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BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-29-02

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IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473

and

An Application by BC Gas Utility Ltd.
for the Disposition of Property and
Approval of Customer Care Agreements

BEFORE: P. Ostergaard, Chair)
K.L. Hall, Commissioner) April 17, 2002
R.D. Deane, Commissioner)

O R D E R

WHEREAS:

A. On December 21, 2001, BC Gas Utility Ltd. ("BC Gas", "Utility"), pursuant to Section 52 of the Utilities Commission Act, applied to the British Columbia Utilities Commission ("the Commission") for approval for the disposition of its partially-completed Program Mercury and other customer care related assets to BC Gas Inc., pursuant to an Asset Transfer Agreement; and

B. BC Gas Inc. would transfer those assets to a limited partnership between itself and Enbridge Inc. ("CustomerWorks"), which would perform customer care services including call handling, billing, metering, payment processing, and credit and collection; and

C. BC Gas also requests approval of two agreements with CustomerWorks: a Client Services Agreement for the provision of customer care services, and a Shared Services Agreement for the provision of corporate support services; and

D. BC Gas seeks such approvals effective December 31, 2001 but states that, pending any Commission determination, it will complete only those parts of the transaction that can be unwound; and

E. Prior to the Application, the Commission retained the services of Douglas Louth Associates Inc. ("DLAI") to carry out a formal review of BC Gas' plans; and

F. DLAI subsequently assisted BC Gas to negotiate, draft and finalize the Agreements; and

G. On January 8, 2002, DLAI provided its Report on the review; and

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H. By Order No. G-02-02 the Commission scheduled a Workshop for Tuesday, January 29, 2002 and a written public hearing process into the Application and related agreements; and

I. Submissions were received from registered intervenors and replied to by BC Gas; and

J. The Commission has considered the Application and all of the submissions and finds that approval of the Application is in the public interest.

NOW THEREFORE the Commission orders as follows:

1. The Commission, pursuant to Section 52, approves the disposition of the BC Gas Program Mercury and other customer care related assets to BC Gas Inc., effective December 31, 2001, in accordance with the Asset Transfer Agreement.

2. The Commission approves the two agreements with CustomerWorks, being a Client Services Agreement for the provision of customer care services, and a Shared Services Agreement for the provision of corporate support services, effective December 31, 2001.

3. BC Gas is to provide a Report and Recommendation to the Commission for review prior to the renewal of contracts with CustomerWorks in 2007 or before committing to another service provider.

4. Any significant improvement initiatives or scope changes pursuant to the Client Services Agreement are to be submitted to the Commission for review.

5. Reasons for Decision are attached as Appendix A to this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 17th day of April 2002.

BY ORDER

Original signed by:

Peter Ostergaard
Chair

Attachment

BC GAS LTD.
An Application for the Disposition of Property and
Approval of Customer Care Agreements

REASONS FOR DECISION

1.0 BACKGROUND

BC Gas Utility Ltd. ("BC Gas", "Utility") provides sales and transportation services to more than 760,000 residential, commercial and industrial customers in more than 100 communities throughout the Province. The BC Gas distribution network delivers gas to approximately 90% of the natural gas customers in British Columbia. BC Gas also provides a number of "customer information systems" ("CIS") or "customer care services" including call handling, billing, meter reading, payment processing and credit and collections. Customers in the Interior have been supported largely by BC Gas' in-house systems. For the Lower Mainland network, purchased from British Columbia Hydro and Power Authority ("B.C. Hydro") in 1988, customer care services in this area continue to be provided by B.C. Hydro.

Both customer billing systems were aging and inflexible, with the information being of limited quality and difficult to access. BC Gas considered that both would be unable to support increasing customer demand for detailed information and choices in services, rates, and providers. However, an attempt in 1991 to develop a new custom-built CIS (the Theseus Project) as part of a consortium of Canadian gas utilities failed in 1994 after cost estimates and development schedules dramatically increased.

In 1995, a team was formed to assess the CIS market, develop a new customer care approach, and recommend system alternatives. As there were no viable outsourcing options available in Canada at that time, BC Gas ran a pilot project covering 26,000 customers in Prince George ("Project Pathfinder") to assess the viability of a customer information system obtained from Peace Computers. This was originally developed for utility companies in New Zealand, together with call handling and scheduling and dispatch software systems.

After the success of the pilot project in 1998, BC Gas applied to the British Columbia Utilities Commission ("Commission") on March 22, 1999 for a Certificate of Public Convenience and Necessity ("CPCN") for approval of Program Mercury, which consisted of a customer information system and call handling technologies, together with patriation of BC Gas customers from B.C. Hydro. The new, packaged system was designed to interface with other key BC Gas service delivery systems in two stages, at an expected cost of approximately $33.2 million. BC Gas' then-current annual direct operating cost of $20.77 per customer was expected to decrease. This cost does not include other administration and capital costs comparable to the fees being considered in the current application.

As part of its supporting business plan for Program Mercury, BC Gas did an assessment of outsourcing possibilities involving B.C. Hydro, Canadian Utilities, Enlogix, UtiliCorp and others, but concluded that B.C. Hydro's customer care plans and directions were unclear and that the market was still very immature. The application also noted that almost every option available to BC Gas in addressing its customer care requirements involves moderate to high business risk.

Intervenors into the BC Gas rate application process had been briefed by the BC Gas Program Manager at the November 18, 1998 Annual Review. However, none of the intervenors at that time expressed interest in further review of the program. After review of the costs, timing and justification of Program Mercury, the CPCN application was approved by Commission Order No. C-7-99. The Order required BC Gas to provide the Commission with quarterly updates of the project and a final project cost report in accordance with a format agreed to by Commission staff. The Order stated that the Commission would review the required final report with respect to capital costs, overhead allocation and any cost over-runs in order to determine eligibility for rate base treatment. BC Gas provided a number of updates to the Commission and continued to inform intervenors of the status of the program expenditures in subsequent Annual Reviews.

Although the decision was made to proceed with Program Mercury, the CPCN application noted that three key risks remained:

1. Long-term support and viability of Peace Computers;
2. Scalability of the entire customer care solution; and
3. BC Gas' organizational readiness and ability.

The first stage of Program Mercury (CS-I) was structured to convert the 250,000 Interior customers to a single customer care environment, together with a BC Gas call centre in Kelowna. Updates continued to show that the project was on schedule and on budget, and the Interior cutover to the new system was successfully completed in April 2000.

Problems arose during the second stage (CS-II), which was designed to transfer the 530,000 Lower Mainland customers to the new platform and establish a new BC Gas call centre in the Lower Mainland. As B.C. Hydro did not maintain separate gas and electric call volume statistics, prior estimates had a large margin of error. Actual Kelowna call centre volumes and average handling times in 2000 were 30-70% higher than normal, due to the large rate increases arising from unprecedented commodity prices. Postage rates increased and the high natural gas prices increased the amount of credit and collections activity.

The Program Mercury personnel also had to attempt to develop interfaces with an as yet unresolved model for an unbundled Agency, Billing and Collections - Transportation ("ABC-T") service requested by a number of natural gas agents, brokers and marketers. Together with the anticipated move to monthly billing, it became obvious that the Lower Mainland costs would be higher than forecast. At the same time, BC Gas was undergoing considerable restructuring and corporate realignment and the customer support operations were reorganized. Strategic initiatives began taking resources from Program Mercury, slowing decision making.

Early in 2000, BC Gas felt that its limited customer base would provide insufficient economies of scale and entered into negotiations with B.C. Hydro to create a joint venture to provide common customer care services for both companies (the Servco initiative). Success would mean that patriation of Lower Mainland customers would not be necessary and so CS-II was put on hold. The project's timeline was also delayed due to the longer than anticipated time required to finalize a meter reading contract with B.C. Hydro. BC Gas states that the delay was significant in that the interfaces between the various systems could not be completed until the contract was finalized. It contributed to an increase in the cost to complete the project, but retained the advantage of some joint services with B.C. Hydro.

The Servco initiative to transfer assets and technology risks to a non-regulated partnership and receive customer care services under a long-term contract was similar to the present proposal. In late 2000, B.C. Hydro and BC Gas established a Board of Directors and announced the appointment of senior officers for Servco. Although Peace Computers undertook a benchmark project demonstrating support of up to one million customers, B.C. Hydro eventually decided that the software would not be sufficiently scalable and made continuance of a joint venture contingent upon BC Gas accepting its own CIS solution. BC Gas' \$30-\$40 million share of these costs would have offset any savings associated with a common bill program so, after six months of discussions, BC Gas decided it could not proceed with the Servco initiative.

The Operating and Maintenance costs were forecast in the 1999 Program Mercury CPCN application at $36.70 per customer (including meter reading and dispatch). At its update session with Commission staff in May 2001, BC Gas reported that the Operating and Maintenance costs were now expected to be in excess of $44.00 per customer, due to initial under-forecasting and changing customer expectations. The original $28.2 million capital budget was now estimated to be $39 million, resulting in a fully loaded cost per customer estimated to be between $50-55 in 2003.

The original problem of how to patriate 530,000 Lower Mainland customers remained. The contract with B.C. Hydro provided billing and call centre services for an amount well below market but was unsustainable and could be cancelled on six months notice. As well, BC Gas reported that B.C. Hydro's CIS was outdated and couldn't support unbundling. However, Enbridge Inc. had already selected Peace Computer software to replace its industrial billing system and had an established call centre base with excess capacity, so BC Gas Utility Ltd.'s parent company, BC Gas Inc., started discussions with them to establish a customer care joint venture.

Enbridge provides energy transportation, distribution and services in North America and internationally. It operates the world's longest crude oil and liquids pipeline system, owns and operates Canada's largest natural gas distribution company, with service to 1.5 million utility customers and 1.2 million retail customers, and is also involved in natural gas transmission.

Both parties decided that, due to the relatively risky and highly technology-based nature of the customer care services business and the increasing growth and competitiveness of the market for these services, the new venture should not be regulated. CustomerWorks was established as an unregulated limited partnership owned 70% by Enbridge and 30% by BC Gas Inc. BC Gas negotiated contracts with CustomerWorks for the transfer of its utility customer care assets, the provision of customer care services by CustomerWorks to BC Gas (the Client Services Agreement) and the provision of corporate support services by BC Gas to CustomerWorks (the Shared Services Agreement).

The Commission was concerned about the cost, impact and risk of an unregulated joint venture as it relates to BC Gas ratepayers because of the past history of high expense and relatively high risk. On July 24, 2001 the

Commission instructed the president of Douglas Louth Associates Inc. ("DLAI") to carry out a formal review of BC Gas' plans. DLAI also subsequently assisted BC Gas to negotiate, draft and finalize the agreements. The DLAI final report was submitted on January 8, 2002 and concluded that "CustomerWorks appears to be a realistic approach for BC Gas in the context of its present and immediate future customer care needs."

2.0 APPLICATION

BC Gas had included details of the CustomerWorks proposal in its 2002 rate application which was copied to intervenors and filed with the Commission on August 24, 2001, noting that a separate application for approval of the proposal would be required. Increases in customer care costs for 2002 were identified but the subsequent withdrawal of the rate application meant that BC Gas' shareholder had to absorb them. Commission Order No. G-123-01 which approved BC Gas' Revenue Requirements Application withdrawal also directed that intervenors would be invited to provide comment on the CustomerWorks proposal prior to the Commission's Decision.

On December 21, 2001, BC Gas applied to the Commission pursuant to Section 52 of the Utilities Commission Act for approval for the disposition of its partially-completed Program Mercury and other customer care related assets to BC Gas Inc., pursuant to an Asset Transfer Agreement ("the Application"). The Application also requests approval of the provision of customer care services by CustomerWorks and the related support services under the terms and conditions set out in the Client Services Agreement and the Shared Services Agreement with CustomerWorks, all effective December 31, 2001.

Section 52 states:

> "(1) Except for a disposition of its property in the ordinary course of business, a public utility must not, without first obtaining the commission's approval,
>
> (a) dispose of or encumber the whole or a part of its property, franchises, licences, permits, concessions, privileges or rights, or
>
> (b) by any means, direct or indirect, merge, amalgamate or consolidate in whole or in part its property, franchises, licences, permits, concessions, privileges or rights with those of another person.
>
> (2) The commission may give its approval under this section subject to conditions and requirements considered necessary or desirable in the public interest."

In this proposal, CustomerWorks becomes the customer care provider, completes the Program Mercury project and assumes the software licence, converts customer data now on the B.C. Hydro system and assumes control of the Kelowna call centre. BC Gas transfers its customer care assets and 130 employees to CustomerWorks, out-sources its customer care functions to CustomerWorks, and sets and enforces customer care service levels.

The proposal is designed to mitigate the risks to ratepayers of continuing with an in-house project. The benefits include avoiding potential escalation of implementation costs, no cost for B.C. Hydro conversion, no need for a new call centre, access to Enbridge experience and call centre capacity, a fixed price per customer, continued benefits from the Peace Computer software licence, and cost sharing of any process improvements. The trade-offs include dependence on CustomerWorks with a possible difficulty in separation at the end of the contract period, decreased flexibility in technology and customer processes, lack of opportunity to reduce service costs or obtain a return on CustomerWorks' possible successes, and the potential cost of renegotiating the contract in 2007.

The Asset Transfer Agreement lists the software licences, hardware and equipment to be transferred from BC Gas to BC Gas Inc. and then transferred from BC Gas Inc. to CustomerWorks, to ensure that any residual risks of the transfer reside in BC Gas Inc. rather than in BC Gas Utility Ltd. The assets consist mainly of Program Mercury capital expenditures for software and hardware to be transferred at a book value of $39.2 million, which is estimated to be equal to their fair market value. CustomerWorks will be required to fund the capital cost to complete the project, currently estimated by BC Gas to total $48.4 million.

The Client Services Agreement sets out the pricing structure and terms and conditions of service to be provided by CustomerWorks to BC Gas, based on a fixed price per customer. For 2002, the charge is $46.42 per customer and includes the recovery of operating and maintenance costs, overheads, taxes, depreciation and financing for assets that would have been in utility rate base for 2002, if approved by the Commission. There will be no impact on customer rates due to the withdrawal of BC Gas' revenue requirement application for 2002.

For the years 2003 to 2006, the price is capped at $54.54 per customer. At the end of 2006, BC Gas will renegotiate with CustomerWorks or choose another supplier if they can provide superior services. If BC Gas chooses not to issue a Request for Quotation, the Client Services Agreement stipulates that any increase in the fixed rate per customer in the year following the initial term is capped at 50% of the annual inflation rate. The Client Service Agreement also requires CustomerWorks to use commercially reasonable efforts to pursue opportunities that will reduce costs to BC Gas, increase system efficiencies, or avail itself of any business synergies.

The Shared Services Agreement identifies the support services and the pricing of those services to be provided by BC Gas to CustomerWorks. For the first year of CustomerWorks' operation, BC Gas will provide the same estimated level of support services and service levels to CustomerWorks that the same operations within BC Gas currently receive. Prior to the end of the initial term of the Shared Services Agreement, BC Gas will receive the opportunity to seek renewed services agreements. This transition period provides BC Gas the opportunity to adjust its services, service levels and pricing to respond to CustomerWorks' needs.

By Order No. G-02-02 the Commission scheduled a Workshop on Tuesday, January 29, 2002 and a written public hearing process into the Application and related agreements. Submissions were received from registered intervenors and replied to by BC Gas.

3.0 INTERVENOR ISSUES

Active intervenors represented core market customers (e.g. the Consumers Association of Canada [B.C. Branch] et al.), high volume gas users (e.g. Lower Mainland Large Gas Users Association, Inland Industrial Gas User Group), gas marketers (e.g. Avista Energy Canada, Ltd.) and gas industry contractors (e.g. Heating Ventilating Cooling Industry Association of B.C.).

<u>Avista Energy Canada, Ltd.</u>

Avista Energy Canada, Ltd. ("Avista") was generally concerned about the negative effect that clauses in the agreement may have on the competitive marketplace and that the BC Gas responses to its information requests do not provide any further clarity on specific benefits to customers. Avista suggests that consumers could obtain a lower cost if both BC Gas and B.C. Hydro join forces and that CustomerWorks must be directly overseen by the Commission.

BC Gas replied that the responses were as complete as possible, agreed that an arrangement with B.C. Hydro would have been desirable, and took their submission as positive support for the Application.

Lower Mainland Large Gas Users Association

The Lower Mainland Large Gas Users Association submitted that the Commission's process has been inappropriate, but that it would be less concerned if BC Gas had followed an open tendering process with a purely arms length relationship. The Association felt that the proposal's emphasis on reducing risk ignored the Commission's ability to transfer the risk of project failure to the shareholders. The Association noted that out-sourcing may warrant support providing fair value is established, but that the implied risk to customers for service to remain in the utility is overstated, and the value of the software and opportunities for third party revenue is understated. The Association sees a potential abuse of market power by Enbridge to sell other products and services and agrees with Avista that there should have been more effort to negotiate a resolution with B.C. Hydro. More specifically, its view is that the tender process after five years will not result in competitive bids.

BC Gas replied that the Commission's process was not inappropriate, that there were numerous negotiations with other utilities, and that it agreed with the CAC (B.C.) et al. submission that "Given the history …, it is likely that BC Gas has explored most of the realistic options." BC Gas agrees that a joint arrangement with B.C. Hydro would have been desirable, which is why it pursued the Servco initiative.

BC Gas responded that fair value has been established because the value of the customer care assets form the basis for the CustomerWorks fees and that the Commission cannot order BC Gas shareholders to absorb costs which were prudently incurred. The Utility also notes that market power is not an issue as CustomerWorks will not have personnel working on functions such as furnace repair and because BC Gas must comply with the Code of Conduct for Provision of Utility Resources and Services. BC Gas states that it is more likely that competitive bids will be forthcoming in five years under this proposal than if the assets are completed, maintained, and upgraded within the utility.

Consumers' Association of Canada (B.C. Branch) et al.

Consumers' Association of Canada (B.C. Branch) et al. ["CAC (B.C.) et al."] believes that the outsourcing is appropriate in that it mitigates the risk to customers, but has concerns similar to those of other intervenors, including the level and determination of both CustomerWorks and BC Gas fees, risks inherent in scope changes, the valuation of assets, quality of service, and the role of the Commission. CAC (B.C.) et al. submits that the arrangement can, and should, be improved and that the Commission should define the scope changes that require prior approval and establish a special review process to allow input from customers.

CAC (B.C.) et al. said it was difficult to determine whether customers would benefit more from a lower asset value and lower fees or a higher asset value and higher fees. It submitted that the fair market of the assets and the reasonableness of the CustomerWorks fees could be better determined by comparison to the fees being paid by Enbridge Consumers Gas.

BC Gas replied that the net effect to customers would be nil, as the residual rate base value would also change and noted that CustomerWorks stated at the Workshop that the fees being paid by Enbridge Consumers Gas for similar services are higher than those to be paid by BC Gas. BC Gas pointed out that the service levels in the Client Services Agreement mirror the service levels provided to customers at the time of the agreement. The Utility also noted that the word "qualitative" was added to Clause 3.2(b) in the final contract to ensure that, at renewal, BC Gas will be able to assess the CustomerWorks counter proposal by means of other criteria in addition to price. These other criteria would be based on then-current customer and utility needs, including revised quality of service, long term technical development direction and on-going vendor reliability and viability. It stated that the details of these criteria can only be estimated at that time and it would be premature to attempt to specifically define them. As well, the purpose of Section 4.3 of the Client Services Agreement is to ensure that service levels are adjusted to reflect any service enhancements gained through the completion of Program Mercury.

BC Gas agreed with CAC (B.C.) et al. that the risks to customers with regard to scope changes, increasing customer count and end of term renewal are minimized under a multi-year PBR mechanism as directed by the Commission.

<u>Heating Ventilating Cooling Industry Association of B.C.</u>

The Heating Ventilating Cooling Industry Association of B.C. ("HVCI") is concerned that the Application process created a false sense of crisis and did not allow enough time for any thoughtful consideration. It recommends that the Commission not accept the Application "as it presents no convincing, and at times confusing, arguments as to why this joint venture would be of any benefit to ratepayers." HVCI felt that BC Gas presented unverifiable estimates to complete Program Mercury and, to prove its case, compared them to guaranteed costs. As the difference between these costs is only $1 million per year, HVCI believed that the ratepayers could be at less risk and receive more benefits if the program were kept in-house.

HVCI submitted that the contract presents its own risks: the "low bid matching clause" means rates may never be lower, the contract wording cannot be changed, penalties to its parent company and partner are the only recourse to unsatisfactory service, and ratepayers will be at risk if the partnership fails or is sold.

BC Gas replied that HVCI simply overlooked the facts and that its primary desire is to prevent utilities from competing with its members. The DLAI Report and the Application extensively discuss the benefits to customers, the value of risk mitigation, and the necessary trade-offs. BC Gas submitted that the process was not inappropriate, that the Commission could not appropriately assess the proposal without completed information, and pointed to clauses in the contracts which addressed the HVCI concerns.

Inland Industrial Group

The Inland Industrial Group stated that its members are facing severe financial challenges but it was not opposed to the proposal provided that its members receive the same or improved services with no increase in rates. It asks the Commission to address its concerns about clear rules for affiliate-related transactions (in particular the "right to match" and protection of customer information), rate increases if the Centra acquisition results in an amalgamated CIS, and reasonable customer consultation prior to service changes.

BC Gas replied that the members will receive improved service at rates lower than they would otherwise be and that the proposal complies with the Commission's transfer pricing policy. The right of first refusal was accepted in exchange for a five year contract term rather than the eight year term necessary to recover the capital costs of the customer care assets. Furthermore, the "right to match" is a free option at an attractive price, and BC Gas is prepared to identify and approach potential service providers and could assist in the funding of competitive bids. Customer information remains the property of the Utility and CustomerWorks is required to keep it confidential. BC Gas notes that any amalgamation of systems would be a scope change and is not part of this Application. In any case, it would consider new services that affected rates only after consultation with customers.

4.0 COMMISSION FINDINGS

The major issues to be considered in the CustomerWorks Application include the potential to mitigate Utility risks, the potential for cost increases to accommodate scope changes, the maintenance of a high quality of service for ratepayers, potential costs when the contracts are renegotiated in 2007, the competitiveness of the CustomerWorks proposal, and the valuation of existing assets to be transferred to CustomerWorks.

Risk Mitigation

The outsourcing proposal resolves a number of problems in a function which BC Gas no longer considers to be a core competency. Most of the benefits involve a mitigation of risks to ratepayers. BC Gas avoids the estimated Program Mercury completion costs together with any potential overruns, and the same services are obtained at a fixed price per customer, avoiding the risk of higher annual system maintenance and upgrade costs. The fixed price fees are currently competitive with other outsourcers and the limit on fee increases after the initial term of the Client Services Agreement reduces the financial risks to the ratepayers. The five year term reduces the risk of stranded software assets, which would otherwise be depreciated over an eight year period if left in B.C. Gas' rate base.

CustomerWorks assumes the risk of converting the data necessary to patriate customers from the B.C. Hydro system and will set up call centre facilities for the Lower Mainland customers. The agreements also require CustomerWorks to look for ways to reduce BC Gas costs or provide efficiencies. As well, the larger Enbridge system gives BC Gas access to greater experience with bill unbundling initiatives and reduces the risks of specific call centre site disruptions.

Scope Changes

The Client Services Agreement and attached Schedules specify the scope of services to be provided by CustomerWorks. The parties accept that changes in scope to client services may be required from time to time for a variety of reasons and itemize a number of triggers that could occur. Article 15 of the agreement describes a scope change process.

To protect ratepayers, it is essential that the Commission maintain an overview of such changes. As a condition of approval of the agreements, the Commission must also retain the right to review for approval any improvement initiatives or scope changes that have the potential to impact the level or quality of service or proposed adjustments to the Base Fee.

Quality of Service

Article 4.3, Performance Standards, of the Client Services Agreement states:

> "The scope of services and levels of performance documented in the Schedules are intended to be consistent with the level of service BC Gas currently provides to Customers."

Each of the five schedules of services is designed to achieve that objective and contains articles describing the scope of services, guidelines, customer issue management, pricing, performance measures, deficiency cure periods and penalties.

The parties to the agreement acknowledge that the transfer to CustomerWorks will not be without difficulties. To mitigate problems, the agreement calls for setting up a "Client Committee", with representatives from both parties, to monitor the ongoing performance of CustomerWorks. The Committee will meet at least monthly to evaluate performance and anticipate future needs.

Provision has been made for an adjustment period of 90 days following patriation of the Lower Mainland customers. This is to allow CustomerWorks a period without penalties in which to attain the performance standards. The performance standards will be re-evaluated at the end of this adjustment period. BC Gas will be requested by the Commission to report on the results of the 90-day re-evaluation and on the level of performance standards attained.

The Commission recognizes that quality of service measures exist in BC Gas' revenue requirements settlements and that BC Gas cannot enjoy financial incentives unless quality of service is maintained. These measures allow the Commission to protect ratepayers' interests.

Renegotiation and Matching

Over the last decade the Commission has followed the efforts of BC Gas to achieve an efficient and cost-effective customer care system. BC Gas has found that new systems are required and these are specialized, complex and costly. The reasons for the continuation of specialized systems with high costs appear to be the rapid pace of change in technology, business practices and customer expectations. While it is believed that customer care costs may fall significantly due to technology advancements and competition between service providers, it is not known when this will occur.

A significant concern of the Commission and intervenors is whether BC Gas, after the initial five-year term will truly be able to gain the benefit of a more favourable price and quality of service available from other suppliers than CustomerWorks. As set out clearly in the DLAI Report, BC Gas will likely find it very difficult to secure competitive bids if CustomerWorks only needs to match the prices offered by the lowest bidder to enforce renewal, and this applies even after BC Gas was able to add 'quality' as a factor in the matching provision. As well, differences between BC Gas and CustomerWorks as to what constitutes a matching of price and qualitative factors seem possible, and may prove difficult to resolve.

BC Gas' response is that the right of first refusal will not materially inhibit the tendering process at the end of the initial term of the contract, and that the BC Gas customer base of more than 750,000 will be an attractive opportunity for other large scale providers. Further, BC Gas has committed to identify and approach potential candidates to ensure they understand the tendering process and the conditions of the right of first refusal held by CustomerWorks, and BC Gas has proposed, if necessary, to assist in funding the preparation of competitive bids.

BC Gas made unequivocal statements that the intent of the arrangements with CustomerWorks is that BC Gas will be free to choose another supplier, including the statements that "BC Gas Utility will be guaranteed .... the option to leave CustomerWorks after five years if lower-cost services are available from another service provider", and that "At the end of 2006, BC Gas Utility will be free to choose another supplier or renegotiate with CustomerWorks."

The specific arrangements with CustomerWorks still leave the Commission with questions as to whether BC Gas will be truly free to obtain tenders from, and to choose another supplier after the initial five year term. This freedom is of fundamental importance to BC Gas ratepayers so as to maintain competitive services through time. The Commission is prepared to rely on the warranty of BC Gas that their freedom to select another supplier is intended and can be achieved within the CustomerWorks agreements. The Commission will review the process of contract renewal in 2007 and the BC Gas will be held accountable to the commitments it has made, even if the foregoing commitments are beyond the contract language as it may be interpreted in 2007. BC Gas must demonstrate that any future contract with CustomerWorks or another service provider is in the best interests of its ratepayers for 2007 and beyond.

Competitiveness of CustomerWorks

Concerns were expressed that BC Gas entered into the agreements without a thorough canvassing of other options for the provision of customer care functions. Some intervenors felt some form of open tendering process would have been preferable; others considered that a joint venture with BC Hydro should have been pursued more diligently.

The Application outlines the reasons why remaining with BC Hydro's current system was not acceptable, and the four realistic options:

- provide all customer care services internally by completing Program Mercury;
- implement Program Mercury billing services internally and outsource call handling;
- outsource customer care to third party providers; and
- outsource customer care through a joint arrangement with another utility partner.

The Application then describes the reasons for abandoning the Servco initiative with BC Hydro, and the subsequent synergies that emerged with Enbridge as CustomerWorks took shape.

The Commission agrees with BC Gas and some intervenors that a joint arrangement with B.C. Hydro would have been desirable. This is why negotiations to create Servco were pursued. BC Gas felt that the Peace Energy CIS was the lowest cost solution for both companies and was capable of meeting B.C. Hydro's needs. B.C. Hydro was not prepared to adopt this system developed for BC Gas; rather B.C. Hydro made the establishment of Servco conditional upon BC Gas accepting B.C. Hydro's proposed CIS solution and funding a proportional share of implementation costs. BC Gas concluded these costs would be greater than the savings associated with a common bill for electricity and gas. Despite the failure of Servco, some of the economies of scale and scope it would have created will still be achieved, as meters in the Lower Mainland will continue to be read in conjunction with B.C. Hydro. Also, with CustomerWorks, there are no plans to change the status of the Kelowna Call Centre.

On the issue of open tendering, BC Gas notes that it had the benefit of a competitive bid tender while part of Servco negotiations, it had already negotiated with three other Canadian utilities for a customer joint venture, and was aware that only Enbridge had excess call centre capacity and useful experience. With regard to the issue of the reasonableness of the contracted costs per customer to be charged by CustomerWorks, DLAI surveyed the comparable customer care costs incurred by 17 utilities. CustomerWorks' cost in 2003 of $54.54 is very close to the median in the survey. DLAI concludes that CustomerWorks' costs are reasonable when compared to other utilities.

The Commission concludes that BC Gas has canvassed the range of viable customer care options to the extent necessary to convince the Commission that a more beneficial arrangement for customers would not have emerged.

Fair Value for Assets

Assets are to be transferred from the utility to CustomerWorks at the following book values:

Completed CIS and Call Centre Software	$ 14,348,000
Mercury CIS Software Work in Progress	20,170,000
Hardware	3,119,000
Equipment	1,567,000
Total	$ 39,204,000

The Asset Transfer Agreement states that the $39.2 million sale price for these assets being transferred at their net book value is also the fair market value. This agreement also states (Section 5(c)) that if any taxing authority determines that the purchase price is not equal to the fair market value of the purchased assets, then the parties will make such adjustments as are necessary to ensure the purchase price is equal to the fair market value as assessed by the taxing authority.

Some intervenors suggest that the market value of some of the assets to be transferred to CustomerWorks is below book value, and if the assets are valued above market value then the fees for service charged by CustomerWorks will be high due to the linkage of fees and assets. Others argued that the assets may have a market value in excess of book value.

Background data used to calculate the present value of these assets was provided to DLAI, and DLAI was assured that the setup costs for the joint venture equate to the transfer of assets from the regulated utility to CustomerWorks. DLAI concludes that fair market value has been placed on the assets. DLAI notes that future price protection is the only major direct financial return to ratepayers from CustomerWorks: since the value of existing assets is reflected fairly in the Asset Transfer Agreement, and an offsetting payment is to be made to the Utility, the arrangement with CustomerWorks benefits ratepayers in providing this future price protection.

If the assets are found to be valued above market value and the asset transfer price was lowered, then fees charged by CustomerWorks would also be lowered. However, as BC Gas notes, the reduction in rate base due to the asset transfer would also be reduced, leaving a higher residual rate base value. There would be no net effect on customers since there would be lower fees from CustomerWorks but customers would be subject to greater depreciation within the utility.

Recognizing in particular the relationship between CustomerWorks fees and residual rate base, the Commission accepts that the transfer of the assets at book value fairly represents their market value.

Based on the Commission's findings in these Reasons, the Commission concludes that the three Agreements should be approved.