariff where the price will change at set intervals any by set amounts that are specified at the outset of a contract. We use 'tracker' tariff here to refer to a tariff whose price is benchmarked against an independent index.

make sure that the consumer receives a transparent projection of the costs they are likely to pay on a given tariff.

### **Name and description of the estimated annual cost**

2.46. Suppliers and Confidence Code-accredited comparison sites are currently required to refer to the estimated annual cost as the 'Personal Projection' wherever they provide it to consumers. The projection must be accompanied by a description of what is included in it.

2.47. The changes proposed in this consultation would leave room for suppliers and comparison sites to come up with their own methodologies. In light of this, a single consistent name for the projection may be inappropriate, as it may give consumers the impression that they are seeing equivalent projections when they are not.

2.48. Additionally, describing the projection in a clear and transparent way will be increasingly important if industry parties have flexibility to come up with their own methodologies. We propose to strengthen the requirements relating to the description of the projection to make sure that consumers are able to understand what their estimated annual cost is and can be used for, and any assumptions that have been made in its calculation.

### **Period covered by the projection**

2.49. The projection is currently always an annual figure. Consumers may have different preferences for the period to be covered by their cost projections. We intend to continue to require the projections to be annual as a default, to ensure that prompts such as the cheapest tariff message continue to be as impactful as possible. However, we may choose to revisit this requirement in future depending on the outcome of our work to support the trialling of prompts for consumers to engage. In the meantime, suppliers are free to provide additional projections that cover different time periods should they choose.

### **Use of the methodology by suppliers and price comparison websites**

2.50. As covered above, at present the Confidence Code requires accredited sites to use the Personal Projection as a default when calculating the cost of different tariffs. We felt that such a requirement was sensible as price comparison websites, as 'representatives' of suppliers in certain contexts, may be subject to the licence requirements to provide a Personal Projection anyway. We thus amended the Code in order to avoid ambiguity. We consider that arguments to allow greater flexibility for suppliers to innovate in how they calculate cost estimates apply equally to comparison sites, and so we intend to apply the same requirements to accredited sites and suppliers.

2.51. We have proposed amended drafting to the Code in appendix 3 for stakeholder feedback. We intend to issue a decision on amendments to the Code at the same time as we make our licence change decision.

## Options for reforming the estimated annual costs

2.52. In our July working paper we set out four high-level options for reforming the current approach to estimating the annual cost of tariffs. We briefly summarise these options below.

### Option 1: Retain prescriptive methodology

2.53. Under this option, we would make adjustments to the existing methodology to reflect the removal of restrictions on percentage discounts following the CMA's recommendations, and our recent change to the rules around default tariffs for customers at the end of fixed-term tariffs. We would not make any further proactive changes to the methodology but would monitor market developments to assess whether further changes were warranted in future.

2.54. This change would address immediately-obvious gaps in the current methodology, bringing it up to date with recent retail rule changes. However, it is not likely to be a sustainable solution as the current level of prescription would remain in place. This may mean we need to regularly update the methodology as new tariff types are offered. This may slow or stifle tariff innovation, without delivering better outcomes for consumers as confusion with the current '12-month forward-looking' approach would continue.

### Option 2: Revert to pre-Retail Market Review requirements

2.55. Under this option, we would revert to the pre-existing requirement for suppliers to provide *an illustrative projection of the costs in pounds sterling of the quantity of energy supplied to the consumer for the forthcoming 12 months assuming the consumer were supplied with the same quantity of energy as during the previous 12 months*.

2.56. This option would provide a significant amount of flexibility to suppliers and comparison sites to come up with their own way of estimating annual costs, and in so doing reduce the risk that the methodology becomes a barrier to innovation. However, we know from past experience that this formulation of the requirement can be problematic. Part of the reason for creating the current methodology was to prevent some of the poor practices that had been adopted around the industry, including inconsistent approaches to the inclusion of certain discounts and charges, and the provision of heavily caveated statements to consumers describing what *may* or *could be* included in cost projections.

### Option 3: Narrow principles

2.57. Under this option we would replace the existing prescriptive rules with a simpler definition requiring suppliers and comparison sites to provide a projection of annual costs that:

- Is personalised to the consumer, based on all data that is reasonably available to the supplier or comparison site, and reasonable assumptions where actual data is not available;
- Is based on actual historic consumption wherever this is available (and a best estimate of consumption where it is not), in all but the most exceptional circumstances;
- Includes non-contingent discounts and bundled charges, and excludes contingent discounts and bundled charges;
- When used for comparisons, is applied consistently, such that the same assumptions, where relevant, should be made for all tariffs that are being compared; and
- Is transparent, and accompanied by a name and description for the projection that makes clear to the consumer what it is, what it can be used for, and any assumptions that have been used in its calculation.

2.58. This option would retain the current approach to the inclusion of discounts and bundles, but in a simplified, high-level form. It would give suppliers and comparison sites room to move away from the current 12-month forward-looking projection, which can be confusing for some consumers where they get a 'blended' set of current and default tariff rates. They will instead be able to provide consumers with a projection based on the consumer's current tariff rates.

2.59. This option would also ensure that the estimated annual cost would be personalised to the consumer. It would be based on actual historic consumption, wherever this is available, and a best estimate of the individual consumer's usage where it is not available. Suppliers and comparison sites would be free to provide additional projections where they want to demonstrate the potential benefits of changes in consumer behaviour or consumption patterns. Where a supplier or comparison site has to make assumptions about consumption or consumer behaviour, we would expect these to be reasonable – based on the information they have (eg partial consumption readings) or could reasonably obtain – so that the consumer is provided with a realistic estimate of what they are likely to pay on a given tariff.

2.60. Under this option, we would strengthen the requirements for suppliers and comparison sites to provide a clear and transparent description of the estimate, so that consumers can easily understand any assumptions that have been made in its calculation.

#### **Option 4: Mixed methodologies**

2.61. Under this option we would apply a prescriptive methodology to certain 'basic' tariffs such as standard variable and fixed-term, fixed-rate tariffs, and allow suppliers flexibility to develop their own methodologies for more complex tariffs.

2.62. This may provide some consistency of cost calculation across the most common types of tariffs while giving suppliers space to develop bespoke methodologies for more innovative tariffs. However, we are concerned that this may increase complexity for consumers, who may receive several price projections for

different tariffs, each with their own assumptions attached. This may damage consumer confidence in their ability to make the right decision for them and cause them to disengage.

## Recommendation

2.63. We propose to implement option 3: narrow principles.

2.64. We have carefully considered the feedback we have received in response to estimated annual cost consultations, both recent and historical, as well as stakeholder submissions in response to our July working paper.

2.65. We believe that our proposal strikes an appropriate balance between continuing to provide strong protections for consumers in an area that has been prone to poor practice in the past, and ensuring that consumers get an estimate of their annual costs that can accurately reflect the tariffs that are on the market now and in future.

2.66. We acknowledge supplier concerns that limiting their ability to factor expected future consumer behaviour or consumption changes into cost projections may make it more difficult to promote time-of-use tariffs. However, we consider that the risks of misleading consumers by allowing this flexibility outweigh its potential benefits at this time.

2.67. We also recognise, and to an extent share, stakeholder concerns that inconsistent results across the industry may be confusing for consumers. However, we do not think that it would be desirable or practical to attempt to deliver full cross-market consistency. The measures required would risk causing worse outcomes for consumers in the long term. Instead, we want to ensure that consumers get like-for-like comparisons *within* each supplier or comparison site.

## Next steps

2.68. We welcome stakeholder views on the proposals in this consultation by 29 November 2017. Alongside this document, we have also published statutory notices, setting out our envisaged licence drafting to reflect the proposed changes. We have also set out envisaged Confidence Code amendments in appendix 3. Please send any responses to [futureretailregulation@ofgem.gov.uk](mailto:futureretailregulation@ofgem.gov.uk)

2.69. Subject to careful consideration of stakeholder feedback, we intend to make a decision around the end of the year so that any changes can come into effect as soon as possible.

# Appendices

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## Appendix 1 – Consultation responses and questions

We would like to hear the views of anyone interested in the proposals set out in this document. We especially welcome responses to the questions below.

Please respond by 29 November 2017 and send your response to  
[futureretailregulation@ofgem.gov.uk](mailto:futureretailregulation@ofgem.gov.uk)

**Question 1:** Do you agree with the changes we propose to make to the Estimated Annual Cost requirements?

**Question 2:** Do you agree that we should require that the Estimated Annual Cost is always based, as a default, on actual historic consumption where this is available? Please provide supporting reasons for your answer.

**Question 3:** Do you agree that we should aim to deliver within-channel consistency of results rather than full cross-market consistency? Please provide supporting reasons for your answer.

## Appendix 2 – Detailed licence condition changes

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| <b>SLC</b>   | <b>Recommendation</b> | <b>Reasoning</b>   | <b>Nature of obligation</b> |
|--|-----------------------|--|-----------------------------|
| 1  | Amend                 | We propose to delete the existing formula for the calculation of Estimated Annual Costs and replace with a higher-level set of requirements that will protect consumers while providing a certain amount of flexibility for suppliers to come up with their own methodology. | Defined term                |
| 22D.5(c)(xvi)<br>22D.9(e)(vi)  | Amend                 | We propose to align references to the description that must accompany the Estimated Annual Cost when it is provided to consumers in SLC 22D with those set out in 31E.   | Customer information        |
| 23.4(t)<br>23 Schedule 3 – S3.9<br>23 Schedule 4 – S4.12             | Amend                 | We propose to align references to the description that must accompany the Estimated Annual Cost when it is provided to consumers in SLC 23 with those set out in 31E.  | Customer information        |
| 31A Schedule 1 – S1.5<br>31A Schedule 4 – S4.11(f) and S4.15(q)(iii) | Amend                 | We propose to align references to the description that must accompany the Estimated Annual Cost when it is provided to consumers in SLC 31A with those set out in 31E.   | Customer information        |
| 31E.7  | Delete                | We propose to remove the requirement for suppliers to always refer to the Estimated Annual Cost as the 'Personal Projection'. As suppliers will have flexibility to come up with their own methodologies a single consistent title may give                                  | Customer information        |

|       |       |  |                      |
|-------|-------|--|----------------------|
|       |       | consumers the impression that all estimates are calculated the same way when in future they may not be.  |                      |
| 31E.9 | Amend | Suppliers are currently required to provide a description alongside the Estimated Annual Cost setting out what has been included in its calculation. We propose to amend this requirement to make this description more impactful and useful, ensuring that consumers are aware of what the estimate is and can be used for, and any assumptions that have been made in its calculation. | Customer information |

## Appendix 3 – Proposed Confidence Code drafting

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We have included the sections of the Confidence Code conditions we propose to remove or amend below. Deletions are shown in strike through and new text is double underlined. Paragraphs deleted from Code will show the text 'Not Used' in order to keep the existing numbering.

In addition to those changes we propose to make to estimated annual cost requirements, we also propose to remove the definition of 'Relevant Cheapest Evergreen Tariff'. As a result of our recent changes to the requirements relating to default tariffs for domestic customers at the end of fixed-term contracts, this clause is now out of date and unnecessary.

### Definitions

|  |   |
|--|---|
| <b><u>Estimated Annual Costs</u></b>             | <del>means the estimated annual cost of a tariff calculated using the methodology set out in the definition of Estimated Annual Costs</del> <u>has the same meaning as defined</u> in Standard Licence Condition 1. |
| <b><u>Relevant Cheapest Evergreen Tariff</u></b> | <del>has the same meaning as defined in Standard Licence Condition 1.</del>   |

### Requirement seven – Accuracy and updating tariffs

#### *Calculation methodology and assumptions*

- (E) Where a Service Provider provides a comparison for a time period, the estimated costs of all tariffs (including a consumer's current tariff) must be calculated as a default ~~using the methodology based on the definition of Estimated Annual Costs~~ in Standard Licence Condition 1.
- (F) ~~Where provided, estimated annual costs must be referred to as a 'Personal Projection'. Not used~~

#### *Calculation messaging*

- (H) At a minimum, a Service Provider must provide a link or message on the results page explaining ~~how estimated annual costs of tariffs are calculated, including:~~
  - i. ~~what is included in the Estimated Annual Costs, what it is and what it can be used for, and outlining any assumptions that have been made in its calculation that, if the consumer's fixed term tariff is coming to an end within 12 months from the date of calculation, the Personal~~

~~Projection methodology assumes that the consumer will take no action and be rolled onto their current supplier's Relevant Cheapest Evergreen Tariff when their fixed term tariff ends;~~

- ii. details of any alternative methodology where offered; and
- iii. that the consumer may incur a termination fee if switching to a new tariff.

*Displaying current tariff and spend details*

- (R) A Service Provider must give the consumer ~~the Estimated Annual Costs a Personal Projection~~ before the consumer completes a switch to a tariff through the Service Provider's Price Comparison Service.

## Appendix 4 – Summary of stakeholder feedback to working paper

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Five stakeholders provided written responses to the working paper and we had bilateral meetings with several others. All respondents supported us taking action to amend the current methodology, and most were broadly supportive of our proposed changes.

There were several issues on which respondents were split in their views, and where some recommended that we consider changing our proposals.

**Assumptions about consumption and future behaviour change:** Three respondents agreed that, as a default, the estimated annual cost should be based on a consumer's actual historic consumption where this is available. They felt that cost projections should be based on available data, not expected future behaviour change. One respondent suggested that suppliers could not yet be trusted not to game a methodology that allowed flexibility to make assumptions about what a consumer will use in future. They also said that in the case of the impact time-of-use tariffs, the evidence did not point towards there being enduring changes in consumer behaviour, which they say undermines the case for allowing expected future behaviour change to be factored into the estimate.

Three other respondents, however, argued that suppliers should be able to include expected future changes in behaviour where they have evidence to support. They suggested that without this flexibility, it would be more difficult to drive take-up of time-of-use tariffs. They also felt that, in certain cases, basing cost estimates on historical consumption may be misleading, for example where household circumstances had changed or energy-saving measures had been installed.

**Contingent discounts:** Four respondents argued that suppliers should be able to include contingent discounts – those that a consumer has to behave a certain way to receive – in the estimated annual cost. They said that, similar to expected changes in consumption above, where they have the evidence to suggest that a consumer will behave a certain way and thus get the discount then they should be allowed to include it to present the full benefits of the tariff. Two other respondents fully supported our proposed changes.

**Bundled products and services:** Three respondents suggested that they should be able to provide separately itemised cost estimates for the energy component of the bill and any bundled products or services. They argued that separating costs in this way would be easier for consumers to understand. Our previous discussions in relation to estimating annual costs have, however, shown that stakeholders generally recognise that separating the costs of bundled products or services could be misleading for consumers in certain cases. For example, if the cost of a bundle is excluded from the cost estimate then it may appear high up a comparison results table, when in fact it would be more expensive for the consumer than other deals.

**Consultation process:** Two respondents requested further engagement ahead of our statutory consultation. In light of the extensive consultation we have had on the issue of estimated annual costs over the past number of years, and the absence of any new evidence or arguments from stakeholders, we have decided it is appropriate that we move to statutory consultation stage in order to deliver changes as quickly as possible.

## Appendix 5 – Feedback on this consultation

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We want to hear from anyone interested in this document. Send your response to the person or team named at the top of the front page.

We've asked for your feedback in each of the questions throughout it. Please respond to each one as fully as you can.

Unless you mark your response confidential, we'll publish it on our website, [www.ofgem.gov.uk](http://www.ofgem.gov.uk), and put it in our library. You can ask us to keep your response confidential, and we'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. If you want us to keep your response confidential, you should clearly mark your response to that effect and include reasons.

If the information you give in your response contains personal data under the Data Protection Act 1998, the Gas and Electricity Markets Authority will be the data controller. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. If you are including any confidential material in your response, please put it in the appendices.

### General feedback

We believe that consultation is at the heart of good policy development. We are keen to hear your comments about how we've conducted this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Do you have any further comments?

Please send your comments to [stakeholders@ofgem.gov.uk](mailto:stakeholders@ofgem.gov.uk)