



Making a positive difference  
for energy consumers

Domestic gas and electricity suppliers, energy consumers and their representatives, and other interested parties

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## **Modification of the electricity and gas supply licences to change the rules relating to the Estimated Annual Cost for domestic consumers**

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 and compare their current tariffs with others.

One such tool that suppliers should provide to consumers is an estimate of their annual costs – a projection of the costs they are likely to pay on a given tariff. This estimate should be personalised and transparent, so that consumers can use it to confidently make the right tariff choice for them. To make the best use of the estimate, consumers need to be able to understand what it is, what it can be used for, and any assumptions that have been made in its calculation. This will help to ensure consumers can understand how their consumption or behaviour may impact on this estimate and affect their bill.

The current methodology that suppliers and Confidence Code-accredited comparison sites<sup>1</sup> are required to follow is prescriptive. The methodology sets out in detail how suppliers and comparison sites should factor in standing charges, unit rates, discounts and charges for bundled products or services.

We think that consumers will be better served by enabling suppliers and comparison sites to tailor the cost estimates they provide, while remaining consistent across certain criteria.

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 the increasing tariff innovation in the market means that the existing methodology needs to change to keep pace with current market rules and tariff offerings.

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 precise detail exactly *how* suppliers should go about doing so. Suppliers will, in many cases, be best-placed to identify and respond to their customer's needs and expectations without the need for prescriptive rules.

With this in mind, and following extensive stakeholder engagement and consideration of responses to our statutory consultation, we have decided to modify the electricity and gas

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<sup>1</sup> Our [Confidence Code](#) is a code of practice governing independent domestic energy price comparison sites. The Code insists that accredited sites follow key principles to ensure consumers using those sites will find the process of switching energy supplier easy and reliable.

supply licences to amend the current Estimated Annual Cost definition. The change will allow suppliers and comparison sites to come up with their own methodologies for estimating a consumer's annual costs, where they are required to provide one, as long as the estimate:

- Is personalised to the consumer, based on information that is reasonably available to the supplier or comparison site, and on 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);
- Includes non-contingent discounts and non-optional bundled charges, and excludes contingent discounts and optional bundled charges;
- Is applied consistently when used to provide the consumer with a comparison of different tariffs, such that the same assumptions, where relevant, are made for all tariffs that are being compared; and
- Is transparent, and accompanied by a description of the estimate 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.

By replacing the existing prescriptive methodology with one that is based on principles, we aim to make sure that the estimate is fit-for-purpose now and in future, when we expect initiatives such as smart meters and settlement changes to facilitate greater innovation by suppliers. In this way, we expect the new methodology will support, rather than constrain, tariff innovation.

The changes will also help to ensure that the estimate is capable of being adapted to consumer preferences and expectations, maximising its usefulness as a tool to help consumers engage. We expect suppliers and comparison sites to use the opportunity provided by this rule change and by new technologies, eg online calculators, to make it as easy as possible for consumers to make an informed choice of tariff for them.

We have carefully considered the responses to our November 2017 statutory consultation<sup>2</sup> and decided to proceed with the modifications proposed in the statutory notices, other than a minor change to the licence drafting in order to better express our policy intent in relation to the treatment of discounts. We do not generally envisage that it would be appropriate to take enforcement action in relation to the existing Estimated Annual Cost requirements directly affected<sup>3</sup> by this change during the 56-day implementation window. Suppliers and Confidence Code-accredited sites are therefore free to make changes as soon as practicable should they choose, before the licence modifications formally take effect.

The notification and decision documents, and a copy of the new Confidence Code document, are published alongside this letter.

## **Overview of consultation responses and way forward**

In our November 2017 statutory consultation, we proposed to allow suppliers and comparison sites flexibility to come up with their own methodologies for estimating a consumer's annual costs, as long as the estimate met certain criteria, or 'principles'.

We invited stakeholders to submit their views on our consultation proposals and to express any concerns they had with our recommendation. In particular, we requested their responses to three questions:

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<sup>2</sup> Ofgem, [Statutory consultation: Estimated annual costs for domestic consumers](#), November 2017

<sup>3</sup> By directly affected we refer only to the particular conditions and the particular amendments to those conditions which are shown in track changes in the accompanying modification notices.

- Did stakeholders agree with the changes we proposed to make to the Estimated Annual Cost requirements?
- Did stakeholders agree that we should require that the Estimated Annual Cost is always based, as a default, on actual historic consumption where this is available?
- Did stakeholders agree that we should aim to deliver within-channel consistency of results rather than full cross-market consistency?

We received 18 responses – from suppliers, consumer groups, third party intermediaries and consumers. We have published non-confidential responses on our website.<sup>4</sup> We provide a summary of responses followed by our proposed way forward below. We also provide clarification on certain points.

Stakeholders generally supported our intention to move away from a prescriptive formula for the Estimated Annual Cost and to give suppliers and comparison sites the opportunity to develop their own methodology, subject to certain criteria. There was broad agreement that the criteria we proposed to attach to the Estimated Annual Cost were the right ones. There were some differences of opinion. Several stakeholders called for a methodology that will generate identical results across the entire industry, while two suggested that suppliers should have complete freedom to factor their own assumptions into the calculation. We cover these points and others below.

### **Overall do stakeholders agree with the proposals to amend the Estimated Annual Cost set out in our statutory consultation?**

#### *Statutory consultation proposal*

We proposed to replace the existing prescriptive formula for calculating the Estimated Annual Cost with a simpler set of requirements that would enable suppliers and Confidence Code-accredited sites to develop their own methodology, subject to certain criteria.

#### *Stakeholder feedback*

Respondents were almost universally in favour of changing the existing methodology. Many recognised that there is unlikely to be a perfect formula that would work for in all cases, and suggested that the proposed methodology provided the right protections for consumers without stifling industry parties' ability to develop tailored calculations. One consumer group agreed with the strong criteria we proposed to place around the estimate, to ensure that we do not see a return to some of the poor practices observed in the past.

One respondent suggested that all discounts, whether contingent or non-contingent, should be excluded from the calculation. They suggested that all discounts should be presented to the consumer as separate itemised amounts. A different stakeholder requested that we clarify how one-off discounts would be treated under the proposed methodology.

Two respondents suggested that the estimate should not be annual. One recommended that costs should be projected over multiple years so that consumers are made aware of when they are being sold a set of initially-low rates that increase in later years. Another thought that consumers would prefer to receive estimates that are shorter, eg monthly, to align with their billing cycle.

Several respondents emphasised that our compliance monitoring would be important in ensuring that suppliers and comparison sites did not game the flexibility provided by the proposed methodology to their advantage, including by making their own projections more prominent than the Estimated Annual Cost.

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<sup>4</sup> Ofgem, [Statutory consultation: Estimated annual costs for domestic consumers](#), November 2017

A number of stakeholders raised concerns about our proposal to require suppliers and sites to always use actual historic consumption where this is available, and about the potential for results to diverge across the industry. We cover these points in later sections of this paper.

### *Way forward and rationale*

We believe that our proposals will provide strong protections for consumers in an area that has been prone to poor practice in the past, and ensure that consumers get an estimate of their annual costs that can accurately reflect the tariffs that are on the market now and in future.

Our proposed treatment of discounts is that all contingent or one-off discounts (eg prompt pay or loyalty discounts, or cashback) would be excluded from the estimate, and all non-contingent discounts would be included. This is consistent with what is currently set out in the licence. We consider that this proposal will ensure consumers get an estimate that includes those discounts they are certain to receive upon signing up to the terms and conditions of a tariff (eg some types of dual fuel and online account management discount), and that excludes those discounts that they would only get if they behave a certain way (eg paying on time, submitting meter readings, staying with the supplier for a certain length of time).

The estimate should also exclude one-off discounts, even where these are paid upfront. These are often used to encourage a consumer to switch via a certain site rather than to switch to a certain tariff. It would in any event be inappropriate to continue including these discounts in the calculation after they have been paid to the consumer, as doing so may give a misleading impression of their likely costs.

We have made minor revisions to the licence drafting in the notices published alongside this document to make clearer which discounts should be included and excluded from the Estimated Annual Cost.

As stated in our statutory consultation, we intend to continue to require the estimate to be annual, 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.

We would like to emphasise that suppliers and comparison sites are free to provide additional estimates, should they choose, covering different time periods or that communicate the discounts a consumer could receive by behaving a certain way. Where additional estimates are provided, consumers will continue to receive strong protections from the Standards of Conduct, which will ensure that they are treated fairly and receive information that is complete, accurate and not misleading.

We intend to monitor compliance with the new rules, which may include checks on suppliers websites and communications such as bills, and audits of Confidence Code-accredited sites, to ensure that suppliers and sites deliver the outcomes we expect to see for consumers. We encourage stakeholders to engage with us where they have concerns with the estimates provided by suppliers or comparison sites.

### **Use of actual historic consumption wherever this is available**

#### *Statutory consultation proposal*

We proposed to require suppliers and Confidence Code sites to base the estimate of annual costs on a consumer's actual historic consumption wherever this is available, or a best estimate of actual consumption where it is not.

### *Stakeholder feedback*

The majority of respondents agreed that cost estimates should be based on actual consumption where this is available. Some respondents noted that actual consumption would become more widely available in future as more consumers get smart meters, and this would provide a consistent basis for calculating costs across the industry. Others said that using actual historic readings was the best way of ensuring that the estimates are transparent and easy for consumers to understand.

Most respondents acknowledged that estimation may be needed in some cases, eg where actual readings weren't obtainable. However, they felt that to depart from actual readings where they are available could lead to consumer confusion. They noted that suppliers and comparison sites could provide additional estimates if they wanted to convey the potential benefits of changes in consumption patterns.

Two respondents disagreed with our proposal, and suggested that suppliers should have the ability to make assumptions about what a consumer's energy use is likely to be in future. They argued that this would, for example, help to communicate the potential benefits of switching to time-of-use tariffs to consumers.

### *Way forward and rationale*

We intend to proceed with our proposal to require suppliers and sites to use actual historic consumption information, wherever this is available, to calculate the Estimated Annual Cost.

We agree with stakeholders that the benefits of time-of-use tariffs should be clearly communicated to consumers. Estimates of annual cost can be a way of conveying to consumers what they are likely to pay on a given tariff, including time-of-use tariffs. However, we are concerned that consumers could easily be misled if estimates of annual cost include assumptions about how their future behaviour or consumption patterns might change if this is all that is provided.

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 well have to pay substantially more. We consider the risks associated with this outweigh the potential benefits. Consumer trust, and the prospects of wider take-up of time-of-use tariffs in future, is likely to be harmed if consumers inadvertently switch to a tariff that makes them worse off.

We consider that using historic actual consumption provides a consistent, transparent basis for estimating costs. Where suppliers or sites want to emphasise the benefits of behaviour change and time-of-use tariffs then they can provide additional estimates to consumers accompanied by suitable explanations.

## **Delivering within-channel consistency of results rather than full cross-market consistency**

### *Statutory consultation proposal*

In our statutory consultation, we proposed to include requirements that would ensure within-channel<sup>5</sup> consistency of results. This would mean that, on a comparison site for instance, consumers could be confident that the tariff costs presented to them are

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<sup>5</sup> We use the word 'channel' in this context to refer to, for example, an individual price comparison site, so providing for 'within-channel' consistency means that consumers will get like-for-like comparisons within that site, but would not necessarily get identical results across different comparison sites.

calculated on a like-for-like basis. We did not propose to develop a completely prescriptive methodology that would provide for full cross-market consistency.

### *Stakeholder feedback*

A majority of stakeholders agreed with our proposal. They felt that suppliers and sites should have the ability to adapt their calculations, though noted that they should be transparent about how they do so. One suggested that within-channel consistency would help consumers to make an informed choice of tariff for them, without introducing an overly-complicated methodology.

Several stakeholders felt that any solution that did not guarantee full-cross market consistency may confuse consumers and lead to mistrust. Some suggested that suppliers were more likely to have access to accurate information, and were particularly concerned about the scope for difference between sites and suppliers.

One respondent suggested that suppliers and comparison sites should provide two cost estimates to consumers – one representing the annual cost of their current tariff, the other showing the annual cost of the tariff they would roll onto if they don't switch in the meantime.

Another respondent suggested that suppliers and comparison sites should focus efforts on educating consumers on *why* differences in results may arise. Several stakeholders suggested that clear explanations and descriptions alongside the cost estimates could help to minimise any consumer confusion. One respondent requested guidance on what such an explanation should include.

One respondent suggested that suppliers and comparison sites should no longer provide savings figures at all. Instead they recommended that consumers should be provided only with a figure for the cost they may pay on a given tariff. They suggested that projections should be based on the cost over multiple years, to make sure that consumers are not misled by 'teaser rates' where the first year is relatively cheap and later years more expensive.

### *Way forward and rationale*

We intend to proceed with the proposals set out in our statutory consultation. By doing so, we will enable each individual supplier<sup>6</sup> and comparison site to develop a methodology that works for them and their customers, and ensure that consumers get like-for-like comparisons within that channel. This will help them to make an informed choice of tariff for them.

We acknowledge stakeholder concerns about the potential for confusion if consumers see different results in different places. However, we do not think it would be desirable or easily achievable to impose a single one-size-fits-all solution across all market participants. This would (i) prevent the calculation being adapted to consumer preferences, (ii) stifle the potential for the calculation to be improved over time, (iii) likely require frequent updates as new tariffs and technologies appear, and (iv) may stifle tariff innovation.

We expect suppliers and comparison sites to work hard to make sure that consumers understand the estimates that are provided to them. We do not intend to provide guidance on how the description should be worded. It is up to suppliers and comparison sites to make sure that the explanation they provide to consumers makes clear what is included in

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<sup>6</sup> For the avoidance of doubt, we consider that for the purposes of this paper a white label supplier can be considered as an individual supplier. We note, however, that the requirement for the Estimated Annual Cost to be applied consistently when providing consumers with a comparison of two or more tariffs would continue to apply. This may be relevant for calculating the cheapest tariff message to be included on bills and other communications.

the estimate, what it is, what it can be used for, and outlines any assumptions that have been made in its calculation.

We note that existing requirements under supply licence condition 31E.8 will continue to apply. This condition requires that, among other things, suppliers or their representatives (which may include comparison sites) must provide the Estimated Annual Cost at the same time as they provide Principal Terms. This includes before a consumer enters into a contract with the supplier. As suppliers and comparison sites may, following this decision, adopt different methodologies then they may need to consider the process by which they provide a consumer with all relevant information at or around the point of sale to ensure continued compliance.

More broadly, through our ongoing work to ensure consumers get effective prompts to encourage them to engage, among other initiatives, we aim to make sure that consumers are aware of the savings they could make and can get the right deal for them.<sup>7</sup> This work includes changes to renewal notices<sup>8</sup>, which may help to ensure that consumers don't inadvertently default onto a poor deal when their fixed-term tariff comes to an end.

## **Other general stakeholder comments and requests for clarification**

### **Require suppliers to provide information about default tariffs to comparison sites**

Two respondents suggested that suppliers should be required to provide information about default tariffs for customers at the end of fixed-term tariffs to comparison sites.

The focus of this decision is on setting the criteria by which suppliers and comparison sites should estimate a consumer's annual costs, rather than determining where to get the information to do so. Suppliers are currently required to make available tariff information to anyone that requests it (including comparison sites), so there are already some rules in place. However, we welcome further engagement with stakeholders should they feel that more could be done to facilitate better access to tariff information.

### **Implementation**

One supplier and one comparison site requested that we clarify whether suppliers and sites are able to proceed to make changes immediately. We are happy to clarify that suppliers and comparison sites can proceed to make changes immediately if they choose, as we do not generally envisage that it would be appropriate to take enforcement action in relation to the existing Estimated Annual Cost requirements directly affected<sup>9</sup> by this change during the 56-day implementation window. We have published an updated version of the Code alongside this decision letter.

### **Treatment of bundles**

One respondent suggested that they should be able to include the cost of optional bundles in the Estimated Annual Cost where the customer has requested this. We have considered this suggestion but decided not to amend the licence drafting to reflect it. As we have set out above, suppliers and comparison sites have flexibility to provide additional estimates and additional contextual information if they choose to, which would allow room for optional bundled costs to be covered.

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<sup>7</sup> Ofgem, [Consumer engagement work: trial results and next steps](#), November 2017

<sup>8</sup> Ofgem, [Market-wide derogation – Statement of Renewal Terms](#), December 2017

<sup>9</sup> By directly affected we refer only to the particular conditions and the particular amendments to those conditions which are shown in track changes in the accompanying modification notices.

## Licence and Code drafting

Alongside our November statutory consultation we set out our proposed licence and Confidence Code drafting to reflect the policy changes. Stakeholders suggested a number of potential changes:

- Refer within the definition to 'an estimate': One stakeholder suggested that the word 'calculation' should be replaced by the word 'estimate' to make clear what it is.
- Clarify that 'annual' refers to the duration and not the frequency of the calculation: One respondent suggested that the wording of the definition should be changed to make clear that the estimate should be for an annual cost, as opposed to being calculated annually.
- Clarify that we expect the Estimated Annual Cost to be more prominent than any other additional calculations the supplier chooses to provide: One supplier suggested including an additional clause in the definition to clarify that further estimates provided by suppliers or sites that don't meet the Estimated Annual Cost requirements should not be assigned greater prominence:
  - "(g) is given equal or greater prominence to any additional estimated cost projections provided to a Domestic Customer;"
- Suggested clarification to the scope of the 'applied consistently' requirement: One respondent suggested that our proposed clause (e) should be amended to read "is applied consistently *across the licensee's tariffs* when providing the Domestic Customer with a comparison of the relative cost of two or more Domestic Supply Contracts or Deemed Contracts".

We have considered these drafting suggestions and have decided not to reflect them in the licence drafting, as we consider the proposed drafting adequately reflects our policy intent. We consider that the proposed drafting makes clear that the Estimated Annual Cost is an estimate and that the duration it covers (rather than the frequency with which it is provided) should be annual. Should suppliers or sites make other, additional estimates more prominent than the Estimated Annual Cost then this is not likely to comply with our Standards of Conduct or SLC 25 informed choices principles. We do not consider the edit to the 'applied consistently' requirement necessary, as in some cases, eg on comparison sites, we expect that the estimate will be applied consistently across multiple suppliers' tariffs.

One respondent suggested that we clarify how one-off discounts such as cashback rewards should be treated for the purposes of the Estimated Annual Cost. They suggested expanding the definition to include additional clauses:

- "(f) excludes any One-Off Discount;"
- "One-Off Discount means a single monetary amount, or series of monetary amounts, which is provided to a Domestic Customer separately to the Domestic Supply Contract;"

We agree that our proposed new definition for Estimated Annual Cost could be improved to make clearer that one-off discounts should be excluded from the calculation. We have not used the precise drafting suggested by the respondent, but have updated our drafting in the decision notices published alongside this document to reflect the substance of their feedback.

One comparison site suggested that as we are giving Confidence Code-accredited sites some flexibility to come up with their own methodology, existing requirements 7G and 7J are no longer necessary.<sup>10</sup> Although comparison sites may wish to make changes to the

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<sup>10</sup> These requirements, respectively, allow comparison sites to provide consumers with alternative methodologies for estimating the cost of tariffs, and, where an alternative methodology is provided, requires sites to provide a



way they present cost estimates to consumers as a result of the change we are making today, we consider there are still potential benefits in retaining these requirements. Going forward, suppliers will have the ability to provide additional estimates if they want to emphasise the potential benefits of certain tariff features or of changes in consumer behaviour or consumption patterns. These requirements could offer that same flexibility to comparison sites, and so we intend to retain them.

## **Related initiatives**

### **Customer communications**

Two stakeholders noted the interdependency between the Estimated Annual Cost and the supplier-customer communications rule changes we are currently considering.

Our work on customer communications will consider issues such as where the Estimated Annual Cost should be provided to consumers, which we have not looked at as part of this decision. This is so that we can consider the rules relating to customer communications in the round. We recently issued a working paper<sup>11</sup> setting out our latest thinking on the changes we are considering, and will consult on a detailed set of proposals in the spring.

### **Confidence Code**

One supplier suggested that a broad review of the Confidence Code should be conducted to ensure it is fit for purpose in light of the findings of the CMA's recent investigations and other recent developments.

We will shortly consult on certain changes to the Confidence Code. We welcome stakeholder feedback should they consider there are areas in which the Code could be enhanced.

### **Cheaper Market Offers Letters**

One respondent noted the link between the Estimated Annual Cost and the information contained on the cheaper market offers letters that are currently being trialled<sup>12</sup>, as well as other prompts to engage.

The Estimated Annual Cost for different suppliers' tariffs may be included on cheaper market offers letters and other prompts to engage. We expect that our new requirement for the estimate to be applied consistently when providing a consumer with a comparison of the cost of different tariffs will continue to apply, even where these tariffs are from different suppliers.

## **Our decision**

For the reasons set out above, we are proceeding to amend the current Estimated Annual Cost definition. The change will allow suppliers and comparison sites to come up with their own methodologies for estimating a consumer's annual costs, where they are required to provide one, as long as the estimate:

- Is personalised to the consumer, based on information that is reasonably available to the supplier or comparison site, and on reasonable assumptions where actual data is not available;

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link on the results page allowing the consumer to switch from the default methodology to the alternative and vice versa.

<sup>11</sup> Ofgem, [Working paper: Domestic supplier-customer communications rulebook reforms](#), December 2017

<sup>12</sup> Ofgem, [Results from the Cheaper Market Offers Letter Trial](#), November 2017

- Is based on actual historic consumption wherever this is available (and a best estimate of consumption where it is not);
- Includes non-contingent discounts and non-optional bundled charges, and excludes contingent discounts and optional bundled charges;
- Is applied consistently when used to provide the consumer with a comparison of different tariffs, such that the same assumptions, where relevant, are made for all tariffs that are being compared; and
- Is transparent, and accompanied by a description of the estimate 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 do not generally envisage that it would be appropriate to take enforcement action in relation to the existing Estimated Annual Cost requirements directly affected<sup>13</sup> by this change during the 56-day implementation window. Suppliers and Confidence Code-accredited sites are therefore free to make changes as soon as practicable should they choose, before the licence modifications formally take effect.

Yours faithfully,

**Neil Barnes**  
**Associate Partner, Consumers and Competition**  
**Duly authorised on behalf of the Gas and Electricity Markets Authority**

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<sup>13</sup> By directly affected we refer only to the particular conditions and the particular amendments to those conditions which are shown in track changes in the accompanying modification notices.