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14 November 2001

Dr FN Ginwala
Speaker of the National Assembly
PO Box 15
CAPE TOWN
8000

Dear Madam Speaker

TRANSMITTAL LETTER: JOINT INVESTIGATION – STRATEGIC DEFENCE PROCUREMENT PACKAGES

The Public Protector, Auditor-General and National Director of Public Prosecutions hereby submit their Report to Parliament on the joint investigation into the Strategic Defence Procurement Packages undertaken by them. Due process and consultation have taken place in finalising this report.

Your attention is respectfully directed to the appropriate legislation of the three agencies, which provides that their report must be tabled in Parliament as soon as possible.

Yours sincerely

SAM BAQWA, SC
Public Protector

SA FAKIE
Auditor-General

BT NGCUKA
National Director of
Public Prosecutions

i. PREFACE

1. Investigations, by their very nature, generate expectations and controversy: controversy in that an over-zealous investigation might be seen as a witch-hunt or a fishing expedition, whilst a superficial investigation might smack of a cover-up.
2. The test of commitment lies not in a preference for any of these extremes, but in a golden mid-way, where a balance is struck between the demands for accuracy, rigorous investigation and the rights of privacy of those affected.
3. Our pursuit has been deliberate; to conduct a proper and diligent examination that reaffirms the solid foundation and pillars of our legal system and ultimately enhances our democracy.
4. Because of human nature, news that an investigation is underway tends to create the expectation that something bad will be found. Any investigation is expected to either implicate or exculpate. Often that is not the case.
5. The investigation has essentially been about probity: whether those representing the government have conducted business diligently, properly and in the best interest of the country. Secondly, whether the contracting parties have followed the rules of good faith and fairness.
6. The issues of procedure, checks and balances, compliance with policy and good business practice have all been an important part of this inquiry. Relating to this has been the question whether crimes have been committed and, more

specifically, whether prosecutions could be and ought to be instituted. Our findings, given the purpose of this report, will probably be the subject of considerable debate.

7. We have at all times endeavoured to act in accordance with the spirit of the Constitution in conducting the investigation with resolute independence, depth of courage and an uncompromising standard of intellectual integrity.
8. In essence, we are duty-bound to conduct our business in a measured, accountable and objective manner that instils legitimacy and respect for the law. That, we hope, we have done without the abuse of power or process.
9. An investigation of this kind can, of course, never be perfect because the discipline involved is not an exact science and the human element can never be accounted for fully.
10. The challenge, presented by this investigation, goes to the *raison d'etre* of the institutions supporting constitutional democracy and those involved in the administration of justice. The impartiality, objectivity and independence of the three institutions involved are issues that have remained in the arena consistently. We hope that we will not be found wanting.

CHAPTER 1

BACKGROUND

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CHAPTER 1

BACKGROUND

1.1 INTRODUCTION

1.1.1 The Basis for the Submission of the Joint Report

This joint report is submitted to Parliament in terms of sections 182(1)(b) and 188(3) of the Constitution, 1996 (Act No 108 of 1996 – hereinafter referred to as the Constitution), and section 35(2)(b) of the National Prosecuting Authority Act, 1998 (Act No 32 of 1998, as amended). The report relates to the investigation into the Strategic Defence Packages for the acquisition of armaments for the South African National Defence Force, which was conducted jointly by the Offices of the Public Protector, Auditor-General (A-G) and the National Director of Public Prosecutions (hereinafter referred to as the National Director).

1.1.2 The Defence Review: Aim, Logic and Force Design Options

1.1.2.1 Section 200(2) of the Constitution, provides that it is the primary objective of the South African National Defence Force to defend and protect the Republic, its territorial integrity and its people in accordance with the Constitution and the principles of international law regulating the use of force. South Africa also has international commitments, particularly in the African Region, to support operations under the auspices of the United Nations and other similar organizations, which involve military resources. The SANDF has the additional task of protecting the coastline and the marine resources of the Republic.

1.1.2.2 During May 1996 the former Minister of Defence, Mr J Modise presented the White Paper on National Defence for the Republic of South Africa to Parliament.

(White Paper). It has received strong support from all the political parties and was approved by Parliament. A policy framework and the main principles of defence were thereby established.

1.1.2.3 The White Paper also made provision for a Defence Review to include the following:

- (a) Options with regard to the size, roles and the structure of the SANDF.
- (b) Addressing the implications of the core force approach for the size, doctrine, structure, weaponry, equipment and other features of the SANDF.
- (c) Addressing the Strategic and technical implications of the constitutional provision that the SANDF *“shall be primarily defensive in the exercise of its powers and functions”*.

1.1.2.4 The aim of the proposed Defence Review was to elaborate on the policy framework based on the long-term planning of issues such as structure, force design, force levels and armaments.

1.1.2.5 The former Minister of Defence appointed a working group to draft the Defence Review with the Secretary of Defence as coordinator. The working group presented several briefings to the parliamentary Standing Committee on Defence. For the periods September 1994 to January 1999 and February 1999 to 1 June 1999, the committee was chaired by Mr T Y Yengeni and Ms T R Modise, respectively. The current chairperson is Mr J N Mashimbye.

1.1.3 Logic of the Defence Review

1.1.3.1 In determining the appropriate size, structure and force design of the SANDF for the 21st century, the following had to be established by the Defence Review:

- (a) The tasks that the SANDF will and may have to perform in the future.
- (b) The manner in which these tasks should be undertaken.
- (c) The equipment and weaponry required by the SANDF to fulfil these tasks.

1.1.3.2 The identification of the SANDF tasks has been based on the following:

- (a) The constitutional provisions on Defence.
- (b) The policy contained in the White Paper on Defence.
- (c) An analysis of the internal and external security environment.

1.1.3.3 The Defence Review indicated that defence planning can be described as *"needs driven and cost constrained"*.

1.1.4 Force Design Options

1.1.4.1 The Department of Defence developed different force design options. These options reflected the different permutations of the level of defence, defence structure and cost, for public consideration during the consultative conferences on the Defence Review.

1.1.4.2 Cabinet and the Parliamentary Defence Committees were presented with four options, which were discussed in detail. The chosen option relevant to this investigation is set out below and was approved, subject to the availability of finances.

SANDF FORCE DESIGN	
SA Air Force	
Fighters	
Light Fighters	16
Medium Fighters	32
Helicopters	
Combat Support Helicopters	12
Maritime Helicopters	5
Transport Helicopters	96
SA Navy	
Submarines	4
Corvettes	4

1.1.4.3 During the selection process, certain foreign countries approached the DoD, formally and informally with various offers to enter into agreements to procure military equipment. These offers entailed packages consisting of Naval, Air Force and Army equipment. This resulted in the DoD adopting a “package” approach to the acquisition process as opposed to the individual purchasing of equipment types. These offers became known as the Strategic Defence Packages (SDP).

1.1.4.4 The South African Defence Review was approved by Parliament in April 1998.

1.1.5 Special Review of the Auditor-General [RP 161/2000]

1.1.5.1 During November 1998, the Defence Audit Centre of the Office of the Auditor-General identified the procurement of the SDP as a high-risk area from an audit point of view and decided on the need to perform a special review of the procurement process.

1.1.5.2 On 28 September 1999, after various consultations, the Minister of Defence, Mr M P G Lekota, finally approved the audit review into the SDP. The audit process was duly followed and the A-G finalized and signed the Special Review on 15 September 2000.

- 1.1.5.3 The main findings and recommendations of the Special Review by the A-G dealt with the following issues:
- (a) The independence of role players involved with the procurement of the SDP.
 - (b) The technical evaluation of the Lead in Fighter Trainer (LIFT) during the procurement process.
 - (c) The adequacy of the performance guarantees pertaining to the National Industrial Participation programme (NIP).
 - (d) The policy of the Ministry of Defence pertaining to the SDP procurement.
 - (e) The armaments acquisition policy applied during the SDP procurement.
 - (f) The Negotiations in respect of the Frigates (corvettes).
 - (g) The tender procedures followed to award subcontracts.

1.1.6 Subsequent events

- 1.1.6.1 The Special Review was the subject of hearings and deliberations of the Parliamentary Standing Committee on Public Accounts (SCOPA), which culminated in the fourteenth report of the committee. On 2 November 2000 the National Assembly adopted the SCOPA report.
- 1.1.6.2 SCOPA suggested in the report that a meeting be convened with the A-G, the Public Protector, the National Director of Public Prosecutions and the Health Special Investigation Unit (SIU) to discuss the broad framework of an independent and expert forensic investigation into a number of issues, which

were referred to in the Special Review, as well as other information in the possession of SCOPA.

1.1.6.3 The proposed meeting was held on 13 November 2000 and SCOPA was informed of the decisions as set out hereunder:

(a) The Directorate of Special Operations of the National Prosecuting Authority (DSO), the Offices of the A-G and the Public Protector and SIU would conduct a joint investigation in order to combine skills, resources and legal mandates.

(b) The A-G would act as the coordinator of the investigation.

1.1.6.4 On 16 November 2000, the three agencies held a meeting to discuss the approach to the investigation, the responsibilities of the agencies, the sharing of information and the way forward. A further meeting was held on 1 December 2000.

1.1.6.5 Following these meetings, DoD was requested to declassify all the relevant documentation pertaining to the SDP. As this was not possible, they requested DSO to provide them with a summons, which was issued in early January 2001.

1.1.6.6 It should be pointed out that the SIU was not formally instructed by Proclamation by the President, as required by law and hence did not form part of the joint investigation. The President publicly announced the reasons for his decision in this regard.

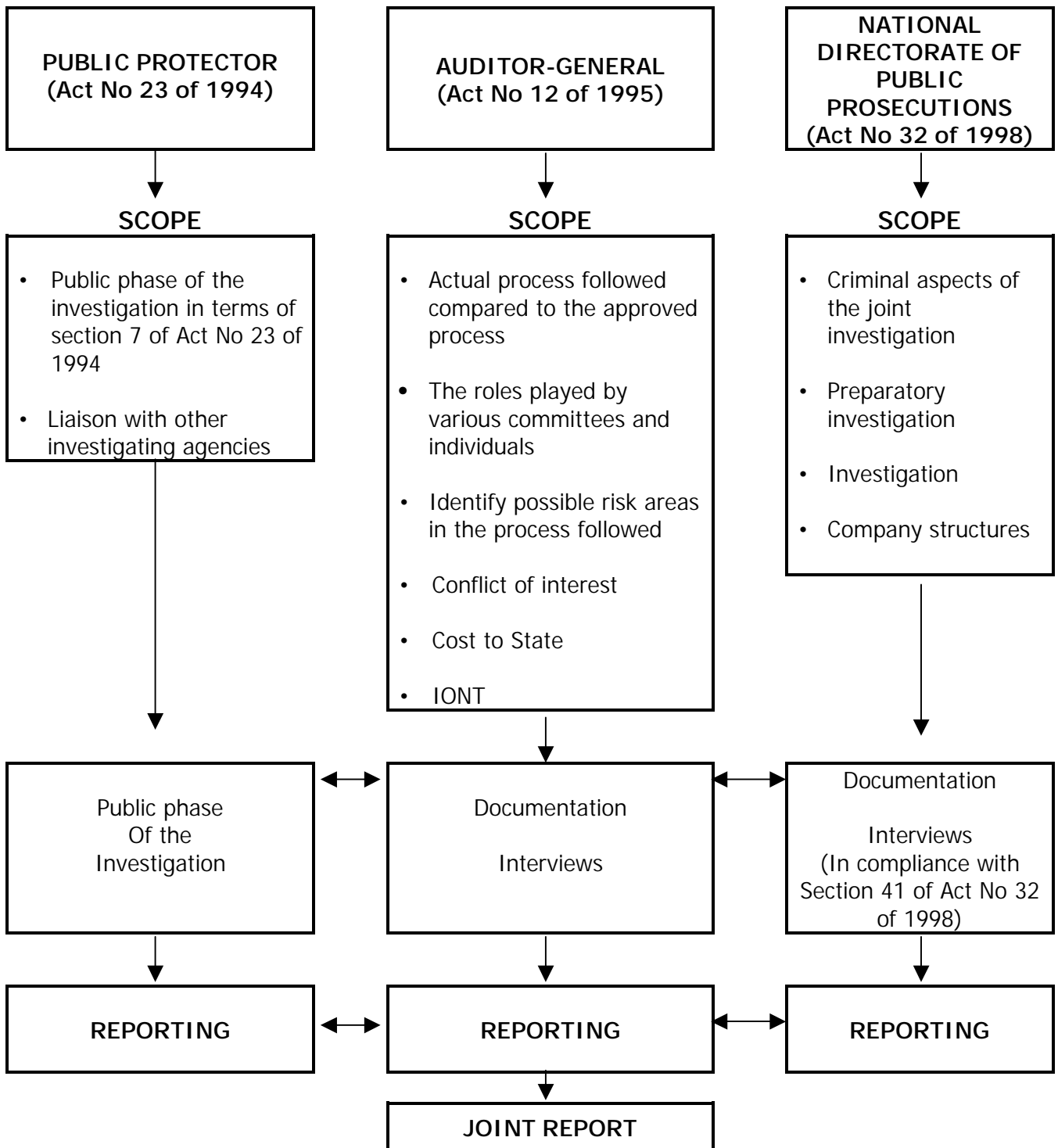
1.1.6.7 Following these meetings and the President's decision on the SIU, it was agreed as follows:

- (a) The DSO would focus on the allegations and suspicions of criminal conduct, whilst the Office of the A-G would conduct an extensive forensic investigation.

- (b) The Public Protector would look into the quality of the SDP contracts and unethical conduct by any of the public officials.

(Refer to the schematic presentation below, which provides an exposition of the areas of responsibilities and the inter- relationship between the three agencies).

AREAS OF RESPONSIBILITY AND INTER-RELATIONSHIP



- 1.1.6.8 On 18 January 2001, the President, the Ministers involved in the approval of the arms procurement, the A-G, the National Director and the Public Protector met to discuss the availability of the documentation. An agreement was reached about the withdrawal of the summonses and the development of alternative measures to allow the investigation teams access to the documentation. This entailed the granting of controlled access to the documents, which was agreed upon by the investigation teams and DoD. In terms of this arrangement, Officials of DoD identified the location of the documents concerned to the investigations.
- 1.1.6.9 On 7 February 2001, the Deputy A-G appeared before SCOPA in a public briefing and provided them with an overview of the nature and scope of the investigation together with a status report and a budget.
- 1.1.6.10 SCOPA held a further hearing on 26 February 2001, where the Ministers of Defence, Finance and Trade and Industry were called to testify and explain the procurement process of the SDP.
- 1.1.6.11 On 2 March 2001, the investigation agencies held a meeting with the Secretary for Defence to finalise arrangements to obtain access to the documentation.
- 1.1.6.12 On 26 March 2001, the three agencies decided that the public phase should commence towards the end of May 2001 under the auspices and legal mandate of the Public Protector.
- 1.1.6.13 The joint investigation was unique in that the three organs of State, for the first time, conducted an investigation into alleged irregularities and criminal conduct simultaneously. The holding of a public phase as part of the investigation can equally be described as unique. This was by no means an easy task as all three agencies had to pioneer their way through uncharted and, at times, difficult territory.

1.1.6.14 All the information and evidence that was obtained to date and the effects thereof have been considered. Due process was also followed in the investigation.

1.1.6.15 The findings of the investigation where considered necessary and appropriate, have been included in this report. Areas of a criminal and sensitive nature, were considered inappropriate to be included in this report.

1.1.7 Practical difficulties and challenges

1.1.7.1 As with any other investigation, practical difficulties and challenges were encountered. Some of these were the following:

- (a) Obtaining the documents according to the controlled access arrangement proved to be cumbersome. The investigation teams also had to accept that the documents, which were found at the identified locations, were all the documents pertaining to the procurement in question. It was therefore not possible to ensure that access was provided to all the documents. There is, however, no indication that any documents has been willfully hidden, destroyed or kept from the agencies.
- (b) One of the many challenges, was to control and manage documents in excess of 700 000 pages, which were obtained from the DoD.
- (c) The agencies recognised the right to legal representation of those persons or institutions affected by the investigation. Therefore, the investigation teams had to contend with the different time schedules of the different legal teams in order to find suitable dates for consultations and the questioning of witnesses. In addition, many of the witnesses have left the employ of the departments in question and therefore had to be traced.

- (d) The role and function of the media to keep the public informed and to ensure accountability and transparency has been recognised and respected equally throughout the investigation. Clearly, the investigation is a matter of enormous public interest and hence the intense media interest. It appears from news reports that the media conducted an investigation concurrently with the investigation team. This has led to some difficulties.
- (i) The media exposed the names of various individuals and connected them to various allegations before any findings have been made.
- (ii) This resulted in the affected individuals' unwillingness to cooperate with the agencies. There were also unexplained leaks to the media, which often prejudiced the investigation.

In order to address these difficulties, a meeting was held with the media to obtain their support in cooperating with the joint investigation teams.

It should be borne in mind that, while recognising the media's freedom to receive and report information and the public's right to know, these rights are not absolute; they are limited by what is reasonable and justifiable in an open democratic society based on human dignity equality and freedoms.

What we should guard against and what is often counter-productive, are unconsidered and premature revelations and disclosures, speculation, defamatory name-calling and, other actions that might be detrimental to an investigation.

- (e) Difficulties were also experienced at the commencement of the public phase when SABC and Midi TV lodged applications for the direct and/or

delayed broadcasting of the proceedings. After the Public Protector dismissed the applications, SABC and Midi TV applied to the High Court (Transvaal Provincial Division) to have the ruling reviewed. This application was also dismissed.

1.1.7.2 It should be pointed out that the government departments and agencies that were involved in the investigation cooperated with the three agencies. The difficulties experienced also did not have any effect on the results of the investigation.

1.2 THE LEGAL MANDATES, POWERS AND FUNCTIONS OF THE PUBLIC PROTECTOR, THE AUDITOR-GENERAL AND THE NATIONAL DIRECTOR OF PUBLIC PROSECUTIONS

1.2.1 The Public Protector, Auditor-General and National Prosecuting Authority, headed by the National Director, exist separately in terms of the Constitution. Each has his own constitutional mandate.

1.2.2 In chapter 9 of the Constitution, the Public Protector and the Auditor-General are grouped together under the heading *“State Institutions Supporting Constitutional Democracy”*. In terms of section 181(2) these institutions are independent and subject to only to the Constitution and the law. They are constitutionally bound to be impartial and to exercise their powers and perform their functions without fear, favour or prejudice.

1.2.3 Section 181(3) of the Constitution places a duty on other organs of State to assist and protect these institutions in order to ensure their independence, impartiality, dignity and effectiveness.

1.2.4 In terms of section 182(1) of the Constitution, the Public Protector has the power to:

"(a) investigate any conduct in state affairs, or in the public administration in any sphere of government, that is alleged or suspected to be improper or to result in any impropriety or prejudice;

(b) to report on that conduct; and

(c) to take appropriate remedial action."

1.2.5 Any report issued by the Public Protector must be open to the public unless exceptional circumstances require that it be kept confidential.

1.2.6 The powers and functions of the Public Protector are regulated in more detail by the provisions of the Public Protector Act, 1994 (Act No 23 of 1994). In terms of section 7 of the Act, the Public Protector can conduct informal preliminary investigations of allegations and information that refer to matters that fall within his jurisdiction. He can also conduct more formal investigations such as the one under discussion in this report. The Public Protector determines the format and procedure of any investigation.

1.2.7 In terms of section 7(1)(b)(ii) of the Act, the Public Protector may direct that any category of persons or all persons whose presence is not desirable shall not be present at the proceedings of an investigation.

1.2.8 The Act, furthermore, provides in section 7(3) that the Public Protector may request any person at any level of government, performing a public function or otherwise subject to the jurisdiction of the Public Protector to assist him in an investigation.

1.2.9 The Public Protector may direct any person by means of a subpoena to submit an affidavit or affirmation or to appear before him to give evidence in connection with any matter that has a bearing on the matter being investigated

(Section 7[4][a]). He may also request an explanation (without a subpoena) from any person he reasonably suspects of having information regarding the matter being investigated (Section 7[4][b]).

1.2.10 Any person appearing before the Public Protector is entitled to legal representation. He is entitled, through the Public Protector, to question other witnesses (Section 7[9][b][ii]).

1.2.11 Section 9(a) of the Act provides that if it appears to the Public Protector during the course of an investigation that any person is being implicated in the matter being investigated and that such implication may be to the detriment of that person or that an adverse finding pertaining to that person may result, the Public Protector shall afford such person an opportunity to respond in connection therewith, in any manner that may be expedient under the circumstances.

1.2.12 In terms of section 6(4) the Public Protector can, in his sole discretion, take the following action to resolve a dispute or to address any improper act or omission:

- (a) mediation, conciliation or negotiation;
- (b) advising the complainant of appropriate remedies, where necessary;
- (c) making appropriate recommendations to the public body involved;
- (d) referring the matter to the authority charged with prosecutions where the facts disclose the commission of an offence; or
- (e) any other means that may be expedient under the circumstances.

1.2.13 Section 188(1) of the Constitution provides that the A-G must audit and report on the accounts, financial statements and financial management of:

- (a) all national and provincial state departments and administrations;

- (b) all municipalities; and
 - (c) any other institution or accounting entity required by national or provincial legislation to be audited by the A-G.
- 1.2.14 The A-G must submit audit reports to any legislature that has a direct interest in the audit. All reports must be made public.
- 1.2.15 The additional powers and functions of the A-G are prescribed by the Auditor-General Act, 1995 (Act No 12 of 1995).
- 1.2.16 In terms of section 3(5) of the Auditor-General Act, the A-G may, when exercising his powers, require any person in the employment of an institution whose accounts are being audited by him to appear before him and to produce all such records, books and other documents in the possession or under the control of such person as the A-G may deem necessary.
- 1.2.17 The A-G has the power, in terms of the Act, to investigate and to make extracts from any record, book, document and other information of an institution whose accounts are being audited by him.
- 1.2.18 Sections 3(5)(b)(ii) and (iii) of the Auditor-General Act provide that the A-G has the right to investigate whether any property, money, equipment and other assets of an institution accounts are being audited by him have been obtained in an economical manner and are being applied efficiently and effectively. The A-G can also investigate the efficiency and effectiveness of internal control and management measures relating to the expenditure and revenue of such an institution.
- 1.2.19 The A-G may interrogate under oath or upon affirmation any person whom he thinks fit to interrogate in connection with any matter in so far as it may be

necessary for the due performance and exercise of his powers and duties (Section 3[5][c]).

- 1.2.20 The National Prosecuting Authority is grouped in chapter 8 of the Constitution under the heading *Courts and Administration of Justice* and is equally constitutionally bound to exercise its functions without fear, favour or prejudice.
- 1.2.21 Section 179(2) of the Constitution empowers the national prosecuting authority to institute criminal proceedings on behalf of the State, and to carry out any necessary functions incidental to instituting criminal proceedings. The Preamble to the National Prosecuting Authority Act, 1998 (Act No 32 of 1998, as amended – hereinafter referred to as the NPA Act), further provides that in order to ensure that the prosecuting authority fulfils this constitutional mandate, provision has been made for the establishment of an Investigating Directorate, which is known as the Directorate of Special Operations (DSO). The directorate has been established in the Office of the National Director (Section 7[1][a]).
- 1.2.22 The NPA Act regulates the powers and functions of the National Director, other members of the prosecuting authority and the DSO.
- 1.2.23 The DSO is headed by a Deputy-National Director, who performs his powers, duties and functions subject to the control and the directions of the National Director (Section 7[3][a]). The Head of the DSO is, in turn, assisted by, *inter alia*, an Investigating Director, Deputy Directors and Special Investigators (Section 7[4][a]).
- 1.2.24 Chapter 5 of the NPA Act sets out the powers, duties and functions relating to the DSO. Investigations are conducted in terms of section 28, which also endows the Investigating Director with discretion to determine the procedure to be followed as dictated by the circumstances of each case (Section 28[4]). This

chapter also makes provision for, *inter alia*, the power of search, seizure and arrest.

- 1.2.25 In terms of section 28(1), if the Investigating Director has reason to suspect that a specified offence (as defined in section 1) has been or is being committed or that an attempt has been or is being made to commit such an offence, he may conduct an investigation into the matter in question. In terms of section 28(13), if the Investigating Director considers it necessary to hear evidence in order to enable him to determine if there are reasonable grounds to conduct an investigation in terms of section 28(1), he may hold a preparatory investigation.
- 1.2.26 The specified offences in respect of which the Investigating Director can conduct an investigation or preparatory investigation include, *inter alia*, any offence of fraud, theft, forgery and uttering, corruption in terms of the Corruption Act, 1992 (Act No 94 of 1992), or any other economic common law offence or economic offence in contravention of any statutory provision, which involves actual or potential patrimonial prejudice to the State, any body corporate, trust, institution or person, which is of a serious and complicated nature.
- 1.2.27 The Investigating Director has a discretion to designate any of the persons provided for in the Act to assist him in the exercise of his functions (Section 28[2][a]).
- 1.2.28 The Investigating Director (or any person designated by him) may, for the purpose of conducting investigations and preparatory investigations, summons anyone who is believed to be able to furnish any information in connection with the investigation or is believed to have in his/her possession or under his/her control any book, document or object relating to the investigation to be questioned or to produce the relevant information (Section 28[6][a]).

1.2.29 Section 28(6)(b) also empowers the Investigating Director (or person designated by him) to question any person who is believed to have information pertaining to the investigation, under oath. The Act also makes provision for such a person to be assisted by a legal representative. Further, that any proceedings in relation to the questioning must take place *in camera* (Section 28[3]).

1.2.30 Section 41(6) prohibits the disclosure of information, the contents of any document or the record of any evidence given at an investigation as contemplated in section 28(1) without the permission of the National Director.

1.3 THE ALLEGATIONS AND CONCERNS INVESTIGATED

1.3.1 The investigation agencies received numerous allegations, most of which were of a criminal nature, referring to issues such as corruption and conflict of interest. The DSO conducted preliminary investigations into these allegations. Some were found to be without any substance and therefore required no further investigation. These allegations are the following:

- (a) That Mr L Swan, a senior official at Armscor, became a director of BAe Systems, which was one of the prime contractors.
- (b) That the Chief of Acquisition of the SANDF, Mr S Shaik; Messrs M Sisulu, M Scott and N Mashembye received motor vehicles from the prime contractors/bidders.
- (c) That there was a link between the arms procurement presently under investigation and the Mpumalanga Parks board promissory notes.
- (d) That the former Minister of Defence, Mr J Modise, paid for shares in Conlog with a bribe received from a successful prime contractor.

Other allegations appeared to have substance and are currently being pursued. In the main, the allegations and concerns, which required extensive investigation by the three agencies can be graphically summarised as set out in the tables below.

1.3.1.1 Concerns raised by SCOPA

	AREA OF CONCERN	INVESTIGATION AGENCY	STATUS OF INVESTIGATION
1.	Cost to State		
1.1	<p><u>Validity of contract amount</u></p> <p>Cabinet's announcement of a total cost of the procurement of R30,3 bn, whilst in September 2000 the figure had allegedly risen to R43,4 bn. The inclusion or omission in determining the final figure of the cost of the SDP of interest, price escalation conditions and the cost effects of negative foreign exchange movements.</p>	A-G and Public Protector	The investigation has been completed. See chapter 9 of the report.
1.2	<p><u>Full financial and fiscal implications</u></p> <p>The movements within certain major currency markets and the realism of the macro-economic assumptions used in determining the cost to the state of the procurement.</p>	A-G and Public Protector	The investigation has been completed. See chapter 9 of the report.
1.3	<p><u>The price of the Gripen and Hawk procurement</u></p> <p>The suggestion that the price of these two items was improperly inflated.</p>	A-G and Public Protector	The investigation has been concluded. See chapter 4 of the report.
2.	The selection of prime contractors		
2.1	The addition of a non-costed option to the value system of the LIFT.	A-G and Public Protector	The investigation has been completed. See chapter 4 of the report.
2.2	The reason for subjecting the value system of only one programme of the SDP to a non-costed option.	A-G and Public Protector	The investigation has been completed. See chapter 4 of the report.
2.3	The presentation to Cabinet of the costed and non-costed options in respect of the LIFT.	A-G and Public Protector	The investigation has been completed. See chapter 4 of the report.

3.	The selection of subcontractors		
3.1	<p><u><i>Conflict of interest</i></u></p> <p>The suggestion that a potential conflict of interest in respect of the Chief of Acquisitions of the DoD could have had an improper influence on decisions pertaining to tenders.</p>	A-G and Public Protector	The investigation has been completed. See chapter 10 of the report.
3.2	<p><u><i>Complaints of C²I²</i></u></p> <p>The complaints and allegations of C²I² (an unsuccessful tenderer) that they have been treated improperly and unfairly during the procurement process.</p>	A-G and Public Protector	The investigation has been completed. See chapter 11 of the report.
4.	Post review of arms procurement process	A-G and Public Protector	The investigation has been completed. See Chapter 3 of the report.
5.	<p>Contracts</p> <p>The concern that the drafting of the contracts is of a low standard, that some of the annexures are missing and that several currencies are referred to in one contract.</p>	Public Protector	The investigation has been completed. See Chapter 13 of the report.
6.	Auditing of bi-annual reports of the progressive realisation of national industrial participation (NIP) and defence industrial participation (DIP)	A-G	It was decided at an early stage of the planning of the investigation that this matter should not be included. It will form part of the normal auditing activities of the A-G.

1.3.1.2 Allegations

	ALLEGATION	INVESTIGATION AGENCY	STATUS OF INVESTIGATION
1.	A possible conflict of interest in respect of various persons involved in the overall acquisition process due to directorships, shareholding, relatives, etc.	Directorate of Special Operations	Under investigation
2.	A high-ranking official is a shareholder and chairman of a local sub-contractor that is a beneficiary of a prime contractor DIP offset offer.	Directorate of Special Operations	Under investigation
3.	Various role players in the overall acquisition process hold shares through nominees in entities, which benefited from the acquisition.	Directorate of Special Operations	Under investigation
4.	Persons involved in the overall acquisition process (amongst whom high-ranking officials) received various gifts.	Directorate of Special Operations	Messrs T Yengeni and Woerfel arrested and prosecuted. Criminal case pending.
5.	A certain bidder was overlooked in favour of a prime contractor at a unit price of more than R3 million above the cost of the bidder's product.	Directorate of Special Operations	Under investigation
6.	An important role player in the acquisition process had personally communicated to several bidders that they would have to come to a specific arrangement with two South African subcontractors if their bids were to be successful.	Directorate of Special Operations	Under investigation
7.	The German Submarine Consortium came last or second-last in the technical and price evaluation of the Submarine bids according to the formal value system and points allocation methodology.	A-G	Investigation completed. See chapter 6 of the report.
8.	FBS did not have the capacity and had to subcontract the initial work allocated to them in terms of a contract until the merger with Conlog/Logtek. The making of undue payments.	Directorate of Special Operations	Under investigation

1.3.2 Status of the investigation by DSO

- 1.3.2.1 In conducting these investigations, the DSO subteams mainly used the provisions of section 28 of the NPA Act. As at the date of this report, in excess of 102 summonses have been issued. As a result of these summonses, more than 57 statements from witnesses, statutory records in excess of 193 entities and numerous documents have been obtained. To date, Messrs Yengeni and Woerfel have been brought before court on charges of corruption, fraud, forgery and uttering. Various premises in France, Mauritius and South Africa have been searched and documents seized.
- 1.3.2.2 It should be borne in mind that the questioning of witnesses has often been laborious, extensive and clouded by issues of participative legal representation, prior requests for access to information and threats of litigation.
- 1.3.2.3 Whilst there may have been individuals and institutions who used or attempted to use their positions improperly, within government departments, parastatal bodies and in private capacity, to obtain undue benefits in relation to these packages, up until now no evidence has emerged, to suggest that these activities affected the selection of the successful contractors/bidders, which may render the contracts questionable. As matters stand, there are presently no grounds to suggest that the Government's contracting position is flawed.
- 1.3.2.4 Due to the nature of an investigation of this kind, and also in order to avoid disclosure of information in contravention of section 41(6) of the NPA Act, it has been decided not to make public the details of the matters under investigation. By the time this report is tabled, numerous events flowing from the investigation would have materialized, which should provide an indication as to its contents.

CHAPTER 2

METHODOLOGY EMPLOYED

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CHAPTER 2

METHODOLOGY EMPLOYED

2.1 THE PUBLIC PHASE OF THE INVESTIGATION CONDUCTED BY THE PUBLIC PROTECTOR

2.1.1 Reasons for the public phase

2.1.1.1 Due to the huge public interest in the joint investigation, it was decided that it would be in the public interest and in the interests of the investigation that a part of it be conducted in public. The principles of transparency and openness that underpin our constitutional democracy require that matters of national interest be dealt with in a manner that is accessible and comprehensible to the citizens of our country and every other interested person or institution. However, for obvious reasons, the DSO could not conduct the criminal part of the investigation in public. The format of a forensic investigation also does not allow for public insight and participation. As indicated above, the Public Protector Act, 1994, however, makes provision for investigations to be conducted in public, the format and contents of which are to be determined and regulated by the Public Protector.

2.1.1.2 As the different parts of the joint investigation involved many of the same role players and key issues, considerable care was taken to ensure that one part of the investigation did not have a negative impact on any of the other parts. The selection of the issues to be addressed and the witnesses to be called during the public phase of the investigation, was carefully managed.

2.1.1.3 The view was held that it was in the interest of the public to be informed of what the acquisition under investigation was. Why was it necessary; what was required; how was it acquired; at what cost and what its effect on the country

was going to be? These were all the issues that could be addressed in the public phase by inviting some of the key role players to give testimony. There were also some specific allegations, however limited, that could be addressed in public.

- 2.1.1.4 In order to limit overlapping and possible interference in the other parts of the investigation, it was decided to divide the public phase of the investigation into two stages. The first stage was referred to as the “scene setting stage” and comprised testimony in respect of the requirements of the SANDF and the process and procedure of acquisition. The second stage was referred to as the “specific complaints stage”. It included the evidence of a tenderer who alleged certain improprieties in the acquisition process that caused his company to be deselected from obtaining a specific contract.
- 2.1.1.5 As the public phase of the investigation was conducted on a voluntary basis, witnesses were invited to participate and notified accordingly. All witnesses were represented by legal counsel. Persons and institutions implicated by the evidence provided during the public phase were informed of their right to attend and to respond and a number of them did so. The media covered the proceedings extensively. Documents, media and other reports and the inputs of several interested parties were also considered and evaluated during this phase.
- 2.1.1.6 The public phase of the investigation commenced on 28 May 2001 and was finalised on 31 August 2001. The Public Protector was assisted by Dr S Ramaite, Director of Public Prosecutions and Mr H van Zyl, Executive Manager of the Office of the Auditor-General during the hearings.

2.1.2 The scene setting stage of the public phase of the investigation

2.1.2.1 *The purpose of this stage of the investigation*

During the first stage of the public phase of the investigation evidence was heard in connection with the process and procedure that was followed for the acquisition concerned, the requirements that had to be met by the procurement, the financial implications thereof for the State and the Industrial Participation Programmes relevant to the acquisition.

2.1.2.2 *The witnesses*

The following witnesses testified during the first stage of the public phase of the investigation:

- Rear Admiral S J Verster, Director: Weapons Systems of the Department of Defence.
- Mr D Griesel: Senior Manager: Telecommunications and Acquisition Systems at Armscor.
- Mr J Naidoo, the former Chief Negotiator of the International Offers Negotiating Team.
- Lieutenant General (ret) W H Hechter, the former Chief of the South African Air Force.
- Vice Admiral (ret) R C Simpson-Anderson, the former Chief of the South African Navy.
- Minister A Erwin, the Minister of Trade and Industry; and
- Minister M Lekota, the Minister of Defence.

The three investigation agencies had a consultation with Mr R White, a former senior manager of the former Department of Finance (now National Treasury) by way of video recording. During the public hearing the video was screened

and entered into the record of the evidence. This had to be done as Mr White is currently based in Washington where he is an employee of the World Bank.

2.1.3 The Second Stage of the public phase of the investigation: specific complaints

2.1.3.1 This stage of the public phase of the investigation presented a particular challenge as most, if not all of the specific complaints in connection with the SDP were being investigated by the other two agencies involved. In order not to interfere with those investigations or to duplicate efforts, care had to be taken to select specific complaints that could be investigated in public. Eventually it was decided that, a public investigation into the complaint of C²I² Systems (Pty) Ltd (C²I²) would not be detrimental to the other investigations and that it would be in the public interest, in the interest of the complainant and in the interest of openness and transparency, that this complaint and any rebuttals thereof be ventilated properly.

2.2 THE FORENSIC INVESTIGATION BY THE AUDITOR-GENERAL

2.2.1 Operational Teams of the Auditor-General

The operational team of the Auditor-General was divided into five subteams. Each subteam was allocated certain responsibilities to ensure that the investigation would be completed within a reasonable time. Due to the shortage of personnel in the Office of the A-G, personnel from private audit firms were contracted in and formed part of the teams. Precaution was taken to ensure that no conflict of interest would arise. Security clearances were obtained for all personnel involved in the investigation. A project office was established, which was headed by a project manager. The project manager was responsible for managing all the subteams and liaising with the investigators attached to the other investigation agencies.

2.2.2 Scope of the Investigation

2.2.2.1 The subteams were instructed to adopt a focused approach in order to address the allegations and concerns and to ensure that the investigation is completed within reasonable time.

2.2.2.2 As a result the teams investigated the following areas:

- (a) The arms procurement process;
- (b) Selection of prime contractors – LIFT, ALFA, LUH, Submarines, Corvettes;
- (c) Final contracts vis-à-vis IONT;
- (d) Cost to State: Validity of contract amount;
- (e) Cost to State: Full financial and fiscal implications;
- (f) Selection of subcontractors: Conflict of interest;
- (g) Selection of subcontractors: Process followed by prime contractors in the selection of subcontractors;
- (h) The complaints of a subcontractor: C²I²;
- (i) The validity of a statement by ministers with regard to deterrent losses on NIP for prime contractors;
- (j) International norms for NIP guarantees; and
- (k) Progressive realisation of NIP and DIP.

2.2.3 Standards Applied

The forensic investigation conformed to internationally acceptable forensic investigation standards. It, however, does not constitute an audit and the principles applied during the investigation, did not incorporate any standards as prescribed by the General Accepted Government Auditing Standards (GAGAS) or the South African Auditing Standards (SAAS).

2.2.4 Study of Documents

2.2.4.1 A proper forensic investigation is usually underscored by an in-depth studying of documents. In order to give effect to this, the investigation team adopted a multi-phased approach, which involved the following:

- (a) Identifying and photocopying the relevant documents from the approximately 700 000 pages furnished. Approximately 134 768 pages have been copied to date. Apart from these documents, documentation from subcontractors was also obtained and studied.
- (b) Perusing the relevant documents, which were identified to address the areas of the investigation. From these documents a number of witnesses were identified for interviews in order to complete the investigation.
- (c) Identifying, obtaining, and studying any other documents relevant to the investigation.
- (d) Presenting the documents to the relevant witnesses during the interviewing process in order to obtain their views.

2.2.5 Interviewing of Witnesses

2.2.5.1 During the course of the forensic investigation, interviews were held with various persons involved in the procurement process. This was necessary in order to obtain their interpretation of the process, their involvement with the process, to clarify certain issues and to provide some of them with an opportunity to explain certain decisions and/or actions. It was also essential to conduct the interviews in order to test the versions of the different individuals in relation to one another, and in relation to the facts appearing from the documentation.

2.2.5.2 Different approaches were adopted during this process. For example, in some instances, witnesses were consulted and consultation notes prepared, whilst in other instances the interviews were recorded under oath in terms of section 28(1) of the NPA Act.

2.2.5.3 All the evidence obtained in terms of this provision has been dealt with in terms of the prohibition of disclosure provided for in section 41(6) of the NPA Act.

2.3 THE CRIMINAL INVESTIGATION BY THE DIRECTORATE OF SPECIAL OPERATIONS

2.3.1 Operational Teams

The DSO investigation team was divided into four subteams, and each team was allocated responsibilities to investigate specific areas of the SDP. Two of the subteams concentrated on the process of the arms procurement and they worked very closely with the teams of the A-G. The other two mainly focused on the issues pertaining to the conflict of interest and other allegations of criminality.

2.3.2 Scope of Investigation

2.3.2.1 On 6 November 2000, the Investigating Director instituted a preparatory investigation to determine whether there are reasonable grounds to conduct an investigation pertaining to corruption and/or fraud in connection with the acquisition of armaments at DoD in respect of negotiations and/or contracts concluded regarding the purchase of corvettes, submarines, light utility helicopters, maritime helicopters, lead in fighter trainers and advanced light fighter aircraft.

2.3.2.2 The DSO investigation progressed to a stage where, on 24 August 2001, the Investigating Director was satisfied that reasonable grounds existed to conduct an investigation in terms of section 28(1)(a), into the suspected commission of offences of fraud and/or corruption in contravention of the Corruption Act, 1992 (No 94 of 1992), relating to certain contracts and/or subcontracts. Those allegations where reasonable grounds have not yet been found are still the subject of a preparatory investigation.

2.3.2.3 It should be mentioned that the scope of the DSO investigation was not aimed at determining the status of and/or legality and/or enforceability of the contracts between the South African Government and the various contracting parties in terms of the SDP. The quality of the contracts was reviewed by the Public Protector and is dealt with in chapter 13 of this report.

2.4 REPORT AND DUE PROCESS

2.4.1 A draft Joint Report was compiled by a task team of the three investigation agencies and submitted to the President, in his capacity as the Chairperson of the Ministers' Committee involved in the procurement under investigation, and to the Ministers of Finance, Defence, Public Enterprises and Trade and Industry for comment in adherence to the provisions of section 4(6) of the Auditor-General Act, 1995 and due process. Government submitted a response on the draft Joint Report that was appropriately considered, in terms of due process, when finalising this report.

2.4.2 This report includes the evidence obtained during the public and forensic phases of the investigation.

2.4.3 Chapters 1 – 2 provide a background and introduction to the investigations reported on and methodology adopted.

Strategic Defence Packages

Joint Report



- 2.4.4 Chapters 3 – 13 focus on the specific areas of the investigation with key findings at the end of each chapter.

- 2.4.5 The report concludes in chapter 14 with the overall findings and recommendations of the investigation.

CHAPTER 3

POST REVIEW OF THE ARMS PROCUREMENT PROCESS

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CHAPTER 3

POST REVIEW OF THE ARMS PROCUREMENT PROCESS

3.1 THE PUBLIC PHASE OF THE INVESTIGATION

The following is a compilation of the testimony given by the witnesses with regard to the process and procedure of the procurement under investigation.

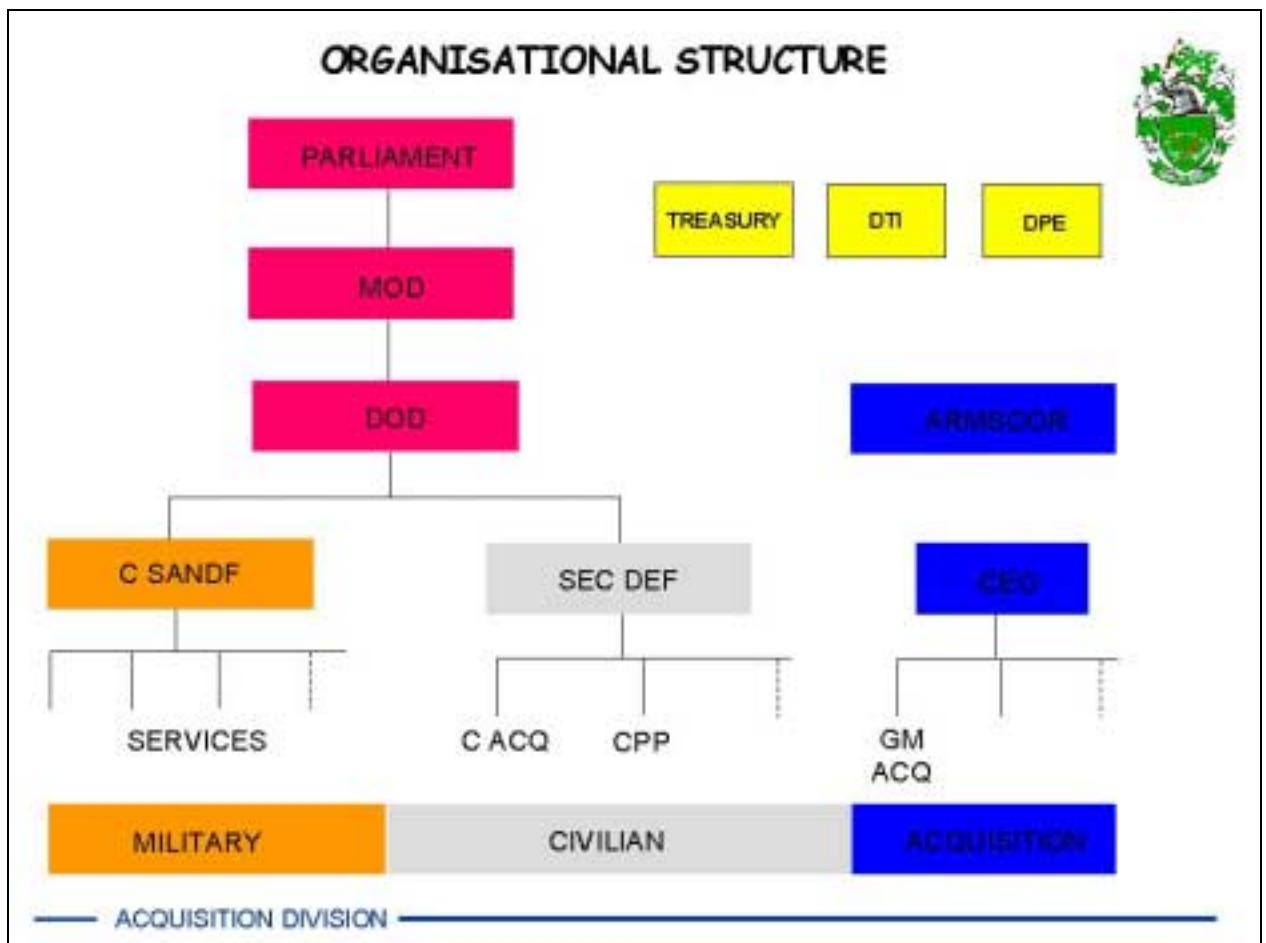
3.1.1 The acquisition process of the Department of Defence

3.1.1.1 The organisational structure

The organisational structure involved in the acquisition of armaments for the SANDF consists of the following four components:

- (a) The military component consisting of the Chiefs of the SANDF and the arms of service. They are mainly the clients of an acquisition programme.
- (b) The civilian component consisting of the Secretary for Defence, the Chief of Acquisitions and the Chief of Policy and Planning.
- (c) The Minister of Defence and his/her department, Cabinet and Parliament.
- (d) The Armaments Corporation of South Africa (Armscor). It was established in terms of the provisions of the Armaments Development and Production Act, 1968 and its core business is to acquire and produce defence material and related services for the Department of Defence. In addition, it also has to:

- (i) participate in the drafting of value systems;
- (ii) provide a system for tender management, tender evaluation and adjudication;
- (iii) contract with the defence industry;
- (iv) conduct professional programme management of acquisition programmes;
- (v) provide scientific support to the requirements definition and value for money assessment processes and manage the DIP programmes.



In the acquisition under consideration there were also other role players involved, such as the Departments of Finance (DoF), Trade and Industry (DTI) and Public Enterprises. DoF dealt with budgetary implications, financial affordability and macro fiscal and economic implications, whilst the Department

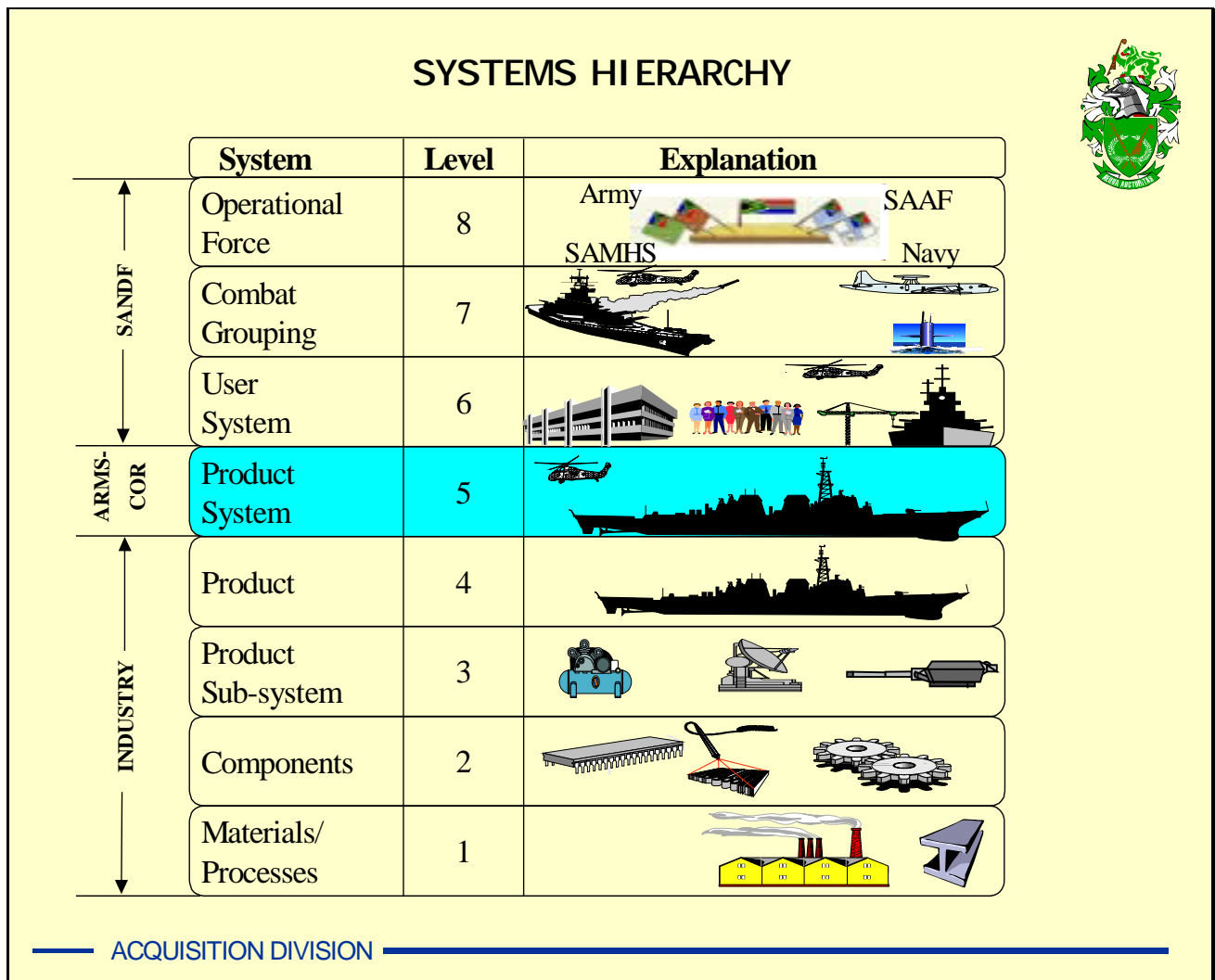
of Public Enterprises was responsible for the aspects relating to state-owned corporations. Industrial Participation was mostly the responsibility of the DTI.

3.1.1.2 The Acquisition Policy

Prior to 1994, South Africa experienced sanctions with regard to the acquisition of armaments in the international domain. Consequently, the modified acquisition policy in many respects did not make provision for armaments acquisitions on international markets. It was not structured to deal with a multi-project as it was the first time that the government acquired armaments of the magnitude of the SDP concerned.

3.1.1.3 The Weapons System Hierarchy

In order to understand the acquisition process fully one has to take note of the different levels of a weapons system.



Level 1 consists of raw material and processes, such as the manufacturing of ceramics. Level 2 consists of components such as integrated circuits, gears, etc. In level 3 one will find sub-systems such as air conditioning plants, radar and guns. Level 4 consists of a product, such as an aircraft or a ship. The Product System referred to in level 5 consists of a combination of level 4 products. Level 6 includes training facilities, airfields, etc. The combat grouping referred to in level 7 consists of a combination of ships, tanks, helicopters, submarines, etc that are grouped together. Level 8 is the full force structure of the SANDF.

The acquisition of the SDP was somewhere between off the shelf purchases and level 5 developments.

3.1.1.4 The milestone documents of an acquisition project

An acquisition project for an arm of service of the SANDF is not authorised at one level only. It is a process of progressive authorisation and each process is depicted in the following prescribed documentation:

(a) The Required Operational Capability

The contents of this document are based on a priority decision as to what is required to address particular deficiencies in the arm of service concerned. It is not a mandatory document.

(b) The Staff Target (ST)

This is a mandatory document containing a decision in respect of the proposed project of acquisition.

(c) The Staff Requirement (SR)

This document deals with the concept decision of what is required and contains the Functional User Requirement Specification. The User Requirement Specification (URS) does not necessarily refer to the technical specifications of what is required, but, in most cases, rather to what it is that the required system, irrespective of its technical specifications, should be able to achieve. The SR is not a mandatory document.

(d) The Project Study Report contains the decision about whether the product required would have to be designed and developed or whether it can be procured off the shelf. It is not a mandatory document.

(e) The Acquisition Plan

This is a mandatory document that indicates a commitment to acquire the product concerned at a specified price. It thus commits the budget of DoD to a particular expenditure.

(f) The Closure Report

This document indicates that the acquisition has been concluded and that no payments or deliveries are outstanding.

PROJECT DOCUMENTATION		
Required Operational Capability	(ROC)	- Priority Decision
Staff Target	(ST)	- Project Decision
Staff Requirement (FURS)	(SR)	- Concept Decision
Project Study Report (A –Specification)	(PSR)	- Make / Buy Decision
Development Plan (B-Specification)	(DP)	- Development Decision
Acquisition Plan (C, D, E-Specifications)	(AP)	- Manufacturing Decision
Closure Report	(CR)	- Operational Decision

ACQUISITION DIVISION

3.1.1.5 The approval forums

The approval of the milestone documents, referred to in paragraph 3.1.1.4 above, has to be granted by forums at different levels within the arms of service and DoD.

These forums are the following:

- (a) The Service Council, such as the Navy Council

This forum is chaired by the Chief of the service concerned.

- (b) The Operations Staff Council
- (c) The Defence Staff Council
- (d) The Armaments Acquisition Control Board (AACB)

The Chairperson of this Board is the Chief of the Acquisition Division of DoD. Its main function is to ensure that the acquisition policy has been followed and that all the submitted milestone documents can be forwarded to the next level for approval.

- (e) The Armaments Acquisition Steering Board (AASB)

This Board is chaired by the Secretary for Defence. It has to approve the ST, Project Study Report and the Acquisition Plan before they are forwarded to the next level of approval.

(f) The Armaments Acquisition Council (AAC)

The Minister of Defence chairs this Council and it, *inter alia*, also has the Deputy Minister of Defence, the Chief of the SANDF and the Chief Executive Officer of Armscor as members. In the case of the SDP the mandatory ST and Acquisition Plan documents had to be approved at this level.

(g) The Council on Defence (CoD)

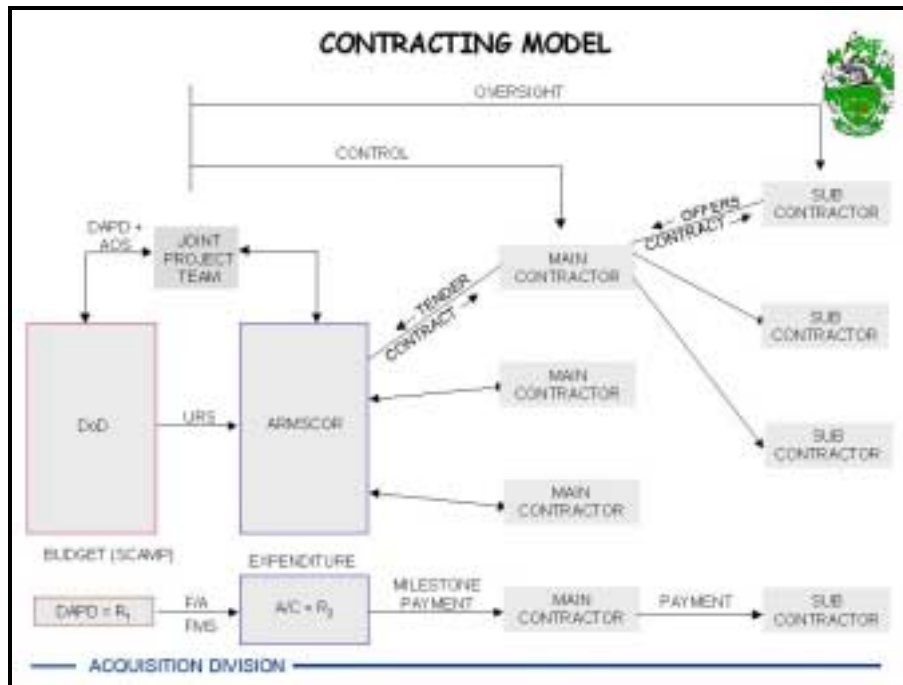
This Council is virtually the same as the AAC, but it also has some other functions.

The next step would be to refer the matter to a Ministers' Committee or directly to Cabinet, depending on the circumstances. Once Cabinet approves the acquisition, the project is referred to Armscor for implementation.

3.1.1.6 *The contractual relationship between the Department of Defence and contractors*

The Department does not pay suppliers. The contractual relationship exists between Armscor and the contractor. It is for the main contractor to contract with subcontractors for the provision of services and products required to deliver the product described in the main contract. However, the Department, in certain cases can deliver some input with regard to the approval of subcontractors, although this does not constitute total control over the decision about which subcontractor is appointed by the main contractor. Issues such as a history of poor delivery by a subcontractor or the risk involved in using a particular subcontractor may be brought to the attention of the main contractor. The final decision about which subcontractor should be used

remains the responsibility and the right of the main contractor. (For more detail on the selection of sub-contractors, see chapter 10 of the report)

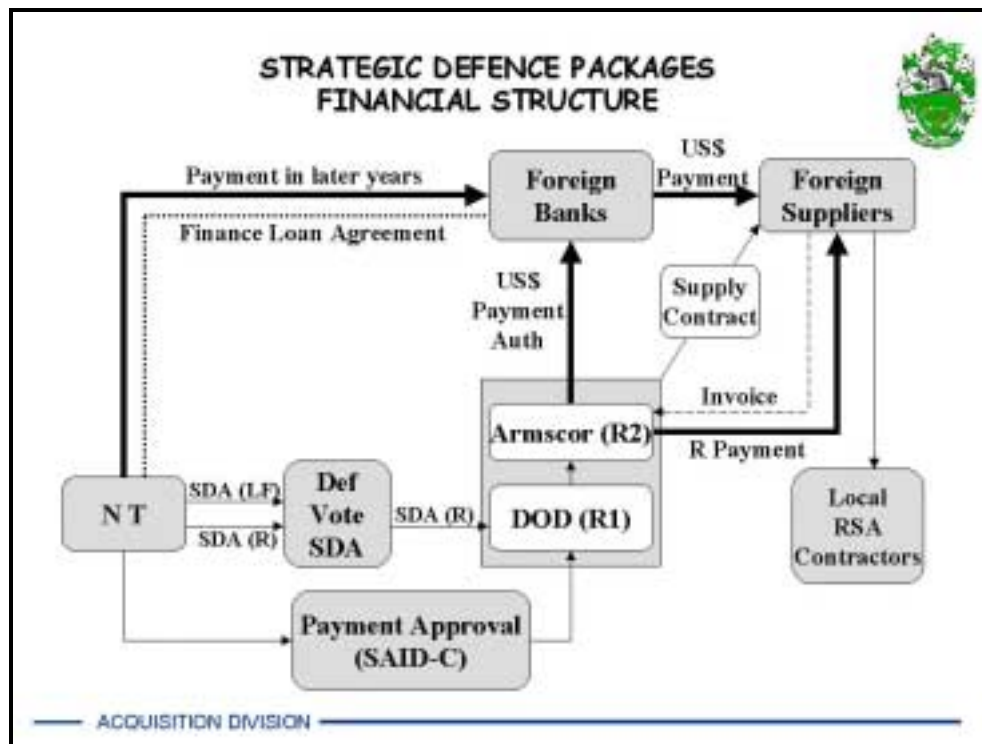


3.1.1.7 The financial structure of the Strategic Defence Packages

There are two types of funds for the SDP. On the one hand there is the funding provided in South African currency *via* the Special Defence Account. The Chief of Acquisitions tasks Armscor, as the expenditure authority, to pay the supplier (main contractor) for the product or service provided. If the money claimed by a foreign supplier is for the payment of a local subcontractor, the payment will be made in Rands.

On the other hand, there is a Special Defence Account approval for loan funds or so-called "quasi-money". If a foreign supplier submits an invoice for payment to be made to itself or a foreign subcontractor, Armscor is instructed to authorise a foreign bank, with which an arrangement has been made, to pay the supplier. The funds for such payment are drawn from a loan pool in terms of an agreement between foreign banks and the Department of Finance

(National Treasury). The currency of payment is also determined in terms of the agreement, taking into account the most suitable exchange rate at the time of payment.



3.1.2 The role of Armscor in the acquisition process

Armscor is governed by a Board of Directors and the Chairperson of the Board is accountable to the Minister of Defence. As indicated above, Armscor is the acquisition agency of the Department of Defence. The core business of Armscor is briefly explained by the following presentation:

ARMSCOR : CORE BUSINESS

- Core business of Armscor is to acquire/produce defence matériel and related services for the Department of Defence (Para 3(2)(l) of act)
- Tasks of Armscor
 - Participating in the drafting of value systems
 - Providing a system for tender management, tender evaluation and tender adjudication.
 - Contracting of Industry to satisfy DoD requirements
 - Professional Programme Management
 - Providing scientific support during requirements definition process and value for money assessment process
 - Management of Defence Industrial Participation programmes
 - Expenditure Authority for selected Capital and Operating budget elements (Including SDP funds)



3.1.2.1 *Armscor as a tender board*

The Armscor Board of Directors is also a tender board as provided for by the provisions of the State Tender Board Act. It functions as a defence matériel tender board. In this capacity, the Board considers and evaluates all acquisition recommendations made by project teams. The Board has to approve the supplier, the product and the agreed price. As the contracting authority for the acquisition of all defence material, the Board must also take into account specific performance criteria and risk factors pertaining to a particular proposed acquisition. The Board may delegate some of its authorisation responsibilities to subordinate committees and has done so in terms of very specific policy documents.

ARMSCOR AS A TENDER BOARD

- Armscor Board functions as Defence Matériel Tender Board
- Considers and evaluates all acquisition recommendations made by project teams for purposes of approving
 - The supplier
 - The product
 - The agreed price
- Makes recommendations and directs performance on
 - Specific contracting conditions and considerations
 - Specific performance criteria
 - Specific and appropriate controls
 - Specific financial risk management plans & actions
- Contracting Authority for the acquisition of all defence matériel

 Formally issues delegations to subservient authorization committees by means of A-Proc-019 (Clause 5B(1) of Act)

3.1.2.2 *The standard Armscor acquisition process*

Being the acquisition agency of the DoD, Armscor is involved in the initial stages of determining the needs of the arm of service involved, the development of plans to address the user requirements and the selection of the best possible alternatives. However, the arm of service involved leads these processes.

Once approval has been obtained for the acquisition to be effected, a Request for Proposal (RFP) document is generated during a process of identifying potential suppliers of the product required. Armscor has a process by which tenders are not only solicited from such suppliers, but a RFP is also advertised on a bulletin board which makes it available to all other unknown potential suppliers. The RFP document contains all the requirements of the product or service required, the industrial participation requirements, if applicable, and the

evaluation criteria that would be used to evaluate the tenders, excluding the weightings of the criteria. The Procurement Secretariat of Armscor has to verify that an approved value system is lodged prior to the distribution of a RFP. The value system is developed to ensure that the successful offer would best meet the need as described in the RFO, keeping in mind also the best value for money. After receipt of the offers, a joint evaluation team evaluates them against the approved value system. The recommendation of the evaluation team is then submitted to the Armscor Board. Once it is approved, an order is issued and the contract managed by Armscor.

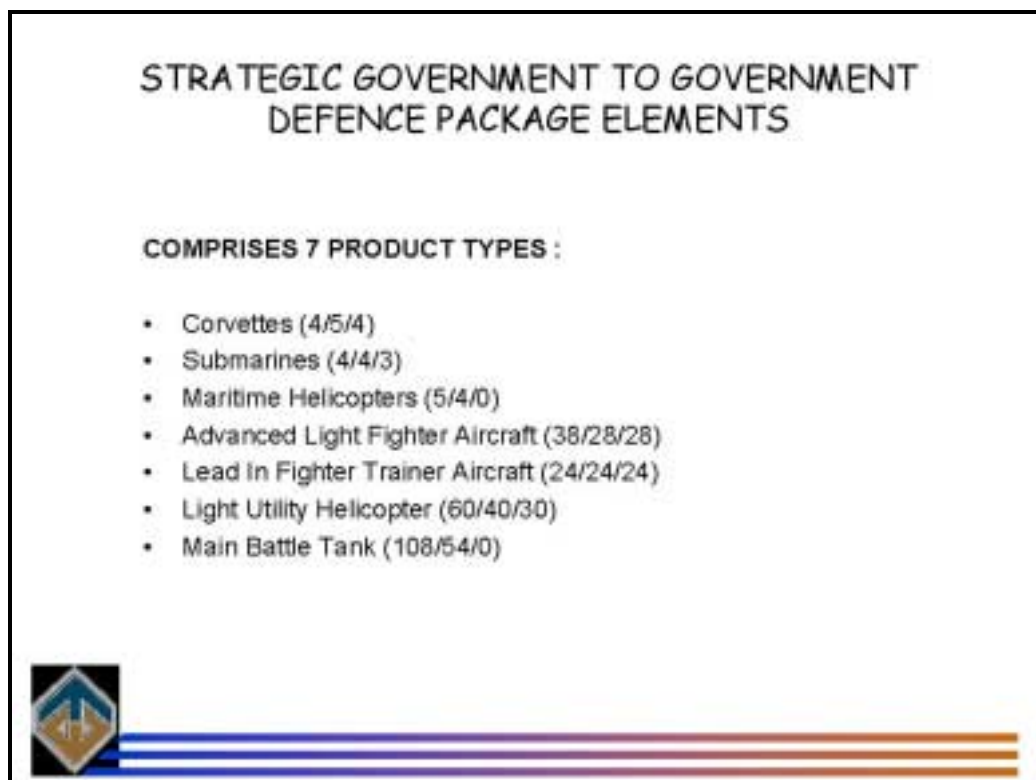
3.1.2.3 The acquisition of the Strategic Defence Packages

The seven core capability requirements of the SANDF that were identified by the Defence Review are the following:

CAPABILITY	EQUIPMENT	QTY	SOURCE
Surface Combat	Corvette (+ Helicopter)	4 (+6)	Foreign
Sea	Submarine	4	Foreign
Combat Air Transport	Light Utility Helicopter	60	Foreign
Air Space Control	Fighter Aircraft	38	Foreign
	Trainer Aircraft	24	
Armour	Main Battle Tank	108	Foreign
	Infantry Fighting Vehicle	-	Local
	Personnel Carrier	-	Local
Air Defence	SAM (Portable + Towed)	-	To be defined
	Fire Control System	-	To be defined
Anti Armour	Combat Support Helicopter	16	Local
	Anti Armour Missile	-	To be defined

This force design was revised during 1998. The numbers in brackets in the table below indicate the following:

- (a) The first number refers to the initial force design quantity. These were the numbers which were requested during the Request for Information (RFI) phase.
- (b) The second number indicates the revised force design.
- (c) The third number indicates the final quantity of the particular product that was contracted for, following the negotiation process.

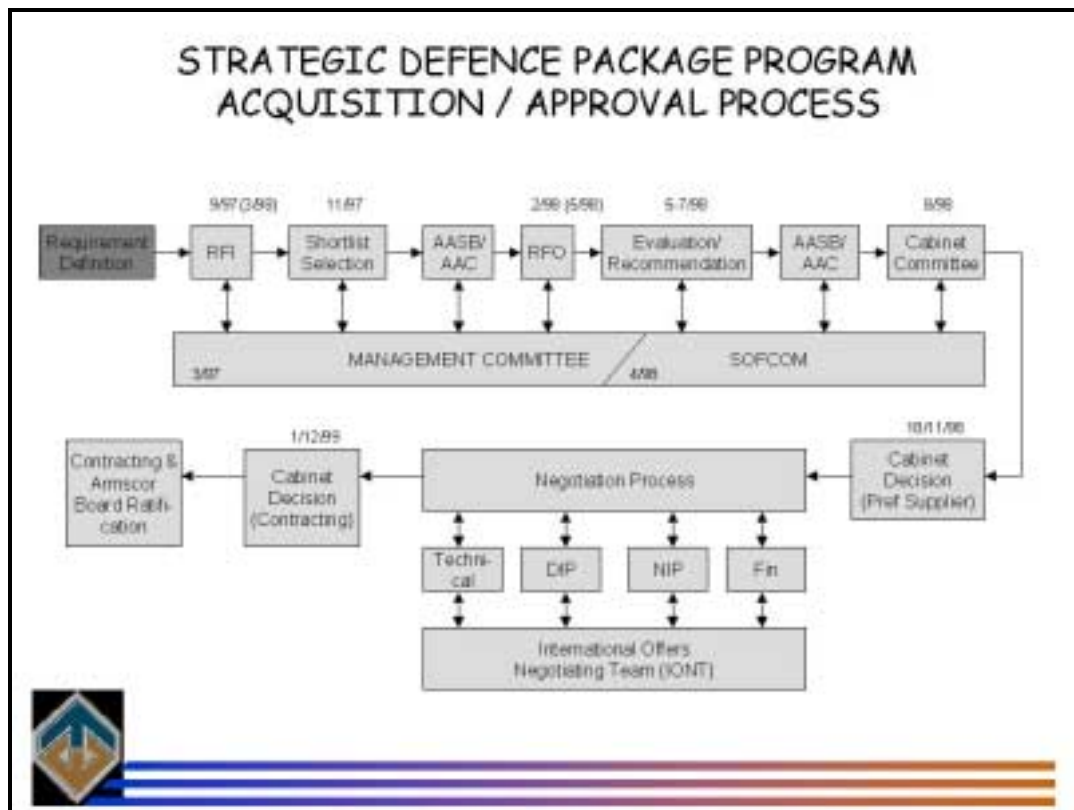


Following the in-principle authorisation by Government of the acquisition of the SDP, a document entitled "Request for Information" in respect of each of the required product types was forwarded to the embassies of 9 countries during September 1997 and March 1998. The purpose of this process was to establish

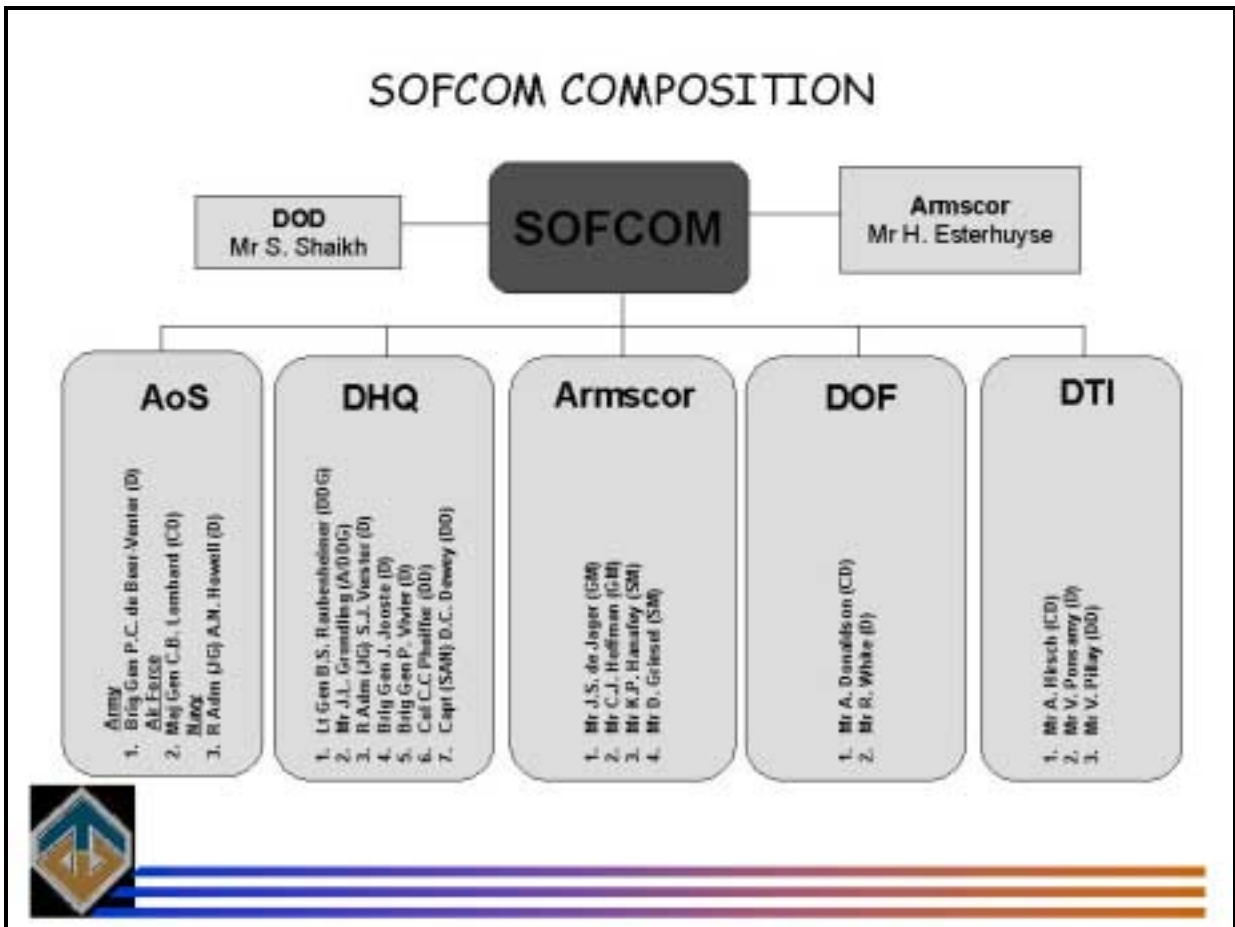
who could potentially provide the required weapon systems. Responses were received from 11 countries (3 unsolicited countries also responded). In total 37 responses were received for the 7 product types (system level 4).

The next process was to select a short list of the equipment available according to a value system. The short list essentially indicated which products within each category met the minimum requirements of the respective end users. The short list was presented to the AASB who made a recommendation to the AAC. During February and May 1998, Armscor forwarded RFOs to the potential suppliers of the equipment, as per the short list. This was done in order to solicit the best and final offers for the supply of the equipment involved. This request included reference to all the requirements, such as the technical specifications, industrial participation and financing of the acquisition.

On receipt of the bids in response to the RFOs, the evaluation phase commenced. This happened during the period May to July 1998. The recommendation as to who the preferred supplier should be was then made to the AASB for further recommendation to the AAC. At this time it was decided not to continue with the proposed acquisition of the main battle tank. The packages were thus reduced to 6. After the AAC made the recommendation in September 1998, it was submitted to the Cabinet Committee (the Ministers' Committee) responsible for the acquisition of the SDP. The Ministers' Committee consisted of the Ministers of Finance, Trade and Industry, Public Enterprises and Defence and was chaired by the Deputy President. The Cabinet decision regarding the preferred suppliers was made on 18 November 1998.

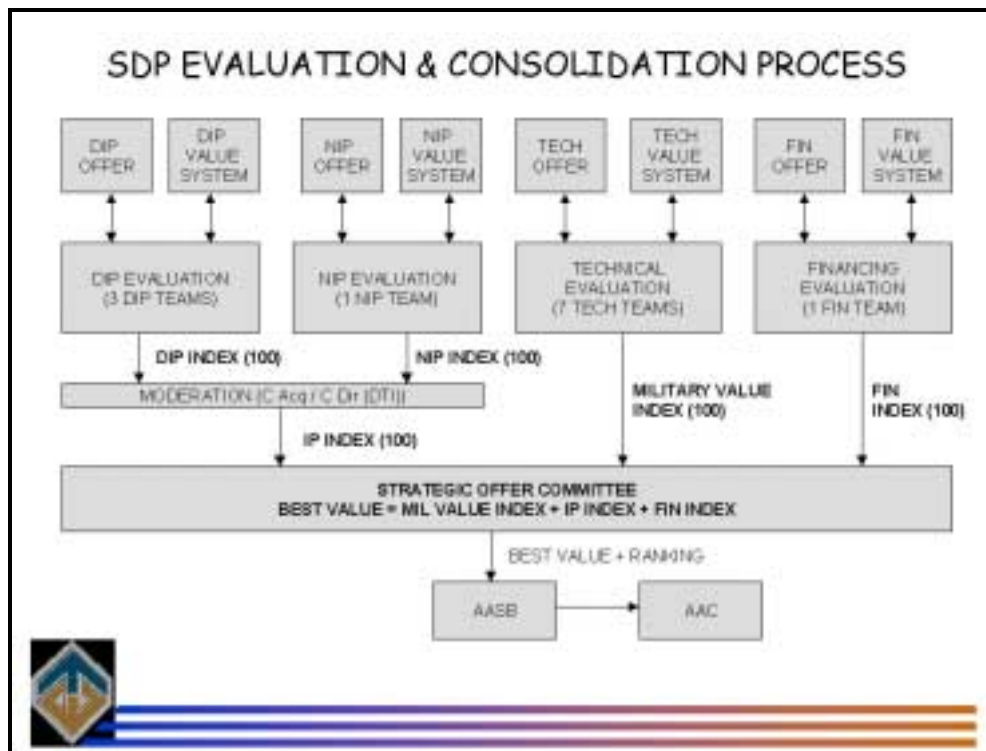


The process from the RFO stage up to the recommendation to the Ministers' Committee was initially co-ordinated by a Management Committee that was constituted in March 1997. It initially consisted of members of DoD and Armscor. However, it was expanded over time to include members of the Departments of Trade and Industry, Finance and Public Enterprises. During April 1998, the Management Committee was replaced by a more formal inter-departmental committee called the Strategic Offers Committee (SOFCOM). The participation of these committees in an acquisition process is not normal procedure. It was, however, thought prudent to have such a co-ordinating structure under the circumstances, to effect additional safeguards, where seven acquisition programmes were running simultaneously so as to ensure uniformity in all respects, including evaluation. SOFCOM was constituted as follows:



The representation of DTI on the SOFCOM changed as a result of the absence of Mr Hirsch from the department and the departure of Mr V Ponsamy. Mr V Pillay was the remaining DTI representative and he reported to the then Director-General.

The evaluation and consolidation processes pertaining to the SDP are explained by the following diagram:



The industrial participation (refer chapter 12), military value and financing parts of the offers each had an index of 100 points. The different evaluation teams met early in July 1998 with SOFCOM and the final consolidation was done. The military value was added to the industrial participation and financing values and the offerer with the highest score was recommended as the preferred supplier to the AASB and AAC, as indicated earlier.

It is not the policy of Armscor to interfere with the selection of subcontractors.

The prime contractor is held responsible for providing the service or product contracted for.

In the case of the acquisition of the SDP, Armscor had to deviate from its policy in the sense that the Board could not insist on having financial authority from DoD prior to approving a preferred bidder for the purposes of negotiation. In this case the financial authorisation had to come from Cabinet once the total

impact of the acquisition, not only on the defence budget, but also on the financial well being of the country as a whole, had been considered.

3.2 THE FORENSIC INVESTIGATION BY THE OFFICE OF THE AUDITOR-GENERAL

The forensic investigation by the Office of the Auditor-General of the procurement process of the SDP should be considered in addition to the evidence obtained during the public phase of the investigation in this regard.

3.2.1 The scope of the forensic investigation

3.2.1.1 Documenting the overall process followed and comparing this with approved or standard procedures.

3.2.1.2 Documenting the role played by various committees, individuals and Cabinet in this process, from the specification stage up to the awarding of contracts.

3.2.1.3 Evaluating State Tender Board process, Armscor process, and general procurement practices, and recommending best practice.

3.2.2 Approach

3.2.2.1 During the course of the investigation, the procedures dealt with below were performed.

3.2.2.2 The "*Special Review by the Auditor-General*" issued on 15 September 2000, was studied, and the key findings regarding the following were investigated:

- (a) Ministry of Defence (MoD) Policy
- (b) Armaments Acquisition Policy

- 3.2.2.3 The response of DoD with regard to the Special Review was studied.
- 3.2.2.4 The following documents (policies) were reviewed to obtain an understanding of the acquisition process and to achieve the above objectives:
- (a) Armscor
 - Armaments Development and Production Act No 57 of 1968
 - VB1000 – Armscor general policy for the management of category 1 matériel acquisition process
 - KB1000 – Armscor Acquisition Policy
 - A-PROC-097 – Armscor practice for the selection of contractual sources
 - (b) Department of Defence
 - Defence Act No 44 of 1957
 - MODAC Investigation of Technology and Armaments: Acquisition in the Department of Defence
 - DoD Policy Directive No 4/147: MoD policy for dealing with International Defence Equipment offers in the MoD
 - DoD instruction No ACQ/1/98: Policy on the acquisition of armaments
 - (c) Defence Review 1998
 - Chapter 13, The Acquisition Management Process
 - (d) International Arms Procurement Procedures
 - The Acquisition Handbook: United Kingdom

- Defence Procurement Policy Manual: Australia

3.2.2.5 Interviews were conducted with various role players in order to obtain evidence pertaining to the acquisition process of the SDP and to discuss areas of concern regarding the acquisition process.

3.2.2.6 The testimony given by witnesses in the public phase of the investigation was also considered.

3.2.3 Background – DoD’s response to the Special Review of the Auditor-General

During the Special Review of the Auditor-General [RP161/2000], certain procedures during the acquisition process were found not to be in accordance with the procedures laid down for armaments acquisition. In response, the DoD verified the following:

3.2.3.1 VB1000

(a) The DoD and Armscor procedures relating to proper acquisition management were incorporated into a single document called VB1000, by merging LOG 12 Pamphlet 2 of the DoD and KB1000 of Armscor. The fundamental basis of this policy relates to risk abatement during the transformation of an operational needs statement through conceptual design and detail design development culminating in industrialisation and the eventual manufacturing of the product. In essence this policy was created to control the creation of new locally designed and developed weapon system products. The VB1000 is both an engineering management tool as well as a programme management tool used and interpreted by comprehensively trained engineering and programme

management staff in order to transform operational requirements into a weapon systems product by means of the systems engineering process.

- (b) DoD and Armscor developed the VB1000 during the sanctions period prior to 1994, when local design-development was paramount. The lifting of the arms embargo created new opportunities in the acquisition management process. It was therefore important to interpret the acquisition management document, which, in its proper perspective, is a risk abatement strategy document.
- (c) The SDP can therefore be considered to be unique acquisition management programmes, in which seven cardinal projects had to be brought to a common starting baseline. This required extensive interaction within the arms of service with regard to individual authorisation procedures. Approvals and recommendations had then to be submitted to DoD and Armscor at corporate level for final approval and execution. The distinguishing feature of the SDP lies therein that they are basically all existing foreign designed and developed weapon system products. Hence it was necessary to adapt and interpret VB1000 in order to merge it with a foreign procurement programme.
- (d) The VB1000 policy document states clearly that the only two non-negotiable milestone documents of a project are the ST and the Acquisition Plan. Submission of all other prescribed milestone documents is a derivative of the nature of the programme undertaken.

3.2.4 MODAC

Although DoD indicated that the VB1000 was used during the acquisition of the SDP, the following other policies were approved during the acquisition, since

international defence equipment offers fall outside the scope of the existing policies and a policy about this had to be established.

3.2.4.1 *Modac Investigation of technology and armament: Acquisition in the DoD*

In August 1994, the former Minister of Defence issued an instruction that the acquisition function in DoD should be investigated. The objective was to comply with the White Paper on Defence, which stated that the management expertise for the specialised procurement function should be located within DoD. A Steering Committee, under the chairmanship of the Minister, and a Departmental Project Team were appointed. The project team became known as the MODAC work-group. This work-group was instructed to investigate and make proposals with regard to the management, execution and structure of the acquisition function in DoD. The work-group conducted the investigation in three phases, and produced the following reports:

- (a) MODAC 1 – Technology and Armament Acquisition Management in the Department of Defence:

The MODAC 1 report defined the roles of different parties within the Department of Defence, and established a new acquisition management process and approval structure. This included the establishment of the AACB, AASB and the AAC, which replaced the existing mechanism, namely the Project Control Board, the Defence Command Council and the Defence Planning Council. This report was approved by the Steering Committee on 10 February 1995.

- (b) MODAC 2 – Defence Industry Policy:

This policy deals with acquisition, industrial development and arms trade. The policy also stated that all major foreign procurement contracts should

contain counter trade agreements. This report was approved by the Steering Committee on 26 September 1995.

(c) MODAC 3 – The Organisational Structure of the Defence Acquisition Programme Management Organisation:

The organisational structure of the Defence Acquisition Programme Management Organisation (Armscor) was investigated. A standard value-analysis methodology was used to analyse alternative structures. The MODAC 3 analysis was presented to the Steering Committee on 31 May 1996 and the Minister decided that Armscor should continue to operate as a state-owned entity with statutory powers.

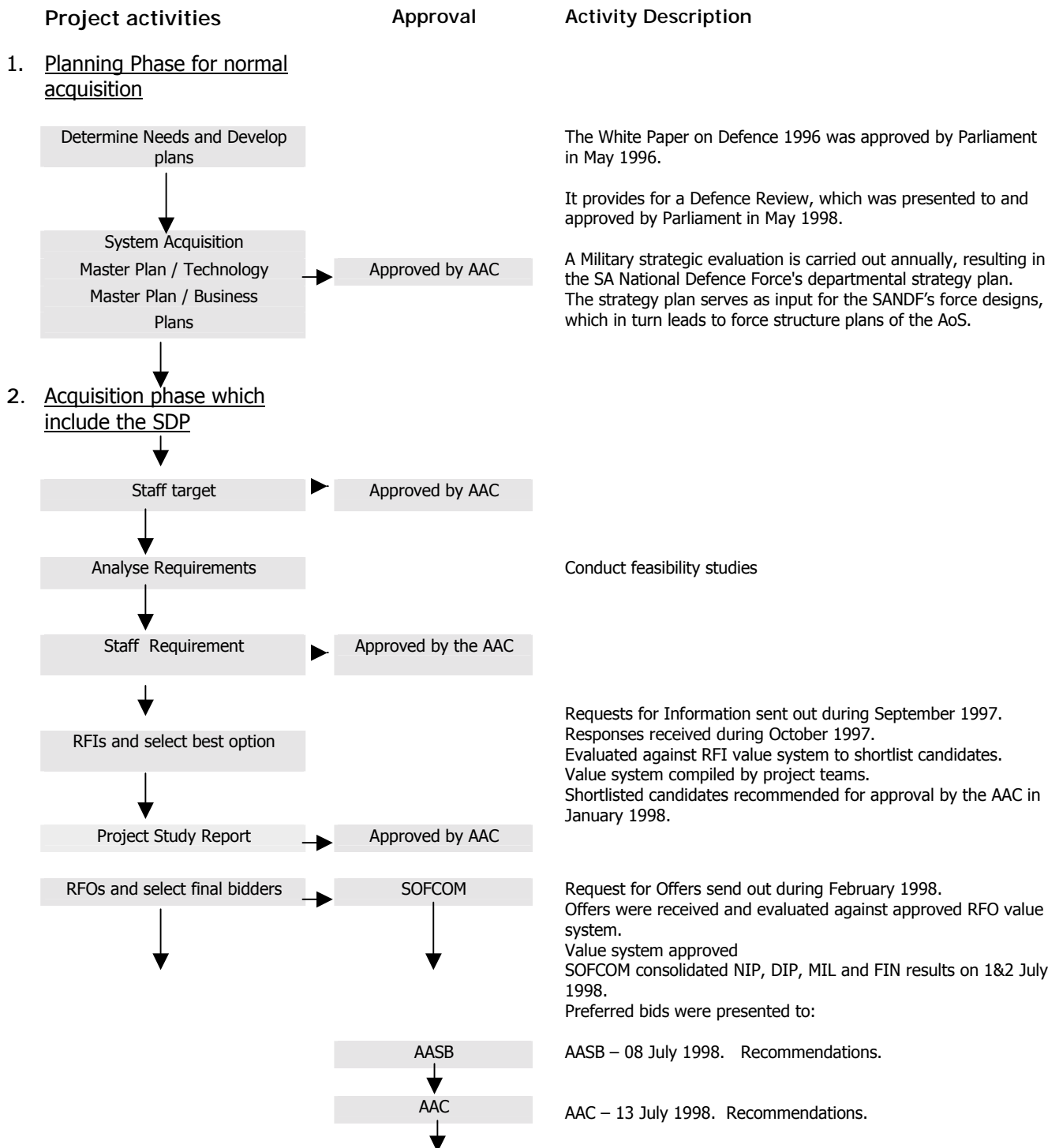
These reports were approved by the Steering Committee as departmental policies. The former Minister of Defence, Mr J Modise, signed the reports on 8 August 1996.

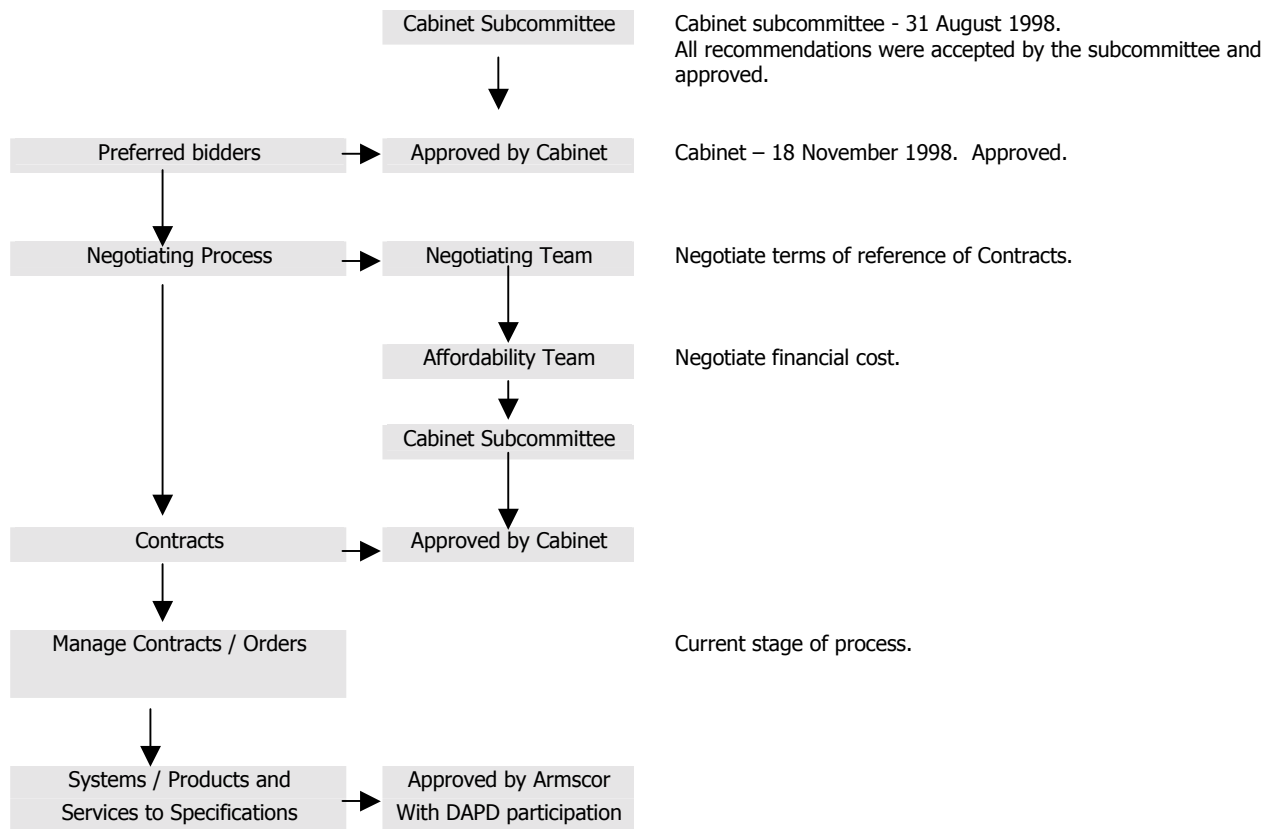
3.2.5 DoD instruction No ACQ/1/98: Policy on the acquisition of armaments

DoD issued instruction No ACQ/1/98: Policy on the acquisition of armaments, which was authorised by the Acting Secretary for Defence and implemented on 19 July 1999. It provides for the acquisition of armaments for the DoD in pursuit of national objectives, defines accountability and responsibilities, the armaments acquisition approach, as well as the armaments acquisition management policy and project management. The policy includes the necessary procedures and authorising bodies in order for the DoD and Armscor to be able to deal with international defence equipment procurement in future. During the investigation, similar policies of the United Kingdom and Australia were considered and found to compare favourably with the mentioned policy developed during the acquisition process of the SDP, referred to above.

3.2.6 The acquisition process

During the forensic investigation, the process followed for the acquisition of the SDP was documented and can be summarised as follows:





Note: according to the VB1000, the Staff Target and Acquisition Plan are the only mandatory non-negotiable milestones. The other milestone documents are a derivative of the nature of the programme.

3.3 FINDINGS

From the public phase and the forensic investigation it appears that:

- 3.3.1 The Strategic Defence Packages were unique to South Africa. Firstly, it was the first time that a “package approach” to the acquisition of armaments was adopted. Secondly, the acquisition consisted mainly of foreign designed and developed weapon systems.
- 3.3.2 Due to the sanctions imposed on the acquisition of arms prior to 1994, an adequate acquisition policy to accommodate the procurement of armaments for the SANDF in the international markets did not exist.

- 3.3.3 DoD recognised the limitations of the procurement policy (i.e. VB1000), which existed during the acquisition process in question and the need to adapt and interpret it, in order to render it suitable for the international procurement programmes.
- 3.3.4 In addition to the VB1000, a number of departmental policies (MODAC) were developed during the acquisition process in question to comply with the White Paper, at the instance of the former Minister of Defence, which culminated in DoD Instruction No ACQ/1/98:Policy on the Acquisition of Armaments.
- 3.3.5 The MODAC policies gave rise to the replacement of the former Project Control Board, the Defence Command Council and the Defence Planning Council by the AACB, AASB and the AAC as the highest approval authority.
- 3.3.6 An additional body, namely SOFCOM has been established during the acquisition phase of the SDP to consolidate evaluation results for presentation to authorising bodies. The constitution of SOFCOM did not provide for decision-making authority. However, it was entitled to submit recommendations to CoD.
- 3.3.7 During the procurement process of the SDP, due to its magnitude and the cost involved the following was included, in addition to normal procedure:
- (a) Approved value systems for National Industrial Participation and Defence Industrial Participation as well as evaluation teams.
 - (b) Approved negotiation and affordability teams to negotiate terms of reference for contracts and to negotiate final costs before signing the contracts.
 - (c) SOFCOM, as reflected in paragraph 3.3.6, to consolidate evaluation results for presentations to authorising bodies.

(d) The Ministers' Committee, which considered recommendations presented to it and submitted final recommendations to Cabinet.

(e) The procurement process required the final approval by Cabinet.

3.3.8 The policy on the acquisition of armaments that evolved during SDP procurement process and that was approved in July 1999 (ACQ/1/98), consists of the necessary procedures and authorising bodies to enable DoD and Armscor effectively to deal with international defence equipment procurement. This policy compares favourably with defence procurement policies in the United Kingdom and Australia.

3.3.9 The variances from standard procurement practices were reported in the Special Review of the Auditor-General and included, *inter alia*, the fact that Staff Targets and Staff Requirements were not approved before sending out RFOs. It has been established during the investigation that the VB 1000 did not contain specific instructions in this regard.

3.4 RECOMMENDATION

It is recommended that the policy document (ACQ/1/98) referred in paragraph 3.2.5 above be further refined with specific reference to the lessons learnt from the acquisition process under investigation as reflected in this report. The staff of DoD and Armscor involved in procurement should be properly trained to ensure that they assimilate and fully understand the policy with a view to its effective implementation.

CHAPTER 4

SELECTION OF PRIME CONTRACTORS – ALFA & LIFT

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CHAPTER 4

SELECTION OF PRIME CONTRACTORS – ALFA & LIFT

4.1 ALFA - BACKGROUND

- 4.1.1 During the early 1990s the SAAF had a 3-tier fighter training philosophy. The three tiers consisted of the Pilatus PC7 Mk II Astra (Astra) trainer, the Impala Mk I and Mk II (Impala) fighter trainer, the Cheetah C and D (Cheetah) fighters and the Mirage F1AZ (Mirage).
- 4.1.2 The SAAF strategy for the long-term replacement of its air combat capability was proposed in the early nineties. This strategy made provision for an advanced fighter trainer (AFT) and a medium fighter to be acquired in the future. The SAAF fighter programme that was started included two programmes, namely Project Ukhozi and Project Kambro.
- 4.1.3 Project Ukhozi was established to satisfy trainer requirements and it focused on the replacement of 94 Impala aircraft with 48 aircraft. The project was aimed at acquiring the AFT. The Minister of Defence approved the AFT Staff Target (ST) No 2/94 on 18 October 1994, as first acquisition requirement, and the DCC approved the Staff Requirement (SR) on 4 October 1995. The constitution of the UCC was approved on 3 November 1995 and its main aim was to determine the overall programme strategy, to approve the evaluation process and to make major milestone decisions.
- 4.1.4 Project Kambro was established to satisfy the medium fighter requirement, and it focused on the replacement of the Mirage F 1 as well as the Cheetah C and D aircraft with a future multi-role supersonic fighter by the year 2012, which was described as a Future Medium Fighter (FMF).

4.1.5 According to the SR, the AFT aircraft had to have the capacity to carry out successfully a wide spectrum of jet conversions, advanced fighter training and combat missions. The training philosophy for the AFT aircraft assumed that the Astra trainer would be fully operational by 1997 and the Cheetah would remain in place until the fleet is replaced in approximately 2012. This implied a future SAAF fighter force design of a front line squadron, completed by the light fighter squadron and combat flying school.

4.1.6 A Request For Information (RFI) was forwarded to 30 suppliers from which 23 aircraft proposals and four service proposals were received.

4.1.7 The following responses were received for transonic aircraft:

In production	Under development
Martin F16 SAAB JAS39 Gripen British Aerospace Hawk 100 AIDC AT-3	LCA Sukhoi S54/55 CASA ATX Samsung KTX-2 MGA-T

The following responses were received for subsonic aircraft:

In production	Under development
Aermacchi AMX-T Dassault Alphajet FMA IA 63 PAMPA Aermacchi MB339FD IAR 99 Aero Vodochody L159 CATIC/PAC K-8 KIRAN MK2 Pilatus Super PC-9	Yakovlev YAK 130 Mikoyan Venga TG-10 Promavia Jet

4.1.8 The above responses were evaluated in accordance with an AFT proposed value system. Values were allocated to the following aspects: airframe performance, onboard systems; avionics systems; supportability systems; acquisition cost index and operating/support cost index. Evidence could not be found that the

relevant authority approved this value system. The results of the evaluation were as follows:

No	Aircraft	Score
1	SAAB JAS39 Gripen	0.899
2	Sukhoi S55	0.887
3	Sukhoi S54	0.884
4	Martin F-16	0.859
5	Aermacchi AMX-T	0.788
6	Dassault Alphajet	0.766
7	CASA ATX	0.763
8	MiG AT	0.703
9	Aero Vodochody L159	0.693
10	Yakovlev Yak 130	0.682
11	CATIC/PAC K-8	0.668
12	FMA IA 63 PAMPA	0.648
13	Aermacchi MB339FD	0.647
14	AIDC AT-3	0.631
15	British Aerospace Hawk 100	0.623
16	TAR 99	0.553
17	Impala	0.335

Not evaluated	Disqualified
LCA (Insufficient information)	Pilatus PC-9 (Turbo prop)
MGA-T (Insufficient information)	T-4 (no RFI reply)
Jet Squalus (Insufficient information)	I22 (no RFI reply)
Venga TG-10 (Insufficient information)	
KIRAN MK2 (Insufficient information)	
KTX-2 (Insufficient information)	

4.1.9 The proposed value system results were presented to the UCC on 13 May 1996, and the following five additional criteria for performing the first level contender short list selection were approved:

Criteria number	Criteria
1	Aircraft must be jet propelled and have a tandem cockpit to resemble a modern fighter.
2	Aircraft must have better performance than Impala MKII to fill training gap between Astra and Cheetah C.
3	Aircraft must be in advanced development or production.
4	Delivery must not be later than 2003.
5	Manufacturer must have indicated willingness to participate by having replied to the request for additional information (27 March 1996) or the reminder (6 June 1996).

4.1.10 Each contender on the short list of 17 was evaluated against the criteria and any contender who did not comply with any one of these criteria was recommended for elimination from the short list. The submission by the AASB in respect of contender elimination was approved by the AAC on 31 July 1996. The result of the evaluation left the following nine contenders that were further investigated by visiting each supplier:

No	Aircraft	Manufacturer	Country
1	AMX-T	Aermacchi/Alenia/Embraer	Italy/Brazil
2	AT2000	Daimler-Benz Aerospace	Germany
3	Hawk 100	British Aerospace	Britain
4	JAS39 Gripen	SAAB	Sweden
5	L159	Aero Vodochody	Czech Republic
6	MB339FD	Aermacchi	Italy
7	MiG AT	MiG/MAPO	Russia
8	S-54	SUKHOI	Russia
9	Yak/AEM-130	Yakovlev/Aermacchi	Russia

4.1.11 After visits to the suppliers, which took place during September and October 1996, an interim project study report, dated February 1997, was compiled. The objective of the report was to recommend a short list of aircraft types that can satisfy the requirement for an AFT and to obtain approval to issue Requests For Proposal (RFP) to the suppliers of these aircraft. The nine contenders were evaluated against a value system, which included the following:

- Operational value (50%).
- Logistic value (30%).
- Supplier value (20%).

A cost analysis, risk analysis and a trade-off analysis were also conducted.

4.1.12 The results were presented to the DCC in March 1997, and were then referred to the AASB. The results were as follows:

RFP contenders	
Type	Comments
AMX-T	In production, multi-role, growth path.
AT2000	Potential for wide-band performance at reasonable cost. Best opportunity for industry participation. High programme risk.
L159	Balanced performance and systems at reasonable cost. Good logistic support. SAAF might be only user outside Czech Republic.
Yak/AEM-130	Balanced all-round performance for multi-role. Re-engine option. Feasible only if acquired by Russian Federation.

Contenders removed from the short list	
Type	Comments
Hawk 100	High cost. Does not satisfy SAAF operational requirement.
JAS 39 Gripen	Unaffordable.
MB339FD	Low performance cannot satisfy user requirement.
MiG-AT	High development and production risk.
S-54	Insufficient/incomplete information provided.

4.1.13 During January 1997, the British Government tabled a package proposal for the supply of armaments to South Africa. This included, *inter alia*, the replacement of the Impala with the Hawk jet trainer or a combination of the Hawk and the Gripen fighter *via* British Aerospace (BAe).

4.1.14 In response, the chairperson of the UCC, after careful scrutiny of the proposal, indicated in July 1997, that it was evident that this advanced training system

could be acquired far more cost-effectively outside the British Package Proposal of the Hawk 100. However, the SAAF would include this requirement in the RSA/UK SDP only in the event of it being politically obliged to accept the training system on offer. The operational shortcomings of the training system on offer could be overcome at an affordable cost in terms of acquisition as well as life-cycle support. According to the chairperson, the aircraft systems on offer in the British proposal did not comply with the defined operational and logistical requirements of either the fighter or fighter trainer replacement programmes.

Neither the Hawk nor Gripen systems, as offered by BAe during its formal response to the Project Ukhozi acquisition, satisfied the full requirement specifications. In terms of quoted acquisition and life cycle support costs, both aircraft systems were by far the most expensive options in their respective classes. In order to satisfy the requirement for these two systems, the SAAF would have preferred not to participate in the stated fighter component of the SDP as there were aircraft systems that were operationally far more acceptable and available at substantially lower acquisition and operating costs. Such systems formed part of package proposals received from other countries. In this instance, the acceptance of the Hawk would have been based on the interim lease of a limited number of Hawk 100 only until an agreed number of Gripens had been delivered and the Astra training system had been adapted to address the new training gap. Before inclusion of SAAF requirements within the proposed SDP could be finalised, substantial staff work within the SANDF would have to be concluded to safeguard the interest of DoD.

4.1.15 In July 1997 the President was advised by DoD and the SANDF of the reasons why the British proposal was not acceptable.

4.1.16 At that stage the Chief of the SAAF was concerned that, although the acquisition process for Ukhozi had followed the normal path and had not taken

into account the MoD package offer made by the British Government, the wrong impression might be created if the RFP were issued without the inclusion of the Gripen aircraft. It was decided that the normal process for Ukhozi would go ahead as planned and that it would be reconsidered once greater clarity was obtained on the British MoD offer and the Defence Review completed.

4.1.17 However, before the submission was made to the AASB, the Executive Council of the UCC considered the following facts:

- There were insufficient funds on the approved Force Design Steering Committee (FDSC) plan to initiate Project Ukhozi before the year 2000, at the earliest.
- To issue requests for proposal (RFP) to the international aerospace industry without being able to place the contract in the feasible future for a number of years.
- The British SDP offer could affect the course of the project.

In view of the above, a decision was made by the UCC on 17 March 1997, to recommend to the AASB that the project be delayed by 12 months. A submission was made accordingly on 20 March 1997, to the AASB that approved the recommendation.

4.2 ALFA - PLANNING

4.2.1 Due to budget cuts in 1997, the acquisition process of Project Ukhozi could not continue within the proposed timescales. SAAF Operations Council considered the budgetary implications of both Projects Ukhozi and Kambro. These implications were R5,2 billion for Project Ukhozi and R8 billion for Project Kambro. This was considered to be unaffordable. It was considered that a

mid-range light fighter could satisfy both of the projects' requirements at a lower cost. The SAAF Command Council therefore decided on 7 July 1997, that Project Ukhozi had to redefine its SR to that of an advanced light fighter aircraft (ALFA) concept that would meet the requirements of both Project Ukhozi and Project Kambro. This effectively meant a change from a 3-tier to a 2-tier fighter strategy. The 2-tier fighter strategy would include the Astra that would be used for basic fighter orientation training. This would be followed by jet conversion, operational conversion and operations on the ALFA. The ALFA would therefore take over the operational roles of the Impala, Mirage and the Cheetah as the only front line fighter with precision air defence and ground attack capabilities. The SAAF was therefore forced to redesign in terms of costs and not according to its requirements.

- 4.2.2 During a meeting held on 5 August 1997, the UCC approved that the DCC and the Military Command Council should be informed of the new 2-tier strategy and that the project team should change their URS accordingly.
- 4.2.3 On 19 September 1997, CoD approved a proposal to continue with the SDP and decided to include the ALFA in the SDP. At the UCC meeting of 7 October 1997, the revised URS for the ALFA within the 2-tier system was presented. According to the minutes *"the URS is in it's final stages of completion, and that it should be finalised by the end of October 1997. In parallel to the update of the URS to reflect the new requirement, the Staff Target as well as the Staff Requirement are also updated and should be finished together with the URS."* The fact that the URS, the ST and the SR were updated to reflect the new requirement, was indicative of the fact that CoD accepted the ALFA as part of the 2-tier fighter strategy in the SDP.

4.3 ALFA – ACQUISITION PHASE

4.3.1 ALFA – Request for Information

4.3.1.1 On 23 September 1997, a RFI for 48 aircraft were sent to eight Governments, i.e. the United Kingdom, France, Germany, Italy, Brazil, Sweden, Canada and Spain. The following responses to the RFIs were received:

Country	Aircraft
Germany	AT 2000
France	Dassault Mirage 2000
Canada	CF 5
United Kingdom	SAAB Gripen
Italy	Yak/AEM 130; MB339FD
Russia	MiG 29
Czech Republic	L159

4.3.1.2 The RFI technical value system presented to, and approved by, the UCC at a meeting held on 7 October 1997, was used as a weeding-out process and five contenders were eliminated. The RFI responses were received on 31 October 1997.

4.3.1.3 During a meeting of the SAAF Command Council on 17 November 1997, the ALFA project team presented the results of the RFI evaluation process. According to the minutes, it was decided to reduce the number of aircraft for the ALFA project from 48 to 38. The results were presented for the procurement of 38 aircraft (eight dual-seat and 30 single-seat aircraft) and three aircraft were shortlisted, namely the Gripen, AT2000 and Mirage 2000.

4.3.1.4 The RFIs were issued to the respective governments with the envisaged SAAF Force Design in mind. The project team experienced the dilemma that it subsequently became clear that another type of aircraft would be required as an interim trainer between the Astra and the ALFA. The minutes of the meeting of 17 November 1997 indicate that a strategic planning workshop was held, prior to the meeting, to address this matter. Documentation of the

strategic planning workshop attached to the minutes of the meeting indicates that the 2-tier system was not acceptable to the Minister of Defence. The SAAF Command Council then concluded that a 3-tier system, incorporating both the ALFA and a lead in fighter trainer (LIFT), was essential to satisfy the requirements of the SAAF in relation to fighter training and fighter consolidation in a cost-effective manner. This presentation was very important in the sense that it marked a turning point in the SAAF strategy. As a result of this presentation four significant decisions were taken:

- *"The SAAF required both a LIFT and an ALFA, i.e. a 3-tier system."*
- *"Both had to be satisfied through the government-to-government SDPs."*
- *"The LIFT constituted an additional requirement to the SDP and had to be registered as such."*
- *"The LIFT was the more urgent requirement that had to be satisfied first."*

4.3.1.5 On 19 and 20 November 1997, a Steering Committee Meeting was held where the results of the RFI evaluations were discussed. The purpose of the meeting was to prepare the information for presentation to the AAC and Cabinet for decision-making purposes. Documentation attached to the minutes indicate that all the suppliers, except those for the Mirage 2000, confirmed that pilots could convert to the proposed aircraft directly from the Astra.

4.3.1.6 On 24 and 28 November 1997, presentations were made by the UCC to the AAC and during these meetings the following short list for Request For Offers (RFOs) was approved:

Aircraft type	Supplier	Normalised Military Value (RFI results)	Motivation
AT 2000	DASA	1,0	Best cost-effectiveness. Also best operational capability. Development programme with very high risk – unless DASA and German Government commit to programme. Also option that can satisfy the SAAF requirement. Financial commitment during development (next three years) low.
Mirage 2000	Dassault	0,83	Lowest technical and programme risk with high operational capability. Cost provisional estimate that has to be verified.
Gripen	BAe/SAAB	0,81	Capable modern fighter with low development risk but high cost.

All three the above aircraft were considered acceptable to satisfy the SAAF's requirement for an ALFA, subject to the risks being covered contractually and by government-to-government agreement.

4.3.1.7 On 2 December 1997, Project Ukhozi was redefined to satisfy the requirements for the ALFA as part of a 3-tier system. At a meeting of the UCC it was reported that the URS of Project Ukhozi for the ALFA was completed and signed by the Director: Projects. The revised ST and SR for Project Ukhozi were forwarded to the SAAF Command Council for review and approval by the AAC. They were approved by the AAC on 16 March 1998.

4.3.2 ALFA – Request For Offer

4.3.2.1 A RFO was issued on 14 February 1998, to BAe/SAAB, Dassault and Daimler-Benz Aerospace with 14 May 1998 as the final date for submission of offers. The issuing was authorised by the former Minister of Defence at the AAC on 28 February 1998. The combined ST/SR and the SAAF URS served as the technical basis for the RFO. On 26 February 1998, a proposal was presented to visit the final contenders for Project Ukhozi.

4.3.2.2 On 20 February 1998, the revised ST No 2/94 for 38 aircraft and SR No 2/95 for Project Ukhozi were submitted for approval. It was approved on 16 March 1998, by the chairperson of the AAC. The total acquisition cost required for 38 ALFA aircraft was expected to be in the order of R11,0 billion (1998 rand value, i.e. US\$1=R5.10), i.e. including initial logistic package for two years, taxes, mission equipment, mission simulator and programme management cost. The ST and SR were therefore approved after the RFOs were issued.

4.3.2.3 The final offers for the ALFA were received from all three contenders on 14 May 1998. Thereafter a detailed evaluation of the value systems commenced.

4.3.3 ALFA – Technical value system and evaluation

4.3.3.1 Each proposal had to be measured against a set of mandatory requirements. These mandatory requirements were evaluated in the RFI phase. This was a measure to ensure that the proposals still comply with the minimum requirements. These proposals were measured against a set of discriminatory criteria, which formed part of the final value system. A score had to be determined for each proposal and this score was the military value. The life-cycle cost was calculated for each proposal and a life-cycle cost index determined. The military value then had to be divided by the life-cycle cost to provide the cost-effectiveness for each contender. The cost-effectiveness values were ranked from highest to lowest and the most cost-effective contender recommended to SOFCOM.

4.3.3.2 The ALFA technical evaluation report was compiled by the Programme Manager of Armscor. The results of the evaluation of the ALFA final offers were presented to SOFCOM on 1 July 1998. The presentation to SOFCOM was based on the recommendation on the military value. The technical scores presented to SOFCOM were the following:

Characteristic/Weightings	Gripen	Mirage 2000	AT 2000
Total score (Rounded off)	76	60	58
Programme cost (US\$ mil)	2,234	2,314	2,157
Cost-effectiveness	34.02	25.93	26.89
Rating (Normalised)	100	76.22	79.04

Although the value system required that the military value be divided by the lifecycle cost in order to get the Military Cost-Effectiveness Index, the programme cost was used instead. However, this had no effect on the final ranking of the bidders.

4.3.4 ALFA – DIP value system and evaluation

4.3.4.1 In 1997 the DTI imposed a specific policy of counter trade for all contracts in excess of US\$10 million. These contracts had to have a minimum of 30% industrial participation (IP) based on the contract price. Defence contracts had to have a minimum defence industrial participation (DIP) of 50%. Normal tendering procedures require a 50-50 split between DIP and NIP (Refer chapter 12). A decision was taken that if 100% IP was committed, the bidder would not be penalised. This decision was noted in an urgent notice in respect of final recommendations for DIP and NIP, dated 16 April 1998.

4.3.4.2 The DIP evaluation team compiled a value system that was used to evaluate the bidders' offers. SOFCOM approved this value system programme on 5 May 1998.

4.3.4.3 The normalised scores regarding the final DIP recommendation presented to SOFCOM were the following:

Bidder	Normalised rating
DASA – Germany – AT2000	100
BAE/SAAB – UK/Sweden – JAS Gripen	88
Dassault – France – Mirage	40

4.3.5 ALFA – NIP value system and evaluation

4.3.5.1 A bidder submitted its project proposals to the DTI. The NIP evaluation team consisted of officials of the department. The evaluation was performed in two parts. Part one was to obtain NIP credits for the value of items, such as export sales, domestic sales and investments. This was more of a quantitative phase. It involved looking at the items in the business plans and multiplying them by the weighting as per the approved value system.

4.3.5.2 Part two was more qualitative and it was made up of five sections for which points were allocated. Each section had a maximum score of 5, therefore the maximum possible score for phase two was 25.

4.3.5.3 The scoring in part two was by consensus. An objective approach was used to obtain a reasonable score. The score in part one was multiplied by the score in part two and the total was the final score. The NIP team leaders communicated the scores to SOFCOM.

4.3.5.4 The normalised scores regarding the final NIP recommendation presented to SOFCOM were the following:

Bidder	Normalised Rating
BAe/SAAB – UK/Sweden – JAS Gripen	100
DASA – Germany – AT2000	11
Dassault – France – Mirage	7

4.3.6 ALFA – Finance value system and evaluation

4.3.6.1 The critical criteria used to evaluate the RFOs in this regard were as follows:

- A grace period of four years.
- A repayment period of 15 and 20 years, the grace period included.
- The bidder must have quoted for both periods.
- It must have been an all costs included proposal.
- Currency denominations must have been expressed in US\$.
- All conversion rates used in their calculations had to be indicated clearly.
- All the information requested had to be supplied.

4.3.6.2 The discriminating criteria with their respective weights, were as follows:

- Cost of finance 30%.
- Cash flow 30%.
- Hidden cost 30%.
- Financial soundness 10%.

The financial evaluation results, which were also as such presented to SOFCOM were as follows:

Bidder	Programme cost (US\$m)	Finance Cost (US\$m)	Cash flow (US\$m)	Years	Finance cost (%)	NPV (%)	IRR (%)	Rating	Rank
UK SAAB Gripen	2217,0	1252,1	3469,1	20	56	2129,1	5,8	100	1
Germany DASA AT 2000	2139,0	-	-	-	-	-	-	-	-
France Dassault Mirage	2257,0	-	-	-	-	-	-	-	-

Legend:

- Programme cost – The contract price as determined by each project team, excluding programme management cost and financing cost.
- Finance cost (US\$m) – Value of the total financing cost payable over the financing period.
- Cash flow – The total programme cost and financing cost.
- Period – Period/duration of the loan.
- Finance cost (%) – Finance cost expressed as a percentage of programme cost.
- NPV – Net present value of the discounted cash flows.
- IRR – The internal rate of return calculates the expected cost of capital of a project.

The following comments were made by the Finance Evaluation Team on slides presented to SOFCOM:

(a) UK – SAAB

- No hedging strategy.
- 85% of contract value financed over 20 years, the balance over seven years.
- Fees in grace period.

(b) Germany – DASA

- Was not ready to submit a proposal.
- No evaluation was possible.

(c) France – Dassault

- Offer only financing for the definition phase (0,4% of contract value).

- Only letter of intent from financier for the balance.
- No proper evaluation possible.

4.3.6.3 It is clear from the above that there was no competitive financial evaluation. The aforementioned lack of a competitive financial evaluation played an important role during the overall evaluation process, as the financial evaluation score comprised 33,3% of the total evaluation.

4.3.7 ALFA - SOFCOM combined results

4.3.7.1 SOFCOM consolidated the normalised evaluation scores for technical, IP and finance (all normalised to 100) and was responsible for presenting the combined results (out of 300) to AASB and AAC for approval.

4.3.7.2 The minutes of a special meeting on 10 June 1998 attended by, *inter alia*, all team leaders responsible for the value determination of strategic programmes, indicated the following:

Formulas to be used:

$$BV = \frac{MV + IV}{\text{Financing Index}}$$

Where: BV = Best Value
MV = Military Value
IV = Industrial Value

4.3.7.3 According to the confirmation notes of the SOFCOM work session, held on 1 and 2 July 1998, the chairperson addressed the top level value system and advised that the formula should be as follows:

$$BV = MV + IV + \text{Financing Index}$$

4.3.7.4 This change in the formula was tested and the different results based on the two formulas mentioned above are as follows:

(a) $BV = \frac{MV + IV}{\text{Financing Index}}$

Aircraft	Military value	Industrial value	Financing Index	Best value	Ranking
AT2000	79	59	0	-	-
Mirage 2000	76	25	0	-	-
Gripen	100	100	100	2	1

(b) $BV = MV + IV + \text{Financing Index}$

Aircraft	Military value	Industrial value	Financing Index	Best value	Ranking
AT2000	79	59	0	138	2
Mirage 2000	76	25	0	101	3
Gripen	100	100	100	300	1

As can be seen from the above tables, the change in the formula did not have an effect on the ranking in the case of the ALFA.

4.3.7.5 The combined results for ALFA were presented to the AASB on 8 July 1998.

4.4 LIFT - PLANNING

4.4.1 During a meeting of the SAAF Command Council on 17 November 1997, (after the ALFA RFI replies were received) it was decided that the SAAF required both a LIFT and an ALFA, and therefore Project Winchester was registered. Project Winchester involves the acquisition of a fleet of 24 dual-seat LIFT aircraft including 1 Flight Test Aircraft (FTA). During initial stages, Project Winchester and Project Ukhozi ran parallel as a single SDP programme and all the technical aspects for both projects were managed by the UCC.

4.4.2 On 20 February 1998, the combined ST No 1/98 for 24 LIFT Aircraft and SR No 1/98 for Project Winchester were submitted for approval.

4.4.3 On 16 March 1998, the chairperson of the AAC approved the revised ST and SR for Project Winchester. The total acquisition cost required for 24 LIFT aircraft was expected to be in the order of R2,2 billion ('98 Rand value, i.e. US\$1=R5.10). The operating cost for 24 aircraft flying 4 000 hours per year at an estimated R15 000 per flying hour was estimated to be approximately R70 million per year. The chairperson of the AAC also made the following remarks: *"the project team/SAAF must consider the leasing of the above mentioned aircraft as an option before any final recommendation is forwarded to the AAC for approval. Project Winchester must be brought in line, together with Project UKHOZI, with the SDP time scales"*. The total acquisition cost for both ALFA and LIFT at this stage amounted to R13,2 billion. Eight months prior to this, projects Ukhozi and Kambro amounting to R13,2 billion were cancelled due to unaffordability.

4.5 LIFT – ACQUISITION PHASE

4.5.1 LIFT – Request for Information

4.5.1.1 On 3 February 1998, the UCC approved that RFIs be issued. To ensure that the LIFT process was synchronised with the other programmes under the SDP process, the RFI was issued to 20 suppliers on 9 March 1998. The RFI was therefore issued before the ST and SR were approved by the AAC on 16 March 1998. Responses were received from all 20 suppliers on 6 April 1998.

4.5.1.2 From the minutes of the UCC, dated 7 and 8 April 1998, it was noted that the value system for the evaluation of the replies to the LIFT RFI was approved. It should be mentioned that this approval was given after the replies were received on 6 April 1998. Although it was noted that a decision was also taken at the meeting of 7 April 1998, that proposals would only be opened after approval of the final value system, the risk existed that manipulation of either

the value system or the RFI could take place. No evidence of such manipulation of the value system on the RFI was found.

4.5.1.3 From Project Winchester: Interim Study Report dated November 1998, it was noted that the proposals were evaluated against mandatory requirements and a discriminatory value system.

4.5.1.4 Although the military value for all 20 contenders was determined, the following contenders were eliminated, as all the mandatory requirements have not been met. This was presented as such to the *ad hoc* Project Ukhozi/Winchester Control Council meeting held on 30 April 1998:

Aircraft	Country	Mandatories not achieved	Notes
ALPHA JET	France	No information provided	Second-hand ex-French A/F
F7 MG	China	Single seat only. Only 16 aircraft offered	M2 Fighter
CF-5	Canada	Service life. Mix of 18 dual and 8 single seat aircraft	Second-hand ex-Canadian A/F
MONITOR	Canada	Insufficient information provided	New development. Little known manufacturer (Canadian Aero) JPATS Class
RANGER	Germany	Insufficient equipment, e.g. No cannon, missiles not integrated	Prototype Flying JPATS Class
SK 60	Sweden	Service life (upgrade), questionable support beyond 2015	Second-hand ex-Swedish A/F Side-by-side

4.5.1.5 The military value results of the 14 remaining contenders are indicated in the following table:

Aircraft	Military value	Rating
Hawk 100	82	1
L159	72	2
AMX-ATA	71	3
Yak 130	71	4
MB339FD	69	5
MiG-AT	69	6
L59	63	7
S211A	61	8
PC-TT	57	9
T6-A	57	10
L139	54	11
TAW TRAINER	52	12
C101	31	13
K8	27	14

4.5.1.6 The cost-effectiveness of the aircraft on offer was also calculated by dividing the military value by the life-cycle cost. The results of the cost-effectiveness evaluation were as follows:

Aircraft	Military value	Life-cycle cost (US\$m)	Cost-effectiveness
S211A	61	474,6	12,9
MB339FD	69	544,1	12,7
PC-TT	57	448,8	12,7
T6-A	57	471,4	12,1
L59	63	599,7	10,5
L139	54	526,1	10,3
Hawk 100	82	979,0	8,3
L159	72	902,1	8,0
Yak 130	71	969,3	7,3
AMX	71	985,8	7,2
MiG AT	69	1009,2	6,8
K8	27	430,2	6,3
CASA 101	31	636,6	4,9

4.5.1.7 During a work session of the project team, held on 24 April 1998, it was decided to recommend to the UCC not to use acquisition cost as a limiting factor, as no firm acquisition budget allocation existed, but rather to base the short list on a military value of 60 and higher and life-cycle cost-effectiveness of above 8,0. The resulting short list to the UCC included the following aircraft:



- L159 / L59 (Aero Vodochody to present only one option).
- MB339FD.
- S211A.
- Hawk 100.

4.5.1.8 On 30 April 1998, a special UCC meeting was held to present the evaluation results of the replies to the LIFT RFI. The meeting decided that the short list should be determined on the military value only and that the cost impact be deferred for discussion at the AAC. The UCC approved a recommendation to be tabled to the AAC for the following manufacturers/aircraft to receive a request for best and final offer, based on a military value result of more than 68:

Country	Supplier	Aircraft
Czech Republic	Aero Vodochody	L159
Italy	Aermacchi	MB339FD
Italy	Aermacchi	Yak 130
United Kingdom	British Aerospace	Hawk 100
Russia	MiG-MAPO/Kulkoni	MiG-AT

4.5.1.9 After the technical evaluations, the project team presented a short list of contenders to a combined AASB and AAC on 30 April 1998. The project team short-listed six aircraft for consideration and further recommendation. The AAC supported their recommendations that both the MiG AT and AMX-TT be removed from the formal RFO stage. This was due to the AMX being designed and developed as a multi-role ground attack operational aircraft. Although the AMX complied with the training requirements of the LIFT programme, it was due to the collateral training capability inherent in the operational design philosophy. The MiG AT was excluded as it was the highest cost for the lowest military value contender. This left four aircraft on the RFO list, i.e. the HAWK, Yak 130, L159 and MB339FD. These aircraft all complied with the minimum functional capabilities for a LIFT.



4.5.1.10 Minutes of the Joint AASB/AAC forum of 30 April 1998 indicate, in paragraphs 8 and 9 thereof, that the project team presented the meeting with an affordability analysis of LIFT contenders. Without cost considerations the selection process was biased towards the higher performance category aircraft. These aircraft are, however, also significantly more expensive to acquire, operate and maintain. Therefore, unless additional funding could be found to support the acquisition of a more superior aircraft, the SAAF would have to take cognisance of budgetary constraints in the selection process. The Minister of Defence cautioned the meeting that a visionary approach should not be excluded, as the decision on the acquisition of a new fighter trainer aircraft would impact on the South African defence industry's chances to be part of the global defence market through partnership with major international defence companies, in this case European companies. In terms of this vision, the most inexpensive option might not necessarily be the best option. The Minister requested the DoD acquisition staff to bear this vision in mind during the selection process.

According to the combined minutes the following decisions were taken:

- The Minister instructed the project team to issue the approved short list of contenders with RFOs and thus bring the LIFT programme in line with the other offers received under the SDP process.
- The Minister further instructed the project team to include the option of a lease in the RFOs.
- The meeting approved the list of contenders to receive RFOs as:

Contender	Aircraft
Aermacchi	MB339FD
Aermacchi	Yak 130
Aero Vodochody	L159
British Aerospace	Hawk 100

4.5.1.11 On 5 May 1998, the approval of the combined AASB/AAC on 30 April 1998, of the recommended short list was presented to the UCC. At this meeting it was minuted that the reason why the recommendation to the combined AASB/AAC was not based on cost-effectiveness was because it was thought that the cost constraint for the inclusion of the LIFT into the SDP should be determined by the AAC.

4.5.1.12 At a special SAAF Command Council meeting held on 29 June 1998, the LIFT recommendation to be presented to SOFCOM was formulated and approved. With regard to preparing two recommendations, the following two decisions were minuted:

"Paragraph 3.3

A separate recommendation is required where cost is not taken into account as per the request from the Minister of Defence.

Paragraph 3.6

The final recommendation gives two alternatives; the first alternative (A) is the most cost-effective solution based on achieved military value for the aircraft taken into account the associated risk and the cost of the aircraft system. The second alternative (B) does not take the cost of the aircraft system into account and is therefore the recommended aircraft based on the achieved military value with its associated risk."

The Director: Air Force Acquisitions, testified that when the then Chief of the SAAF was presented with a single finding of a costed option at the meeting, he said that there was a request by the AAC to consider a non-costed option. This led to paragraph 3.3 of the minutes as quoted above.

4.5.1.13 The minutes of a SOFCOM meeting held on 6 May 1998, mentioned the following regarding the LIFT timescales:

"The Chairman briefed the SOFCOM on the Lead In Lighter (sic) Trainer (LIFT) contender evaluation, and resulting short list that will be solicited for proposals on 11 May 98. The new timescales for the LIFT evaluation have been compressed to permit consideration of the LIFT recommendation in parallel with the overall SDP recommendation. The leasing option requested by the Minister must be developed as well. Clearly the direct industrial participation falls away in this case; but the remaining IP needs to be addressed as well."

4.5.2 LIFT – Request for Offer

4.5.2.1 The RFO for the LIFT was issued to BAe (Hawk 100), Aero Vodochody (L159) and to Aermacchi (Yak 130, MB339FD) on 12 May 1998. The final offers for the LIFT closed on 15 June 1998, and the evaluation started thereafter.

4.5.2.2 From the internal audit report the following was noted:

"Par. 2.10 Value systems used during the evaluation process had all been finalised, formally approved and registered prior to the start of evaluation of the best and final offers. Extensive input from the SANDF user community had been incorporated in the value systems. However, in at least some cases the content of the value system, and specifically the value of the relative weights, were known to the evaluators. This is undesirable as evaluators may be influenced by knowledge of the relative importance of parameters, or could manipulate the results through knowledge of relative weights."

No evidence was found that manipulation had taken place.

4.5.3 LIFT – Technical value system and evaluation

4.5.3.1 Each proposal was measured against a set of mandatory requirements in order to ensure that the proposals still complied with the minimum requirements. The proposals were also evaluated by using a value system which consisted of

a military value index, which was broken down into programme management, engineering management, training aircraft functionality and logistic support.

- 4.5.3.2 The minutes of a special meeting relating to value determination of strategic programmes on 10 June 1998 indicated the formulas to be used (Refer paragraph 4.3.7.2).
- 4.5.3.3 The Project Study Report for LIFT indicated that a risk analysis was also carried out. As a subset to the final selection value system, a risk assessment *pro forma* was prepared to perform a risk analysis on each of the contenders. The *pro forma* consisted of 33 pre-determined risk factors, a description of the impact of each on the LIFT should the risk realise and a severity score where a mark of 1 indicates a very low programme impact and 5 an extremely severe impact. The risk assessment *pro forma* was approved by the Ukhozi/Winchester Control Council and the Chief of Acquisitions with the final selection value system.
- 4.5.3.4 All mandatory requirements that were not met were presented to a special SAAF Command Council meeting 24c/98 held on 29 June 1998, as part of the LIFT evaluation results presentation. The delivery schedule for the Yak 130 did not meet the mandatory requirements by at least three years. As this was unacceptable, the Yak 130 was excluded from any further consideration. The remaining three aircraft, Hawk 100, MB339FD and the L159 all had a number of mandatory requirements that had not been met, but were considered as acceptable to the SAAF. It was also decided that these aircraft would all adequately breach the training gap between the Astra and the anticipated ALFA.
- 4.5.3.5 According to the Project Study Report the project teams were requested by SOFCOM to present their recommendations based on risk moderated cost-effectiveness index. The report indicated that note was also taken during the

evaluation of the Minister of Defence's request not to make cost the only consideration when recommending a LIFT contender for final selection.

4.5.3.6 According to the minutes of a special SAAF Command Council meeting, held on 29 June 1998, the SAAF Command Council further instructed the project team to prepare the 'adapted' military value in a costed and non-costed evaluation, to give execution to the AAC's guideline in this regard. It was further stated that the amended evaluations should be presented to SOFCOM for consideration. Based on the risk moderated value and programme cost, the results were as follows:

Aircraft	Moderated value	Programme cost	Cost effectiveness	Normalised	Rating
MB339FD	73,93	US\$0,3777b	195,7	100	1
L159	65,3	US\$0,6414b	101,8	52	2
Hawk	66,7	US\$0,7715b	86,5	44,2	3
Yak 130	46,2	US\$0,5506b	83,9	42,9	4

4.5.3.7 The ranking based only on risk moderated military value (excluding cost) was as follows:

Aircraft	Moderated value	Normalised
MB339FD	73,93	100
Hawk	66,7	90,2
L159	65,3	88,3
Yak 130	46,2	62,5

4.5.3.8 The leasing option, as mentioned, in paragraph 4.5.1.10 above, was investigated and it was found that leasing LIFT aircraft over a 30-year period is not a viable option. None of the contenders could provide a feasible leasing proposal.

4.5.4 LIFT – DIP value system and evaluation

4.5.4.1 The DIP project proposals submitted by each contender in the RFO phase were evaluated against an approved DIP value system. The DIP evaluation team

compiled a value system that was used to evaluate the contender's proposals. The normalised scores regarding the final DIP recommendation presented to SOFCOM were the following:

Bidder	Normalised rating
Italy/Russia – Yak 130	100
Italy – MB339FD	95
UK – Hawk	94
Czech – L159	84

4.5.5 LIFT – NIP value system and evaluation

4.5.5.1 The NIP project proposals of each contender, as submitted in the RFO phase, were evaluated against an approved NIP value system. A description of the process followed and criteria used to evaluate these project proposals is similar to that of the ALFA NIP value system summary mentioned in paragraph 4.3.5. The normalised scores regarding the final NIP recommendation presented to SOFCOM were the following:

Bidder	Normalised rating
UK – Hawk	100
Italy – MB339FD	25
Italy – Yak 130	25
Czech – L159	97

4.5.5.2 According to the records of DTI, a view was expressed in June 1999, that a report that was submitted to the Ministers' Committee on the proposed package for the LIFT programme had a radically inflated Hawk NIP offer. This view held that a "breakdown" in communication within the Department caused the Ministers to have been provided with an incorrect impression of the quality of the offer.

Data to Cabinet Subcommittee (Rm)				
Package	Price	Investment	Exports	Sales
Hawks	4900	3536	5975	81



4.5.5.3 Furthermore, data derived from an assessment provided by the DTI as indicated in the table below, shows that the power procurement project as proposed by BAe was the old (rejected) National Power project in another form: BAe proposed that National Power would invest US\$400 million in local manufacturers of power station equipment, which would be exported to their power station contracts in Africa. However, neither the investments nor the local manufacturers have been defined and the African projects are not yet firm (Sengwa/Gokwe in ZIM). This was therefore not in a state ready for consideration. The only other NIP of significance is the titanium plant, which they expected Ti-Met to establish, but they subsequently withdrew due to the oversupply of titanium sponge from the ex-USSR countries. They then suggested a titanium pigment plant to be put in by Kronos (US).

4.5.5.4 Without these two projects, BAe had virtually no NIP package. Mintek and IDC (BAe to pay) were commissioned to do a rapid pre-feasibility study, after which a visit was planned to Kronos in the US to convince them to invest.

The following data was derived from an assessment provided by the DTI:

Project	Investment	Exports	Local Sales
Power Procurement	400	370	0
BAe Industrial Park	25	78	0
Infrastructure JV	0	134	0
Ind-agri Bus Park	0.8	15	13
Titanium plant	140	359	0
Total	565.8	956	13

4.5.5.5 The above situation led to negotiations with the supplier in order to replace certain projects. This is indicative of the fact that the NIP offer of BAe was not properly evaluated during the RFO phase.

4.5.6 LIFT – Finance value system and evaluation

4.5.6.1 The critical criteria used to evaluate the RFOs were similar to those used in respect of the ALFA, referred to in paragraph 4.3.6.1 above.

The financial evaluation results were as follows:

Bidder	Program cost (US\$m)	Finance cost (US\$m)	Cash flow (US\$m)	Years	Finance cost (%)	NPV	IRR (%)	Rating	Rank
UK BAe Hawk	756,5	402,5	1 159,0	16	53%	422,2	5,1	100	1
Czech Aero L159	641,1	273,3	821,2	18	28%	243,7	11,6	69	4
Italy Aermacchi MD339FD	377,7	139,9	517,6	16	37%	193,2	7,4	92	2
Italy Aermacchi Yak 130	550,6	203,9	754,5	16	37%	281,7	7,4	90	3

4.5.7 LIFT - SOFCOM combined results

4.5.7.1 The results of the evaluation of the LIFT final offers were presented to SOFCOM on 2 July 1998. From this point on the LIFT was included in all SOFCOM presentations.

4.5.7.2 As mentioned in paragraph 4.3.7.1 SOFCOM consolidated the normalised evaluation scores for technical, IP and finance (all normalised to 100) and was responsible for presenting the combined results (out of 300) to AASB and AAC for approval.

4.5.7.3 The same formula as mentioned in paragraph 4.3.7.2, was used for combining the results.

The different results based on the two formulas are as follows:

Costed:

$$(a) \quad BV = \frac{MV + IV}{\text{Financing Index}}$$

Aircraft	Military value	Industrial value	Financing index	Best value	Ranking
MB339FD	100	62	85.58	1.9	1
Hawk 100	45.1	100	80.35	1.8	2
L159	52	93	100	1.5	3
Yak 130	42.9	64	86.46	1.2	4

$$(b) \quad BV = MV + IV + \text{Financing Index}$$

Aircraft	Military value	Industrial value	Financing index	Best value	Ranking
MB339FD	100	62	92	254	1
Hawk 100	45.1	100	100	245	2
L159	52	93	69	214	3
Yak 130	42.9	64	90	196	4

Non-costed:

$$(a) \quad BV = \frac{MV + IV}{\text{Financing Index}}$$

Aircraft	Military value	Industrial value	Financing index	Best value	Ranking
MB339FD	100	62	85.58	1.9	2
Hawk 100	90.2	100	80.35	2.4	1
L159	88.3	93	100	1.8	3
Yak 130	62.5	64	86.46	1.5	4

$$(b) \quad BV = MV + IV + \text{Financing Index}$$

Aircraft	Military value	Industrial value	Financing index	Best value	Ranking
MB339FD	100	62	92	254.0	2
Hawk 100	90.2	100	100	290.2	1
L159	88.3	93	69	250.3	3
Yak 130	62.5	64	90	216.5	4

From the above recalculations it can be seen that the change in the formula did not affect the ranking of the contenders.

4.5.7.4 The combined results for LIFT were presented to the AASB on 8 July 1998.

4.6 APPROVAL PHASE

4.6.1 Attached to the agenda for the international offers work session of 1 and 2 July 1998, was the presentation of each evaluation team regarding technical, DIP, NIP and finance.

4.6.2 According to the minutes of the special AASB of 8 July 1998, SOFCOM briefed the AASB on the combined evaluation results concerning the ALFA and LIFT. The results were as follows:

ALFA

Military value									
Offeror/Product	Program Cost US\$m	Finance cost US\$m	Total cost (NPV @13.5%)	Mil perf Index	Mil Value Index	IP value Index	Mil+ IP index	Finance index	Best value
United Kingdom JAS39 Gripen	2 217.0	1 252.1	3 469.1 (1 067.6)	100.0	100.0	100.0	100.0	100.0	100.0
Germany DASA AT2000	2 139.0	No offer	****	76.0	79.0	59.0	69.0	0**	46.0
France Dassault Mirage 2000	2 257.0	No offer	****	79.0	76.0	25.0	50.5	0**	33.7

Industrial participation							
Country	Tender Price	DIP		NIP		Total IP	
		Value	%	Value	%	Value	%
United Kinadom	1 877.1	574.2	30.6	8 168.8	435.2	8 742.9	465.8
Germany	1 461.5	781.2	53.5	1 030.2	70.5	1 811.5	123.9
France	1 874.7	937.4	50	915.8	48.8	1 853.1	98.8

LIFT

Military value including cost									
Offeror/Product	Program Cost US\$m	Finance Cost US\$m	Total cost (NPV @13.5%)	Mil perf Index	Mil Value Index	IP Value Index	Mil+ IP index	Finance index	Best Value
United Kingdom BAe Hawk	756.5	402.5	1159.0	90.2	45.1	100.0	89.6	100.0	96.5
Czech A Vodochody L159	641.4	179.8	821.2	88.3	52.0	93.0	89.5	69.0	84.3
Italy Aermacchi MB339FD	377.7	139.9	517.6	100.0	100.0	62.0	100.0	92.0	100.0
Italy Aermacchi Yak 130	550.6	203.9	754.5	62.5	42.9	64.0	66.0	90.0	77.5

Military value excluding cost									
Offeror/Product	Program Cost US\$m	Finance Cost US\$m	Total cost (NPV @13.5%)	Mil Perf Index	Mil Value Index	IP Value Index	Mil+ IP Index	Finance Index	Best Value
United Kingdom BAE Hawk	756.5	402.5	1159.0	90.2	90.2	100.0	100.0	100.0	100.0
Czech A Vodochody L159	641.4	179.8	821.2	88.3	88.3	93.0	95.3	69.0	86.3
Italy Aermacchi MB339FD	377.7	139.9	517.6	100.0	100.0	62.0	85.2	92.0	87.5
Italy Aermacchi Yak 130	550.6	203.9	754.5	62.5	62.5	64.0	66.5	90.0	74.6

Industrial participation							
Country	Tender Price	DIP		NIP		Total IP	
		Value US\$	%	Value US\$	%	Value US\$	%
United Kingdom	599.0	429.4	71.7	848.5	141.7	1 277.9	213.3
Czech Republic	513.7	254.5	49.5	981.4	191.0	1 235.9	240.6
Italy – MB339FD	278.1	184.6	66.4	246.3	88.6	430.9	154.9
Italy – Yak 130	420.6	237.4	56.4	246.3	58.5	483.6	115.0

According to the minutes, the chairman also advised that the AAC be briefed in this regard.

Note: Although the MB339FD was still the preferred option under the costed and non-costed option in terms of the military performance index, the Hawk was

placed in an advantageous position under the non-costed option for the total evaluation.

4.6.3 SOFCOM briefed the AAC on 13 July 1998, regarding the combined evaluation results for LIFT and ALFA. The same results as in paragraph 4.6.2 were presented.

4.6.3.1 At the meeting the following was minuted regarding the ALFA:

"Prices in the offer are 'quoted' prices; and DASA and Dassault failed to offer financing, notwithstanding repeated requests. The condition of a business case involving 330 AT2000 aircraft was advised."

4.6.3.2 The minutes of the AAC meeting of 13 July 1998, indicate that two consolidated evaluation summaries were presented, i.e. in respect of costed military value and non-costed military value regarding the LIFT. According to the minutes, the Chief of the Air Force highlighted the limited operational capabilities of the more expensive cluster and the preference of SAAF for a training aircraft that would meet the minimum pilot qualification requirements, starting with the Astra and upgrading from there.

4.6.4 At an AASB meeting held on 16 July 1998, it was minuted that SAAF confirmed that the first contenders in respect of the LIFT, i.e. the MB339FD, the L159 and the Hawk, could all satisfy the pilot training requirements for a conversion from the Astra to the ALFA. The chairman of the meeting ruled that it was the AASB's recommendation that the MB339FD be procured in accordance with the preference of SAAF within its envisaged fighter training system.

4.6.5 CoD was briefed by the AASB on 21 August 1998. It was noted in the minutes of this meeting that the Chief of Acquisitions of DoD explained the difference in the procurement costs between the MB339FD and the Hawk. The Secretary for

Defence remarked that the cost of the Hawk would be twice that of the MB339FD, for an increase in performance of approximately 15%. Hence the recommendation of the AASB that the cheaper option be selected. The minutes stated that the Hawk was more expensive because it has operational capabilities not offered by the MB339FD. According to the minutes the Minister held the view that the operational qualities of the aircraft were only part of the consideration and that the Government had to decide whether or not to enter the European market, and if so, through which partner.

- 4.6.6 After the CoD meeting of 21 August 1998, a special ministerial briefing was held on 31 August 1998 regarding the progress relating to the SDP process. According to the minutes, the following information was given to the ministers to make a decision on the preferred bidder: *"Two options were proposed in the SOFCOM presentations for the LIFT programme. Option A (MB339FD) considered a military value system including programme cost and option B (HAWK) considered a military value system excluding programme cost. Option A considered and selected an aircraft from the lower acquisition cost cluster while option B considered and selected an aircraft from the higher acquisition cost cluster. Option B (HAWK) offered a dual role aircraft both pilot training and a limited operational use capability at a higher acquisition cost. The dual role advantage of the HAWK is not apparent in the value system applied in making the military performance recommendations. The IP proposals of option B were higher in total dollar value and higher in total percentage against the tender price offered. The final decision for selecting the preferred bidders of the SDP rests with the executive level of government"*.

Furthermore, the minutes of the meeting indicate that the following decision was taken:

"11. After a discussion it was decided by the ministers present that the HAWK (Option B) should be recommended as the preferred option. This decision to recommend the HAWK was based on national strategic considerations for the future survival of the defence aviation sector and the best teaming-up arrangements offered

by the respective bidders. Strategically important industrial participation programmes offered with the best advantage to the state and local industries were also a determining factor in the final recommendations for the preferred bidders per programme.”

- 4.6.7 During the public phase of the investigation it was explained by witnesses that the Ministers’ Committee decided on and prepared final recommendations in respect of the procurement, to Cabinet. It was contended by Government that the nature of the structure of the acquisition process was such that any corruption in the awarding of the tenders would have had to infiltrate effectively up to ministerial level, which was theoretically impossible. The committee dealt with the selection of the preferred bidders on the basis of the evaluation that was done in the other forums discussed above. It was the contention of the committee that industrial participation can never be used to justify a decision to purchase any equipment. Any procurement must be justified in its own right.
- 4.6.8 The Minister of Trade and Industry explained in his testimony that the initiative to consider a non-costed option in the case of the LIFT came from the Ministers’ Committee and not from the AAC. The AAC was requested to submit different options to the committee and the following were considered:
- (a) The substantial differences in the pricing and capabilities of the different groups of aircraft that were offered.
 - (b) The package that could have been negotiated and that eventually was negotiated with the British supplier.
 - (c) The favourable industrial participation benefits that would flow from the Hawk offer.
 - (d) The dual capabilities of the Hawk.

- 4.6.9 The Ministers' Committee considered very carefully any possible prejudice to tenderers should a non-costed option be considered. It was decided that the consideration of the different options did not amount to moving beyond the parameters of evaluation criteria, but that it was rather a qualitative assessment about the precise value of a weighting figure. The Ministers' Committee was confident that the manner in which the consideration of the different options was done did not require any further bidding process. None of the unsuccessful bidders complained in this regard as might have been expected had the conduct of the Ministers' Committee been improper.
- 4.6.10 The decision to accept the Hawk/Gripen combination that was offered by the suppliers was, according to the evidence of the Minister of Trade and Industry, made by the Ministers' Committee. The reasons for the decision were:
- (a) When considering the two groups of possibilities with regard to the links between trainers, advanced trainers and advanced fighters, the combination of the Hawk/Gripen procurement option offered a more effective overall possibility of achieving technologically advanced NIP projects and achieving a package of NIP projects that was more favourable than the original offers.
 - (b) The fact that the procurement could be packaged through a single export credit agency was beneficial.
 - (c) The considerable structural changes in the European defence industry and the resultant longer-term trajectory of that industry that Government would have to deal with in future.
 - (d) The fact that the design of the selected option was seen as beneficial to DoD.

4.6.11 The following bidders for ALFA and LIFT were recommended for final considerations:

- ALFA - SAAB JAS 39 Gripen (Sweden/UK).
- LIFT - BAe HAWK (United Kingdom).

4.6.12 In a memorandum dated 7 September 1998, to the Chief of Acquisitions, the former Secretary of Defence made the following remarks regarding the minutes distributed to him, signed by the Chief of Acquisitions:

"I question the completeness and accuracy of paragraph 11. I cannot recall that a decision was made. The merits of either the Hawk and the MB 339 were discussed. The fact that the MB 339 meets the SAAF LIFT requirements adequately (with reference to the pre-determined criteria) is not reflected. The Hawk is not the "best" option from a military point of view - the fact that its acquisition cost would solicit substantially more IP apparently carries the day. The SAAF, however, will have to absorb considerably higher operating costs during its life cycle.

As far as I can recall, the choice between the Hawk and MB 339 will be made later by the Cabinet. Hence the Italians should be afforded the opportunity to respond with other successful bidders. If we fail to do this, I submit that the ensuing fracas could derail the initiative completely. In any event, by keeping the Italians in play, it would sustain the element of competition."

4.6.13 A presentation regarding the SDP was made to Cabinet on 21 October 1998. Cabinet discussed the presentation and resolved that the committee dealing with the procurement must have further discussions with the Minister of Finance regarding the recommendations, after which the matter must be resubmitted to Cabinet.

4.6.14 During the Cabinet briefing on 18 November 1998, Cabinet decided on the following:

"The Cabinet discussed the matter and resolved that the recommendations on the preferred suppliers for the strategic defence equipment be accepted as recommended as an interim step and that the Departments of Defence (convenor), Finance, Public Enterprises and Trade and Industry proceed with further detailed negotiations with the preferred bidders with the view to achieve affordable agreements."

4.6.15 The report of the Affordability Team was presented to the Ministers' Committee in August 1999, it stated the following regarding the total cost of the procurement:

"2.1.1 The total cost of the procurements comprises a number of elements:

- Costs of the actual military equipment as procured from the suppliers (i.e. the tender or contract price).*
- Statutory costs which consist of items such as freight, insurance and taxes, the largest portion of which is incurred in South Africa.*
- Project management costs incurred by the DoD and ARMSCOR in managing the procurements.*
- Financing costs for deferring payments to suppliers so as to fit an optimum cash-flow schedule more closely.*
- ECA premiums which are payable on all ECA-backed loans.*
- Escalation on all of the above payments made in future years.*

2.1.2 The costs as presented to the Cabinet in November 1998 did not take into account all the elements as described above for each and every package. Consequently, the total full cost is substantially higher than that originally presented to the Cabinet."

The estimate made by the Affordability Team for both ALFA and LIFT at August 1999 came to R19 620 million, which was R4 017 million more than the R15 603 million approved by Cabinet on 18 November 1998.

4.7 NEGOTIATION PHASE

4.7.1 On 18 November 1998, the International Offers Negotiating Team (IONT) was constituted by Cabinet with the brief to negotiate an achievable funding arrangement and an affordable package with the identified preferred suppliers, which would result in final contracting for the offered strategic defence equipment to the SANDF. IONT comprised appointed members from DoD, DoF, DTI and Armscor, and was led by a Chief Negotiator appointed by the Deputy President (IONT is discussed in chapter 8).

4.7.2 The minutes of the meeting of the Ministers' Committee held on 20 January 1999, stated the following:

"Initial discussions by the negotiating team with the project teams indicated a possible increase in the overall procurement cost presented to the Cabinet on 18 November 1998. These increases in cost were directly related to technical performance of the equipment and programme management cost associated with equipment acceptance. The DoD undertook to ensure that all technical performance-related costs would be accommodated within the programme cost as approved by the Cabinet on 18 November 1998. However, it was proposed by the DoD that all programme management cost should be addressed outside the approved procurement cost."

4.7.3 According to an air combat programmes status report for the period February 1999 to April 1999, the programme management cost which was not included in the cabinet figures of 1998 for ALFA and LIFT, at that stage calculated at a rate of exchange R6.25 = US\$1, was the following:

ALFA:	US\$25m which equals	R156,25 million
LIFT:	US\$15m which equals	<u>R 93,75 million</u>
Total:		<u>R 250,00 million</u>

- 4.7.4 On 26 May 1999, IONT met with the Ministers' Committee and recommended that the procurement of the ALFA be deferred. This recommendation was made on the basis of:
- 4.7.4.1 The timing of the need for this equipment, alternative approaches to meeting these needs and the requirements of an affordable package.
 - 4.7.4.2 The current operational capabilities of the SAAF in terms of the number of Cheetah fighter aircraft available.
 - 4.7.4.3 The fighter pilot capacity of the SAAF.
 - 4.7.4.4 The currency risk implications of procuring equipment in advance and the possibility that better priced suitable alternatives may be available, should the procurement take place at a more appropriate time.
 - 4.7.4.5 The fact that the financing cost of the procurement would be higher than it would otherwise have been, should the procurement take place at a later stage.
- 4.7.5 It was, however, also indicated by IONT during the meeting that the planned procurement of the Gripen would generate significant industrial participation benefits for the Defence and non-defence related industry.
- 4.7.6 IONT's recommendation amounted to engaging the suppliers in a negotiation of a deferment of the procurement on terms and conditions which are practical and favourable, failing which the tender should be scrapped for the present moment.

4.7.7 The recommendation of IONT was considered by the Ministers' Committee on 26 May 1999. According to the minutes, it was decided to defer the decision regarding the procurement of the Gripen and to allow IONT to endeavour to conclude a single contract with BAe for both the Hawk and Gripen.

4.7.8 As part of IONT an Affordability Team was established after the March 1999, Ministers' Committee meeting. The Affordability Team conducted a comprehensive analysis of the economic, fiscal and financial impact of the procurements on the country, and used the macroeconomic model of the Bureau of Economic Research at the University of Stellenbosch to test and develop alternative scenarios for consideration by the Ministers' Committee. Their report, compiled in August 1999, indicates that:

4.7.8.1 "4.4.2 *Adverse Rand: forex movements*

The South African government is fully exposed to the depreciation of the Rand against foreign currencies, which accounts for about 75% of the total purchase amount. There is no effective means hedging the currency risk inherent in the procurements. Although the forward exchange rate used in the affordability assessment incorporates a premium for exchange rate risk, there is clearly a possibility that currency depreciation could be even more rapid. Should this occur, additional costs are for the account of government, with the obvious implication that the costs of the packages and their financing could be considerably higher than expected."

4.7.8.2 BAe/Saab were approached by the negotiating team, in terms of the mandate of the Ministers' Committee, to explore the possibility of their supplying the Gripen at a time in the future on condition that this would not lead to a price premium or technological obsolescence and that BAe/Saab would continue to deliver in terms of their industrial participation commitments.

4.7.8.3 BAe proposed, as an alternative, a combination transaction for the supply of 24 Hawk and 28 Gripen aircraft. This offer involved the supply of a number of Hawk and dual-seater Gripen upfront with an option to the Government to cancel the procurement of the remaining aircraft.

Summary of BAe tranching options:

	Tranche 1	Tranche 2	Tranche 3	Total
Equipment:	12 Hawk 9 Gripen	12 Hawk	19 Gripen	24 Hawk 28 Gripen
Payment dates:				
First	2000	2002	2004	
Final	2009	2006	2011	
Total price	R 6 565 m	R 1292 m	R 5 316 m	R 13 173 m
Unit cost:				
Hawk	R 213 m	R 108 m		R 161 m
Gripen	R 445 m		R 280 m	R 333 m
Margin above / below average unit cost:				
Hawk	+35%	-33%	-	-
Gripen	+34%	-	-16%	-

Note: prices stated are at the exchange rate of R6.25 = US\$1

4.7.8.4 The costs of the aircraft in tranche 1 are 35% and 34% higher than the average cost for the Hawk and Gripen, respectively. The reason for this is that BAe/SAAB have front loaded their non-recurrent expenditures for the full contract on tranche 1. The implication is that the option to cancel involves a large implicit cost. Exercising the cancellation would effectively mean that the Government would pay a premium of 35% and 34%. This equates to a total of R1 736 million.

4.7.8.5 Exercising the option to cancel the single-seater Gripen in 2004 would imply a major waste of resources as the only purpose of acquiring the dual-seater is to train pilots to fly the single-seater.

4.7.8.6 On 18 August 1999, the Chief of the Air Force indicated that:

- (a) The LIFT and ALFA aircraft is a system in terms of the total system management approach. This means that any scenario that does not include all the components of the system, cannot be supported.
- (b) The scaling down of the number of aircraft available to train pilots is a risk.
- (c) The dual-seater Gripen does not have the full operational capability of the single-seater and, consequently, does not have the same deterrent value.
- (d) Without the delivery of the second and third tranches, the operational fighter capability of the SANDF will be severely limited after 2010.

4.7.9 During the negotiation phase the packages were reviewed in order to stay with the amounts approved by Cabinet. This resulted in some essential functionalities of the aircraft in the LIFT and ALFA package not being included in the contracts. Funding will have to be found outside the Cabinet approved package funding for these functionalities.

4.8 THE INFORMATION ON COST SUBMITTED TO CABINET

4.8.1 Information regarding the total cost of ALFA and LIFT was not submitted to Cabinet, which had the result that such costs would have to be accommodated in DoD budget. The following costs were not submitted:

- (a) The minutes of the meeting of the subcommittee of Cabinet Ministers held on 20 January 1999, state that DoD undertook to ensure that all technical performance-related costs would be accommodated within the programme cost as approved by Cabinet on 18 November 1998. However, DoD proposed that all programme management cost should be addressed outside the approved procurement cost.

- (b) According to an air combat programme status report of April 1999, the programme management cost for ALFA and LIFT, which was not included in the Cabinet figures of 1998, amounted to R250 million.
- (c) It is accepted that the total "other cost", including program management cost was not yet determined by 18 November 1998. However, no indication of such additional cost was brought to the attention of Cabinet during the presentation on 18 November 1998. (Refer paragraphs 4.7.2 and 4.7.3)

4.9 CONTRACT PHASE

4.9.1 During a Cabinet meeting held on 15 September 1999, Cabinet approved that:

"(a) The total price for the military equipment should amount to R29 992 million. This total amount will consist of two options to cancel decisions to be taken by the government in 2002 and 2004. The South African Government is committed to the respective suppliers for tranche one only at this stage at a cost of R21 330 million"

For ALFA and LIFT the tranches consist of the following:

"(b) Tranche one consists of –

- (iv) Twelve dual-seater trainers aircraft from British Aerospace – Hawks 100.*
- (v) Nine dual-seater fighters aircrafts from Britain, Sweden-Gripen-Jas 39.*

(d) Tranche 2 consists of 12 dual-seater trainer aircraft from British Aerospace – Hawks 100 and the option to cancel must be exercised by the government by 2004 (sic).

- (e) *Tranche three consists of 19 single-seater fighter aircraft from Britain, Sweden-Gripen JAS39 and the option to cancel must be exercised by the government by 2004.*"

4.9.2 A decision of Cabinet meeting of 1 December 1999, indicates that Cabinet:

"(a) granted the permission required by the department to sign supply non-defence industrial participation (NIP), defence industrial participation (DIP) and umbrella agreements for –

- (iv) Twelve HAWK 100 trainer aircraft (Tranche 1);*
- (v) Nine dual GRIPEN fighter aircraft (Tranche 1);*
- (vi) Twelve HAWK 100 trainer aircraft (Tranche 2);*
- (vii) Nineteen single GRIPEN fighter aircraft (Tranche 3)"*

According to the contract, the nine dual-seater Gripen aircraft will be delivered from July 2007 and the nineteen single-seaters from August 2009. However, the air force has 50 supersonic Cheetah fighter aircraft able to operate until 2012, which will be replaced by the Gripen from August 2009.

4.9.3 On 3 December 1999 the umbrella agreement incorporating the LIFT supply terms as well as the associated NIP and DIP agreements was signed. It linked the LIFT and ALFA Projects into a combined programme.

4.10 A COMPARISON OF NIP AND DIP

The following comparison of NIP and DIP was made:

Project	RFO R6.25=US\$1 Rm IP	Cabinet Nov '98 R6.25=US\$1 Rm IP	Contract Dec '99 R6.25=US\$1 Rm IP
ALFA	54 643	48 313	-
LIFT	7 987	8 580	-
ALFA and LIFT (tranché)	-	-	54 302
TOTAL	63 630	56 893	54 302

The reason for the difference in IP between the RFO and Cabinet approved IP of 18 November 1998, was due to the number of ALFA aircraft being reduced from 38 to 28 and therefore the IP was reduced accordingly. However, no further reduction of aircraft took place although the IP was again reduced by approximately R2,5 billion in the final contract.

4.11 THE BASIC UNIT PRICE

Allegations were made that South Africa is paying double the normal basic unit price for the Hawk and Gripen aircraft. The following tables indicate the unit cost per aircraft according to the annex AC1 of the Supply Terms:

COST OF AIRCRAFT ALONE (US\$)		
Description	Hawk	Gripen
Total aircraft cost	470 218 430	958 009 000
Number of aircraft	24	28
Average aircraft unit cost	19 592 434	34 214 607

TOTAL EQUIPMENT PACKAGE COST (US\$)		
Description	Hawk	Gripen
Total equipment package cost	623 907 199	1 513 535 996
Number of aircraft	24	28
Average aircraft unit cost	25 996 133	54 054 857

The cost for the total equipment package includes the cost of the aircraft plus the cost of the following items:

- Operation support equipment.
- Spares.
- Ground support equipment.
- Initial logistical support equipment.
- Mission planning and ground support system.
- Non-recurring engineering and testing.
- Technical training, flying training and training aids.
- Technical publications.
- Technical support services.
- Programme management and customer liaison.

It is unclear what figures were used by those who made the allegations and on what functionalities it was based.

4.12 FINDINGS

4.12.1 The decision that the evaluation criteria in respect of the LIFT had to be expanded to include a non-costed option and that eventually resulted in a different bidder being selected, was taken by the Ministers' Committee, a subcommittee of Cabinet. Although unusual in terms of normal procurement practice, this decision was neither unlawful, nor irregular in terms of the procurement process as it evolved during the SDP acquisition. As the ultimate decision-maker, Cabinet was entitled to select the preferred bidder, taking into account the recommendations of the evaluating bodies as well as other factors, such as strategic considerations.

4.12.2 The decision to recommend the Hawk/Gripen combination to Cabinet as the preferred selection for the LIFT/ALFA was taken by the Ministers' Committee for strategic reasons, including the total benefit to the country in terms of counter trade investment and the operational capabilities of the SANDF.

- 4.12.3 The RFOs for the ALFA was issued prior to the approval of the revised Staff Target and Staff Requirement. Although the latter is not a mandatory milestone document, it is advisable that planning should first be done to determine needs and technical requirements before tenders are requested. It was noted that DoD considered the Staff Target for the AFT to be adequate for the ALFA and LIFT projects.
- 4.12.4 The value system for the evaluation of the responses to the LIFT RFIs was approved after the replies had been received. Value systems should be properly approved, prior to the receipt of RFI replies.
- 4.12.5 In some cases, the value systems used during the evaluation process were known to evaluators. This is undesirable as evaluators may be influenced by knowledge of the relative importance of parameters, or could manipulate the results through knowledge of relative weights. No evidence was, however, found that such manipulation had taken place.
- 4.12.6 No evidence could be found in support of the allegation that South Africa is paying more than the normal basic unit price for the Hawk and Gripen aircraft.
- 4.12.7 Certain information regarding the total cost of the ALFA and LIFT was not submitted to Cabinet. The result is that such costs will have to be accommodated in the DoD budget.

4.13 RECOMMENDATIONS

From the shortcomings identified during the investigation discussed in this chapter and the observations made, the following is recommended as improvements to the procurement process:

- 4.13.1 Proper approved needs determination (ST and SR) should be compiled during the acquisition process. During needs determination it should be ensured that the planned acquisition addresses the operational capability required as well as the future sustainability thereof.
- 4.13.2 The evaluation system should contain effective controls to ensure a fair and regular process in order to exclude the possibility of manipulation.
- 4.13.3 During cardinal acquisitions, sufficient time should be made available to determine needs properly, compile acquisition plans, evaluate offers and finalise contracting.
- 4.13.4 Changes to approved value systems should only take place in exceptional cases. Such changes should be properly motivated, approved and documented. It should also be ensured that such changes are not to the advantage/prejudice of a specific bidder.
- 4.13.5 Detailed and accurate information, including all possible costs, should be submitted to Cabinet. All currency risk implications regarding international armament acquisitions should be disclosed to Cabinet. Such information is necessary to ensure that essential functionalities are not removed from aircraft during negotiations due to budget constraints.
- 4.13.6 The NIP offers during RFO stage should be properly evaluated. This will ensure that only feasible projects are accepted and negotiations with bidders to replace projects at a later stage will not be necessary.

CHAPTER 5

SELECTION OF PRIME CONTRACTORS – LIGHT UTILITY HELICOPTERS

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CHAPTER 5

SELECTION OF PRIME CONTRACTORS – LIGHT UTILITY HELICOPTERS

This matter was not investigated during the public phase of the investigation. The contents of this chapter deal with the forensic investigation conducted by the Office of the Auditor-General.

5.1 BACKGROUND

5.1.1 The SAAF has a fleet of Alouette III helicopters that has been in use since 1962. During 1996 a policy decision was taken to replace the Alouette with a new fleet of Light Utility Helicopters (LUH). The project to replace the helicopters was codenamed “Project Flange”.

5.1.2 On 17 June 1996, a RFI was issued to 16 companies for the supply of the LUH. The purpose was to determine whether these companies had a suitable product that would meet the requirements of SAAF and whether they wished to participate in the programme.

5.1.3 Three companies were short-listed, namely:

- Agusta Un’Azienda Finmeccanica S.p.A., an Italian company, for their A109 helicopter.
- Bell Helicopter Textron, a Division of Textron Canada Ltd, for the BELL 427.
- Eurocopter, a European company situated in France, for the EC 635.

- 5.1.4 Project Flange was subsequently dealt with as part of the SDP.
- 5.1.5 On 13 February 1998, RFOs were issued to the above-mentioned three companies. They submitted their offers to Armscor on 13 May 1998. The offers were evaluated according to a specific evaluation model and Agusta was ranked first. In November 1998, Cabinet approved the selection of Agusta as the preferred supplier of the LUH.
- 5.1.6 A contract (supply terms) was ultimately concluded between Armscor and Agusta for the development, manufacturing, assembly, qualification, testing and delivery of 30 A109 Light Utility Helicopters. The Minister of Defence, Mr Lekota, signed this contract on behalf of the SA Government on 3 December 1999. The contract price was fixed at US\$199 778 887.
- 5.2 **PLANNING PHASE**
- 5.2.1 **SAAF operational requirement No 3/95: Alouette III replacement**
- 5.2.1.1 Lt Col F K S Viljoen compiled the operational requirement No 3/95 and it was date stamped 1 August 1995 by DoD's Chief of the Air Force.
- 5.2.1.2 The operational requirement consisted of a problem statement and a requirement statement. The problem statement highlighted the operational doctrine of the SANDF and how the Alouette III is incapable of fulfilling certain operational roles. The requirement statement detailed the performance and equipment requirements, as approved by the Air Force Project Committee (AFPC) in November 1994. This had to form the basis against which the Alouette III replacement was measured.

5.2.2 Staff Target 3/95

5.2.2.1 Staff Target 3/95 for Project Flange, that addressed the replacement of the Alouette III LUH, was compiled by Maj Genl Lombard.

5.2.2.2 The Staff Target was submitted to the chairperson of the Defence Control Council on 29 January 1996 and approved by the chairperson of the AACB, Lt Gen P O du Preez, on 16 May 1996.

5.3 ACQUISITION PHASE

5.3.1 Staff Requirement 3/95

5.3.1.1 It appears from the various versions of the Staff Requirement that it was originally compiled by Maj Gen W H Hechter in January 1999.

5.3.1.2 The following aspects are discussed in detail in the Staff Requirement:

(a) Finances

The following table indicated the breakdown of costs:

LUH programme budget in rand million at an exchange rate of 1US\$=R6.25	Rm
Quantity 29 Operational and 1 Development LUH	1,503,00
Local statutory costs	362,05
Management costs	38,00
ECA premium	54,17
Total contract price	1,957,22
Implementation and CFE	176,32
Additional management costs	3,00
Total programme costs in rands	2,136,54

(b) Facilities

No funds were included in the sum approved by Cabinet for the implementation of the LUH into service. An amount of US\$10 000 000 at an exchange rate of R6.25=US\$1 was initially indicated, but according to the Staff Requirement, the project team was informed by SOFCOM that these funds were to be removed from the budget to be submitted to Cabinet. A revised amount of R176,32 million was required for implementation, R14,89 million of which was required to satisfy the infrastructure requirements. The balance of R161,43 million was required for the ILS elements, CFE and operation support until 2006.

The Chief of the Air Force agreed at the Project Control Board meeting on 24 August 1999, that funds for the implementation of the LUH would be provided from the SAAF operating budget. However, Lt Col J B West raised concerns about the additional financial burden that was being placed on the operating budget and that it should actually be borne by the capital budget. Brig Gen F J Labuschagne concurred with Lt Col J B West's comment, stating that the additional cost would have a serious impact on the helicopter group and also on other system groups.

5.3.1.3 The Staff Requirement was approved in February 2000, subsequent to the signing of the contract. According to Armscor personnel, this document was forwarded to the project team in Italy in March 2001 for final signature.

5.3.1.4 The matter of the Staff Requirement not being timeously finalised was confirmed in the response to the Special Review by the Auditor-General when Armscor and DoD stated that: *"a formal staff requirement was not authorised for this project and is a definite oversight of this division in spite of the non-mandatory status of this type of document in the policy prescripts. The five cardinal issues described*

under Para 7a were, however, fortunately addressed so as not to have a detrimental effect on the outcome of the project.”

5.3.1.5 The Staff Requirement provides that it is of utmost importance that specific contents as prescribed for staff requirements be available at specific points later in the acquisition process. The contents referred to that were of cardinal importance included:

- Functional user requirement specification.
- Logistic user requirement specification.
- Project management plan.
- Value system.
- Costs plus timescales.

5.3.1.6 According to the final version of the Staff Requirement, *“A comprehensive Helicopter Logistics User Requirement Statement had been compiled”*. This document could, however, not be traced during the course of the investigation.

5.3.2 User Requirement Statement

5.3.2.1 The Project Officer compiled the URS in March 2000 for the Director of Air Force Acquisition. The URS was recommended and approved on 20 March 2000.

5.3.2.2 The URS defines the LUH system in terms of capabilities, performance, design, development, support, training and test requirements.

5.3.2.3 It was noted that the URS was not timeously finalised and approved. As the URS details the initial system requirements of the arms of service, it was dubbed a “live” document and was amended as the needs of the user changed.

For this reason a deviation report, which records the differences between the initial URS and the final contract, was compiled. The deviation report serves to highlight the requirements of the user that could not be met and that might have needed to be addressed at a later stage.

5.3.3 Request For Information (RFI)

5.3.3.1 The SAAF intended to replace its Alouette III Light Utility Helicopter fleet with a fleet of suitable light utility helicopters to act as a basic helicopter trainer as well as a light utility helicopter.

5.3.3.2 In addition to the training and light utility role, the helicopter needed to have a limited combat capability, suitable for effective use in a low intensity threat environment.

5.3.3.3 The objective of the RFI was to obtain information from the various companies on a helicopter system, which was in service or that was being developed and which would satisfy the SAAF's requirement. It was with this in mind that a Request for Information was issued on 17 July 1996 to 16 different companies, which were identified as possible suppliers of suitable LUHs, namely:

Company	Confirmation of receipt
Agusta	17 July 1996
Bell Helicopter Textron	19 July 1996
Eurocopter SA	17 July 1996
HAL Hindustan Aeronautics (Pty) Ltd	26 July 1996
Kamov	19 July 1996
McDonnell Douglas Helicopter Co.	22 July 1996
MIL (Moskovsky Vertolyotny Zavod)	19 July 1996
Sikorsky Aircraft	17 July 1996
WSK PZL-Swidnik	No confirmation found
Comair Sales (Pty) Ltd	17 July 1996
National Airways Corporation	29 July 1996
Bell Helicopter Textron Canada	2 August 1996
Moscow Aircraft Production Organisation	25 July 1996
Denel Aviation	31 July 1996

Company	Confirmation of receipt
Court Helicopters	8 August 1996
Kazan Helicopter Plant	6 August 1996

5.3.3.4 The response data was analysed by the project team and a short list recommended for approval. However, due to the decision to include the LUH in the SDP, it was decided not to continue with a RFO, but to re-issue a second Request For Information covering aspects relating to the SDP.

5.3.3.5 A second Request For Information document dated 29 September 1997, was issued to three short-listed suppliers as part of an information request package, authorised by the Minister of Defence. The three potential suppliers being:

- Agusta.
- Bell Textron Canada.
- Eurocopter.

5.3.3.6 The purpose of the second RFI was to obtain information to address the specific requirements of the SDP. Hence, the potential suppliers were instructed to take note of the requirements and minimum levels of industrial participation as described in the document "*Industrial Participation Requirements, Conditions and Reference documents*" and attached to the RFI.

5.3.3.7 In the RFI potential suppliers were notified that information eventually submitted would be evaluated against the following assessment criteria according to a structured value system:

- Technical effectiveness of the proposed system.
- Supportability.
- Value for money.
- Risk associated with the tender.
- RSA economical benefit/ local participation.

5.3.3.8 A response evaluation model dated 21 October 1997, entitled "*Response Evaluation Model for September 1997 Request for Information*" was compiled and approved. This RFI evaluation model (value system) was designed for the evaluation of the RFI responses and took into account the information requested in the RFI as well as the User Requirements, taken from the Staff Target.

5.3.4 RFI evaluation results: September 1997

5.3.4.1 An evaluation report dated 14 November 1997, was approved as a true reflection of the SAAF LUH September 1997 RFI response evaluation. The report indicated that responses from all three of the above-mentioned short-listed companies were received.

5.3.4.2 The purpose of the document was to record the results of the LUH response evaluation model as applied to the three responses.

5.3.4.3 The evaluation team agreed unanimously that all three proposals complied with each of the 19 mandatory criteria and, as such, qualified for further analysis.

5.3.4.4 Results of the RFI technical evaluation were as follows:

(a) The operational effectiveness index (OEI)

Final score for discriminatory criteria and calculated OEI			
Category	A109SAAF	Bell 427	EC635
Total	70	44	54
Operation effectiveness index	1.00	0.63	0.77

(b) The life-cycle cost index (LCCI)

Summary of life-cycle cost calculation results			
CATEGORY	A109SAAF	Bell 427	EC635
Total life-cycle cost (US\$m)	5.1665	5.1298	5.0005
Life-cycle cost index	1.033	1.025	1.000

5.3.4.5 The military value index (MVI) of Figure of Merit (FOM) can be calculated for each of the offers as follows $MVI = OEI/LCCI$:

- A109 SAAF: $1.00/1.033 = 0.97$
- Bell 427: $0.63/1.025 = 0.61$
- EC635: $0.77/1.000 = 0.77$

5.3.4.6 Only the final computerised LUH RFI evaluation team score sheets were found during the investigation. No other documents have been reviewed.

5.3.5 Project Study Report

5.3.5.1 The Programme Manager of the LUH team, Mr J Odendal, compiled the project study report, dated 9 September 1999, that described the equipment/source selection process followed for Project Flange. This report was approved and authorised.

5.3.5.2 The purpose of the document was to describe the process followed to select a suitable LUH and a supplier thereof to *"cost-effectively meet the user requirement to the largest extent possible at the lowest risk."*

5.3.6 Acquisition Plan

5.3.6.1 The Acquisition Plan is a document summarising the results of the acquisition study.

The approval of this plan confirmed that the user requirements contained in the Functional User Requirement Statement (FURS), the logistical requirements contained in the Logistical User Requirement Statement (LURS), and the solutions contained in the Project Study Report (PSR), satisfied the user's current operational needs, thus permitting production to continue.

- 5.3.6.2 Correspondence dated 4 February 2000, indicates that *"Project FLANGE is one of the projects included in the Strategic Defence Packages (SDP) whose acquisition plans (AP) have to be submitted for approval at the Armaments Acquisition Steering Board on 17 February 2000."* It was noted that the Acquisition Plan was approved subsequent to the signing of the contract, and as such *"this acquisition plan to acquire 30 Agusta A109 SAAF LUH had to be approved and recommended in accordance with the Umbrella Agreement and LUH Supply Terms"*.
- 5.3.6.3 The Acquisition Plan was distributed to appropriate staff members for recommendation and was finally approved on 23 March 2000.
- 5.3.6.4 The following was noted in the Acquisition Plan:
- (a) The RFOs issued were for 60 operational units and one development model. The RFOs received were evaluated over the period May/June 1998 and the results indicated that the Agusta A109 LUH was the best suited.
 - (b) A recommendation that the Agusta A109 was the best suited, was tabled and accepted by Cabinet on 18 November 1998.
 - (c) Approval was granted for negotiations to be entered into with Agusta for the supply of 40 Agusta A109 LUH.

(d) A contract was initialled on 13 July 1999 for 40 LUHs, together with logistical support, NIP and DIP.

(e) However, when the proposals were re-submitted to Cabinet on 15 September 1999, approval was given to procure only 30 LUHs initially. The final contract was signed on 3 December 1999 for 30 LUHs.

5.3.7 RFO

5.3.7.1 An RFO was issued on 13 February 1998 to the three short-listed suppliers:

- Agusta
- Bell Textron Canada
- Eurocopter

5.3.7.2 The RFO was an invitation to submit an offer for the supply of the LUH as part of a competitive tender process, authorised by the Minister of Defence. The RFO was, in User Requirement terms, based on the June 1996 LUH Staff Target with information added and adapted by the Project Team as required.

5.3.7.3 As per the tender secretariat date stamp on the original RFO proposals, it was confirmed that they were received from the aforementioned short-listed suppliers on 13 May 1998.

5.3.8 Technical evaluation

5.3.8.1 A response evaluation model for the RFO of February 1998 was approved by Mr Britz, Maj Gen Lombard and Mr Shaik on 22 May 1998.

- 5.3.8.2 The RFO evaluation model (value system) was designed for the technical evaluation of the RFO responses and based on the information requested in the data requirement list section of the RFO. The technical evaluation of the RFO responses determined the military value of each proposed system.
- 5.3.8.3 The proposals submitted were evaluated according to the following technical criteria.
- Programme requirements
 - Operational effectiveness, technical functionality, supportability
 - Life-cycle cost
 - Risk associated with placing a contract
- 5.3.8.4 Price is usually not scored as it is viewed as the sacrifice to be made to obtain the benefit from the proposal as represented by its weight-score. The OEI is divided by the LCCI to give the Military Figure of Merit (MFOM), which can also be seen as a cost-effectiveness index or the unit's effectiveness per price unit ratio.
- 5.3.8.5 The MFOM was mathematically normalised to provide the score obtained by a proposal as a percentage of the maximum score obtained by any of the three proposals, i.e. it was normalised so that the best score had 100.
- 5.3.8.6 It was required that the RFO of each prospective supplier include a Risk Management Plan (RMP). During evaluation each RMP was to be assessed to determine whether the risk attached was normal or higher than normal. Should the risk be judged higher than normal, a decision would be taken by the evaluation team on the need to make a downward adjustment to the MFOM. This would only be done to a maximum of 5%.

5.3.8.7 The following detailed investigation procedures were performed in respect of the technical evaluation:

- (a) The original score sheets were identified and checked to ensure that each evaluator had duly completed his/her sheet and that it was timeously signed and dated.
- (b) The scores from these sheets were then tabulated to ensure the accuracy of the summary sheet.
- (c) The additions and calculations according to the value model were re-calculated and tested.
- (d) Figures utilised in the scoring sheet and calculations in the original RFO documents were compared.
- (e) It was verified whether all documents entitled "*Undertaking by Evaluator*" had been signed by the relevant parties.

5.3.8.8 The LUH team adopted a three-stage approach for evaluation of the proposals, namely:

- (a) Two pre-evaluation meetings were held where the relevant documents were discussed and a strategy agreement reached.
- (b) Individual evaluations of the proposals were completed by the team members and proposal risk score sheets prepared and submitted.

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- (c) A risk analysis was undertaken, during a combined work session, and proposal risk adjustments were developed through a consensus agreement.

5.3.8.9 Initial system acquisition costs (all costs, excluding programme management costs) for a product system of 60 helicopters, were:

- Agusta : US\$ 423m
- Bell : US\$ 462m
- Eurocopter: US\$ 503m

5.3.8.10 Evaluation results

- (a) Operational effectiveness index

Final scores for discriminatory criteria and calculated OEI			
CATEGORY	A109 LUH	M427	EC635
Programme requirement index (PRI)	97.07	95.38	93.85
Technical functionality index (TFI)	100	61.30	68.41
System supportability index (SSI)	100	59.13	99.11
Calculated operational effectiveness	99.71	63.84	83.23
Operational effectiveness index (OEI)	100	64.03	83.48

- (b) Life-cycle cost calculation

Summary of life-cycle cost calculation results			
CATEGORY	A109 LUH	M427	EC635
System element acquisition (US\$m)	311 084	351 072	379 362
Role equipment acquisition (US\$m)	35 718	28 928	34 343
Fleet direct operating cost (US\$m)	80 991	91 335	93 577
Total life-cycle cost (US\$m)	427 793	471 335	507 282
Life-cycle cost index (LCCI)	1.000	1.102	1.186

5.3.8.11 A risk analysis was done during the evaluation closure meeting held on 6 June 1998, and proposal risk adjustments were developed through consensus. The evaluation team agreed on the following proposal risks:

(a) Product maturity

- Eurocopter – Tail boom flutter problem not fully solved, airframe changes could reintroduce the problem.
- Bell – The product system is still immature.

(b) Technology

Composite technology employed by Eurocopter and Bell is unknown to the SAAF and product introduction carries a risk (long-term benefits probable).

(c) Qualification

Equipment qualification on the EC635, and especially the M427, carries a risk.

It was agreed to allocate the following proposal risk adjustment factors (PRAF) to the three proposals:

- Agusta : No risk penalisation
- Bell : 2.5%
- Eurocopter : 2.0%

5.3.8.12 The MFOM was calculated by the method as described in the value model (MFOM = [OEI / LCCI] – PRAF).

- Agusta : (100/1.000) – 0% = 100 Ranked 1st
- Bell : (64.03/1.102) – 2.5% = 57 Ranked 3rd
- Eurocopter: (83.48/1.186) – 2.0% = 69 Ranked 2nd

5.3.9 Financial evaluation

5.3.9.1 Financing was one of the three main criteria used in the evaluation of the SDP and bidders were therefore required to submit specific financial information in their proposals.

5.3.9.2 Requests were forwarded to the three bidders for the LUH to submit an abridged version of their cash flows on standardised spreadsheets provided by Armscor. They had to include two cash-flow items, namely:

- A detailed cash-flow analysis
- An internal rate of return

5.3.9.3 Armscor also specified the cost and exchange rates that had to be applied to ensure that the second cash flows submitted were comparable.

5.3.9.4 The finance evaluation team members each received a document entitled: *"International Package Deal – RFO Financing Evaluation Instructions"*, signed by Mr C J Hoffman, the team leader of Armscor, on 19 May 1998. This document described aspects such as the scope of the evaluation, responsibilities of the team members, assessment instructions and evaluation aspects and weights. Although each evaluator participated in the process to determine the weights to be allocated to each discriminating criteria, the evaluators were not informed of the final weights allocated.

5.3.9.5 A letter dated 20 May 1998 and signed by Mr C J Hoffman, was sent to each of the evaluators with the following documentation:

- A set of evaluation instructions.
- A set of evaluation score sheets.

- A complete set of the relevant RFO financing proposals.
- 5.3.9.6 The financing team developed a value system against which the proposals would be evaluated. The criteria were detailed in the Request for Best and Final Offer.
- 5.3.9.7 The value system contained a set of critical criteria and discriminating criteria that had to be addressed by the bidders and assessed by the evaluation team (Refer to chapter 4).
- 5.3.9.8 The bidders were required to submit specific financial information in their proposals. The findings of the evaluation team regarding non-conformance by the bidders in this regard were reported at a SOFCOM meeting held on 3 June 1998. The team tabled a number of non-conformances, shortfalls in cash flow and general issues that impacted on the financing evaluation.
- 5.3.9.9 The finance report dated 29 June 1998, confirmed: *"several non-conformances even with our critical criteria and that it did not seem practical to disqualify most of the proposals. These non-conformances were reported to the SOFCOM on 3 June 1998. The SOFCOM indicated that we should continue and evaluate as much of the proposals as possible with indication of their non-conformances "*
- 5.3.9.10 As has been discussed in chapter 4, the best value formula has been changed, based on sound reasons.
- 5.3.10 DIP evaluation
- 5.3.10.1 Agusta, Bell and Eurocopter submitted the required DIP proposals.
- 5.3.10.2 The following investigation procedures were performed in respect of the DIP evaluation process:

- (a) Review of the Armscor DIP policies and procedures and establishing whether these policies and procedures had been adhered to.
- (b) Review of the actual scoring system used by the DIP teams to determine whether it was in accordance with the guidelines.
- (c) Review the DIP proposals in the business plans that were submitted by bidders in the RFOs and following the information through to the score sheets that were used to evaluate the DIP proposals. Recalculating the scoring on each score sheet.
- (d) Since Agusta had altered their DIP proposals, a comparison was performed of Agusta's DIP terms in the RFO and those in the final contract. This was done to test whether the final contract contained the same or fewer DIP credits than those committed to in the original proposal of Agusta.

5.3.10.3 Various minor evaluation errors were found during the investigation, but were immaterial as they did not have an impact on the final result.

5.3.11 NIP evaluation

5.3.11.1 Agusta, Bell and Eurocopter submitted the required national industrial participation proposals.

5.3.11.2 The following investigation procedures were performed in respect of the NIP evaluation process:

- (a) Review of the DTI policies and procedures and establishing whether these policies and procedures had been adhered to.

- (b) Review of the actual scoring system used by the NIP teams to determine whether it was in accordance with the guidelines.
- (c) Review of the NIP proposals in the business plan of the RFO received from each bidder and following the information through to the score sheets used to evaluate the NIP proposals. Recalculating the scoring of each score sheet.
- (d) A comparison was performed of Augusta's NIP terms in the RFO and those in the final contract. This was done to test whether the final contract contained the same or fewer NIP credits than those committed to in the original proposal of Agusta.
- (e) The NIP credits were scored in accordance with the guidelines that were issued to the bidders. After the NIP value in US\$ terms was established, this value was increased with a multiplier to get to a final score. The multipliers gave weighted values for job creation, empowerment, global integration, technology transfer and sectoral structure.
- (f) The RFO set a baseline for the engines that had to be fitted to the LUH in that the proposals had to at least conform to the specification for the Pratt & Whitney engine. All the bidders accordingly included the Pratt & Whitney engine as part of their proposals. This proposal was scored differently for Eurocopter than for Bell and Agusta. It was considered necessary to adjust the scores for Eurocopter to bring it in line with the others.
- (g) A project of Eurocopter (the Giordano project) was rounded off to the nearest 1 000 but the figures in the RFO were already rounded off to the

nearest 1 000. The credits on this project were recalculated and resulted in a higher score for Eurocopter.

5.3.11.3 The errors found in this part of the investigation were immaterial and the result remained the same.

5.4 APPROVAL PHASE

5.4.1 Procedures performed in respect of the approval phase

5.4.1.1 Relevant policies and the procurement process were reviewed during the investigation to determine whether the required milestone documents had been compiled and approved by the appropriate level of authority or forum.

5.4.1.2 Milestone documents build on one another, i.e. the ST is the predecessor of the SR and the Acquisition Plan confirms the solutions of the project study report. These reports should be approved in chronological order. The table below lists the documents in terms of the process flow:

Document	Required approval (Highest level)	Sighted approval	Date
Staff Target	AACB	AACB	16 May 1996
Staff Requirement	AACB	Director Helicopter Systems	4 Feb 2000
Project Study Report	AASB / AAC	Snr Manager Aircraft Division	25 Sept 1999
Acquisition Plan	AAC	AAC (DOD)	Not dated

5.4.1.3 In-house working documents such as the Operational Requirement and Programme Plan, are referred to as "live" documents. This means that they are always changing and are used internally by the arms of service to document requirements and methodology. Once again, the list below details the relevant documents in process order and not chronologically.

Document	Required approval (Highest level)	Sighted approval	Date
Operational Requirement	Staff council	Confirmed by Air Force Operations Council	Not dated
Programme Plan	<i>See note</i>	Director Air Force Acquisitions	12 June 2000
User Requirement Statement	<i>See note</i>	Chief of the Air Force	20 March 2000

Note: This type of document serves as a contracting medium between the relevant parties and as such only needs to be approved by the highest level of authority within the contracting forums. For example, the URS defines the LUH system needs of the Air Force and as such it needs to be approved only by the highest authority in the Air Force namely the Chief.

5.4.1.4 Once the technical, NIP, DIP and financing evaluations of the RFOs had been completed, the consolidated results were presented to various forums. The first presentation was made to SOFCOM during a work session held on 1 and 2 July 1998. This presentation was made for information purposes only as SOFCOM had no decision-making powers. The following results were presented to SOFCOM:

Initial system acquisition cost	
Supplier	US\$ MILLION
Agusta	423
Bell	462
Eurocopter	503

Military figure of merit		
Supplier	MFOM Index	Ranking
Agusta	100	1
Bell	57	3
Eurocopter	69	2

DIP results			
Supplier	DIP Value USD	DIP Index	Ranking
Agusta	202 864 000	100	1
Bell	229 274 500	90	2
Eurocopter	203 040 000	76	3

NIP results			
Supplier	NIP Value USD	NIP Index	Ranking
Agusta	631 977 000	100	1
Bell	262 243 000	44	3
Eurocopter	480 981 000	65	2

5.4.1.5 Although combined NIP and DIP results had not been presented at the SOFCOM meeting, the consolidated IP index was as follows:

Supplier	Total IP Value US\$m	Total IP Index	Ranking
Agusta	834.8	100	1
Bell	491.5	67	3
Eurocopter	684.0	71	2

Financing results					
Supplier	Programme Cost US\$M	Fin. Cost US\$m	Cash Flow US\$m	Finance Index	Ranking
Agusta	423	192,3	615,3	97	2
Bell	462	294,9	756,9	68	3
Eurocopter	503	196,3	699,3	100	1

5.4.1.6 The chairperson of SOFCOM recommended that the consolidated results be presented to a special AASB meeting and a special AAC meeting. The results were presented as advised to a special AASB meeting held on 8 July 1998.

Evaluation results							
Supplier	Prog. Cost US\$m	Fin. Cost US\$m	Total Cost US\$m	Mil Value Index	IP Value Index	Fin Index	Best Value
Agusta	423	192,3	615,3	100	100	97	100
Bell	462	294,9	756,9	57	67	68	64.6
Eurocopter	503	196,3	699,3	69	71	100	80.8

Industrial participation							
Supplier	Tender Price US\$m	DIP Value US\$m	DIP %	NIP Value US\$m	NIP %	Total IP Value US\$m	Total IP %
Agusta	347	202,9	58,5	632,0	182,1	834,8	240,6
Bell	380	229,3	60,3	262,2	69,0	491,5	129,3
Eurocopter	414	203,0	49,0	481,0	116,2	684,0	165,2

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- 5.4.1.7 The consolidated results were then presented to a special AAC meeting held on 13 July 1998. The same slides that were shown to the AASB were used to present the detailed results to the AAC.
- 5.4.1.8 The co-chairperson of SOFCOM, Mr Shaik, made a slide presentation of SOFCOM findings to a special ministerial briefing on 31 August 1998. The same results were presented at this meeting as those presented to the special AASB meeting held on 8 July 1998. At this meeting, the Agusta A109 LUH was recommended for final consideration as the preferred bidder. The Ministers of Defence, Trade and Industry, Public Enterprises and the Deputy Minister of Defence were present at this presentation and signed the minutes of the meeting.
- 5.4.1.9 All the presentations, up to and including the special ministerial briefing, were based on 60 LUHs as required in the original RFO and quantified in US\$.
- 5.4.1.10 On 18 November 1998, DoD recommended to Cabinet that Agusta be chosen as the preferred bidder.
- 5.4.1.11 At the 7th CoD meeting held on 21 August 1998, the government-to-government offers were discussed. Mr Shaik presented the department's budget, which illustrated the expected deficit on the packages. The expected deficit resulted in the DoD having to re-plan, which in turn resulted in the number of LUHs being reduced from 60 to 40. The presentation to Cabinet on 18 November 1998 was therefore based on a quantity of 40 helicopters and values were denoted in ZAR. The following results were presented:

Quantity	Programme cost Rm	Total IP Rm
40	2 168,75	4 685

5.4.1.12 Cabinet discussed the matter and resolved that the recommendations for the preferred suppliers for the strategic defence equipment be accepted as an interim step and that the Departments of Defence, Finance, Public Enterprises, and Trade and Industry proceed with further detailed negotiations with the preferred bidders with a view to achieving affordable agreements.

5.5 NEGOTIATION PHASE

5.5.1 Introduction

5.5.1.1 On 18 November 1998, Cabinet resolved that the Government should pursue negotiations with the various preferred suppliers for the purchasing of military equipment in terms of the SDP. The LUH negotiations would commence for a quantity of 40 helicopters at an estimated cost of R2 168,75 million.

5.5.1.2 As a result the IONT was established with the brief to negotiate an achievable funding arrangement and an affordable package, which would result in final contracts for the offered strategic defence equipment.

5.5.2 Investigation procedures performed in respect of negotiation phase

5.5.2.1 The results of the RFO evaluation, as presented at the ministerial briefing, were traced through to Cabinet presentation that was made to obtain approval.

5.5.2.2 The quantity, cost and industrial participation approved by Cabinet were reconciled with the final contract.

5.5.3 Ministerial briefing presentation – 31 August 1998

5.5.3.1 The results of the RFO evaluation were presented at the ministerial briefing on 31 August 1998 and are as follows:

No	Tender Price US\$m	Programme Cost US\$m	DIP US\$m	Total NIP US\$m	Total IP US\$m
60	347	423	202.9	632	834.8

5.5.3.2 The figures above then had to be converted into rands, to be comparable to the Cabinet presentation. The applicable exchange rate was R6.25 = US\$1.

No	Tender Price Rm	Programme Cost Rm	DIP Rm	Total NIP Rm	Total IP Rm
60	2 168,75	2 643,75	1 268	3 950	5 218

5.5.4 DoD presentation to the Cabinet – 18 November 1998

Due to the expected deficit in the DoD’s budget on the SDP, the number of helicopters to be acquired was reduced from 60 to 40. The costs and commitments presented by DoD to Cabinet on 18 November 1998, were based on this reduced number.

No	Tender Price Rm	Programme Cost Rm	NIP Investments Rm	NIP Exports Rm	NIP Local Sales Rm	Total IP Rm
40	-	2 168,75	431	2 847	1 407	4 685

5.5.5 IONT progress report – August 1999

5.5.5.1 In the progress report compiled by IONT in August 1999, the figures presented to Cabinet in November 1998 were compared to the results of the negotiations. The following information was disclosed:

- Cabinet cost figure November 1998: R2 169 million.
- Negotiated contract price: R2 303 million.

DIP Progress Report	Direct DIP Rm	Indirect DIP Rm	Technology Rm	Total DIP Rm
Info to the Cabinet on 60 a/c	686	285	298	1 269
Present status on 40 a/c	469	391	548	1 408

NIP Progress Report	Investment Rm	Exports Rm	Local Sales Rm	Total NIP Rm
Info to the Cabinet on 60 a/c	255	2 619	544	3 418
Present status on 40 a/c	1 153	2 926	720	4 799

5.5.5.2 The combined NIP and DIP shown in this progress report described as information to Cabinet for 60 units, is R4 687 million. According to Cabinet presentation slides the total IP value of R4 685 million was for 40 units.

5.5.6 Cabinet briefing – 15 September 1999

5.5.6.1 At a Cabinet briefing held on 15 September 1999, slides were presented detailing the following costs and commitments:

No	Cost Rm	NIP Value Rm	DIP Value Rm	Total IP Rm
40	1 949	4 799	1 410	6 209

5.5.6.2 The figures presented were discussed and it was approved that tranche 1 of the armaments acquisition should include 30 LUHs from Agusta.

5.5.6.3 The amount of R1 949 million was submitted to Cabinet on 15 September 1999 as the preferred bid figure. The latter amount includes most of the project management costs, but excludes certain mission equipment and implementation costs. The project team was initially instructed by SOFCOM that management and implementation costs should not be included in the LUH budget to be

submitted to Cabinet. This matter has been partially resolved as most of project management costs have now been included in the approved budget. The current management budget is insufficient to place both a test pilot and a flight test engineer at the Agusta factory in Italy for the duration of the development and flight test phases of the project. An amount of R176 320 000 is required for implementation costs. The Chief of the Air Force agreed at the Project Control Board on 24 August 1999 that the costs of implementation would be funded from the SAAF operating budget.

5.5.7 LUH contracts – 3 December 1999

5.5.7.1 The final SDP contracts for the LUH, excluding the buyer credit agreement, were signed on 3 December 1999.

5.5.7.2 The supply terms agreement specifies the quantity and costs as follows:

No	Contract Price US\$ Portion	SACE Premium (incl in US\$ Portion)	ZAR Portion (payable in cash)
30	199,778,887	11,999,126	340,648,991

Therefore the final contract price for 30 units, converted to rands at R6.25 = US\$1, amounts to R1 249 million.

5.5.7.3 The final committed DIP credits amounted to US\$190,987,395. The reason for this decrease in value from the RFO submitted, is the reduction in the number of units and the contract price.

5.5.7.4 In NIP terms, Agusta committed themselves to US\$ 767,930,000 NIP credits. The significant increase, as compared to the amount in the RFO, is due to the fact that the Jeans Project and two Pratt & Whitney Projects had been withdrawn and were replaced by two new projects, namely the Mohair Project

and Speciality Steel Minimill Projects, in the final agreement. The value of the two new projects when added together exceeded the value of those removed.

5.5.7.5 The final buyer credit agreement, dated 25 January 2000, provided for a financing facility of US\$199,778,887.

5.6 CONTRACT PHASE

5.6.1 Decision of Cabinet meeting of 1 December 1999

5.6.1.1 In Cabinet Memorandum No 14 of 1999 dated 25 November 1999, it was recorded that:

"The Cabinet

- *granted the permission required by the department to sign supply, NIP, DIP and umbrella agreements for amongst others 30 LUHs.*
- *noted the loan agreement to be concluded between the Department of Finance and the banks to be completed by mid-December 1999."*

5.6.1.2 The documents stating the decision and memorandum as detailed above, do not appear to require signatures and are therefore not signed.

5.6.1.3 The contracts were finalised and signed by the relevant parties on 3 December 1999.

5.6.2 Defence Industrial Participation terms of agreement

5.6.2.1 The DIP terms 1120/3 between Armscor and Agusta were signed on 3 December 1999. The plan also included DIP activities from Sextant *via*

Agusta, which had not been analysed and accepted by the Armscor DIP division before the contract was signed.

5.6.2.2 A clause in the DIP terms allowed a 60 day period within which such analysis, negotiation and acceptance of the plan should have been concluded.

5.6.2.3 It was noted in the DIP team's analysis of the DIP business plans that the proposed DIP business plan of Agusta contained several activities from their Avionics subcontractor, Sextant. Sextant and Agusta changed the activities after several discussions with the SA companies involved, as well as the Armscor Programme Team. Agusta submitted the changed proposals for inclusion in the DIP terms of 3 December 1999, but the Armscor DIP division could not agree to these changes, as they had not been analysed and generally accepted at that stage. However, the DIP division acknowledged the changes, subject to investigation, negotiation and final agreement upon a changed business plan, within 60 days after the signature of the Umbrella Agreement.

5.6.2.4 The business plans, which were annexed to the main agreement, were subject to negotiation and could therefore be changed. The changing of the business plans was an ongoing process aimed at attaining the best benefits for the State. Since Sextant had been recommended by the SAAF as the avionics supplier on several of their programmes, Government had more bargaining power and could negotiate the terms and conditions of the business plans. Such a globally integrated approach from Sextant was necessary to ensure long-term support of all these programmes.

5.6.2.5 The DIP evaluation team recommended that the LUH Project Control Board should approve the amendment to the DIP terms.

5.6.3 National Industrial Participation terms of agreement

5.6.3.1 The NIP terms of the agreement between Armscor and Agusta were signed on 3 December 1999. The seller undertook to achieve an aggregate of 767,930,000 credits (1 NIP credit having a value of 1 US Dollar) made up of US\$184,500,000 in respect of investments; US\$468,230,000 in respect of net export revenue; and US\$115,200,000 in respect of local sales.

5.6.3.2 The seller undertook to furnish the NIP implementation mechanism with detailed bankable business plans within nine months of the effective date in respect of the core projects. The NIP terms provided for substitute projects which the seller was allowed to introduce to fulfil its NIP commitments. These substitute projects must be approved or rejected by the NIP implementation mechanism within 90 days, failing which it shall be deemed to have been approved. The NIP terms set out some milestones that had to be achieved by the seller at some stages during the period of the contract phase. The NIP terms provided for the monitoring of the seller's obligations and milestones. Provisions were made for the increase or reduction of NIP credits as the contract value might fluctuate.

5.6.4 Financing buyer credit agreement

5.6.4.1 The buyer credit agreement is dated 25 January 2000 and was entered into between:

- The Republic of South Africa (RSA) acting through its Department of Finance (DoF) (the borrower).
- Mediocredito Centrale S.p.A (MCC), (Arranger and Agent).
- Several banks and financial institutions whose names appear in the agreement (the banks).

- 5.6.4.2 On 10 July 1997, a memorandum of understanding between the Republic of Italy (RI) and the RSA was signed in Rome, Italy. On 30 October 1997, by way of an exchange of letters, the Ministry of Defence of the RI and the MoD of the RSA undertook, *inter alia*, to provide financial support covering the contracts awarded to Italian companies under the “Strategic Defence Alliance Programme” by means of the granting of an inter-governmental line of credit.
- 5.6.4.3 Within the framework of the *inter-governmental agreement – IA*, Armscor acting as the procurement agency of DoD, entered into a contract dated 3 December 1999, with Agusta S.p.A for the supply of 30 A109 Light Utility Helicopters, together with equipment and support services as defined in the contract. The contract price was US\$199,778,887 (firm and fixed). This sum includes an amount of US\$11,999,126 for the SACE Premium and a ZAR portion of R340,648,991 payable in cash, which, according to the contract corresponds to 23,2% of the total contract price.
- 5.6.4.4 Pursuant to agreements, Mediocredito Centrale S.p.A acting as the arranger and agent, raised the required bank loan in an aggregate amount not exceeding US\$199,778,887 (“the facility”), for the purpose of financing:
- (a) The payment obligations of the buyer under the contract in respect of 100% of the goods and services of Italian origin, including pre-shipment goods to be supplied by the supplier to the buyer in an amount not exceeding 85% of the total contract price.
 - (b) Up to 100% of the SACE Premium.

5.6.5 Changing of contracting parties

5.6.5.1 An internal memo of Armscor dated 5 April 2000, indicates that a letter from Agusta dated 23 December 1999, “gave Armscor notice that the Board of Directors Finmeccanica has approved that with effect from 1 January 2000 that all assets and liabilities and all rights and obligations of Agusta Un’Azienda Finmeccanica in relation to its helicopter business will be transferred to the new subsidiary to be known as Agusta S.p.A.”

5.6.6 Programme Plan

5.6.6.1 The programme plan was detailed in a document titled “*Programme Plan for the Acquisition of LUH for the SAAF (Project Flange)*”.

5.6.6.2 The first draft of the document had originally been compiled on 19 February 1999, but was only finalised on 5 February 2000. The programme plan was approved by Messrs Odendal and Viljoen and authorised by Messrs Britz and Brig Gen on 9 and 12 June 2000, respectively.

5.6.6.3 This document described the execution methodology for the acquisition phase of Project Flange and serves as a contracting medium between Armscor and the SAAF.

5.6.6.4 The purpose of this Programme Plan is to state and describe the activities and planning for the execution of the acquisition phase of the SAAF LUH Project (Project Flange). As the Programme Plan is unique to each project and does not fall within the scope of the milestone documents for the acquisition process, it is not necessarily required in every instance.

5.6.6.5 The Programme Plan also serves as a contracting document between Armscor and the DAPD, in as much as it details the manner in which Project Flange will be conducted. Acquisition and programme management policy documents are valid for Project Flange.

5.6.6.6 The programme plan describes the activities and responsibilities that will lead to the achievement of the objectives of Project Flange in an effective manner.

5.6.6.7 The contents in the programme plan provide information about how Project Flange will be executed with regard to the programme planning and control, the process of programme management and programme integration.

5.7 FINDINGS

5.7.1 The acquisition policies and procedures of the DoD and Armscor required the compilation and approval of certain key programme documents. These documents provide the basis for informed decision-making during the acquisition process. Various key documents had not been finalised and/or duly approved before the final contracts were concluded.

5.7.2 Implementation costs of R176 320 000 were not included in the total programme cost submitted to Cabinet in September 1999. This amount had to be incorporated in the normal SAAF operating budget, for which approval was sought only after signature of the contract.

5.7.3 No evidence could be found that any person had improperly influenced the selection of the prime bidder.

5.7.4 Minor discrepancies were found during the investigation. However, these did not affect the overall ratings. It was noted that some of the team members did

not utilise the Master Scoring Matrix but had compiled their own table, indicating their rankings. This also had no effect on the ultimate results.

CHAPTER 6

SELECTION OF PRIME CONTRACTORS: SUBMARINES

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CHAPTER 6

SELECTION OF PRIME CONTRACTORS: SUBMARINES

The selection of prime contractors for the submarines was not investigated during the public phase of the investigation.

6.1 BACKGROUND

6.1.1 The Defence Review allowed for, *inter alia*, the acquisition of four submarines for the South African Navy.

6.1.2 RFIs on the defence requirements were submitted to 11 countries during September 1997, and 37 responses were received from nine countries during October 1997. DoD and Armscor evaluated the responses against pre-determined value systems and a shortlist of possible suppliers from seven different countries was recommended to, and approved by, the AAC during January 1998.

6.1.3 During February 1998, RFOs were issued to the shortlisted seven countries to submit proposals for the supply of the seven categories of equipment to be procured with foreign participation. At the RFO stage, offers for submarines were received from the following foreign suppliers:

Supplier	Submarine model	Country
DCN	Scorpene	France
GSC	209 1400 Mod	Germany
Fincantieri	S1600	Italy
Kockums	Type 192	Sweden

6.1.4 The offers received from the respective bidders were adjudicated against pre-determined value systems in the following three domains:

- 6.1.4.1 Military value and performance of the products.
- 6.1.4.2 Financing of the product.
- 6.1.4.3 Industrial participation offered (comprising NIP and DIP in equal proportions).
- 6.1.5 The three evaluation criteria were to be consolidated in terms of the following formula:

$$\text{Best value} = \frac{M + IP}{F}$$

Where M is the technical/military value index, IP is the industrial participation index, and F is the financing index.

As stated in chapter 4 of this report, the formula was changed during the evaluation process.

- 6.1.6 The results and final ranking after the formal evaluation process are set out in the table below:

Bidder	NIP	DIP	Normalised Total IP Value	Mil Value Index	Financial Index	Best value	Final Ranking
GSC	100	54	100	100	100	100	1
Kockums	14	93	69	91	78	79.3	2
Fincantieri	10	93	67	83	87	79	3
DCN	11	100	72	66	93	77	4

- 6.1.7 On 18 November 1998, Cabinet approved a recommendation from DoD, the DoF and the DTI regarding preferred bidders for the supply of the equipment. Cabinet resolved that the DoF, DoD, Department of Public Enterprises and DTI could enter into contract negotiations with the preferred bidders with a view to achieving affordable agreements. GSC of Germany was selected as the preferred submarine supplier.

- 6.1.8 The brief of the negotiating team was to negotiate and conclude an affordable set of contracts, which combined the technical, industrial participation, and financial domains.
- 6.1.9 On 26 May 1999 the Chief Negotiator and DoD recommended to the Ministers Committee that in view of the fact that the Minister of Defence would be leaving public office, he initial the submarine contract at a press conference marking the departure of the Minister of Defence as the initiator of the defence package. The Ministers decided that the Minister of Defence could proceed with the press conference. The initialling of a contract pertaining to the acquisition of the three submarines appears to have taken place on 12 June 1999. The parties to the initialling were members of IONT and the preferred supplier. The Minister was not a member of IONT and did not initial the contract. It should be noted that the initialling occurred prior to the outcome of an affordability study undertaken by the DoF on the strategic defence package as a whole.
- 6.1.10 On 13 June 1999 the Minister of Defence released a press statement indicating that IONT had reached a milestone in finalising the equipment cost and IP draft terms of the agreement for the acquisition of three submarines for the South African Navy at a contract price of R4,5 billion subject to Cabinet approval. The industrial participation benefits that would accrue to the South African economy were given as R19 billion.
- 6.1.11 The press release by the Minister did, however, state that the terms of the agreement had to be ratified by the Ministers' Committee, whereafter a final agreement would be considered by Cabinet and depend on affordability. It would appear that the initialling of the contract without the actual signing thereof by all the parties did not constitute a binding agreement. Final approval for the contracting was granted by Cabinet on 1 December 1999 for DoD to sign the contracts pertaining to the SDP including the acquisition of three

submarines. Minister M P G Lekota signed the contract on 3 December 1999, on behalf of the Government of South Africa through its Department of Defence.

6.2 SCOPE OF INVESTIGATION

6.2.1 The scope of the investigation covered the following:

6.2.1.1 To document the actual process followed in the selection of the submarines' prime contractor.

6.2.1.2 To determine if the process above deviated from the approved process.

6.2.1.3 To determine if there was a risk of any individual/s influencing the selection process.

6.2.1.4 Investigate any allegations that have a bearing on the process.

6.3 INDUSTRIAL PARTICIPATION (IP)

6.3.1 The following documents form an integral part of the IP requirements:

6.3.1.1 National Industrial Participation Programme of the Republic of South Africa.

6.3.1.2 *Pro forma* Memorandum of Defence Industrial Participation Agreement.

6.3.1.3 Defence Industrial Participation Confirmation by Bidder Form.

6.3.1.4 Format for DIP business plans.

6.3.1.5 Format for DIP target planning schedule.

- 6.3.1.6 Generic Evaluation Guideline (DIP).
- 6.3.2 The requirements of the RFO with regard to IP are covered by section 4: Industrial Participation and Requirements and Conditions of the RFO. Section 4 of the RFO refers to the applicable document "Industrial Participation Requirements & Conditions for Submarines. DIPCO-ZS, Dated 27 January 1998." The relevant sections of the DIPCO-ZS are dealt with below:
- 6.3.2.1 Paragraph 2 of DIPCO-ZS indicated that it is national policy of the Republic of South Africa that, whenever acquisitions have to be made from a foreign country by any state department or parastatal and the total value of such contract awarded to a foreign contractor is equal to or more than US\$10 million, the total value of the foreign contract shall be subject to industrial participation as described therein.
- 6.3.2.2 The total obligation shall at least be equal to:
- (a) A defence industrial participation (DIP) portion of at least 50% of the total contract price.
 - (b) A non-defence industrial participation (NIP) portion of at least 50% of the total contract price.
- 6.3.2.3 In terms of paragraph 10 of DIPCO-ZS, DoD, in consultation with the DTI, reserves the right to re-apportion the respective DIP and NIP obligations, in the eventuality of specific business proposals justifying such a decision.
- 6.3.3 The document "National Industrial Participation Policy and Guidelines" was approved by Cabinet on 30 April 1997. In essence all state and parastatal purchases and lease contracts (goods and services) signed after this date, that are equal to or exceed US\$10 million in imported content, are subject to an

industrial participation obligation. The NIP obligation for the defence purchase was 50% of the total contract value. No contract can be awarded to a bidder if the industrial participation requirements have not been complied with.

6.3.4 In the event where the respective percentage obligations are interchanged between the non-defence and the defence industrial participation programmes, it must be clearly noted and understood that the portion added/transferred will be evaluated strictly in accordance with the respective evaluation prescriptions of the DTI and/or Armscor. This means that, if a defence-related project is re-apportioned to the NIP programme, this additional portion will be assessed and evaluated in terms of the DTI prescriptions and *vice versa*.

6.4 NON-DEFENCE INDUSTRIAL PARTICIPATION (NIP)

6.4.1 NIP evaluation results

The table below sets out the NIP projects considered from the submarine offers and indicates the scores and rankings achieved after evaluation by the DTI.

Bidder and project	Credit value US\$'000	Multiplier	Credit value projection US\$'000	Normalised score	Ranking
German Submarine Consortium					
Stainless Steel COEGA	10 102 450	23	232 356 350		(Note 3)
Tech transfer Tolkmith and Prokura Diesel	3 400	4	13 600		
Marketing assistance Ferrostaal & Murray & Roberts	280 000	13	3 640 000		
Marketing assistance Ferrostaal & CSIR	352 000	9	3 168 000		(Note 1)
Export promotion involvement of SA industry	32 000	1	416 000		
	10 769 850		239 593 950	100	1
Fincantieri					
Coogemar S.R.I- Marble & Granite	69 567	17	1 182 639		
JV Company for waterproof & low-energy lighting system	26 656	13	346 528		
JV Company for production of glass reinforced pipes	127 840	17	2 173 280		
JV Company to increase exports to Caribbean	324 304	11	3 567 344		
JV Company for production of	411 300	14	5 758 200		

Bidder and project	Credit value US\$'000	Multiplier	Credit value projection US\$'000	Normalised score	Ranking
electrical power by wind resources					
JV Company for exports to Ansaldo Group	171 846	9	1 546 614		
Fiat Palio Security System	53 014	7	371 098		
Plessey: Equipment as turnkey ICT infrastructure project	425 541	0			(Note 2)
Plessey: Production of locally developed microwave systems	585 540	13	7 612 020		
Equipment components and services for transmission and distribution electrical energy	95 970	4	383 880		
	2 291 578		22 941 603	10	4
Kockums					
Mining equipment	24 000	10	240 000		
Joint Swedish industrial efforts to create maximised prerequisites for cooperation between SA and Swedish industrial & economic life statement	893 020	9	8 037 180		
General and civil aircraft maintenance	474 080	16	7 585 280		
GSM positioning, vehicle and recovery, fleet management services	26 400	13	343 200		
Exploitation of SA gas and oil finds	1 562 423	9	14 061 807		
SES Stirling electric generating system	200 252	16	3 204 032		
Windmill power generation	46 563	13	605 319		
SA Business Centre	155 194	0	0		
Transmission and distribution of electrical energy	80	10	800		
	3 382 012		34 077 618	14	2
DCN International					
Titanium Technology	927 960	22	20 415 120		
Discard coal	295 412	16	4 726 592		
Thermex Carbontech (Pty) Ltd	128 038	13	1 664 494		
ASA Biotechnology (Pty) Ltd	2 016 664	14	28 233 296		
	3 368 074		55 039 502		
50% of 55 039 502			27 519 751	11	3

6.4.2 Review of the NIP evaluation working papers

6.4.2.1 Error in computations - German Submarine Consortium (Refer note 1 in table above)

An IP project from Ferrostaal and CSIR classified under the R&D sector was valued at US\$3 168 000 000, represented by US\$352 000 000 credits multiplied by a strategic factor of 9. A review of the relevant credit schedule indicated that

the total should have been US\$1 584 000 000, represented by credits of US\$176 000 000 multiplied by a strategic factor of 9. Mr V Pillay of DTI confirmed that this was a computation error. This computation error resulted in an overstatement of the total score allocated to GSC by an amount of US\$1 584 000 000 (US\$3 168 000 000 – US\$1 584 000 000). In view of the large value of the score attributable to GSC, this error amounted to 1% of the total score of GSC, which in isolation did not have an impact on the final ranking.

6.4.2.2 *Error in computations – Fincantieri (Refer Note 2 in table above)*

- (a) A project by Plessey specified as a “turnkey ICT infrastructure project” was reflected as US\$0 (represented by credits of US\$425 541 000 multiplied by a strategic factor of 0 on the evaluation summary schedule). It appears that the strategic factor has been incorrectly transferred to the summary schedule as 0, because the schedule analysing the five strategic considerations does not crosscast. The crosscasting of the relevant line of this schedule should have been 3 and not 0. Consequently, the total value attributed to Fincantieri has been understated by US\$1 276 623 000 (US\$425 541 000 x 3).
- (b) Mr V Pillay of DTI stated that this might have been a computation error or it might have been a conscious decision by the economic evaluation team not to award a score for this project. The time that had elapsed made it impossible to recollect the actual situation. Taken in isolation this error did not have an effect on the final outcome.

6.4.2.3 The overall effects of the computation errors with respect to both GSC and Fincantieri are depicted in the table below. Although no effect on the overall result was evident, adjustment of the errors would have resulted in DCN

achieving a score of 12 as opposed to a score of 11 calculated by the evaluation team.

Supplier	Value as determined by DTI US\$'000	Rating of bidder evaluated by DTI	Value after adjustment for computation errors US\$'000	Rating after adjusting for computation errors
GSC	239 593 950	100	238 009 950	100
Fincantieri	22 941 603	10	24 218 226	10
Kockums	34 077 618	14	34 077 618	14
DCN	27 519 751	11	27 519 751	12

6.4.3 NIP contract values vs NIP offered values

6.4.3.1 It was found that the value of the NIP finally contracted for on 3 December 1999 was different to the value of NIP offered by the GSC. The last mentioned NIP was utilised in the determination of the preferred bidder and included in the presentation by DoD to Cabinet on 18 November 1998.

6.4.3.2 The reduction related to a price difference of stainless steel in the contract of US\$1 380 per ton for Austenitics (grade 304) and US\$950 per ton for Ferritics (grade 409) compared to prices of US\$1 800 per ton for Austenitics and US\$880 per ton for Ferritics as contained in the GSC offer.

6.4.3.3 A recomputation of the evaluation, utilising the contracted values instead of the values according to the original offer are depicted in the following table:

Credit criteria	Original credit allocation US\$'000*	Revised credit allocation US\$'000**	Difference US\$'000
Domestic sales	-	258 400	258 400
Export sales	6 872 000	4 023 288	(2 848 712)
PDI ownership	1 202 600	904 400	(298 200)
Total investment	1 974 000	1 980 000	6000
Salaries and wages	53 850	-	(53 850)
	10 102 450	7 166 088	(2 936 362)

* Refer to note 3 on table in paragraph 6.4.1

** Based on contract values

6.4.3.4 The effect of utilising the actual contract values is a reduction in the total score awarded to the GSC of US\$67 536 326 000 (US\$2 936 362 000 multiplied by 23).

6.4.3.5 The cumulative effect after adjusting for computation errors and the actual contract values on the overall NIP rating is indicated in the following table:

Supplier	Value as determined by DTI US\$'000	Rating of bidder evaluated by DTI	Value after cumulative adjustments US\$'000	Rating after adjustments
GSC	239 593 950	100	170 473 624	100
Fincantieri	22 941 603	10	24 218 226	14
Kockums	34 077 618	14	34 077 618	20
DCN	27 519 751	11	27 519 751	16

6.4.4 Investment credits

6.4.4.1 In terms of the NIP value system investments in the form of capital outlay or capital injections were awarded 2 credits for every US\$1 spent.

6.4.4.2 It was observed that an investment of US\$990 million was proposed in respect of the GSC business plan for the COEGA Stainless Steel Plant. The business plan indicated that the funding would be sourced locally and from foreign sources on a 50/50 split. On the basis that only 50% of investments are foreign sourced, a credit of US\$990 000 000 should have been awarded in respect of investments prior to the effect of the multiplier and not US\$1 980 000 000 (US\$990 000 000x 2).

6.4.4.3 The effect after taking the multiplier into account indicates that the credits in respect of investment were overstated by US\$22 770 000 000 (US\$990 000 000 x23).

6.4.4.4 The cumulative effect after considering the previous adjustments (paragraphs 6.4.2.3 and 6.4.3.5) of an appropriate investment credit computation is depicted in the table below:

Supplier	Value as determined by the DTI US\$'000	Rating of bidder evaluated by the DTI	Value after adjustments US\$'000	Rating after cumulative adjustment
GSC	239 593 950	100	147 703 624	100
Fincantieri	22 941 603	10	24 218 226	16
Kockums	34 077 618	14	34 077 618	23
DCN	27 519 751	11	27 519 751	19

6.4.5 Other factors that could have had an impact on the final evaluation results

6.4.5.1 Approval of the NIP value system

No evidence indicating that the value system registered at the Armscor procurement division is a document that was approved either by the DTI or any relevant authority at Armscor/DoD was found. The document is not signed by anyone to signify approval thereof. Furthermore, the team members assigned to evaluate the NIP offers were recorded in the value system in manuscript. Mr V Pillay stated that the value system was presented to SOFCOM. A review of SOFCOM minutes did not indicate that the value system had been considered and approved by the members. In terms of its constitution, SOFCOM did not appear to be a decision making body. This was confirmed by Mr S Shaik during a formal consultation. In response to a further inquiry in this regard, Mr S Shaik stated that: *"To my knowledge the value system was approved by DTI."* This was also confirmed by DTI in that the Director General of DTI had approved the value system.

6.4.5.2 Exclusion of 50% of DCN

- (a) SOFCOM minutes dated 20 May 1998 indicated that the DCN proposal contained a repetition of offers in respect of the Corvette and submarine programmes.
- (b) As a result of this repetition, Mr Pillay stated that it was decided at a joint NIP/DIP meeting to divide the IP offered by DCN equally between the Corvette and submarine programmes. The DIP value system provided for disqualification in the event of repetition. The NIP value system was silent on the matter.
- (c) Although the SOFCOM meeting on 20 May 1998 enabled communication with bidders to obtain clarification information, there is no evidence that DCN was requested to provide an indication of the allocation of offered activities. Lack of consistency in this regard was evident as Eurocopter, a bidder in the LUH programme, who also offered a basket of certain indirect activities, were requested to rectify the matter by committing to specific activities under the respective projects.
- (d) A written response from Mr S Shaik to an inquiry in this regard stated: *"The tender for corvettes and submarines were indicated as independent tenders, with separate Technical, DIP, NIP and Financial requirements. The French company DCN refused to comply with these instructions as per the RFO document. They requested meetings with myself, Armscor, Secretary for Defence, Minister of Defence who all informed them that this was a tender requirement to which they should comply. The French DGA/DCN refused to comply with this tender requirement and offered a "basket" across for both their corvette and submarine tenders. Hence, a decision was required from DoD/Armscor/DTI on this issue. From my recollection, both Acting Chief Executive Officer and Chief of Acquisition were requested to provide advice to the Armscor DIP division. The acknowledgement of 50% was also based on the assumption that DCN*

would/might be in a position to secure both contracts on corvette and submarines. If this would have been the case, there would have been a major problem in securing a firm commitment under either programme. Again DCN was explicitly instructed by both the DoD/Armscor not to offer a basket IP. Strictly speaking the DCN should have been disqualified, or the SOFCOM co-chair and SOFCOM had to make a decision on how to proceed. From my recollection both co-chairs agreed to split the IP offer in 50% to the corvette offer and 50% to the submarine offer. This decision was subsequently approved by SOFCOM, AASB and the AAC."

6.4.5.3 *The business concept phase*

- (a) In terms of the industrial participation requirements, business concepts were required to be forwarded to the DTI IP Secretariat for discussion purposes and approval prior to the submission of the offers. A more detailed business plan incorporating approved business concepts was then required to be submitted with the offer.
- (b) Mr V Pillay stated that not all bidders had submitted business concepts for approval and, consequently, activities included in the offers constituted a combination of approved concepts for certain activities as well as business proposals which had not previously been considered and approved by the DTI.
- (c) In view of the fact that not all business concepts had been considered by the DTI prior to the submission of the offers, it is possible that bidders might have been prejudiced by not knowing if submitted projects would have been approved or rejected prior to the submission of offers, whilst other bidders might have known that their business concepts were acceptable for inclusion in the final offers. The aforementioned is not in accordance with good procurement practices.

6.4.5.4 *Acceptance and rejection of projects*

- (a) Various activities offered by bidders were excluded from evaluation, at times without any reasons and at times with insufficient reasons.
- (b) The lack of supporting documentation and evidence that exclusions were considered and approved at an appropriate level, opened the possibility that bidders might have been prejudiced through arbitrary exclusion of activities offered.
- (c) Interviews with personnel from the DTI indicated that acceptable projects were evaluated on the basis of a list of 22 special projects devised by the DTI. Proposals not representative of these 22 projects were excluded. It was also noted that certain projects, which did not qualify in terms of the list of special projects, were included in the evaluation process.

6.4.5.5 *Assumptions pertaining to export sales, domestic sales and local content*

- (a) It was found that in a number of instances evaluators assumed that all sales reflected in the business plans were in respect of exports where no information in this regard was furnished. In instances where business plans indicated a distinction between export and domestic sales, this was taken into account in the credit computations.
- (b) According to Mr V Pillay, industry experts within the DTI advised the evaluators on the percentages of local and export sales as well as local content, where this information had not been furnished. No working papers have been furnished by DTI to substantiate this.
- (c) With regard to GSC, the evaluators assumed that the total value of sales offered according to their business plan amounting to US\$3 436 000 000,

pertained to export sales. However, the actual sales contracted for amounted to US\$2 584 000 000, of which 10% was in respect of local sales. The aforementioned indicate that the assumptions used by the evaluators were incorrect. Projects proposed by Kockums and DCN were analysed correctly with regard to export and local sales as well as local content, as the required information was furnished by these bidders.

6.4.5.6 Strategic considerations

- (a) In terms of the NIP value system, the total score that could be attained by a bidder was derived by multiplying the credits evaluated in terms of the business plans by the sum of the values of strategic considerations out of a maximum score of 25 arising from the economic evaluation.
- (b) The economic evaluation consisted of rating the following five strategic considerations on the basis of information extracted from the business plans and listed in the economic evaluation schedule. This schedule was apparently given to the industry experts within the DTI for scoring.

Strategic considerations	Possible range of scoring
Technology	1 - 5
Empowerment	1 - 5
Job creation	1 - 5
Global integration	1 - 5
Sectoral strategy	1 - 5

- (c) Consultations with Mr V Pillay of the DTI suggested that the scores of the strategic considerations were finalised during a workshop by members of the relevant committee charged with this responsibility. No minutes of the workshop were maintained. There was therefore no evidence that the final scores agreed upon, had been consented to by all the members present.

The only evidence of some sort of consensus on the final scores utilised is three illegible initials on the computer spreadsheet summarising the scoring for each strategic consideration per bidder.

- (d) The economic evaluation schedules furnished by DTI which purport to support the final scoring utilised, bore no relation to the final scores actually utilised. A subsequent consultation with Mr V Pillay indicated that the economic evaluation schedules referred to above had been considered by the team at the workshop and that the final scores were determined by the team at the workshop. Examples of differences in this regard are highlighted in the following table.

Bidder	Projects	Scoring per economic evaluation schedule furnished	Final score utilised
GSC	COEGA stainless steel plant	17	23
	Ferrostaal & Murray & Robberts	9	13
DCN	Titanium technology	15	22
	Discard coal	12	16
Fincantieri	Marble and granite	4	17
	Reinforced glass polyester pipes	11	17
Kockums	Stirling solar	10	16
	Windmill power generation	10	16

- (e) The final scores as determined by the evaluation team were used as the multiplier for the determination of the final scores of each bidder.

The technology proposed by GSC in their business plan for the stainless steel project, called "Compact Strip Production" (CSP) technology, was recognised by the evaluators during the evaluation process as "a new technology with no competition".

- (f) Given the fact that the technology (CSP) has subsequently been withdrawn and that re-negotiation of NIP commitments has taken place, the score of 23 out of a maximum possible score of 25 in respect of the

strategic considerations appears to be rated highly in comparison with other projects (refer paragraph 6.4.5.8).

6.4.5.7 *Initial independent assessment of steel industry projects*

- (a) During a review of files made available by the Department of Finance, two draft reports on the assessment of steel industry projects by Locker Associates Inc and Warburg Dillon Read were identified. These reports were a result of an assessment of the projects requested by IONT and reflected that the Coega stainless steel project was risky.
- (b) During consultations with Mr V Pillay he indicated that at the time of the evaluation, the rating for the stainless steel mill was realistic and that the assessment reports were prepared only during the negotiation phase of the SDP acquisition.

6.4.5.8 *Substitution of the Coega stainless steel project*

- (a) A Department of Trade and Industry EXCO submission dated 5 July 2000, stated, *inter alia*, that:
 - *"The original project (integrated stainless steel plant) was withdrawn due to the withdrawal of the technology (thin slab) and the new project (stainless steel cold rolling mill) was tabled."*
 - The submission listed and discussed the substitute projects proposed by GSC and suggested that the combinations of alternative projects would exceed the obligation value of US\$960 million. It should be noted that this amount relates to the investment element only of the original IP. No mention is made of the contracted total IP of Euro 2 852 million.

- The submission also indicated that Columbus Stainless would be Ferrostaal's operating partner.
- The submission recommended that EXCO should consider *"the GSC latest proposal and accept that: the following are to the satisfaction of the committee, indicate commitment, and adequate equity contributions in respect of the NIP Project, thus enabling the triggering of the purchase contract:*
 - (i) *Cold Mill [Par. 5.1]*
 - (ii) *Downstream projects [Par.5.2]*
 - (iii) *Additional Projects – subject to full business plans [Par.5.3]*

The above projects serve as Suitable Substitute Projects for the original NIP Investment commitment of 960 US\$-M"

- The submission further recommended that *"in view of full economic analysis not being conducted, as previously done before a cabinet decision, that this be brought to the attention of the ministers subcommittee on the Defence Equipment Acquisition."*
- (b) It is also not clear whether the substitute projects were brought to the attention of the Ministers' Committee as recommended above.

6.4.5.9 Presentation by DoD to Cabinet dated 18 November 1998

- (a) A presentation by DoD to Cabinet on 18 November 1998 reflected, *inter alia*, the following information in respect of the submarine acquisition. There was a significant variance in the value of IP presented to Cabinet and the value of IP contracted for. However, the presentation to Cabinet on 18 November 1998, was in respect of the acquisition of three

submarines, whilst the IP value to Cabinet was in respect of four submarines as offered by the GSC.

		Outflows	IP Inflows				
Product	Qty	Acquisition cost	Investment	Exports	Local sales	Total	No of jobs
Submarines	3	R5 212 50m	R6 262m	R22 950m	R1 062m	R30 274m	16 251

A comparison of the cabinet presentation referred to above, to the final contract commitment is summarised in the tables below:

	EURO contract value	Contract value @ 1 EURO = R6.40 *	Cabinet presentation value (R)
Investment	960 300 000	6 145 920 000	6 262 000 000
Gross export revenue	2 255 832 000	14 437 324 800	22 950 000 000
Local sales	250 648 000	1 604 147 200	1 062 000 000
Total IP	3 466 780 000	22 187 392 000	30 274 000 000

* Represents an estimate of the exchange rate at the time of the presentation to Cabinet.

(b) The reduction in the value of IP finally contracted for appears to be acceptable as it compensates for the three submarines contracted for compared to the four submarines as offered by GSC.

6.4.6 Defence industrial participation

6.4.6.1 Summary of DIP value system

The DIP value system, which governs the evaluation process, was prepared by staff of the DIP division of Armscor.

6.4.6.2 Approval

(a) The DIP value system was issued by the countertrade division of Armscor and approved by the chairpersons of SOFCOM.

- (b) It has not been ascertained which policy document prescribed the approval process to be followed and the relevant authority to approve a value system. Consequently, uncertainty exists regarding the authority of the above persons to approve the value system.

6.4.6.3 *General provisions*

- (a) The document was intended for use by evaluators to assess the DIP proposals received in order for SOFCOM to formulate recommendations to the Minister of Defence and to adjudicate the tenders for the respective package deal elements.
- (b) In terms of the value system, the data from all evaluators was to be collated by the countertrade division and a final report issued to the Chief of Acquisition of DoD, who acted as auditor and moderator for the DIP process and consolidator of the NIP responses which were to be generated by the Department of Trade and Industry.
- (c) The assessment of all business plans was to be performed on the face value of proposals contained therein.
- (d) The correctness of proposals contained in the DIP section of each bidder's offer was the responsibility of the bidders. This was to be acknowledged in terms of "confirmation by bidder" forms duly completed and signed by each bidder.

6.4.6.4 *Organisation structure of the DIP evaluation team*

- (a) A two-tier management process was in place.

- (b) Mr Johan van Dyk, Head of Armscor's Countertrade Division, was the DIP team leader.
- (c) Mr S Shaik was the auditor and moderator for the DIP process.
- (d) Mr Shaik and Mr A Hirsch (DTI) were to discuss and agree on the respective evaluations made by the Armscor countertrade division and the IP Secretariat of the DTI, before it was collated by the Armscor countertrade division into a combined input.
- (e) A process flow diagram reflected that once the evaluations had been performed, the results were required to be audited by the DTI and the Chief of Acquisition.
- (f) After the auditing of the results, approval was to be obtained from the relevant IP control committee of the DTI and a DIP committee of DoD/Armscor, whereafter combined inputs were to be recommended to the steering committee (SOFCOM). In this document no reference was made to the composition and establishment of these committees.
- (g) No evidence of approval of the results by either the IP control committee or a DIP committee was found. However, Mr Hirsch of the DTI indicated that discussions and agreement on the respective evaluations had taken place as required.

6.4.6.5 Evaluation team

No policy was in place with regard to the appointment of the evaluation team. According to Mr B de Beer (Manager of DIP division: Armscor) the selection of the evaluation teams was made on the basis of the experience of personnel in DIP evaluations.

- 6.4.6.6 Prescribed documents for the evaluation were:
- (a) IP evaluation guidelines (Issue 0 of 27/1/98).
 - (b) *Pro forma* business plan (as attached to RFO).
 - (c) Signed "Confirmation by Bidder".
 - (d) DIP policy and procedural issues as contained in two Armscor documents, *viz* the A-POL- 6100: DIP Policy dated 1.4/97 and A-PRAC-008: DIP procedure dated 1/4/97.
 - (e) *Pro forma* DIP agreement as attached to RFO.
 - (f) Target planning schedule as attached to RFO.
- 6.4.6.7 The weighting methodology comprised the following scores:
- (a) 0: non-compliance/non-conformance.
 - (b) 1-4: falls short of expectations.
 - (c) 5: is the norm (i.e. proposals just meet expectations).
 - (d) 6-10: exceeds expectations, or conforms to highly critical norms.
- 6.4.6.8 Each bidder was required to comply with the critical criteria as discussed in chapter 4 of the report in order to qualify for the discriminating criteria phase of the evaluation.
- 6.4.6.9 The discriminating criteria consisted of two elements, namely a conformance and compliance element and also an activity element.
- 6.4.6.10 The overall evaluation formula specified in the value system was:

$$\frac{T = 100 \times IP = 100}{F = 100}$$

Where T = Technical, IP = Combined NIP and DIP input and F = Finance

6.4.6.11 The table below sets out the final evaluation summary as determined by the DIP evaluation team:

Factors	Fincantieri		GSC		DCN		Kockums	
	US\$m	% of tender value	US\$m	% of tender value	US\$m	% of tender value	US\$m	% of tender value
Tender value	1,009		852		1,022,2		1,094,6	
DIP amount	505,7	50,12	160	18,78	283,9	27,78	546	49,88
Direct DIP	388,8	38,54	101	11,85	50	4,89	152	13,89
Local IP between 40% - 50%	171,2	16,96			151,2	14,79		
Technology transfer of 6% - 10%	177,5	17,59			18,4	1,80		
Value of five-year equity investments of 10% - 14%	40,2	3,98			64,4	6,30		
Value of globalisation (exports) of 8% - 12%	116,9	11,58	59	6,92			379	34,63
Value of marketing Support of 2% - 3%							15	1,37
Evaluation score		93,30		54,00		100,00		93,28
Ranking		2		4		1		3

6.4.6.12 The review of the evaluation procedures reflected various inaccuracies which, however, did not have an effect on the ranking.

6.4.6.13 The table below provides an indication of the effect of the computation errors:

Bidder	Original DIP score	Ranking	Revised DIP score	Ranking
DCN	100,0	1	100,00	1
Fincantieri	93,30	2	89,60	2
Kockums	93,28	3	88,80	3
GSC	54,00	4	25,10	4

6.4.6.14 The revised DIP score compiled by the investigation team took into account the abovementioned errors, which reflected no change in the ranking of the bidders.

6.4.6.15 The investigation team factored the adjustments into the NIP and DIP scores, and found that the ranking remained unchanged as is depicted in the table below.

Bidder	Original DIP score	Original NIP score	Original total IP Normalised	Original Ranking	Revised DIP score	Revised NIP score	Revised total IP normalised	Ranking
GSC	54,00	100	100	1	25,10	100	100	1
Fincantieri	93,30	10	67	4	89,6	16	84,41	4
DCN	100,00	11	72	2	100	19	95,12	2
Kockums	93,28	14	70	3	88,8	23	89,37	3

6.4.6.16 *Non-compliance with DIP requirements: GSC and Kockums*

In two memoranda dated 18 May 1998 from Mr J van Dyk (Manager: Countertrade Division) to Mr E Phiyega (Company Secretary/Armscor Legal Head) it was indicated that in terms of a joint statement made, the submarine DIP evaluation team stated that *"the GSC and Kockums did not comply with the DIP requirements as contained in the submarine RFO. A legal opinion is requested as to whether the bidders complied with the tender prescriptions."*

(a) The reasons furnished by the DIP evaluation team for requesting a legal opinion regarding the GSC offer were, *inter alia*, the following:

" i) No confirmation by bidder form was submitted with the proposal, a fact that was also confirmed by the bidder during his presentation.

ii) In terms of the RFO requirements, a critical requirement was not met.

- iii) *Furthermore, due to the absence of this “Bidders Confirmation” there was no confirmation that a guarantee had been supplied, which again is a critical element not met.*
- iv) *A formal presentation to explain their business plan to meet the DIP, was made by GSC on 15 May 1998. During this meeting the bidder tabled the missing “Bidders Confirmation”, dated 12 May 1998.*
- v) *The bidder was told clearly that this constituted a late submission as well as additional documentation which will not be considered for evaluation purposes, and that the matter will be referred to higher authorities for confirmation.*
- vi) *The bidder also committed himself to:*
Direct DIP: 7% (\$59 million)
Indirect DIP: 12%(\$102 million)

However, in both cases this was on a collective basis, i.e. they could not relate to any specific project or activity as required by the RFO.
- vii) *A number of presentations highlighting some very promising projects as well as various other activity elements were mentioned with regard to direct DIP but no offset values were or could be allocated to any activity.*
- viii) *Accordingly, no business plan as required was submitted to detail how the DIP commitment will be executed.*
- ix) *GSC confirmed that, at that stage, they were not in a position to allocate any values to any specific activities.*
- x) *It needs to be mentioned that a large number of MoUs, all relating to programmes still to be finalised, were submitted.*

- x i) *No specific details were given on how they planned to fulfil the indirect DIP, although there were many intentions.*
- x ii) *GSC again confirmed that, at that stage, they were only prepared to commit themselves to a firm 7% DIRECT DIP (\$59 million) and 12% INDIRECT DIP (\$102 million) as overall figures without any allocation to any individual activity, although they felt confident that they could exceed these figures as time passed."*

(b) The reasons furnished by the DIP evaluation team for requesting a legal opinion regarding the Kockums offer were, *inter alia*, the following:

"Kockums submitted business proposals containing:

- Three direct projects valued at \$152 million; and*
- Twelve indirect DIP projects valued at \$1 094 028.*

i) *The company did not submit a completed "Bidders Confirmation" form and accordingly all the information called for in this form was non-existing (i.e. percentages split, details of guarantee, acceptance of general conditions, target planning schedule, etc.)*

ii) *Following their verbal committal to the individual amounts making up the totals under the first bullet above it was possible to evaluate the 15 projects as submitted, although there seemed to be a very high risk on some of the projects such as sale of Rooivalk for \$700 million."*

6.4.6.17 The legal response dated 22 May 1998 from the legal advisor P Hlahane regarding the abovementioned was as follows:

(a) *“RE: GERMAN SUBMARINE CONSORTIUM (GSC)”*

“GSC has failed materially to meet the essential requirements of the DIP. Without confirmation by the bidder there is no basis on which it could be evaluated. GSC therefore did not comply with conditions and requirements of both the IPRCR clauses 3.1; 5.6; 8.2 and 8.6 and all conditions as contained in DIPCB, which have been outlined above. The DIP requirements are very specific and GSC’s bid is tantamount to an undertaking of intent.”

(b) *RE: SUBMARINE - KOCKUMS*

“It is acknowledged that KOCKUMS has signed a statement to fulfil an industrial participation in accordance with the South African terms and conditions. This statement is very broadly worded and it is not clear whether it was intended to cover all the undertakings as requested by the DIP. To easily interpret it to mean this to be the case will be very dangerous as the DIP conditions specifically spelt out what has to be done in terms of respective requirements.

Without the compliance of clauses 6; 8.1; 8.2 and 8.6 of IPRCR and conditions of DIPCB, the bidder has failed to meet the DIP requirements.”

(c) Mr Hlahane then concluded, *“I have found your analysis and your fellow evaluation team members not to have been divorced from opinion provided herein.”*

(d) Despite the above, Mr S Shaik and Mr L Esterhuyse gave approval that all the bidders who had failed the minimum criteria be allowed to take corrective action in order to proceed to the next round of the DIP evaluation.

6.4.6.18 It was observed that in terms of paragraph 39(a) of SOFCOM minutes of 20 May 1998, the following guidelines for the evaluation team were provided by the chairperson:

- (a) *“Communication/interaction must be restricted to clarification of information in the offers. No new information that contributes to altering an assessment against the value system must be entertained, only information clearly traceable to the official offers.*
- (b) *Written (letter/fax/email) clarification requests must be registered at the Armscor Procurement Secretariat before transmission.*
- (c) *All members of evaluation teams must avoid consorting with offerors (potential beneficiaries of the results/decisions emanating from the information being evaluated) until after official promulgation of the final decision by the Cabinet. This precautionary practice applies to SOFCOM members after 1 July.”*

6.4.6.19 A memorandum dated 1 June 1998 entitled *“DIP ASSESSMENT PRIORITY ISSUES”* from Mr J J van Dyk which was addressed to the chairpersons of SOFCOM, Messrs H de W Esterhuyse and S Shaik contained, *inter alia*, the following:

“Deviations

- a) *It was already reported at the SOFCOM meeting of 20/5/98 that we have witnessed numerous deviations (in the various DIP offers) from the official tender prescriptions insofar as it relates to the DIP section of the respective RFOs.*
- b) *At the instruction of the SOFCOM chair (on 20/5/98) the countertrade division embarked on an additional-information-gathering exercise. The countertrade division, supported by the respective DIP evaluation teams, was of the opinion that some of the contenders have disqualified themselves.”*

- c) *"In order to create visibility of the actions taken to "legalise" everybody's participation, a matrix schedule (as per annexure A) has been drawn up for each of the contenders, clearly showing the deviations from requirements, additional info requested to correct these and the result of the responses received.*
- d) *It must be noted that not exactly the same information was requested from **all** the contenders as the responses and specific deviations varied from bidder to bidder.*
- e) *It was only Dassault Aviation, as well as Giat, GFC and Kockums (to some extent), which did not comply with all of the DIP requirements. They were all (as a matter of courtesy) requested to comply fully."*
- f) *"SOFCOM's condonation and subsequent approval are formally needed to utilise all of the additional information requested, some already received (on 1 June 1998) and others still to be received (on 9 June 1998) in order to finalise our DIP recommendations.*
- g) *A summary (annexure B) of the information requested is attached for approval of acceptances as requested in par 1.6."*

It was observed with respect to the submarine programme that only Fincantieri had fully complied with the critical criteria pertaining to the DIP. According to the value system, only Fincantieri should then have gone through to the second round of the DIP evaluation, as the only bidder that had fully complied with the critical criteria pertaining to the DIP evaluation.

6.4.7 Finance evaluation

6.4.7.1 Approval of value system

(a) The financing evaluation instruction (i.e. the value system) was compiled and issued by Mr C J Hoffman, General Manager: Finance and Administration Armscor on 19 May 1998.

(b) Mr Hoffman stated that there was no evidence that the value system was approved by a higher authority. Mr Hoffman was of the opinion that the submission of the value system to SOFCOM constituted approval. No minutes of SOFCOM suggesting approval of the said value system were found.

6.4.7.2 It was confirmed that there was no formal policy for the appointment of team members. The selection was made at the discretion of the team leader in view of the limited availability of the necessary expertise that was required.

6.4.7.3 Benchmarks for evaluation were contained in annexure B of the value system, which had a rating from 1 (good) to 5 (poor) for discriminating performance criteria categorised under four headings *viz*:

- (a) Cost of finance.
- (b) Cash flow.
- (c) Hidden costs.
- (d) Financial soundness.

No provision appeared to have been made for the moderation of actual results.

6.4.7.4 Each bidder was required to comply with the critical criteria, as discussed in chapter 4 of the report, in order to proceed to the next round of evaluation (i.e. the discriminating criteria).

6.4.7.5 The results of the financial evaluation as submitted to SOFCOM and contained in the finance evaluation report were summarised as follows:

OFFERS EVALUATED	PROGRAMME COST (US\$m)	PERIOD	FIN. COST %	NPV	IRR	NORM RATING	RAN-KING
Germany GSC 209 1400 MOD	995,9	17yrs	53%	523,0	6,4%	100	1
France DCN SCORPENE	1 210,2	19yrs	60%	615,0	7,0%	93	2
Italy Fincantieri S1600	1 173,1	18yrs	49%	632,4	7,6%	87	3
Sweden Kockums Type 192	1 280,8	17yrs	58%	676,6	8,6%	78	4

6.4.7.6 *Flaw in the value system*

- (a) In terms of the financing value system the original formula to determine the preferred bidder $v/z (T+IP)/F = \text{Best Value}$, provided that the bidder with the best financing proposal would receive the lowest score in view of financing forming the denominator in the above formula. This correlated with the scoring to be awarded in respect of each criteria being evaluated, whereby a rating ranging from "excellent" to "poor" represented by a score ranging from 1 to 5, respectively was applicable.
- (b) Consequently, an evaluator who failed to award a score for non-compliance would give a bidder a lower score and therefore a better rating, compared to an evaluator who rated a bidder as poor (5) for non-compliance.

- (c) It was established that evaluators who did not allocate a score were excluded from the final computation, as provided for in the value system instructions.
- (d) However, a flaw in the finance value system was noted in that, where an evaluator was excluded because he had failed to allocate a score in respect of any particular criteria, this would have an impact on the scoring because of the method of scoring specified. If the value system had compelled the allocation of a score (e.g. a rating requirement of 5 for poor or non-compliance), this risk would have been eliminated. A recomputation, on the basis that an evaluator had to at least allocate a rating of 5, as opposed to excluding that evaluator in calculating the final score, indicated that the results in respect of the financing evaluation would have been:

Bidder	Original score	Original Ranking	Revised score	Normalised Score	Revised Ranking
GSC	2,279	1	2,823	86.98	3
DCN	2,459	2	2,497	100.00	1
Fincantieri	2,621	3	2,663	93.37	2
Kockums	2,878	4	2,967	81.22	4

The recomputation indicates that DCN would have been placed first and Fincantieri second in the financing domain. GSC would have been placed third and not first as originally determined (refer paragraph 6.4.7.5).

6.4.8 Technical evaluation

- 6.4.8.1 The submarine technical value system was approved by Mr S Shaik (Chief of Acquisition), R Adm A N Howell (Director: Naval Acquisition) and V Adm R C Simpson-Anderson (Chief of the SA Navy). There does not appear to be a policy that prescribes the process to be followed for approval of technical value systems or the level of authority at which it should be approved.

In a written response to an inquiry in this regard, Mr S Shaik stated that: "*there is no clear position as to who must sign value systems*".

- 6.4.8.2 One of the assumptions of the value system was that the acquisition of replacement submarines for the SAN Daphne class would be of strategic importance, with the emphasis on long term sustainability rather than short term replacement.
- 6.4.8.3 The offerors were required essentially to respond to three aspects of the RFO, viz:
- (a) The RFO itself (referred to as the engineering management component), which carried a weight factor of 6,54 per cent.
 - (b) Integrated logistic support (ILS), which carried a weight factor of 67,51 per cent (in terms of a product evaluation component report prepared by the evaluation team, the short-listed submarines passed through the RFI phase in October 1997 and were all technically acceptable to the SA Navy on the basis of their stated product and the information provided at that time. The emphasis of the RFO therefore shifted to the logistic support offer to ensure that the availability of the submarine acquired would remain acceptable), and
 - (c) Product performance, which carried a weight factor of 25,95 per cent.
- 6.4.8.4 Insufficient clarity was given in the value system about the manner in which costs were to be used in calculating or consolidating the scores for the three criteria.

6.4.8.5 The military performance results of the individual components of the technical domain, as determined by the evaluation team, prior to the consideration of costs, were as follows:

Offeror	Product performance Evaluation	Logistic Evaluation	Engineering Management	Total Normalised
Fincantieri (S1600)	89,40	71,14	54,4	100,00
DCN (Scorpene)	84,80	57,70	45,90	85,67
Kockums (T192)	88,60	50,60	49,84	80,86
GSC (209 MOD)	87,10	48,95	71,25	80,60

The normalised scores reflected in the table above have been determined by multiplying each component score by its relevant weighting and normalising the total of the highest scoring bidder to 100 (i.e. highest combined score = 100). The weighted scores of the other bidders were then computed and normalised against the score of the highest scoring bidder.

The ranking of the results prior to the introduction of costs was therefore:

Bidder	Normalised score	Ranking
Fincantieri	100	1
DCN	85,67	2
Kockums	80,86	3
GSC	80,60	4

6.4.8.6 The total costs per bidder, as determined by the evaluation team were:

Cost categories	France US\$m	Germany US\$m	Italy US\$m	Sweden US\$m
Acquisition Cost of 4 submarines	916,70	816,00	897,72	1 047,60
ILS & In country support	113,74	36,00	111,18	47,00
Re-allocation of costs	0,00	27,00	0,00	23,00
Total ILS costs	113,74	63,00	111,18	70,00
VAT	145,74	119,92	141,41	154,22
Freight insurance & clearance	9,32	4,05	0,00	6,15
Excise duties	1,24	0,54	1,15	0,82
Risk Abatement	20,00	95,00	20,00	80,00
Project management	60,00	60,00	60,00	60,00
Re-allocation of costs	0,00	(27,00)	0,00	(23,00)
Other costs	236,30	252,51	222,56	278,19
TOTAL COST	1 266,74	1 131,51	1 231,46	1 395,79

6.4.8.7 The military performance index (MPI), which is the consolidated technical result, was then calculated by taking the three component scores and dividing these scores by their associated costs as reflected in the table above, in terms of the following formula:

$$\text{MPI} = \left\{ \frac{\text{Weight factor} \times \text{Product Score}}{\text{Cost}} \right\} + \left\{ \frac{\text{Weight factor} \times \text{Logistic Score}}{\text{Cost}} \right\} + \left\{ \frac{\text{Weight factor} \times \text{Eng. management}}{\text{Cost}} \right\}$$

6.4.8.8 The “cost” as indicated as the denominator under each element in the above formula was determined with reference to the figures as analysed in the table above, where the denominator for the technical product element of the formula was represented by the acquisition cost of four submarines (e.g. US\$916,70 million for France): the denominator for the logistic element of the formula was represented by total ILS costs and the denominator for the engineering management element of the formula was represented by the total of “other costs”.

6.4.8.9 The final results as determined by the evaluation team utilising the above formula are summarised in the table below:

Offeror	Product performance	ILS	Engineering Management	Military Performance
GSC	100,00	100,00	100,00	100,00
Kockums	79,23	92,37	65,25	90,93
Fincantieri	93,26	82,48	86,67	83,13
DCN	86,66	65,29	68,82	66,43

As can be seen from the table above, GSC was rated as the best in all three components after using the separate costs of US\$816 million, US\$63 million and US\$252,51 million as denominators for product performance, ILS and engineering management, respectively, in the MPI formula. Although GSC came fourth from an overall performance perspective, the lower costs offered by them in relation to the other bidders resulted in the GSC being the overall preferred supplier over all three components evaluated. Costs were therefore a

significant factor in the identification of the overall preferred supplier. It should be noted that the weight factor, representing the scale of importance of the ILS component, was 67,51%.

6.4.8.10 The costs for ILS, as offered by the GSC and reflected in the cost table above was US\$36 million. This was significantly less than the costs offered by Fincantieri (US\$111,18 million) and DCN (US\$113,74 million). In the submarine evaluation report, paragraph 20 relating to the GSC states *“The logistic support package is comprehensive but a large amount of deliverables are offered as options and were not costed into the proposal. The log risk is determined as low, but because many options were not costed additional funds should be allocated. As directed by the moderator of the submarine offers, an amount of 75% of the quoted logistic cost was added to the logistic cost for risk management”*. The decision to allocate an additional 75% of the quoted logistic cost of the GSC, which was significantly less than the logistic costs offered by Fincantieri and DCN, was arbitrary. This additional 75%, amounting to US\$27 million, resulted in a total ILS cost of US\$63 million for the GSC, compared to US\$111.18 million for Fincantieri and US\$113.74 million for DCN.

6.4.8.11 Therefore, because the denominator for the ILS element in the formula for GSC was much less than the other bidders, and because of the impact of the weight factor of 67,51% allocated to the ILS component, the result was that the GSC was effectively the preferred bidder in the overall technical evaluation on the basis of the value of US\$63 million.

6.5 APPROVAL PHASE

6.5.1 A SOFCOM work-session was held on 1 and 2 July 1998 when evaluation results of the technical, IP and financing domains were consolidated.

6.5.2 The final rankings, as consolidated at SOFCOM work-session, were presented to the AASB on 8 July 1998.

6.5.3 The consolidated results were then presented to the AAC on 12 July 1998.

6.5.4 At a special ministerial briefing held on 31 August 1998, the recommendations for the preferred bidders were supported and approved.

6.5.5 On 18 November 1998, the preferred bidders were approved by Cabinet.

6.6 NEGOTIATION PHASE

6.6.1 Following the acceptance of the recommendations on the preferred suppliers on 18 November 1998, Cabinet mandated the Departments of Defence, Finance, Public Enterprise and Trade and Industry to proceed with detailed negotiations with the preferred bidders with a view to achieving affordable agreements. To this end, IONT was constituted to negotiate with the preferred bidders.

6.6.2 The functioning of IONT was governed by a terms of reference issued on 25 January 1999, and approved during a Ministers Committee meeting held on 26 May 1999.

6.6.3 During a meeting of the Ministers' Committee held on 31 August 1999, the Chief Negotiator presented the recommendations of IONT with regard to the affordability of the defence packages.

6.6.4 On 15 September 1999, Cabinet approved the affordability recommendation by IONT.

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6.6.5 The cost for three submarines presented to Cabinet on 18 November 1998, was R5 212,50 million. This figure comprises the program cost which encompasses the tender price as well as other statutory and programme management costs.

6.6.6 On 15 September 1999, the costs presented to Cabinet by IONT for the three submarines, based on the affordability report issued on 31 August 1999, amounted to R5 354 million. This cost comprised:

	R million
Tender price	4 226
Statutory cost and project management	744
Financing preferred cash flow	97
ECA premium	287
Total	5 354

The difference between the abovementioned cost and the cost at 18 November 1998 is apparently due to the fact that in November 1998 costs did not take into account all the elements of costs as outlined in paragraph 2.1.1 of the affordability report.

6.6.7 On 1 December 1999 the Cabinet discussed a memorandum from IONT, Cabinet Memorandum no. 14 dated 25 November 1999. The purpose of the memorandum was to obtain Cabinet approval to contract formally with the preferred bidders. A schedule with two sets of costs was annexed to the memorandum, the first set of costs being those presented on 15 September 1999, which amounted to R5 354 million. The other set of costs amounted to R5 531 million at 24 November 1999. This increased cost was in respect of increased financing cash flows and the ECA premium. The actual contract value of the three submarines was equal to the tender value of R4 226 million included in the presentation on 15 September 1999. On 1 December 1999 Cabinet approved the contracting with the selected bidders.

6.7 CONTRACTING PHASE

6.7.1 A contract was signed on 3 December 1999 between the Government of the Republic of South Africa and the GSC for the acquisition of three HDW Class 209 Type 1400 MOD submarines.

6.7.2 The contract price for the submarines and the deliverables was Euro 660 300 000. Euro 628 832 516 of the contract price was payable in Euro and the balance of Euro 31 467 484 was payable in Rand at a fixed rate of R6.40 to the Euro. DoD had an option to purchase an additional submarine at a price of Euro 181 000 000.

6.7.3 The delivery periods for the submarines are:

6.7.3.1 First submarine and support equipment: five years after effective date of contract (EDC).

6.7.3.2 Second submarine: six years after EDC.

6.7.3.3 Third submarine: seven years after EDC.

6.7.4 A performance guarantee of 5% of the unit price was stipulated.

6.7.5 The total commitment in respect of DIP was Euro 175 200 423. Should the option to acquire one additional submarine be exercised, the additional DIP commitment would amount to Euro 38 074 942.

6.7.6 In terms of paragraph 3.2.2 all DIP contracts must be completed within 4 (four) years from the date of entering into such DIP contract(s) with a company, unless otherwise agreed to between the seller and Armscor.

- 6.7.7 In the event of the seller failing to comply with its obligation in respect of direct DIP activities under the DIP terms, Armscor shall be entitled to give notice in writing to the seller to make good the failure or default. Should the seller fail to comply with the notice within sixty (60) days from the date of receipt of the notice or any longer period that is specifically agreed to in writing by Armscor, Armscor shall be entitled to claim, in which event the seller shall be obliged to pay as per estimated and liquidated damages, an amount equal to the fixed percentage of 5% of the unfulfilled portion of its obligation in respect of indirect DIP activities as set out in the DIP terms. Once those damages have been paid, that unfulfilled portion of its obligation shall be deemed to have been fulfilled in full and shall no longer be owed. This shall be without prejudice to the seller's obligation to perform its obligations under the supply terms, failing which the above remedy shall be implemented.
- 6.7.8 In terms of the umbrella agreement, a combined performance guarantee initially covering an amount of Euro 66 300 000, being 10% (ten per cent) of the contract price, is offered as security for the full performance of the suppliers NIP and DIP commitments.
- 6.7.9 Armscor shall be entitled to claim, in which event the seller shall be obliged to pay, as pre-estimated and liquidated damages an amount equal to the fixed percentage of 5% (five per cent) of the unfulfilled portion of its obligation in respect of direct DIP activities, as those are set out in DIP terms, and 5% (five per cent) of the unfulfilled portion of its obligation in respect of indirect DIP. As the seller's DIP commitment is discharged, the portion of the guarantee which covers the unfulfilled portion of the seller's DIP commitment will be reduced accordingly, but the reduced portion of the guarantee will remain available as cover for the remaining unfulfilled portion of the NIP commitment.
- 6.7.10 The total NIP commitment contracted for is an aggregate of Euro 2 852 460 454 NIP credits, where one NIP credit has a value of 1 Euro.

The aggregate comprises:	EURO
Investments	960 300 000
Net export revenue	1 641 512 454
Local sales	250 648 000
TOTAL	2 852 460 454

6.7.11 The following table represents the milestones in terms of paragraph 14 of the NIP terms, for the Stainless Steel Flat Production Plant:

	Year 1 Euro (‘000)	Year2 Euro (‘000)	Year3 Euro (‘000)	Year4 Euro (‘000)	Year5 Euro (‘000)	Year6 Euro (‘000)	Year7 Euro (‘000)	Total Euro (‘000)
Investments	0	364 720	419 040	176 540	0	0	0	960 300
Local sales	0	0	0	0	64 210	87 690	98 750	250 650
Net export revenues	0	0	0	0	427 480	576 060	637 970	1 641 510
Total	0	364 720	419 040	176 540	491 690	663 750	736 720	2 852 460

The seller's overall performance in respect of the NIP project shall be measured against the milestone programme detailed in the table above. The milestone measurement shall be made at the second, fourth, sixth and seventh year from the effective date. *“Failure to meet the milestones as per clause 14.2 (above table) in respect of the NIP Project or any Substitute NIP Project at the end of the fourth and seventh years, respectively from the Effective Date will entitle the NIP Implementing Mechanism to trigger the remedies set out in the Umbrella Agreement. For the avoidance of doubt the NIP Implementing Mechanism agrees that it shall not be entitled to trigger the aforesaid remedies at any other milestone.”*

6.7.12 The umbrella agreement provided for a combined guarantee in relation to the seller's obligation in respect of DIP and NIP. This combined guarantee shall initially be for a sum equal to 10% of the contract price, which shall initially cover the unfulfilled portion of the seller's DIP commitment and the unfulfilled portion of the seller's NIP commitment proportionally to those commitments. As the seller's DIP commitment is discharged, a portion of this guarantee which covers the unfulfilled portion of the seller's DIP commitment will be reduced accordingly, but that reduced portion of the guarantee will remain available as cover for the then remaining unfulfilled portion of the seller's NIP commitment.

The combined guarantee will be maintained at its full amount until the seventh anniversary of the effective date. If during that period payments are made from that guarantee, the seller shall not be required to “top up” or reinstate that combined guarantee to its original amount.

6.8 FINDINGS

6.8.1 The investigation revealed the following types of quantifiable deviations and errors pertaining to the evaluation process, which had no effect on the selection of the preferred supplier:

6.8.1.1 Computation errors were identified in respect of both the NIP and DIP evaluation results.

6.8.1.2 NIP credit values were incorrectly awarded to GSC in respect of business proposals where the investments were not from foreign sources.

6.8.1.3 A flaw in the method of scoring in the finance value system was noted.

6.8.2 During the NIP evaluations, some projects offered by bidders were not evaluated and no reasons for excluding these projects were documented. However, projects proposed by certain bidders were evaluated although they did not qualify as projects according to the list of projects approved by DTI.

6.8.3 The RFO required that business proposals included in the final offers distinguish between export sales, local sales and the percentage of local content included in goods to be exported. Where this information was not provided, the evaluation team assumed that all sales proposed were in respect of exports and that the local content comprised 100% of such export sales, thereby potentially prejudicing those bidders who furnished the correct information called for in

this regard. The assumptions made by the evaluators were incorrect as, according to the final contract, export sales were less than 100%

- 6.8.4 A critical component of the NIP evaluation process was the determination of a strategic score ranging from 0 to 25. The value of credits attributed to each business proposal was multiplied by this score to arrive at the final score to determine the preferred bidder. There is no audit trail supporting the final determination of the scores awarded.
- 6.8.5 The DIP evaluation worksheets indicated that only Fincantieri complied with the minimum requirements in order to qualify for the next round of the DIP evaluation. A legal opinion from Armscor's legal division sought by the evaluation team confirmed that "*GSC had failed materially to meet the essential requirements of the DIP.*" The outcome of this legal opinion was not communicated to SOFCOM to enable its members to take it into consideration when making recommendations. Messrs Shaik and Esterhuyse gave approval that all the bidders who had failed to meet the minimum criteria be allowed to take corrective action in order to proceed to the next round of the DIP evaluation.
- 6.8.6 There is no evidence that the NIP and finance value systems, registered at Armscor prior to commencement of the evaluation, were approved.
- 6.8.7 Although the technical value system was approved by the Chief of Acquisition, the Director Naval Acquisition and the Chief of the SA Navy, there is no policy that prescribes the approval process and the level at which the technical value system should be approved.
- 6.8.8 There is no evidence to indicate that any individuals influenced the selection process.

6.9 RECOMMENDATIONS

- 6.9.1 Based on the findings highlighted in this chapter, it is recommended that sound procurement practices be implemented. This should include and ensure that:
- 6.9.1.1 The selection of evaluation team members is conducted in an open and transparent manner with due regard to the requisite skills and experience required.
 - 6.9.1.2 Adequate audit trails, with particular emphasis on the visibility of supervision, decision-making and assumption of responsibility at appropriate levels, are in place.
 - 6.9.1.3 Value systems are tested prior to approval, thereby avoiding the need for amendments during the evaluation process.
 - 6.9.1.4 Moderation of results should take place to ensure that computation errors and significant variances in scores awarded are addressed.

CHAPTER 7

SELECTION OF PRIME CONTRACTORS – CORVETTES

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CHAPTER 7

SELECTION OF PRIME CONTRACTORS – CORVETTES

7.1 THE PUBLIC PHASE OF THE INVESTIGATION

- 7.1.1 During the public phase of the investigation, the former Chief of the S A Navy, Vice Adm R C Simpson-Anderson testified that during the Second World War the Navy acquired over 80 vessels within a time span of 6 years. These were primitive vessels converted from commercial ships. After the war a number of warships were transferred to the SA Navy from the British Royal Navy, including destroyers and frigates.
- 7.1.2 In the 1960's the Navy acquired three new frigates and a second hand supply ship, followed by a survey vessel. In the 1970's three new submarines and nine high-speed strike craft were acquired. The destroyers and frigates of the Navy were phased out due to age and technical obsolescence and by mid 1980 none was left. In 1991 a frigate replacement project based on a staff target requirement approved in 1980 was cancelled before building commenced.
- 7.1.3 The Navy thus entered the 1990's with nine strike craft nearing the end of their design life of 15 years. Three submarines, over 20 years old, and support vessels and mine counter vessels were still in use. The Navy had lost its capability to operate effectively in our very rough sea conditions and also the capability to operate maritime helicopters at sea.
- 7.1.4 In 1993 the Naval Board (Chaired by the Chief of the Navy) decided to address the problem. The surface ship issue was first. Project Sitron was launched. Due to budget constraints certain requirements were cut and it was decided to opt for patrol Corvettes rather than frigates.

- 7.1.5 Project Sitron went through all the prescribed project phases and findings. Recommendations were presented to Cabinet in May 1995. Cabinet, was however, not ready to make a decision in this regard. The former Minister of Defence was, at the time, concerned about the issue of block obsolescence of the main equipment of all the arms of service. He thought of the idea of countertrade (off-sets or industrial participation). This, *inter alia*, led to the concept of a strategic defence package that would benefit the SANDF as a whole.
- 7.1.6 The force design of the Defence Review included four patrol Corvettes. During the time of the Defence Review the Navy refined the technical specifications for the Corvettes and submarines and invested in technology retention programmes for possible components and subsystems that could be included in the proposed new vessels.
- 7.1.7 Requests for Information were sent to the shipyards on the shortlist of project Sitron (Corvettes) after the principle of the acquisition of the Strategic Defence Packages was approved by Cabinet on 23 September 1997. Responses were to be made by 31 October 1997. The value system used was 100 points each for technical evaluation, NIP and DIP evaluation and financial evaluation. The Navy was involved in the technical evaluation system only.
- 7.1.8 The Acquisition Division of the Department of Defence was established in 1998 and projects were transferred to this division. The teams and project staff were transferred with the project to the Acquisition Division. The Project Control Board (PCB), with the Chief of Acquisition as Chairperson, was established. The Chief of the Navy and Chief Executive Officer of Armscor were senior members of this Board. The PCB controlled all projects and all high-level project decisions were forwarded to it. Issues affecting the technical baseline were first referred to the Naval Board for ratification before a final decision by the PCB could be taken.

7.2 THE FORENSIC INVESTIGATION BY THE AUDITOR-GENERAL

7.2.1 Background

7.2.1.1 In 1997 DoD in terms of the MoD policy entered into partnership proposals in respect of the procurement of armaments with the following three countries:

- United Kingdom
- France
- Germany

It is a requirement of the MoD policy that there must be a security agreement between the South African Government and the offering country. No evidence of the existence of such an agreement with Spain could be found.

7.2.1.2 On 23 September 1997, MoD distributed RFIs to eleven countries for the procurement of the SDP.

7.2.1.3 Thirty-seven responses were received from nine countries. The RFIs were evaluated subsequent to 31 October 1997 and a short-list of four bidders for the Corvettes was compiled. The short list of 4 bidders consisted of the German Frigate Consortium (GFC) of Germany, Bazan of Spain, GEC of the United Kingdom and DCN International of France. On 13 February 1998 RFOs were sent out to the short-listed bidders and their offers were submitted by the due date of 12 May 1998. An evaluation process was then performed in terms of which the four bidders were evaluated on the basis of:

- Military value and performance of the products.
- Financing of the products.
- Industrial participation offered.

7.2.1.4 The Corvette bidders were requested to bid only for the ship platform. The Combat Suite, which is the weaponry system of the Corvettes, was to be subcontracted to South African entities to the extent of 60% of its cost which had a ceiling amount of R1 471 billion. The preferred bidder was to enter into a teaming agreement with a local arms manufacturer for the purposes of supplying the Combat Suite.

7.2.1.5 The three evaluation criteria were to be consolidated in terms of the following formula:

$$BV = \frac{M + IP}{F}$$

M is the technical/military value index
IP is the industrial participation index, and
F is the financing index.
BV is the best value

This formula was subsequently changed to: $BV=M+IP+F$ at a SOFCOM meeting. The reasons furnished by DoD for changing the formula appear to be sound.

7.2.1.6 Based on the consolidated evaluation results, GFC's Meko A200 was selected as the preferred Corvette at a cost of R6 001,25 million and a contract was entered into with them on 3 December 1999.

7.3 EVALUATION PROCESS

7.3.1 Introduction

7.3.1.1 The bidders were evaluated in terms of the evaluation criteria mentioned in paragraph 7.2.1.5 above.

7.3.1.2 Value systems were compiled for each of the main criteria and the evaluation was to be performed strictly in accordance with the relevant value system.

During the forensic investigation of the process, the relevant value systems (the details of which are set out below) and the actual process followed in the evaluation, as set out in the evaluation reports and other relevant documentation, were considered.

7.3.2 Details of investigation performed in respect of the evaluation process

7.3.2.1 The following investigation procedures were performed with regard to the evaluation documentation and process:

- (a) The activities evaluated as *per* the available evaluation worksheets were compared to the activities stipulated in the value systems. No exceptions were noted in this regard.
- (b) The available worksheets were reviewed in order to ensure that the evaluators approved the worksheets. No exceptions were noted.
- (c) The mathematical accuracy of the scores allocated was re-evaluated to ensure correct application of the formula.
- (d) The values as indicated on the evaluation worksheets were compared to the values as per the bidders' offers, where applicable.
- (e) The summarised evaluation worksheets were reviewed to determine the correct incorporation of the correct values on the individual worksheets. No exceptions were found in this regard.
- (f) The percentages of DIP values given as against the contract, platform, and Combat Suite prices were re-evaluated to ensure that the scores given are in compliance with the percentages as stipulated in the DIP value system.

- (g) The final ranking and normalisation of the scores was re-performed to ensure the accuracy thereof. No exceptions were noted in this regard.
- (h) Consultations were held with certain individuals who were involved in the evaluation process.

7.3.3 Technical value system

7.3.3.1 Preparation & approval

- (a) The Project Officer: Capt J E G Kamerman [now Rear Admiral (JG)] compiled the technical value system for the Corvettes on 8 May 1998. The Chief of Naval Staff Plans: R Adm A N Howell signed it off on behalf of the responsible authority on the same date.
- (b) The Chief of the SA Navy: V Adm R C Simpson-Anderson approved the value system for issuing on 11 May 1998.

7.3.3.2 Description of the value system

- (a) The system is divided into the following two phases:
 - (i) Critical performance filter (CPF)

This phase sets out the critical minimum performance criteria as specified in the ship platform requirement specification. These minimum criteria must be complied with for eligibility for further evaluation.

(ii) Relative military performance evaluation (RMPE)

This phase is a measure of the relativity amongst the various offers that have satisfied the first phase. The phase is made up of 44 functional characteristics, which are grouped into 12 functional groups for the evaluation of the ship platform. Each characteristic has several evaluation criteria that are scored.

7.3.3.3 *Actual evaluation*

- (a) The evaluation was performed at DoD from 12 May 1998 to 29 May 1998 by the Naval Evaluation Team, led by Capt (SAN) J E G Kamerman, with R Adm (J G) A N Howell acting as co-ordinator and Mr Shaik as co-ordinator between the military, industrial participation and financing evaluation teams.
- (b) The technical evaluation results were presented to, and were ratified by, the Naval Board on 18 June 1998.
- (c) According to the evaluation report, a total of 15 clarification questions were sent to the bidders during the evaluation process. Care was taken to prevent any improvement or modifications being made to the offers received.

7.3.3.4 *Evaluation results*

- (a) The proposals were evaluated for military performance to obtain a weighted score out of a maximum of 1 080 points. The overall technical evaluation result was as follows:

Country/Offeror	Score out of 1080	Ranking
United Kingdom GEC F3000	649.9	4
Germany GFC MEKO 200	790	2
Germany GFC MEKO A200	810.5	1
France DCN PATROL CORVETTE	618.3	5
Spain BAZAN 590B	766.6	3

- (b) The calculation of the scores on the individual evaluation worksheets was re-performed and no major discrepancies were noted. As can be seen in the table above, GFC Meko A200 was ranked first.

7.3.3.5 *Non-conformance with critical minimum criteria*

- (a) According to the technical evaluation report issued on 25 June 1998, some bidders proposed ship platforms that did not conform to the critical minimum performance criteria, as stipulated in the value system. The platforms in question were:
- (i) The patrol Corvette of DCN failed the minimum ballistic protection requirement. This could apparently be corrected with a slight cost implication.
 - (ii) The F3000 of GEC failed the specified radar signature and the minimum ballistic protection requirement. The former could apparently be corrected with major cost and redesign implications whilst the latter could be corrected with a slight cost implication.

- (iii) The Meko A200 of GFC failed the specified engine compartment vulnerability separation requirement due to the CODAG-WARP design. The design apparently affords other compensating vulnerability advantages and did not need to be corrected.
- (iv) Despite these non-conformances, the above offers were nevertheless evaluated in the second round. No evidence of approval of such a decision could be found during the forensic investigation. Upon enquiries made to the co-chairperson of SOFCOM, Mr Shaik, regarding these non-conformances, indicated that he was not aware of these failures to conform. He referred the investigators to the technical evaluation team.
- (v) Only Bazan complied with all the minimum technical performance criteria.

7.3.4 Industrial Participation

The Industrial Participation requirement comprised two parts, namely Defence Industrial Participation (DIP), and National Industrial Participation (NIP).

7.3.5 Defence Industrial Participation value system

7.3.5.1 Preparation and approval

- (a) Mr J J van Dyk, Manager: Countertrade Division of Armscor, compiled the Defence Industrial Participation value system. It was accepted, endorsed and approved by Mr H de W Esterhuysen: General Manager: Aeronautics and Maritime of Armscor and Mr Shaik.

- (b) In terms of the evaluation instructions, Mr Van Dyk would be the DIP team leader and Mr Shaik would act as auditor and moderator for the DIP process. Three evaluation teams were to be appointed and these were to operate in parallel. Messrs Shaik and Hirsch of DTI were to discuss and agree on the respective evaluations done before they were summarised by Armscor Countertrade Division into a combined output.
- (c) Mr Van Dyk, would act as team leader, co-ordinator, and mentor for all three evaluation teams.
- (d) In order to progress to the second round of the evaluation, each bidder had to have:
- Signed the “confirmation by bidder” form.
 - Furnished a detailed business plan.
 - Provided an undertaking to provide a bank or sovereign guarantee to the value of 5% of their commitment.

7.3.5.2 Evaluation aspects and weights

- (a) Conformance and compliance

The Defence Industrial Participation requirements were valued in terms of the following components:

Component	Required %	Scoring
Value of commitment (DIP)	50%	Less than 45% = 1 Between 45% and 55% = 5 More than 55% = 10
Value of direct DIP	Corvette platform value = 10% Combat suite value = 60%	If full % or more is offered = 10 For 1% – 10% less than required = 7 For 11%-25% less than required = 3 For 25% or more less than required = 0
Total value of local participation (consists of activities as contained under par 8 of value system)	45%	Between 40% and 50% = 10 For 20% – 40% = 5 For less than 20% = 0
Total value of technology transfer	8%	Between 6% and 10% = 10 More than 10% or less than 6% = 0
Total value of global integration (Exports)	10%	Between 8% and 12% = 10 For 5%-7% less than required = 5 For 5% or more less = 0
Total value of empowerment	20%	Between 18% and 23% = 10, subject to provisos on par 7.1.7 of value system For 18% or less = 0
Total value of investments (Investments must at least be for 5 years)	12%	Between 10% - 14% = 10 i.e. >5yrs Between 10% - 8% = 5 i.e. >3<5 yrs Less than 8% = 0 i.e. <3 yr.
Total value of marketing/promotion	2.5%	Between 2% and 3% = 5 Any other percentage = 0
Contribution to job creation	None	None

7.3.5.3 DIP evaluation results

- (a) The DIP evaluation results regarding the activities offered by the bidders for the Corvette programme were as follows:

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	GEC Rm	DCN Rm	GFC Rm	BAZAN Rm
Total contract value	863 600 000	903 600 000	846 964 133	737 053 000
Total platform value	550 000 000	590 000 000	533 364 133	423 453 000
Total Combat Suite value	313 600 000	313 600 000	313 600 000	313 600 000
Total value of DIP @50%	967 000 000	377 450 000	255 962 000	676 000 000
Total value of direct DIP	440 000 000	247 950 000	249 464 000	269 400 000
Total value of platform element	42 000 000	59 950 000	61 464 000	81 400 000
Total value of Combat Suite	188 000 000	188 000 000	188 000 000	188 000 000
Total value of indirect activities	527 000 000	129 500 000	6 498 000	406 600 000
Local industry participation	230 000 000	311 950 000	249 464 000	365 000 000
Value of technology transfer	210 000 000	500 000	0	10 000 000
Value of globalisation	527 000 000	65 000 000	6 498 000	301 000 000
Job creation	10 093	5 026	3 413	8 880
Overall normalised ranking	92	96	81	100

7.3.5.4 The results of the forensic investigation

- (a) Several calculation errors were found in the scores allocated to certain bidders. The differences in the calculation are set out below:

	GEC	DCN	GFC	BAZAN
Conformance and compliance <i>Paragraph 12.2.5.1</i>	4.09	4.36	4.09	5.45
Sectoral development <i>Paragraph 12.2.5.2</i>	8.00	7.82	5.31	7.83
Average score	6.05	6.09	4.70	6.64
Normalised score per our calculation	91	92	71	100
Ranking per our calculation	3	2	4	14
Normalised score per evaluation <i>Table 5</i>	92	96	81	100
Ranking per evaluation	3	2	4	14
Change in normalised score	-1	-4	-10	0

Note: Paragraph references in table refers to annexure A and C of Dip value system.

- (b) As evident from the table above, no change occurred in the final ranking. In terms of the calculation performed during the forensic investigation, the normalised score decreased for DCN, GEC and GFC by 4, 1, and 10 points

respectively. This change did not have an effect on the final consolidated ranking where the three evaluation criteria were combined.

(c) Non-conformance to critical criteria

(i) GFC did not comply with the minimum criterion specified in the DIP value system of providing a bank or sovereign guarantee to the value of 5% of the DIP commitment. GFC should have been disqualified from proceeding to the next round of evaluation. The said guarantee, according to one evaluator, was submitted only on 6 June 1998 after GFC had been requested to do so by the co-chairpersons of SOFCOM. Despite this non-conformance, GFC proceeded to be evaluated in the next round after SOFCOM's chairpersons approved a request by Mr Van Dyk to allow GFC to comply with this requirement.

(ii) This was clearly a deviation from the value system instructions. Had it not been for this late submission of the guarantee, GFC would not have proceeded to the second round of evaluation and would therefore not have won the bid for the Corvettes. According to DoD, the decision to allow GFC to submit the guarantee after the tender submission date, was taken in terms of the tender rules and RFO documents. The specific paragraphs referred to by DoD in the RFO are the following:

"2.1.3 The buyer reserves the right to deviate from the prescribed rules applicable to prospective contractors (K-STD-0010) in any case where such deviation is deemed justified.

"2.10.1 Offerors may submit an alternative offer not strictly in accordance with the requirements, or an alternative offer to satisfy a requirement, provided that all information requested in the RFO is

furnished by the closing date. The alternative offers and deviations from the requirements must be indicated in the offer”.

- (iii) Upon noting non-compliance by GFC with the minimum DIP criteria, Mr Van Dyk sought legal opinion from Armscor’s legal division on 14 May 1998.
- (iv) On 22 May 1998, the legal division issued its opinion, confirming the non-conformances by, *inter alia*, GFC.

On 1 June 1998 Mr Van Dyk issued a memorandum to the chairpersons of SOFCOM requesting, *inter alia*, that they approve the procurement of additional information from the non-complying bidders in order for them to comply. This memorandum was issued notwithstanding the fact that the legal opinion had already confirmed the deviations and that the evaluation team held the opinion that the non-complying bidders should be disqualified.

Upon enquiry, Mr Van Dyk asserted that no consideration was in fact given to the legal opinion.

Also worth noting from the memorandum is the fact that additional information from the non-complying bidders had already been requested at the time the memorandum was issued. Such additional information was new and this amounted to a deviation from the DIP requirements as stated in paragraph 4.7.1 of the DIP evaluation instruction.

There is no evidence from the minutes of SOFCOM that the memorandum directed to SOFCOM chairpersons had, at any stage, been submitted to the entire committee. In the absence of such

evidence, it would appear that the chairpersons took a decision to condone the mentioned non-compliance without the approval of the committee. This decision had a far-reaching impact on the eventual selection of the preferred bidder for the Corvettes, which was GFC. Upon enquiry about this decision, Mr Shaik indicated that this decision was taken by them in their capacities as Chief of Acquisition of DoD and CEO of Armscor. His authority, according to him, vested in his management delegation from DoD.

(d) Deviation from value system

Mr Van Dyk, as Head of Armscor Countertrade, was overall supervisor of the three DIP evaluation teams, chairman of one team, and an evaluator. This led to his performing incompatible functions. DIP values offered by GEC were reduced for evaluation purposes from those offered in the offers. Although reasons were given for such reductions, the DIP value system provided for the evaluation of business plans at face value and this was therefore a deviation from the value system requirement. SOFCOM chairpersons approved the reduction.

DIP and NIP proposals were to be consolidated at 50% each in terms of the minutes of CoD meeting held on 9 February 1998. This was also held to be the case in the legal opinion given by the Armscor Legal Division. The presentation by Mr Van Dyk to the AAC on 13 July 1998 also indicated the same split. However, this was not complied with upon the consolidation of the NIP and DIP to determine the total industrial participation. Instead, the two criteria were simply added together and the average was used to determine the scores for the preferred bidder.

In terms of the minutes of a special AAC meeting held on 13 July 1998 it was stated that the ranking of the Spanish bidder was due to most of their

industrial participation not being of a strategic nature. The DIP value system required that the assessment of all business plans be carried out on the face value of the proposals contained therein.

A portion of the direct DIP to be offered by the bidders was based on the value of the Combat Suite, in terms of which 60% of the value of the Combat Suite was to be offered as a minimum. It was noted that the evaluators used a standard contract value of US\$313 600 000 for all the bidders, resulting in the direct DIP portion of US\$188 000 000 for all bidders. However, this had no effect on the final results. Though the DIP evaluation instruction was clear on this requirement, DoD is of the view that this *"appeared to be an interpretation issue between two sets of documents in the offers"*.

(e) GEC

In terms of the offer by GEC, an amount of US\$670 million was offered for the technology transfer and know-how. It appears, however, that the DIP evaluation team did not approve of this amount, whereupon an amount of US\$210 million was used, being 25% of the contract price offered by GEC. This, according to Mr Van Dyk's memo, is the logistics provision normally applicable to projects of this nature. Upon request, SOFCOM chairpersons approved the use of the adjusted amount by Mr Van Dyk. This was not confirmed with the bidders.

A comment by one evaluator on GEC was that *"GEC's proposal is fraught with anomalies, qualifying and contradictory statements. Even their commitment is suspect..."*. In terms of paragraph 1.4 of the value system, assessment of all business plans was to be carried out on the face value of the proposals contained therein.

It was noted from the evaluator's comments that GEC did not provide a business plan on the Combat Suite as required in terms of the critical criteria of the value system. They should therefore have been disqualified, but were nevertheless evaluated in the second round. Though the DIP evaluation instruction was clear on this requirement DoD is of the view that this "appeared to be an interpretation issue between two sets of documents in the offers".

(f) DCN

Five activities were apparently offered by DCN under both the Corvettes and the submarine programmes. In terms of the DIP value system duplicated activities had to be ignored completely for the other programme. However, Mr Shaik, apparently, directed on 24 June 1998 that the specific activities should be included at 50% in both the programmes. The total values of the activities were US\$105 000 000, US\$54 000 000, US\$55 000 000, US\$20 000 000 and US\$25 000 000.

(g) GFC

According to the comments given by one evaluator and a letter sent by Mr Van Dyk to SOFCOM chairpersons, GFC and GEC failed to provide the 60% direct DIP required on the Combat Suite. They were, however, allocated the same direct DIP value as the other bidders, which was based on Bazan's direct DIP value. No business plan was initially submitted by GFC on the 60% direct DIP. This was only done on 6 June 1998, after GFC was requested to do so by the evaluation team following the approval of SOFCOM chairpersons on 20 May 1998. There is no evidence in SOFCOM minutes of the same date that the committee approved such a decision. This point was recorded in the deviation report prepared by Mr Van Dyk to SOFCOM.

GFC was given a score of 5 instead of 1 on the total DIP offered in terms of paragraph 7.1.2 of the conformance and compliance summary schedule. The reason given for this is that GFC was given this standard credit because of an increased NIP commitment. It was the understanding of the investigation team that NIP and DIP were to be evaluated separately.

(h) Bazan

According to one evaluator, Bazan did not provide a business plan for a particular activity although they committed themselves in this respect. In terms of the value system, Bazan should not have gone through to the second round of evaluation.

The decision to allow the bidders who did not conform with the critical minimum criteria in respect of technical, financing and DIP evaluations was a deviation from the approved value systems. Had this decision not been taken, only Bazan could have been evaluated on two of the three domains. All the others did not comply with all three and Bazan did not comply with one. This could have resulted in Bazan being the preferred bidder.

The DIP and NIP value systems did not explicitly provide for the manner of calculation of the scores. Certain formulae were used in the calculation of DIP scores but these could not be found to have been specified in any approved document.

(i) Further observations with regard to the selection process are that:

- Bazan was the only bidder that complied with all the critical minimum criteria in respect of technical and DIP evaluation.

- Bazan obtained the highest military value and DIP scores.
- Bazan provided the highest percentage of DIP and NIP in relation to the contract price.
- Bazan offered the lowest price of the four bidders.

GFC, however, was nominated the preferred bidder on the basis of their NIP offer. This is despite the fact that NIP is not ascertainable in terms of achievability.

7.3.6 National Industrial Participation Value System

7.3.6.1 Introduction

- (a) No approved NIP value system could be found during the forensic investigation. It could, therefore, not be established whether an approved NIP value system was in place for the purposes of evaluating the bids. What was found was an individual schedule titled “economic value system”.
- (b) A statement given by Mr A Hirsch, a former Chief Director at the DTI, revealed the following:
 - Mr A Hirsch and Mr V Ponsammy, also from the DTI, drafted the value system used. This was the first value system they had ever drafted as the NIP projects had never before been used to select preferred bidders.

- Mr C Nakooda, under the supervision of Mr Ponsammy, performed the actual evaluation of all the NIP proposals.

7.3.6.2 The NIP evaluation results for the bidders were as follows:

Country/Offerer	Value	Score	Ranking
United Kingdom GEC MARINE	5 892 344	11	4
Germany GFC	52 423 525	100	1
France DCN International	27 519 751	52	2
Spain Bazan	25 030 877	48	3

7.3.6.3 *Results of the forensic investigation*

As indicated above, no approved value system could be found.

(a) There is no evidence regarding the manner of awarding the NIP quality multipliers of 1 to 25, as these were not linked to any documented benchmarks.

(b) Combined IP evaluation (DIP and NIP):

	GFC Rm	BAZAN Rm	DCN Rm	GEC Rm
Contract	846 964 000	73 7053 000	903 600 000	863 600 000
DIP Value	255 962 000	676 000 000	377 450 000	967 000 000
NIP Value	2 730 783 000	2 722 645 000	1 684 037 000	413 936 000
% DIP	30	91.7	41.8	112
% NIP	322.4	369.4	186.37	49.48
NIP Ranking	100	48	52	11
DIP	81	100	96	92
Average	90.5	74	74	51.5
Final IP ranking	100	82	82	57

(c) There was a lack of a clear statement as to the manner of calculating the scores with regard to the NIP and DIP value systems. In the absence of

this, it could not be ascertained if the scoring complied with the prescribed value system.

7.3.7 Financial evaluation

7.3.7.1 Financing value system

(a) Preparation

The value system was compiled and issued by Mr C J Hoffman: General Manager: Finance and Administration of Armscor. It is not evident who had approved the value system.

(b) Evaluation aspects and weights

According to the value system, each bidder had to comply with the critical criteria, as has been described in chapter 4 of this report, to proceed to the next round of evaluation.

(c) During this investigation it was found that some of the criteria of the financing value system were not evaluated even though these were included in the evaluation worksheets.

7.3.7.2 Overall financing evaluation

Set out below is the ranking of the bidders based on the finance value system:

OFFEROR	SCORE	RATING	RANKING
United Kingdom GEC F3000	2.2071	100	1
Germany GFC MEKO 200	2.786	79	4
France	2.786	79	4

OFFEROR	SCORE	RATING	RANKING
GFC MEKO A200			
France DCN Patron Corvette	2.497	90	2
Spain BAZAN 590B	2.659	84	3

7.3.7.3 Results of the forensic investigation

- (a) In terms of the financing evaluation report and the evaluation worksheets, none of the bidders complied with the minimum criteria set out in the financing value system.

These non-conformances were apparently reported to SOFCOM on 3 June 1998, whereupon SOFCOM indicated that the evaluation team should continue evaluating as many of the proposals as possible with an indication of their non-conformances.

- (b) GFC Meko 200 SAN: adjustments

- The cash flow calculated as per proposal amounted to US\$907,705 million. This was adjusted to US\$871 million on the evaluation worksheet.
- The calculated NPV of US\$437,241 million was adjusted to US\$419,6 million on the evaluation worksheet.
- The contract value was adjusted to US\$640,3 million from the US\$667,287 million proposed by GFC.
- According to a member of the financing evaluation team, Mrs B Potgieter, these adjusted contract prices were given to the team by the technical evaluation team.

- The adjusted contract prices automatically resulted in adjusted cash flows and NPV. The proposal amounts referred to above have been confirmed with Mrs B. Potgieter. The adjustments did not have an effect on the evaluation results.
- (c) GFC Meko A200 SAN: Adjustments
- The cash flow as calculated from the proposal was reduced from US\$922,713 million to US\$885,5 million.
 - The NPV was also reduced from US\$444,469 million as calculated from the proposal to US\$426 million.
 - The contract amount proposed amounted to US\$678,329 million but the evaluation worksheet indicates US\$651 million. The adjustments did not have an effect on the evaluation results.
- (d) In respect of the DCN evaluation of section 1(a) of the finance evaluation worksheet, one evaluator gave a score of 2.4 but this was indicated as 2.2 on the summarised evaluation sheet. This had no effect on the overall ranking of the bidders.
- (e) The IBCA rating, i.e. section 4.2(c) of the evaluation sheet, was not evaluated even though this was included in the evaluation sheet. This had no effect on the results as it was left out in respect of all the bidders.
- (f) Apparently section 2(a) of the evaluation worksheet could not be evaluated, since no available funds figure was provided. However, four of the five evaluators evaluated this criterion. This could have influenced the ultimate evaluation of the bidders. Whether this was material could not

be ascertained, as the scores that might have been allocated by the other evaluator could not be determined.

- (g) No provision was made for the rating in instances where the information had not been provided. In such cases nothing was scored and the result was that the bidder who provided no information had the lowest score, which placed that bidder in a more favourable position than those who had furnished the information. In terms of the finance value system, the bidder with the lowest score was ranked first.
- (h) A decision was taken during SOFCOM meeting on 3 June 1998 that all bids will be evaluated even though these did not conform to the minimum critical criteria as stipulated in the value system. As non of the bidders complied, this decision did not favour or prejudice any specific bidder with regard to the financing evaluation.
- (i) No review of the evaluation results was performed, as was confirmed by one of the evaluators, Mrs B Potgieter.
- (j) The overall evaluation formula that was used was identical to the one relevant to the ALFA as described in paragraph 4.3.7.2 above

7.4 APPROVAL PHASE

7.4.1 Detailed investigation procedures performed

7.4.1.1 The minutes of the various committees involved with the approval of the evaluation results were perused in order to ascertain whether proper procedures were followed in approving the value systems.

7.4.1.2 Interviews with various role players were conducted.

7.4.2 SOFCOM consolidation of evaluation results

The evaluation results from the evaluation teams were consolidated by SOFCOM. The ranked bidders were recommended by SOFCOM and this final ranking was presented to the AASB on 8 July 1998. On 13 July 1998 the consolidated results were presented to the AAC. The names of the preferred bidders were then sent through to the Ministers' Committee in July 1998.

7.4.3 Ministers' Committee

7.4.3.1 As stated above, SOFCOM forwarded the details of the preferred bidders to the Ministerial Subcommittee, subsequent to their being presented to the AAC.

7.4.3.2 A ministerial briefing by the co-chair of SOFCOM, Mr Shaik, was conducted on 31 August 1998, when the preferred bidders were recommended for final consideration.

7.4.3.3 On 18 November 1998 the preferred bidders were recommended by SOFCOM and were approved by Cabinet.

7.4.3.4 The preferred bidder for the Corvettes was GFC.

7.5 NEGOTIATION PHASE

7.5.1 Investigation procedures performed

The general procedures as described in chapter 3 were performed.

7.5.2 The International Offers Negotiating Team (IONT)

- 7.5.2.1 Subsequent to the approval of the preferred bidders, IONT was mandated to negotiate better contract terms with the selected bidders.
- 7.5.2.2 The terms of reference of IONT were issued on 25 January 1999.
- 7.5.2.3 Other consultants, legal and financial, were appointed to assist IONT in the negotiation process.
- 7.5.2.4 On 27 August 1999 the affordability recommendation, in the form of the affordability report, was made to the Ministers' Committee by IONT.
- 7.5.2.5 On 15 September 1999 Cabinet approved the affordability recommendation by IONT.
- 7.5.2.6 On 1 December 1999 Cabinet approved contracting with the selected bidders as per memorandum 14/99.

7.5.3 Comparison of costs presented to Cabinet and costs contracted for

- 7.5.3.1 The amount for the Corvettes presented to Cabinet on 18 November 1998 was R6 001 million.
- 7.5.3.2 On 15 September 1999 the costs presented to Cabinet by IONT for the Corvettes, based on the affordability report issued on 31 August 1999, amounted to R6 917 million. These costs were inclusive of the statutory and project management costs. The difference between these costs and the costs presented on 18 November 1998 is apparently due to the fact that in November 1998 the costs projection did not take into account all the elements of costs as outlined in paragraph 2.1.1 of the affordability report.

7.5.3.3 On 1 December 1999 Cabinet discussed a memorandum from IONT: Cabinet Memorandum No 14 dated 25 November 1999. The purpose of the memorandum was to obtain Cabinet approval to contract formally with the preferred bidders. A schedule with two sets of costs was annexed to the memorandum; the first set of costs being those presented on 15 September 1999, which amounted to R6 917 million.

7.5.3.4 The other set of costs amounted to R6 873 million as on 24 November 1999. The reduction was mainly due, but not limited to, the reduction of the tender price from R5 469 million to R5 412 million due to negotiated cost reductions.

7.6 CONTRACTING PHASE

7.6.1 Investigation procedures performed

The relevant agreements were perused and consultations were held with the officials involved in the procurement process.

7.6.2 Findings on the contracting phase

7.6.2.1 On 3 December 1999 DoD signed the contracts with the selected bidder, GFC, for the acquisition of four Type MEKO A200 SAN Corvettes. The deliverables included:

- Four Corvette platforms.
- Four Corvette Combat Suites.
- Integrated logistic support (ILS).
- Integrated test bed (ITB).
- Combat team trainer (CTT).
- Integrated platform management system simulator (IPMS).

- Programme management documentation and any other documentation as specified.

7.6.2.2 The contract price amounted to Euro 611 842 759 + R1 496 227 105. The Euro amount is for the foreign cost component and the Rand amount for the local cost component.

7.6.2.3 The delivery of the Corvettes was agreed to as follows:

- The first platform was scheduled for delivery 32 months after the effective date.
- The second platform was scheduled for delivery 37 months after the effective date.
- The third platform was scheduled for delivery 43 months after the effective date.
- The fourth platform was scheduled for delivery 48 months after effective date, with the effective date being the effective contract date, 3 December 1999.

7.6.2.4 Performance guarantees had to be furnished by the seller and these amounted to:

- 5% of 25% of the contract price for each platform.
- 5% of the unit price for each Combat Suite.
- 5% of the unit price in respect of each part C subcontract.

7.7 FINDINGS

- 7.7.1 With the exception of Bazan, all the bidders involved in the Corvette procurement programme failed to comply with the minimum evaluation criteria in respect of financing, technical requirements and Defence Industrial Participation. Bazan failed only in terms of the financing evaluation criteria.
- 7.7.2 The decision to allow bidders to supply information after the offers had been submitted constituted a deviation from proper procurement practice.
- 7.7.3 The amounts offered by the bidders, as per the RFIs/RFOs were, in some instances, changed by the evaluators during the evaluation process. However, this did not have an effect on the outcome of the rankings.
- 7.7.4 The DIP and NIP value systems did not provide the formulae for the calculation of the scores. Certain formulae were used in the calculation of DIP scores, but these could not be found to have been specified in any approved document.
- 7.7.5 No evidence regarding the manner for awarding the NIP quality multipliers could be found as these were not linked to any documented benchmarks.
- 7.7.6 No evidence of the required approval of the financing value system, other than the signature of the compiler thereof, was found.

7.8 RECOMMENDATIONS

- 7.8.1 Once evaluation criteria and instructions have been compiled, compliance with these should be enforced, even if it means that the process must re-commence from RFO stage. This will ensure a fair, competitive and open procurement process.

7.8.2 Sufficient time should be allowed to perform the evaluation on large procurements, such as the SDP.

CHAPTER 8

THE INTERNATIONAL OFFERS NEGOTIATING TEAM (IONT)

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CHAPTER 8

THE INTERNATIONAL OFFERS NEGOTIATING TEAM (IONT)

This chapter deals with the evidence obtained during the public and forensic phases of the joint investigation. To avoid duplication, the evidence is referred to without specific reference about when and by which investigation agency it was obtained, unless it is deemed appropriate to do so.

8.1 BACKGROUND

During November 1998, Cabinet resolved that the recommendations on preferred suppliers as presented to it by the Minister of Defence, be accepted. Cabinet mandated the Departments of Defence, Finance, Public Enterprises and Trade and Industry to proceed with detailed negotiations with the preferred bidders with a view to achieving affordable agreements. To this end, IONT was constituted to negotiate with the preferred bidders.

8.2 SCOPE OF THE INVESTIGATION

8.2.1 The scope of the investigation was to conduct a high-level overview and to determine:

8.2.1.1 The prescribed procedures to be followed by IONT and the extent to which they were.

8.2.1.2 Whether the negotiating process conducted by IONT was documented.

8.2.1.3 The impact of IONT on the procurement process by comparing final contracts concluded with the original offers made.

8.3 PROCEDURES PERFORMED

8.3.1 The general forensic investigation procedures, as detailed in chapter 2 of this report, were performed in order to comply with the abovementioned mandate. In addition, the evidence in this regard of the Chief Negotiator - Mr Naidoo, and the Minister of Trade and Industry - Mr A Erwin, was presented during the public phase of the investigation.

8.3.2 The documentation perused included, inter alia, the following:

- Minutes of the meetings held by IONT.
- Minutes of the meetings held by the Ministers' Committee.
- The report submitted by the Affordability Team of IONT.
- Minutes of Cabinet meetings.
- The terms of reference of IONT.
- Reports by IONT to the Ministers' Committee.
- The Special Review of the SDP by the Auditor-General.

8.4 THE ESTABLISHMENT OF IONT

8.4.1 On 18 November 1998, Cabinet mandated the four departments involved in the SDP procurement to proceed with further detailed negotiations with the preferred bidders with a view to achieving affordable agreements.

8.4.2 On 23 and 24 November 1998, a work session was held where the terms of reference for IONT were drafted. It was decided that IONT would be headed by the Chief Negotiator, Mr J Naidoo. These terms of reference were to be followed by IONT during the negotiations with the preferred bidders.

8.5 THE STRUCTURE OF IONT

8.5.1 IONT was headed by the Chief Negotiator and its members were:

8.5.1.1 Mr S Shaik, Chief of Acquisitions of the DoD, who, in conjunction with Mr L Swan, CEO of Armscor, attended to the technical and DIP aspects of the negotiation. With regard to DIP, they were assisted by Mr J J van Dyk, Senior Manager: Counter Trade of Armscor.

8.5.1.2 Mr V Pillay of the Department of Trade and Industry, who attended to the NIP domain.

8.5.1.3 Mr R White of the Department of Finance, who attended to the financing aspects.

8.5.2 The terms of reference provided for the briefing of legal and financial experts to assist IONT. IONT procured the assistance of an international group of lawyers, White and Case, to advise and assist with the consolidation of the individual contracts into an umbrella agreement.

8.5.3 Warburg Dillion Read was appointed as financial advisors to IONT and assisted with the financing aspects.

8.5.4 The diagram below reflects the structure and composition of IONT as presented during the public phase of the investigation.



8.6 THE APPOINTMENT OF THE CHIEF NEGOTIATOR

- 8.6.1 The Minister of Trade and Industry and Mr Naidoo stated during the public phase of the investigation that Mr Erwin had approached Mr Naidoo, to request him to consider accepting the role of Chief Negotiator representing the Office of the Deputy President during the Defence Packages negotiations.
- 8.6.2 The Chief Negotiator was appointed during a work session of IONT, held on 23 and 24 November 1998.
- 8.6.3 According to the minutes of the work session, it was decided that the DoD was liable for the costs pertaining to the fees of the Chief Negotiator and other operational costs associated with his activities. As a result, the Armscor tender

procedures had to be followed with regard to the appointment of the Chief Negotiator, as Armscor normally procures on behalf of DoD. The Armscor tender procedures as prescribed in policy document STD 20 were not followed.

8.7 THE TERMS OF REFERENCE OF IONT (ToR)

8.7.1 During the work session of IONT on 23 and 24 November 1998, a draft negotiation plan was agreed. This draft negotiation plan, referred to as the terms of reference, was submitted to the Ministers of the Departments involved for their inputs before a final plan was submitted to higher authority, that being the Ministers' Committee.

8.7.2 The final terms of reference of IONT were approved during a meeting of the Ministers' Committee on 26 May 1999. It was noted that the Deputy President and the Minister of Public Enterprises did not sign the recommended terms of reference. The Ministers of Defence, Finance, and Trade and Industry signed the terms of reference.

8.7.3 The mandate of the negotiating team was to negotiate an achievable funding arrangement and an affordable package with the preferred supplier. It was to result in a final contract for the offered equipment to the SANDF.

8.7.4 The negotiating team was to negotiate and conclude an affordable set of contracts, which would satisfactorily combine the technical, industrial participation and financial imperatives.

8.7.5 The initial processes outlined in the ToR were:

- (a) The negotiating team was to define the character and schedule of the negotiating process.

- (b) Additional consulting and technical capacity was to be identified and appointed.
- (c) The team leaders of the negotiating work groups were to produce a schedule of tasks and responsibilities for each of the four domains.
- (d) Initial discussions between the preferred supplier and the negotiating workgroups regarding the negotiating process would then commence.
- (e) Technical preparatory work by the negotiating workgroups and the negotiating team would then be undertaken.
- (f) Local industry involvement in the definition of the DIP and NIP as well as the equipment programmes were to be progressed under the guidance of the negotiating team.
- (g) Commencement with the negotiations.

8.7.6 In accordance with the terms of reference, the Chief Negotiator reported directly to the Deputy President and to the Ministers' Committee.

8.7.7 The Chief Negotiator was often accompanied by Mr Shaik when reporting to the Ministers' Committee. The reports were in the form of presentations to the committee. These reports dealt with the four domains developed per equipment type.

8.8 REPORTS SUBMITTED BY IONT TO THE MINISTERS' COMMITTEE

8.8.1 Meeting of the Ministers' Committee held on 20 January 1999

8.8.1.1 During this meeting, IONT made a presentation and informed the committee that initial discussions with project teams indicated a possible increase in the overall procurement costs presented to Cabinet on 18 November 1998.

8.8.1.2 These increases in costs were directly related to the technical performance of the equipment and the programme management costs associated with equipment acceptance. DoD then undertook to ensure that all the technical performance-related costs would be accommodated within the programme costs as approved by Cabinet on 18 November 1998. However, DoD proposed that all the programme management costs should be addressed outside the approved SDP procurement costs.

8.8.1.3 It was recommended by the committee that all NIP, DIP, technical and financing discussions should proceed concurrently by the negotiating team members and that the Ministers' Committee should be briefed timeously to give guidance and direction.

8.8.1.4 The Ministers' Committee had to be consulted and briefed at all the major milestones of the negotiating process. This would include issues relating to the affordability and the structuring of the SDP. Final contracts would only be concluded with the respective bidders after approval had been obtained from the Ministers' Committee.

8.8.2 Meeting of the Ministers' Committee held on 26 May 1999

8.8.2.1 The Chief Negotiator presented a status report during this meeting. This report included the reports on all the domains except finance.

- 8.8.2.2 It was explained to the chairperson that the finance report was still being considered by the Department of Finance and that it would be available to the negotiating team shortly.
- 8.8.2.3 The Chief Negotiator informed the meeting of the progress on all the packages and the target dates for each package.
- 8.8.2.4 He recommended to the Ministers that the decision to defer the requirements for the ALFA should be re-considered. The Ministers decided to defer the Gripen decision and to allow the negotiating team to try to conclude a single contract with BAe for Hawks and Gripens.
- 8.8.2.5 The Chief Negotiator also recommended that, in view of the fact that the Minister of Defence would be leaving public office, the Minister be allowed to initial the submarine contract at a press conference. This was to mark his role as the initiator of the defence packages.
- 8.8.2.6 Only Mr Naidoo and Mr Shaik (secretary of the meeting) signed the minutes of the meeting.
- 8.8.3 Meeting of the Ministers' Committee held on 31 August 1999**
- 8.8.3.1 The Chief Negotiator presented the recommendations of IONT with regard to the affordability of the Defence Packages.
- 8.8.3.2 He highlighted key issues for further consideration by the Ministers. The re-introduction of the Gripen aircraft as a tranching option was discussed and its implications for the SAAF fighter capability were noted. IONT proposed three tranches for both Hawks and Gripens. He stated that the decision to separate tranches 2 and 3 from the initial approval of the "core" requirement was largely due to the unpredictability of the exchange rate and growth rate over a 10 to

15 year period. The approach also allows government to re-address the issue of the affordability of the total fighter aircraft requirement at a later stage if economic conditions deteriorate.

- 8.8.3.3 Three cost scenarios were used to do the affordability modelling, with each scenario having its own risk factors and multipliers.
- 8.8.3.4 Mr Naidoo advised the committee of the possible risk associated with the communication of the government's intent to acquire military equipment above the R16,5 billion expenditure level and the timing of such an announcement.
- 8.8.3.5 The Ministers' Committee recommended that the R21,6 billion scenario should be selected as the baseline figure and that the negotiating team should explore further minor reductions to the R21,6 billion option. It also recommended communicating to the international markets the full package requirement of all three tranches at a total cost of R29,9 billion with the option to cancel/acquire tranche 2 in 2003 and to cancel/acquire tranche 3 in 2005.
- 8.8.3.6 The legal position with regard to "option to acquire" vs. "option to cancel" had to be cleared with the Minister of Finance before the next Cabinet meeting on 15 September 1999.
- 8.8.3.7 It was further recommended that the SDP proposals be submitted to Cabinet on 15 September 1999.
- 8.8.3.8 The minutes of the meeting were signed by all the Ministers of the Departments involved.

8.9 THE APPOINTMENT OF EXPERT ADVISORS

8.9.1 The appointment of financial advisors

8.9.1.1 The Department of Finance approached seven institutions to submit bids for the provision of financial advisory services to IONT. A selection committee was appointed consisting of Messrs R White, A Donaldson and K Kruger.

8.9.1.2 The task of the selection committee was to rank all bidders, with the bidders scoring highest being the preferred bidder. After this exercise the committee submitted their recommended bidder to Armscor for the conclusion of a contract. The recommended bidder was Warburg Dillion Read.

8.9.1.3 A contract was entered into between Armscor and Warburg Dillion Read to provide financial advice to the Department of Finance. Therefore, prescribed Armscor tender procedures should have been followed.

8.9.1.4 Although Armscor tender procedures were not followed, the process adopted by DoF for the appointment of the financial advisors appears reasonable.

8.9.2 The appointment of legal advisors

8.9.2.1 According to the terms of reference of IONT, they needed experts to assist them in legal matters.

8.9.2.2 Armscor was the acquisition agency of the DoD. Funds for the provision of IONT personnel requirements were made available from the Special Defence Account. Armscor was obliged to follow its tender procedures when briefing legal advisors for IONT.

8.9.2.3 Armscor sent ten (10) proposals to law firms/legal advisors. Five legal firms submitted proposals, and the other five did not respond.

8.9.2.4 White and Case, one of the firms that were requested to submit proposals, was appointed.

8.9.2.5 Although the Armscor tender procedures, as prescribed in policy document STD 20 were not adhered to, the process followed appears reasonable.

8.10 THE CONTRIBUTION OF IONT

8.10.1 The improvement of the NIP system and establishing the credibility record of Industrial Participation.

8.10.1.1 During the public phase of the investigation, there was evidence that IONT had found that the industrial participation part of the tenders had certain deficiencies that allowed a contractor to exaggerate the proposed benefits, which was to the disadvantage of the people of South Africa. With the consent of the Department of Trade and Industry, IONT amended the NIP system with regard to the SDP. A 1:1 ratio between NIP plus DIP investments and the contract price was targeted. These improvements required the preferred bidders to improve on their offers significantly above the tender requirements. This was eventually achieved by agreement with them. IONT's negotiations in this regard produced NIP commitments that were improved by more than 100% and of a higher quality.

8.10.1.2 Together with the DIP investments it has the potential of creating an estimated 40 000 to 65 000 direct job opportunities over a 15 year period. Up to June 2001 an estimated 1300 jobs have already been created.

8.10.1.3 According to Mr Naidoo, studies conducted by IONT found sufficient evidence that, where there is a basic industrial and economic capacity to carry out such projects and where there is strategic direction to the projects, they will succeed. Countries such as Switzerland, Finland and the United States of America had very good experiences in this regard. The danger in these projects is to attempt to implant an industrial process into an economy that cannot support it. South Africa is becoming an extremely competitive manufacturing industrial economy and the projects offered as part of the procurement of the SDP fit perfectly into that mould. IONT also researched the record of delivery of the preferred bidders pertaining to industrial participation and could find no evidence of failure.

8.10.2 The financing contracts

8.10.2.1 According to the evidence, each offer for the supply of military equipment was accompanied by a financing package to fund the purchase. As far as the preferred bidders are concerned, their offers included financing the total contract in the form of foreign currency offshore loans consisting of:

- (a) Export finance officially supported by the Export Credit Agency of the supplying country (ECA loans).
- (b) Foreign commercial credits at normal market rates and terms (commercial loans).

8.10.2.2 The main objectives of IONT in this regard were to raise the ECA loan coverage to cover the total imported content of the packages; to avoid commercial loans and to achieve the best currency and interest rate options.

8.10.2.3 The result of these negotiations, according to Mr Naidoo, was that 100% of the imported content of the packages would now be covered by ECA loans, which

created a substantial cash flow benefit for the Government. The South African Government can also choose to effect payments in different currencies, depending on certain formulas. The currency used in most of the contracts is Euro. These improvements in the financing arrangements will result in a significant saving for the South African Government.

8.10.3 The review of defence equipment

8.10.3.1 Mr Naidoo testified that IONT consulted extensively with the Chiefs of the arms of service, the Chief of the SANDF and the Minister of Defence on the need for the defence equipment under consideration, the timing of these needs, alternative approaches to meeting these needs and the requirements of an affordable package. Having considered these matters, IONT recommended to the Ministers' Committee in May 1999, that the procurement of the ALFA be deferred. The basis for this recommendation was that the SAAF, at the time of the negotiations, still had a number of Cheetah fighter aircraft that could operate effectively until 2012. From a financial point of view, the view was held that there was a currency risk associated with procuring the Gripen in advance of requirements. The possibility that better priced alternatives might become available at the appropriate time was also considered.

8.10.3.2 However, cognisance was also taken of the fact that the planned procurement of the Gripen would generate significant industrial participation benefits for South Africa.

8.11 COMPARISON OF COSTS PRESENTED TO CABINET AND CONTRACTED COSTS

8.11.1 Corvettes

8.11.1.1 A comparison of the cost presented to Cabinet and the contracted cost pertaining to the Corvettes indicated that the amount presented to Cabinet on 18 November 1998 was R6 001 million. The cost presented to Cabinet on 15 September 1999 was R6 917 million. The difference in the cost was due to the non-inclusion of all the elements of the cost when presented to Cabinet on 18 November 1998. The complete cost elements are set out below.

- (a) Statutory costs, which consist of items such as freight, insurance and taxes. The largest portion is incurred in South Africa.
- (b) Project management costs incurred by the DoD and Armscor in managing the procurements.
- (c) Financing costs for deferring payments to suppliers so as to fit more closely into an optimum cash-flow schedule.
- (d) ECA premium, which is payable on all ECA-backed loans.
- (e) Escalation on all of the above payments made in future years.

8.11.1.2 Cabinet Memorandum No 14 dated 25 November 1999, was submitted to seek approval to contract formally with the preferred bidders. A set of costs was annexed to the memorandum. These costs were as follows:

	Sept 1999 R million	Nov 1999 R million
Tender price	5 469	5 412
Statutory and project management cost	1 030	1 010
Financing preferred cash flow	164	171
ECA premium	254	280
TOTAL	6 917	6 873

The reduction in the costs was primarily due to the reduction of the tender price from R5 469 million to R5 412 million because of the negotiations.

8.11.1.3 The contract price for the four Corvettes amounted to Euro 611 842 759 for foreign cost components, plus R1 496 227 105 for local cost components.

8.11.1.4 Converting from Euro to Rands using the exchange rate of R6.40 = 1 Euro, the foreign cost components amounted to R3 915 793 657,60 (611 842 759 x 6.4). The total contract price in Rand amounted to R3 915 793 657,60 + R1 496 227 105 = R5 412 020 762,60.

8.11.1.5 The actual contract price of the four Corvettes is equal to the tender price of R5 412 million included in the presentation attached to Cabinet Memorandum No 14 dated 25 November 1999.

8.11.2 LIFT and ALFA

8.11.2.1 With regard to LIFT and ALFA the following amounts were presented to Cabinet:

Equipment	Cabinet 18 November 1998 R6.25=US\$1 Rm	Cabinet 15 September 1999 R6.25=\$1 Rm
LIFT (24)	4 728	-
ALFA (28)	10 875	-
LIFT & ALFA (tranché)	-	15 772
Total	15 603	15 772

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8.11.2.2 In November 1998, the program cost presented to Cabinet for the LIFT and ALFA was R15 603 million and on 15 September 1999, when the program cost was presented to Cabinet, it was R15 772 million. It is important to note that the LIFT and ALFA programmes were tranced in 1999.

8.11.2.3 A schedule of cost was attached to Cabinet Memorandum No 14 dated 25 November 1999, and the following breakdown of costs was reflected:

	Sept 1999 Rm	Nov 1999 Rm
Tender price	12 711	12 711
Statutory and project management cost	2 445	2 557
Training equipment	616	648
TOTAL	15 772	15 916

The increased cost was in respect of increased statutory costs, project management and the training equipment.

The purpose of the memorandum was to seek approval to increase the program cost from R15 772 million to R15 916 million. The cost, as presented to Cabinet in November 1998, did not take into account all the elements as described above for each and every package.

8.11.2.4 During the negotiations by IONT, some of the essential functionalities of the aircraft in the LIFT and the ALFA packages had been excluded, thereby causing a reduction of the program cost. The cost of these items will have to be funded outside of the approved SDP.

8.11.2.5 The contract price is R13 359 million, which is equal to the tender price, plus the training equipment indicated in the table in paragraph 8.11.2.3.

8.11.3 LUH

8.11.3.1 A comparison of the costs for the LUH presented to Cabinet on 18 November 1998 and on 15 September 1999 is detailed below:

Equipment type	November 1998 Rm	September 1999 Rm
LUH (40)	2 169	-
LUH (30)	-	1 949

8.11.3.2 On 18 November 1998, Cabinet approved the procurement of 40 LUH at a program cost of R2 169 million. During the presentation to Cabinet on 15 September 1999, the number of LUH was reduced to 30 at a cost of R1 949 million.

8.11.3.3 The breakdown of costs as presented to Cabinet during September 1999, is as follows:

	Rm
Tender price	1 503
Statutory and program management cost	397
Financing preferred cash flow	0
ECA premium	49
Total	1 949

In Cabinet memorandum No 14 dated 25 November 1999, the cost was stated as follows:

	Rm
Tender price	1 503
Statutory and program management cost	400
Financing preferred cash flow	11
ECA premium	51
Total	1 965

8.11.3.4 The above mentioned difference between the cost presented on 15 September 1999, to that reflected on Cabinet Memorandum No 14 of 25 November 1999,

is due to the increase in the statutory cost and project management, financing preferred cash flow and ECA premium.

8.11.3.5 The final contract price for 30 LUH was US\$199 778 887. The contract included SACE premiums in US dollars and in South African Rands. The contract price for 30 LUH converted into Rands at a rate of R6.25 = US\$1 amounts to R1 248 618 043.

8.11.3.6 The implementation cost of R176 320 000 was not included in the program cost presented to Cabinet on 15 September 1999. The cost had to be incorporated in the normal SAAF operating budget, for which approval was only sought after the signature of the contract.

8.11.3.7 The difference between the program cost presented to Cabinet on 18 November 1998, and the program cost reflected in Cabinet Memorandum No 14 of 25 November 1999, is due to the reduction in the number of LUH from 40 to 30.

8.11.4 Submarines

8.11.4.1 A comparison of costs as presented to Cabinet during November 1998 and September 1999 respectively, is detailed below:

Equipment type	November 1998 Rm	September 1999 Rm
Submarine (3)	5 212,5	5 354

8.11.4.2 Upon comparing the cost presented to Cabinet with contracted cost, it was found that the amount presented to Cabinet on 18 November 1998, was R5 212,50 million. The cost presented to Cabinet on 15 September 1999, was R5 354 million. The difference between these figures is due to the omission of some elements of costs when presented to Cabinet on 18 November 1998.

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8.11.4.3 In Cabinet Memorandum No 14 dated 25 November 1999, the total cost reflected is R5 531 million. This increase in the cost was in respect of increased statutory and project management cost, financing cash flows and the ECA premium as indicated in the table below:

	Sept 1999 Rm	Nov 1999 Rm
Tender price	4 226	4 226
Statutory and project management cost	744	752
Financing preferred cash flow	97	197
ECA premium	287	356
TOTAL	5 354	5 531

8.11.4.4 The actual contract price of the three submarines was equal to the tender price of R4 226 million included in the presentation on 15 September 1999 and Cabinet Memorandum No 14 dated 25 November 1999.

8.12 FINDINGS

8.12.1 IONT was mandated by Cabinet to negotiate an acceptable funding arrangement and an affordable package with the preferred suppliers. Mr J Naidoo was appointed during November 1998, as the Chief Negotiator of IONT, representing the Office of the Deputy President.

8.12.2 The final terms of reference of IONT were approved by the Ministers' Committee on 26 May 1999.

8.12.3 In accordance with its terms of reference, IONT briefed legal and financial experts.

8.12.4 From the investigation it is clear that IONT made a positive contribution to improving the overall procurement process and its outcomes. However, it is not possible to make a conclusive finding on the total impact of IONT, because:

- Some functionalities of the packages were removed.
- The quantity of equipment for the LUH programme was reduced.
- Certain costs, for example management and statutory costs, had not been included in the presentation to Cabinet.

8.12.5 The negotiations conducted by IONT were not always minuted or recorded.

8.13 RECOMMENDATIONS

8.13.1 It should be prescribed that all procurement processes, including negotiations with preferred bidders, are properly documented to ensure a proper audit trail.

8.13.2 DoD should take steps to ensure that good procurement practices are adhered to and that compliance with the prescribed tender procedures is strictly controlled.

8.13.3 An approved negotiation strategy and terms of reference should be in place prior to the commencement of negotiations.

8.13.4 Proper consultation and an impact study should be done before equipment types or functionalities are reduced.

CHAPTER 9

COST TO STATE AND THE FINANCIAL AND FISCAL IMPLICATIONS OF THE STRATEGIC DEFENCE PACKAGES

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CHAPTER 9

COST TO STATE AND THE FINANCIAL AND FISCAL IMPLICATIONS OF THE STRATEGIC DEFENCE PACKAGES

9.1 THE PUBLIC PHASE OF THE INVESTIGATION

9.1.1 The involvement of the Department of Finance and the Affordability Team

9.1.1.1 From the evidence presented to the Public Protector during the public phase of the investigation, it appeared that the former Department of Finance (now National Treasury) was requested in June 1998, by SOFCOM to assist in the evaluation of financing offers that were received as part of the tenders for the SDP. The evaluations were done in terms of a value system developed by Armscor. Two officials of the Department of Finance assisted in completing the evaluation score sheets that were subsequently used by Armscor's finance team to calculate the financing index for each of the offers for the supply of equipment.

9.1.1.2 In November 1998, a Senior Manager of the Department of Finance, Mr R White, was asked to join IONT, representing the Department of Finance. The decision regarding his involvement was taken at ministerial level. At first, Mr White's task within IONT was to head the finance negotiations working group which had the responsibility of looking into loan and financing agreements.

9.1.1.3 In March 1999, the Ministers' Committee decided to establish a separate Affordability Team to look into the issues of the affordability of offers, alongside IONT. Mr J Naidoo, who was also the Chief Negotiator of IONT, headed the Affordability Team.

- 9.1.1.4 The Affordability Team was assisted by internationally renowned experts in the field of financial strategy and the European export credit market. They were also assisted by an international firm of attorneys who looked after the legal issues pertaining to agreements. The output of this team was an extremely favourable set of loans for the South African Government to acquire the SDP. These agreements eliminated the need for Government to borrow any hard currency on commercial terms. What was achieved by the Affordability Team and IONT in this regard is unprecedented in the international credit market. It ultimately means that the loans agreed to would be a great deal cheaper with substantially lower risk to Government. A saving of over R600 million, in 1999 prices, was achieved in this regard.
- 9.1.1.5 The assessment of the affordability of the SDP, involved devising methods to increase affordability and assessing the budgetary and financial implications and fiscal impact of the proposed acquisition. The Affordability Team, was in this regard, also assisted by the Bureau of Economic Research of the University of Stellenbosh. The final affordability assessment was submitted to the Ministers' Committee in August 1999. It was a voluminous document that dealt comprehensively with all the relevant issues. It also superseded all previous reports and inputs that were submitted on the matter of affordability. It sufficiently equipped the Ministers concerned to make a properly informed decision, as far as issues of affordability were concerned. Affordability is ultimately a question of political choice. The task of the Affordability Team was not to make that choice, but to enable the ultimate decisionmakers to make a well-informed choice about what the country could and could not afford.
- 9.1.1.6 The procurement of the services of experts to assist the Affordability Team was ultimately the responsibility of Armscor. However, the Department of Finance assisted in selecting candidates that had a history of exposure specifically with regard to the European export credit market.

- 9.1.1.7 As far as the impact of industrial participation benefits is concerned, the Affordability Team took into account a certain percentage of risk that all of these benefits would not materialise. The risks pertaining to the economic impact of the procurement were also dealt with in some detail. Different scenarios were thus considered in the economic analysis that was submitted to the Ministers' Committee as part of the affordability assessment of August 1999. However, it was not the intention to evaluate all the possible scenarios as the many variables of the packages made it virtually impossible. The purpose of referring to some scenarios was only to alert the decisionmakers to what may happen under certain circumstances.
- 9.1.1.8 The affordability assessment dealt with additional expenditure to be financed, but not the cost of financing. Financing costs do not form part of the expenditure of DoD on the SDP, but are accounted for as "state debt costs" and charged against the National Revenue Fund.
- 9.1.1.9 The depreciation of the Rand against other major currencies will cause the cost of the procurement to escalate. The Ministers' Committee was made fully aware of this risk by the Affordability Team in August 1999, and was fully satisfied with the report submitted to them.
- 9.1.2 **The total cost of the procurement**
- 9.1.2.1 According to the evidence, the cash price of the procurement at the time of the signing of the contracts (3 December 1999) was R30 300 million. This figure differed substantially from the cost estimates that were submitted to Cabinet in November 1998, as those figures did not include a number of items such as freight insurance, taxes, project management costs, financing costs and loan premiums.

- 9.1.2.2 The cost estimates that were submitted to the Ministers' Committee in August 1999 were done on two different bases. The first assumed a Rand exchange rate at the August 1999 rate to calculate a nominal or cash price. That is the cost should a single payment be made at the time of the signing of the contract.
- 9.1.2.3 The second cost estimate was calculated taking into account the risk that the Rand could depreciate in real terms over the duration of the procurement period. There are a number of currencies involved in the procurement, such as Euro, Pounds and US Dollars. This cost estimate was based on a proven scientific model and its purpose was to alert the Ministers' Committee to the possible impact of future Rand weakness on the aggregate cost of the procurement. Its calculation was based on a depreciation of the currency along the market forward exchange rate curve, which exceeds the likely inflation differential between South Africa and the supplier countries, resulting in an increase in the present value of the contractual commitments.
- 9.1.2.4 The commitment to industrial participation by the contractors is also in foreign currencies, which means that when the Rand depreciates against them, the Rand value of the counter investments increases.
- 9.1.2.5 The Ministers' Committee regarded the affordability assessment that was presented to them by the Affordability Team in August 1999, as a professional and very precise document that could be relied on. The contents of the assessment and the implications of the cost of the procurement were extensively debated and considered. These debates and considerations included issues such as the risk of the depreciation of the Rand against other currencies over the life of the contracts, the risk of interest rate increases in the economy and the risk of non-performance by contractors in relation to industrial participation commitments. These issues were fully addressed in the risk analysis that was submitted to Cabinet in October 1999.

9.2 THE FORENSIC INVESTIGATION BY THE AUDITOR-GENERAL

9.2.1 Scope of the investigation

9.2.1.1 To determine the costs presented to Cabinet and the basis on which Cabinet took the decision to approve the expenditure, including the contents of any reports on the assessment of the impact of the procurement on the economy and its affordability.

9.2.1.2 To determine whether the amounts calculated by the model used in the affordability assessment are reasonable and reliable, taking into account that this formed the basis for the decision taken by Cabinet.

9.2.1.3 The macro-economic and other assumptions and variables used.

9.2.1.4 The completeness of the model used.

9.2.1.5 The treatment of the financing charges.

9.2.1.6 The full financial and fiscal implications of the SDP.

9.2.2 Procedures performed

9.2.2.1 The minutes of the AASB, AAC, CoD, and the Ministers' Committee were perused to ascertain the cost as presented to it.

9.2.2.2 Presentations to Cabinet were perused to ascertain the cost presented to it and the affordability report was studied.

9.2.2.3 Various consultations were conducted with relevant role players in order to understand the calculated cost of the procurement at various stages.

9.2.2.4 Two independent economists were appointed to assess the reasonability and appropriateness of the models used by the Affordability Team.

9.2.3 Evidence obtained

9.2.3.1 *Presentation made to the AASB on 8 July 1998*

SOFCOM was tasked with the consolidation of the evaluation results pertaining to the SDP made in the presentation to the AASB on 8 July 1998. The costs presented, according to the minutes, included all applicable costs, and were based on quantities other than those eventually contracted for in respect of some programmes. The AASB resolved not to make any pronouncement on the presentation, but that the Minister of Defence and AAC should be advised of the progress. The total costs presented to the AASB included the financing costs, which were in respect of all the bidders. The details of the costs presented are dealt with in paragraph 9.2.3.2.

9.2.3.2 *Presentation made to the AAC on 13 and 16 July 1998*

(a) The presentation made to the AASB on 8 July 1998 was also made to the AAC on 13 July 1998, with the latter presentation including an additional spreadsheet detailing the costs pertaining to the successful bidders. The total amount presented was US\$10 761,10 million, which was made up of US\$7 273,5 million in programme costs and US\$3 487,6 million in finance costs. These costs were based on the selection of the Aermacchi MB339FD for the LIFT programme. If the BAe Hawk were to be selected, the total cost would have been US\$11 402,5 million, comprising US\$7 652,3 million and US\$3 750,2 million in programme costs and financing costs, respectively. No Rand equivalent was mentioned in the presentation or the minutes.

- (b) During a meeting of the AAC on 16 July 1998, the chairman ruled that the negotiations should proceed without eliminating any of the contenders or exposing the results.

9.2.3.3 *CoD meeting of 21 August 1998*

At this meeting, Mr S Shaik, the Chief of Acquisitions of DoD, informed CoD that the total package deal, excluding financing charges, amounted to R66 718 million. This amount did not account for the elimination of the main battle tank (MBT) programme and the reduction of quantities on other programmes. The amount is based on cost of US\$10 761,10 million referred to in paragraph 9.2.3.2. In a response received by the investigation team from the Government it was stated that this financial cost was a first level attempt to estimate the cost of financing without any hedging or alternative repayment structures.

9.2.3.4 *Ministerial briefing on 31 August 1998*

A special ministerial briefing was held on 31 August 1998, at which the cost of the SDP was presented by the co-chairperson of SOFCOM, Mr Shaik. The cost presented was R27 406,3 million, based on the selection of Aermacchi MB339FD as the LIFT, and R29 773,8 million, based on the selection of the BAe Hawk as the LIFT. The Rand/Dollar exchange rate used in the presentation was US\$1 = R6.25, which resulted in dollar amounts of US\$4 385 million and US\$4 763,81 million, respectively. These amounts were programme costs and were exclusive of financing costs. The difference between the amounts in paragraph 9.2.3.2 and those above is due to:

- (a) The inclusion of the amounts of the MBT on 13 July 1998 which amounts were excluded on 31 August 1998.

- (b) The inclusion of four submarines on 13 July 1998, and only three on 31 August 1998.
- (c) The probable difference in exchange rates between the two dates.

9.2.3.5 *Presentation to Cabinet on 18 November 1998*

A presentation was made to Cabinet on 18 November 1998, with the objective of obtaining approval for the recommendation of the preferred bidders and for DoD, DTI and DoF to enter into contract negotiations. The total programme cost of the SDP indicated in this presentation amounted to R29 773,13 million. This cost did not include the financing costs of the SDP. Cabinet resolved that the proposals of the preferred bidders be accepted in the interim, and that DoD, DoF, Department of Public Enterprises and DTI should proceed with further detailed negotiations with the preferred bidders to achieve affordable agreements.

9.2.3.6 *Affordability report of 31 August 1999*

- (a) An "*Affordability of the Defence Strategic Armaments Packages*" report was compiled and issued by the Affordability Team of IONT on 31 August 1999. The report consisted of an assessment of the SDP's economic, fiscal and financial impacts. The total cost of the procurement according to the report, comprised:
 - (i) The contract price, which is the actual military equipment as procured from the suppliers.
 - (ii) Statutory costs, consisting of freight, insurance and taxes.

- (iii) Project management costs incurred by DoD and Armscor in managing the procurements.
 - (iv) Financing costs for deferring payments to suppliers.
 - (v) ECA premiums which are payable on all ECA-backed loans.
 - (vi) Escalation on all of the above payments made in future years.
- (b) According to paragraph 2.1.2 of the affordability report, the costs as presented to Cabinet in November 1998, did not take into account all the elements as described above for each and every package. The report further states that *"consequently the total full cost is substantially higher than that originally presented to Cabinet"*. The total cost indicated in the affordability report as at August 1999 at an estimated forward exchange rate, is:

Equipment Type	Quantity	Costs Aug 1999 (Fwd fx rate estimate) Rm
Submarines	3	6 088
Corvettes	4	7 361
Maritime Helicopter	4	967
Light Utility Helicopter	40	2 446
Lead-in-fighter trainer (LIFT)	24	5 469
LIFT & ALFA- Tranche 1	12 & 9	8 502
LIFT & ALFA- Tranche 1,2,3	24 & 28	19 620
Total – Excl Gripen		22 331
Total – Tranche 1 only		25 364
Total – Tranche 1, 2 & 3		36 482

- (c) According to the report, the amounts above include all known costs as outlined above.

9.2.3.7 Briefing of the Ministers' Committee on 31 August 1999

According to the minutes of the above meeting, the recommendations were the following:

- (a) The scenario of some R21,6 billion was selected as the baseline figure. It should be stated that it is not indicated in the minutes whether this figure includes financing costs or not. The amount, however, appears to include project management, ECA premium and statutory costs and is based on tranche 1 only. This conclusion is based on the comparability of the baseline figure with the tranche 1 figure.
- (b) The cost of the full package requirement of all three tranches was R29,9 billion, with the option to cancel/acquire tranche 2 and 3 in 2002 and 2004, respectively to be communicated to the international markets. The above figure also excludes financing costs.
- (c) The negotiation team should further explore a minor reduction to the R21,6 billion option.
- (d) The legal position with respect to "option to acquire" vs "option to cancel" should be cleared with the Minister of Finance before the next Cabinet meeting on 15 September 1999.
- (e) The negotiating team should conclude the final set of agreements with the respective suppliers for contract signature.
- (f) The recommendation of the Ministers' Committee on the SDP should be tabled in Cabinet on 15 September 1999.

9.2.3.8 Cabinet briefing on 15 September 1999

- (a) On 15 September 1999, Mr J Naidoo, the Chief Negotiator of IONT, briefed Cabinet on the SDP's affordability. According to the minutes, Cabinet approved that the total price for the equipment should amount to R29 992 million. This total amount includes two options to cancel - decisions to be taken by the Government in 2002 and 2004.
- (b) According to the minutes, Government was further committed to the respective suppliers for tranche one only at this stage at a cost of R21 330 million. The amount of R21 330 million does not include financing costs.

9.2.3.9 Cabinet Memorandum No 14 of 25 November 1999

In terms of the memorandum mentioned above, the cost of the equipment package was R22,2 billion over an eight-year period. This was based on the transfer of the leasing of the simulator equipment for the Hawk and Gripen from tranche 2 and 3 to a full purchase agreement in tranche 1. If the option to procure the additional equipment in tranche 2 and 3 was exercised, the total equipment cost would rise to R30,3 billion (the amount is rounded off to the nearest R100 million; the full amount is R30 285 million) over 12 years. The totals include statutory and programme management costs and ECA premium where applicable, but not the financing costs.

9.2.3.10 Cabinet decision on 1 December 1999

- (a) On 1 December 1999, Cabinet discussed Cabinet Memorandum No 14 of 1999, dated 25 November 1999, the objective of which was to obtain Cabinet approval to contract formally with the preferred bidders. Cabinet, according to the minutes, granted the permission required by DoD to sign

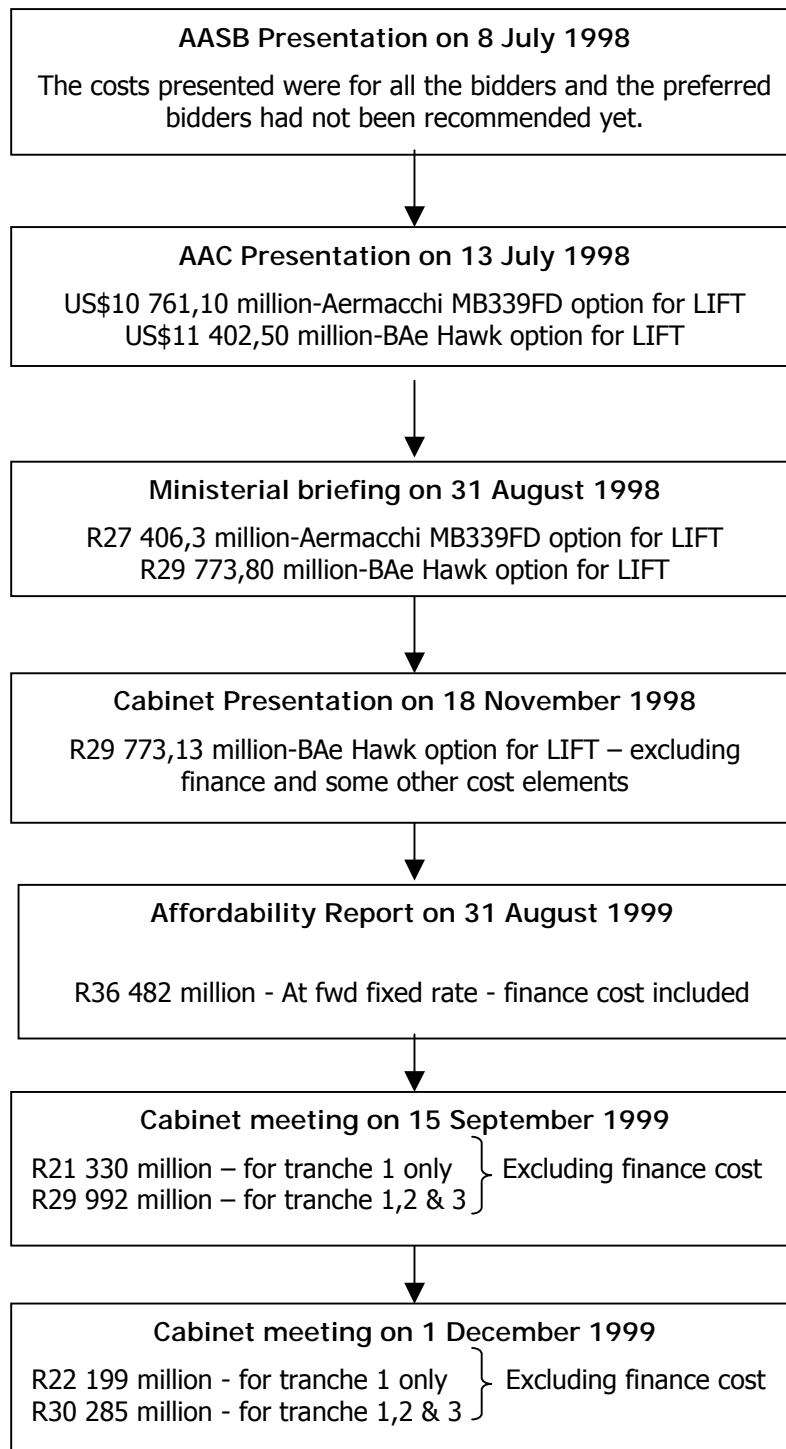
supply, Non-DIP, DIP and umbrella agreements. Cabinet also noted the cost associated with the supply of the defence equipment, to be as follows:

	24/11/99 Rm	15/09/99 Rm
Total Tranche 1 Only	22,199	21,330
Total Tranche 1,2 & 3	30,285	29,992

- (b) The difference in cost between the two columns was mainly due to the transfer of the leasing of the simulator equipment for the Hawk and Gripen from tranche 2 and 3 to a full purchase agreement in tranche 1.

9.2.3.11 Graphical Representation of the Costs Presented

A graphical representation of the costs of the SDP presented to the various bodies at the various stages is set out below:



9.2.3.12 Reasons for variations in amounts presented

The different amounts presented to Cabinet and the Ministers' Committee are as follows:

	18/11/98 Rm	31/08/99 Rm	31/08/99 Rm	15/09/99 Rm	25/11/99 Rm
Tranche 1 costs	-	25 364	-	21 330	22 200
Total costs	29 773,13	36 482	29 900	29 992	30 300

(a) According to the affordability report the reasons for the differences in the amounts presented on the various dates are the following:

(i) Total costs

- The total costs on 18 November 1998 did not take into account all the elements of costs and are based on real Rand values.
- The total costs on 31 August 1999 (column 3: that is, the costs as per the affordability report) are apparently based on all the elements of costs and are stated at a forward estimated rate of exchange.
- The costs on 31 August 1999 (column 4: that is, costs as per the Ministers' Committee recommendation) as recommended by the Ministers' Committee are apparently based on real Rand values.
- The costs on 15 September 1999 are based on real Rand values.

(ii) Tranche 1 costs

- The basis for these costs as presented on 31 August 1999, is the same as for the total costs above.
- The basis for these costs as presented on 15 September 1999, is the same as for the total costs above.
- The tranche 1 costs presented on 25 November 1999, are based on the transfer of the leasing of the simulator equipment for the Hawk and Gripen from tranche 2 and 3 to a full purchase agreement in tranche 1; hence the increase.

9.2.3.13 The contract price (cash price) at the date of the signing of the contracts (3 December 1999) was R30,3 billion. This figure was based on real Rand value. Evidence provided by R Adm Verster to SCOPA in October 2000, indicated that this figure would be approximately R43 billion based on the exchange rate at that time. It is on the basis of this statement that the procurement was often referred to as *"the R43 billion arms deal"* in the media. It would be extremely difficult to fix a value because of the continuous fluctuations in the exchange rate.

9.2.3.14 *Implications of the Procurements on the Fiscal, Financial and Economic Conditions*

The affordability report compiled by the Affordability Team for submission to the Ministers' Committee on 31 August 1999 included specialised inputs on economic models by the Industrial Development Corporation and the Bureau of Economic Research at the University of Stellenbosch. Inputs by independent experts, Warburg Dillon Read and Locker and Associates were also considered. The assessment of this report with regard to the adequacy

of the information and appropriateness of the financial and economic model used therein was performed by two independent economists during the forensic investigation.

9.2.3.15 Reasonability of the financial and economic model used

Two independent economists were appointed during the forensic investigation to assess the reasonability and appropriateness of the models used by the Affordability Team. The economists were of the view that the models used by the Affordability Team were reasonable under the circumstances. The economists made the following comments:

- (a) Certain errors, such as the accounting for the packages in the national and balance of payments accounts, crept into the assumptions used in the affordability scenarios.
- (b) A substantial impact on affordability that could materialise in future is the unsuccessful restructuring of DoD's budget and the effect on DoD's budget of underestimating the long-term full cost of ownership of the packages.
- (c) The affordability report was presented in a fragmented fashion. The implication of this is that no clear set of low to high-risk scenarios, incorporating as many as possible of the major risk factors was available for evaluation. This limits a clear understanding of the potential future costs and associated risks of the procurement process.
- (d) The general results of the affordability report also highlight the negative effect of unproductive expenditure on military equipment on the economy in general and its impact on government finance in particular.

- (e) The fact that the major elements of the affordability analysis were not available at an earlier stage of the negotiations limits the usefulness of the analysis.
- (f) The impact of expenditure on armaments is generally negative in terms of growth, employment and the budget deficit.
- (g) The industrial participation packages have a potentially positive impact on Gross Domestic Product and employment creation. However, the extent of this is uncertain.
- (h) The model did not include all relevant costs, such as price escalations, cost of negative foreign exchange movements.
- (i) The exchange rate projections by Warburg Dillon Read were found to be overly optimistic. Notwithstanding the benefit of hindsight, no high-risk scenarios relating to exchange rates were factored into the report.
- (j) Very little attention seems to have been paid to the opportunity cost analysis of spending on SDP.

9.3 FINDINGS

9.3.1 The costs of the SDP presented to Cabinet on 18 November 1998, amounted to R29 773,13 million that excluded financing costs amounting to 49% of the procurement costs.

9.3.2 The contract price (cash price) of the SDP on the date of the signing of the contracts (3 December 1999) amounted to R30,3 billion.

- 9.3.3 Although two independent economists criticised elements of the financial and economic models used, they confirmed that the model as a whole was reasonable.
- 9.3.4 The model did not include all relevant costs, such as price escalations, cost of negative foreign exchange movements, etc.
- 9.3.5 Certain aspects of the financial and economic model used by the Affordability Team in their presentation to the Ministers' Committee in August 1999, can be criticised to an extent. However, even though there might be different views and models explaining future projected costs and effects, it appears from the investigation that the Affordability Team and IONT took adequate measures under the circumstances to present to the Government a scientifically based and realistic view on these matters. The Ministers' Committee was put in a proper position by the Affordability Team to apply their minds in essence as to the financial impacts of the procurement. Ultimately, the decision as to what the country can and cannot afford is one of political choice.

CHAPTER 10

REPORT ON THE SELECTION OF SUBCONTRACTORS AND CONFLICT OF INTEREST

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CHAPTER 10

THE SELECTION OF SUBCONTRACTORS AND CONFLICT OF INTEREST

This matter was mainly investigated by the Office of the Auditor-General. The allegations of a conflict of interest in respect of the Combat Suite of the Corvettes that were investigated during the public phase of the investigation are referred to and discussed in Chapter 11 of the report.

10.1 BACKGROUND

10.1.1 The Auditor-General's report on the Special Review of the SDP indicated that the role players in the acquisition process were subjected to a security clearance process. However, potential conflicts of interest that could have existed were not adequately addressed by the process. Certain officials of DoD allegedly had interests in companies that were bidding for the SDP and such interests were apparently not disclosed.

10.1.2 In its response to the said report SCOPA expressed concern about *"the possible role played by influential parties in determining the choice of subcontractors by prime contractors."* SCOPA was furthermore concerned *"...that government had no influence in the appointment of subcontractors"*.

10.1.3 SCOPA recommended a forensic investigation that had to include a review of the selection of subcontractors and conflict of interest.

10.2 SELECTION OF SUBCONTRACTORS

10.2.1 DoD and Armscor policy regarding selection of subcontractors

10.2.1.1 The following policy documents were perused and contained relevant information:

DoD instruction no ACQ/1/98	Policy on the acquisition of armaments
K-STD-0020	Armscor's general conditions of contract
K-STD-0010	Rules applicable to prospective contractors
A-POL-1000	Armscor's policy: Acquisition and weapon system management support
A-PRAC-1011	Supplier registration
KP 021	Practice for the request of proposals, quotations, submissions and orders
KP 009	Practice for baseline review boards and authorisation committees
VB 1000	General policy for the management of category 1 materiel acquisition process
KB 1400	Policy on affirmative procurement
KB 1000	Armscor policy: Acquisition
A-Proc -008	Defence Industrial Participation procedure

10.2.1.2 A subcontractor is defined as *"the PERSON named in the ORDER for the performance of any part of the ORDER, or the person to whom any part of the ORDER has been granted by the CONTRACTOR, and includes the successors and assigns of such PERSON."* (Paragraph 3.24 of K-STD-0020 - Armscor's general conditions of contract).

10.2.1.3 The acquisition policies of Armscor and DoD as well as the Defence Review stipulate that the prime responsibility for the selection of subcontractors rests with the main contractor. However, Armscor was not precluded from contracting subcontractors directly if this proved to be more cost-effective (K-STD-0020 - Armscor's general conditions of contract).

- 10.2.1.4 Armscor is primarily responsible for all the contractual aspects during the armaments acquisition process, i.e. the drafting of tender documents and contracts (Refer paragraph 36 of the Defence Review).
- 10.2.1.5 The standard "*general conditions of contract*" which were included in the contracts between Armscor and the main contractors stipulate that the main contractors were responsible for (and accountable to Armscor) the due performance of any subcontractor except if the contract expressly stipulated otherwise.
- 10.2.1.6 According to Armscor's accreditation policy any company, both local and foreign, must be accredited or registered as a defence supplier to Armscor. Only accredited defence suppliers should be allowed to compete for defence contracts. Any company may apply to Armscor to be added to the list of accredited suppliers. Companies should meet certain criteria to qualify for accreditation. A potential supplier's technical and security competence, work force, quality system, financial soundness and technologies offered would be assessed against standards in order to identify risks to Armscor. The assessments are submitted to the Accreditation Board for final adjudication. However, paragraph 3.4 of the policy states that it is not necessary to be an accredited Armscor supplier to perform subcontract work on an Armscor contract. It is the responsibility of the nominated prime contractor to ensure that such work complies with the required quality standards. Subcontractors to the main contracting company should, however, conform to the same principles as mentioned above to ensure the cascading of competition to lower levels in the acquisition hierarchy.

10.2.2 Armscor requirements imposed on the main contractors

10.2.2.1 The RFOs that were sent out during 1997 to the preferred bidders, stipulated, *inter alia*, the following general requirements:

- (a) Bidders were required to submit a list of the subcontractors they proposed to use to Armscor for its approval.
- (b) All the bidders had to provide proof of the required experience and expertise pertaining to the management of major subcontractors.
- (c) A memorandum of understanding or letter of intent between the bidder and his proposed subcontractors.

10.2.2.2 In terms of its policy, Armscor was entitled to make it mandatory for the prime contractors at higher levels on the system hierarchy, to subcontract with enterprises owned by designated groups to the maximum possible extent without unduly compromising on cost and time. Depending on the extent and nature of any acquisition programme, Armscor reserved the right to require that a predetermined percentage of the contract value be subcontracted to enterprises owned and staffed by designated groups.

10.2.3 Local defence industry

The local industry was involved in the process, mainly as subcontractors, except for the Corvettes programme where ADS was regarded as a member of the consortium i.e. main contractor.

10.2.4 Requirements for an open, fair and competitive procurement process

10.2.4.1 The Defence Review stipulated that competition should be fair and open as far as is practicable in the procurement of armaments.

10.2.4.2 Armscor, as the contracting party, did not expressly impose such a requirement on the main suppliers to ensure fair competition between subcontractors; nor did Armscor prescribe to the main bidders any specific procedure for the selection of subcontractors.

10.2.4.3 The main contractors did not follow a formal process for the selection of subcontractors in all instances. Instead, they embarked on teaming arrangements and joint ventures with the local defence industry.

10.2.4.4 In at least two instances where a tender process was followed, the basic principles of fairness and open competition appear not to have been followed. i.e.:

- The selection of the supplier of the engines for the LUH.
- The selection of the supplier of the gearboxes for the Corvettes.

10.2.4.5 The entire process pertaining to the abovementioned instances, from soliciting through to adjudication of the relevant tenders can be criticized. The facts and circumstances show that the project teams and senior personnel in the employ of Armscor and DoD played a significant role in these instances of the selection of subcontractors, apparently because of technical and strategic considerations. Complaints were lodged by the competitors against the process followed for the selection of these subcontractors. Another such instance, the selection of the subcontractors for the supply of the SMS and NDSS, is discussed separately in chapter 11 of this report.

10.2.4.6 Strategic considerations in some cases also led to Programme Managers having to accept technical values that were lower than the parameters set in the user specifications and which carried higher risks. For example, the Turbomeca engine posed more risks and was more expensive than the engine proposed by another bidder. Armscor and DoD, however, considered it strategically more important for Denel Aviation that Turbomeca should get the contract.

10.3 CONFLICT OF INTEREST

10.3.1 Definition

10.3.1.1 Conflict of interest can be defined as *"a situation in which a person, such as a public official, an employee, or a professional, has a private or personal interest sufficient to appear to influence the objective exercise of his or her official duties."*

10.3.1.2 There are three key elements in this definition:

(a) A private or personal interest

It is often a financial interest, but it can also be another interest, such as providing a special advantage to a relative.

(b) An official duty

This refers literally to the duty that an official or employee has by virtue of holding a particular public office or acting in his official capacity. The official assumes certain official responsibilities and he acquires obligations to his employer and/or the general public. These obligations are supposed to override private or personal interests.

(c) Interference with objective professional judgement

Conflicts of interest interfere with official or professional responsibilities in a specific way, namely an interference with the official's objective judgement. Government officials and employees serve the general public and they are expected to be objective and independent. Factors, such as private and personal interests, *that either interfere or appear likely to interfere with objectivity* are then a matter of legitimate concern to those who rely on these employees or officials. It is also important to avoid apparent or potential as well as actual conflicts of interests. An apparent conflict of interest is one that causes a reasonable person to think that the employee's or official's judgement is likely to be compromised. A potential conflict of interest involves a situation that may develop into an actual conflict of interest. Private and personal interests can cloud a person's objectivity.

10.3.1.3 An employee shall be considered to have a possible conflict of interest if he has an existing or potential financial or other interest, which impairs or appears to impair his ability to exercise independent and unbiased judgement in the discharge of his/her responsibilities.

10.3.1.4 The mere appearance of a conflict may be as serious and potentially damaging as an actual conflict of interest. Reports of conflicts based on appearances can undermine public trust in ways that may not be restored adequately even when the mitigating facts of a situation are brought to light. Apparent conflicts should therefore be evaluated and managed with the same vigour as known conflicts.

10.3.1.5 Once a conflict of interest situation, actual or potential, is recognised, the ethical responses are straightforward: the person must avoid the conflict by

disclosure and complete recusal. This is, for instance, in line with the State Tender Board Code of Conduct, which stipulates that a member shall, beforehand, declare his interest *vis-à-vis* a matter serving before the Board and the member shall recuse himself during the discussion of the memorandum. No discussion by the member concerned will be allowed prior to or after the serving of the memorandum and such a member may not retain that specific memorandum.

10.3.2 Typical examples of conflict of interest

10.3.2.1 *Self-dealing*

For example, an employee works for government and uses his official position to secure a contract for a private consultancy company he or a member of his family owns. Another instance is using his Government position to get part-time employment for family members.

10.3.2.2 *Accepting benefits*

Corruption is one example and accepting substantial non-token gifts is another. For example, when an employee is the purchasing agent for his department and he accepts substantial gifts from a major supplier.

10.3.2.3 *Influence peddling*

Here the professional solicits benefits in exchange for using his influence to advance unfairly the interests of a particular party.

10.3.2.4 Using an employer's property for private advantage

This could be as blatant as stealing office supplies for home use. Or it might be more subtle, for instance, using software which is licensed to an employer for private consultancy work. In the first case the employer's permission eliminates the conflict, while in the second, it does not.

10.3.2.5 Using confidential information

While working for a private client, an employee learns that the client is planning to buy land in his region. He hurriedly buys the land in his wife's name.

10.3.2.6 Outside employment or moonlighting

An example would be establishing a separate business that is in direct competition with his employer. Another example would be accepting so many private clients that he does not have time and energy to devote to his regular employer. In combination with *influence peddling*, it might be that a professional, employed in the public service, sells private consultancy services to an individual with the assurance that they will secure benefits from government: "*If you use my company, I am sure that you will pass the environmental review.*"

10.3.2.7 Post-employment

Here the difficult situation might be one in which a person who resigns from public or private employment, goes into business in the same field. For example, a former public servant sets up a practice lobbying the department in which he was formerly employed.

10.3.2.8 The existence of a conflict of interest, whether actual, apparent, or potential revolves around the key question of whether the employee or official was in a situation which was likely to interfere or appear to interfere with the independent judgement that he is supposed to exercise in performing his official duties. The “trust test” could be used to test this. This test implies the following: would others (employer or the general public) trust the official’s judgement if they knew that he was in this particular situation? Trust is the ethical heart or core of this issue. Conflicts of interest involve the abuse, actual or potential, of the trust people have in certain employees or officials. It reduces the trust people generally have in the employer, i.e. the government.

10.4 ALLEGED CONFLICT OF INTEREST OF MR SHAIK

10.4.1 Mr Shaik’s official duties

10.4.1.1 Mr Shaik is a Chief Director in DoD. He was appointed as Chief of Acquisitions in May 1998, although he was designated to take over this post sooner. As such he was the Fund Manager of the Special Defence Account from which the SDP were to be funded. He was also in control of policy matters and planning relating to all acquisition matters.

10.4.1.2 In his capacity as Chief of Acquisitions, he played a pivotal role in the process for the acquisition of the SDP. He occupied the following influential positions:

- Chairperson of the PCB.
- Member of the Defence Staff Council.
- Co-chairperson of the Strategic Offers Committee (SOFCOM).
- Member of the NIP and DIP Consolidation Committee.
- Member of IONT.
- Secretary of the Ministers’ Committee.

10.4.2 Private or personal interest

10.4.2.1 Mr Shaik has a brother, Mr Shabir Shaik. The latter, at various times, directly and/or indirectly held interests in the following companies:

- Nkobi Investments (Pty) Ltd.
- Nkobi Holdings (Pty) Ltd.
- Thomson–CSF (Pty) Ltd.
- Thomson CSF Holdings (SA) (Pty) Ltd.
- African Defence Systems (Pty) Ltd (ADS).

10.4.2.2 Before the name was changed, Altech Defence Systems had generally been referred to as ADS. This abbreviated name was later retained when the company changed its name to African Defence Systems.

10.4.2.3 Mr Shabir Shaik's interest in the said companies can be summarised as follows:

(a) Nkobi Investments (Pty) Ltd was incorporated on 24 February 1995 with Mr Shabir Shaik owning 100% of the issued share capital. In 1996 he transferred 69% of his shares as follows:

- | | |
|--------------------------------|-----|
| ● Floryn Investments (Pty) Ltd | 20% |
| ● Workers College | 10% |
| ● Chartley Investments | 39% |

On 20 August 1996, all the said shareholders transferred their shares to Nkobi Holdings (Pty) Ltd. This company was incorporated on 27 February 1995, with Mr Shabir Shaik holding 100% of the issued shares. Various share transfers occurred subsequently, but essentially Mr Shabir Shaik indirectly held the majority shares in Nkobi Holdings (Pty) Ltd.

- (b) Since 1996, Nkobi Holdings had been holding 10% of the shares in Thomson-CSF Holdings (SA) (Pty) and 30% of the shares in Thomson–CSF (Pty) Ltd. In September 1999, certain share transactions were concluded that resulted in Nkobi Holdings acquiring 25% of the shares of Thomson–CSF (Pty) Ltd. The purchase price was R7 464 000. The background to these transactions can briefly be stated as follows:
- Thomson-CSF Holdings (SA) (Pty) Ltd had been incorporated on 21 May 1996, to *promote development in SA by entering into joint ventures.*
 - On 26 May 1996, Nkobi Investments acquired 10% of Thomson-CSF Holdings (SA) (Pty) Ltd from Thomson-CSF France for R10 000. Thomson-CSF France held 85%, Nkobi Investments 10% and Gestilic 5% (Nkobi Investments, however, sold back its shares on 30 September 1999 for R500 000).
 - On 1 August 1996 Nkobi Investment obtained 30% of the shares of Thomson–CSF (Pty) Ltd from Thomson-CSF Holdings (SA) (Pty).
- (c) Thomson-CSF of France acquired 50% of the shares in ADS on 24 April 1998. The negotiations that led to this purchase apparently commenced a year earlier. On 25 August 1998, ADS changed its name from Altech Defence Systems to African Defence Systems and retained the abbreviated name ADS. Thomson-CSF France acquired the remaining 50% of the shares on 19 February 1999.
- (d) The shares in ADS were all transferred to Thomson-CSF France, a company incorporated in France. However, on 9 June 1999, Thomson-CSF France transferred the shares to Thomson-CSF International. Later,

on 15 September 1999, Thomson International transferred 80% of the ADS shares to Thomson-CSF (SA) (Pty) Ltd for R29,8 million and the remaining 20% to FBS for R7,4 million. On 30 September 1999, Nkobi Holdings acquired 25% of the shares in Thomson-CSF (SA) (Pty) Ltd for R7,4 million.

- (e) The negotiations pertaining to these transactions had apparently commenced early in 1999, which is evident from the fact that on 22 June 1999, Thomson-CSF International had signed an agreement with FBS for the sale of 20% of its shares in ADS. Pursuant to this agreement the shares were transferred in September 1999, as discussed above.

10.4.3 Directorship

Mr Shabir Shaik was a Director of Thomson-CSF Holdings (SA) (Pty) Ltd from 21 May 1996 until 30 September 1999. He was also a Director of Thomson-CSF (Pty) Ltd from 16 July 1996, a position which he still holds. His interests in these companies were held *via* Nkobi Holdings and Nkobi Investments and he had been a Director of both these latter two companies since incorporation in February 1995. Mr Shabir Shaik was appointed as an alternate director of ADS in September 1999.

10.4.4 Involvement of the Thomson Group and ADS in the SDP

- 10.4.4.1 Altech was a company that conducted business in the defence industry for many years and had been working with Armscor in its retention of technology programmes. Hence, it featured strongly in the SDP. In the proposal submitted in 1998 by the GFC for the supply of the Corvettes, ADS was nominated to undertake the development, design and production of the Combat

Suite. GSC also proposed it as a subcontractor for the Submarines and Agusta in the LUH programme.

10.4.4.2 Thomson-CSF France also became a partner in the GFC for the supply of the Corvettes. Minutes of the PCB meeting held on 6 June 1999, revealed that Thomson (SA) (Pty) Ltd was a strong contender in the Corvettes programme as one of the subcontractors for certain elements of the Combat Suite.

10.4.5 Declaration of interest

10.4.5.1 V Adm Simpson-Anderson dealt with the conflict of interest relating to Mr Shaik's position in a letter dated 17 October 2000 addressed to Mr Gavin Woods of SCOPA. He stated the following:

"To my knowledge no members of the SA Navy involved in the selection process to determine equipment, whether at Project Team, Naval Board or Project Control Board level had then or has now any interest or connection with any of the tendering suppliers or sub-suppliers"

The chief of acquisition disclosed his perceived interest that his brother had an interest in ADS which was tendering for the submarines, on the grounds that a perception of bias might exist. It was agreed that whenever the corvette and submarine combat suites were discussed I would take over as chairperson, Mr Shaik would not take part in any discussions, consultations or decisions. This was at the level of the Project Control Board."

10.4.5.2 The minutes of the PCB meeting held on 4 December 1998, indicate that Mr Shaik declared an interest in the following terms: *"The Chairperson informed the meeting that, due to a conflict of interest, he is to recuse himself from the combat suite element of the corvette and submarine requirement."*

10.4.5.3 Minister Erwin testified during the public phase of the investigation that:

"We were appraised of this matter very, very early on in the process. Before the final decisions were taken.

Mr Shaik himself informed me of the position. I happen to know his brother well. So I was aware of it from that source as well, and we discussed the matter once again when Jarenda Naidoo was appointed as the chief negotiator.

The was no sense in him recusing himself from all the areas at all because this was a certain part of the equipment, not the total contract as a whole."

On the issue whether Mr Shaik had to recuse himself, Mr Erwin testified that:
"From my point it was an instruction taken with the minister of defence. The president knew about it, we issued an instruction that he must recuse himself".

10.4.5.4 A letter from the former Minister of Defence, Mr J Modise, addressed to the chairperson of SCOPA, indicated that Mr Shaik had informed the former Minister of his possible conflict of interest due to the fact that Thomson-CSF France was in the process of acquiring ADS. The letter stated that Mr Shaik's conflict of interest could materialise in the event of Thomson-CSF France transferring its shares to Thomson South Africa as his brother, Mr Shabir Shaik, was a shareholder in Thomson South Africa. He had advised Mr Shaik to follow the Armscor procedures in this regard.

10.4.5.5 The PCB minutes of subsequent meetings showed that, despite his declaration of conflict of interest in December 1998, and contrary to the instruction referred to by Mr Erwin, Mr Shaik had actively participated in discussions relating to the evaluation, selection and appointment of the main contractors and subcontractors in respect of which ADS and Thomson had been contenders. It also appeared that, outside the PCB, he was also involved in matters that

directly or indirectly concerned ADS and Thomson, despite having previously declared a possible conflict of interest based on his brother's interest in these companies (Refer chapter 11).

10.4.5.6 In this regard the following serve as examples:

(a) At a meeting of the PC held on 8 March 1999, the following was recorded: *"The chairperson re-iterated that, due to a possible conflict of interest, he will recuse himself from any decisions taken on the combat suite but will not recuse himself from the meeting."* Mr Shaik merely handed over the chairmanship but remained in the meeting when the Combat Suite negotiations were presented. He was also present when a briefing was given on the submarines, which included an element of the Combat Suite in respect of which Thomson was a contender against STN Atlas.

(b) Mr Shaik chaired the PCB meeting of 27 May 1999. He did not declare any conflict nor did he recuse himself. He actively participated in the discussions relating directly to the issues in respect of which he had previously declared a conflict of interest. The following was recorded:

"the best and final offer was received on 24 May from GFC/ADS incorporating the price reductions arising from the functional and scope reductions of both the platform and combat suite.....The Chairperson then explained the contractors concern wrt their negotiations with the Department of Trade and Industry and the Department of Finance. POP Sitron said he believes that the combat suite price be reduced to less than RM2600. PMP then stated that the project team would not be able to reduce the price any further unless a different suite configuration and contracting model is used. The chairperson indicated that a total of RM 6694,61 was set aside by the DOF in the affordability study documents presented to Cabinet subcommittee. A combat price of RRM2600 was indicated in the affordability documents.

The Chairperson instructed the POP Sitron to complete the price negotiations first. Once this is done POP SITRON is to return to the PCB with a further presentation."

- (c) During the same meeting, the JPT presented a detailed list of the Combat Suite elements, the supplier and the estimated prices for discussion.
- (d) There was also a presentation of the submarine Combat Suite and a comparison of the ADS and STN Combat Suites offers. In this regard the following was noted: *"The project officer presented the impact of the parallel combat suite offer (statutory cost excluded) and gave an overview of how the increase in the ADS price is determined. The Chairperson then raised his concern regarding the visibility of how the GSC determined the price difference and indicated that the GSC had undertaken to give him and CEO Armscor the required visibility."*
- (e) On 8 June 1999, a "decision-making PCB" was convened and chaired by Mr Shaik. He informed the meeting that its aim was to confirm decisions already taken by the PCB with regard to certain projects. This in itself seemed strange. A list of contenders for the various elements of the ship platform and the Combat Suite was presented to the board for ratification. The list was entitled *"Project SITRON: summary of supplier decisions by PCB where alternatives were evaluated or considered."* Thomson featured prominently on this list. The PCB proceeded to ratify the decisions to select the suppliers. There is no indication that Mr Shaik recused himself from this "decision-making PCB" meeting. Mr Shaik signed the minutes. He participated in the discussions as per the following recordings:
- *"The Chairperson tasked POP S to provide CEO Armscor and C Acq with a list of the single source equipment for the Corvette."*

- *"In reply to a query by SM DIP, the Chairperson confirmed that as from this meeting GFC could be approached to firm-up on proposals connected with decisions ratified by the board".*

(f) Mr Shaik chaired the PCB meeting that was held on 24 August 1999. The following was recorded in minutes of that meeting:

"ITEM 5: CORVETTES

Contracting Model Categories of Risks. The acting project officer briefed the board on the combat suite risk and the risk management pertaining to project-contracting model contained in Appendix A. He emphasised that, although the SAN accepts some risk wrt Category C products the Prime Contractor retains full responsibility for the delivery and performance of a fully integrated vessel, which includes the full integration of the combat suite ashore and abroad.

Combat Suite Data Bus

The project team categorise the C²I² Bus as a Category B risk, i.e. the Prime Contractor retains full responsibility for the delivery and performance of a fully integrated vessel, which includes sub-systems that have a critical effect on the overall vessel delivery. Further, acting POP S informed the board that if C²I² Data bus option is selected over the ADS Detexis Data bus the project team would have to find the extra funds required to bring both options on par wrt risk coverage. This would result in lifting the ceiling price of the Corvettes

C.Acq informed the board that the CEO of Armscor had presented this matter to the AAC and that the Minister supported the issue of the main contractor carrying the overall risk and the responsibility for the sub-contractors. If the principle of the Main contractor carrying the risk for the sub-suppliers is changed, then the added difference in costs will have to be borne by the DoD. The principle of the

contractor carrying the risk must be adhered to. The AAC decided that the ceiling price per equipment should not be raised.

Mr Swan and R Adm Howell will meet with Mr Richard Young of C²I² to discuss the matter with him”

- (g) The presentation was annexed to the minutes and contains details of the contracting model for the Combat Suite. The background problem relating to the Combat Suite was discussed. Of significance is the list with Category B equipment which contained the following information:

"Combat Management System: Thomson/ADS

- *Includes Databus and interface units*
- *Merging of Thomson Tavitec and ADS diamond*
- *Considerable software development*
- *Risk: medium to high*
- *Surveillance Radar: Thomson NCS*
- *Navigation segment: ADS*
- *System Management System: ADS*
- *IFF: Thomson /Tellumet*
- *Underwater Telephone ADS*
- *Bathy Thermograph ADS*
- *Combat Team Trainer ADS*
- *Integration Test Bed: ADS”*

- (h) Later in the same meeting the following appears:

"Ratification by Board.

The following proposals by the project team, details of which are contained at Appendix F were ratified by the board

(Note: refer to C.Acq's possible conflict of interest as indicated in par 13 of the minutes of the PCB held on 28 April 1999):

- (i) Combat Suite software only to be frozen by delivery of the third vessel.*
- (ii) Delivery of Cat C sub-systems to Main contractor be extended by six months.*
- (iii) SAN takes delivery of platforms in Germany.*
- (iv) Navy accepts risk for CS equipment while in Dockyard awaiting installation."*

Mr Shaik signed the abovementioned minutes on 30 September 1999.

- (i) At the PCB meeting held on 3 February 2000, the project team reported that C²I² Databus was a Category B risk and that Mr Swan and Adm Howell met Dr R Young who apparently agreed to withdraw legal action. This report was received under the chairmanship of Mr Shaik. In respect of the Hull Mounted Sonar for the submarine programme, Mr Shaik had recused himself from the discussion surrounding the evaluation of the equipment.
- (j) The PCB convened three times thereafter i.e. on 4 August 2000, 28 August 2000 and 6 October 2000. The minutes of the meeting held on 4 August 2000 stated that the minutes of the previous meeting were accepted after the word "reclused" in the Note under item 5 on page 5 was corrected to read "recuse". This referred to a statement in the minutes of the meeting held on 3 February. However, the minutes of the meeting held on 28 August stated that the minutes of the previous meeting were accepted with the following amendments:

"The note on page 5 is to be amended to read; "C Acq stated that due to a possible conflict of interest he recuses himself from any decision that may arise in discussions surrounding the combat suite elements, including the hull mounted sonar"

- (k) However, this appears not to be relevant to the minutes of the previous meeting, but was in fact relevant to the minutes of the meeting held on 3 February 2000 which had already been amended once. The 3 February 2000 minutes had therefore been corrected twice; the word 'reclused' was corrected to read "recuse", and the entire paragraph was subsequently amended to include the declaration of conflict of interest and recusal.

10.4.5.7 It is noteworthy that certain important share agreements were being negotiated during the same months when the contracts, that were ultimately awarded to ADS and Thomson, were discussed in the PCB minutes. The negotiations that ultimately resulted in Thomson purchasing the remaining shares in Altech, the name being changed to ADS and the acquisitions in September 1999.

10.4.5.8 Certain allegations in connection with the involvement of the former Minister of Defence, in a company that was to benefit from the SDP procurement, came to the attention of the investigation teams. This matter was not investigated during the public and forensic phases of the investigation.

10.5 FINDINGS

10.5.1 The acquisition policies and guidelines of DoD and Armscor, as well as the Defence Review, stipulate that the prime responsibility for the selection of subcontractors rests with the main supplier. However, Armscor was not precluded from contracting subcontractors directly if this proved to be more cost effective. Armscor did in fact nominate and select subcontractors for the supply of the engines for the LUH and the gearboxes for the Corvettes.

- 10.5.2 Fair and competitive procurement procedures for the selection of sub-contractors were not followed in all cases where strategic considerations played a significant role.
- 10.5.3 DoD and Armscor nominated certain subcontractors for equipment that had been locally developed in order to ensure compliance with technical standards. This did not, however, preclude the main contractor from suggesting and selecting a different subcontractor.
- 10.5.4 There was a conflict of interest with regard to the position held and role played by the Chief of Acquisitions of DoD, Mr S Shaik, by virtue of his brother's interests in the Thomson Group and ADS, which he held through Nkobi Holdings. Mr Shaik, in his capacity as Chief of Acquisitions, declared this conflict of interest in December 1998 to the PCB, but continued to take part in the process that led to the ultimate awarding of contracts to the said companies. He did not recuse himself properly.
- 10.5.5 During the course of the investigation it was established that the Chief of Acquisitions, Mr S Shaik, has not applied for and did not receive the military security clearances required by law.
- 10.6 RECOMMENDATIONS**
- 10.6.1 The guidelines contained in the Defence Review that relate to the selection and appointment of subcontractors must be followed and steps taken to ensure that a open and fair process is adhered to for the selection of subcontractors.
- 10.6.2 DoD and Armscor should develop specific rules and guidelines to address conflict of interest issues and to ensure that personnel are properly informed in

this regard. Steps should also be taken to ensure that a particular individual, irrespective of his/her position is not tasked with incompatible functions in multifaceted procurements in order to prevent a conflict or perceived conflict of interest, which would have a detrimental effect on the overall acquisition process.

- 10.6.3 DoD undertakes an urgent personnel audit to ensure that all its staff comply with the prescribed security clearance requirements.

CHAPTER 11

ALLEGATIONS/COMPLAINTS BY C²I² SYSTEMS (PTY) LTD

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CHAPTER 11

ALLEGATIONS/COMPLAINTS BY C²I² SYSTEMS (PTY) LTD

C²I², a company that participated in the procurement process of the SDP complained to the three investigation agencies that they had been treated unfairly and improperly by the government agencies and certain of the officials involved. The agencies conducted an in-depth investigation into these allegations, albeit in different formats. Those allegations that point to criminal conduct form the subject of an investigation by DSO, the contents of which are, for the reasons explained earlier, not discussed in this report. This chapter deals with the investigations conducted by the Office of the Auditor-General and the Public Protector. To avoid duplication, the investigations are not referred to separately, but reference is made, where necessary and appropriate, to evidence specifically obtained by either one of the two investigation agencies.

11.1 BACKGROUND

11.1.1 Introduction

11.1.1.1 Since 1980, the SA Navy had been planning to replace its frigates. In 1993, Project Sitron was registered for this purpose and steps were taken to obtain proposals from different suppliers. A request for Best and Final Offer (BAFO) was issued in 1994 to shipyards in Spain and Britain, and the former was eventually selected as the preferred bidder. In 1995 the then Minister of Defence deferred the decision to procure the vessels and Project Sitron was suspended, pending the Defence Review.

11.1.1.2 During June 1997, Cabinet approved the Defence Review in terms of which, *inter alia*, four Corvettes (and 6 helicopters) would be acquired. Parliament approved the Defence Review in April 1998. Project Sitron was subsequently revived.

11.1.1.3 The Technology Retention Programme of the S A Navy commenced in 1992 as Project Diodon. When Project Sitron was started in 1993, it consisted of small contracts issued by Armscor, and not by a main contractor, for the development of certain project elements. Project Sitron came to a halt when the Corvette acquisition programme was deferred by Cabinet in 1995. It was then decided to introduce a technology retention programme, called SUVECS (Surface Vessel Combat Suite), in an attempt to preserve the local naval technology base that had been nurtured at substantial cost to the State for years during the time that the Defence Review was conducted. SUVECS consisted of small contracts issued to a number of local companies, on a year-to-year basis, not to develop products, but rather technology demonstrators; in other words something that could work and could be considered for further development. Other important considerations were the following:

- (a) The strategic advantages of local sourcing of sensitive combat technologies; and
- (b) The economic advantages of supporting an industry that has a major job creation factor and significant export potential.

11.1.2 The Combat Suite Element Costing and Description

11.1.2.1 When Government in September 1997 eventually in principle approved the acquisition of the patrol Corvettes under Project Sitron, Armscor formally issued a Request for Information to a number of countries. Responses were received in October 1997. The short-list of four potential suppliers was approved in December 1997 and a Request for Offer issued to them.

11.1.2.2 The document titled "SA Navy Patrol Corvette Combat Suite Element Costing and Description" that formed part of the RFO, contained various provisions with the following specific extracts being of cardinal importance:

"ii.....The Combat Suite Element, comprising of systems developed and produced by nominated RSA industry,"

3. *"..... The Vessel Contractor will be a teaming arrangement between the ship platform supplier and the nominated RSA combat suite supplier, with sub-contracts placed on nominated companies for the various sub-systems"*

"9. *The Combat Suite consists mainly of sub-systems developed or under development by South African industry, in addition to some items of equipment from the SA Navy inventory; and three major sub-systems to be acquired from foreign suppliers"*

11.1.2.3 It is therefore clear that nominated South African industry was to play a significant role in the supply of the Combat Suite. The total cost of the Combat Suite amounts to approximately R2,6 billion in 1998 Rands, according to the evidence of the programme manager, Mr Nortjé. The value of the local elements of the Combat Suite amounted to R1,938 billion and the foreign elements to R671 million.

11.1.3 Relevant entities involved

11.1.3.1 Altech Defence Systems (Pty) Ltd (ADS)

(a) It appears from the evidence that an organisation called Thomson-CSF had, until 1997, been a French government-owned enterprise. It was one of the largest providers of defence electronic equipment and the largest exporter in this field. In October 1997, the French Government decided to privatise Thomson-CSF and other multi-national companies, such as ALCATEL and Dassault Electronique, were invited to take part in the process. This resulted in a merger between Thomson-CSF and Dassault in January 1999 and a new entity called Thomson-CSF Detexis was created.

- (b) The acronym "ADS" previously represented a South African Company by the name of Altech Defence Systems (Pty) Ltd. In 1996 Altech absorbed the activities of two companies operating in the defence industry, namely UEC Projects and Teklogic.
- (c) After 1994, a revolution occurred in the arms industry in South Africa. From 1996 the S A Navy and Armscor required any contractor of a major acquisition to accept full responsibility for its product. Previously Armscor carried the risks in this regard. It is against this background that Altech and other companies started to look for commercial and technical support from the major players in the international defence industry.
- (d) In April 1998, Thomson-CSF acquired 50% of Altech and the remaining 50% in February 1999. At that time Thomson-CSF was actively looking for a black empowerment partner in South Africa. As a result, Thomson-CSF sold 80% of its shares in Altech to its South African subsidiary under the name of African Defence Systems. The remaining 20% was sold to a company called FBS.
- (e) Altech Defence Systems (Pty) Ltd, whose name was changed to African Defence Systems after the above-mentioned transfer of shares, was a nominated or listed supplier for various elements of the combat suite, as well as the Combat Suite integrator.

11.1.3.2 *The German Frigate Consortium (GFC)*

- (a) The German Frigate Consortium was selected as the preferred supplier of the Corvettes by Cabinet on 18 November 1998. The Consortium consisted of the following companies:
- Blohm and Voss GmbH;

- Thyssen Rheinstahl GmbH; and
 - Howaldtswerke - Deutsche Werft AG.
- (b) In their bid, dated 11 May 1998, the Consortium offered to form a consortium with ADS in order to supply at least 60% of the Combat Suite from the local industry, but without committing themselves to a particular subcontractor. At the time of the selection of the German Frigate Consortium (GFC), as the preferred main contractor, it already included, for all intents and purposes, ADS. The GFC was then requested on 12 December 1998, to expand their offer to include an offer for the Combat Suite in terms of the S A Navy User Requirement Specification wherein all candidate suppliers, including C²I² were listed.
- (c) Armscor concluded a contract with the GFC on 3 December 1999.
- (d) All contractors for the sub-systems of the Combat Suite therefore submitted their offers to the GFC, who submitted its offer to Armscor. As the cost of the Combat Suite was far beyond what the SA Navy could afford, the GFC was requested, in March 1999, to submit a more affordable offer, with the option of submitting alternative contracting models or alternative sources of supply.

11.1.3.3 C²I² Systems (Pty) Ltd

- (a) C²I² is a Cape Town based company and Dr R M Young is its Managing Director. C²I² has, since August 1996, been accredited by Armscor as a supplier of software and computer systems for naval, airborne and mobile applications.
- (b) C²I² was the recipient of funding from Armscor in terms of its technology retention programme.

- (c) Separate contracts were signed with C²I² in respect of the technology funding. In respect of the IMS, most contracts specify that the SANDF shall retain ownership and copyright of the product once full and final payment has been made. One contract stipulates that the SANDF and C²I² shall have joint ownership. In respect of the NDSS, the contract stipulates that Armscor and the Navy shall have joint ownership.
- (d) C²I² submitted their quotation for the IMS to Blohm & Voss GmbH on 9 February 1999.

11.2 SCOPE OF THE INVESTIGATION

- 11.2.1 Dr Young was requested to assist in the public phase of the investigation by testifying in public about the contents of and the reasons for his complaints. The persons and institutions that might be implicated by his testimony were alerted in advance of their right to question Dr Young and to respond to his testimony. DoD, Armscor, Mr S Shaik (the Chief of Acquisitions of DoD), the German Frigate Consortium, African Defence Systems (Pty) Ltd (ADS), and Mr L Swan (the former CEO of Armscor) responded and were all represented by legal counsel. Dr Young's testimony, which consisted of much detail, technical and otherwise, together with the response by DoD (in the form of testimony by R Adm Kamerman, the leader of the project team during the acquisition process of the Corvettes) lasted five days. A request by ADS to provide a response in writing was granted and copies thereof were provided to all the affected parties.
- 11.2.2 The mandate of the public and forensic phases of the investigation was to investigate the non-selection of C²I² as the subcontractor for the IMS and to make a determination on the following issues:
- 11.2.3 The validity of the R40 million risk premium added to the price of C²I² for the IMS.

- 11.2.4 Whether C²I²'s commercial specifications were released to competitors.
- 11.2.5 The regularity or otherwise of the non-selection of C²I²'s IMS.
- 11.2.6 The fact that a R20 million technology retention product (whether fully developed or still under development) was not used by the Navy.

11.3 THE COMPLAINTS OF C²I²

Dr Young primarily had the following complaints regarding the process followed for the selection of various subsystems of the Combat Suite:

- 11.3.1 The non-selection of his company regarding the supply of the databus for the IMS.
- 11.3.2 The addition of a R40 million risk premium to the IMS.
- 11.3.3 That the Detexis databus is an inferior product when compared to the databus created by his company.
- 11.3.4 That there were irregularities in the award of the contract for the SMS.
- 11.3.5 That ADS a competitor of his, obtained full technical details and pricing information of his product. He is of the opinion that this led to a substantial conflict of interest and subsequent unfair and unlawful competition. Examples of such conflict were listed by Dr Young as follows:
 - (a) That ADS, the nominated and main contractor eventually selected, could compete with other bidders for the sub-system contracts.

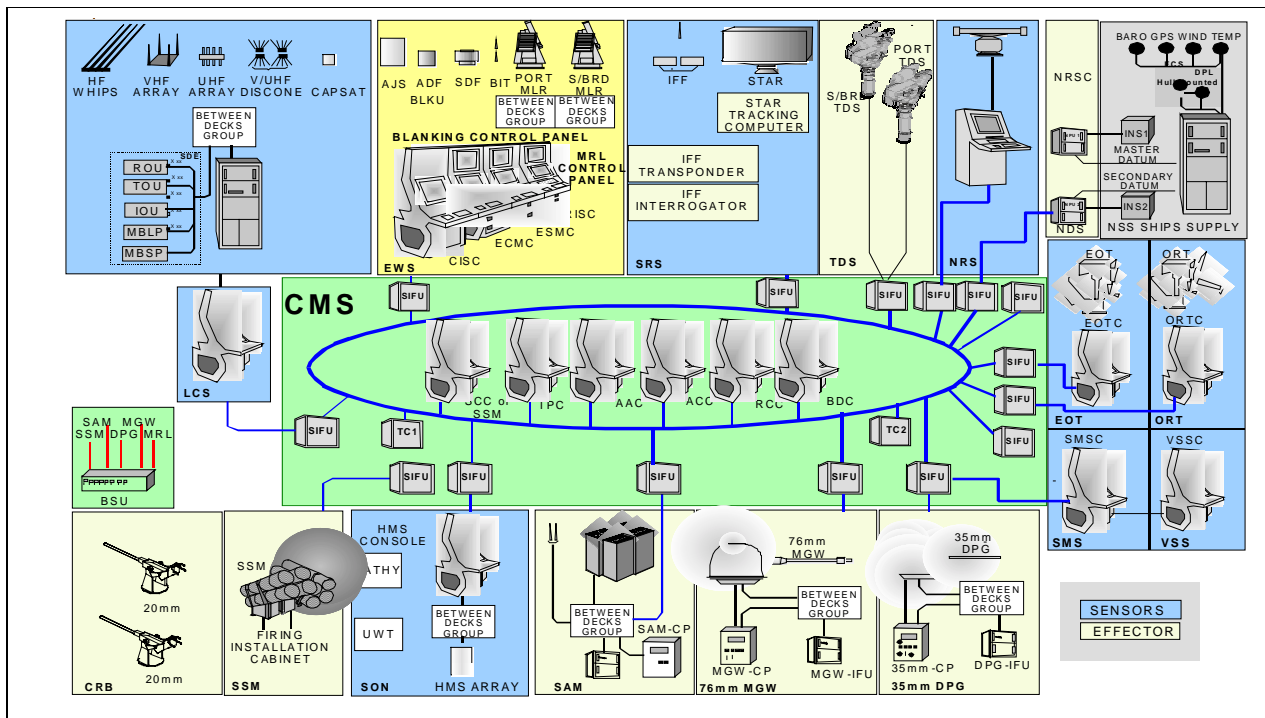
- (b) That ADS obtained C²I²'s price and technical specifications and directly or indirectly disclosed these to what later became C²I²'s competitor.
- (c) That Detexis and ADS are both in the Thomson-CSF group and form part of the prime contractor, i.e. the European South African Corvette Consortium (ESACC).
- (d) That Mr S Shaik played a role in the process regarding the selection of the contractors for the Combat Suite. This was improper, considering that his brother, Mr Schabir Shaik, has a direct interest, as director of and shareholder in both ADS and Thomson.

11.4 WHAT IS THE IMS?

In order to understand some of the technical issues referred in this chapter, one needs to have a basic understanding of what the IMS is and of the importance attached to it in terms of the effective functioning of a vessel.

- 11.4.1 A patrol Corvette consists mainly of a hull, propulsion system and a Combat Suite. The Combat Suite includes basically everything that provides the Corvette with its fighting capabilities. A fundamental part of the Combat Suite is the Combat Management System (CMS). This is the brain of any modern combat system. It provides the electronic impulses and data to the different components of the Combat Suite to enable it to operate in a co-ordinated manner. The different components of the Combat Suite are connected to the CMS via a databus. This is a very sophisticated fibre optic cable plant. The IMS developed by C²I² is such a databus. Failure of the databus will result in total failure of the Combat Suite and will thus cause the ship to become completely deficient.

11.4.2 In the diagram below, the databus is depicted as the encircled area of the CMS in the centre.



11.5 INVESTIGATION CONDUCTED WITH REGARD TO THE PROCESS FOLLOWED FOR THE ACQUISITION OF THE COMBAT SUITE

11.5.1 The Joint Project Team

11.5.1.1 The role of, the procedures followed and the decisions taken by the JPT were ascertained by the investigation team.

- (a) The JPT played a major role in the nomination of element suppliers and the decision regarding the award of the contracts to subcontractors: it was the JPT that had the necessary technical know-how and also negotiated with both the main contractor and the subcontractors. The JPT took decisions, e.g. regarding the categorisation of subcontractors as either Category B or Category C subcontractors, and submitted their decisions to

the Project Control Board (PCB), which consisted of SA Navy, Armscor and DoD officials.

- (b) Apart from this, the Project Officer and Programme Manager reported to their supervisors, which in the case of the Project Officer included the Naval Board.
- (c) Furthermore, relevant issues were discussed at the regular so-called Friday-morning meetings in the office of Mr Swan, the CEO of Armscor, attended by Mr Hanafey, R Adm Kamerman, Mr Nortjé, Mr Shaik and others.
- (d) The evidence indicates that certain members of the PCB did not have the technical knowledge to interfere with the decisions of the JPT and it appears that the PCB merely ratified the decisions of the JPT (only one recommendation of the JPT was not accepted). As R Adm Howell put it, the PCB had basically to trust their experts, i.e. the members of the JPT. It seems that the PCB relied heavily on the input of the Project Officer. In actual fact, therefore, relevant decisions regarding the award of contracts to subcontractors appear to have been taken by the JPT. To complicate matters, the JPT did not keep minutes of its meetings.
- (e) It should be pointed out that conflicting versions were given about whether minutes were kept of formal JPT meetings. No minutes were found during the investigation. This, coupled with the evidence, leads to the conclusion that minutes were not kept; this is not in accordance with good procurement practice.
- (f) The lack of record-keeping complicated the issue as it made it difficult to establish objectively what took place and to determine responsibility. Furthermore, Mr Nortjé testified that all decisions were not necessarily

taken by the whole JPT as decisions could also have been taken at component level and from there be taken to the next level, i.e. the PCB. This complicated issues even further.

- (g) Mr Mathieson, the Armcors Acquisition Manager of the Combat Suite, testified that in the case of the IMS, SMS and NDSS, a cost evaluation was done by the Project Team. No records were kept of decisions reached. Scorecards were kept, but they could have been kept on a white board. The only records kept were reports produced by them. The proposals however, would also be reflected in spreadsheets. He stated that this was not the process normally followed with acquisitions because the GFC was responsible for the subcontractors and because of time pressures in terms of getting things done.
- (h) Based on the above, it can be stated that proceedings of the JPT were not properly recorded so as to create a proper audit trail.
- (i) It is clear that the JPT played an important, if not crucial, role in the whole process. In this regard the following is pointed out:
- The JPT was mandated to negotiate with contractors about, *inter alia*, the price and specifications of products. According to R Adm Kamerman, the International Offers Negotiating Team (IONT) was regularly briefed by them.
 - Although the JPT did not deal directly with subcontractors regarding the subcontracts, they did have direct contact and negotiations with the subcontractors who received technology retention funding about technology development. Annual audit and risk assessments were done of all the contractors who received funding in terms of the technology retention programme. Mr Nortjé explained that, in

dealing with these subcontractors, the JPT members therefore had to wear two hats.

- (j) It is therefore clear that it is not correct, as apparently alleged by DoD and Armscor, that they had nothing to do with the choice of subcontractors.
- (k) All the evidence points to the contrary and Mr Nortjé in fact admitted it when asked about it specifically.
- (l) The fact that the JPT exercised considerable power in the choice of subcontractors is clear from all the evidence. It is also pointed out that, according to R Adm Kamerman's evidence, they requested the GFC to replace ADS with C²I² for the supply of the NDS, an issue which is discussed later on in this report.

11.5.2 The nomination of suppliers for the Combat Suite

- 11.5.2.1 In the presentation by DoD to SCOPA it is stated that *"At no stage in the RFO or Combat Suite tender process was any company designated by the DoD or Armscor as a 'nominated supplier'."*
- 11.5.2.2 As has been pointed out, at least in the SA Navy Patrol Corvette Combat Suite Element Costing and Description, there was a reference to certain "nominated" suppliers.
- 11.5.2.3 Whatever was intended by the use of the word "nominated", it is clear that a list of Combat Suite suppliers was compiled, and given to the GFC. This was apparently done in terms of the RFO.

- 11.5.2.4 This list was compiled by the JPT. No tender procedures were applied and other potential suppliers had no opportunity of applying for inclusion in the list that listed only one supplier per element. No records were kept of the process.
- 11.5.2.5 There is no record of the JPT having compiled a list of subcontractors. Some witnesses suggested that R Adm Kamerman compiled the list himself. However, Mr Mathieson testified that the project team compiled the list, and that he took part in the process. The reason why certain companies were listed had to do with their past performance and the fact that they are local entities. R Adm Howell testified that the list of subcontractors was compiled under his supervision and that the Navy wanted to list as many local companies involved as possible and attempt to utilise the investments already made in some of them.
- 11.5.2.6 According to R Adm Kamerman, the list of nominated suppliers was compiled by the project team, transposed into documents and submitted to the Armscor Secretariat to make sure that they complied with Armscor tender regulations, before they were issued.
- 11.5.2.7 C²I² was not listed for the supply of the Navigation Distribution Sub-System (NDSS), even though it had received technology retention funding in respect of it. No reason for this omission could be found during the investigation. ADS was the only nominated supplier in this regard.
- 11.5.2.8 The nomination of a single supplier also created the potential for abuse of the nomination process and potential prejudice to the State, as was demonstrated by ADS's high tender of R64,73 million for the System Management System (SMS), which was reduced to R29,647 million after a competitive quote was obtained from C²I². ADS was the only nominated supplier for the SMS, and C²I², though not nominated, was apparently only invited to quote in order to lower ADS's quote. This aspect is dealt with more fully below.

- 11.5.2.9 The nomination of suppliers was clearly not intended to indicate that they had to be contracted. Tender documents also referred to candidate suppliers in this regard and allowed the main contractor to submit alternative offers.
- 11.5.2.10 During the investigation no acceptable explanation for not applying a fairer and more transparent process was offered.
- 11.5.3 The tender process**
- 11.5.3.1 Different procedures for obtaining offers for sub-systems of the Combat Suite were used.
- 11.5.3.2 The GFC was supplied with the URS for the Combat Suite and a list of nominated South African companies as local suppliers. The GFC was required to obtain quotations from these companies, but was free to submit alternatives. This happened in the case of the Diacerto bus of Detexis, which was submitted as an alternative to the IMS of C²I².
- 11.5.3.3 Where the GFC submitted only one quotation for a particular sub-system, the JPT evaluated the offer and, if it thought that the price was too high, negotiated with the subcontractor in the presence of the main contractor in an attempt to reduce the price to a level which the JPT found acceptable.
- 11.5.3.4 In two instances the JPT requested the GFC to obtain competitive tenders, as the negotiation process did not achieve the required result. This related to the System Management System (SMS) and the Navigation Distribution Sub-System (NDS or NDSS).
- 11.5.3.5 In the case of a group of three sub-systems, the decision was taken that it should be procured from abroad. The GFC was requested to obtain competitive quotes from the outset. These sub-systems are the Hull-mounted Sonar (HMS),

the Surveillance and Target Acquisition Radar (STAR) and the Surface to Surface Missiles (SSM).

11.5.3.6 The tendering process in respect of subcontractors was administered by the GFC.

11.5.3.7 Mr Nortjé testified that the details of the tenders received were submitted to the JPT by the GFC on spreadsheets. The JPT did not receive the actual tenders, except in those cases where the JPT obliged the GFC to obtain and submit formal competitive tenders. Such competitive tenders, as well as the tenders for the foreign procured items, were received via the GFC.

11.5.3.8 R Adm Kamerman testified that this procedure was also followed in respect of the IMS/Detexis databus.

11.5.3.9 R Adm Howell testified that there was no control from the Navy's side over the fairness of the tender process conducted by the GFC, and that in fact no normal state tender procedures were applied in respect of the approximately R2,6 billion to be spent on the Combat Suite.

11.5.3.10 Witnesses stated that time constraints precluded a thorough procedure from being applied and that the Navy and Armscor did not have experience of such a major acquisition process.

11.5.3.11 Criticism of the process followed apparently also came from the project team. A document entitled "*Selection of Foreign Procured Items*" deals with four elements to be procured from abroad via a competitive bidding process, i.e. the STAR, HMS, SSM and INS. It is stated that the GFC had been provided with detailed URS for each element in order to solicit competitive bids, but "*as far as can be ascertained, no uniform closing date was set*". It is further stated that "*although the situation was of GFC's making, it could be argued that, technically, Armscor's tender*

process has been compromised” and “to rectify the situation, the JPT has decided to consider the exercise as a Request for Information only”. This proposal of 16 April 1999 by R Adm Kamerman and Mr Nortjé, as contained in the above-mentioned document, was accepted by Adm Howell and Mr Hanafey.

- 11.5.3.12 Although the GFC was required to tender in accordance with the URS, it was free to offer alternatives that did not comply with the URS but that, as a witness put it, *“could also do the job”*.
- 11.5.3.13 Various witnesses testified that the URS was not a minimum standard, but that it was the ideal towards which the Navy was striving.
- 11.5.3.14 The URS was not changed. Where products did not comply with it, the Navy compiled a Delta document, which captured the deviations from the URS.
- 11.5.3.15 Bearing in mind the manner in which the list of nominated suppliers was compiled and Armscor’s and the Navy’s lack of any effective control over the tendering process, the whole process of acquiring the Combat Suite, involving some R2,6 billion, was conducted outside Armscor’s and the Navy’s normal tender provisions. It is not clear who authorised this, and whether he/she had the necessary authority to do so.
- 11.5.3.16 Although the process of tendering was not investigated in respect of all subcontracts, there is nevertheless evidence that a fair and regular process was followed regarding certain subcontracts.

11.6 NON-SELECTION OF THE IMS OF C²I² SYSTEMS (PTY) LTD

11.6.1 The C²I² and Detexis proposals

11.6.1.1 The JPT categorised contracts into three groups, i.e.:

- (a) Category A, which consisted of the vessel platform.
- (b) Category B, which consisted of all sub-systems, which have a critical effect on the overall vessel delivery and for which the prime contractor retains full responsibility.
- (c) Category C, which consisted of sub-systems whose performance and delivery remained the responsibility of the subcontractors until delivery to the prime contractor for integration into the vessel.

11.6.1.2 The SA Navy accepted some risk with respect to Category C products.

11.6.1.3 According to the evidence, the IMS was regarded as a critical sub-system of the Combat Suite. (Category B).

11.6.1.4 A request for an offer for the IMS was issued to C²I² by ADS on their letterhead and C²I²'s Best and Final Offer, dated 14 May 1999, was addressed to ADS.

11.6.1.5 C²I² quoted a price of R37 863 086-00 excluding VAT, which equates to R44 303 918-00 including VAT.

11.6.1.6 The GFC was not prepared to accept the risk for the C²I² IMS as a Category B item, and offered an alternative, i.e. the so-called Diacerto bus of Detexis, a Thomson company. It offered the C²I² IMS with a risk premium added to its price, which almost doubled it to R89 255 000.

11.6.1.7 It appears from the presentation to SCOPA that the main contractor submitted the Detexis offer as part of its BAFO on 24 May 1999, as an alternative to the IMS of C²I² and added a risk premium of some R42 million to C²I²'s price: R12 million for a risk analysis and R30 million to cover integration risks and the risk of having to replace the system if it failed. The Detexis product was offered at R49 million.

11.6.1.8 The investigation team did not have access to the Detexis proposal, which is in the GFC's possession. The JPT merely received spreadsheets from the GFC reflecting details of the tenders submitted. Evidence indicates though that the Detexis product was offered at a price of R49 255 000.

11.6.1.9 An ADS letter addressed to R Adm Kamerman on 26 May 1999, entitled "*Response to questions arising from BAFO delivered on 24th May 1999*" states the following:

"Item 13. Information Management System

The current price of R77 157k is based on a formal BAFO received from CCII (CCII/PROP/051 dated 14th April 1999). The increase in price to is due to:

- *An increase in the price quoted by CCII;*
- *The moving of the IMS from "Part C" to Part B" of the contract; and*
- *Specific Terms & Conditions of CCII offer.*

Item 14. IMS Study

ADS confirms its best and final quote at R12 098k".

In a further ADS letter of the same date, addressed to Messrs. Kamerman and Nortjé, the following appears:

"This letter is a follow up to the meeting held this morning at the Secretariat of Defence.

3. The bus to be used is now the Dassault Electronique one".

11.6.1.10 It is obvious that at the time when the GFC presented the Detexis proposal, it was in possession of the C²I² proposal.

11.6.2 Background to the non-selection of the IMS

11.6.2.1 The possibility of replacing the IMS was first reported to the PCB, according to its minutes, on 27 May 1999, when R Adm Kamerman submitted his status report, in which the following is stated:

"Dassault databus now offered i.p.o C²I² bus: project team awaiting full specification and system architecture implications before this can be deemed to be acceptable".

11.6.2.2 This issue was not dealt with at the next PCB meeting on 8 June 1999 and is only recorded in the minutes of the PCB meeting on 24 August 1999.

11.6.3 The SCOPA presentation

11.6.3.1 In their presentation to SCOPA, DoD stated that, *"at no point in the entire tendering process did the SA Navy indicate a preference for the C²I² IMS product or technology, even though the SA Navy being (sic) a co-owner of the C²I² IMS technology", and "on the contrary, the final selection between the C²I² option and the proposed alternative Detexis option was ratified by the PCB which was chaired by the Chief of the Navy".*

11.6.3.2 Mr Shaik testified before SCOPA on 11 October 2000 that (the decision not to bear the risk of the IMS of C²I²) *"was taken by the Chief of the Navy who chaired*

the meeting on the Project Control Board with the approval of his Naval Command Council”.

11.6.3.3 These statements raise several issues, which will be discussed below.

11.6.4 The Navy's preference

11.6.4.1 Apparently in support of the statement mentioned in paragraph 11.6.3.1 above, the Chief of the Navy, Vice Adm R C Simpson-Anderson, drafted a letter, dated 18 September 2000 and marked “Without prejudice”, for action by the Chief of Acquisition, in which he stated the following: *“The Combat Suite databus selected for the Patrol Corvette by the Project Control Board was considered the best option. At no stage was the C²I² option the SA Navy's selected or preferred option”.* This letter was submitted to SCOPA.

11.6.4.2 From the investigation it appears that, up to a point, the C²I² IMS was the preferred databus of the SA Navy. This is clear, not merely from its nomination as the IMS supplier and the amounts spent by the Navy on its development, but also from the conclusion of the Navy (and Detexis) engineers as reflected in the “Report on the Diacerto bus”. It was also confirmed by different witnesses. It is difficult to accept, in the light of the evidence, that the C²I² option had at no stage been the Navy's preference, in spite of R Adm Kamerman's statement that it is not correct to say that the Navy preferred the C²I² bus.

11.6.5 Report on the process followed for the IMS

11.6.5.1 During the investigation clear indications were found that the JPT preferred the IMS of C²I² on technical grounds. This aspect requires some elaboration. The technical evaluation of the Detexis bus took place over three days early in June 1999, and was conducted, according to the *“Report on the Process followed for Information Management System (IMS) for the SAN of Project Sitron”* by Combat

Suite and Detexis engineers. It was also attended by Dr Wolfgang Vogel, an expert in the field, employed by the GFC. Note that Dr Young alleged that the Detexis representatives were not engineers.

11.6.5.2 This Technical Evaluation report was drafted by Messrs Mathieson and Nortjé and submitted to Mr Thomo, the CEO of Armscor, in approximately February 2001. Mr Thomo testified that it was submitted to him at his request, soon after his appointment as CEO of Armscor.

11.6.6 Report on the Diacerto Bus

11.6.6.1 Following the technical evaluation, Mr Mathieson in conjunction with Lt Cmdr Cothill and Cmdr Egan-Fowler, compiled the "*Report on the Diacerto bus proposed by the SAN of Project Sitron*". It is not clear who all the recipients of the report were, but Mr Mathieson testified that it was initially given to R Adm Kamerman, Mr Nortjé and his divisional manager, Mr P Meiring. Later it was also supplied to Mr Thomo. R Adm Kamerman went further and stated that it was issued to PCB members and the Armscor top management prior to contract signature, under cover of a letter signed by Mr Nortjé. It is clear, however, that it was not submitted to the PCB.

11.6.6.2 R Adm Kamerman's sworn evidence provided during the forensic investigation (during an 18 hour consultation) differs in this regard materially from his testimony provided during the public phase of the investigation. In the latter investigation he testified that:

(a) The report (i.e. on the Diacerto) bus was only "*an interim preliminary evaluation report*".

(b) "*Mr Lewis Mathieson absolutely stands by the fact that this was a preliminary report to the project executive*".

- (c) That Detexis was then invited to send a senior engineering team, which had several sessions with the JPT, at least one of which, namely that on 16 June 1999, was recorded.
- (d) That Mr Mathieson then wrote further reports.
- (e) That he, Mr Nortjé, Mr Mathieson and Lt Cmdr Cotthill were then of the unanimous opinion that the Detexis bus was a *"perfectly satisfactory technical alternative to IMS bus"*; and
- (f) That Mr Emmanuel Mary from the main contractor's side, *"one of the leading integration experts of naval combat systems today in Europe"*, took part in the evaluation.

11.6.6.3 Mr Mathieson was requested to respond to these conflicting statements. Two statements were provided, i.e. a joint sworn statement of Mr Mathieson and Andrew Cothill dated 11 September 2001, and an unsworn statement of Mr Mathieson, dated 26 September 2001, which can be summarised as follows:

- (a) The brief of the technical evaluation team from the Project Executive was to undertake a preliminary technical evaluation of the Detexis Combat Suite databus.
- (b) As the output of this preliminary evaluation, a preliminary internal technical report was produced by the technical evaluation team.
- (c) Subsequent to the workgroup of 3 and 4 June 1999, various additional technical exchanges took place between the project team and ADS.
- (d) The results of these technical interchanges did not result in any further technical reports being written.

(e) Further reports were written on the IMS bus. These focussed more on the processes followed.

11.6.6.4 The investigation team did not have access to any other technical reports in this regard, as they were not part of the documents that were made available.

11.6.6.5 It should be pointed out that there appear to be two copies of this report, a shorter and a longer version. The shorter version was used when witnesses were examined during the investigation.

11.6.6.6 The Report on the Diacerto bus, in its opening paragraph, states that it *"is intended to provide a brief overview of the bus architecture being proposed by Thomson ADS for the SAN Patrol Corvette"*. It is also mentioned that Detexis is *"another Thomson company"*.

11.6.6.7 Although it is stated that the proposed LAN will do the job required, aspects are listed which negatively reflect on the Detexis product. These include the following:

(a) *"Extensive use of copper enhances the expected EMI/EMC problems which Thomson has already said they will not be accepting any responsibility for"*.

(b) *"The proposed 100 Mbit/s ethernet products still require a degree of development"*.

(c) *"The SAN will have to rely heavily on the supplier for future support, despite allegations to the contrary by the supplier"*.

(d) *"The 100 Mbit/s ethernet system has never been done on a warship before"*.

(e) *"The design is in fact only a concept at this stage"*.

- (f) *"Strategically the core technical understanding and support of this system will lie in the hands of the supplier".*
- (g) *"It is the CS (i.e. combat suite) project team's expert opinion that for a mid-life upgrade of the vessels, the entire LAN will have to be replaced with the associated consequences on the CS".*

11.6.6.8 The report concludes with the following:

- (a) *"From a technical point of view, the CS project team proposes that the current architecture based on the IMS be retained"*

Mr Mathieson emphasised in his testimony that the recommendation was not that the IMS be retained, but that, from a technical point of view, its architecture be retained.

- (b) *"Both Thomson and GFC recognise that the IMS is a superior product".*

Mr Mathieson testified that this was hearsay, and that the Detexis engineers did not express any opinion.

11.6.6.9 The longer version of the report, contains the following in its last two paragraphs:

"1.6 CONCLUSION

After the above report had been completed, it was provided to the Project Officer and Programme (sic) under cover of a memorandum. While the report clearly shows a preference for the CCII option, it must be stated that the evaluation undertaken was purely of a technical nature and that the technical potential of the CCII is preferred for all of the reasons listed in section 1.5.

The Detexis option was selected purely on financial constraints placed on the project. The risk, as determined by the main contractor, translated into financial penalties for the CCII option. The databus is a critical sub-system to the overall performance of the Combat Suite of the SAN Patrol Corvette. As such, from a technical point of view, the Main Contractor has to assume the responsibility for ensuring that it works.

1.7 FURTHER NOTES ON THE DETEXIS BUS

In short, after delving a bit more into the Detexis bus, the technology is more widely used than that of the CCII option without any degradation in performance"

11.6.6.10 A senior naval officer testified that he and others recommended to the JPT Executive that C²I² and Detexis should be given the opportunity to present their systems on a competitive basis to prove maturity, reliability and performance. Their recommendation was, however, not accepted. The same happened in respect of a recommendation that ADS should be requested to substantiate and explain, in detail, the reasoning behind their statement of high risk and immaturity of the C²I² system and why they were adding so many millions to the C²I² price.

11.6.6.11 Another officer confirmed that, in view of the risk premium added, they asked for a risk evaluation to be done so that the apportionment of risk could be justified. He was unsure, but seemed to think some evaluation was done.

11.6.6.12 A senior naval officer, who took part in the evaluation which led to the "Report on the Diacerto bus", testified that in October and December 1999, C²I² demonstrated its bus to the Navy *"with resounding success, confirming the reason why we still prefer that system"*. He testified that he was concerned about the long-term support of the Corvettes if the Detexis system was used, *"because any minor change or addition or modification to the combat suite, will necessitate major modifications and changes to the databus, which can only be done in France by the particular company"*.

- 11.6.6.13 During the public phase of the investigation, R Adm Kamerman testified that Dr Young, on several occasions, proposed a full risk evaluation of the IMS, including a demonstration of functionality on a strike craft. This proposal was not accepted as, *inter alia*, "the Chief of the Navy was not prepared to take one of his last remaining and precious few operational warships and turn it into a guinea pig laboratory under a technology demonstrator program".
- 11.6.6.14 According to R Adm Kamerman, the mandate of technical team was to ascertain whether the Detexis bus could do the job. He and Mr Nortjé, thereafter, also considered other relevant factors and the full team then decided that the most cost-effective bus was the Detexis bus. He explained that the Report on the Diacerto bus formed "the input to an extensive work session with the full project team and the result of that work session was consensus, full consensus, on the project team that we should recommend the technical, the Detexis solution". No minutes were kept.
- 11.6.6.15 This evaluation was vital to the acceptance of the Detexis bus and the rejection of C²I²'s IMS.
- 11.6.6.16 Had it been found, that the Detexis bus was not acceptable, the chain of events leading to the non-selection of C²I² would probably not have taken place.
- 11.6.6.17 This significant report, which provided a lot of clarity, was not submitted to the PCB, or to SCOPA. R Adm Kamerman's allegation that it was submitted to the PCB members, is not borne out by the evidence obtained. Likewise, his statement that the PCB was advised that Detexis is a Thomson company is not reflected in the PCB minutes and was not mentioned or confirmed by any of the witnesses.
- 11.6.6.18 The failure to advise the PCB of the report, is explained by R Adm Kamerman in his evidence during the public phase of the investigation, as follows:

"It is bizarre to consider that we should or would have taken a preliminary high level report commissioned internally on a project team which had no status except within that team, to the PCB, which was alleged by Dr Young, and I tell you now, personally it was put to me by members of the forensic committee, forensic team, which it is their perfect right to do so. But my response then and my response now remains, that we would never have taken a preliminary high level, untested, unsubstantiated technical report that was commissioned internally, solely for the further internal considerations, to a higher forum until we were certain of our facts. It is only when we were certain of our facts, several weeks later, in fact a month or so later - two months later, that when we went to the PCB we were able to state, gentlemen, these are real alternatives and these are the risks and cost - this is the risk and cost scenario with the buses".

This explanation was certainly not provided by R Adm Kamerman during the forensic investigation.

11.6.6.19 The failure to submit the said report on the Diacerto bus to the PCB has a bearing on the above-mentioned statement to SCOPA that the PCB ratified the selection of the Detexis product. Coupled with this is the fact that the PCB was not informed of the Thomson take-over of ADS (although it was apparently a known fact).

11.6.6.20 Furthermore, there is a lack of clarity about what the PCB decided or ratified. It is therefore necessary to refer, in some detail, to the minutes of the PCB meeting of 24 August 1999.

11.6.7 The PCB meeting of 24 August 1999

11.6.7.1 Witnesses were generally of the view that the meeting of 24 August 1999 took the decision to opt for the Detexis bus, rather than the IMS of C²I².

11.6.7.2 The minutes show firstly that Mr Shaik was the chairperson. There is no indication that he, at any stage, handed the chair over to the Chief of the Navy.

The minutes therefore do not support the statement to SCOPA that the Chief of the Navy chaired this meeting.

11.6.7.3 Item 5 of the minutes refers to the Corvettes, and reads as follows:

- "9. Contracting Model Categories of Risks. *The acting project officer briefed the board on combat suite risk and risk management pertaining to project-contracting model, contained at Appendix A. He emphasised that, although the SAN accepts some risk with Category C products the Prime Contractor retains full responsibility for the delivery and performance of a fully integrated vessel, which includes the full integration of the combat suite ashore and abroad. (All to take note).*
10. Combat Suite Data BUS.
- a. *The project team categorised the C²I² Bus as a Category B risk, i.e. the Prime Contractor retains full responsibility for the delivery and performance of a fully integrated vessel, which includes sub-systems that have a critical effect on the overall vessel delivery. Further, acting POPS informed the board that if the C²I² Data BUS option was selected over the ADS Detexis Data BUS the project team would have to find the extra funds required to bring both options on a par wrt risk coverage. This would result in lifting the ceiling price of the Corvettes.*
- b. *C Acq informed the board that the CEO of ARMSCOR had presented this matter to the AAC and that the Minister supported the issue of the main contractor carrying the overall risk and the responsibility for the sub-contractors. If the principle of the Main Contractor carrying the risk for the sub-suppliers is changed, then the added difference in costs will have to be borne by the DoD. The principle of the contractor carrying the risk must be adhered to. The AAC decided that the ceiling price per equipment should not be raised.*

- c. *Mr Swan and R Adm Howell will meet with Mr Richard Young from C²I² to discuss the matter with him. (Mr Swan and R Adm Howell for action)*”.

11.6.7.4 Apart from showing that Mr S Shaik took part in the discussion, the minutes merely reflect that the PCB was informed of certain facts.

11.6.7.5 Paragraph 15 of the minutes is headed “Ratification by the Board” and reads as follows:

“The following proposals by the project team, detail of which are contained at Appendix F, were ratified by the board (Note: Refer to C Acq’s possible conflict of interest as indicated in par. 13 of the minutes of the PCB held 28 April 1999):

- a. *Combat Suite software only to be frozen by the delivery of the third vessel.*
- b. *Delivery of Cat C sub-systems to Main Contractor to extended by six months.*
- c. *SAN takes delivery of platforms in Germany.*
- d. *Navy accepts risk for CS equipment while in Dockyard awaiting installation”.*

11.6.7.6 The reference to Appendix F, is clearly wrong, and should be a reference to Appendix D of which the covering page contains the following:

“Project Sitron
Presentation to special PCB meeting regarding contracting model
Combat Suite
19/08/1999

Background/problem
List of Category B Equipment;
List of Category C Equipment.
Risk reduction measures
Other areas
Implications”

11.6.7.7 However, Appendix D contains no reference to the IMS of C²I², and there is therefore no indication of any decision, or ratification of a decision.

11.6.7.8 Appendix C, according to the minutes, is a project status report. Only the first page is relevant and it reads as follows:

*“PROJECT SITRON: PROJECT REPORT
REPORT TO PROJECT CONTROL BOARD 24 AUGUST 1999*

RISK COST PERTAINING TO CS BUS

- 1. Equivalent risk to project:*
 - a. CCII databus + RM40*
 - b. DETEXiS databus*
- 2. Legal*
 - a. State advised not at legal risk*
 - b. ADS refuting CCII legal action, referring to State*

CONTRACTING MODEL AND CATEGORIES OF RISK

MANAGEMENT COSTS”

11.6.7.9 There is no reference to either any decision or ratification in regard to Appendix C.

11.6.8 The alleged PCB meeting of 19 August 1999

11.6.8.1 It is alleged by some witnesses that a special PCB meeting took place on 19 August 1999 to discuss the categorisation of sub-systems as either Category B or Category C, i.e. shortly before the PCB meeting of 24 August 1999.

11.6.8.2 This special meeting, if it took place, was one of the most crucial meetings of the PCB. The investigation team has ascertained that all other special PCB meetings were duly recorded and minuted.

11.6.8.3 However, various factors create doubt whether this meeting on 19 August 1999 in fact took place; alternatively, if it is accepted that it did take place, serious doubt exists whether it was a properly constituted and valid meeting. Some of the pertinent factors are the following:

- (a) Although all PCB meetings were minuted, this one was not. No reason for such omission could be advanced; nor is it obvious.
- (b) The minutes of the meeting of 24 August 1999, refer back to the minutes of the previous meeting of 6 June 1998, and contain absolutely no reference to a meeting on 19 August 1999. The minutes of the meeting of 24 August 1999 were accepted as correct at the next meeting, which took place on 6 October 1999.
- (c) No agenda for such a meeting could be found. Only the agenda for the meeting of the 24th August was found.
- (d) There does not seem to be any reason why a meeting had to be held on Wednesday, 19 August 1999 only five days before the regular PCB meeting of Monday, 24 August 1999.
- (e) Likewise, the exclusion of certain people from the meeting casts doubt on its being properly constituted and the issues discussed.

11.6.8.4 R Adm Kamerman testified that a special PCB meeting was held on 19 August 1999 to discuss the risk issue, although no record of such a meeting exists. He and Mr Nortjé made a presentation, and the same presentation was done five

days later at the PCB meeting of 24 August 1999 (although he was not present then). He testified that not all members attended, but that there was certainly a quorum in terms of the PCB constitution. The meeting was requested by Mr Swan, and was attended by Messrs Swan and Shaik, the Chief of the Navy, R Adm Howell, R Adm Van der Schyff and Mr Hanafey. He is not sure if Mr Thomo attended. As far as R Adm Van der Schyff's attendance is concerned, he added that *"he subsequently does not remember it, but, not maliciously, he just said 'I do not recall the meeting'".* As far as Mr Shaik's attendance is concerned, he initially stated that he believed that he had attended. Later, however, he said, *"I cannot recall that Mr Shaik was there. I cannot say that he was there (inaudible). Really, but I do not know, I would be trying to invent something if I said he was or he was not. I cannot recall it".* He and Mr Nortjé made their presentations to the meeting. The presentation was also made to the Naval Board.

11.6.8.5 Mr Nortjé testified that a special PCB meeting was called by Messrs Shaik and Swan and that it took place on 19 August 1999. Only the Combat Suite issue was on the agenda, and he had to make a presentation on the Category B and C risk issue. The proceedings were not minuted. The meeting was chaired jointly by Messrs Shaik and Swan, and attended, as far as he recalls, by Mr Hanafey, Capt Watson, R Adm Howell, R Adm Van der Schyff and the Chief of the Navy, who stayed only for a short period of time. Mr Shaik remained present during the whole discussion and took part in it. The presentation made by him is Appendix "D" to the minutes of the meeting of 24 August 1999. His impression was that the PCB approved his proposals.

11.6.8.6 According to Mr Nortjé, the proposal put forward was not a proposal of the JPT, but of Kamerman, Cothill, Watson, Mathieson and himself; it was also not decided at a specific meeting, but evolved over time.

- 11.6.8.7 Mr Mathieson testified that the project team decided that both options should be presented to the PCB for a decision, and that the project team did not decide on any of the two products. The decision of the project team was not minuted. He did not assist in preparing the presentation to the PCB, and does not know what was presented. He stated that R Adm Kamerman and Mr Nortjé prepared the presentation.
- 11.6.8.8 It should be pointed out that dates of PCB meetings were usually arranged telephonically and agendas were prepared and issued. No agenda for a meeting of 19 August 1999 could be found, according to Capt Clayden-Fink, whose responsibility it was to arrange meetings, prepare agendas and keep minutes of PCB meetings regarding Project Sitron.
- 11.6.8.9 Mr Hanafey of Armscor testified that he does not remember such a meeting or attending a meeting on 19 August 1999, and that, if it did take place as described, it would have been irregular. Mr Thomo's evidence was that he never attended a special PCB meeting. R Adm Howell testified that he would have to check his diary in this regard. He did and advised that it showed an entry relating to a PCB meeting on 24 August 1999, which means that it did not take place on the 19th but on the 24th of August 1999. R Adm Van der Schyff makes no mention of such a meeting in his statement.
- 11.6.8.10 Mr Shaik testified that there was no PCB meeting on 19 August 1999, and when he asked R Adm Kamerman about it, he said that there was "*a briefing on the categories of contractual risk and the contractual model to the CEO of ARMSCOR*".
- 11.6.8.11 This clearly casts serious doubts on the veracity of the versions of R Adm Kamerman and Mr Nortje.
- 11.6.8.12 To complicate issues further, Mr Swan sent a letter, dated 29 June 1999, (i.e. well before the PCB meeting of 24 August 1999) to the GFC regarding "*Project*

Control Board decisions regarding the Project Sitron Technical baseline”, in which he stated that, “at a meeting held recently regarding the selection of major products and their suppliers for the Corvette programme, the following were selected (see attached list)”.

11.6.8.13 The PCB meeting prior to Mr Swan’s letter (and the last one before the meeting of 24 (or 19) August 1999) was a decision-making PCB meeting held on 8 June 1999. The minutes record that the following relevant recommendations were presented by the Project Officer:

Element	Contenders	Selected suppliers
STAR	Thomson Dasa Ericsson	Thomson NDS
IFF System	Thomson Reutech	Thomson NCS/Tellumat
HMS	Thomson STN Alenia	Thomson Marconi
SSM	Aerospatiale SAAB DASA	Aerospatiale

11.6.8.14 It also records that the decisions (regarding the selected suppliers) were ratified by the board. (The minutes contain no reference at all to the C²I²/Detexis issue).

11.6.8.15 It is therefore not known to which meeting Mr Swan referred, and some of the details on the list seem to be wrong in any event.

11.6.8.16 When R Adm Kamerman testified during the public phase of the investigation, he made no mention of the meeting of 19 August 1999. This is a further indication that, in all probability, no such meeting took place.

11.6.8.17 Based on the above-mentioned evidence, the only conclusion that can be drawn is that, if a decision was taken regarding whether the IMS of C²I² should be a

Category C item, doubt exists regarding the regularity and validity of such a decision and the process followed in arriving at such a decision.

11.6.9 The imposition of a risk premium on the IMS of C²I²

11.6.9.1 As has been stated, the GFC placed a risk premium on the IMS of C²I².

11.6.9.2 R Adm Kamerman testified that the GFC submitted a high-level work breakdown regarding the R12 million cost for the risk assessment of the IMS.

11.6.9.3 It is clear from the evidence that the IMS was a critical sub-system, that it was still under development and that it was reasonable to expect either the State or the GFC to assume responsibility for the risk attached to the IMS, if C²I² could not assume such responsibility.

11.6.9.4 It is not clear how the risk premium was calculated. Furthermore, the calculation of the risk premium cannot be evaluated without evidence from the GFC and the assistance of an expert witness.

11.6.9.5 It seems that the risk premium placed on the IMS of C²I² was merely accepted by the JPT and PCB, without any attempt to properly evaluate or assess it. One would have expected a proper assessment by the JPT instead of a mere acceptance.

11.6.9.6 Sufficient documentary and other evidence regarding risk premiums placed on other products has not been obtained. In regard to risk premiums placed on other products, it was stated in the SCOPA presentation that risk premiums were also placed on other subcontractors by the main contractor, "*mainly due to most of them still being under technology development*", and that in addition to the main contractor's risk premiums, "*most of the RSA sub-contractors included an internal development risk allocation in their quotations to the main*

contractor". Some witnesses also referred to these risk premiums; e.g. Mr Mathieson, who testified that it varied from 40% to 100% and probably 120% in the case of Kentron, which would be reflected on the spreadsheets provided to the GFC. R Adm Kamerman testified that risk premiums were placed on all subcontractors.

- 11.6.9.7 Other subcontractors were not consulted during the investigation.
- 11.6.9.8 Witnesses generally seem to have accepted that there was a risk attached to the application of C²I²'s IMS. According to R Adm Kamerman, their assessment of the IMS was that, regarding technical aspects, the risk to the Combat Suite was "relatively benign", and was "a manageable technical risk". However, there is no evidence to indicate that a proper risk assessment of the IMS was made.
- 11.6.9.9 R Adm Kamerman conceded that, with hindsight, the Navy could have obliged the GFC to go out on competitive tender.
- 11.6.9.10 The investigation team is of the view that it cannot be found that the imposition of a risk premium on the IMS of C²I² was unreasonable. On all accounts the IMS is a critical sub-system and it appears reasonable that the GFC would not have been prepared to accept the IMS as a Category B system.
- 11.6.9.11 Whether the decision of the State not to bear the risk was reasonable, especially in view of the R22 249 592-42 spent on the development of the IMS, is open to question. However, it will probably be impossible to prove that the decision was unreasonable, in view of the fact that the SANDF remains the owner of the technology developed during the technology retention programmes.

11.6.10 Effect of funding of C²I² by Armscor

11.6.10.1 The investigation was required to verify the fact that more than R20 million had been invested in C²I² up to the point of its non-selection as a supplier of the IMS. From a review of documentation that was made available to the investigation team it was established that, according to invoices and credit notes presented to Armscor by C²I² in respect of the development of the IMS and NDSS, that amounted to R23 149 508-42, R22 249 592-42 was paid in respect of the IMS, and R899 916-00 in respect of the NDSS.

11.6.10.2 Separate contracts were signed with C²I² in respect of the technology funding. In respect of the IMS, most contracts specify that the SANDF shall retain ownership and copyright of the product once full and final payment has been made. One contract stipulates that the SANDF and C²I² shall have joint ownership. In respect of the NDSS, the contract stipulates that Armscor and the Navy shall have joint ownership.

11.6.10.3 In light of the explanations received regarding the use of technology retention funding, we cannot conclude that it was unreasonable not to use the product for which the particular funding had been provided.

11.7 THE RELEASE OF C²I² SPECIFICATIONS TO COMPETITORS

11.7.1 As indicated above, ADS became part of the GFC, i.e. the main contractor, and was also the Combat Suite contractor and a contender for subcontracts.

11.7.2 As far as the complaint that the specifications and quoted price of C²I² were disclosed to Detexis is concerned, the investigation revealed the following:

11.7.2.1 On 11 November 1998 ADS submitted a RFQ for the IMS to C²I², with which C²I² complied.

11.7.2.2 On 13 May 1999 ADS, on an ADS letterhead, submitted the following request to C²I²:

"The Consortium of African Defence Systems (ADS) and German Frigate Consortium (GFC) have undertaken to submit a Best and Final Offer (BAFO) for the Vessel System as requested by the South African Navy and ARMSCOR.

The BAFO needs to be submitted by ADS/GFC on Wednesday, 19th May 1999 at 15h00. The pertinent parts of the request from SAN to ADS/GFC is provided in Appendix A.

You are requested to submit a best and final offer for your segment/sub-system by Friday, 14th May 1999 at 16h30 in order that ADS/GFC is able to consolidate the offer from all the segment/system suppliers for Wednesday, 19th May 1999".

11.7.2.3 On 14 May 1999 C²I² submitted its BAFO to the GFC.

11.7.2.4 On 24 May 1999 the GFC submitted its BAFO. It is not clear whether the Detexis bus was part of the offer, although in the presentation to SCOPA it was stated that it was.

11.7.2.5 On 29 July 1999, in response to a letter from Dr Young, Mr P Moynot of ADS sent a letter on an ADS letterhead to C²I² stating the following:

*"However, I would like to strongly contest your saying that I told you that I have passed your confidential business information to competitors. What I have told you is that when confronted with price reductions we have asked Dassault Electronique (now part of Detexis, subsidiary of Thomson), to provide us with a price which we then **internally** compared to your price to see it if was affordable. This is the normal practice and no prejudice can have been created in doing so. I would appreciate your acknowledgement of this fact as soon as possible so that the possible relationship between our Companies becomes normal and not antagonistic as it seems to have been in the last few months"(our emphasis).*

11.7.2.6 Bearing in mind that both ADS and Detexis were Thomson companies and that ADS was part of a consortium with the GFC, there was certainly the possibility that C²I²'s specifications and price were disclosed to Detexis.

11.7.2.7 R Adm Kamerman testified that the C²I² and Detexis offers would not be "on file". He stated: *"they are only on file at the level of the information that we were obliging him (i.e. the GFC) to record on a line item basis and our spreadsheet in terms of those various columns that we had and the subsequent negotiation on each of those line items. We did not take his quote, or the quote received by him from Detexis and the quote received by him from C²I² and do a comparison"*.

11.7.2.8 A senior naval officer testified that he suspected unethical business practice on the part of ADS, by making C²I²'s prices available to Detexis prior to the latter submitting their proposal. He stated that he heard two Detexis employees talking on 3 June 1999 in Cape Town where one of them said that they were offering their bus system approximately 30% cheaper than the C²I² bus.

11.8 THE COMPLAINT BY C²I² IN RESPECT OF THE SYSTEM MANAGEMENT SYSTEM AND NAVIGATION DISTRIBUTION SUB-SYSTEM

11.8.1 The gist of the complaint

11.8.1.2 In April 1999 C²I² was requested by the German Frigate Consortium to submit an offer for two sub-systems of the Combat Suite of the Patrol Corvette, namely the System Management System (SMS) and the Navigation Distribution Sub-System (NDSS). C²I² was eventually awarded the contract for the NDSS. On 1 September 1999 C²I² was informed that their tender for the SMS had not been successful.

11.8.1.3 From a document entitled *"Report on the Process followed for System Management System and Navigation Distribution Sub-System for the SAN of*

Project Sitron” prepared by Armscor, Dr Young came to learn that ADS was awarded the contract. C²I² regards the process that was followed to award the contract to ADS as fundamentally flawed.

11.8.2 The award of contracts for the SMS and NDSS

11.8.2.1 The process followed for the award of the contracts for the System Management System (SMS) and the Navigation Distribution Sub-System (NDSS) indicates how a procurement system can be manipulated.

11.8.2.2 Mr Nortjé testified that the “*Report on the Process followed for the System Management System (SMS) and Navigation Distribution Sub-System (NDSS) for the SAN of Project Sitron*” was compiled by Mr Mathieson. For his part, Mr Mathieson testified that he compiled it in conjunction with the programme manager who was Mr Nortjé.

11.8.2.3 ADS was the only nominated supplier for both the SMS and NDSS.

11.8.2.4 The above-mentioned report states, inter alia, the following:

"This report is intended to provide a brief overview of the process that has been followed for the acquisition of the System Management System (SMS) and Navigation Distribution Sub-System (NDSS) for the SAN patrol corvette of Project SITRON.

PROCESS

In a letter, dated 12th April 1999, the German Frigate Consortium (GFC) was requested by the Project Team to obtain competitive quotes for the SMS and NDSS of the Combat Suite of Project Sitron. The two parties requested to quote were ADS (Pty) Ltd and CCII (Pty) Ltd.

The Offers were presented to the Project Team on 16th April 1999, the defined closing date.

Thereafter, a team of technical personnel, comprising SAN and ARMSCOR engineers did an evaluation on the Offers and made recommendations to the Programme Manager and Project Officer.

SYSTEM MANAGEMENT SYSTEM

For the SMS, the following prices were evaluated:

<u>ADS</u>	<u>CCII</u>
R29.647m	R30.04m

"NAVIGATION DISTRIBUTION SYSTEM

For the NDSS, the following prices were evaluated:

<u>ADS</u>	<u>CCII</u>
R18.9m	R15.99m

"NOTES

A fundamental point to note in this whole exercise is that the first quote received from ADS on 15th March 1999 for the SMS was R64.73m and subsequent quote on 07th April 1999 was R37.62m. In going out on competitive tender, a normal business practice, the price was reduced to R29.65m. This equates to a saving to the State of at least R7.9m for the SMS.

Similarly for the NDSS. The first quotation received from ADS on 15th March 1999 was R45.94m and the subsequent quote on 07th April 1999 was R25.03m. As a normal business practice, the eliciting of a competitive quote reduced this price to R15.99m, a saving of at least R9.0m to the State"

- 11.8.2.5 The request to obtain competitive quotes for the SMS and NDSS, was conveyed to the GFC by means of a letter from R Adm Kamerman, dated 12 April 1999, in

which it was specified that quotes should be obtained from ADS and C²I² and that the closing date would be 16 April 1999.

- 11.8.2.6 The contract for the SMS was awarded to ADS and for the NDSS to C²I².
- 11.8.2.7 According to the witnesses, the process of inviting further tenders was aimed at lowering the price and took place as part of the negotiation process.
- 11.8.2.8 C²I² was not given the opportunity of submitting a second tender, because, according to Mr Mathieson, C²I² was not the designated SMS supplier and because of tender regulations. He stated that: *"you cannot keep going back to any one of the parties and say, listen, do you not want to lower your price?"*.
- 11.8.2.9 The mentioned report shows the following:
- (a) The unfairness of the process of nominating one supplier only in a unilateral way. It is clear that C²I² was a contender who should have qualified during the nomination process for inclusion in the list of nominated suppliers for both the SMS and NDSS.
 - (b) The first quotation of ADS for the SMS was not reasonable and was inflated.
 - (c) ADS was given the opportunity of lowering its tender of R64,73 million for the SMS to just below that of C²I² over a period of more than a month; C²I² was given four days at the most to submit its tender. This seems to have been unfair and created the impression that C²I² was merely requested to quote in order to bring down ADS' price.
 - (d) The GFC requested C²I² to submit its quotation for the SMS by 15 April 1999, as it had to lodge its tender by 16 April 1999. C²I² submitted its

quote on 14 April 1999. ADS submitted its third quote on 15 April 1999. It is not clear if ADS had access to C²I²'s quote. A letter from ADS to R Adm Kamerman dated 26 May 1999, seems to indicate that it may have had access to the quote because the following is stated:

"Item 20. Navigation Distribution System (NDS).

The current offer from CCII (CCII/PROP/055 dated 14th April 1999) does not comply with our terms and conditions (base date May 1998, 1 USD = R5.5) and thus requires some financial adjustment prior to being integrated into our offer. Also, a risk assessment needs to be carried out in order to add relevant provisions, if these are required. The lack of time to properly assess financial and technical implications resulted in the CCII system not being included in the offer submitted on 24th April 1999. Consequently this offer included the ADS Navigation Distribution System".

- 11.8.2.10 The last point demonstrates the ease with which a contractor can get access to a competitor's quotation if proper procurement procedures are not followed.
- 11.8.2.11 It can be argued, however, that the fact that ADS submitted a higher quote for the NDSS than C²I², is an indication that they did not have access to C²I²'s price, and that the GFC was administering the tendering process fairly.
- 11.8.2.12 As far as the NDSS is concerned, the contract was awarded to C²I² as stated above. This fact demonstrates a lack of fairness in the process of nomination of single suppliers per system. Clearly C²I², who had been the recipient of R899 916-00 technology funding in respect of the NDSS, should have been listed with ADS as a potential supplier.
- 11.8.2.13 A further point regarding the SMS proposal of C²I², is that a cheaper option was offered by C²I², which reads as follows:

"The SMS is offered with the standard ADS VMC frame and housings, with Multibus II processor units. An option available for the SMS will be to provide a C²I² Systems console. The savings for four systems would be R1 500 000.00 (excl. VAT). Therefore the SMS total with C²I² Systems consoles would be: R21 680 922.00".

- 11.8.2.14 It was apparently not properly considered by the project team. No acceptable explanation in this regard was offered by the various witnesses.
- 11.8.2.15 R Adm Howell testified that the facts regarding the SMS and NDSS tenders were not disclosed to the PCB. They merely got the recommendation of the Project Team.

11.9 THE COMPLAINT BY C²I² IN RESPECT OF THE INTEGRATED PLATFORM MANAGEMENT SYSTEM SIMULATOR (IPMS)

11.9.1 The Complaint

C²I² complained that they were requested by the GFC to submit an offer for the IPMS on 23 June 1999. After C²I² had been selected by the Project Control Board to supply the IPMS, an extension of their offer was requested twice. Eventually they were requested to provide a last and final offer by 2 March 2001. On 11 April 2001 C²I² was informed that their tender had been unsuccessful. C²I² had thus been deselected in respect of the IPMS in an improper manner.

11.9.2 The response by the Department of Defence

R Adm Kamerman testified in response to this complaint that the contract between the State and the main supplier signed in December 1999 stated that Siemens would be the preferred supplier of the IPMS. However, it was also

stated that during the design phase, the system offered by C²I² had to be explored as an option and that the final selection would only be made after such investigation. It was thus the S A Navy that suggested that the offer of C²I² be considered as they had been involved in the development of similar systems and had a reasonable potential to participate in the supply of the IPMS. That did not amount to a selection and the main contractor was not influenced in any way to make a particular choice. It appears from the records of meetings between C²I² and the GFC that the main contractor had difficulties with the increase in the price by C²I², their inability to meet time limits, their demand for free technology to be provided to them by Siemens and their inexperience in contracting for systems of this nature. The contract was awarded to Siemens South Africa.

11.10 CONFLICT OF INTEREST OF MR SHAIK

- 11.10.1 The regularity or not of the decision not to select the IMS of C²I², may also have been affected by the position of Mr Shaik.
- 11.10.2 The minutes of a special meeting to discuss the way ahead with Projects Sitron and Wills, held on 29 September 1998 under the chairmanship of Mr Shaik, do not reflect that any conflict of interest was disclosed, but show that Mr Shaik informed the meeting that the Combat Suite had become a political issue and should be resolved urgently.
- 11.10.3 At the first PCB meeting on 4 December 1998, again chaired by Mr Shaik, it was recorded that: *"The chairperson informed the meeting that, due to a conflict of interest, he is to recuse himself from the combat suite element of the corvette and submarine requirement"*. These minutes were accepted as correct at the next PCB meeting of 8 March 1999.

11.10.4 There is no indication in those minutes, or the minutes of subsequent meetings, exactly what interest he declared. It does appear though that it related to his brother's involvement with ADS and possibly his wife's involvement as well. R Adm Kamerman even went so far as to say that Mr Shaik declared that his brother was a director of Nkobi Holdings.

11.10.5 With this as background, reference should be made to the letter of 17 October 2000 by Chief of the Navy, Vice-Adm RC Simpson-Anderson, to the Secretary of Defence, which reads as follows:

3. *Chief of Acquisition.* On 4 Dec 98, before preferred Main Contractors were requested to solicit offers for any combat suite equipment, the Chairman, Mr S Shaik, Chief of Acquisition, informed the first Project Control Board meeting of a family member's business connection with one of the tendering parties for the Corvette and Submarine combat suites, viz. ADS. Although he personally had no interest in ADS, he proposed to recuse himself from any decision making related to the Corvette and Submarine combat suites on the grounds that a perception of bias might exist. It was agreed that whenever the combat suites were discussed I would take over the chair and that Mr Shaik would not take part in any discussions, consultations or decisions. This process in the Project Control Board was followed throughout the period leading to final contract signature. I consider it laudable of Mr Shaik to have voluntarily recused himself early on, despite having no actual "conflict of interest" as defined" (Our emphasise).

11.10.6 The above-mentioned minutes clearly do not bear out what was stated in the letter.

11.10.7 In the presentation by the DoD to SCOPA, it was stated that Mr Shaik disclosed "his potential conflict of interest due to a family member being associated with one of the candidate suppliers"; further that the "PCB agreed that the procedure to be followed would be that he would hand over chairmanship of the PCB to the Chief of the Navy during discussion/decisions on combat suite matters in which he would take no

part unless requested to amplify a point. This procedure was followed throughout the combat suite tendering and contract negotiations phase. In several instances the Chief of Acquisitions physically absented himself from the meeting room during such discussions/decisions”.

- 11.10.8 During the public phase of the investigation, Vice Adm Simpson-Anderson testified that at the first PCB meeting held on 4 December 1998, Mr Shaik informed the meeting about his possible conflict of interest with regard to discussions in connection with the Combat Suite because of his brother’s involvement with ADS. He informed the meeting that he would recuse himself from discussions about the Combat Suite and he handed the chair of the meeting to Adm Simpson-Anderson in that and subsequent meetings whenever the Combat Suite came up for discussion. Mr Shaik’s recusal did, however not mean that he left the room where the meeting was held. This did not bother Adm Simpson-Anderson as Mr Shaik did not participate in discussions or the decision making process. As he was the link between the PCB, the Acquisition Division of the Department of Defence, the Secretary for Defence, the SOFCOM, the Minister of Defence and the Ministers` Committee, Mr Shaik had to provide relevant information to the PCB meeting and had to attend the PCB meetings to enable him to convey important decisions and other information to the above-mentioned persons and institutions.
- 11.10.9 Adm Simpson-Anderson held the view that Mr Shaik’s presence when the Combat Suite was discussed did not put him in a position to influence the final decisions taken in that regard. As a matter of fact, as the decision making process pertaining to the Combat Suite was such a long and interactive process involving personnel from the Navy, Armscor, DoD and the main contractor, it was impossible for one individual to have had a manipulating influence. Mr Shaik’s presence at the PCB meetings that he attended was in no way intimidating to the other members. Even if Mr Shaik were not allowed to attend the PCB meetings when the Combat Suite was discussed, he, as Chief of

Acquisitions, would have been informed of the details of the decisions taken in connection with the Combat Suite. He would thus in any event have been in a position to convey such information to his brother, if he wished to do so. There is, however, no indication that he did so.

11.10.10 The alleged agreed procedure does not appear in the PCB minutes. Had it been agreed upon, one would have expected it to be recorded.

11.10.11 An example of Mr Shaik's "recusal" is to be found in the minutes:

11.10.11.1 At the PCB meeting of 23 March 1999 held at the Departmental Acquisition and Procurement Division (DAPD), the following was recorded:

"13. The Chairperson re-iterated that, due to a possible conflict of interest, he will recuse himself from any decisions taken on the combat suite, but will not recuse himself from the meeting".

11.10.11.2 After paragraphs 14 and 15, dealing with the Corvettes platforms, the following appears:

"Note: The Chief of Acquisition handed over the Chair to C Navy for the discussion on the combat suite".

"18. Technology Effort: C. Acq. indicated that care should be taken to indicate

Note 1 : C. Acq. again took over the chair;

Note 2 : Members of Corvette team withdraw".

11.10.12 It is evident from these minutes that there was no recusal in the true sense of the word, and that in spite of his "recusal" Mr Shaik took part in the discussions. His taking part in discussions is contrary to what Vice Adm Simpson-Anderson stated in this regard.

PCB Meeting attended	Chairman	Interest declared	Recused	Comments	Page
29/09/1998	S Shaik	No	No	Took part in discussion of Combat Suite	15002881
04/12/1998	S Shaik	Yes	No	Combat suite discussed	15002872
08/03/1999	S Shaik	Yes	Yes - Will recuse himself from decisions taken but not from the meeting	Chair handed over to Chief of Navy for Combat Suite discussion, but Mr Shaik remained present.	16000440
28/04/1999	S Shaik	Yes	Yes - Will recuse himself from decisions taken but not from the meeting	Mr Shaik handed over to Chief of Navy, but he remained present.	16001068
27/05/1999	S Shaik	No	No	Project report <i>inter alia</i> on Combat Suite presented by project officer. Combat Suite reductions discussed in Chair's presence.	16001046
08/06/1999	S Shaik	No	No	Decisions regarding Combat Suite were ratified.	16001005
24/08/1999	S Shaik	Yes	No	Decisions regarding Combat Suite were ratified	15002764
06/10/1999	S Shaik	No	No	PCB amended Constitution approved.	15002745
11/02/2000	RC Simpson-Anderson	No	Yes	Mr Shaik joined meeting later and took part in discussion of Corvettes	14008395
04/08/2000	RC Simpson-Anderson	No	No	Mr Shaik joined meeting later and took part in discussion of C ² I ² issue	15002714
06/10/2000	SJ Verster	No	No	Combat suite not discussed	15002681

11.10.13 Mr Shaik testified before SCOPA on 11 October 2000 that "*I had a conflict of interest with ADS as a family member became a director this year in ADS and I have declared that conflict of interest*".

11.10.14 As stated, the details of what Mr Shaik disclosed, were not minuted. However, it is clear that his disclosure related to a family member's interest in ADS.

11.10.15 As far as Mr Shaik's conflict of interest is concerned, it would of course have been a factor also affecting his other capacities in the procurement process.

11.10.16 It is clear that Mr Shaik's "recusal" from PCB meetings, was no recusal at all.

11.11 FINDINGS

11.11.1 The Joint Project Team

A Joint Project Team (JPT), was appointed to manage the procurement project in respect of the patrol Corvettes, consisting of SA Navy and Armscor personnel, with the project officer being R Adm J E G Kamerman, and the programme manager being Mr F Nortjé of Armscor. The JPT played a major role in the nomination and eventual selection of element suppliers.

11.11.2 The nomination of suppliers for the Combat Suite

11.11.2.1 A list of suppliers for the Combat Suite was compiled by DoD. Only one supplier per element was listed, and the list was made available to the GFC. No records were kept of the process and no tender procedures were applied, which means that potential suppliers could not apply for inclusion in the list. Evidence obtained indicates that the suppliers listed were those who had received funding in terms of the technology retention programme.

11.11.2.2 The nomination of suppliers was clearly not intended to indicate that they had to be contracted. Tender documents also referred to candidate suppliers in this regard and allowed the main contractor to submit alternative offers.

11.11.2.3 The compilation of the list of nominated suppliers was not a fair and transparent procurement practice.

11.11.3 The tender process

11.11.3.1 The GFC, being the main contractor, had to administer a tender system that was not subject to the control of Armscor or the SA Navy.

- 11.11.3.2 All contractors for the sub-systems of the Combat Suite had to submit their tenders to the GFC.
- 11.11.3.3 The GFC evaluated tenders received by it and recorded the relevant details on spreadsheets, which were then submitted to the JPT. The JPT, therefore, did not have access to the tenders.
- 11.11.3.4 This had the effect that the award of contracts worth approximately R2,6 billion took place without the normal Armscor or State Tender Board procedures being applied.
- 11.11.3.5 The fact that ADS became part of the GFC, i.e. the main contractor, and was also the Combat Suite contractor and a contender for subcontracts, probably created a conflict of interest situation that amounts to non-compliance with good procurement practice.
- 11.11.4 **The non-selection of the IMS of C²I²**
- 11.11.4.1 At some stage the JPT categorised contracts into three groups, i.e.:
- (a) Category A, which consisted of the vessel platform.
 - (b) Category B, which consisted of all sub-systems which have a critical effect on the overall vessel delivery and for which the prime contractor retains full responsibility.
 - (c) Category C, which consisted of sub-systems, whose performance and delivery remain the responsibility of the subcontractors up to the point of delivery to the prime contractor for integration into the vessel.

- 11.11.4.2 The SA Navy accepted some risk with respect to Category C products.
- 11.11.4.3 According to the evidence, the IMS was regarded as a critical sub-system of the Combat Suite.
- 11.11.4.4 The request for an offer for the IMS was issued to C²I² by ADS on their letterhead and C²I²'s Best and Final Offer, dated 14 May 1999, was submitted to ADS. It is therefore clear, as Dr Young alleged, that the C²I² proposal was presented to ADS.
- 11.11.4.5 C²I² quoted a price of R37 863 086-00 excluding VAT, which equates to R43 163 918.00 including VAT.
- 11.11.4.6 The GFC was not prepared to accept the risk for the IMS as a Category B item, and offered an alternative, i.e. the so-called Diacerto bus of Detexis, a Thomson company. It offered the IMS with a risk premium added to its price, which almost doubled it to R89 255 000.
- 11.11.4.7 The investigation team did not have access to the GFC documentation, and had to rely on the following version of the Department of Defence:
- A risk premium of some R42 million was added, consisting of R12 million to conduct a risk analysis of the IMS and R30 million to cover integration risks and the risk of having to replace the system if it failed.
- 11.11.4.8 The investigation team is of the opinion that the risk premium placed on the IMS was merely accepted by the JPT and PCB, without any attempt to properly evaluate or assess it.

- 11.11.4.9 Furthermore, there is no evidence to indicate that a proper technical risk assessment of the IMS was made.
- 11.11.4.10 The JPT had an evaluation of the Detexis databus done in June 1999, which led to the compilation of the *"Report on the Diacerto bus proposed by the SAN of Project Sitron"*. In terms of this report, it was found that the IMS was a superior product and the JPT consequently, from a technical point of view, proposed that the IMS be retained. It was further found, however, that the Diacerto bus of Detexis could also do the job. Although further technical interchanges between the JPT and ADS/Detexis took place, no further technical reports were produced.
- 11.11.4.11 It appears that the JPT, or the members involved with the IMS, decided to opt for the Detexis product in view of the fact that it was cheaper, bearing in mind the risk premium placed on the IMS.
- 11.11.4.12 No PCB minutes reflecting a decision to award the contract to Detexis, or ratifying such a decision, could be found. It appears from the minutes of the PCB meeting of 24 August 1999 that the PCB was merely informed of the JPT's view.
- 11.11.4.13 The project officer and programme manager testified that, five days prior to this PCB meeting, i.e. on 19 August 1999, a special PCB meeting was held where it was decided to award the contract to Detexis. However, their evidence is contradicted by other witnesses and the available documentation.
- 11.11.4.14 Furthermore, no minutes of Naval Board meetings, reflecting a decision to opt for the Detexis bus, could be found.

- 11.11.4.15 It is therefore not clear when and by whom the decision was taken not to award the contract to C²I². However, it is clear that such a decision was taken and that it was taken, generically speaking, by the State.
- 11.11.4.16 The investigation team is of the view that it cannot be found that the imposition of a risk premium on the IMS of C²I² was unreasonable. On all accounts the IMS was a critical sub-system and it appears reasonable that the GFC would not have been prepared to accept the IMS as a category B system.
- 11.11.4.17 Whether the decision of the State not to bear the risk was reasonable, especially in view of the R22 249 592.42 spent on the development of the IMS, is open to question. However, it will probably be impossible to prove that the decision was unreasonable, in view of the fact that the SANDF remains the owner of the technology developed.
- 11.11.4.18 Risk premiums were also placed on other subcontractors.
- 11.11.5 The award of the contract for the SMS**
- 11.11.5.1 ADS was the only supplier nominated or listed for the SMS. ADS submitted its first quote for the SMS on 15 March 1999 for R64,73 million. On 7 April 1999, ADS submitted a lower quote for R37,62 million. The JPT thereafter requested the GFC to obtain competitive quotes, which resulted in a further quote being obtained from ADS, and a quote also being obtained from C²I². ADS then, on 15 April 1999, submitted its third quote for an amount of R29,647 million. C²I² submitted a quote for R30,04 million. All quotes were submitted to the GFC.
- 11.11.5.2 ADS therefore had three chances to quote. Their third offer was R35,08 million less than their first quote, and R390 000 less than that of C²I². ADS was awarded the contract.

11.11.5.3 It is clear that the first ADS quotation was inflated. Furthermore, ADS was given the opportunity of lowering its tender of R64,73 million for the SMS to just below that of C²I² over a period of more than a month. C²I² was given a maximum of four days to submit its tender. This creates the impression that C²I² was merely requested to quote in order to bring down ADS's price.

11.11.6 The awarding of the contract for the NDSS

11.11.6.1 ADS, who was the only nominated supplier for the NDSS, submitted a quotation of R45,94 million on 15 March 1999, and subsequently, on 7 April 1999, a quotation of R25,03 million.

11.11.6.2 The JPT then requested the GFC to obtain competitive quotes, as a result of which ADS submitted a quote of R18,9 million. C²I² was also invited to submit a quote, and submitted one for R15,99 million. The contract was awarded to C²I².

11.11.6.3 This demonstrates a lack of fairness in the process of the nomination of single suppliers per system. Clearly C²I², who had been the recipient of technology funding in respect of the NDSS, should have been listed with ADS as a potential supplier.

11.11.7 The awarding of the contract for the IPMS

It appears from the evidence that the State had not been involved in the selection of the subcontractor for the IPMS.

11.11.8 Conflict of interest of Mr S Shaik

11.11.8.1 Mr S Shaik chaired most of the PCB meetings. He disclosed a conflict of interest at the second PCB meeting and indicated that he would recuse

himself from decisions regarding the Combat Suite, but not from the meeting.

11.11.8.2 His recusal was no recusal at all. It appears that he mostly remained present during discussions of the Combat Suite and that he also, on occasion, took part in discussions of the topic.

11.11.8.3 Mr Shaik's presence at certain meetings of the PCB, even though he declared a possible conflict of interest, created a perception of impropriety. The mere fact that he remained in the room and that he made certain inputs could have created a belief that he could have influenced certain decisions in favour of ADS or Thomson-CSF, as some of the other members of the Board might have regarded his presence as intimidating.

11.11.8.4 Although the explanation provided by Vice Adm Simpson-Anderson about why Mr Shaik was allowed to remain present during discussions of the Combat Suite might be regarded as reasonable under the circumstances where Mr Shaik played a key role in almost all aspects of the acquisition, it in no way negates the perception of improper influence that was created.

11.11.8.5 The fact that the procurement policy and procedures of DoD did not contain any provisions or prescripts pertaining to a conflict of interests is a fundamental shortcoming.

11.11.9 The validity of the R40 million-risk premium added to the price of C²I² for the IMS

11.11.9.1 The imposition of a risk premium was not unreasonable.

- 11.11.9.2 The calculation of the risk premium cannot be evaluated without evidence from the GFC and the assistance of an expert witness. From a cost and time point of view it was not considered feasible to pursue this matter.
- 11.11.9.3 The JPT and PCB did not attempt to evaluate or assess the risk premium.
- 11.11.10 Whether C²I²'s commercial specifications were released to competitors**
- 11.11.10.1 This cannot be conclusively proven, because the GFC administered the tender process and the GFC's evidence was not obtained.
- 11.11.10.2 The fact that ADS was part of the main contractor and Combat Suite contractor does give rise to a probable conflict of interest. Due to the lack of proper procurement procedures, it cannot be confirmed that this did occur.
- 11.11.11 The regularity or not of the non-selection of C²I²'s IMS**
- The process followed is not properly documented and proper tender procedures were not followed, which makes it difficult to assess.
- 11.11.12 The Navy did not use a R20 million technology retention product**
- 11.11.12.1 No logical explanation was found. However, it will probably be impossible to prove that the decision not to select the IMS was unreasonable, in view of the fact that the SANDF remains either the owner or joint-owner of the technology developed. While an expectation had been created that the particular technology would be used, this expectation was not contractually enforceable.

CHAPTER 12

NATIONAL INDUSTRIAL PARTICIPATION (NIP) & DEFENCE INDUSTRIAL PARTICIPATION (DIP)

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CHAPTER 12

NATIONAL INDUSTRIAL PARTICIPATION (NIP) & DEFENCE INDUSTRIAL PARTICIPATION (DIP)

12.1 THE PUBLIC PHASE OF THE INVESTIGATION

12.1.1 The role of the Department of Trade and Industry

12.1.1.1 There was testimony during the public phase of the investigation that DTI was tasked with attending to the Industrial Participation Programmes connected to the acquisition of the SDP.

12.1.1.2 The NIP Programme was adopted by Cabinet in 1997. It applies to all public sector procurements where the imported content exceeds 10 million US dollars. It fulfils two roles. The first is as an effective investment and export promotion device that assists in job creation; the second is in the assessment of economic risk. The mission of the programme is to leverage large economic benefits and to support the South African industry by effectively utilising the instrument of government procurement. Industrial Participation projects must be economically and operationally sustainable, even after the discharge period.

12.1.1.3 DTI has been substantially restructured and more resources have been provided to enable the department to regulate and monitor projects such as Industrial Participation. An agreement has also been signed between the governments of South Africa and the United Kingdom in terms of which they would work together to ensure the successful implementation of the Industrial Participation projects. An experienced official of the United Kingdom has already been seconded to DTI to assist in this process.

12.2 THE FORENSIC INVESTIGATION BY THE AUDITOR-GENERAL

12.2.1 Background

12.2.1.1 The Minister of Trade and Industry stated that the decision to procure was the prime decision. However, Industrial Participation in the form of countertrade forms a significant element of the SDP acquisition announced by Cabinet and contracted for on 3 December 1999. According to the Minister, the acquisition was subject to the constraint of affordability and not the industrial participation component of the deal. NIP refers to the National Industrial Participation programme, which is administered by DTI. DIP refers to Defence Industrial Participation, which is administered by Armscor. Direct DIP (DDIP) refers to DIP activities which are directly related to the equipment being acquired through the SDP. Industrial Participation (IP) refers to the combined NIP and DIP elements of the SDP.

12.2.1.2 Uncertainty exists in respect of the adequacy of performance guarantees committed to by the relevant suppliers of the SDP as identified by the various forums listed below:

- (a) The Special Review by the Auditor-General of the selection process of SDP for the acquisition of armaments at DoD, dated 15 September 2000.

Paragraph 3.3 of the Special Review addressing the adequacy of performance guarantees: NIP stipulated: *"All bidders with whom contracts have been finalised had to sign performance guarantees regarding the NIP obligations. The guarantees were on average approximately 10% of the contract price. I am of the opinion that the guarantees, in case of non-performance may be inadequate to ensure the delivery of the NIP obligations. This could undermine one of the major objectives of the strategic defence packages which was the counter-trade element of the armament package deal."*

- (b) The Fourteenth Report of the Standing Committee on Public Accountants (SCOPA) dated 30 October 2000.

Paragraph 3 entitled: "*Offset arrangements - Defence Industrial Participation Programme (DIP) and National Industrial Participation Programme (NIP)*" It was, *inter alia*, stated that concern was expressed by the committee at the Government's announcement of the R104 billion offset. The issue raised by the Auditor-General in this regard was of concern to the committee. The NIP contractual arrangements appear to allow a supplier, once he has supplied the arms and received payment therefor, to pay over a relatively modest sum of money and be unconditionally excused from all offset obligations. Notwithstanding the Departments of Defence and Trade and Industry believing that this is unlikely, the committee remains concerned.

- (c) Summary of background information on the SDP (issued on behalf of the Government of South Africa by the Ministers of Defence, Finance, Public Enterprise and Trade and Industry) dated 15 January 2001.

In terms of the said summary by the Ministers it was, *inter alia*, stated, that: "*Firstly, these guarantees are in line with the National Industrial Participation Programme adopted by the Cabinet in 1997 and best international practice; and if the matter is studied more carefully the deterrent losses that will be suffered by the prime contractors if the total obligations are not met are considerable*".

12.2.2 Scope of the forensic investigation

12.2.2.1 The mandate was to determine whether the statement by the Ministers, namely that:

- (a) The performance guarantees were in line with the NIP Policy.
- (b) The performance guarantees were in line with best international practice.
- (c) The terms of the contracts addressed the issue that the deterrent losses that would be suffered by the prime contractors if the total obligations were not met would be considerable.

12.2.2.2 Consequently, the following investigation procedures had to be performed:

- (a) Ascertain what the trends are in international norms for NIP guarantees.
- (b) Determine what the Industrial Participation policy was.
- (c) Review the progressive realisation of NIP and DIP by conducting a high-level overview of what was promised for NIP and DIP.
- (d) Ascertaining controls in place to ensure that NIP and DIP offers are actually realised.

12.2.3 Scope limitation

12.2.3.1 The final composition of the industrial participation commitment was made up of approximately 86% NIPs and 14% DIPs.

12.2.3.2 The view was therefore held that the major focus area of the forensic investigation had to be on the activities pertaining to NIP and the controls implemented by the Department of Trade and Industry in relation thereto. Access to personnel and records pertaining to events subsequent to

3 December 1999 (being the date of signing of the contracts) was, however, granted to the investigation team for a limited purpose.

12.2.3.3 Reasons furnished by DTI for not granting unlimited access were that:

- (a) They were of the view that the scope of the investigation did not extend beyond 3 December 1999.
- (b) Confidentiality agreements concluded with prime contractors prevented disclosures in this regard.

12.2.3.4 Consequently, this chapter only addresses information relevant to DIP as ascertained from information made available by Armscor and the information pertaining to NIP that was obtained from the limited documentation made available in this regard.

12.2.4 Investigation conducted

12.2.4.1 The following procedures were performed:

- (a) An understanding of the guarantee provisions contained in the IP programme applicable to South Africa was obtained.
- (b) A comparison was made between the industrial participation obligations and performance guarantees that had been committed to in terms of the contracts and the requirements of the IP programme.
- (c) A comparison was made between the industrial participation commitment contracted for in each programme and the contract price in the agreement.

12.2.5 Cabinet approved policy

12.2.5.1 The performance guarantees contained in the IP Programme adopted by Cabinet in 1997 were:

(a) NIP

For any single contract exceeding US\$10 million, or multiple contracts of US\$3 million over two years, exceeding US\$10 million in total, the obligation required in terms of industrial participation was required to be equal to or exceed 30% of the imported content. The performance guarantee required was 5% of the NIP obligation.

(b) DIP

For contracts exceeding US\$10 million an obligation required in terms of DIP to be equal to or exceed 50% of the contract price. The performance guarantee required was 5% of the unfulfilled portion of the commitment.

12.2.6 The industrial participation requirements of the SDP

The request for proposals pertaining to the SDP required a combined obligation of at least 100% of the contract price for industrial participation, and an acceptable performance guarantee.

12.2.7 Obligations contracted for in SDP

12.2.7.1 The following table illustrates the percentage of the industrial participation obligation contracted for in relation to the contract price as stipulated in the agreement:

Programme	Value of IP obligation ZAR* million	Contract price ZAR million	Approx % of obligation to contract %
Corvettes	20 267	5 473	370
Submarines	19 680	4 289	459
LUH	6 137	1 532	400
LIFTS and ALFAs	55 606	13 680	407

* Converted at an exchange rate of 1US\$ = R6.40; Euro 1 = R6,50 as stipulated in the contract.

12.2.7.2 *The Industrial Participation obligations that were contracted for as compared to IP Policy*

- (a) The contracts were concluded in US\$ and in Euro. The following conversion rates, as stipulated in the contracts were used to convert to Rand: US\$1 = R6.40, EURO 1 = R6.50.
- (b) As illustrated in the table above, the combined industrial participation for both NIP and DIP contracted for in each programme was in excess of the 100% of contract price as required by the SDP request for proposal, as well as the 30% and 50% of the contract price required by the NIP and DIP policies respectively.

12.2.7.3 *Performance guarantees contracted for*

- (a) Cabinet approved policy stipulates a performance guarantee of 5% of the industrial participation obligation. In the SDP acquisition the performance guarantees that were contracted for were calculated as a percentage of the contract price. During a consultation with the Armscor DIP Division Manager, the reason furnished for this was that, in all the programmes, the amounts offered by bidders and contracted for in terms of the industrial participation obligation were well in excess of the 100% minimum requirement. The calculation of the performance guarantee on

the increased obligation would unduly prejudice, and could possibly discourage, the increased industrial participation offered.

- (b) The following table illustrates the performance guarantees relevant to the obligations contracted for:

Programme	Guarantee as % of contract price
Corvettes	10% of foreign content
Submarines	10% of contract price
LUH	10% of contract price
LIFTS and ALFAs	10% of contract price

12.2.8 Best international practice

12.2.8.1 Various publications including, inter alia, the following have been studied to conduct research:

- (a) The Australian Countertrade Association.
- (b) Access Business Online.
- (c) UK Ministry of Defence Website.
- (d) National Commission on Use of Offsets in Defense Trade – US.
- (e) Offset Program Department, Ministry of Finance; Kuwait.
- (f) Finland’s New Offset Guidelines – industrial participation expected from foreign sellers.

12.2.8.2 Detailed procedures performed in respect of best international practice were as follows:

- (a) An understanding of prevailing best international practice with regard to industrial participation obligations, performance guarantees and penalties was obtained.

- (b) A summary of information with regard to the industrial participation obligations, performance guarantees and penalties was compiled from the contracts.
- (c) A comparison was made between international standards and the SDP industrial participation obligations, performance guarantees and penalties as contracted for.
- (d) Research was conducted on countertrade from the following sources:
- Internet
 - Libraries
 - Various magazines on countertrade
- (e) Consultations were held with identified experts in DIP. (The information on NIP was limited due to the scope limitation on the investigation with regard to access to information at the DTI).

12.2.8.3 The following table summarises relevant results of research conducted into trends in international practice on countertrade:

Country	Area of application	IP Obligation	Value threshold	Discharge period	Penalty*
Philippines	All government purchases	50% of contract value	US\$1 million	5 to 10 years	5% to 100%
Saudi Arabia	All government purchases	35% of contract value	All purchases	10 years	Blacklist
UAE	Defence purchases	60% of contract value	All purchases	7 years	8,5%
South Korea	All government purchases	50% of contract	US\$1 million	Purchase contract period	10%
Canada	All government purchases	30% of contract price	C\$2 million	Purchase contract period	2,5% to 12%
Greece	Defence purchases	60% of contract value	All purchases	Purchase contract period	10%
Australia	All government purchases	30% of contract value	US\$2,5 million	Purchase contract period	Blacklist
Kuwait	All government purchases	30% of contract value	US\$1 million	8 years	6%

Country	Area of application	IP Obligation	Value threshold	Discharge period	Penalty*
Thailand	All government purchases	50% of contract value	US\$5 million	Purchase contract period	5%
Taiwan	All government purchases	30% of contract value	US\$5 million	10 years	None
Netherlands	Defence purchases	100% of contract value	US\$3 million	Maximum 10 years	5%
Sweden	Defence purchases	50%-100% of contract value	All purchases	Purchase contract period	Negotiated
Denmark	Defence purchases	100% of contract value	US\$15 million	Purchase contract period	Blacklist
South Africa	All government purchases	30% of imported content – NIP	US\$10 million	7 years	5%
	SDP	100% of contract price	All contracts	7 – 9 years	10 % of contract price

* Based on IP obligation

12.2.8.4 With reference to the above research conducted, the following observations were made:

The area of application differs from country to country. South Africa's policy of requiring IP in respect of government imports can be compared to countries such as Thailand, Kuwait, Philippines, Saudi Arabia, South Korea, Canada, Australia and Taiwan, which also require industrial participation for government purchases.

12.2.8.5 South Africa's policy regarding obligations of the contract value are as follows:

- Obligation of 30% in respect of imported content for national industrial participation (NIP).
- Obligation of 50 % in respect of defence industrial participation (DIP).

12.2.8.6 These percentages compare favourably with percentages required by other countries. However, the percentages obtained for the SDP substantially exceeded the above requirements. Approximately 400% of the contract price was committed for NIP and DIP.

- 12.2.8.7 The norm in international markets covers anything from 20% to 100% obligation of the contract value. Few countries actually require 100% obligation. These include countries such as Sweden (50% up to 100%), Norway, Finland, Denmark and the Netherlands (80% -100%).
- 12.2.8.8 The majority of countries only require 30% obligations, e.g. New Zealand, Kuwait, Canada, Australia & Taiwan.
- 12.2.8.9 South Africa requires industrial participation for purchases exceeding US\$10 million. This compares favourably with Sweden, Finland, and Denmark. However, it appears that the threshold for most countries is approximately US\$1 – US\$5 million.
- 12.2.8.10 South Africa usually reserves the right to impose a 5% penalty on the unfulfilled portion of the obligation. This appears to be the norm in international markets. Few countries require more than 5%, e.g. UAE (8,5%), Norway (10%), Kuwait (6%), Belgium (10%), South Korea (10%), Philippines (5% - 100%). Certain countries do not impose any penalties but have the option to blacklist the companies, e.g. Saudi Arabia, Australia and Denmark.
- 12.2.8.11 In the South African context the format of the performance guarantee was, for example, bank guarantees equivalent to the penalty, furnished by the prime contractors. Sufficient information could not be obtained to draw any conclusion on this aspect for other countries.
- 12.2.8.12 Based on the research conducted, it would appear that the obligations contracted for by the prime contractors in terms of the SDP as well as the performance guarantees in relation thereto, compare favourably with other countries that exercise countertrade practices.

12.2.9 Controls to deter non-fulfilment of obligations

12.2.9.1 Detailed investigation procedures performed in respect of deterrence of losses and progressive realisation of obligations were as follows:

- (a) Control mechanisms built into the contracts were analysed.
- (b) The penalties that would be suffered for non-fulfilment of obligations were determined.
- (c) The deterrent losses if total obligations are not met were evaluated.
- (d) A summary of the performance guarantees as stipulated in the contracts was compiled.
- (e) The bank guarantees provided by the suppliers in respect of the performance guarantees held for both the NIP and DIP obligations, were inspected at the Armscor Finance Division and compared to the contracts.
- (f) The systems used for the management of DIP were recorded by means of:
 - Completion of internal control questionnaires.
 - Conducting of walk through tests.
 - Meetings/enquiries from senior DIP staff.
- (g) The documentation for a DIP claim was inspected and the process verified for approval of these claims by:
 - Observing a meeting between contractors and subcontractors.

- Observing a DIP Committee (DIPCom) meeting.
 - Perusal of minutes of the DIPCom meetings.
 - Attendance at a field visit to a subcontractor.
- (h) The capacity of the DIP department for handling the SDP portfolio was evaluated with reference to:
- Resources of the department.
 - Skills of the team.
 - Competency of the team.
 - Experience of the team.
- (i) Other factors that could contribute to the controls in place or prevent non-adherence to the fulfilment of the DIP obligations by contractors were considered. These included, *inter alia*:
- Inquiry into failure and successes of any DIP programmes in the past.
 - Inquiry into future plans for the management of the SDP portfolio.
 - Inquiry into the history of any performance guarantees being withheld.
 - Inquiry into other possible factors which could influence the non adherence to the fulfilment of the DIP obligations, for example, the reputation of contractors, the method of dealing with default/non-performance and corrective measures/ incentives to discourage non-fulfilment of obligations.

- (j) Conducted a high-level overview of what controls were in place to ensure that NIP and DIP promised were actually realised.

12.2.9.2 A summary of the milestones contracted for with respect to the progressive realisation of the NIP and DIP was compiled. These milestones relate to the relevant discharge period of each programme and are significant for the following reasons:

- (a) Performance guarantees are furnished by all the prime contractors. They are approximately 10% of the contract price.
- (b) These guarantees (both DIP and NIP) are held in the form of bank guarantees, which are in the custody of the Finance Department of Armscor.
- (c) The projects are formally evaluated during each milestone period as specified in the contracts.
- (d) Upon attainment of the relevant milestones, after certain processes have been followed, the bank guarantees held for performance are reduced proportionately.

12.2.9.3 At the date of compiling this report most projects were approximately one year old and all the DIP programmes were on target in relation to the second milestone. Some contractors had exceeded their milestone targets.

12.2.9.4 The contracts were reviewed to determine the consequences for prime contractors of not meeting their obligations in terms of provisions contained in the contracts. The following table highlights the relevant provision in this regard:

Programme	Performance guarantee	Breach remedy period	Reduction of guarantee on achievement of milestones	Obligation fulfilled on payment of penalty
Corvettes platforms	7,5% Contract price	90 days	Yes	D DIP No Other Yes
Corvette combat suite	10% foreign content of contract price	60 days	Yes	D DIP No Other Yes
Submarines	10% Contract price	60 days	Yes	No
LIFTS	10% Contract price	60 days	Yes	Yes
ALFA	10 % Contract price	60 days	Yes	Yes
LUH	10 % Contract price	60 days	Yes	D DIP No

12.2.9.5 The following observations with regard to contractual provisions as identified in the table above have been noted:

- (a) The guarantees held are reduced proportionately upon attainment of the predetermined milestones. Upon breach of the contract, however, the contractor is given notice in writing to rectify the situation in either sixty or ninety days as specified within the relevant contract. Alternatively, a claim can be made against the performance guarantee held in the proportion that the unfulfilled portion of DIP activities bears to the total price of obligations.
- (b) Payment of damages will not release the prime contractor from the obligation to perform the relevant activities on certain elements of the following contracts:
 - Corvettes, Direct DIP.
 - Light Utility Helicopters (LUH) Direct DIP.
 - Submarines.

- (c) However, for the other programmes, as indicated in the table above, claiming the penalty is deemed to be fulfilment by the prime contractor and therefore it discharges the contractor from the milestone obligation.
- (d) It was noted that regarding industrial participation obligations, the prime contractors could, upon payment of the penalty, be discharged from fulfilment of outstanding obligations as is permitted by the contractual provisions.
- (e) With regard to the review of other contractual control measures pertaining to the progressive realisation of NIP and DIP, the following observations have been made:
- Claims submitted by contractors are deemed to be approved if no correspondence to the contrary has been received within three months of having submitted the claim. There is the risk of contractors being entitled to credits merely through the passage of time, without the necessary verification processes having been followed by the DIP Division. This could be further exacerbated if insufficient resources are available within the division to verify the claim adequately.
 - The credits towards the discharge of the NIP and DIP obligations can be claimed on presentation of signed contracts with local suppliers. There is therefore a risk that activities relating to the attainment of milestones might be recognised prior to the actual commencement of work. There could therefore be a possibility of milestones claimed being overstated, with a resultant reduction of performance guarantees held merely upon the signing of contracts. Given the fact that the claims are approved and authorised for reduction of

performance guarantees on achievement of six-monthly milestones, the minimum period that a credit may be claimed without evidence of the work being done is therefore six months.

- The credits towards the discharge of the NIP and DIP obligations can be claimed on presentation of invoices from local suppliers. It is submitted that this should be the preferred option for all the programmes and will facilitate a fairer reflection of the milestones achieved. It would also reduce negative cashflow implications and is less susceptible to potential manipulation where credits are allowed on presentation of contracts.
- In the event of there being a breach of the contract solely due to a local supplier defaulting, the prime contractor retains the credits and is deemed to have fulfilled its NIP and DIP obligations.

12.2.9.6 All the contracts have a clause relating to independent audits conducted on NIP and DIP claims, except for the NIP on the LUH. However, the audits are not mandatory, but are discretionary in that the respective NIP and DIP divisions *"have the right to effect audits"*. In most programmes, the party responsible for audit costs is determined by the extent of the discrepancy identified by the audit. If the discrepancy is less than 5% of the claim, the NIP or DIP division bears the cost. If the discrepancy exceeds 5% then the seller bears the cost of the audit. The degree of discretion allowed in the execution of audits and the corresponding responsibility for the costs thereof could create the opportunity for manipulation by, for example, neglecting to call for an audit to avoid the responsibility for the cost of the audit. It is submitted that a better control measure would be for example, the requirement of mandatory audits in respect of claims having a value in excess of a prescribed materiality threshold.

12.2.9.7 A review of the internal and accounting controls within the DIP Division of Armscor was conducted through consultations with relevant employees, system walk-through tests and inspection of documentation. Tests conducted with reference to the documentation and procedures outlined above indicated that the system was found to be operating as described.

12.2.10 Review of capacity within Armscor's DIP Division

12.2.10.1 Consultations with Armscor personnel indicated that no increased staffing requirements were identified as a result of the SDP acquisition.

12.2.10.2 The establishment of the DIP Division comprises one senior manager, two managers and three administration staff. During the investigation the post of senior manager, which was previously vacant as a result of the resignation of Mr J van Dyk, was filled.

12.2.10.3 The total DIP obligation in terms of the SDP is approximately R14 billion. These obligations are to be fulfilled over a period of 108 months. At the date of the investigation, most of the programmes were in their first year of implementation. Controls exercised over the monitoring of project progress by the existing staff complement of Armscor appear to be well managed at this stage of the process.

12.2.10.4 However, additional resources may have to be considered as the projects increase over time.

12.2.10.5 The composition of the DIP Division of Armscor, at the date of the investigation, comprised of well skilled and adequately equipped staff.

12.2.10.6 During the investigation nothing came to the attention of the investigation team to suggest that the division is not competent in the execution of their tasks. Project progress and monitoring thereof were well documented.

12.2.11 Other factors that were considered which could impact on the successful outcome of IP obligations.

12.2.11.1 There has not been any significant failure of DIP programmes in the past.

12.2.11.2 To date, no performance guarantees have been withheld for non-fulfilment of DIP obligations.

12.2.11.3 According to the DIP manager the strongest deterrent against non-fulfilment of obligations was that the reputation of the contractors was at stake. All the prime contractors in the SDP were of high standing in the arms industry. The possibility of having reputations impaired and the consequent loss of future contracts could have far-reaching implications. Some countries, e.g. Saudi Arabia are known to "*blacklist*" defaulting contractors. This apparently could preclude the contractor from all future business.

12.2.11.4 The DIP manager informed the investigators that every effort is made to encourage the contractors to fulfil their obligations. These include, *inter alia*:

- (a) Encouraging dialogue between the prime contractors and the local suppliers to keep projects on track.
- (b) Facilitating/arbitrating in disputes between the contractors and the local suppliers.

- (c) Encouraging the contractors to continue with the nominated local suppliers unless this is no longer feasible.
- (d) Enquiring whether the contractor is being unreasonable or unrealistic in demands on local suppliers.
- (e) Conducting site visits to local suppliers.
- (f) Maintaining offices/sites abroad to inspect progress of prime product and, where relevant, adherence to DIP obligations.

12.2.12 High-level overview of what was offered for NIP and DIP

- (a) Detailed procedures performed in respect of what was offered for NIP and DIP were as follows:
 - (i) Analysed all the final contracts concluded with prime contractors.
 - (ii) Summarised the NIP and DIP terms from the contracts.
 - (iii) Drew a comparison between the NIP and DIP that were contracted for and that promised in the bids by the relevant contractors.
 - (iv) Analysed the presentations made to Cabinet in November 1998, with regard to the preferred bidder, and compared this to what was offered in the bids.
- (b) A review of the total NIP and DIP contracted for, compared to the values offered by preferred bidders presented to the Cabinet in November 1998, is illustrated in the following table:

Programme	IP value presented to Cabinet Rm	Contracted IP Value R	Difference Rm	Comment
Corvettes	16 007	20 267	4 260	Favourable variance
Submarines	30 274	19 780	-10 494	Unfavourable variance
LUH	4 685	6 137	1 452	Favourable variance
LIFTS / ALFAS	56 893	55 606	-1 287	Unfavourable variance
Total	107 859	101 790	- 6 069	Unfavourable variance

- (c) Due to reductions in quantities contracted for compared to quantities offered, as well as tranching options with regard to the LIFT and ALFA programmes, meaningful comparison between offers received and what was contracted for from a high-level perspective could not be achieved.
- (d) However, in total, there does not appear to be a material difference between the value of R108 billion presented to Cabinet and the value of R102 billion finally contracted for. The differences highlighted above are addressed under the separate programme reports.

12.3 FINDINGS

12.3.1 Industrial Participation obligations committed to by suppliers and contracted for, were in excess of the minimum requirements of both the National Industrial Participation programme approved by Cabinet and the 100% of contract price as stipulated in the RFP.

12.3.2 The performance guarantees, although based on contract price as opposed to the value of Industrial Participation obligations, were found to be reasonable in view of the higher value of the obligations and because the obligations were in excess of the IP policy requirements approved by Cabinet. This allays the concern raised in the Special Review by the A-G as well as the 14th report of SCOPA.

- 12.3.3 South Africa requires Industrial Participation for purchases exceeding US\$10 million. The threshold for most countries is approximately US\$1 – US\$5 million.
- 12.3.4 South Africa reserves the right to impose a 5% penalty on the unfulfilled portion of the Industrial Participation obligation. This appears to be the norm in international markets.
- 12.3.5 In the South African context the format of the performance guarantee was, for example, bank guarantees equivalent to the penalty, furnished by the prime contractors.
- 12.3.6 Based on the research conducted, it would appear that the Industrial Participation obligations contracted for by the prime contractors in terms of the SDP as well as the performance guarantees in relation thereto, compare favourably with the position in other countries that exercise countertrade practices.
- 12.3.7 It was noted that in some instances regarding Industrial Participation obligations, the prime contractors could, upon payment of the penalty, be discharged from fulfilment of outstanding obligations as is permitted by the contractual provisions.
- 12.3.8 Although the findings support the statement made by the Minister of Trade and Industry pertaining to the guarantees being in line with best international trends, as well as with the NIP policy, it appears that intended controls contained within contracts were potentially deficient and may therefore, in certain instances, not be sufficient to deter prime contractors from fully meeting their obligations.

12.4 RECOMMENDATIONS

It is recommended that DTI and DoD obtain legal opinion pertaining to the controls in respect of the effective implementation of the NIP and DIP programmes respectively, to ensure that prime contractors fully meet their obligations, as contained in the relevant agreements.

CHAPTER 13

DRAFTING OF THE CONTRACTS

- 13.1 In its mentioned 14th Report, SCOPA expressed their concern regarding certain aspects of the contracts concluded with the main contractors. According to SCOPA, the contracts did not appear to have been well prepared. They took the view that the contracts contained clumsy language, incorrect references, reference to more than one currency in one contract and that some of the annexures were missing.
- 13.2 Although evidence was not led during the public phase of the investigation on the contracts specifically, it appeared from the testimony of Messrs Erwin, White and Naidoo that the procurement was effected in different currencies. It was also their testimony that the contracts were drafted with the assistance of an international firm of attorneys who are experts in this field.
- 13.3 The Public Protector instructed legally qualified and experienced members of his staff to scrutinize the contracts, specifically with regard to the other comments made by SCOPA. During this investigation copies of the contracts were studied at the offices of Armscor. These copies were complete and contained all the annexures. It was also found that the legal division of Armscor, being ultimately responsible for the drafting of the contracts, was furthermore assisted by a local firm of attorneys, who were selected for their expertise in this regard.

13.4 FINDING

No instance was found of particularly clumsy language in the contracts. The contracts were found to be understandable, well defined and the drafting was of a high standard.

CHAPTER 14

KEY FINDINGS AND RECOMMENDATIONS

From the joint investigation discussed in the preceding chapters of this report, the following key findings and recommendations are made:

14.1 KEY FINDINGS

- 14.1.1 No evidence was found of any improper or unlawful conduct by the Government. The irregularities and improprieties referred to in the findings as contained in this report, point to the conduct of certain officials of the government departments involved and cannot, in our view, be ascribed to the President or the Ministers involved in their capacity as members of the Ministers' Committee or Cabinet. There are therefore no grounds to suggest that the Government's contracting position is flawed.
- 14.1.2 The Strategic Defence Packages were unique to South Africa. Firstly, it was the first time that a "package approach" to the acquisition of armaments was adopted. Secondly, the acquisition consisted mainly of weapon systems designed and developed overseas.
- 14.1.3 Due to the sanctions imposed on the acquisition of arms prior to 1994, an adequate acquisition policy to accommodate the procurement of armaments for SANDF in the international markets did not exist.
- 14.1.4 The policy on the acquisition of armaments that evolved during SDP procurement process and that was approved in July 1999 (ACQ/1/98), consists of the necessary procedures and provides for the necessary authorising bodies to enable DoD and Armscor effectively to deal with international defence

equipment procurement. This policy compares favourably with defence procurement policies in the United Kingdom and Australia.

- 14.1.5 In view of the magnitude and extent of the SDP procurement, the time allocated for each evaluation and execution was insufficient to ensure that it was done properly and efficiently.
- 14.1.6 The decision that the evaluation criteria in respect of the LIFT had to be expanded to include a non-costed option and which eventually resulted in a different bidder being selected, was taken by the Ministers' Committee, a subcommittee of Cabinet. Although unusual in terms of normal procurement practice, this decision was neither unlawful, nor irregular in terms of the procurement process as it evolved during the SDP acquisition. As the ultimate decision-maker, Cabinet was entitled to select the preferred bidder, taking into account the recommendations of the evaluating bodies as well as other factors, such as strategic considerations.
- 14.1.7 The decision to recommend the Hawk/Gripen combination to Cabinet as the preferred selection for the LIFT/ALFA was taken by the Ministers' Committee for strategic reasons, including the total benefit to the country in terms of countertrade investment and the operational capabilities of the SANDF.
- 14.1.8 The acquisition policies and procedures of the DoD and Armscor required the compilation and approval of certain key programme documents. These documents provide the basis for informed decision-making during the acquisition process. Various key documents had not been finalised and/or duly approved before the final contracts were concluded.
- 14.1.9 From the investigation it is evident that IONT made a positive contribution to improving the overall procurement process and its outcome. However, it is not possible to make a conclusive finding on the total impact of IONT, because:

- Some functionalities of the packages were removed.
- The quantity of equipment for the LUH programme was reduced.
- Certain costs, for example management and statutory costs, had not been included in the presentation to Cabinet during November 1988.

14.1.10 With the exception of Bazan, all the bidders involved in the Corvette procurement programme failed to comply with the minimum evaluation criteria in respect of financing, technical requirements and Defence Industrial Participation. Bazan failed only in terms of the financing evaluation criteria.

14.1.11 The decision to allow bidders for the Corvette programme to supply information after the offers were submitted constituted a deviation from proper procurement practice.

14.1.12 Certain aspects of the financial and economic model used by the Affordability Team in their presentation to the Ministers' Committee in August 1999 on the cost of the procurement, can be criticised to an extent. However, even though there might be different views and models explaining future projected costs and effects, it appears from the investigation that the Affordability Team and IONT took adequate measures under the circumstances to present to the Government a scientifically based and realistic view on these matters. The Ministers' Committee was put in a position by the Affordability Team to apply their minds properly to the financial impact of the procurement. Ultimately, the decision about what the country can and cannot afford is one of political choice.

14.1.13 The acquisition policies and guidelines of DoD and Armscor, as well as the Defence Review, stipulate that the prime responsibility for the selection of subcontractors rests with the main supplier. However, Armscor was not precluded from contracting subcontractors directly if this proved to be more cost effective. Armscor did, in fact, nominate and select subcontractors for the supply of the engines for the LUH and the gearboxes for the Corvettes.

- 14.1.14 Fair and competitive procurement procedures for the selection of subcontractors were not followed in all cases where strategic considerations played a significant role.
- 14.1.15 No instance was found of particularly clumsy language in the contracts. The contracts were found to be understandable, well defined and the drafting was of a high standard.
- 14.1.16 Proper evaluation procedures were not consistently and diligently applied and a proper audit trail was not established throughout the procurement process.
- 14.1.17 There was a conflict of interest with regard to the position held and role played by the Chief of Acquisitions of DoD, Mr S Shaik, by virtue of his brother's interests in the Thomson Group and ADS, which he held through Nkobi Holdings. Mr Shaik, in his capacity as Chief of Acquisitions, declared this conflict of interest in December 1998 to the PCB, but continued to participate in the process that led ultimately to the awarding of contracts to the said companies. He did not recuse himself properly.
- 14.1.18 During the course of the investigation it was established that the Chief of Acquisitions, Mr S Shaik, had not applied for and did not receive the military security clearances required by law.
- 14.1.19 The imposition of a risk premium on the IMS of C²I² was not unreasonable. By all accounts the IMS was a critical sub-system and it appears reasonable that the GFC would not have been prepared to accept the IMS as a category B system.

- 14.1.20 ADS was given the opportunity to lower its inflated tender of R64,73 million for the SMS to just below that of C²I² over a period of more than a month. C²I² was given a maximum of four days to submit its tender.
- 14.1.21 Industrial Participation obligations committed to by suppliers and contracted for, were in excess of the minimum requirements of both the National Industrial Participation programme approved by Cabinet and the 100% of contract price as stipulated in the RFP.
- 14.1.22 The performance guarantees, although based on contract price as opposed to the value of Industrial Participation obligations, were found to be reasonable in view of the higher value of the obligations and because the obligations were in excess of the IP policy requirements approved by Cabinet.
- 14.1.23 The Industrial Participation obligations contracted for by the prime contractors in terms of the SDP as well as the performance guarantees in relation thereto, compare favourably with the position in other countries that exercise countertrade practices.
- 14.1.24 The intended controls contained within contracts may, in certain instances, not be sufficient to deter prime contractors from fully meeting their industrial participation obligations.
- 14.1.25 It has come to the attention of the investigation teams that the former Minister of Defence was allegedly involved in a company that was to benefit from the SDP procurement. The Minister concerned was actively involved in the procurement process before his retirement. Although no evidence of impropriety was found in this regard during the public and forensic phases of the investigation, such a situation seems extremely undesirable as it creates negative public perception about a process that might otherwise be in order.

14.2 RECOMMENDATIONS

- 14.2.1 It is recommended that the policy document, referred in paragraph 3.2.5 above, be further refined with specific reference to the lessons learnt from the acquisition process under investigation as reflected in this report. The staff of DoD and Armscor involved in procurement should be properly trained to ensure that they assimilate and fully understand the policy with a view to its effective implementation.
- 14.2.2 Properly approved needs determination should be compiled during the acquisition process. During needs determination it should be ensured that the planned acquisition addresses the operational capability required as well as the future sustainability thereof. During cardinal acquisitions, sufficient time should be made available to determine needs properly, compile acquisition plans, evaluate offers and finalise contracting.
- 14.2.3 The evaluation process should contain effective controls to ensure a fair and regular process in order to exclude the possibility of manipulation. Internal audit should be involved far more extensively to ensure effective controls are in place and that they are complied with during the various stages of the procurement process.
- 14.2.4 Detailed and accurate information, including all possible costs, should be submitted to Cabinet. All currency risk implications regarding international armament acquisitions should be disclosed to Cabinet. Such information is necessary to ensure that essential functionalities are not removed from equipment during negotiations due to budget constraints.
- 14.2.5 The NIP offers during RFO stage should be properly evaluated. This will ensure that only feasible projects are accepted and negotiations with bidders to replace projects at a later stage will not be necessary.

- 14.2.6 Adequate audit trails, with particular emphasis on the visibility of supervision, decision-making and assumption of responsibility should be in place at appropriate levels in the procurement process.
- 14.2.7 Moderation of results should take place to ensure that computation errors and significant variances in scores awarded are addressed.
- 14.2.8 DoD should take steps to ensure that good procurement practices are adhered to and that compliance with the prescribed tender procedures is strictly enforced.
- 14.2.9 An approved negotiation strategy and terms of reference should be in place prior to the commencement of negotiations.
- 14.2.10 Proper consultation and an impact study should be done before equipment types or functionalities are reduced.
- 14.2.11 The guidelines contained in the Defence Review that relate to the selection and appointment of subcontractors must be followed and steps taken to ensure that an open and fair process is adhered to for the selection of subcontractors.
- 14.2.12 DoD and Armscor should develop specific rules and guidelines to address conflict of interest issues and to ensure that personnel are properly informed in this regard. These rules and guidelines should be developed, taking into account the principles contained in the Code of Conduct of the State Tender Board and the King Report on Corporate Governance, 1994, regarding improved ethics and probity as well as international norms in this regard. Steps should also be taken to ensure that a particular individual, irrespective of his/her position is not tasked with incompatible functions in multifaceted procurements. This will prevent a conflict or perceived conflict of interest, which could have a detrimental effect on the overall acquisition process.

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- 14.2.13 DoD should undertake an urgent personnel audit to ensure that all its' staff comply with the prescribed security clearance requirements.
- 14.2.14 The Department of Trade and Industry should consider obtaining legal opinion pertaining to the controls in respect of the effective implementation of the NIP and DIP programmes, to ensure that prime contractors fully meet their obligations, as contained in the relevant agreements.
- 14.2.15 Parliament should take urgent steps to ensure that high ranking officials and office bearers, such as Ministers and Deputy Ministers, are not allowed to be involved, whether personally or as part of private enterprise, for a reasonable period of time after they leave public office, in contracts that are concluded with the State.

A handwritten signature in black ink, appearing to read 'S A M Baqwa'.

*Adv S A M Baqwa, SC
Public Protector*

A handwritten signature in black ink, appearing to read 'S A Fakie'.

*Mr S A Fakie
Auditor-General*

A handwritten signature in black ink, appearing to read 'B T Ngcuka'.

*Mr B T Ngcuka
National Director of
Public Prosecutions*

14 November 2001

ANNEXURE A

LIST OF ABBREVIATIONS/ TERMINOLOGY USED

LIST OF ABBREVIATIONS/TERMINOLOGY USED

\$	Dollars
AAC	Armaments Acquisition Council
AACB	Armament Acquisition Control Board
AASB	Armaments Acquisition Steering Board
ABSA	ABSA Treasury
ADS	African Defence Systems
AFPC	Air Force Project Committee
AFT	Advanced Fighter Trainer
A-G	Auditor-General
Agusta	Agusta Un'Azienda Finmeccanica S.p.A
ALFA	Advanced Light Fighter Aircraft
AoS	Arms of Service
AP	Acquisition Plan
Arm Scor	Armaments Corporation of South Africa Ltd
AS	Acquisition Study
Bae	British Aerospace
Bell	Bell Helicopter Textron
BV	Best value
C ² I ²	C ² I ² Systems (Pty) Ltd
CACQ	Chief of Acquisitions
CAF	Chief of the Air Force
CDRE	Commodore
CEO	Chief Executive Officer
CFE	Client Furnished Equipment
CPP	Chief of Policy and Planning
COD	Council of Defence
CPT	Client project team
DAPD	Department Acquisition and Procurement Division
DASA	Daimler Benz Aerospace
DCC	Defence Command Council
DIP	Defence Industrial Participation
DNA	Department Naval Acquisitions
DOC	Direct Operating Cost
DoD	Department of Defence
DoF	Department of Finance
DPE	Department of Public Enterprises
DSO	Directorate Special Operations of the National Prosecuting Authority
DTI	Department of Trade and Industry
EBF	Economic Benefit Factor
EC	Eurocopter
ECA Premium	Export Credit Agencies
ESACC	European South African Corvette Consortium
Fin. Cost	Finance Cost
FDSC	Force Design Steering Committee
FMF	Future Medium Fighter
FURS	Functional User Requirement Statement
GEL	Grinaker Electronics Limited

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GFC	German Frigate Consortium
GM	General Manager
GSC	German Submarine Consortium
HPCB	Helicopter Programme Control Board
IA	Intergovernmental Agreement
IFR	Instrument Flight Rules
ILS	Integrated Logistic Support
ILS	Integrated Logistic Statement
ILSM	Integrated Logistics Support Management
IMS	Information Management System
IONT	International Offers Negotiating Team
IP	Industrial Participation
IPCC	Industrial Participation Control Committee
IRR	Internal Rate of Return
IV	Industrial Value
JV	Joint Venture
LCC	Life Cycle Costs
LCCI	Life Cycle Cost Index
LE	Logistics engineering
LIP	Local Industrial Participation
LIFT	Lead in Fighter Trainer
LUH	Light Utility Helicopter
LURS	Logistic User Requirement Statement
MCC	Mediocredito Centrale S.p.A
MCC	Military Command Council
MFOM	Military Figure of Merit
MoD	Ministry of Defence
MOU	Memorandum of understanding
MV	Military Value
MVI	Military Value Index
NDSS	Navigation Distribution Sub-System
NIP	Non-Defence Industrial Participation
NIP	National Industrial Participation
NPV	Net Present Value
OAG	Office of the Auditor-General
OEI	Operational Effectiveness Index
OEM	Original Equipment Manufacturer
PB	Price Breakdown
PCB	Project Control Board
PDI	Previously Disadvantaged Individual
POP W	Project Officer Project Wills
PP	Public Protector
PRAF	Proposal Risk Assessment Factor
PRI	Programme Requirements Index
Prog Cost	Programme Cost
PSR	Project Study Report
R	Rands
R Adm	Rear Admiral
RAM	RAM engineering
RDI	Reutech Defence Industries
RFFO	Request for final offer

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Joint Report



RFI	Request for information
RFO	Request for offer
RFP	Request for proposal
RI	Republic of Italy
RM	Rand Millions
RMP	Risk Management Plan
RSA	Republic of South Africa
SA	South Africa
SAAF	South African Air Force
SAN	South African Navy
SANDF	South African National Defence Force
SCOPA	Standing Committee on Public Accounts
SDP	Strategic Defence Packages
SMME	Small medium and micro enterprises
SMS	System Management System
SOC	Statement of compliance
SOFCOM	Strategic Offers Committee
SPA	Strategic Partnership Agreements
SR	Staff Requirement
SSI	System Supportability Index
SSO	Senior Superintendent Officer
ST	Staff Target
T	Technical
TCG	Tsiki Cohen & Gmeiner
TFI	Technical Functionality Index
TM	Technical manuals, engineering drawings & other data
TOR	Terms of Reference
Tpy	Tons per year
UCC	Ukhozi Control Council
UK	United Kingdom
URS	User Requirement Statement
US	United States
US\$	United States Dollar
US\$m	United States Dollar Millions
USD	US Dollar
USD	United States Dollar
V ADM	Vice Admiral
Wf	Weight factor
ZAR	South African Rand

TERMINOLOGY/DEFINITIONS

Due Process: means to apply internationally recognised procedures and practices in gathering factual information, studying, analysing and interpreting the factual information before arriving at a factual finding situation. The factual findings are then confirmed with the relevant and affected role players offering them the opportunity to make inputs/comment on the factual correctness of the report before the report is finalised and tabled in Parliament.

1. STAFF TARGET

1.1 The Staff Target is defined in the Acquisition Glossary as,

"A short summary of the operational requirements with particular reference to the function of the equipment, together with an indication of the shortcomings of the existing equipment which is to be ruled out by the new requirement."

Clarification

A staff target is the predecessor of the staff requirement.

A staff target indicates broadly what is envisaged."

1.2 The Staff Target is essentially a needs-assessment of the equipment required (in this instance by the air force). It is a formal document in which the technical requirements are determined according to the following categories:

- Desired capability
- Role requirement
- Training and deployment
- Shortcomings of the current system

- Required quantities
- Finances
- Support policy
- Infrastructure
- Manpower requirements
- Design requirements
- Project administration
- Operations
- Approval

2. STAFF REQUIREMENT

2.1 The Staff Requirement is defined in the Acquisition Glossary as:

"A detailed description of the user requirements of an envisaged equipment/weapons system as proposed in the staff objective.

Clarification: The staff requirement includes the user requirement statement (URS)"

3. VALUE SYSTEM

3.1 A value system is defined in the Acquisition Glossary as,

"A collection of interdependent elements, including goals, limitations, evaluation factors and criteria for decisionmaking, which provides a basis for rational decisionmaking.

Clarification: The basic elements of decision-making are prediction and value determination. It is always essential to determine the (relative) value of a certain goal, solution or alternative. In order to acknowledge and consider these decision alternatives, goals and a criterion for decision-making (generally multi-dimensional) are developed, against which alternatives can be measured."

4. PROJECT STUDY REPORT

4.1 The project study report is defined in the Acquisition Glossary as,

“A document that concludes and records the concept phase of an acquisition project and constitutes the beginning of the definition phase of the product system level.

Clarification

The project study report is basically a summary of the results of the project study as compiled by Armscor. The report motivates the manufacture/buy decision by means of the advantages and disadvantages of all options that were considered against the requirements stated in the confirmed requirements as contained in the staff target. On the basis of this evaluation, the choice of preferred options is motivated.”

5. LIFE CYCLE COSTS

5.1 The costs of a weapon system, which entail all direct marginal relevant costs to the user of the entire system, as stipulated in the relevant system specification in its intended environment, during its entire planned life up to and including the phasing out of the system.

Clarification: The LCCs of weapon systems are determined by means of the weapon system's agreed life and mission profile on which the user's statement of requirements is based, without the cost of warfare outside the agreed life profile being taken into account.

5.2 Direct costs are those costs directly traceable to the system, i.e. excluding overhead costs, which, without the system, would have existed in any case.

- 5.3 Marginal costs are costs involved in one additional unit of the system, *viz.*
- (a) Fixed costs, i.e. costs, including development costs, that have to be incurred before the first unit can be manufactured, and
 - (b) Variable costs i.e. the additional costs of subsequent manufactured units.
 - (c) The life profile of a weapon system describes the use of the system and deals with the usable life of the system, i.e. from commissioning onwards but prior to phasing out.
 - (d) The life cycle of a system is the entire life course of a system, from acquisition up to and including phasing out.
- 5.4 The two elements added in the equation are initial unit acquisition cost and direct operating cost (DOC) over 15 years. The LCCI is the LCC normalised so that the lowest cost is equal to one.

6. INITIAL ACQUISITION COST

The sum total of the quoted prices for the LUH system acquisition elements plus the sum total of the quoted prices for the LUH role equipment cost options gave the initial acquisition cost for each proposed system. If an item was not quoted, the LCC was adjusted by using the highest figure for that particular item in the other two proposals, plus ten per cent.

7. OPERATING COST

The only element of operating cost that could be used with success for comparison was the direct operating cost (DOC) per flight hour. The DOC is a standard measure and includes fuel, lubricants and all maintenance. The total

DOC over 15 years would be higher if 20 versus a discounted cash flow multiplied the annual DOC. However, it was believed that although the LCC was overstated, it was the better approach.

8. PROCUREMENT COST

The total cost of the procurement comprises a number of elements including the tender (contract) price, statutory and freight costs, project management costs, ECA premium and escalation.

9. PROGRAMME COST

According to a special meeting relating to value determination of the strategic programmes held on 10 June 1998, programme cost was defined as follows:

- 9.1 For purposes of determining the financing cost index for the top level value system model, programme costs shall include all costs, i.e. quoted costs, statutory costs, contingencies, freight, insurance, clearing costs, and exclude programme management costs.
- 9.2 The final programme cost indicated per programme shall be calculated as above, but will include programme management costs.
- 9.3 Programme cost indicated shall not include life-cycle costs (helicopter programmes to be handled as a special case).

10. FINANCING COSTS

The value of the total financing costs payable over the financing period, i.e. interest, management fees, export credit fees, etc. expressed in million US\$.

11. CASH FLOW

Total programme cost and financing cost.

12. FINANCING COST %

Financing cost expressed as a percentage of programme cost.

13. NPV

Net present value of the discounted cash flows.

14. IRR

The internal rate of return calculates the expected cost of capital. Drawdowns requested by contractors are seen as positive inflows, while all payments due under the financing scheme are seen as outflows.