

Benchmark agreement and SRAM-related Code changes

Decision paper

Tuesday, 22 August 2023

Executive Summary

The Electricity Authority (Authority) has decided to amend the Electricity Industry Participation Code 2010 (Code) and the benchmark agreement to provide for Transpower's recovery of settlement residual allocation methodology (SRAM) implementation costs from all transmission customers and to deem these amendments to be included in all existing transmission agreements. Additionally, the Authority has decided to make the benchmark agreement consistent with the new transmission pricing methodology (TPM), to make other minor changes to reflect other law changes, and to deem these amendments be included in all existing transmission agreements (other than certain pre-2008 agreements mentioned in clause 12.49 of the Code, which are not based on the benchmark agreement).

Transpower funding for SRAM implementation

The Authority has decided to replace Part D of the benchmark agreement to include default terms and conditions that allow Transpower to recover its settlement residue implementation and administration costs. Replacement of Part D permits Transpower to recover reasonable costs for its administration of the SRAM. The Authority's decision is to permit the recovery of the administration fee in proportion to the settlement residue received by each transmission customer. Additionally, the Authority has decided to amend the Code to include provisions for the recovery of SRAM implementation costs in all existing agreements, from the amendment's effective date.

The Authority's decision ensures that Transpower has appropriate systems in place to calculate and allocate settlement residual rebates to its customers in accordance with the new SRAM. This promotes competition and improves the efficient operation of the electricity industry, by reducing the overpayment for transmission services that occurs due to customers paying nodal transport charges, while supporting incentives for efficient grid use and investment. Over time this will lead to consumers paying relatively lower prices for delivered electricity.

Focused changes to benchmark agreement

The Authority has decided to amend the benchmark agreement to ensure consistency with the new TPM and make minor changes to reflect other law updates. These amendments will apply to all existing transmission agreements, except the pre-2008 agreements referred to in clause 12.49 of the Code. Additionally, the Authority has decided to include the benchmark agreement as a new Schedule in the Code and rename the benchmark agreement as the "default transmission agreement template" to better reflect its nature and the purpose of the agreement template as prescribing default terms and conditions for transmission agreements.

Next steps

In its submission, Transpower suggested changes to the Code to provide that the schedules in the default transmission agreement template take effect from the date a participant becomes a designated transmission customer or the date an earlier agreement expires or terminates (rather than two months after this date). The Authority will consult on these suggested changes through the Code Review Programme consultation, which is due to be released on 29 August 2023.

In 2024 the Authority intends to conduct a more comprehensive review of the benchmark agreement (the default transmission agreement template) as part of its Future Security and Resilience (FSR) work.

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1. Introduction

- 1.1. In November 2022, the Authority decided on a Code change giving effect to a new settlement residual allocation methodology (SRAM), which applied from 1 April 2023. The decision required Transpower to develop a SRAM which calculates allocations of settlement residue for each designated transmission customer based on the simple method for the allocation of the benefit-based charge in the Transmission Pricing Methodology (TPM).
- 1.2. From May 2023, Transpower is required to pay settlement residue to its customers in accordance with the SRAM. Distributors that receive settlement residue payments (settlement residual rebates) are required to pass these through to their own customers.
- 1.3. On 17 May 2023, the Authority released a consultation paper that set out some proposed amendments to the Code and the benchmark agreement, relating to:
 - a) Transpower funding for SRAM implementation (a consequence of the Authority's November 2022 SRAM decision)
 - b) focused changes to the benchmark agreement.
- 1.4. The consultation paper also discussed a potential issue relating to embedded networks (but did not include any proposed Code amendments with respect to this issue).
- 1.5. Following consultation, the Authority has decided to amend the Code and benchmark agreement to:
 - a) provide for Transpower's recovery of SRAM implementation costs from all transmission customers and to deem these amendments be included in all existing transmission agreements
 - b) promote consistency with the new TPM and to make other minor changes to reflect other law changes and to deem these amendments be included in all existing transmission agreements other than the pre-2008 agreements set out in clause 12.49 of the Code.

2. SRAM implementation cost recovery

Changes to Part D of the benchmark agreement

Our decision

- 2.1. The Authority has decided to amend the benchmark agreement to include default terms and conditions providing for recovery by Transpower of its actual and reasonable settlement residue implementation and administration costs (SRAM processing costs and future maintenance of the system). This is done by replacing Part D of the benchmark agreement.

What we proposed

- 2.2. The Authority's proposal was based on the view that the best way to ensure that Transpower could recover its SRAM processing costs was to amend the benchmark agreement to provide for this. The consultation paper noted that the payment of settlement residue was currently dealt with by Part D of the benchmark agreement. This part sets out the payment of loss and constraint excess (the previous name for settlement residue). As the payment of settlement residue is now prescribed elsewhere in the Code, the current provisions of Part D are no longer required.
- 2.3. The Authority proposed to replace current Part D with a new Part D providing that Transpower may charge an administration fee to cover its SRAM processing costs.

Submitters views and our assessment

- 2.4. The Authority received five submissions relating to this issue.
- 2.5. ENA, Vector, Transpower and Orion supported the Authority's approach to amend the benchmark agreement to provide for Transpower to recover costs related to the implementation of SRAM.
- 2.6. Meridian expressed a differing opinion regarding the Authority's approach and was in favour of increasing the levy on industry participants (and the associated appropriation) to cover these costs. Meridian stated that:

Meridian's preference would be for the Authority to manage this through its own arrangements with Transpower. This would be preferable to amending the contractual arrangements between Transpower and each of its customers. The Authority's alternative option of increasing the industry levy to cover these costs would achieve this outcome.

- 2.7. Meridian's submission expressed the opinion that increasing the levy on industry participants would be simpler, stating:

It is not clear to us on what basis the Authority thinks its proposed approach would be simpler. The alternative levy recovery option would avoid the cost allocation issues that would arise if basing the cost allocation on portion of settlement residue. Settlement residue payments are volatile and payments to individual participants can be heavily influenced by events on the grid. Even if the cost allocation was spread over a year, there could be significant variation between years in each participant's share of settlement residue due to factors like hydrology or planned outages in any given year.

- 2.8. The Authority acknowledges Meridian's submission but remains of the view that the amendment to the benchmark agreement is a more certain, more targeted and more transparent way to permit Transpower to recover its SRAM processing costs through the charging and invoicing mechanisms of transmission agreements.¹ The Authority considers this method to be more straightforward as it ensures Transpower can do its work with certainty that the funding will be obtained. The Authority does not consider that volatility will pose a problem, as there are measures in place (eg, in clause 12A.3(7) of the Code) to deal

¹ The levy is prescribed on the basis of different levies for different classes of participants but is not set at the level of granularity that is possible by providing for funding through transmission agreements. Charging through the transmission agreement will also enable the SRAM processing costs to be visible alongside the SRAM distribution amounts on invoices issued by Transpower – aiding transparency.

with the situation arising where administration costs exceed SRAM payments in any given month and it is highly unlikely that administration costs would exceed total SRAM payments over the 12-month period of recovery.

- 2.9. The Authority's approach, which provides for recovery of SRAM processing costs in transmission agreements, ensures that those parties receiving distributions of settlement residue have those distributions proportionately reduced to cover the costs Transpower must bear to make the distributions (see further below). This means that those who receive a relatively large share of the settlement residue will be required to pay a proportionately large share of the administration fee. If this was not the case, then parties might need to pay – on an ongoing basis – administration fees that are out of proportion to the amounts they receive in SRAM payments. This outcome would be misaligned and difficult to rationalise and as such is unlikely to lead to the regulatory arrangements under discussion being durable (which could put at risk the efficiency benefits of the Authority's November 2022 decision on the SRAM). Recovering SRAM processing costs in a proportional manner also addresses, as the Authority understands it, Meridian's concern with variation between years as to each participant's share of settlement residue paid, as in years where a participant's share is lower, for example, the related processing charge will be consequently smaller (and vice versa for years where a participant's share of settlement residue is greater).
- 2.10. Providing for recovery of SRAM processing costs in transmission agreements also enables the dispute resolution provisions of transmission agreements to be used to resolve any disputes about Transpower's SRAM processing charge.²
- 2.11. Meridian expressed its concern that the Authority had already made a decision on the proposed approach prior to the consultation, stating:
- We understand that Transpower expects to be able to recover the efficiently incurred cost of administering the SRAM and that the Authority committed to ensuring that outcome in a letter to Transpower last year. We query whether, having made that undertaking, consultation on the options remains meaningful. The Authority appears already committed to a regulatory intervention.*
- 2.12. The Authority disagrees with how this has been characterised by Meridian. Although the Authority expressed a commitment in its letter to Transpower in December 2023 to work to ensure the recovery of efficiently incurred costs associated with SRAM implementation, it is important to clarify that this commitment did not include the approval of the benchmark agreement approach for funding. Rather, this was stated to be a preferred option for the purposes of consultation, with such consultation being an opportunity to further test the feasibility of this option.
- 2.13. During the consultation phase, the Authority presented a comprehensive paper that outlined an alternative option for funding Transpower. The Authority welcomed and encouraged stakeholders to submit their perspectives and evidence on preferred alternative funding approaches, in order to assist the Authority in weighing up the merits of its preferred approach relative to any other options put forward.
- 2.14. Meridian also had some concerns about how the approach to funding through the use of the benchmark agreement aligns with the Authority's statutory objectives. Meridian stated:
- It is also not clear to us how the Authority considers this Code change will promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers. The change proposed is purely to give effect to a wealth transfer between participants, namely Transpower and transmission customers.*

² This is also the Authority's response to Vector's submission expressing concern about the calculation of Transpower's costs, which suggested a Code requirement requiring Transpower to get an independent technical and legal review of the costs, once the timelines and work are defined. In the Authority's view, Vector's proposed solution is not warranted given the ability of parties to dispute the charges, and the consequent incentive on Transpower to justify them.

³ Refer to letter: https://www.ea.govt.nz/documents/1399/21_Dec_2022_Letter_from_EA_to_TP_-_Funding_for_SRAM.pdf

- 2.15. The Authority disagrees with Meridian's characterisation of the proposed amendments.⁴ Enabling Transpower to recover its efficiently incurred SRAM processing costs promotes the efficient operation of the electricity industry as it ensures that Transpower has appropriate systems in place to calculate and allocate settlement residue to its customers in accordance with the new SRAM. This in turn enables the Authority's November 2022 SRAM decision to be most effectively implemented. Whilst Meridian's submission seeks to construe the proposed approach in isolation as a wealth transfer, the Authority sees the current proposal as an integral part of its SRAM policy. The current proposal helps to achieve the underlying policy rationale for the SRAM provisions of the Code, which also promotes the Authority's objectives.⁵

Calculating the administration fee

Our decision

- 2.16. The Authority has decided that the administration fee that is charged to recover SRAM processing costs must not exceed a proportionate contribution measured against settlement residual rebates paid to customers.
- 2.17. The Authority has made one small consequential amendment to clause 12A.3(7) of the Code to clarify that that the amount of settlement residue distributors are required to pass on is the amount they received less the administration fee they are charged. As stated in the consultation paper the Authority expects Transpower to recover the costs over 12 months by deducting one twelfth of the total SRAM implementation cost from the overall settlement residue before allocating it to customers. The costs associated with SRAM implementation and administration may vary each year depending on the level of work needed to establish and maintain the system.

What we proposed

- 2.18. The Authority's proposed approach was to require the portion of costs recovered from each customer to be proportional to the settlement residue each customer receives. This means that those who receive a relatively large share of the settlement residue will be required to pay a proportionately large share of the administration fee.
- 2.19. The Authority expects that Transpower would recover costs over a sufficiently long period to avoid unduly high or low administration fees driven by one-off events falling on customers. A pragmatic approach would be to recover the costs over 12 months by Transpower deducting one twelfth of the total annual SRAM processing costs from the overall settlement residue before allocating it to customers. The difference between allocations before and after deducting SRAM processing costs is the administration fee paid by each customer (proportional to the settlement residue each customer receives).

Submitters views and our assessment

- 2.20. The Authority received six submissions relating to calculating the administration fee. Orion and Vector agreed with the proposed approach.
- 2.21. Meridian disagreed with the proposed proportional approach to allocation, arguing that the administrative costs should be recovered from consumers via the levy.
- 2.22. However, the Authority considers that its approach to allocation is more consistent with its statutory objective than Meridian's approach. As noted above, our approach is more certain, more targeted and more transparent, and ensures that those parties who receive a relatively large share of the settlement residue will be required to pay a proportionately large

⁴ Note also that transmission customers are not the end-payers of the SRAM processing costs as distributors are only required to pass on to their customers settlement residue less these processing costs (see below).

⁵ The new SRAM promotes the Authority's main statutory objective by promoting competition and improving the efficient operation of the electricity industry – by reducing the overpayment for transmission services that occurs due to customers paying nodal transport charges, while supporting efficient incentives for grid usage and investment, which over time leads to consumers paying relatively lower prices for delivered electricity.
https://www.ea.govt.nz/documents/1402/SRAM_Decision_Paper.pdf

share of the administration fee. If this was not the case, then parties might need to pay fees that are out of proportion to the amounts they receive in SRAM payments. This outcome would be misaligned and difficult to rationalise and as such would be unlikely to lead to the regulatory arrangements under discussion being durable (which could put at risk the efficiency benefits of the Authority's November 2022 decision on the SRAM).

2.23. Other submissions indicated that more clarity was needed regarding the following:

- a) distributors covering the cost of the administration fee in certain scenarios
- b) uncertainty over whether distributors can net off the administration fee
- c) recovery of costs associated with settlement residue pass-through by distributors.

2.24. These matters are discussed below.

Distributors covering the cost of the administration fee in certain scenarios

2.25. Transpower has indicated how it plans to deduct the administration fee and what it intends to do in the scenario where there is negative settlement residue in a month or where the settlement residue is insufficient to cover the administration fee. In its submission Transpower stated:

The approach we plan to adopt is to (transparently) deduct the amount of the administration fee to recover in each month from the total settlement residue received from NZX and apply the SRAM to the adjusted amount, thereby allocating the administration fee to customers in proportion to their settlement residue receipts. Each customer would see the amount of the administration fee deducted from their settlement residue allocation. On the rare occasions when total settlement residue is negative or otherwise insufficient to fully cover the administration fee, we would issue customers invoices for the part of the administration fee not covered by settlement residue.

2.26. Transpower is of the view that distributors should always be able to recover from their customers any part of the administration fee that Transpower passes on to them and has suggested that further changes to the Code may be needed to ensure this does not become a cost recovery issue for distributors.

2.27. The Authority agrees with Transpower's view that distributors should not be required to cover the administration fee cost in scenarios where the administration fee is larger than the settlement residue allocated in a given month. This should be dealt with under clause 12A.3(7) of the Code which permits distributors to adjust payments of settlement residue to correct for previous overpayment and underpayments. Where a distributor receives an invoice in respect of a customer's settlement residue, the Authority considers clause 12A.3(7) should permit future payments of settlement residue to the affected customer to be reduced enabling in most instances for distributors to not be left bearing an administration fee cost that is not passed on. A small consequential amendment has been made to this clause to clarify this.

Uncertainty over whether distributors can net off the administration fee

2.28. Transpower submitted that as currently drafted, the Code appears to require the entire settlement residue to be allocated to customers and does not allow for a deduction of the administration fee.

2.29. Transpower's submission suggested amending the Code to remove this uncertainty through amending:

clause 12A.3 of the Code to clarify that the effect of clause 43(3) of the default transmission agreement is that the settlement residue distributors must pass-through is net of the administration fee i.e., distributors are only required to pass-through the amount of settlement residue that Transpower passes-through to them, which is settlement residue minus the administration fee.

2.30. The Authority agrees that the current drafting of the Code needs to be amended to ensure that the settlement residue that is required to be passed through is the settlement residue

amount remaining after deducting the administration fee. The Authority has therefore decided to make an amendment to clause 12A.3 of the Code to clarify that the amount of settlement residue distributors are required to pass on is the amount they received less the administration fee they are charged.

Recovery of costs associated with settlement residue pass-through by distributors

- 2.31. ENA supports the payment of settlement residual rebates to transmission customers net of administration costs but considers that distributors should be allowed to pass on to customers only the settlement residue net of both Transpower's and distributors' SRAM processing costs.
- 2.32. Northpower shared ENA's view, expressing its belief that distributors should be entitled to recoup their SRAM processing costs. Specifically, Northpower stated:
- While Transpower have been allowed to recoup their costs to distribute SRAM, the final SRAM guidance paper appears to be silent on this matter for EDBs. There will be costs to configure systems, run monthly processes, and prepare the methodology and annual disclosures. Can you please advise how the Authority expects these costs to be funded.*
- 2.33. This issue is out of scope for the current consultation. The scope of this consultation is to address the recovery of Transpower's SRAM processing costs through proposed changes to the benchmark agreement. The issue raised by ENA and Northpower could be considered by the Authority in a future consultation.

Effect on existing transmission agreements

Our decision

- 2.34. The Authority has decided to amend the Code to deem the amendments to the default transmission agreement enabling recovery of Transpower's SRAM processing costs to be made to all existing transmission agreements from the date the amendment comes into force.

What we proposed

- 2.35. Amending the benchmark agreement would only provide for the recovery of SRAM processing costs under future transmission agreements entered into between Transpower and its customers.
- 2.36. To enable the equitable recovery of costs from all relevant transmission customers' existing transmission agreements, as well as certain "pre-2008" agreements (existing agreements), these agreements need to be amended to include equivalent provisions to those being proposed for inclusion in the benchmark agreement.

Submitters views and our assessment

- 2.37. The Authority received one submission from Orion regarding this issue.
- 2.38. Orion agreed with the proposed amendment. We have not received any submissions that oppose this amendment. The Authority has decided to implement the amendment as proposed in our consultation paper.

Negative SRAM

Our decision

- 2.39. The Authority has decided to amend Part D of the benchmark agreement to provide for Transpower to recover negative settlement residual rebates.

What we proposed

- 2.40. Settlement residual rebates can be negative, either from corrections of previous overpayments or, in relatively rare cases, as a result of the SPD model generating negative LCE in specific grid scenarios.⁶
- 2.41. The Authority proposed two ways that Transpower could pass such negative rebates to its customers:
- a) reducing future rebates (i.e., applying the negative rebate against the rebate amount for the following month).
 - b) invoicing the customer (i.e., requiring payment of the negative amount).

Submitters views and our assessment

- 2.42. We received three submissions relating to this issue.
- 2.43. Orion and Transpower agreed with the proposed amendments; however, Transpower is of the view that distributors should always be able to recover from their customers any costs associated with negative settlement residue that Transpower passes on to them and have suggested that further changes to the Code may be needed to ensure this does not become a cost recovery issue for distributors.
- 2.44. Additionally, Vector stated that:
- The Code, or at least the Authority's practice note (Settlement residual rebates pass-through – Guidance for distributors), should be amended to clarify that clause 12A.3(7) includes adjustments for negative rebates.*
- 2.45. The Authority agrees that, as is the case in rare situations where the administration fee is greater than payments of settlement residue (discussed in paragraph 2.27), in situations where negative settlement residue is greater than positive settlement residue in a particular month, clause 12A.3(7) should enable distributors to adjust future payments of settlement residue made to customers to account for costs that distributors have been left holding in respect of negative settlement residue. A small consequential amendment has been made to this clause to clarify this.

⁶ This can occur where marginal losses are less than average losses (such as where transformers have some fixed losses and are lightly loaded). It can also occur very rarely on unconstrained transmission lines due to very specific loop conditions. See [Appendix B](#) of *Loss and constraint excess payment: Method for determining customer share* It is not uncommon for connection LCE to be negative but has been less common for a customer's total allocation of LCE to be negative.

3. Focused changes to benchmark agreement

Our decision

3.1. The Authority has decided:

- a) to amend the benchmark agreement to include updates for consistency with the new TPM and other minor changes to reflect other law changes;
- b) these amendments will be deemed to be made to all existing transmission agreements, other than certain pre-2008 agreements referred to in clause 12.49 of the Code;
- c) to include the benchmark agreement in the Code as a new Schedule; and
- d) to rename the benchmark agreement the default transmission agreement.

What we proposed

- 3.2. The Authority proposed that the benchmark agreement needs updating for consistency with the new TPM and to make other minor changes to reflect other law changes. These changes are required to provide clarity and reduce uncertainty, ensuring the provisions in transmission agreements effectively reflect and support TPM implementation.
- 3.3. The Authority proposed that these amendments will be deemed to be made to all existing transmission agreements, other than certain pre-2008 agreements referred to in clause 12.49 of the Code. This is to ensure the clarity provided by the updates to the benchmark agreement would also apply to transmission agreements already in place between Transpower and its customers.
- 3.4. The Authority proposed including the benchmark agreement in the Code as a new schedule and updating the underlying Code provisions to make it clear that amendments to the benchmark agreement will be deemed to be made to existing transmission agreements (unless the amendment provides otherwise). This would provide clarity about what happens to existing transmission agreements when the benchmark agreement is amended and that the regular requirements of the Act for Code amendments will apply to any such amendments.
- 3.5. The Authority proposed renaming the benchmark agreement the “default transmission agreement template”, to better reflect the nature and purpose of the agreement (ie, it prescribes the default terms and conditions deemed to be included in transmission agreements in accordance with section 44(2) of the Act).

Submitters views and our assessment

- 3.6. The Authority received three submissions relating to these amendments, from Transpower, Meridian and Vector.
- 3.7. All the submissions are in support of the amendments. Transpower has identified a number of technical and minor drafting tidy-ups, which we have implemented.

Timing for schedules to come into effect

- 3.8. In its submission, Transpower requested drafting changes to clauses 12.10 and 12.13 of the Code to provide that the schedules in the default transmission agreement template, once accepted, amended by Transpower, or determined by the Rulings Panel, be deemed to apply as a default transmission agreement from the date a participant becomes a designated transmission customer or the date that an earlier agreement expires or terminates (rather than two months after this date).
- 3.9. The Authority has decided to consult on this proposal in the Code Review Programme, to provide stakeholders with an opportunity to submit on it. This consultation is due to be released on 29 August 2023.

4. Other matters

Embedded networks

- 4.1. The Code requirements on distributors to pass through settlement residual rebates to their customers do not require embedded networks to pass through rebates. The consultation paper set out a potential issue in that in certain scenarios this might result in an embedded network retaining the settlement residual rebates it receives, potentially leading to competition issues. In the paper, the Authority sought feedback on some potential options that might be used to address this issue as well as any information to assist with understanding the scale of the issue. However, the Authority did not propose a Code amendment to resolve the issue, as we were not sufficiently advanced in our understanding of the matter to be in a position to propose any such amendments.
- 4.2. The Authority appreciates the input stakeholders have provided on this issue.⁷ The issue still requires further consideration. We will consider it further, taking into account the information in the submissions we have received, before making any future proposals on this topic.

Transmission pricing

- 4.3. The Authority received a submission from Stephen Peterson regarding pricing to end consumers that reflects price signals in the TPM. The purpose of this submission was to highlight the potential of utilising the "Benchmark Agreement and SRAM-Related Code Changes" consultation to implement additional adjustments to the Code, intended to contribute to the advancement of electrification and decarbonisation initiatives (such as providing for end-consumers to be treated as notional transmission customers).
- 4.4. The Authority does not consider the "Benchmark Agreement and SRAM-Related Code Changes" consultation to be a suitable platform for addressing these specific concerns (which are more closely related to transmission pricing). Instead, the Authority expects to consider these matters outside of this consultation.

⁷ Submitters included: Orion, Mercury, Transpower, Nova Energy, Meridian, ENA, Vector and Tenco.