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PROJECTS AND INFRASTRUCTURE MATTERS

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Local content in public sector procurement

The Preferential Procurement Policy Framework Act, No 5 of 2000 (Act) was designed to give effect to section 217 (3) of the Constitution, which contemplates that national legislation must prescribe a framework within which a procurement policy must be implemented by organs of state. Thus, the Act creates an overarching framework for implementing the procurement objectives contemplated in the Constitution.

On 10 August 2001, government issued the Preferential Procurement Regulations (2001 Regulations) pursuant to the Act. These regulations mainly set out the framework for implementing the preferential procurement policy determined by the Act. The 2001 Regulations did not address issues such as local content and the Broad-Based Black Economic Empowerment status level certificates.

As a result, the revised Preferential Procurement Regulations (revised Regulations) were issued and came into effect on 7 December 2011. The significant changes that came with these revised Regulations were:

- The revised Regulations elaborate on the preferential point system that is similar to the Act. The formula used in the revised Regulations sets a prescribed threshold of Rand value to be equal to or above R30 000 and up to R1 million and that all tenders received must be evaluated on the 80/20 preferential point system (in terms of Regulation 5(1) and 90/10 (in terms of Regulations 6(1)), whereas in the 2001 Regulations the Rand value was capped from R30 000 to R500 000.
- Local content: this amendment is regulated under Regulation 9 that expressly gives a structured approach to preference for local suppliers and content. The structure of making provision for local suppliers and content under the 2001 Regulations has been elevated in the revised Regulations. Unlike the 2001 Regulations, where an institution had a discretion to accommodate the requirement of locally manufactured products as part of its preference points, under the revised Regulations, this requirement is now peremptory.
- B-BBEE Status Level Certificates: the revised Regulations provide that tenderers with an annual total revenue of R5 million or less qualifying as Exempted Micro Enterprises in terms of the Broad-Based Black Economic Empowerment Act No. 53 of 2008, and must submit a certificate issued by a registered auditor. All other tenderers must submit an original, valid B-BBEE status level verification certification.
- Conditions: it is provided that only a tenderer who has completed and signed the declaration part of the tender documentation may be considered. Organs of state must, when calculating comparatives prices, take into account any discounts which have been offered unconditionally. The points scored must then be rounded off to the nearest two decimal places.

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The revised Regulations apply to organs of state and public entities that are listed in Schedules 2, 3A, 3B, 3C and 3D of the Public Finance Management Act, No 1 of 1999 (PMFA) and municipal entities (institutions) to promote uniformity in public sector procurement. Importantly, the revised Regulations empower the DTI to designate industries, sectors and sub-sectors for local production at a specified level of local content.

In terms of Regulation 9 (1), (2) and (3) of the revised Regulations, in instances of designated sectors, when awarding tenders, organs of state must consider issues such as local production and content, and must advertise such tenders with a specific condition that only locally produced goods, services or works or locally manufactured goods with a stipulated minimum threshold for local production and content, will be considered. Where there is no designated sector, the organs of state may include specific conditions. The National Treasury will be responsible for issuing instructions, circulars and guidelines to all organs of state to ensure compliance. The local content requirement is designed to boost local entrepreneurs and to increase local procurement as part of government's plan to create more jobs.

Local content is a pre-qualification criterion. A specific local content bidding condition must be met first when bids are submitted, and only locally manufactured goods with a stipulated minimum threshold for local production and content will be considered.

In December 2011 and on 8 January 2012, the National Treasury issued a circular as a guideline on local content requirements for accounting officers and accounting authorities. The circular describes the local content designation and is intended to ensure that tenders are advertised with this specific bidding condition, in terms of Regulation 9 of the Act.

The initial Supply Chain Management Circular issued in December 2011 set out various sectors the DTI had identified for designation in terms of Regulation 9(1) of the Act. This circular applied to all national and provincial government departments, constitutional institutions and public entities. This circular was subsequently withdrawn and has been replaced with a new current circular, which was issued on 20 January 2012.

A significant change identified in the current circular is the national government's removal of the steel sector from the designated sectors. This exclusion means that when it comes to steel, which is the single biggest input in infrastructure plans, all products will be treated in the same way, regardless of the origin.

Local content in practice

The government and the relevant state entities are expected to allocate R262 billion in funding over the next three years to transport and logistics infrastructure. This is in an effort to improve public transport and the mobility of people and services.

Public entity, PRASA, is responsible for providing passenger services for South African citizens. PRASA has embarked on a process to invest in new rolling stock and has begun a long term project to renew its fleet of rolling stock and upgrade its stations nationwide. The investment process is the result of the rapidly deteriorating state of rolling stock, high maintenance and refurbishment costs. On 19 April 2012, the Minister of Transport, Sibusiso Ndebele, announced that 7,224 metro coaches would be refurbished at an estimated cost of R123 billion.

PRASA embarked on a local supplier market survey to measure the strength and capacity of the local industry to fulfil the legislated percentage of the minimum local content targets, which has to be satisfied by bidders in any PRASA rolling stock procurement process. As a result of this market survey and subsequent to the published revised Regulations, PRASA produced a rolling stock fleet renewable programme containing a local content document, which unpacks the context, meaning and various aspects of localisation for potential rolling stock manufacturers.

This local content document is a clear demonstration of PRASA's commitment and support of government's objectives set out in the Act and the revised Regulations. The minimum local content threshold of 65% in the rolling stock sector stipulated in the revised Regulations, means that bids for a rolling stock sector will not be considered unless 65% of goods, services or works are locally produced or locally manufactured.

In conclusion, procuring South African goods will lead to economic growth, job creation, income generation and the competitiveness of South African products - a progressive step for South African manufacturers and the economy at large.

Rachel Jiyana and Lindiwe Masina

Variation of contractual terms of tenders

Once tenders have been invited, an Accounting Authority (Authority) will appoint a preferred bidder and an agreement will be concluded with that bidder for the provision of goods and services. After concluding the tender award, if the circumstances change, the Authority may seek to amend the terms of the tender awarded so as to increase the scope of the original assignment.

This article considers the scope or extent to which an Authority may vary the terms of a tender award after concluding an agreement with the preferred bidder, in light of the case of *Nelson Mandela Bay Municipality v Afrisec Strategic Solutions (Pty) Ltd 2008 JDR 1014 (SE) (Afrisec)*.

Constitutional principles

To appreciate the scope to vary the terms of an agreement concluded pursuant to a tender award, one needs to appreciate the purpose of tender specifications in the tender process.

Section 217 of the Constitution of the Republic of South Africa Act, No 108 of 1996 (Constitution) provides that a procurement system must be fair, equitable, transparent, competitive and cost-effective. To this end, section 217 of the Constitution achieves the promotion of equal treatment of bidders and the elimination of corruption. It also ensures that bidders are aware of the requirements of the Authority as set out in the tender invitation and enables bidders to structure their proposals accordingly.

The constitutional implication of a variation to the tender agreement is that the preferred bidder is given the opportunity to conclude an agreement with the Authority, on terms and conditions that are more often than not different to the terms contained in the tender request for proposals. Legal challenges to variations of tender agreements are aimed at showing that the variation contravenes the principles of fairness and transparency, and other principles contained in section 217 of the Constitution.

Addressing the constitutional implications of a variation to the tender agreement, the court in *Premier, Free State, and Others v Firechem Free State (Pty) Ltd 2000 (4) SA 413 (SCA) (Firechem) at 428* held that "competitors should be treated equally, in the sense that they should all be entitled to tender for the same thing. Competitiveness is not served by only one or some of the tenderers knowing what is the true subject matter of tender".

Changes to the terms of the agreement have the potential to violate and undermine the equitable and competitive process envisaged by section 217 of the Constitution.

Scope of variation

In terms of the National Treasury Instruction Note on enhancing compliance monitoring and improving transparency and accountability in supply management issued on 31 May 2011, under section 76(4) of the PFMA, the Instruction Note provides that an Authority may vary or expand the terms of the original contract only in exceptional circumstances. The Instruction Note does not provide any guidance regarding circumstances that may be deemed to be exceptional and therefore justifying a variation or expansion of the terms of the original contract. However, in order to prevent gross abuse of the Authority's discretion in this regard, the National Treasury prescribed thresholds for the variation or expansion of contractual terms of the original contract. In terms of the Instruction Note, contracts may be varied or expanded by not more than 20% or R20 million including all applicable taxes, for construction related goods, works or services, and 15% or R15 million including all applicable taxes, for all other goods or services of the original value of the contract, whichever is the lower amount[1].

According to academic commentators[2], the general view is that public bodies should be prohibited from entering into post-award negotiations with the preferred bidder. It is accepted that in certain instances it may be necessary to do so in order to obtain a lower price. However, such negotiations should be undertaken in very limited circumstances and should not result in the preferred bidder obtaining an advantage, nor should the negotiations result in a fundamental or material change to the original tender.

Our jurisprudence provides little guidance regarding the test for a material or significant variation of a tender agreement. In a German court's decision in the case of *Pressetext Nachrichtenagentur GmbH v Republik Osterreich (Bund) ECJ 2008* at paragraphs 35-37, the court held that a public contract may be regarded as a material variation when:

- It introduced conditions which, had they been part of the initial award procedure, would have allowed for the admission of bidders other than those initially admitted.

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- It extends the scope of the contract considerably to encompass services not initially covered.

- It changes the economic balance of the contract in favour of the contractor or in a manner which was not provided for in terms of the initial contract.

Where the agreement concluded envisages the conclusion of further agreements pursuant to fulfilment of the tender agreement, the accessory agreements must not exceed the purpose or authority of the original agreement.

Accessory agreements that exceed the purpose or scope of the original agreement are invalid, as was found by the court in *Afrisec*.

In the *Afrisec* case, the Nelson Mandela Bay Municipality brought an application to have the scope of works agreements (SOWs) concluded with Afrisec declared invalid because the SOWs exceeded the scope of the tender agreement. The SOWs were concluded pursuant to the fulfilment of the terms of the original agreement. Afrisec had concluded an agreement with the Municipality for the design of a security master plan. The Municipality contended that the scope of the tender agreement concluded with Afrisec was for the design of a security master plan. On the other hand, Afrisec contended that the scope of the tender included the design and implementation of the security master plan.

In order for the SOWs to be declared invalid the court had to find that the SOWs exceeded the scope and purpose of the tender agreement and were therefore invalid. In declaring the SOWs invalid the court noted the following.

Firstly, the import of the original tender was the implementation of the security master plan and not its design, as had been advertised. Secondly, the SOWs purported to grant Afrisec the right to implement the security plan despite this not being part of the advertised tender. Lastly, the original tender was valued at R2,7 million whereas the SOWs were the valued at R12 million. The court concluded that the SOWs exceeded the scope of the original tender and accordingly, the original tender and the SOWs were set aside.

Although the test for material deviation is found in foreign jurisprudence, a similar approach appears to have been adopted by the court in *Afrisec*. The SOWs sought to introduce the implementation aspect of the tender, which was not part of the invitation for proposals. Had the implementation of the security master plan been part of the invitation, it is possible that more bidders would have bid for the tender. By concluding the SOWs in order to enable Afrisec to implement the security master plan, the Municipality was prejudicing bidders that had tendered for the original tender agreement as well as those that had not tendered. Furthermore, the advantage in favour of Afrisec in terms of the SOWs, was greater in value than the original tender.

Afrisec did not consider whether a variation was material but rather whether the SOWs were in fact *ultra vires* of the tender agreement. It is submitted that when our courts are called on to decide on the issue of a material or significant variation of contractual terms after the award of a tender, guidance will and should be sought from foreign case law (as cited above) as well as the thresholds provided for in the Instruction Note. Unlike the Instruction Note, foreign case law is not conclusively binding on our courts. However, it can be used to provide sufficient guidance regarding the issue of a material or significant variation to the contractual terms after a tender award.

Claire Barclay and Khaya Matengu

1. *NT Instruction Note at para 3.9.*
2. *Bolton P "The status of contracts exceeding a municipal tender call" TSAR (2009) 2 at 389.*

Government commits to developing infrastructure projects in South Africa

In the 2012 State of the Nation Address and Budget speech, government committed to expand infrastructure investment. Government intends broadening the infrastructure boom that gained momentum since the 2010 Soccer World Cup and the Gautrain project to achieve national economic growth and development.

Speaking at the Provincial and Local Government Infrastructure Conference in April 2012, Deputy President Kgalema Motlanthe indicated that government's infrastructure development plan is targeted at undeveloped areas, but acknowledged that the pace of infrastructure development was lagging behind. Cabinet set up the Presidential Infrastructure Coordinating Commission (PICC) to bring together representatives of the three spheres of government. The PICC has a mandate to develop a 20 year infrastructure pipeline, to ensure forward planning of infrastructure development and curtail the stop-start syndrome around building infrastructure.

Over the Medium-Term Expenditure Framework (MTEF) period, R845 billion has been approved and budgeted for public sector projects with some R300 billion in the energy sector and R262 billion allocated to transport and logistics projects. Infrastructure funding is largely provided by the national government. However, public entities such as Eskom and Transnet will also undertake infrastructure development in some sectors. Other initiatives include government's expanded public works programme and public private partnerships. Private sector investment is crucial as it will play a significant role in financing several public sectors.

Projected infrastructure plans

Chapter 7 of the Budget speech released by Finance Minister Pravin Gordhan on 22 February 2012, gives an overview of the government's plans for developing infrastructure.

Electricity

The programmes for electricity projects are mainly to increase electricity generation capacity. These programmes are underway. Medupi and Kusile (Eskom's two large coal-fired plants) are under construction and expected to start operating in 2013 and 2014, with full electricity generation expected by 2017 and 2018.

South Africa has a long term plan for renewable energy. The Integrated Resource Plan 2010 - 2030, which is a process to meet users' needs for electricity services in a way that satisfies multiple objectives for resource use, has set its targets. This includes providing 21% or 18.9GW of generation capacity from renewable sources by 2030.

Other complementary renewable energy projects are:

- Government's renewable energy independent power producer programme, which aims at procuring 3 725MW of renewable energy by 2016.
- Eskom's plan to build a 100MW concentrated solar power plant.
- Government is exploring the feasibility of establishing a large solar park between 1000MW and 5000MW in the Northern Cape to accommodate Independent Power Producers.

Liquid Fuels

Liquid fuel powers transportation and a wide range of industrial uses. The first phase of Transnet's R23,4 billion new multiproduct petroleum pipeline has been completed. The pipeline will increase capacity to meet inland demand for fuel and moderate road congestion by reducing the number of fuel tankers travelling between Durban and Johannesburg. Port infrastructure is also being upgraded to enable ports to handle more fuel shipments inland and around the coast.

Water and Sanitation

As a result of South Africa's insufficient capacity and quality of infrastructure required to store and distribute water to households and industry, government has increased investments in this sector.

The Trans-Caledon Tunnel Authority, a state owned entity responsible for project financing and construction, has undertaken large investments.

One such investment is the Kamati Water Scheme Augmentation Project, which will be responsible for providing water to Eskom's power stations. Another investment is the Lesotho Highlands Water Project. This project will augment water supply for domestic and industrial users in Gauteng. Lastly, the Olifants River Water

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Resources Development Project, will provide water for domestic use to semi-urban and rural communities in Limpopo, and will further support mining projects. About R75 billion is allocated to water infrastructure, quality management planning and local government support.

Transport

R262 billion is expected to be allocated to transport and logistics infrastructure, which includes Transnet's spending on pipelines and accounts for 27% of the total public sector infrastructure budget. The national and provincial budget includes funding for road construction and maintenance.

The South African National Roads Agency, which is responsible for maintaining and expanding the 16,170km national road network, will spend around R25 billion on new roads and infrastructure, with R18 billion set aside for maintenance. The Passenger Rail Agency of South Africa (PRASA) has begun a long term project to renew its fleet of rolling stock and upgrading stations. The Airports Company of South Africa completed Durban's King Shaka Airport and facilitated major developments at OR Tambo International Airport in Johannesburg and the Cape Town International Airport. Projected investment to support other airport upgrades amount to R2,9 billion.

Telecommunications

The focus of recent investment is on upgrading broadband internet, mobile and land-based telephone infrastructure. The main telecommunication service providers are from the private sector. Service providers have expanded their land-based and wireless networks, and increased international connections via submarine cables.

Broadband capacity has grown and is becoming more affordable. This is reflected in the growth of internet users from 5,3 million in 2009 to 9,5 million in 2011. State-owned entities such as Infraco, have committed over R1 billion in capital investment to support the West Africa Cable System. Now under construction, the West Africa Cable System is a submarine communications cable linking South Africa with the United Kingdom along the west coast of Africa.

Human Settlements

According to Chapter 7, government has delivered more than 3 million housing units since 1994. But there remains a backlog of an estimated 2,1 million houses. Also according to Chapter 7, the decline in housing delivery can be attributed to the ever increasing demand for housing, which has placed strain on resources. This is partly due to higher building and land costs. As a result R50,5 billion has been allocated to low-income housing and upgrading informal settlements in secondary cities, as well as R27 billion to upgrade informal settlements in large cities.

Special Economic Zones

On 23 January 2012, the Department of Trade and Industry (DTI) issued the Draft Bill on Special Economic Zones (SEZs). The Draft Bill aims to promote widespread industrialisation through effective management of SEZs. Government has allocated R2,3 billion to support business investment in targeted economic zones. The SEZs will promote exports and more widespread industrialisation. The cluster developments are intended to attract manufacturers by providing high quality infrastructure, incentives and support services, with minimal red tape.

It is vital for projects to represent value for money. To this end, government has expressed its intention to develop a comprehensive project register, which will be updated quarterly. This register will improve the monitoring of expenditure monitoring and management of infrastructure programmes. The information will be made available to Parliament and the general public.

This mechanism is being pursued against the backdrop of chronic under-spending against capital budgets. The register will not only improve visibility of the status of each public infrastructure project under construction but will also promote transparency in government departments and enhance public confidence. In addition, all public sector projects will be subject to rigorous feasibility studies and to government choosing the most cost-effective projects that offer the best long term benefits.

Lyle Horsley, Rachel Jiyana and Khaya Matengu

Public Private Partnerships in Africa - project pipeline, professionalism and process

African governments are subscribing to the idea of harnessing private sector skill and capital to meet infrastructure demands in their countries. This is apparent from the various Public Private Partnerships (PPP) regulatory frameworks being promulgated in southern, eastern and western African countries.

There have been a number of PPP laws that have been passed in the last few years, most of which still remain untested. However, before going out to the market, governments need to set up the correct institutional mechanisms and environment for the successful roll out of PPPs.

South Africa has had its regulatory framework in place for about eight years and has been undertaking PPP projects for at least a decade. Media reports show that project sponsors and lenders are disillusioned by the slow pace of the implementation of PPPs.

While the National Treasury is satisfied with the pipeline of projects and the time it takes to close deals, implementing government departments, under pressure to deliver, are voicing frustration with the long periods between inception and closure. Changes in circumstances during these long periods has led a number of government departments to cancel their PPPs. The unpredictability in this approach has led to market cynicism of PPPs as a successful form of infrastructure procurement.

A few of the essential building blocks of any PPP programme includes putting in place the necessary institutional structures and arrangements for a regulator. PPP legislation usually establishes a PPP Unit. Critical to its success is having staff that know and understand PPPs. The diverse skill sets required to fully appreciate the mechanics of PPPs cannot be taught overnight. Burgeoning PPP Units in African countries may consider seconding people with relevant skills from the private sector, or if possible, officials from other SADC PPP Units, in an attempt to provide meaningful skills transfer to officials in those Units.

Another essential requirement is that governments need to prioritise which of their infrastructure projects are suited for PPP and which are suited to direct procurement for shorter term contracts. There is a risk that African governments see PPP as the panacea to their infrastructure woes without understanding the full extent of their exposure. Governments need to understand that PPPs are an expensive form of procurement and come at a much greater cost to government as the fiscus is required to pay lender costs and fees as well as sponsor returns. What generally pushes the drive for governments to go the PPP route is funding constraints. In Africa, the funding options for government are generally limited to procuring debt from commercial lenders, from DFIs or through bond issues.

Governments should also pace the introduction of PPP projects. Flooding a smaller market with projects will see local players losing out to their international competitors which, during strained global economic times, are looking to developing markets for deal flow. Governments need a co-ordinated policy outlining which sectors require greater prioritising in terms of infrastructure development.

The PPP units within governments also have the task of properly mobilising the private sector, which involves speaking to the commercial lenders within that country, and assessing the capacity of sponsors to take on long term projects. In most African countries, it is customary for the commercial lenders to provide debt for a five to seven year tenure. This period is unlikely to match the traditionally longer project term required for a PPP. Changing lending patterns is critical for local banks if they want to participate in the debt funding of a PPP, however this must be driven by the PPP Unit if they want to see successful PPP implementation. These are a few of the essential pre-requirements for a successful PPP programme.

Failure to prepare adequately will lead to a sub-optimal result and a short-lived PPP regime as a mechanism to deliver on essential infrastructure for the African continent.

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