

DEPARTMENT FOR
**BUSINESS, ENTERPRISE
& REGULATORY REFORM**

**CONSUMERS, ESTATE AGENTS AND
REDRESS BILL: MEASURES TO
STRENGTHEN AND STREAMLINE
CONSUMER ADVOCACY**

Partial Regulatory Impact
Assessment for extension of
redress schemes to the gas,
electricity and postal
services sectors.

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CONSUMERS, ESTATE AGENTS AND REDRESS BILL

Proposals to extend statutory redress schemes to the energy and postal services sectors under the Consumers, Estate Agents and Redress Bill.

Purpose and intended effect

1. The Consumers, Estate Agents and Redress (CEAR) Bill contains provisions to strengthen and streamline consumer advocacy. This includes the creation of a powerful consumer advocate, able to address consumer issues that frequently exist across sectors of the economy; and new, statutory, redress schemes to resolve consumer problems with their regulated gas, electricity, or postal services providers. The full Regulatory Impact Assessment setting out the costs and benefits of the measures was published in October 2006¹.
2. This partial Regulatory Impact Assessment looks in more detail at one particular aspect of the measures contained in that full Regulatory Impact Assessment; specifically, the options for, and the associated costs and benefits of, the scope of the redress schemes in terms of the subject matter of complaints that the schemes may consider and the description of the persons making the complaint.

Objective

3. The intention behind the requirement for regulated providers to be members of a redress scheme is to provide much greater effectiveness for consumers in resolving (rather than just handling) consumer problems. Currently, energywatch and Postwatch handle a proportion of consumer complaints in the energy and postal services sectors respectively, and continue to make a huge effort to provide consumers with assistance and support. In 2003/04, for example, a benchmarking study undertaken on behalf of the DTI, HM Treasury and the National Audit Office found that energywatch and Postwatch needed to devote respectively 41% and 18% of their budgets to handling complaints². Sectoral consumer bodies do not, however, have any powers to enforce resolution: they cannot order the service provider to provide compensation or redress.
4. As a consequence of the new arrangements to be brought in by the CEAR Bill, greater emphasis will be placed on regulated service

¹ Available at <http://www.dti.gov.uk/files/file34656.pdf>.

² PricewaterhouseCoopers, March 2004, Benchmarking Review of energywatch and Postwatch. Available at <http://www.dti.gov.uk/files/file25231.pdf>.

providers to resolve complaints to the satisfaction of the consumer. Where the service provider is unable to resolve the complaint, the complaint can be referred to the redress schemes for resolution. The decision reached by the scheme on each complaint will be binding on the service provider. Thus consumers have much greater assurance that should a complaint with a service provider arise, it will be resolved.

Background

5. The CEAR Bill contains measures to strengthen and streamline consumer advocacy. These measures include the creation of a more powerful and coherent consumer advocate (the new National Consumer Council) from energywatch, Postwatch and the existing National Consumer Council, and the extension of redress schemes to the energy and postal services sectors. The Bill would also place a duty on the regulators in the energy and postal services sectors (the Office of Gas and Electricity Markets (Ofgem) and the Postal Services Commission (Postcomm) respectively) to prescribe complaint handling standards in their sector.
6. Alongside the measures in the Bill, the telephone and online consumer advice service supported by the Office of Fair Trading – “Consumer Direct” – will be extended to provide a first point of contact for consumers in all sectors. This avoids consumers with enquiries and complaints first having to determine where to go for help. Consumer Direct will be able to provide help and advice about progressing a consumer’s complaint with their service provider. If the service provider is unable to resolve the complaint, the consumer is then able to take their complaint to a redress scheme.
7. The Bill gives the Secretary of State the power to require “regulated providers” of specified services to belong to a “qualifying redress scheme”. This is explained in the Bill as follows:
 - (a) regulated providers are licensed electricity suppliers, electricity distributors, gas suppliers, gas transporters, postal service providers; and – potentially in future – water undertakers, sewerage undertakers, or licensed water suppliers;
 - (b) a redress scheme means a scheme under which consumer complaints may be made to, and investigated and determined by, an independent person;

- (c) an independent person is one who is independent of the regulated provider and the relevant regulator for the sector; and
 - (d) a qualifying redress scheme is one which has been approved by the relevant regulator for the sector, or one which is administered by the Secretary of State.
8. Redress schemes provide consumers with the means to obtain resolution and redress for complaints in cases where the regulated provider has not been able to resolve the complaint to the consumer's satisfaction. The Bill specifies a minimum range of forms of redress which must be available to a complainant, comprising provision of an apology or explanation; payment of compensation; or taking such other action in the interests of the complainant as the independent person may specify.
 9. As is generally the case in existing redress schemes, the intention is that the schemes will consider complaints brought to them only where the regulated provider has first had the opportunity to resolve the complaint themselves. The determinations made by the schemes on a complaint would be binding on the regulated provider, and compensation or other forms of redress could be awarded where appropriate. The consumer would retain the right to pursue their complaint further if they wished to do so, through action in the courts, for example.
 10. It is envisaged that, if required to become members of an approved redress scheme, regulated energy and postal services providers will establish their own redress scheme(s). However, the Bill also confers a power on the Secretary of State to establish a redress scheme. This is to ensure that if industry has not established a scheme by the time the order to belong to one comes into force, the Secretary of State is able to establish one which industry can join, to avoid regulated providers being in breach of the order. However, we anticipate that industry will be keen to establish their own scheme(s), which will then give them control over the practical operational aspects of the scheme, such as the funding mechanism.
 11. All schemes (except those established by the Secretary of State) must be approved by the sectoral regulator. When deciding whether to approve a scheme, the regulator must take account of the criteria set out in the CEAR Bill. This includes consideration of the manner in which the scheme will be operated; the interests of relevant consumers; and generally accepted principles of best practice in relation to schemes for providing redress to consumers.

Rationale for government intervention

12. In competitive markets, companies will compete for business on either price or customer service, or both. Companies that don't take customer complaints seriously can be punished by customers switching to alternative suppliers. The pressure to attract and retain customers should therefore act as a powerful incentive for business to act responsibly and to take complaint handling seriously.
13. The gas and electricity markets were opened to competition in 1998/99, and there is evidence that customers are switching suppliers to get the best deal. For example, in 2006, over 4 million people switched energy supplier³. Active switching of suppliers indicates that customers are aware of the choices offered to them in a competitive supply market and that they are taking advantage of these choices. The fact that customer switching occurs is an indication that companies do not have substantial market power and risk losing customers if they raise prices above the competitive level.
14. However, switching rates are not necessarily an ideal indication of the competitiveness of a market, as a high switching rate may indicate that offers from competing suppliers have not reached the competitive level. This is the level where economic theory suggests that the tariffs and quality of service offered by competing suppliers are very close, thus not offering customers sufficient incentives to switch supplier.
15. Despite an unprompted recognition rate of only 4%, energywatch received 136,615 enquiries and handled 70,000 complaints⁴ in 2004/05. In 2005/06, the number of enquiries rose to 222,892, whilst the number of complaints fell slightly to 62,000⁵. The number of complaints received in 2006/07 remained stable at about 62,000⁶.
16. In 2005, after more than 8 years of competition, energywatch made a supercomplaint to the energy regulator, Ofgem, concerning the treatment of consumers by regulated gas and electricity suppliers in relation to billing. Ofgem determined that energy suppliers should establish a redress scheme to resolve outstanding billing disputes in a fair and independent way.

³ Ofgem press release, 23 April 2007, available at <http://www.ofgem.gov.uk/Media/PressRel/Documents1/Ofgem17.pdf>.

⁴ Energywatch Annual Report 2004/05, available at http://www.energywatch.org.uk/uploads/Annual_Report_2004_2005.pdf.

⁵ Energywatch Annual Report 2005/06, available at http://www.energywatch.org.uk/uploads/Annual_Report_2005_2006.pdf.

⁶ Energywatch management information.

17. The funding for energywatch comes from the energy industry, and ultimately therefore from energy consumers. However, the contribution from individual regulated energy providers is not related to the number of complaints handled by energywatch in relation to that provider. There is therefore very little incentive on regulated providers to reduce the number of complaints received about them by energywatch (other than any potentially negative impact on their reputation), as providers are able to free ride on the contributions from others.
18. In contrast, redress schemes generally receive the majority of their funding from case fees, which is therefore directly related to the number of complaints resolved in relation to each regulated provider. This gives control over the cost of handling complaints from their own customers back to the regulated providers, creating a real incentive to deal effectively with consumer complaints in the first instance in order to reduce the cost of onward referral.
19. In the postal services sector, the UK's mail market was opened to competition on 1 January 2006. However, in 2005/06, Royal Mail retained a 97% market share⁷ in the regulated addressed letters market. Market pressures to improve complaint handling in the postal services sector may therefore be fairly weak. Instead, the sectoral regulator – Postcomm – has a role to ensure that licensed postal operators, including Royal Mail, meet the needs of their customers throughout the UK.
20. The redress schemes to be established under the CEAR Bill, alongside the prescription of complaints handling standards by the sectoral regulators, should therefore ensure that consumers have their complaints dealt with more effectively by the service provider in the first instance, with the certainty of resolution through the redress schemes where the service provider has been unable to resolve the complaint satisfactorily.
21. Further, the cost of onward referral to a redress scheme provides a strong incentive for regulated providers to ensure that consumer complaints are dealt with effectively in the first instance. For example, the number of complaints received by Postwatch fell from about 34,000 in 2004/05⁸ to just over 18,000 in 2005/06⁹ and less than 11,000 in 2006/07¹⁰. Postwatch attribute part of this reduction

⁷ Postcomm website, available at <http://www.psc.gov.uk/competition/competitive-market-reviews.html>.

⁸ Postwatch Annual Report and Accounts, 2004-05, available at <http://www.postwatch.co.uk/pdf/policydocs/Annual%20Report%202004-05.pdf>.

⁹ Postwatch Annual Report and Accounts, 2005-06, available at <http://www.postwatch.co.uk/pdf/policydocs/Postwatch%20Annual%20Report%202005%20-%202006.pdf>.

¹⁰ Postwatch management information.

to the introduction of a Complaints Recharge Agreement with Royal Mail, whereby Royal Mail pays Postwatch an annual charge in proportion to the number of complaints they receive.

Consultation

22. The public consultation on the measures in the CEAR Bill to strengthen and streamline consumer representation took place between January and April 2006. The consultation asked for views on the benefits of extending redress schemes to the energy and postal services sectors. Nearly all respondents to that consultation agreed that it would be beneficial to extend complaint resolution through redress schemes to the energy and postal sectors, due to the clear benefits this would offer to both industry and consumers.
23. The Government response to the 2006 consultation stated that as a result of the views expressed in response to that consultation, the Government will make it a statutory requirement for regulated providers in the energy and postal services sectors to belong to approved redress schemes.
24. This Regulatory Impact Assessment therefore assumes that any requirement to belong to a redress scheme will apply to all regulated service providers in the energy and postal services sectors. However, the consultation document looks in more detail at the different classes of regulated providers in these sectors, and provides an opportunity to comment further.
25. We have discussed the proposals with Ofgem, the Energy Retail Association, energywatch, Postcomm, Royal Mail, the Mail Competition Forum, Postwatch and the National Consumer Council.

Options

Option 1: Do nothing

26. The CEAR Bill confers a power on the Secretary of State (rather than a duty) to make an order requiring regulated energy and postal services providers to belong to a redress scheme. The Secretary of State could therefore determine not to use this power. However, redress schemes are an integral part of the new arrangements provided for in the CEAR Bill, and are part of the package of measures which includes the prescription of complaint handling standards by the sectoral regulators.

27. The vast majority of responses to the consultation in 2006 on the measures in the CEAR Bill to strengthen and streamline consumer representation expressed the view that it would be beneficial to extend complaint resolution through redress schemes to the energy and postal sectors, due to the clear benefits this would offer to both industry and consumers.
28. The redress schemes are required in order to provide assurance to consumers of complaint resolution, and the provision of compensation or other forms of redress where warranted.
29. The cost of onward referral to a redress scheme also provides a strong incentive for regulated providers to ensure that consumer complaints are dealt with effectively in the first instance by the service provider, which would be lost in the absence of such schemes.

Option 2: Require redress schemes to handle complaints from all consumers in the energy and postal services sectors.

30. Option 2 would require a redress scheme(s) to be established in the energy and postal services sectors which had the authority to handle all complaints (regardless of subject matter) in these sectors. The scheme(s) could be used to obtain redress by all descriptions of consumers, including domestic consumers, small and medium sized enterprises and large businesses.
31. From a practical perspective, the types of complaints to be included within the scope of the redress scheme(s) to enable them to work effectively alongside other existing arrangements would include those which:
 - (a) have been considered by the service provider, and not resolved to the satisfaction of the consumer;
 - (b) relate to the regulated products and services of the service provider, as provided to the complainant, unless there is an established alternative route for resolution of the particular class of complaint;
 - (c) concern complaints about the way in which the service provider handled the initial complaint;
 - (d) concern complaints where there was no evidence to support the complaint, but which were not handled by the service provider in accordance with an established standard or code of practice.

32. An example of an alternative route for resolution of a particular class of complaint (as in (b) above) are the guaranteed standards of performance in the gas and electricity sectors, which provide for automatic compensation of specified amounts where consumers have suffered a loss of supply for a period. These forms of compensation are set out in regulations. The redress schemes do not need to cover the same ground, but might become involved in cases where compensation has not been paid under the regulations, and a consumer considers that it should have been.
33. Another example is that of disputes over charges quoted by gas or electricity distribution companies for connection to a network. In legislation, there is an established role for Ofgem to determine the charge in the event of a dispute. Therefore there does not appear to be a need for these complaints to be resolved by a redress scheme.
34. An example of a complaint where there is no evidence (as in (d) above), might involve a consumer posting a letter which is then lost in the post, but where there is no receipt for the collection of the letter by the postal system and no evidence of it having been posted. In these cases, the regulated service provider could have a code of practice for dealing with the complaints, or the issue could be covered in complaint handling standards set by the regulators. Referral of a complaint to the redress scheme could then be made on an administrative basis: that the regulated provider failed to follow the code of practice or standard.

Option 3: Require redress schemes to handle complaints from domestic consumers and micro-enterprises.

35. Under this option, redress schemes would need to be established in the gas, electricity and postal services sectors which could be used by domestic and micro-enterprise consumers, where:
 - (a) domestic consumer means an individual who purchases, uses, or receives, in Great Britain, goods or services which are supplied in the course of a business by a regulated provider, or an individual in Northern Ireland who purchases, uses or receives postal services from a regulated provider; and
 - (b) micro-enterprise consumer is an enterprise with a headcount of less than 10, and whose annual turnover and/or annual balance sheet total does not exceed €2 million.
36. There is an argument that micro-enterprises have the same lack of commercial power as domestic consumers. In gas and electricity markets, micro-enterprises may have similar levels of energy

consumption as larger domestic consumers, for example. The smallest business consumers may face very similar problems and have similar complaints to those of domestic consumers.

37. In 2005, 95.2% of all enterprises in the UK had less than 10 employees¹¹. This option would therefore require regulated providers in the energy and postal services sectors to establish redress schemes which could be accessed by about 95% of enterprises in the UK in order to achieve complaint resolution and redress.
38. In the case of both domestic and micro-enterprise consumers, it is envisaged that complaints could be accepted from persons – including agents – acting on behalf of the consumer.
39. An alternative to the use of the micro-enterprise definition is to delineate the definition of consumers to have access to the redress schemes on an individual basis, with different criteria for a scheme covering gas and electricity from one dealing with postal services. However, the possible need for a redress scheme for the water industry in England and Wales after the Government consultation in 2008 should also be taken into account. Further, this definition is also consistent with some other existing redress schemes, such as those in the electronic communications sector (the Office of the Telecommunications Ombudsman (OTELO) and the Communications and Internet Services Adjudication Scheme (CISAS)). Adopting a common definition across sectors avoids creating uncertainty for consumers over whether they are eligible for their complaints to be considered by redress schemes for different sectors.
40. The types of complaints to be covered would be the same as for option 2.

Sectors and groups affected

41. The sectors affected are the gas, electricity and postal services sectors. The regulated providers in these sectors would be required to belong to a redress scheme once the Secretary of State has made the order under the CEAR Bill. “Regulated providers” are defined in the Bill as licensed electricity suppliers, electricity distributors, gas suppliers, gas transporters and postal service providers.
42. Consumers in the energy and postal services sectors would also be affected. Consumers would have the assurance that if their service provider is unable to resolve their complaint, it can be taken to a

¹¹ SME Statistics 2005, Small Business Service, available through <http://www.dtistats.net/smes/200612/index.asp>.

redress scheme whose decision is binding on the provider, and who can offer compensation or other forms of redress as appropriate. Consumers would include not only domestic consumers but also micro-enterprise consumers. Large business consumers of energy and postal services would also be affected under option 2.

Devolution

43. Issues concerning the postal services sector are reserved, such that, for example, Postwatch currently has a remit to represent consumers throughout the United Kingdom. We therefore propose that the redress scheme(s) in the postal services sector should also have a remit to consider complaints from consumers throughout the UK.
44. In the energy sector, energywatch currently has a remit which covers Great Britain only – energy consumers in Northern Ireland are represented by the General Consumer Council in Northern Ireland. We therefore propose that the redress scheme(s) in the energy market will apply to energy consumers in Great Britain only.

Funding

45. It is intended that the redress schemes will be funded by the members of the scheme, who will decide and agree upon the funding structure for their scheme. However, we expect that they are likely to follow a similar pattern to existing redress schemes, where a subscription fee (typically based on the size of the firm or its turnover) is levied, coupled with a case fee that is payable by each member for every case referred to the scheme. The scheme is then free to consumers.
46. The redress schemes are expected to operate on a cost recovery basis. General practice is for fees to be set at a level to cover the costs of the scheme, based on an anticipated number of complaints. Fees can be reviewed on a regular basis and adjusted to reflect any differences in the actual number of complaints received from the estimated levels of complaints.
47. Similarly, any scheme administered by the Secretary of State would operate purely on a cost recovery basis and would not be profit making – any subscription costs or case fees charged to members of the scheme would be set at a level and periodically adjusted in order to only cover the costs of running the scheme.

Benefits

48. The benefits given below are only indicative at this stage. **We would welcome views, especially those supported by quantifiable evidence, on the likely benefits of the different options.**

Option 1: Do nothing

49. This option would not result in any additional benefits, although it would avoid the costs associated with the other options, as set out in the costs section below. However, consumers would not benefit from certainty of complaint resolution or the provision of compensation or other forms of redress where warranted.
50. Further, if in the absence of redress schemes, it was decided to maintain the complaint handling role of Postwatch and energywatch, industry would continue to be required to fund this activity, and would not benefit from the cost savings associated with the measures as a whole¹².

Option 2: Require redress schemes to handle complaints from all consumers in the energy and postal services sectors.

51. Extending the availability of redress schemes to complaints in the energy and postal services sectors would produce the following benefits for consumers:
- strong incentive for regulated providers to resolve complaints effectively and efficiently in the first instance, due to the cost of onward referral to the redress scheme for each complaint referred;
 - consumers have certainty of resolution of a complaint, as decisions are binding on the regulated providers (but not on the consumer);
 - compensation or other forms of redress (such as an explanation or an apology) for consumers where this is warranted;
 - quicker resolution of complaints for consumers as companies would have to resolve the complaint within a set period of time or the complainant could go to the redress scheme. Redress schemes, in general, get complaints resolved quicker than the

¹² For an assessment of the costs and benefits associated with the measures as a whole, see the full Regulatory Impact Assessment, available at <http://www.dti.gov.uk/files/file34656.pdf>.

courts as they have targets on the time taken to make a decision on a case; and

- the service is entirely free to consumers.
52. Under option 2, these benefits would accrue to all consumers (including all business consumers) of energy and postal services.
53. The regulated providers who are the members of the redress scheme may also benefit from membership. For example:
- consumer access to a redress scheme that can offer certainty of redress will enhance a customer's confidence in purchasing a service should the situation arise whereby the customer has a complaint with the service received;
 - in more competitive markets, treating complaints seriously and having a reputation for excellent customer service may be a deciding factor for customers when choosing a provider;
 - the cost of the redress scheme(s) is borne by the relevant regulated providers who therefore gain control of the administrative costs of complaints resolution;
 - a redress scheme will provide a valuable way of resolving burdensome and difficult complaints – in the long run it may save time and resource to have a dispute dealt with outside the company; and
 - although the redress schemes will not create new rules for the performance of functions by regulated providers, the process of resolution of complaints by the redress schemes will provide valuable feedback for the regulated providers. This feedback should inform their own internal policies and procedures, enabling regulated providers to avoid similar difficulties with other consumers and improve both their own commercial performance and, importantly, their general standard of performance to consumers.
54. Further, the redress schemes, along with the extension of the Consumer Direct service to consumers in the energy and postal services sectors, will replace the industry funded complaint handling role of energywatch and Postwatch. In 2003/04, energywatch and Postwatch needed to devote £5.3 million and £1.9

million respectively (41% and 18% of their total budget)¹³ to handling complaints.

Option 3: Require redress schemes to handle complaints from domestic consumers and micro-enterprises.

55. The benefits outlined above under option 2 for regulated providers would also accrue under option 3. The benefits for all consumers under option 2 would accrue to domestic and micro-enterprise consumers under option 3; the difference between the two options is that under option 3, there would be no additional benefit over and above the existing system for larger business consumers.
56. However, it is likely that it would be micro-enterprises, who make up about 95% of all businesses in the UK, that would take most advantage of having access to external help with their complaints. For example, energywatch report that over 95% of their current total monthly contacts from business are from businesses with less than 10 employees¹⁴. Many larger business consumers will have sufficient commercial power to resolve problems direct with regulated providers and will not want to seek redress through statutory redress schemes. Their services may be provided under contracts, backed up by specialist staff with the skills to monitor and assess the performance of the service providers against these contracts.
57. These larger business consumers are therefore likely to be able to use their commercial position to resolve complaints, or to have the freedom and expertise to seek alternative service providers. For such consumers, access to a redress scheme for when things go wrong may not provide any significant additional benefit.
58. It is therefore anticipated that the benefits associated with option 3 are about the same as for option 2.

Question 1: Do you agree with the initial assessment of the benefits of the proposed options? Please provide quantifiable evidence where possible to support this view.

Costs

59. The costs set out below are only indicative at this stage. **We would welcome views, especially those supported by quantifiable evidence, on the likely costs of the different options.**

¹³ DTI and HM Treasury report (July 2004), "Consumer Representation in Regulated Industries" (available at <http://www.dti.gov.uk/files/file25252.pdf>).

¹⁴ energywatch management information.

Option 1: Do nothing

60. This option would not result in any additional costs to industry. However, there would be a potential cost to consumers in terms of not having recourse to an independent arbitrator if the service provider is unable to resolve the complaint satisfactorily.
61. The requirement in the CEAR Bill for Ofgem and Postcomm to prescribe complaint handling standards that are binding on regulated providers in their sectors should ensure that this cost is lower than it would otherwise be. However, there is likely to be a proportion of complaints which, for whatever reason, cannot be resolved between the service provider and the consumer.

Option 2: Require redress schemes to handle complaints from all consumers in the energy and postal services sectors.

Policy costs

62. On behalf of the DTI, KPMG produced an estimate of the likely cost to regulated providers in the energy and postal services sectors of extending redress schemes to these sectors. The estimate is based on the level of complaints received by energywatch and Postwatch in 2005/06 which would fall within the likely terms of reference of a redress scheme, and takes account of the existence of the Energy Supply Ombudsman scheme established by the Energy Retail Association on 1 July 2006¹⁵.
63. The estimate suggests that regulated providers in the energy and postal services sectors will face total set-up costs of about £0.4 million. This is based on industry making use of existing schemes through expansion, rather than setting up an entirely new scheme. If industry were to establish an entirely new scheme, set-up costs may be higher. For example, the set-up costs in 2003 for the electronic communications ombudsman – Otelo – amounted to £1.3 million.
64. KPMG also estimated an ongoing total running cost of the required scheme(s) of about £2.2 million per annum, to be split between regulated providers in the energy and postal services sectors. (This compares to Otelo, which had administrative expenses totalling £1.4 million in 2004/05 – a 36% lower budget to resolve an estimated 21% fewer complaints.)

¹⁵ However, any redress scheme in the energy sector would need to be approved by Ofgem against the criteria set out in the CEAR Bill to ensure that it qualified as a statutory scheme under the provisions in the Bill.

Administrative costs

65. There will be an additional cost to Ofgem and Postcomm of approving a redress scheme(s) (which will be a one off cost for each scheme approved) and monitoring of the scheme's ongoing compliance with the approval criteria. The total cost of approval and monitoring will depend on the number of schemes approved.

Option 3: Require redress schemes to handle complaints from domestic consumers and micro-enterprises.

Policy costs

66. The cost of option 3 would differ from option 2 in that the redress schemes established by industry would only be required to resolve complaints from domestic consumers and micro-enterprises.
67. Enquiries and complaints from all business consumers account for about 10% of the total currently received by energywatch¹⁶ (energywatch currently receives around 2,000 contacts a month and dealt with just under 5,000 complaints in 2006/07 from businesses). Similarly, just less than 10% of complaints received by Postwatch (about 950 in 2006/07) are from business¹⁷.
68. Option 3 would require redress schemes to be established that handle complaints from micro-enterprises, but not those from larger businesses. Based on current trends in complaint numbers, redress schemes under option 3 could therefore be required to handle up to 10% fewer complaints than under option 2, depending on the number of complaints within this 10% that are from micro-enterprises.
69. It is anticipated that the vast majority of complaints from business are likely to come from micro-enterprises with less than 10 employees. Larger businesses are more likely to have the experience and resources required to get the best deals from the market and to obtain effective resolution of their complaints when they arise. This suggests that, of the 10% of complaints received from business, the majority are likely to be from micro-enterprises.
70. Given that the difference in the number of complaints received by the redress scheme(s) under options 2 and 3 is only likely to be up to 10%, and that some of the set-up costs of each redress scheme will only have a weak link to the number of complaints likely to be received (such as scheme development costs and consultancy

¹⁶ Energywatch management information.

¹⁷ Postwatch management information.

advice), it is assumed that the set-up costs under option 3 are likely to be roughly the same as for option 2, of about £0.4 million.

71. The running costs of a redress scheme, however, may be more directly related to the number of cases handled by the scheme. The redress schemes under option 3 would be required to handle up to 10% fewer cases than under option 2. Assuming a direct relationship between running costs and the number of cases therefore implies a running cost under option 3 of between £1.98 million per annum (£2.2 million minus 10%) if all business complaints are from larger businesses, and £2.2 million if all business complaints are from micro-enterprises with less than 10 employees.
72. In practice, it is envisaged that the actual cost will be nearer the upper end of this range (£2.2 million). However, the cost of option 3 is expected to be slightly lower than under option 2 as there will be a level of cost associated with ensuring that the redress scheme(s) are in a position to handle complaints from large business (e.g. staff training in issues relevant to larger business consumers), even if few complaints from this description of consumers are expected to be referred.

Administrative costs

73. As with option 2, there will be an additional cost to Ofgem and Postcomm of approving a redress scheme(s) and monitoring the scheme's ongoing compliance with the approval criteria.
74. The total cost of approving the redress scheme(s) will be dependent on the number of schemes approved, rather than the coverage of individual schemes. The slightly narrower scope of the schemes required under option 3 (compared to option 2) could potentially lead to regulated providers establishing fewer redress schemes, which would lead to a lower administrative cost on the regulators associated with option 3 than for option 2. Alternatively, the same number of schemes could be established under both options. In this scenario, the scope of the scheme would be wider under option 2 than option 3, but the cost to the regulator of approving and monitoring the scheme would be more or less the same under both options.

Question 2: Do you agree with the initial assessment of the costs of the proposed options? Please provide quantifiable evidence where possible to support this view.

Summary of Costs and Benefits

Option	Costs	Benefits
Option 1: Do nothing	No additional costs. However, the cost savings from the consumer advocacy measures in the CEAR Bill would not be fully realised.	No additional benefits.
Option 2: Require redress schemes to handle complaints from all consumers in the energy and postal services sectors.	One-off set-up costs to the energy and postal services industry of about £0.4 million. Ongoing cost to industry of about £2.2 million per annum.	All consumers have certainty of complaint resolution and compensation or other forms of redress where warranted. Redress schemes are also part of a package of measures estimated to save industry (and ultimately therefore consumers) up to £9m per annum.
Option 3: Require redress schemes to handle complaints from domestic consumers and micro-enterprises.	One-off set-up costs to the energy and postal services industry of about £0.4 million. Ongoing cost to industry of between £1.98 and £2.2 million per annum.	Domestic and micro-enterprise consumers have certainty of complaint resolution and compensation or other forms of redress where warranted. Redress schemes are also part of a package of measures estimated to save industry (and ultimately therefore consumers) up to £9m per annum.

75. Options 2 and 3 offer a very similar level of benefit, as the additional benefit associated with option 2 over option 3 which would accrue to medium and large businesses is thought to be marginal. However, the cost of option 2 compared to option 3 is expected to be slightly higher. Option 3 is therefore preferred to option 2.
76. The cost of option 3 is higher than option 1. However, redress schemes are part of a package of measures to be brought in by the CEAR Bill. The measures as a whole are estimated to save industry up to about £9 million per annum¹⁸, whilst creating a stronger consumer advocate to represent the interests of consumers. Introducing redress schemes to the energy and postal services sectors will also offer substantial benefits to consumers, in terms of creating certainty of complaints resolution, and the award of compensation or other forms of redress where warranted.
77. The benefits of option 3 are therefore expected to significantly outweigh the costs of transition to the new arrangements. While

¹⁸ See the full Regulatory Impact Assessment for the entire package of measures, available at <http://www.dti.gov.uk/files/file34656.pdf>.

option 1 would avoid these costs, it would also not result in the benefits offered by option 3, including the ongoing savings associated with the measures as a whole.

78. The preferred option is therefore option 3.

Small Firms Impact Test

79. Members of each redress scheme will need to agree a mechanism for funding the scheme which covers its costs of operation. Existing schemes are typically funded by a subscription fee paid by each member and a case fee for each complaint referred.
80. In terms of the case fee, each regulated provider can to a large extent control their costs by ensuring that most complaints are resolved internally, without the need for onward referral to the scheme. The best performing service providers will face the lowest costs – the Financial Ombudsman Service, for example, does not charge for the first two cases they deal with in a year from the same member – whilst those performing less well will be incentivised to improve their internal complaints handling systems to reduce the amount paid to the redress scheme in case fees.
81. The subscription fees, on the other hand, are generally payable by all members of a scheme, regardless of the number of complaints referred. In this way, smaller service providers in the energy and postal services sectors could potentially face a proportionately higher cost of membership than larger providers.
82. Existing redress schemes generally attempt to avoid this by setting a subscription fee based on firm size or turnover. For example, for businesses regulated by the Financial Services Authority, the levy for membership to the Financial Ombudsman Service ranges from around £100 a year for a small firm of financial advisers, to over £300,000 for a high-street bank or major insurance company¹⁹. The subscription fees for members of the Office of the Telecommunications Ombudsman (Otel) are related to the retail value of the services and products covered by the ombudsman service, and range from £90 to over £675 a year²⁰. The Communications and Internet Services Adjudication Scheme (CISAS) charges members a subscription fee based on annual turnover, from £100 plus VAT to over £750 plus VAT²¹.

¹⁹ Financial Ombudsman Service website, available at http://www.financialombudsman.org.uk/faq/businesses/answers/funding_a1.html.

²⁰ Otel website, available at <http://www.otelo.org.uk/downloads/otelo-schedule-of-chargesApril2007.pdf>.

²¹ CISAS website, available at http://www.cisas.org.uk/Joining_CISAS.asp.

83. The CEAR Bill requires regulators to have regard to the provisions of each redress scheme submitted for approval, and this would include the funding provisions of each scheme. Further, when approving a scheme, regulators should follow the principles of good regulation, as set out by the Better Regulation Executive²², such as proportionality and targeting, to ensure that no unintended consequences will result from the funding mechanism of the redress scheme being put forward for approval. Regulators will therefore need to ensure that any subscription costs take account of the impact on smaller members of the proposed redress scheme.
84. Small firms in sectors other than energy and postal services should benefit under both options 2 and 3, as consumers of energy and postal services. These benefits, such as certainty of independent complaint resolution and the provision of compensation or other forms of redress where appropriate, are set out in more detail in the benefits section above.
85. Given that the regulators must take account of the impact on small firms when determining whether to approve a proposed redress scheme, we do not consider that there should be a significant impact on small firms in the energy and postal services sectors from these proposals. Small firms in other sectors should benefit as consumers of energy and postal services.

Question 3: Do you agree with the assessment of the impact of the proposals on small firms? We would welcome, in particular, representations from small firms on the impact of the proposals.

Competition Assessment

86. The proposals would have an impact on regulated providers in the energy and postal services sectors in that they would be required to be members of an approved redress scheme, and would therefore have to pay a fee to contribute towards the cost of the scheme. As industry itself will be setting up the scheme(s), the fees will need to be agreed by all member firms.
87. It is therefore unlikely that the fees will be set at levels that will affect competition between firms in the same sector. If charges for a particular scheme are considered to be too high, firms will have the option of either joining a different scheme, or establishing a new one.

²² See http://www.cabinetoffice.gov.uk/regulation/consultation/consultation_guidance/planning_a_consultation/principles_good_regulation.asp.

88. However, as noted above, redress scheme subscription charges that disproportionately impact on small firms would be detrimental to competition. Again, any redress scheme will need to be approved by the relevant sectoral regulator who is required to have regard to the provisions of the scheme when granting approval, and who should follow the principles of good regulation to ensure that the risk of any such unintended consequence does not materialise.
89. Another concern in relation to competition may arise if firms are asked to pay more for consumer representation in their sector, which could deter firms from entering the market or cause existing firms to withdraw from the market due to higher costs.
90. However, the total amount of funding required from service providers in the energy and postal services sectors for consumer representation under the new arrangements (of which the redress schemes are a part), is estimated to be significantly less than providers in these sectors pay for the current system.
91. Thus in the energy sector, it is not envisaged that existing service providers will withdraw from the market due to higher costs, as costs will be lower overall. Similarly, new entrants to the market will be required to contribute less towards the new system of consumer representation than they would under the current system.
92. In the postal services sector, only Royal Mail currently funds Postwatch under the terms of its licence issued by Postcomm. Under the new arrangements, Postcomm will continue to determine which service providers contribute towards the cost of consumer representation, and the extent of that contribution. However, under options 2 and 3, other service providers in the sector may be required to belong to a redress scheme, with an associated cost. Given the estimates in the costs section above for the likely cost of the scheme(s), and that (as noted above) it is envisaged that any subscription cost will be related to firm size or turnover (and thus ability to pay), it is not envisaged that the cost of membership to the redress scheme will be sufficient to deter new entrants to the postal services market.
93. It may be argued that a requirement for all regulated providers in a sector to belong to an approved redress scheme reduces the ability of those firms relying on good customer service to compete, as to a certain extent it brings all regulated providers up to a similar level of customer service. However, the emphasis of the new arrangements is on regulated providers dealing effectively with consumer complaints in the first instance, without the need for

onward referral to a redress scheme. Regulated providers are therefore still free to compete on levels of customer service **before** complaints reach the point at which they need to be escalated to the redress scheme.

94. Further, ensuring that all regulated providers in the sector are members of a redress scheme may improve competition, as consumers considering switching provider are assured that if they do have the need to complain, that complaint will ultimately be resolved and compensation or other forms of redress awarded as warranted, whichever provider they may choose to switch to.
95. Overall, therefore, we do not anticipate that the proposed measures will have a significant effect on competition in any of the sectors affected by the proposals.

Question 4: Do you agree with the assessment of the impact of the proposals on competition?

Enforcement, sanctions and monitoring

96. The CEAR Bill amends the Gas Act 1986 (c. 44); the Electricity Act 1989 (c. 29) and the Postal Services Act 2000 (c. 26) to enable Ofgem and Postcomm to enforce membership of an approved redress scheme in the same way as they currently enforce other relevant requirements and licence conditions.
97. This means that, first, regulators may make such provision by order as is needed for the purpose of securing compliance with the requirement or condition. Second, the sectoral regulator may fine the regulated providers who refuse to belong to an approved statutory redress scheme up to 10% of turnover.
98. Ofgem and Postcomm will monitor compliance with the requirement to be a member of a redress scheme, and will also monitor each redress scheme(s) to ensure that it continues to meet the criteria set out in the Bill, and any further detailed criteria established by the regulator. For example, Ofcom undertook a review in 2005 of the Alternative Dispute Resolution procedures it had previously approved, and Ofgem will shortly be undertaking a review of the existing voluntary Energy Supply Ombudsman service to ensure that it continues to work effectively for consumers.

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