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Auckland Integrated Fares System Contract Extension for AT HOP

For decision: ☒

For noting: ☐

Te tūtohunga / Recommendation

That the Auckland Transport Board (board):

a) Approve a three-year extension to the Auckland Integrated Fares System (AIFS) contract with Thales for AT HOP at an expected cost of up to $32,653,000.

b) Note that Auckland Transport (AT) will continue to explore contract terms with Thales before finalisation to reduce the expected cost.

c) Delegate authority to the Chief Executive to sign the final contract variation documentation.

Te whakarāpopototanga matua / Executive summary

1. AT has now committed to the conclusion of the procurement phase in the national ticket solution programme (Project Next) which will replace the AT HOP system. Given the status and indicative timeline of Project Next, and the criticality of the AT Hop ticketing system, AT will require the AIFS contract with Thales, for the AT HOP system, to be extended, to coincide with Project Next timelines.
2. Changing suppliers and/or systems, depending on the outcome of the Project Next procurement, means this extension is critical as the resulting change will be complex and lengthy. There is no alternate supplier who AT can engage in the intervening period before the Project Next programme is complete.
3. The AIFS operational contract with Thales is due to expire on 31 May 2021, at which point the term will have exceeded 11 years. The total contract value over this period (across multiple currencies) is $107,878,497. Given the term and value, board approval is required to extend this contract under AT's delegations manual.
4. Further, on 30 September 2021 the AIFS software maintenance contract will also expire. The total contract value of this contract is $6,635,500 and will have been in place for two years. Although this does not (on its own) require board approval, the extension proposal combines both the operational and software maintenance contracts into a single renewal.

5. The extension proposal is for three years at a maximum expected cost to AT under fixed pricing terms of $32,653,000. An alternative component pricing option where AT carries an indexation and foreign currency risk is currently being evaluated.

Ngā tuhinga ō mua / Previous deliberations

6. The requirement for an AIFS contract extension was highlighted in the *National Ticketing Solution (Project Next) and AIFS Extension* paper presented to directors at the October 2020 board meeting.

Te horopaki me te tīaroaro rautaki / Context and strategic alignment

7. The AIFS contract provides for a renewal of up to five years. Given early indications on the expected timeline for Project Next, a three-year extension is sought. If any further extension is required (for up to two years), a further approach to the board will be made when Project Next timelines have been confirmed.
8. The AIFS contract (clause 3.2) requires AT to give six months' notice to Thales of its decision to renew (being December 2020) or for Thales to submit an offer in writing to AT (which is accepted), no less than three months prior to the end of the term (being March 2020). Giving notice to Thales in December provides Thales with the longest notice which in turn provides greater certainty to Thales' staff looking ahead.
9. Currently operations and software maintenance are spread over two contracts with different expiry dates. The extension proposal will see these joined into a single renewal which achieves administrative efficiency for both parties but is otherwise cost neutral.

Ngā matapakinga me ngā tātaritanga / Discussion and analysis

10. The AIFS agreement pricing is currently based on four source currencies – New Zealand, Australia, United States and Europe – that are indicative of the countries that provide services under the maintenance contract (except for the United States currency, where the services are provided out of Hong Kong). The price is increased annually by the indexation formula in the contract based on the published CPI for labour and materials for the source currencies.
11. Following a global restructure in 2019, the Australian support services were moved to Hong Kong and Thales New Zealand now receives most of its support from Thales Hong Kong. The French team have only a small operations scope for AT and are primarily involved in projects; any input to AT will go via Thales Hong Kong. As part of the contract variation, the source currencies will be updated to include only the Hong Kong Dollar (HKD) and the New Zealand Dollar (NZD).
12. The work carried out for AT by Thales is split approximately 33% Hong Kong and 67% New Zealand (based on the NZD value of the work). This is relevant to considering currency and indexation risk discussed in the two options presented below.

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13. Under the AIFS contract, service level performance is calculated monthly, based on availability of fixed equipment and point of installation, reliability of mobile and portable equipment and delivery of operational services. If a service level is exceeded then a service level bonus will be payable, up to a maximum service bonus on 5% of the service charges payable in the relevant month. There is a detailed regime in the AIFS contract for calculating service credits and service bonuses however, historically these have been achievable for Thales so a 5% bonus is consistently paid by AT and has therefore been included in the options below.

14. A discount of $223,000 has been included in both options below, which would be amortised over the three-year extension.

15. Thales has offered two pricing options for the contract, either a fixed price of $32,653,000 (Option A) or a component price (Option B) with AT carrying indexation and foreign currency risk. An initial summary of the options being analysed is provided below. This paper recommends that the contract extension is approved but AT continue to analyse and negotiate the best value for money pricing option before finalisation of contract terms. Delegated authority to the Chief Executive to sign the final contract variation documentation is therefore sought.

Option	Pricing	Payment Terms
Option A	A fixed and firm total cost of $32,653,000 for three years (including a 5% bonus payment).	A fixed monthly fee of $913,215 (compared to $892,500 today) invoiced quarterly over the next 12 quarters.
Option B	The estimated at-risk total cost of $32,816,000 for three years is based on the following pricing conditions: • A variable cost based on initial monthly billing components of NZD583,000 and HKD1,422,500 • Cumulative indexation to be applied annually • A bonus payment of 5% Note – assumptions used are detailed below	A base monthly fee for 2021 of NZD892,282 equivalent, made up of NZD583,000 and HKD1,422,500 (at a 16 November 2020 NZD/HKD spot rate of 0.1876). At risk components include: • **HKD Currency**: The fees would be invoiced quarterly in the source currencies. . • **Indexation**: Indexation will be applied annually based on the published indices from May 2022. The estimated at-risk total costs are calculated using a 2.8% annual increase (based on the last three years average indices for the respective countries)

16. Both options have potentially favourable and unfavourable outcomes:

    a. The main benefit associated with Option A is that it provides AT with price certainty during uncertain times. AT assumes no risk of unfavourable currency or indexation changes.

    b. Conversely with Option B where AT absorbs the currency and indexation risks itself, AT carries the opportunity of a lower total cost in an environment with a strong NZD and lower than historical inflation levels.

17. If AT elected to contract with Thales under Option B, Council Treasury in consultation with AT may elect to hedge the foreign exchange exposure on behalf of AT. Forward exchange contracts would be used to mitigate the HKD foreign exchange exposure risk. With interest rates at historical lows the cost of placing these contracts is extremely competitive and would be assessed at the time of signing a contract.

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Ngā tūraru matua / Key risks and mitigations

Key risk	Mitigation
There is a risk with Option A that AT ends up paying a higher amount to Thales than it would have had AT taken on the currency risk. There is a risk with Option B that if AT takes on the currency risk and this is unfavourable, this will result in AT paying a higher amount than the fixed and firm offer in Option A.	No absolute certainty can be provided around currency fluctuation levels, particularly in a COVID-19 pandemic (COVID-19) environment, however AT has the ability to hedge the HKD currency risk. Over the past five years the HKD has ranged from 0.17 to 0.22 (during the height of COVID-19 in March 2020). The normal range is between 0.17 to 0.20. With a current spot rate of 0.1876 and around $3.5m of the annual contract cost based upon the HKD, the possible risk to AT would be approximately $700,000 over the term of the contract extension but, if the NZD strengthened this would be a benefit of up to $990,000 over the term of the contract extension.
There is a risk with Option A that AT ends up paying a higher amount to Thales than it would have had AT taken on the indexation risk. There is a risk with Option B that if AT takes on the indexation risk and this is unfavourable, this will result in AT paying a higher amount than the fixed and firm offer in Option A.	No absolute certainty can be provided around price indices, particularly in a COVID-19 environment. Over the past three years the average indexation for the Hong Kong work scope has been approximately +4.6% and +1.9% for the New Zealand-based work. Given the Hong Kong scope is approximately 33% of the total services, AT should see a lower indexation amount than the +2.8% allowed for in Option A and used to estimate the cost of Option B. A 1% movement in the average indexation rate results in a $331,000 movement over the term of the contract extension.

Ngā ritenga-ā-pūtea me ngā rauemi / Financial and resource impacts

18. The AT HOP system costs are budgeted for in the 2020/2021 fiscal year, in the Auckland Long Term Plan and the Regional Land Transport Plan. Budgets for subsequent years will be agreed as part of the annual budgeting process.

Ngā whaiwhakaaro ō te taiao me te panonitanga o te āhuarangi / Environment and climate change considerations

19. There are no direct environmental or climate change impacts.

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Ngā reo o mana whenua rātou ko ngā mema pooti, ko ngā roopu kei raro i te maru o te Kaunihera, ko ngā hāpori katoa / Voice of mana whenua, elected members, Council Controlled Organisations, customer and community

20. There are no direct mana whenua, elected member, Council Controlled Organisation, customer or community impacts related to the contract extension request.

Ngā whaiwhakaaro haumaru me ngā whaiwhakaaro hauora / Health, safety and wellbeing considerations

21. There are no direct health, safety and wellbeing impacts.

Ā muri ake nei / Next steps

22. The next steps are for AT to provide notice to Thales of its decision to extend the AIFS contract, finalise negotiations and to execute the relevant contract variation documentation.

Te pou whenua tuhinga / Document ownership

Submitted by	Nina Thomson **Commercial Manager**	
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Approved for submission	Shane Ellison **Chief Executive**	