



11 July 2022

Matthew Hall
Manager, Commercial, Business Improvement and Procurement
Wellington Water
Wellington

Via email: Matthew.Hall@wellingtonwater.co.nz

Three Waters Network Operations and Maintenance Alliance – Charges Framework Review

Dear Matthew,

Bond Construction Management (BondCM) has been requested by Wellington Water Limited (WWL) to review the charges framework in the Three Waters Network Operations and Maintenance Alliance that WWL have with Fulton Hogan (FH). The specific charges to be reviewed are:

1. The corporate overhead charged by FH on all costs except WWL labour.
2. The IT support fee charged by FH on all costs.
3. The profit charged by FH on all costs.
4. The KPI framework charge.

1. Corporate Overhead Charge

Under the Alliance Agreement the corporate overhead charge is currently 7(2)(b)(ii) to be applied to all costs excluding WWL labour and has a cap of 7(2)(b) per annum. This cap has the effect of putting this portion of the Limb 2 value at risk.

Alliances where the corporate overhead (or offsite overhead) is separated from the profit were not generally available to BondCM for comparison purposes. We have, however reviewed the total Limb 2 allowance against other projects to provide a robust comparison. This is included below.

The cap applied to the corporate overhead charge may need to be reviewed considering the market escalation experienced in the last two years. The effect of escalation on the cap will essentially be to get less done before the cap of 7(2)(b) is reached. As an indication of the escalation effect, the Waka Kotahi cost indices for Network Outcomes contracts show total escalation of [redacted] between Jun 2018 and June 2022. Applying that increase to the cap would adjust it to 7(2)(b)

2. IT Support Charge

Schedule 4 of the Alliance Agreement indicates that item 56 which includes Alliance specific IT support, software and setup costs are included as Direct Overheads while item 57 – Alliance Partner head office support – is a corporate overhead cost.

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	Information Technology				
66	Including the following: • IT support for staff on site - Alliance specific Software/systems used • Purchase of IT hardware for the alliance offices • Use/Purchase of Software/Licenses within the Alliance offices (Alliance specific) • Use of Software/Licenses/Upgrades within the Alliance offices (Corporate Software - Payroll, Accounting Etc.) • IT Systems Administrator - Alliance Specific (Full Time/Part Time) • Set up of IT infrastructure (including Demobilisation) • IT installations (Alliance Specific) by Head office		✓		Includes site offices. Subject to relevance and reasonableness tests. Sale on completion to be credited or licenses to be pro-rated at project completion.
67	Alliance Partner Head-Office IT support			✓	Excludes Costs directly relevant to Alliance services outside of Corporate functions

The Fulton Hogan IT Charge is categorised as a Limb 2 charge in Schedule 4 and is calculated based on [REDACTED] of total alliance direct costs. The total alliance direct costs include WWL labour and associated charges. This charge would appear to align with item 57 in the table above.

Other Alliances in the marketplace generally price the IT function in two places, namely staff costs and the site-based IT establishment and running costs. These are Limb 1 costs which then attract Limb 2. The IT infrastructure on a site will be priced specifically for need as per item 56. The IT service costs including provision of laptops, phones, software and support ranges from 7(2)(b)(ii) [REDACTED] per staff member per annum. The provision for IT can total between 7(2)(b)(ii) [REDACTED] of Limb 1 costs.

3. Fulton Hogan Profit

Schedule 4 calculates profit as [REDACTED] of the total Alliance direct costs. This excludes any off-site overhead charges as they are covered by items 1 and 2 above. As with the corporate overhead charge, profit is rarely split out from off-site overhead charges when reviewing Alliance Limb 2 multipliers.

One key aspect of this Alliance is that there is no risk share or pain / gain arrangement in place. Most Alliances have a performance payment cost structure that incentivises the parties to achieve the desired financial outcomes on a win / win basis.

4. KPI Framework

The Key Performance Indicator (KPI) Limb 3 payment is set at [REDACTED] applied to Total Alliance Direct Costs and is noted in Schedule 4 as being subject to adjustment through a performance framework that was to be developed. We understand that the framework has not been developed.

The KPI payment is in line with other Alliances at [REDACTED] however the full [REDACTED] is rarely realised in full as performance requirements are set at a level that requires excellent performance from a high performing team.

Summary

While this review attempts to separate the three key aspects of the Limb 2 payment structure and comment on each in turn, for the purposes of comparison they are best treated as a single payment. This is currently set at [REDACTED]. Comparisons with other Alliance Limb 2 percentages show that [REDACTED] is at the lower end of a range between 7(2)(b)(ii) [REDACTED] for programme or maintenance type alliances. Project alliances generally sit around [REDACTED].

All the other alliances that we have compared the Limb 2 structure against are subject to some form of financial risk share or pain / gain arrangement. Given that no such downside risk exists for the non-owner participant in this alliance, we suggest that [REDACTED] is an appropriate Limb 2 percentage including corporate overheads, IT support fee and profit. We suggest that the cap on the corporate overheads is adjusted in line with published escalation factors to maintain the Contractor position for this portion of Limb 2.

We recommend that the performance framework envisaged for the KPI or Limb 3 charge is developed by the Alliance to enhance performance within the Alliance. Payment of this charge is currently a simple addition to the Limb 2 margin.

Please contact the undersigned with any queries you may have.

Yours Sincerely

Bond Construction Management Ltd

7(2)(a)

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