



## Minding the Gap

### *Strategic Best Practices for Negotiating Your LTSA with Your TPA*

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British prime minister Benjamin Disraeli once warned that “the most dangerous strategy is to jump a chasm in two leaps.” If this advice is true anywhere, it is true in the world of power plant development, where prudent strategic planning can make the difference between the “Owner” power company’s leaping to solid ground or leaping into the chasm. However, when it comes to the negotiation of the contracts that will support the construction, operation and maintenance of a project, prudent strategic planning can often be eclipsed by other practical realities.

A perfect illustration of this is the not-so-uncommon separation of the negotiation of an Owner’s turbine procurement agreement (TPA) from the negotiation of the long term service agreement (LTSA) for the procured turbine. This separation can appear as both a “separation of time” (TPA first, LTSA second), as well as a “separation of teams” (right hand doing one thing, left hand doing another). Several factors can drive this separation. For example, perhaps there is a tight deadline to purchase the turbine, with “no time now” to negotiate the LTSA. Or there may be some notion that the

LTSA would not need to be in place until the plant’s commercial operation date, so “why rush it anyway?” Related to this may be the unquestionably valid premise that the passage of time only increases the competitiveness and maturity of the non-OEM vendor LTSA products hitting the market. Another factor may be that there exists a corporate division between the teams (including the legal, technical and/or commercial teams) who handle construction issues and the teams who handle operations and maintenance issues. Finally, where a turnkey engineering, procurement and construction (EPC) contract approach has been selected to deliver the project, the Owner can find itself contractually separated from the details of the TPA, since the TPA will be a subcontract of the EPC. In this case in particular, where the Owner may not even be dealing directly with the OEM, the separation of the TPA and the LTSA can become exacerbated.

Thus, all of these factors can lead to a separation of the sequence of, and of the teams, negotiating an Owner’s TPA and an Owner’s LTSA. It is this separation that, for reasons as will become apparent from the discussion

below, can be tantamount to the proverbial jumping of the chasm in two leaps. Instead, a nimble Owner will consider negotiating its TPA and its LTSA simultaneously and with the same team. There are at least two main reasons why an Owner should adopt this strategy.

### ***Negotiation Leverage***

The first reason is leverage. If properly played, at no time does an Owner have greater leverage over the OEMs than when the Owner is selecting its turbine vendor. Competition for sales and growth between turbine vendors is tough, and a prudent Owner will realize this and take advantage of the negotiating leverage that this competition creates. Even if the Owner is seriously considering a non-OEM LTSA vendor, it will still be advantageous to introduce them into the competitive process at the early stages of project development.

### ***Coordinating COD Cross-Over Issues***

A second reason for simultaneous and consistent LTSA/TPA negotiations is so that the Owner will be able to address key issues that interrelate between the LTSA and the TPA. Given that most of these issues bridge over the commercial operation date (COD) – the general “connection point” between the end of the TPA and the beginning of the LTSA – these can be considered “COD Cross-Over Issues,” to coin a phrase. The following are (a few of many) examples of COD Cross-Over Issues. For the sake of illustration, these examples hypothetically assume different and uncoordinated TPA (or perhaps “EPC” (if a turnkey EPC is envisioned)) and LTSA “Teams” negotiating the documents separately and at different times.

### ***Warranties on Initial Spare Parts***

***A Separated Approach*** - It is often considered prudent practice for an Owner to have a set of “initial spare parts” on its shelf prior to start-up of the turbine, just in case they are needed during that process or afterwards. Consider the hypothetical where the “TPA Team” decides to purchase these parts under or concurrently with the TPA – perhaps as a final deliverable of the OEM. The OEM only offers a limited warranty for the parts that will expire eighteen months after delivery of the parts, and the parts are delivered just prior to start-up. Perhaps as a matter of good fortune, they are not used then. Instead, they sit on the shelf and await the day when they will finally be sourced for the first combustion or hot gas path inspection months or years later. Unfortunately, by that time, their warranty will have expired. Meanwhile, the LTSA Team cuts a deal with the OEM (or perhaps with a non-OEM) whereby the warranty coverage only applies to parts actually provided under *that* contract (i.e., not the initial spares). Thus, when the initial spares get put into the turbine, they are in no-man’s land - a land with no warranty coverage.

***A Coordinated Best Practice*** – Simply put, a coordinated TPA/LTSA effort that is mindful of this COD Cross-Over Issue can eliminate this risk by making certain that the initial spares are covered by either an extended warranty under the TPA or a “pick-up” warranty under the LTSA.

### ***Pre-COD/Post-COD Product Improvements***

***A Separated Approach*** – As another hypothetical, assume that the TPA Team signs the contract to procure the turbine (perhaps through an EPC contract), and the criteria for acceptance include the standard fare: a turbine that meets the required levels of output, heat rate, emissions, noise and reliability. No mention is

made of compliance with any updated engineering improvements as may be announced via publications known as “Technical Information Letters,” “Engineering Change Notices,” “Product Improvement Bulletins” or the like. Meanwhile, the LTSA Team negotiates a deal whereby the LTSA contractor’s scope is limited to traditional “planned maintenance.” So, what happens when, after COD, the OEM issues letter after notice after bulletin requiring work on the turbine to correct fleet-wide issues? In this scenario, the Owner must pay for such improvement work à la carte, including work to correct problems with the turbine that were covered by improvement publications issued prior to COD!

***A Coordinated Best Practice*** – A coordinated TPA/LTSA effort can tackle this COD Cross-Over Issue head on, by negotiating to transfer this risk to the OEM consistently under both contracts. For example, an Owner might structure the TPA so that, as a condition of acceptance of the turbine, the OEM must have completed all work recommended by those improvement publications as are published prior to COD. In coordination with this, the Owner might at the same time structure the LTSA so as to include within the LTSA contractor’s scope the full coverage of all such product improvement recommendations as are published after the COD.

### ***Pre-COD Hours/Starts***

***A Separated Approach*** – As a final hypothetical, assume that the LTSA Team structures compensation under the LTSA that is based upon a payment of dollars per operating hour and/or per start on the turbine. During start-up, the OEM puts three times the normally anticipated number of hours and starts on the unit in a troubled effort to bring the turbine on-line. A month later, the bill that arrives under the LTSA is equally as excessive, hitting the Owners

budget and bottom line. Of course, the hypothetical TPA Team, only being concerned with reaching the goal of commercial operation, never thought to address the hours/starts issue in that document.

***A Coordinated Best Practice*** - Perhaps this COD Cross-Over Issue could have been addressed under the LTSA alone. However, given the retrospective nature of an LTSA in this context, the OEM may have low limits as to how much risk it is willing to bear for excessive pre-COD hours and starts under the LTSA. (Moreover, a non-OEM LTSA provider will not likely be willing to take *any* pre-COD risk under an LTSA). Thus, an Owner with a coordinated and prospective view of its TPA and LTSA documents will have an advantage: knowing how pre-COD hours/starts under the TPA will impact payments under the LTSA. With this in mind, the Owner may seek to shift the risk of excessive pre-COD hours/starts to the OEM under the TPA, rather than under the LTSA. Given that under the TPA the OEM will have control over the turbine prior to COD, this means that the OEM is better situated to manage and control this risk; and consequently, the Owner is in a strong position to argue that the OEM should bear more risk in this area under the TPA than it would under the LTSA.

### ***Making the Jump in One Leap***

As outlined above, when an Owner coordinates its LTSA and TPA negotiations from both a “time” standpoint and a “team” standpoint, it can then leverage its strong negotiating position to drive more favorable LTSA terms, and can also ensure that COD Cross-Over Issues are properly covered by the contracts. Although some might not be surprised by this conclusion, they would be surprised at how often these negotiations end up being separated. As discussed above, there are many reasons why they can become separated, not the least of which is, quite

frequently, the dynamic created by the Owner's desire to enter into a turn-key EPC contract for project delivery (this can separate the Owner from the TPA negotiating process). Although in some instances the reasons for such separate negotiations cannot be overcome, in most cases, with prior strategic planning, a prudent Owner can find a way.

In this regard, Owners might consider the following "three phase" approach as a guideline for coordinating LTSA and TPA negotiations.

This approach assumes that the Owner wishes to have a full-wrap, turn-key EPC contract for project delivery. It also assumes a single, well-coordinated project development team for the Owner. Finally, it assumes that after COD the Owner will operate the facility itself. It should be noted that the three phases below only represent one possible approach (and are oversimplified at that) to conducting coordinated LTSA/TPA/EPC negotiations. Indeed, several variations of this approach may make sense, based upon relevant facts:

#### **PHASE ONE: THE RFPs**

- Owner issues RFP to OEMs for competing bids on provision of turbine(s)
  - RFP includes full terms and conditions of TPA (which, among other things, address all COD Cross-Over Issues relevant to the TPA)
- Owner simultaneously issues RFP to OEMs (and non-OEM vendors, if applicable) for competing bids for LTSA services RFP includes full term and conditions of LTSA (which, among other things, address all COD Cross-Over Issues relevant to the LTSA)
- Owner simultaneously issues RFP to EPC contractors for competing bids for EPC work
  - RFP explains that the EPC contractor will receive assignment of the TPA
  - RFP includes full terms and conditions for the EPC contract, which will include provisions expressly entitling Owner to certain "flow-through" rights under the TPA to ensure protection of the Owner in COD Cross-Over Issues (e.g., pass-through of extended warranty on initial spare parts)

#### **PHASE TWO: PRELIMINARY NEGOTIATIONS**

- Owner preliminarily negotiates the TPA directly with the OEMs
- Owner preliminarily negotiates the LTSA with the OEMs (and non-OEMs, if applicable)
- Owner preliminarily negotiates the EPC with the EPC bidders (each of whom understand that it would receive assignment of, and wrap, the TPA)

#### **PHASE THREE: CONTRACTOR SELECTION AND FINAL NEGOTIATION**

- Based upon preliminary negotiations, Owner selects favored turbine OEM and EPC contractor
- Owner finalizes negotiations and signs TPA and EPC (note: EPC contractor will likely be involved in TPA negotiations)
- Owner assigns TPA to EPC contractor, for full "turn-key" wrap EPC contract
- Assuming that Phase 2 preliminary negotiations were fruitful, Owner signs the LTSA (the effectiveness of which is contingent upon COD)

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