



MAJOR ELECTRICITY USERS' GROUP

26th February 2016

Rebecca Mehrtens
Manager Customer Solutions Team
Transpower
By email to rebecca.mehrtens@transpower.co.nz

Dear Rebecca

Comments on draft Transpower Works Agreement

1. This letter provides comments by the Major Electricity Users' Group (MEUG) on the draft Transpower Works Agreement (TWA). Invitations for comments were sought in the Transpower Customer Update of 10th December 2015 and by direct correspondence with each Transpower customer.
2. MEUG members have been consulted in the preparation of these comments. This letter is not confidential. Some members may make separate comments.
3. MEUG welcomes the initiative by Transpower to update various customer contracts. The intention to¹ "combine all these contracts into one document with schedules that can be swapped in and out as appropriate to the work" and as a first step develop a base TWA by replacing the current Customer Investment Contract (CIC) is a good approach.
4. The appendix has specific comments on clauses. The comments are a snap shot of work-in-progress thinking and views may change. They are not exhaustive comments on the detail and nor do they canvas the important topic of the Finance Rate. An important part of updating existing contracts is to ensure terms and conditions assigning risks and rewards create optimal incentives on Transpower and customers for these unregulated activities that are consistent with regulated contractual requirements and expected outcomes prescribed in Part 4 of the Commerce Act and the Electricity Industry Participation Code.
5. Completing the initial TWA will not be a trivial task. We are optimistic a win-win can be achieved if the very good engagement by Transpower staff to date continues.

Yours sincerely

Ralph Matthes
Executive Director

¹ Refer Transpower Customer Update, 10th December 2015.

Appendix

Comments from MEUG discussed with Transpower 24 th February 2015	Work-in-progress at 26 th February 2015	
1 Scope of Agreement [Note general comments on contract follow immediately below]		
The Finance Rate formula is not part of the discussion on 24 th February. Note the discussion on other clauses inevitably will canvas the question of which party is bearing a certain risk and therefore this will in part traverse issues on the Finance Rate formula.	Noted by TPNZ.	
The Transpower Works Agreement does not have service levels. Assumes the customer needs to carefully consider this to be included in the scope of the project. The inclusion of service level clause would ensure that Transpower delivers a satisfactory outcome to the customer that meets their needs as well.	This was a deliberate change but TPNZ noted parallel internal work underway on service levels, believe that these service levels should be in Transmission Agreement's (just as some are already). Will explore the inclusion of this. Noted some parties with existing CIC's do not have Transmission Agreements. Noted RCP3 customer performance level review will be underway soon.	
The CIC used to have sections about plant failure and replacement. The new clauses that cover this in the Works Agreement are much more onerous on the customer. A better approach would be to include the approach in the CIC plain English summary as follows: <ul style="list-style-type: none"> • If there is a failure of a "major plant component" prior to the expiry of 90% of the life of that component and the failure is not caused by the Customer, Transpower will replace the plant at the same service levels for the remaining life of the plant at no additional cost to the Customer. • If there is a failure of a "major plant component" after the expiry of 90% of the life of that component, Transpower and the Customer are to confer in good faith on a replacement. If they cannot agree, the Contract ends. • Prior to the end of the Contract, the parties are to confer in good faith on revision to the service levels which will apply under the Transmission Agreement 	TPNZ disagrees with MEUG's interpretation of new clauses but is open to suggestions. Believes clause is less onerous on customers. Changed it so that additional cost for 100% of the asset life. TPNZ still have discretion as per CIC for how they replace components. Customer now gets consulted if TPNZ don't replace asset below 90% of life. Want to ensure that TPNZ have incentive to maintain assets. Warranty on assets for 5 years, then TPNZ managing asset risk post that. Asset fails, TPNZ pays for it, ensures that customer still gets service. Schedule 7 – clause 3.3(d): will update to avoid increase of cost if component fails.	
2. Transpower obligations		
2.1(a)	Should best endeavours be used rather than reasonable endeavours? There should be a best endeavours approach to reach an agreement on costs.	TPNZ agree – will change throughout agreement.
2.2(b)	Agreement can terminate if no agreement on whether a component should be replaced given opening position by Transpower that it need not be replaced. This gives Transpower an unreasonable power to force the customer to agree with Transpower's proposal. If there is a dispute then the parties should be able to refer to a dispute resolution process. Cl. 2.2(b) also refers to cl. 8.2(j).	TPNZ agree – will make clearer. Previously wasn't available under CIC so improvement to customer

3. Customer obligations		
3.2	The customer "must" perform its obligations. Compare cl. 2. Transpower "will use reasonable endeavours". Recommend removing this un-balanced reciprocity in the agreement.	TPNZ agree – will make obligation same for customer as for TPNZ. Customer has 3 obligations in this section – third one is an obligation that TPNZ doesn't have.
4. Health and safety		
4.1	Need to define what PCBU is.	TPNZ will include definition – Person Carrying out Business Undertaking.
4.2(a)	What does the Transpower PCBU policy say with respect to compliance with Customer H&S Policy when on Customer land/premises? ie will it comply completely or are there any circumstances under which it would not?	TPNZ policy not yet on their website, will be made publically available. Will comply with customer policy, except where TPNZ policy is higher and they will comply with TPNZ policy.
4.2(b) (c)	The new H&S Laws come into force in April 2016. Unsure if these clauses are sufficient, ie are they a little vague?	Transpower consider these clauses are sufficient. MEUG understands TPNZ process used to arrive at these comments and we are considering.
5. Works part of grid		
6. Charges and payment		
7. Variation		
7.2(a)	It is unlikely that a customer would propose a regulatory change? Definition of regulatory change later in the agreement is that it is required by law so shouldn't make a difference which party, if any, requested it. Should remove this clause.	TPNZ noted CIC has it as a mutual requirement. EDB may need to invoke a regulatory change, so will leave as mutual.
7.3	The Customer is required to acknowledge the Budget is indicative only. Schedule 4 then provides for a process to update costs and budget. Some customers might accept this uncertainty but most grid or near grid connected consumers would be unable to get their management agreement to such an open ended risk. A way forward would be for Transpower to provide information on assessed accuracy, methodology and breakdown of initial capex estimates and meet more robust requirements for changing the budget. See further comments in schedule 2.	TPNZ agree in principal.
8. Term and termination		
8.2(j)	See comment on cl. 2.2(b).	Noted.
8.6(a)	References 8.8 which doesn't exist, should be 8.7.	Noted.

8.6(c)	Should put the examples in (ii) as a stated option as these clauses of the agreement should not be subject to the customer satisfying Transpower that these things have occurred. They should still include the option that the customer satisfied Transpower that it would be unreasonable to pay the full charge.	TPNZ noted examples may include force majeure or if TPNZ did something wrong. Would need to satisfy TPNZ that full payment is unreasonable (not that event had occurred). This clause does not preclude going through a disputes process if couldn't agree with TPNZ. Looking to improve this so it is clearer.
9. Consumer Guarantees Act		
10. Conditions		
11. Other agreements		
12. Definitions and construction		
12.2	Definition of "Good Engineering Practice" is open ended and never mentions that this Work is for essential infrastructure. Suggest this definition should reflect that best international practice is expected. Good engineering practice means competent and not deficient in any way.	TPNZ noted same as with current CIC but had discussed internally moving to "good electricity industry practice". TPNZ noted have reviewed use of GEIP in contracts. Will review.
Schedule 1: Specific details		
2	Top LHS of table is titled "anticipated commissioning date" – use of anticipated shows that Transpower aren't bearing timeline risk for projects, even though they are best placed to manage this risk.	<p>TPNZ consider it to be a risk to them that if they miss the commissioning date, then customer could terminate the contract.</p> <p>Don't want to include liquidated damages in the template and resistant to including this. Note that customers can negotiate to include this within specific agreements.</p> <p>TPNZ conscious that need to ensure all customers are aware of the menu of T&Cs that could be used including liquidated damages. TPNZ preference not to have liquidated damages as a standard schedule to TWA but will include guidance to customers about the options that they could include. Alternatively there might be an optional schedule for liquidated damages like the optional environmental and property schedule.</p> <p>Commissioning date risk is difficult for them to mitigate.</p> <p>Would consider a penalty payment if xx weeks outside of target commissioning date.</p> <p>TPNZ noted that if contract is terminated, customer doesn't have to pay the accelerated payment charge.</p>

Schedule 2: Indicative budget and project timeline				
1 & 2	<p>As in previous contracts there is no commitment on Transpower's part to commit to a contract budget or timeline. Everything is indicative estimates and best efforts. This does not reflect the ethos of risk management Transpower are taking with the finance charge.</p> <p>These clauses provide the customer with zero certainty on what the potential costs could be and timing for the project.</p> <p>Transpower is best placed to manage this risk and should bear some of the consequences if they get this wrong – as per clause 11(b), the T&C's of this agreement are supposed “to be reasonable or reflect workable or effective competition for the provision of the works” – in other business areas, the supplier bears some of the cost and timeline risk. It is not reflective of the real world to have an open cheque on what the potential cost of a project could be.</p> <p>One approach to consider in these contracts is that is essentially a fully open book approach. Accuracy generally depends on clarity of scope definition (amount of engineering to date) and way costs have been established (from all-inclusive rule of thumb rates to firm quotes).</p> <p>Transpower should have a methodical approach to establishing the likely accuracy of the project cost estimates, including setting the contingency allowance within the budget.</p> <p>A common method of determining costs and timing when they are agreed to be uncertain and a certain amount of risk sharing is appropriate is a “target estimate” with penalty/bonus for either or both cost and time. This puts some incentive on the provider to complete the job within cost and on time and provides the customer with the opportunity to indicate what is important to them.</p> <p>This option seems to be more balanced than the “indicative” cost and timeline approach.</p>			
Schedule 3: Conditions				
Schedule 4: Reports, updated cost estimates and other variations				
1.1(b)	No limit to impact to timeframe given that would give rise to a variation of the contract (c.f. budget >10%).	TPNZ note reporting obligation only.		
1.2(b)	“Transpower will generally keep the customer up to date with the progress of the Works”. The obligation to report progress should be to the standard of best endeavours and or good engineering practice (also 2.3(a)).	<p>TPNZ noted supposed to reflect current practice where Customer Solutions contact person provides customer with verbal updates. Might be too onerous to add in best endeavours obligation as well.</p> <p>In addition to this there are structured reporting processes.</p> <p>There is also requirement to update if there is a significant variance.</p>		

2.3(b)-(c)	Seems unsatisfactory for a customer that the only option they have for a change in the budget is to terminate the agreement (and potentially pay the accelerated payment charge) or to terminate the agreement. Transpower are best placed to manage this risk.	TPNZ agree, will look to include this suggestion for good faith negotiation and dispute resolution. If liquidated damages is included, will need to confirm how these clauses interact.
3	This seems pretty tough to retroactively apply the finance rate and charge interest as well. Again doesn't state how or why they would re-determine the finance rate – it seems to just be whenever Transpower chooses to and they will then provide reasons why. Agreement should state conditions of when the finance rate would be considered to change to provide more certainty to the customer. Note comments above are about process for variation to Finance Rate. What the Finance Rate should be is a key topic but not for the discussion on 24 th February.	TPNZ noted wasn't intended to apply retroactively. Will review. Agree that will include situations of when the finance rate would be changed.
3.3	Uses the finance rate as the interest rate, when could actually use an external benchmark for the interest rate. Similar approach in Schedule 8, cl. 1.2(c).	TPNZ pricing team will consider.

Schedule 5: Property considerations

Schedule 6: Resource management considerations

Schedule 7: Charge

3	Transpower should be obligated to make adjustments whether it is an increase or a decrease.	TPNZ agree, nothing in contract prevents this. Will review internally.
3.3 (c) (i)	This clause allows changes to charges if there is a change in the tax rate. The Finance Rate formula is not part of the discussion on 24 th February. However to illustrate areas MEUG is considering on the formula note that a change in the tax rate is conceptually captured by asset beta in CAPM as part of the risk to a diversified portfolio investor. The Finance Rate formula as it stands has the regulated line service WACC that is a function of asset beta for those services.	
3.3 (d)	Should refer to clause 2.2.	TPNZ noted – might need to be deleted.
4.4 and 5.8	Transpower decides additional information to provide a Customer in response to a written request for more details on charge calculations. Shouldn't all project information relevant for charge calculations be disclosed to the Customer? Would a template or example of charge calculations as an aide memoire help this discussion? Ideally this should be provided automatically by Transpower to ensure that charging is	TPNZ noted hasn't changed from CIC – haven't caused any information in the past and nobody else has raised any concern. TPNZ don't want to provide detailed information all the time (i.e. in invoices). Customer should have right contractual right to full information as a fallback

	transparent. The way it is currently worded, is that Transpower will only act in a timely fashion and only provide the information that Transpower considers necessary.	position, shouldn't impact day to day operations of contract.
5	<p>Total cost should not include forecast unrealised costs (such as removal costs, rehabilitation). This will just be an estimate and these costs may never actually eventuate, yet Transpower propose to receive income based upon these estimated costs.</p> <p>Transpower has other clauses in the agreement to deal with receiving these costs so should not be receiving income on these as well.</p>	<p>TPNZ will be seeking views of whole industry about where such costs should fairly be allocated amongst parties.</p> <p>When build new infrastructure on others land can deal with these costs in easement or lease agreements. Whereas if there is an investment contract in place, they are harder to deal with.</p> <p>TPNZ acknowledge that there could be a risk of double dipping – will look at how to address this.</p> <p>Looking at how to ensure that those costs are recovered – possibility of performance bonds?</p>
5.1 (b)	Recovery of Transpower's operating costs. This implies Transpower want to recover operational costs that aren't recognised by IRD as capex. Transpower want to include BAU costs and costs incurred before the Works Agreement is signed. This needs a tighter definition.	TPNZ noted no change from CIC. TPNZ agreed to review.
5.2 (f)	Total project cost may include (f) "all associated overhead costs (including costs internal to Transpower)." What are these and how can customers be sure they are solely applicable to the project?	TPNZ noted no change from CIC. TPNZ agreed to review.
5.2	Recovery of asset value at end of Agreement term: No mention of the credit that should be allowed for recoverable assets at end of the agreement.	TPNZ noted no change from CIC. TPNZ agreed to review.
5.6	Allows Transpower to readjust the total cost of the project afterwards to ensure it recovers any additional costs it has occurred from carrying out the works. Not reflective of a competitive tender process and in effect Transpower bears no financial risk relating to these projects.	TPNZ noted.
Schedule 8: Accelerated payment charge		
1.2(c)	<p>Similar to Schedule 4, cl. 3.3, uses the finance rate as the interest rate for under/over payments, when could actually use an external benchmark for the interest rate.</p> <p>Interest payments do not seem to apply to payments made by Transpower under 1.3 – no accrued interest, Transpower will only pay as soon as is reasonably practicable.</p>	TPNZ will consider these comments internally.