NATIONAL TREASURY
PPP MANUAL

MODULE 5: PPP PROCUREMENT

NATIONAL TREASURY PPP PRACTICE NOTE NUMBER 06 OF 2004

In accordance with section 76(4)(g) of the Public Finance Management Act, 1999 (PFMA), National Treasury may issue instructions to institutions to which the PFMA applies in order to facilitate the application of the PFMA and the regulations promulgated under the PFMA.

This National Treasury PPP Practice Note Number 06 of 2004 'PPP Procurement' applies to departments, constitutional institutions, public entities listed or required to be listed in schedules 3A, 3B, 3C and 3D to the PFMA, and subsidiaries of such public entities.

Extract from Treasury Regulation 16 to the PFMA

16.5 Procurement – Treasury approvals: IIA and IIB

16.5.1 Prior to the issuing of any procurement documentation for a PPP to any prospective bidders, the institution must obtain approval from the relevant treasury for the procurement documentation, including the draft PPP agreement.

16.5.2 The treasury approval referred to in regulation 16.5.1 shall be regarded as Treasury Approval: IIA.

16.5.3 The procurement procedure –

(a) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective; and

(b) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation.

16.5.4 After the evaluation of the bids, but prior to appointing the preferred bidder, the institution must submit a report for approval by the relevant treasury, demonstrating how the criteria of affordability, value for money and substantial technical, operational and financial risk transfer were applied in the evaluation of the bids, demonstrating how these criteria were satisfied in the preferred bid and including any other information as required by the relevant treasury.

16.5.5 The treasury approval referred to in regulation 16.5.4 shall be regarded as Treasury Approval:IIB.

16.6 Contracting PPP agreements – Treasury Approval: III

16.6.1 After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, that accounting officer or accounting authority must obtain approval from the relevant treasury –

(a) that the PPP agreement meets the requirements of affordability, value for money and substantial technical, operational and financial risk transfer as approved in terms of regulation 16.4.2 or as revised in terms of regulation 16.4.4;

(b) for a management plan that explains the capacity of the institution, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP; and

(c) that a satisfactory due diligence including a legal due diligence has been completed in respect of the accounting officer's or accounting authority and the proposed private party in relation to matters of their respective competence and capacity to enter into the PPP agreement.

16.6.2 The treasury approval referred to in regulation 16.6.1 shall be referred to as Treasury Approval: III.

NATIONAL TREASURY

PPP unit

PPP PROJECT CYCLE

Reflecting Treasury Regulation 16 to the Public Finance Management Act, 1999

PPP Manual reference

PROJECT PREPARATION PERIOD

Phase I — INCEPTION

- Register project with the relevant treasury
- Appoint project officer
- Appoint transaction advisor

PPP Manual reference: Module 1, Module 2, **MODULE 3**, Module 6

Phase II — FEASIBILITY STUDY

Prepare a feasibility study comprising:

- Needs analysis
- Options analysis
- Project due diligence
- Value assessment
- Economic valuation
- Procurement plan

Treasury Approval: I

PPP Manual reference: Module 1, Module 2, **MODULE 4**, Module 6, Module 7, Module 8, Module 9

Phase III — PROCUREMENT

- Design a fair, equitable, transparent, competitive, cost-effective procurement process
- Prepare bid documents, including draft PPP agreement

Treasury Approval: IIA

- Pre-qualify parties
- Issue request for proposals with draft PPP agreement
- Receive bids
- Compare bids with feasibility study and each other
- Select preferred bidder
- Prepare value-for-money report

Treasury Approval: IIB

- Negotiate with preferred bidder
- Finalise PPP agreement management plan

Treasury Approval: III

PPP Manual reference: Module 1, Module 2, Module 4, **MODULE 5**, Module 6, Module 7, Module 8, Module 9

PPP agreement signed

PROJECT TERM

Phase IV — DEVELOPMENT

Phase V — DELIVERY

Phase VI — EXIT

- Measure outputs, monitor and regulate performance, liaise effectively, settle disputes
- Report progress in the Annual Report
- Scrutiny by the Auditor-General

PPP Manual reference: Module 1, Module 2, Module 5, **MODULE 6**, Module 7, Module 8, Module 9

ABOUT THIS MODULE

Module 5: PPP Procurement details the procurement processes of a PPP. Treasury Regulation 16 to the PFMA states that it is the responsibility of the accounting officer/authority to design and manage the procurement process in a way that meets the regulation's requirements. This means that this module is not prescriptive, but rather establishes best practice as it has been developed in National Treasury-regulated PPPs to date. Given the newness of PPPs in South Africa, it is expected that each project will further refine the procurement process and add to the pool of best practice knowledge. The case studies produced at the end of this procurement phase are an important part of tracking best practice. National Treasury will continue to update *National Treasury's PPP Manual*, and to develop sector-specific toolkits to provide further guidance.

Take note

The procurement of PPPs goes through distinct stages:
- pre-qualification
- request for proposals
- best and final offer, where appropriate
- negotiations
- financial closure.

This is different from a conventional tender process. A conventional tender process has a single stage when an offer is made which an institution can accept or not.

Module 5: PPP Procurement explains how to proceed through the stages, with a focus on getting the documentation right. Follow the outlines of suggested contents for the various documents closely to ensure that the institution provides the correct and complete information for getting treasury approvals IIA, IIB, and III (TA:IIA, TA:IIB and TA:III) in terms of Treasury Regulation 16 to the PFMA.

CONTENTS

INTRODUCTION

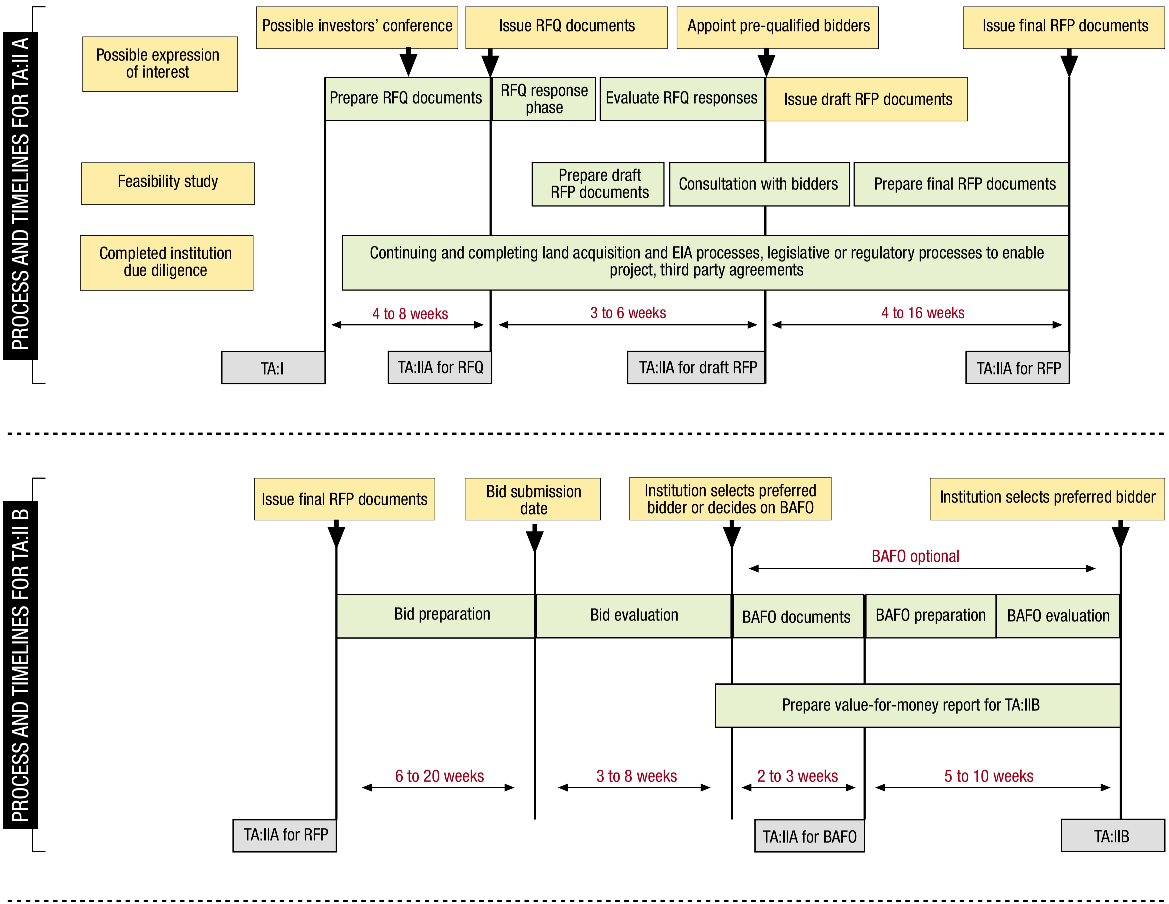
Take note

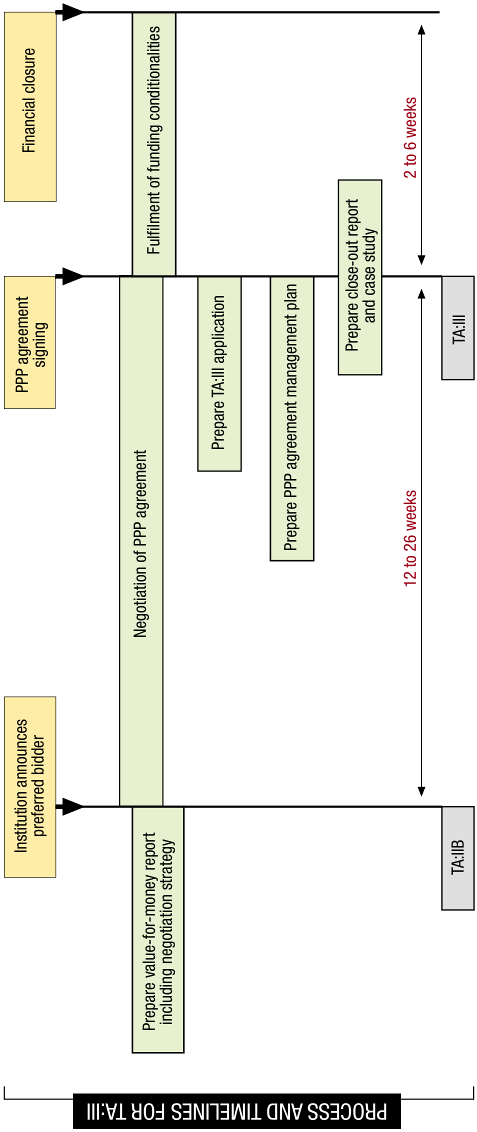
National Treasury's Standardised PPP Provisions (Standardisation) have a very specific and well-consulted risk profile. The provisions are intended for use on limited recourse type projects[1] with a unitary payment made by the procuring institution to the private party. It is obligatory to use the standardised provisions when preparing procurement documents for projects with these characteristics. The only exception is where institutions satisfy the relevant treasury that alternative provisions provide better value for money. It is important that all the PPP procurement documents (including the request for proposals (RFP) documents and the draft PPP agreement) reflect the same risk profile as established in Standardisation.

In projects that do not have the characteristics of a PPP subject to Standardisation, the provisions should be applied to all procurement documents in so far as they are applicable to the project.

1. See also *Module 9: An Introduction to Project Finance*.

Figure 5.1: Stages of PPP procurement with indicative timelines




PROCESS AND TIMELINES FOR TA:III
Institution announces preferred bidder
PPP agreement signing
Financial closure
Prepare value-for-money report including negotiation strategy
Negotiation of PPP agreement
Fulfilment of funding conditionalities
Prepare TA:III application
Prepare PPP agreement management plan
Prepare close-out report and case study
12 to 26 weeks
2 to 6 weeks
TA:IIB
TA:III

LINKS TO THE FEASIBILITY STUDY

The stronger the link between the project's feasibility study and its procurement, the greater the opportunity to create a true value-for-money PPP.

As *Module 4: PPP Feasibility Study* shows, the feasibility study is much more than a theoretical exercise in satisfying Treasury Regulation 16 to the PFMA.

Key outcomes of the feasibility study which are absolutely necessary for a solid PPP procurement

1. A full and detailed understanding of all facets of the project
2. A clear affordability statement
3. A clear exposition of value for money and the drivers of such value
4. Procurement plan
5. Project team
6. Output specifications
7. Project type and participants
8. Third parties
9. Funding sources
10. Payment mechanisms for the private party
11. Due diligence
12. Risk matrix with costs, and sources of risk with sensitivity analyses

1. A full and detailed understanding of all facets of the project

An understanding of the project is perhaps the most difficult outcome to define, but it is key to a successful PPP procurement. A minimum requirement is that the scope of the project is defined and linked to a long-term strategy or institutional plan for service delivery.

A key point here is that, to a great extent, PPPs lock in institutions for long periods of time to particular service outcomes. Flexibility can be built into PPP agreements through certain amendments and variations which are permissible under Treasury regulations. But these are mechanisms dealing with unforeseeable events, the non-occurrence of events, or changes in public sector delivery culture over time. They are not a way of getting around poor planning in the feasibility study phase.

Before designing the procurement documents, restate the project objectives and scope clearly and concisely, in terms of business outcomes supported by expected project outputs. This statement should then be the introduction in every procurement document, from the RFQ to the final version of the PPP agreement.

2. A clear affordability statement

TA:I will always contain a restatement of the affordability limits set in the feasibility study. This is typically the extent of any capital contribution by the institution to the PPP, the annual limits of the unitary payment, and the costs of managing the PPP agreement.

The affordability limit in a well-constructed feasibility study is always determined by three factors:

- existing budgets for the function
- the specifications defined for the project
- the risk sought to be transferred in the PPP.

Two important warnings arise from this:

- Once the external costs of economic factors are stripped away, breaches of affordability limits during the procurement process mean that there is a mismatch between the specification used for costing in the feasibility study and the specification set out in the procurement documents. In such a case affordability limits or specifications need to be amended. Neither is a satisfactory solution, and both invariably involve delays to the project at a time when the private parties are already involved and have spent money on submitting proposals. In particular, a revised TA:I will be required.
- Even though a project appears to be affordable based on private party proposals during the procurement process, private parties may make qualifications to the project risk profile which have a direct impact on the ultimate affordability of the PPP. This is apparent in projects where the private party is able to claw back substantial gains through the term of what began as an affordable PPP.

The TA:I affordability limit is a key indicator during procurement, and deviations (above or below) must be treated with caution and must be fully justified in an application for a revised TA:I.

Use the affordability limit in preparing the procurement documentation. Use discretion to decide whether this will be an explicit statement of affordability, or whether the institution will only use the risk profile and specifications used in the feasibility study.

3. A clear exposition of value for money and the drivers of such value

In its most basic form, value for money is the reason for an institution to enter into a PPP. Value for money is not a vague term; in the feasibility study it is defined in monetary terms and will be subject to audit. The feasibility study must not only have defined the initial value for money in absolute terms, but must also have identified the sources of such value.

It is therefore important that the procurement documentation:

- Sets out the information to bidders so that the value-for-money drivers identified by the institution are absolutely clear. They need to be identified as priorities, whether they are design efficiencies coupled with reduced operating costs in an accommodation project, or the risk of technology refreshments on an information and communication technology project. Setting out these drivers is not prescriptive, but must encourage bidders to offer their best value-for-money solution in a way that enhances these drivers.
- Establishes a way for the private party to determine and justify the value for money in each proposal.
- Encourages private sector innovation through competition.

4. Procurement plan

The feasibility study will have been accompanied by a procurement plan that sets out timelines, processes and strategies. The project officer must update the procurement plan[2] before applying for TA:IIA, and must regularly update the procurement plan throughout the procurement phase.

5. Project team

During the feasibility study phase, information gathering and processing were the main required skills of the project team, involving a multitude of specialist functions. Procurement requires communication and analytical skills, and the project team should be pared down to members who have these skills. This should be done as soon as possible after TA:I is given.

6. Output specifications

The institution's required outputs of the project were clearly specified in the feasibility study phase and used as the basis to develop the PSC and PPP reference models. Stressing the link between the feasibility study and procurement, and particularly the link between affordability and specification, the output specifications must form the basis of the project's specifications in the RFP.

7. Project type and participants

The feasibility study will have identified, in the institution's view, the financial structure best suited to the project's characteristics, as well as the likely participants. This would include essential information about whether the project is suitable for project finance or corporate finance, the likelihood of raising debt and equity, and the types of participants, be they sponsors, subcontractors, lenders or third party investors. Most importantly, when preparing the feasibility study, the transaction advisor will have tested the market's appetite for the project and for some of the specific project risks.

The procurement documentation must then focus on procuring that type of project with particular types of participants. The institution should not restrict participation to these participants, but should strike a balance in the RFP between clearly communicating its view of the project and allowing bidders to propose their own structures and participants.

8. Third parties

All third parties to agreements, whether they are land owners, users or other parties, must be identified before procurement, with a procurement plan that includes the signing of third party agreements at the appropriate times.

2. The procurement plan should be one component of the general project management planning required of the project officer. This module focuses on the procurement of a project. Refer to appropriate project management literature and international best practice for overall project planning and management.

9. Funding sources

Procurement documentation is dependent on the intelligent identification, during the feasibility study, of the possible funding sources. The source/s of funding is closely linked to the types of project and its probable participants. To a large extent, the source/s of funding (e.g. lenders, corporates) dictate the terms of the PPP agreement. Some projects are suited to on-balance sheet treatment. Others are conducive to high levels of limited recourse debt in which lenders require high levels of due diligence on the project. In creating a private party that is capable of servicing debt through the PPP, the value added is considerable, namely, by performing in terms of its obligations for the period of the PPP agreement. This means that the interests of the lenders and the institution can be aligned, although much effort is required in designing and managing this kind of procurement process. Limited recourse debt is thus optimally used in certain projects whose size justifies the cost and time involved.[3]

10. Payment mechanisms

The procurement documents must clearly set out the payment mechanism.

There are three types of revenue for the private party:

- payments from an institution
- user fees
- a combination of the two.

Each has different characteristics. Unitary payments from an institution have greater certainty than user fees because they do not have an inherent demand or collection risk and they allow the institution to manage performance better, by making deductions for non-performance by the private party. User fees are susceptible to demand and collection risk and generally lead to keen consideration by private party bidders and in some cases to an underwriting of demand risk by government. (See 'Annexure 1: The payment mechanism'.)

11. Due diligence by the institution

The project due diligence is crucial to successful procurement. The results cover, among others, existing assets, land ownership, rights and conditions, environmental scoping, heritage issues and staff.

Procurement of a PPP cannot proceed until the due diligence is complete, as any single issue can destroy or at best delay the project. If the due diligence was not completed before the issue of TA:I, it must be completed before any TA:IIA is granted. It is likely that such a delayed due diligence will require a revised TA:I, as project costs will vary as a result of the due diligence.

Nearly all PPPs involve the use of immovable property. Of all the items for which there needs to be certainty before procurement, land is the most important. Who owns the land and any rights over the land must be identified. It is also critical to identify ground conditions on greenfield projects, and conditions of existing assets

3. See *Module 9: An Introduction to Project Finance*.

on brownfield projects. The due diligence on the land must be complete before TA:I. The process of acquisition should be complete before issuance of any TA:IIA.

12. Risk matrix with costs, and sources of risk with sensitivity analyses

The risk matrix from the feasibility study must be continually updated during procurement. Each risk is tracked in terms of where it is dealt with in the procurement documents and how bidders deal with it in their proposals. This risk-tracking is of great importance.

CRITICAL CONSIDERATIONS FOR THE PROCUREMENT PHASE

Critical considerations for the procurement phase

1. Should there be an explicit statement of affordability in the RFP?
2. Variant bids
3. Time allowed for bid preparation
4. Value for money in risk: issues and mitigations
5. Early works
6. Land
7. Staff
8. National Industrial Participation Programme
9. Competition
10. Bidder compensation
11. Shared bid costs
12. Existing institution assets
13. Asset replacement and disposal
14. Expression of interest

1. Should there be an explicit statement of affordability in the RFP?

A statement of affordability sets out the amount of money the institution is willing to pay via the PPP payment mechanism.

The single greatest benefit of disclosure is that it reduces the risk of unaffordable proposals, and bids are focused on achieving maximum value for money. It is also likely that mismatches between output specifications and price will be highlighted very early in the bid process. The interpretation of output specifications can also vary widely from one bidder to the next. In the absence of a common understanding of the affordability constraints, bids will be extremely varied and evaluation will be difficult.

The disadvantages of disclosure are obvious – competition on price is limited, and evaluating variant performance specifications can also be difficult.

Even with these disadvantages, it is the strong recommendation of National Treasury that the affordability limit be published. Consider all aspects of the project before making a decision to the contrary, and review the decision before any BAFO process begins.

2. Variant bids

Significant value for money in PPPs lies in private party innovation during bid preparation. This means that the RFP may be developed to allow for variant bids in addition to a compliant bid. However, evaluating variant bids can be particularly difficult, because they cannot easily be compared to any base, such as the PSC, or even to other bids.

Variant bids must:

- be accompanied by a compliant bid
- meet the specified minimum requirements set out in the RFP

- be supported or underwritten to the same extent as the compliant bid
- show in each element how it differs from the compliant bid, what changes to the risk allocation have been proposed, and what value for money it presents to the institution
- be clearly separable from the compliant bid and from other variant bids, because a shopping list of elements of variant and compliant bids is impossible to evaluate and will result in protracted negotiations.

List the variants that the feasibility study showed as providing possible value for money, but do not limit bidders to these. Examples include a variant concession period, creating additional facilities capable of generating third party revenue, or alternative uses of existing facilities on the project site.

3. Time allowed for bid preparation

There is a direct correlation between the time allowed for preparing bids and the quality of the bids. It is also true that absolute bidder commitment must be secured before a PPP agreement can be finalised. This can be done either in a competitive bid environment or in post-evaluation negotiations with a single bidder. The former is far better value for money. Accordingly, give bidders enough time to meet all the bid requirements. Ascertain what bidders view to be adequate time for preparing a bid during or after pre-qualification.

4. Value for money in risk: issues and mitigations

Since PPPs are intended to maximise value for money, the RFP sets out all the elements that make up value for money for the institution. In many cases this takes the form of a risk matrix. Bidders should be allowed to propose an alternative to any element, provided that, in each case:

- the value for money of the alternative is set out clearly
- the compliant bid reflects the institution's value-for-money requirement, as set out in the RFP.

Amongst others, two important and common value-for-money considerations are:

- the use of alternative inflation indices
- sharing interest rate and foreign exchange risk.

These would be treated differently in project finance and corporate finance bids.

Alternative inflation indices

Bidders commonly propose the use of very specific indices that they feel better represent the inflationary pressures of the particular project. For example, a bidder may propose the use of an index that has a higher component of labour costs than CPIX on a project that has a large labour component.

The advantages of the common use of CPIX in PPPs as the index of adjustment of unitary payments and user charges are:

- the simplicity of a single, common index
- the certainty of budget adjustments
- compliance with inflation targeting

- incentivising the private party to manage above-CPIX increases in costs.

National Treasury's position is that the advantages are such that no index other than CPIX can be used without a clear demonstration of value for money, supported by a detailed submission by the institution and its advisors.

Shared interest rate and foreign exchange risk

Section 67 of the PFMA explicitly prohibits provinces and provincial public entities from entering into future financial commitments denominated in a foreign currency or concluded on a foreign market. National government may only do so in terms of Section 66, through the Minister of Finance.

Pure financial hedges may not provide value for money for a PPP. In some PPPs there has been a tendency to structure currency hedges through financial institutions. The economic theory behind foreign exchange variations is simple, and is known as the purchasing power parity principle – the exchange rate will depreciate by the difference between the local and foreign interest rates. This is a long-term trend, and financial hedges simply project the depreciation over specific periods of time. The shorter the hedge period, the more accurately the hedge can be costed. With long-term PPP projects, hedges increase in cost because the hedge period increases. Financial hedges simply pass currency risk to a third party (a financial institution). It is the third-ranked solution in the avoid-mitigate-pass-off hierarchy of dealing with project risk. It also locks all contracting parties into long-term currency contracts with high breakage costs.

Examine the value for money of such financial hedges. The feasibility study for every PPP must have examined the potential for avoiding currency mismatches as well as for locally sourcing input components and stimulating local development using the purchasing power of the PPP. In addition, raw material and equipment suppliers should be encouraged to enter into forward contracts or other measures that stimulate risk-sharing between the seller and purchaser of goods and services.

It is also quite feasible that the best value for money will be found in allocating bands of foreign exchange changes to different contracting parties – the institution, suppliers or banks. The use of bands would result in the first ***x*** per cent of an increase above the projected exchange rate being for the account of the private party, the next ***y*** per cent being shared by the institution and the private party in a pre-agreed ratio, and the remaining ***z*** per cent being taken by the institution. The same banding approach would apply to decreases in the exchange rate for sharing the benefits. A similar banding approach is used for interest rates. In both cases the relevant foreign exchange rate and interest rate at the time of signing is crucial, and if it is abnormal relative to the forecast rate then the institution should negotiate a way to adjust the banding appropriately.

5. Early works

Early works are construction works undertaken on the PPP facilities before the PPP agreement has been finally negotiated. They are also referred to as enabling works.

Early works are usually carried out by the preferred bidder's construction subcontractor in terms of a separate contract, the early works agreement. The arguments in support of such agreements are usually time-related – fast-tracking the project requires an early start to construction.

National Treasury is not in favour of early works agreements:

- The complexity of negotiating the early works agreement will probably not save the time as intended.
- The institution's bargaining position will lose strength in negotiations if the works have already started with the preferred bidder.
- The early works will invariably have started on substantially different terms from those envisaged in the PPP agreement. The early works agreement may not offer as much protection to the institution as if the works had been carried out under the terms of the PPP agreement.
- The final cost of these works may be more expensive than if they had been procured under the PPP agreement as they are invariably negotiated on a cost plus basis.
- The scope creep – the incremental increase in project scope as needs change – in open-ended early works agreements can result in significant reduction in the value of the PPP. It makes negotiating a PPP agreement difficult, because it is a 'moving target'.
- If the PPP negotiations are terminated it may be very difficult to get a third party in to complete the works, and the works carried out under the early works agreement may therefore lose value, especially as these works are unlikely to suit the designs of a new preferred bidder.

Circumstances that are conducive to early works agreements:

- The work required was stipulated in the feasibility study.
- The risk for this work was allocated at least partially to the institution.
- Value for money is demonstrated.
- The RFP sets out the terms of the early works agreement.

Early works should be limited to:

- relocating existing services on the site
- cleaning up existing contamination of the site
- corrective work or maintenance to remedy latent defects on existing project facilities.

In these cases, it is essential that the early works agreement passes risk on to the future private party by fully integrating the results of the early works into the PPP agreement.

Any early works agreement must be a full contract that is a stand-alone document (namely, containing all essential terms). This will both cater for the risk that the PPP agreement with the preferred bidder will not be signed, and set out the terms on which the early works are incorporated into the PPP agreement. The early works agreement is thus between the institution, the preferred bidder, and the preferred bidder's construction subcontractor.

The scope of the early works must be restricted to avoid scope creep, and the early works agreement must contemplate a no-fault termination arising from failure of the PPP negotiations as well as termination upon signing of the PPP agreement.

6. Land

Land issues are at the forefront of bidders' minds simply because, in almost all cases, the land is selected and owned by government for the period of the PPP agreement. This means that all property annexed to the land, constructed by the private party, belongs to government. Bidders want certainty about their use of the land over the period of the PPP.

Strive for a balance here. The feasibility phase will have involved exhaustive investigations into title to the land, that is the status of any land claims, servitudes, long leases and constraints, as well as investigations into geo-technical conditions, existing contamination, utility service availability and capacity, and the environmental and heritage status of the land. Be proactive about obtaining all necessary filings and approvals to avoid long delays later. The information in all cases should be given to bidders in the RFP, but not warranted unless it clearly provides value for money to do so.

Environmental impact assessment

The National Environmental Management Act, 1998, places an obligation on the institution to 'consider, investigate and assess prior to their implementation and report to the organ of state charged by law with authorising, permitting, or otherwise allowing the implementation of an activity'. As this process cannot meaningfully be delegated to a private party, obtain authorisation or refusal from the relevant organ of state as soon as possible, preferably before the RFP is issued. The decision is made by the relevant organ of state (either the provincial or national department responsible for the environment) and is issued as a public record of decision (RoD). This RoD should be made available in the RFP so that all bidders make proposals that meet all the requirements of the RoD.

The risk transfer must be made clear to ensure that all subsequent fulfilments of the requirements of the RoD must be at the cost and risk of the private party. In effect the institution will have created an equal opportunity for all bidders to deliver the PPP within the environmental constraints for the project. The methods used to mitigate environmental impact will thus vary from party to party, and the responsibility for obtaining approvals for environmental impact assessments in terms of the Environment Conservation Act, 1989, will pass to the private party.

The institution must be confident that the preferred bidder will be able to obtain the required approvals. Private-party financiers will also conduct significant due diligence on this. The institution should not assume any responsibility in the RFP for obtaining such approvals.

Heritage assessment

Make sufficient time available for bidders to carry out their own due diligence on the project site for heritage impacts. This due diligence will be in addition to the heritage impacts established by the institution in the feasibility study. The results of the institution's assessment should be made available but not warranted to bidders in the RFP.

7. Staff

The feasibility study phase requires that all project costs and risks be accounted for. Existing staff costs will play a major role in the procurement of the PPP. The RFP must spell out the requirements for the treatment of existing staff as well as the status of all communications to date, collective agreements, and, most importantly, adequate detail for bidders to cost staff transfers if this is the preferred route for the institution. This includes staff numbers, pension and medical aid status and costs, as well as leave and other entitlements. Bidders should be required to produce personnel plans that are firm, costed commitments, completely in line with the institution's requirements and existing staff agreements.

Communication with staff and organised labour throughout the procurement phase must be well planned and continuous.

8. National Industrial Participation Programme

The principle of industrial participation (IP), in line with the policy developed by the Department of Trade and Industry (DTI), states that where state funds are expended on contracts for goods and services where the imported content is US$10 million or more, this expenditure must be accompanied by one or more of the following – investment, export opportunities, job creation, increased local sales, small, medium and micro enterprises (SMMEs) and BEE promotion, R&D, and technology transfer – up to a value of not less than 30 per cent of the imported content value.

The National Industrial Participation Programme (NIPP) requirements are compulsory. PPPs are not exempt from them and the RFP must draw bidders' attention to this.

The NIPP form

Form ST18 at the Office of the State Tender Board (and its successor/s after its demise in 2004) sets out the NIPP requirements and should be used in the RFP. Bidders should complete this form and ensure that by the time they submit their proposals they have made appropriate arrangements with the DTI to satisfy the NIPP requirements. The form, signed by the DTI to signify compliance with the NIPP requirements, must accompany bidders' proposals. The institution should not accept any responsibilities or risk arising from any compliance or failure to comply with the NIPP.

9. Competition

PPPs are subject to the Competition Act, 1998. The Competition Commission is the statutory body charged with applying the Competition Act. The purpose of the Act is to encourage and maintain competition in the country in order to promote: economic development, employment, SMME participation, and a greater spread of ownership amongst companies in the country. Section 81 of the Act makes the Act expressly applicable to the state.

The Act identifies four events or activities that would require the intervention and adjudication of the Competition Commission.

Restrictive horizontal practice
Restrictive horizontal practice (Section 4) is defined as an agreement between firms[4] in a horizontal relationship, which has the effect of substantially preventing or lessening competition in a market. The key elements here are the application of the section to firms which are competitors and which enter into an agreement that has the effect of reducing competition. The onus is on private party bidders to avoid such practices.

Restrictive vertical practice
The definition of restrictive vertical practice (Section 5) is largely the same as a restrictive horizontal practice, but there is a vertical relationship between a firm and its suppliers, and between a firm and its customers. The onus is on private party bidders to avoid such practices. Good procurement practice will ensure that the institution does not infringe this section of the Act.

Abuse of dominance
In Section 8, the Act prohibits charging excessive prices, engaging in any exclusionary acts which are anti-competitive in nature, and price discrimination by dominant firms. The application of this section to PPPs is limited: it is unlikely that any firms in PPPs would fall within the definition of a dominant firm; price determination in PPPs is not the sole responsibility of the private sector; and exclusionary acts are unlikely to occur in a single-concessionaire type environment.

Mergers
The Act applies most to PPPs in the definition of mergers (Chapter 3) and the process to follow for notifying the commission and other parties of a potential merger.

Mergers are not prohibited in terms of the Act. The Act is intended to prevent mergers which will have the effect of substantially preventing or lessening competition, taking into account factors such as the public interest and technological or efficiency gains which might result from such a merger.

In terms of Section 12, a merger is defined as the event that 'occurs when one or more firms directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another firm'. A number of types of merger is identified in this section and the term 'control' is defined.

There are two tests for whether a transaction must be formally notifiable to the Commission:

4. The definition of firms includes persons, partnerships or trusts, but clearly excludes public sector bodies.

- whether the transaction constitutes a merger in terms of the Act
- whether the required thresholds of annual turnover and gross assets are met.

Government Notice 254 of 2001 sets out the thresholds of annual turnover and gross assets. It also outlines the method for calculating these. The higher amount of the annual turnover or gross assets of the target firm must be equal to or exceed R30 million; and the combined annual turnover and gross assets of the target firm, the acquiring firm and other group firms of the acquiring firm must be equal to or exceed R200 million in order for the merger to be notifiable.

Annual turnover must be ascertained with reference to the gross revenue stated in the seller's income statement of the immediately previous financial year. Gross assets must be ascertained with reference to the gross value of assets as recorded in the seller's balance sheet for the end of the immediately previous financial year. The notice also provides that the annual turnover and gross assets figures of all firms controlled by the target business must be added to the figures for the target firm on a consolidated basis. Similarly, the annual turnover and gross assets figures of all firms forming part of the same group as the acquiring firm must be added to the figures for the acquiring firm on a consolidated basis.

Process for competition filing

During the feasibility study phase, the institution must have identified the competition issues likely to arise. If it is necessary in the procurement phase to approach the Competition Commission for any approval, build a competition filing process into the timeframe for the project.

The private party is responsible for compiling the documents for filing and obtaining the necessary approval from the commission, and for the costs. The RFP must indicate this clearly. The RFP must further indicate that, if the Competition Commission does not approve the project, the institution automatically has the right to withdraw the RFP. Also, the institution will not be liable for any damages (whether direct, indirect, special or consequential) or for any losses, costs, expenses or penalties suffered by the private party in preparing its bid documents and documents for competition filing.

Competition Commission approval must be obtained by the private party before the institution's application for TA:III is lodged. The private party should approach the Competition Commission for approval as soon as the PPP agreement has been finalised but before its execution.

10. Bidder compensation

The general principle is that bids are submitted at the bidder's cost and risk. Bidders build in bid costs so that each successful bid has an element of the cost of past unsuccessful bids. By selecting a small number of well-qualified bidders, the institution minimises total bidder costs to the project and to other projects.

This principle does not apply when the size of the project makes bidding unaffordable or too risky for bidders. In this case, bid compensation should be a pre-agreed percentage of the verifiable costs incurred by a bidder in preparing its bid. This compensation should only be paid to unsuccessful bidders for a compliant bid. The successful bidder has the remuneration of the PPP itself. If the institution terminates the procurement for any reason that is not the fault of the bidders, compensation may also be payable.

11. Shared bid costs

The costs of due diligences by private parties may be significant. Where possible, and where bidders agree, survey costs can be shared between pre-qualified bidders. If the project is so large that high survey costs could reduce the number of bidders, the costs can also be shared by the institution.

12. Existing institution assets

Where existing institution assets are to be incorporated into the PPP, give bidders access to all information on the assets, including their condition and their maintenance records. Existing institution assets are a separate risk category, and bidders may be loath to accept performance and availability risk if they do not have access to detailed information on which to base their due diligence. Allow bidders to demonstrate additional value for money in not using existing institution assets.

13. Asset replacement and disposal

Bidders need to set out clear schedules for asset replacement and disposal. This is not so much for the future management of the PPP agreement, but allows the institution to understand the basis for the private party's use of assets when the institution is evaluating proposals. Be careful not to specify the replacement of assets, as this is not an output and will reduce the private party's ability to maximise the use of assets.

14. Expression of interest

An expression of interest (EoI) is not the same as a Request for Qualification (RFQ). An EoI is a way of establishing the level and type of interest of a particular market sector in a particular project. It is most often used in revenue-generating projects where the broad parameters of the potential PPP are known (for example, in determining the market interest in a potential hospital co-location PPP in a particular location, or determining investor interest in tourism developments in a conservation area).

The advantage of an EoI is that an institution can make an informed decision, based on likely market interest, about whether to proceed with a project. If used, it should be early in the project cycle, either before or as part of the feasibility study.

An EoI must be more than a public advertisement calling for responses. It should consist of an advertisement and an EoI document. The EoI document must include:

- Background and aims of the institution and the project
- A clear identification of the project as a potential PPP to be procured in accordance with National Treasury regulations

- A brief summary of similar South African PPPs and references to more detailed sources of information
- Value for money expected in the provision of an institutional function or use of state property by a proposed PPP
- Expertise sought from the private sector
- Information that respondents must supply
  – Legal status of respondent
  – Respondent's details and profile
  – Why they are interested in the project
  – BEE profile
  – History of involvement in similar projects
  – Input on nature of proposed PPP
  – Contact details
- Process to be followed in the EoI and subsequent communication with respondents (with timelines)
- Appropriate disclaimer of institution liability and reservation of rights.

An EoI does not need to include the same detail as a RFQ. The emphasis is on providing information to the private party and not on soliciting full bids or proprietary information from private parties. An EoI therefore has a limited use on particular projects. Be careful not to abuse the process by spuriously calling for EoIs without proper preparation or the intention to follow them up as they inevitably create market expectation.

STAGE 1: THE RFQ

Objectives of the RFQ

National Treasury considers it to be best practice for an institution to limit the number of private parties eligible to participate in the PPP procurement by carrying out a pre-qualification exercise.

This part of the procurement process is known as the Request for Qualification or RFQ. It is a very important part of the PPP procurement process and must meet all the requirements of procurement legislation, regulations and best practice.

The RFQ's objectives are to:

- select a limited number of the bidding consortia[5] that are qualified – technically, financially and in terms of BEE – and have sufficient experience and commitment to prepare proposals and execute the project
- set out the rules of participation in the procurement process clearly and unequivocally
- disseminate information on the project
- give guidance on the expected kinds of participants in the bidding consortia
- gather information from bidding consortia that is verifiable and can be evaluated.

This ensures that the successful bidder will have not only the qualifications to undertake the project, but also the capacity to execute it effectively and timeously.

Only pre-qualified bidders will be allowed to enter the RFP stage.

Critical considerations in the RFQ stage

Critical considerations in the RFQ stage
1. Number of pre-qualified bidders 2. Bid bond 3. BEE 4. Parties eligible to participate in bidding consortia 5. Conflict of interest

1. Number of pre-qualified bidders

The pre-qualified bidders should be kept to a minimum of three and a maximum of four. Given the high cost to the private sector of submitting proposals, this will give pre-qualified bidders a reasonable chance of success.

Where only two or even only one bidder pre-qualifies, the project is placed at a great disadvantage, because competitive bidding is essential for getting value for money. In

5. In South Africa it is not often that the private party or bidder will ever be a single commercial entity. Bidding consortia are formed that combine a variety of entities contributing expertise, resources (including funding), and BEE components.

principle, under South African procurement law – and subject to the institution's procurement policy – it is not necessary to cancel a bidding process if only one bid is made. However, this may be an indication that the project has not been well structured or conceived and the institution should follow the guidance below.

- Ascertain the likely reasons for the limited interest, and revisit the RFQ documentation and the feasibility study to see what assumptions could be revised to increase market interest. Any changes in the feasibility study must be evaluated for changes in affordability, value for money and risk transfer.
- Secure a revised TA:I if any changes to assumptions in the feasibility study are made.
- Carry out a second pre-qualification exercise if the project assumptions have been changed and if a revised TA:I has been secured.
- If the feasibility study is not revised:
  - carry out the pre-qualification exercise again, with a wider circulation to attract a suitable number of bidders, or
  - continue with the limited number of pre-qualified bidders, but with a revised procurement plan that uses the PSC prepared in the feasibility study as an active 'competitor' for the bids.

2. Bid bond

To mitigate the risk of pre-qualified bidders dropping out of the process, a bid bond should be required from the pre-qualified bidders before the RFP is issued. Formal appointment as pre-qualified bidders should be contingent on the provision of such bid bonds being provided to the institution in the approved format. The size of the bonds should be appropriate to the project, typically, the cost to the institution of restarting the procurement process from the RFQ stage.

3. BEE

To pre-qualify in the BEE component of the RFQ, consortia should at least demonstrate that:

- they have written commitments in place for the required targets of BEE participation in the private party and the first-tier subcontracts, providing verifiable company information to substantiate BEE credentials
- they have the ability to secure the targets of black management control required for the private party and the first-tier subcontracts, attaching curriculum vitae of key personnel
- relevant members of the consortia have demonstrable track records in devising and implementing local socio-economic programmes as part of their operations
- the sponsor companies are compliant with the provisions of the Employment Equity Act, 1998, and can demonstrate their own track record in BEE.

Once consortia have been pre-qualified, they will need agreement from the institution to change their consortia membership, and the qualifying BEE targets may not be compromised in any such change. Fronting of black people and black enterprises will not be tolerated by institutions.

4. Parties eligible to participate in bidding consortia

Private parties

All privately-owned firms that are not blacklisted by the Office of the State Tender Board (and its successor/s after its demise in 2004) or by professional bodies, or which have not been found guilty in a court of law of fraud or corruption-related crimes, should be eligible for participation.

Not-for-profit entities

The NonProfit Organisations Act, 1997, defines a 'nonprofit organisation' as a trust, company or other association of persons established for a public purpose, the income and property of which are not distributable to its members or office-bearers except as reasonable compensation for services rendered. So-called Section 21 companies are associations not for gain under Section 21 of the Companies Act, 1973. The Act restricts these to associations that apply profits to a specific purpose and it does not allow the distribution of dividends to members.

The majority of these entities rely on donor or government funding to some extent, and are therefore vulnerable to a degree of financial uncertainty. As not-for-profit entities, they are excluded from profiting, making them not ideal as key operators or equity participants in PPPs in most cases. They may, however, play an important role in achieving the socio-economic aims of the project. They also ensure that special interest groups are represented. Their participation is at the invitation and risk of the private party.

Public entities

Treasury Regulation 16's definition of a private party in a PPP agreement explicitly excludes public institutions.

PPPs seek private finance and then place it at risk in that payment is performance-based. In principle, therefore, the use of public entities as financiers, equity participants or subcontractors runs contrary to the principle of risk transfer in a PPP. Agreements formed between public entities or between institutions and public entities are not PPPs, but some other form of procurement.

National Treasury views any proposed participation by public entities in a private-party consortium to a PPP as anti-competitive and as skewing the risk profile of the project for government.

National Treasury does, however, envisage situations where public entity financial institutions have a role to play in financing PPPs. They may have a greater risk acceptance than the private sector, be able to provide longer-term debt, and have a greater appetite for BEE funding. This role should be limited to the provision of debt that does not duplicate what the private sector provides and is provided at competitive rates and in a competitive environment. Importantly, such debt should be made available to all pre-qualified bidders.

It is also possible that a public entity can participate as a subcontractor, provided that its services are:

- secured in advance by the institution via a third party agreement
- available to all bidders
- allowed to be provided by law.

All other forms of public entity participation should be explicitly excluded in the RFQ.

5. Conflict of interest

Consortium members

To avoid any potential conflict of interest, no member of any consortium should be a member of, or in any way participate or be involved in (directly or indirectly), another consortium at any stage of the procurement process. This restriction should be backed up by the power to disqualify a consortium member or the entire consortium if there are good grounds to do so.

The restriction can be lifted for:

- any specialist supplier, if the restriction leads to a severely limited number of consortia
- any non-core service provider or general supplier which is not a consortium member
- any commercial entity whose role is strictly limited to lending money or advancing credit to the bidding consortium.

Advisors and lenders

To prevent the conflict, or potential conflict, of interest between lenders and sponsors of projects, no advisor to any consortium or member of a consortium should fulfil the role of arranger, underwriter or lead bank to the consortium. Again, there should be a suitable right to disqualify such a member.

National Treasury is aware that the advisory market is a limited one and that competition for advisory services may therefore be reduced. However, it views the potential conflict of interest as so severe that reduced competition is justified.

Other

It is obvious that no member of the institution's project team, including its transaction advisor, or the relevant treasury's PPP Unit's project advisor may participate in, advise, or have any interest in any bidding consortium.

The RFQ stage
Step 1: Prepare the RFQ document Step 2: Get TA:IIA Step 3: Advertise and distribute the RFQ Step 4: Evaluate the responses Step 5: Communicate with bidders

Step 1: Prepare the RFQ document

The RFQ document must enable bidders to present the appropriate information about themselves. It must also clearly set out the RFQ evaluation criteria and processes. Any special requirements of the institution must be clearly stated, and particular RFQ provisions must be developed for each PPP.

Contents of the RFQ document

Disclaimer

Terms and conditions of issuance of the RFQ

Purpose of issuing the RFQ

Outline of the contents of the RFQ

Information about the project
- Project description, background and overview
- Institution's view of the PPP
- Land issues, where relevant
- BEE and socio-economic requirements[6]
- Defined performance parameters
- Defined legal requirements and statutory regulations related to the PPP
- Identified financing requirements and issues
- Identified revenue parameters, as available
- Summary of the envisaged risk transfer
- Institution requirements for consortium membership

Procurement process
- Stages and timelines
- Clarification processes and briefing notes
- Changes to the composition of consortia
- Participation in more than one consortia
- Bid bond

Instructions to respondents
- Format of submissions, including compulsory forms of response as an aid to evaluation
- Late submissions
- Status and composition of respondents
- No contact policy
- Further information
- Disclosure of legal processes underway that affect bidding consortia
- Grounds for disqualification
- Institution contact details

6. See *Module 2: Code of Good Practice for BEE in PPPs.*

Information required about bidders

- Consortium capability and strength
- Proposed consortium composition and structure with roles of the members clearly spelt out
- Current workload of consortium members
- Skill and experience of relevant organisations and subcontractors in projects of a similar nature
- Strength of covenant between consortium members, subcontractors and lenders (if applicable)
- Financial and market standing
- Equity, ownership and directorship
- Ability to fulfil the project's BEE and socio-economic objectives
- Historical and current approach to social responsibility
- Capacity to deliver
- Commitment and capacity to meet project timetable
- Ability to raise debt and equity and to provide security
- Project management capability
- Risk management capability
- Demonstration of understanding key project demands/complexities
- General issues raised by bidders
- Previous relationship(s) with government
- Quality assurance systems
- Approach to the PPP and integration of deliverables

The evaluation process

- Methodology
- Evaluation criteria

Step 2: Get TA:IIA

Before issuing the RFQ, the project team must have obtained the following approvals:

- the approval of the accounting officer/authority, who is responsible for implementing the institution's procurement policy under the PFMA
- any other approvals that may apply to the particular institution
- Treasury Approval: IIA (TA:IIA) for the RFQ.

Step 3: Advertise and distribute the RFQ

The method of RFQ distribution must follow the institution's procurement plan. This typically involves advertising the project in relevant publications, in the *Government Gazette*, on the institution's website, and by making press statements about the project, calling on interested parties to collect copies of the RFQ from the institution and/or downloading these from its website. It may include an open briefing session for potential bidders to introduce the project and to stimulate private sector interest. Any such public briefings should be careful not to present any information that is not contained in the RFQ document.

Step 4: Evaluate the responses

Evaluation criteria must be based on the information requested from the bidders and must be included in the RFQ to focus private party responses and eliminate unnecessary information. The criteria will vary from project to project.

In the example below, each subcategory will be allocated a response of 'good', 'adequate' or 'poor'. The process of evaluation will include establishing evaluation teams to concentrate on the financial, technical, legal, and BEE capacity of bidders.

Figure 5.2: Example of some RFQ evaluation criteria

Category and subcategories	Good, adequate or poor
Respondent's capability and strength	
Proposed respondent composition and structure Skill and experience of relevant organisations and key subcontractors Construction Operations Advisors Suppliers Strength of covenant between relevant organisations and key subcontractors and respondent Financial and market standing Ability to raise debt and equity and to provide security	
BEE capacity	
Written commitments for BEE equity participation in private party and first-tier subcontracts, with verifiable company information Ability to secure black management in private party and first-tier subcontracts Participants' track record in local socio-economic programmes Employment equity programmes in place in sponsor companies Sponsor companies' track record in BEE	
Deliverability	
Commitment and capacity to meet project timetable Project management capability Current workload of consortium members Quality assurance systems Risk management capability	
Project awareness	
Demonstration of understanding key project demands and complexities	

Step 5: Communicate with bidders

Upon choosing the pre-qualified bidders, communicate with both unsuccessful and pre-qualified bidders as soon as possible, and publicly announce the pre-qualified bidders. It is important to communicate an appropriate level of detail on the decision to unqualified bidders, complying with administrative law requirements.

Call the pre-qualified bidders to a bidders' conference where information on the RFP processes and timelines will be communicated.

STAGE 2: THE RFP

Part 1: Bidder participation in preparing the final RFP

On large, complex or innovative PPP projects, considerable value can be yielded if pre-qualified bidders participate in the preparation of the final RFP.

While the feasibility study would have tested the market, some key market responses can now be tested in detail with parties which have demonstrated their knowledge and capacity related to the project. Bidder participation in preparing the RFP can also lead to a shorter bidding process and greater bidder confidence. Decide whether to use this two-part RFP process by weighing the added value against the added cost to both the bidders and the institution.

The institution's procurement plan, as communicated to the pre-qualified bidders, must clearly identify the two stages, and set out the intention of and rules for each. The RFP proper is strictly competitive and bound by very limited and formal communication. Bidder interaction here is less formal, the end product being the incorporation of feedback from all bidders in a single, final RFP, prepared by the institution and issued to all pre-qualified bidders.

Step 1: Prepare the draft RFP and get TA:IIA

The institution must write the draft RFP, based on its feasibility study, following the steps set out in Part 2 below. Bidders do not participate in writing the RFP. The draft RFP must be the institution's version of a final RFP and must include a draft PPP agreement. It can highlight the areas which bidders are being requested to provide input on.

The draft RFP and its attachments, including the draft PPP agreement, must be submitted to the relevant treasury for TA:IIA before being issued to the pre-qualified bidders.

Take note

Be careful not to tailor the RFP to the inputs of any single bidder.
Also be aware that no bidder is likely to share proprietary or confidential information at this stage and as such the bidder interaction should focus on areas of interest to all bidders.

Step 2: Get feedback from bidders

Feedback from bidders can be a mix of oral and written, though written is preferred. To extract value from the process and not compromise procedural fairness, bidder interaction must be well structured and must not compromise confidential bidder information. Bidder interaction will normally involve a bidders' conference attended by all pre-qualified bidders as well as one-on-one meetings between each bidder and the institution. All conferences and meetings must be conducted according to pre-determined, written rules, and must be recorded.

Take note

The focus should be on getting useful information. Do not use this feedback to evaluate bidders.

All feedback must be considered against the institution's position, which is based on the feasibility study. Feedback that is common to all bidders should be given more weight than isolated feedback. Feedback from a full consortium of lenders, equity sponsors and subcontractors should also be given more weight. Keep meticulous records of the source of feedback and the institution's reasons for including or excluding particular feedback.

Part 2: The final RFP document

The RFP needs to be an effective two-way communication tool between the institution and bidders.

The RFP must communicate project data and the institution's requirements to bidders, and set out how bidders must communicate their proposals to the institution.

Step 1: Prepare the RFP document

Contents of the RFP document

1. General information to bidders
2. Essential minimum requirements
3. Service specifications
4. Standard specifications
5. Payment mechanism and penalty regime
6. Legal requirements and draft PPP agreement
7. Commitments required from bidders
8. Evaluation criteria
9. Bid formalities

1. General information to bidders

1.1 Explanation of project

The project will have been defined during the feasibility study. The RFP must communicate the background to the project, the institution's desired outcomes for the project, and its envisaged outcomes.

1.2 External framework

Provide an explanation of the institutional environment in which the project is to take place. This includes the regulatory, physical, political and social environment.

1.3 Project framework

Set out the institution's view of what the PPP is and how it may be structured. (Note that the PPP is more than just the project in that it includes relationships between parties.) Without being prescriptive, set out the institution's view of the envisaged kinds of contracting parties. These will differ according to the anticipated type of PPP and its envisaged financing structure. For example, a project finance PPP requires lenders with very different participants from a corporate finance PPP.

1.4 Project assets

Core project assets must remain unencumbered for the term of the project. Where there are certain project assets that may be used by the private party for security, specifically list these as such.

The institution must ensure that the RFP identifies all project assets or categories of project assets that the institution will require at the end of the project term, so that this can be taken into account by the bidders in their assessment of the security package and the calculation of their bid prices.

1.5 Procurement framework and timelines

Outline how the procurement will be carried out in terms of processes and the timing of the processes. Spell out the governing legislation and regulations on the procurement, with a statement about the project's compliance with these requirements to date. The processes must be comprehensively described, including any parallel processes, such as securing approvals and consents.

1.6 Instructions to bidders

Provide a formal list of items which all bidders must comply with. Non-compliance should have implications for the acceptability of the bid. Instruct the bidders on:

- any limitations to or specifications about the makeup of the bid consortium
- consortium status requirements: it must be an incorporated entity when the proposal is submitted
- consortium change requirements: a notice of any change is required and the institution usually reserves the right to re-evaluate the consortium's pre-qualification. (See Stage 3 below.)
- requirements relating to submission of proposals
- formal communication requirements
- site visit arrangements
- who bears the costs of submissions
- confidentiality issues
- bidder responsibilities for bid security in the form of bid bonds and bidder warranties[7]

7. Bidder warranties relate to misrepresentation of any kind. Warranties typically cover consortium members' tax clearance and state of solvency, and guarantee that no consortium members are undergoing corruption or criminal-related investigations or have had any past convictions.

- grounds for disqualification (defining non-compliant behaviour): allow for discretion on the part of the institution
- submission requirements: time, date, manner and place of submission
- requirements for variant bids
- other project-specific requirements.

1.7 Requirements related to third parties

It is very likely that the PPP will involve third parties, for example, a municipality or utility provider. Third party relationships need to be managed in two ways: communication during bidding (especially with multiple bidders), and the resultant third party agreement. Spell out both elements clearly, preferably providing draft third party agreements.

The RFP must clearly stipulate how so-called 'utilities supply risk', that is, the possibility that utilities such as water and electricity may not be available, will be allocated between the parties.

1.8 Data room

Each project should have a data room where all the information that bidders need is available. Make available as much information as possible to facilitate the bid process, but do not warrant the information, because all information should be verified by the bidders. This is a crucial element of risk transfer and has implications for the PPP as a whole. RFP provisions about the data room should be carefully drafted to make it clear that there are no warranties on the information unless the institution has made a decision to the contrary based on a careful consideration of value for money, and to set out the rules of access.

1.9 Environmental impact assessment (EIA) data

Provide data, with appropriate indemnities, about all EIA processes carried out, and set out the requirements for the work to be carried out by bidders or the private party to the PPP.

1.10 Bidders' due diligence

The importance of bidder due diligence before bid submission cannot be overstated. Any unverified assumptions by a bidder at submission stage will delay financial closure and may well jeopardise the whole procurement process. (These assumptions may then become negotiating tools, or levers for raising unitary payments or decreasing service levels.) Since very little, if any, institution information is warranted by the institution, the bidders' due diligence must be thorough and must include a host of technical, financial and legal due diligence. The RFP process must enable site visits by the bidders. On project finance type PPPs, lenders will duplicate the due diligence. Include the time required for bidder due diligence in the procurement plan.

1.11 Quality management system

In any PPP, all stakeholders have a vital interest in the quality of the service to be provided. Specifically: the institution retains overall responsibility for the service delivered through the PPP; the private party relies on the quality of products and services provided by consortium members, personnel, subcontractors and suppliers to meet the specifications; lenders need assurance that the service will be sufficient to continuously earn the unitary payment (and by so doing service debt); and the users of the service must be provided with a quality that meets their requirements.

In the procurement process, the institution must clearly state the service specifications. In addition, it must require the bidders to propose a quality management system that includes compliance reporting during both the development phase and the operations phase of the PPP. The institution should also reserve the right to audit or check the private party's compliance with its own quality assurance and control systems. Mechanisms for such audits or checks should be established before the signing of the PPP agreement and be included in the PPP agreement management plan.

1.12 Important definitions

The RFP must clearly list all the definitions used throughout the documents. This is to ensure clarity and to set clearly defined benchmarks. The definitions must be the same as those used in the draft PPP agreement.[8]

2. Essential minimum requirements

What is the minimum that can be expected from a bid for it to meet the pre-defined project objectives established in the feasibility study? There will be minimum requirements for at least the following:

- **Financial** (for example, demonstration of affordability, risk assumption, funding by private party, term sheets, and minimum insurance requirements)
- **Legal** (for example, any institution requirements for the types of participant in the consortium, bidder details, term sheets or draft first-tier subcontracts, and a mark up of the PPP agreement to indicate deviations from the proposed PPP agreement and to explain in their bid documents the reason for the deviation.)
- **Technical** (for example, essential components making up the life cycle of the service and additional operational minimum requirements)
- **BEE** (for example, private party equity, private party management and employment, subcontracting, local socio-economic impact)
- **Additional mandatory requirements** (for example, tax clearance certificates for all consortium members).

These minimum requirements will establish what constitutes a compliant bid. Bids which do not meet them should be rejected in the evaluation process. However, the

8. See *Standardised PPP Provisions*.

requirements must not stifle innovation or be so onerous that otherwise solid bids are knocked out unnecessarily early.

3. Service specifications

These specifications are a further refinement of the services determined in the feasibility study. All the outputs required to provide the service must be specified. These service specifications will form the basis of service level agreements (SLAs), which are schedules to the PPP agreement and specify the services to be performed by the private party (or in particular circumstances by the institution).

At the RFP stage there should be draft SLAs for all service elements. Some will be blank because the bidders are required to populate them in accordance with the service specifications, and the remainder will be set out by the institution. The latter category will typically allow bidder variation, unless that particular requirement is set as an essential minimum requirement. Service specifications subject to bidder input are often contained in square brackets.

There are at least four ways to specify the PPP services and facilities.

1. Expressed as outputs

Services and facilities specifications are generally expressed as outputs by changing what must be done and how it is done to the required service outcome. Thus, in a hospital PPP, 'the provision of five patient trolleys and two porters with eight hour shifts in a 24-hour service' changes to 'the movement of patients by the private party as scheduled or requested by the hospital's clinical staff between beds, wheelchairs, trolleys and tables and between wards and departments with 24-hour availability'. This specification is backed by information on the institution's requirements for patient numbers so that the bidders can plan and cost the required service.

2. Specific outputs not directly related to the overall service

It is likely that an institution may require the creation of a facility not related to the direct provision of a service, for example, a clinic to be constructed by the private party on the hospital grounds, which is to be operated by another party, such as a not-for-profit organisation. Any facility not to be used by the private party in the provision of the service would fall into this category. Although not strictly part of the PPP, there may be value for money in including it in the PPP. This kind of facility cannot be specified purely in terms of service outputs; construction outputs need to be defined.

3. Input specifications

Nearly all projects will have some elements of input specifications. It is essential to identify such inputs upfront and classify them separately in the RFP, because, where the institution has specific requirements for a facility that reverts to the institution at the end of the concession period, it may require a particular aspect of that facility to be created in a specific way, for example, a hospital must be situated on a parti-cular site. These elements must be kept to a minimum as they may affect opera-tional efficiency or impact excessively on the design of the facility. All inputs create constraints on bidders, so carefully consider their appropriateness before including them in an RFP.

4. Conditions-of-asset-specifications

The condition and value of assets at the end of the project term is of great importance to the institution. Where the assets revert to the institution they must be in a specified condition, which dictates replacement and maintenance cycles as well as financial assumptions such as residual value and depreciation. The condition is always expressed as a remaining life or already-utilised life, as determined by industry norms or as agreed between the institution and the private party in the PPP agreement.

4. Standard specifications

The RFP must apply objective standards, which are measurable and consistent with best practice. Make extensive use of specifications applicable to all standard components of the project. These could be construction specifications and standard operational requirements (SABS and ISO are prime examples). Select appropriate standards with care: How applicable are they to the project? How are they used in the industry? Are they appropriate?

5. Payment mechanism and penalty regime

The RFP must not be issued without a payment mechanism, which includes at least the following in a unitary payment arrangement:

- a single, indivisible unitary payment for full availability and performance of the services
- an appropriate indexation (CPIX, unless the feasibility study demonstrates an alternative indexation as providing value for money)
- a mechanism for penalising partial or complete failure of the availability and performance of the service, by means of penalty deductions
- no limit to deductions for non-availability
- a mechanism for dealing with changes to service requirements.
  See 'Annexure 1: The payment mechanism'.

6. Legal requirements and draft PPP agreement

These are all the key commercial and performance requirements necessary to sign off that the consortium has the legal status and capacity to fulfil the requirements of the PPP agreement, including:

- shareholding agreements
- corporate governance requirements
- full disclosure of the consortium makeup, including lenders, sponsors, and parent companies.

The RFP must include a draft PPP agreement that allows for highly structured bidder input. It must be developed in accordance with *Standardised PPP Provisions*.

Although Standardisation provides standard terms, project-specific annexures, dealing with a range of specifications, penalties, payments and other project-specific issues, must be developed and included.

In particular, the institution should consider the following issues:

- At the time when the RFP is being prepared and also at the bid evaluation stage, whether any additional warranties should be sought. For instance, additional warranties may be required from the private party in connection with any intellectual property included in the project assets.
- The various kinds of liabilities against which an institution should seek to be identified are treated in Standardisation.[9] Standardisation considers when the private party should be entitled to cap these liabilities.
- The question of institutional indemnities is treated in Standardisation. Although Standardisation is generally against the provision of institutional indemnities, the institution should carefully consider, having regard to the nature of the project, whether there are any other circumstances peculiar to the proposed project which would justify the institution giving indemnities.
- The institution may reserve the right to control employees of the private party, and if it does so must disclose its control requirements in the RFP.

The institution's requirements to use intellectual property during any institution step-in period, after the termination of the PPP agreement and after the expiry of the PPP agreement, should also be specified in the RFP where appropriate.

7. Commitments required from bidders

The more and better quality information given by the institution in the RFP, and the clearer the institution is about what it expects to receive in bidders' proposals, the higher the quality of proposals should be.

This section is the crux of the RFP and sets out what information is required from bidders. Bidders must be required to provide information on all aspects of their bid, including legal, technical, financial and BEE. The RFP must clearly ask for at least the following information and commitments from bidders.

7.1 All technical aspects, including all relevant service details

As part of this information, bidders should be required to prepare the components of the service level agreements (SLAs) that will be part of the PPP agreement. Where the institution has not specified these as essential minimum requirements, they must respond to the service and standard specifications in the RFP. To simplify the process of preparation, the SLAs should be in prescribed schedules to the draft PPP agreement as well as in the main body of the bidders' proposals. The form and substance of the SLAs will vary from project to project, but the institution and its transaction advisor must take great care in their development from service specifications to their final form in the PPP agreement. Bidder

9. See *Standardised PPP Provisions*: Part 9.

amendments and additions to the payment mechanism must also be required in a structured format in the RFP.

7.2 The quality management system

7.3 All BEE elements of the balanced scorecard, with commitments for each element

Specifically, the bidder's funding structure and financing arrangements reflected in the financial models must show:

- sources or type of black equity (e.g. black enterprises' balance sheet funds, loans to black enterprises or black shareholders, equity funds including exit strategy, etc.)
- costs of black equity;
- timing on project cash flows to black shareholders; and
- operating costs for all skills development, employment equity and socio-economic programmes.

Shareholders' agreements and any third party agreements thereto must show:

- terms for black shareholders;
- sponsor support arrangements to black shareholders, if any; and
- commitments in respect of black people in managment control.

Subcontracts (first-tier) must show:

- terms for black shareholders;
- black people in management control;
- black women in management control;
- skills development and employment equity commitments for first-tier subcontractors; and
- procurement commitments to black enterprise SMMEs.

The marked-up PPP agreement must show:

- any proposed changes to standardised PPP BEE provisions; and
- draft schedules capturing all BEE commitments.

7.4 Level of funding commitment

Who will provide the private finance? How firm is the commitment to fund debt and equity?

The level of funding commitment is determined by the quality of the institution's RFP. An RFP that meets the requirements of this module, based on a robust feasibility study, should be able to attract fully underwritten bids. Proposals that are non-committal on funding will result in protracted negotiations.

7.5 Sign off on competition, NIPP and any other statutory requirements

7.6 Corporate governance commitment

The private party's commitment to corporate governance should be shown, using the King Code on Corporate Governance 2002 as a benchmark.

7.7 Financial and project structure

The RFP must require bidders to submit financial models that allow the institution to thoroughly interrogate the proposal (be it a compliant or variant bid) in detail. The response from bidders will depend on the nature of their approach to funding the project. Corporate finance will be provided from the balance sheet of a private company, while project finance involves limited recourse debt funding to a special purpose vehicle. Regardless of the differences, the institution needs enough information to be able to analyse the funding structure and to determine whether or not it can be provided and sustained through the project. The project participants, including all forms of funding and the terms and conditions of funding, are crucial. Bidders must demonstrate in their bids how the interest rate risk will be managed by means of hedging arrangements and how their interest rate hedging arrangements, if any, will achieve value for money. Furthermore, they must demonstrate during the RFP stage, how exchange rate and currency risks will be managed and how they impact on affordability.

7.8 Security requirements

The institution should clearly stipulate the type as well as the amount of any security that it will require from the private party, and request that each bidder cost for this security as a separate component of its total bid price, as this will aid in the evaluation process. This should include security against late service commencement and for final maintenance obligations. These terms are explored in *Standardised PPP Provisions*.

7.9 Liquidated damages

If the imposition of liquidated damages will not impact severely on the value for money required for a PPP, the institution should specify the level of liquidated damages (including any cap) in the RFP in order to enable the bidders to properly price for these damages. This will also assist the institution's evaluation team in exposing the 'real' costs of the bid and improve competitiveness in the selection of the bids.

7.10 Contents of the financial models

Critical information is contained in bidders' financial models, and the RFP should specify the format in which this information is to be shown in the bids in order to allow the institution to compare a bidder's model with the institution's feasibility study models and with other bidders' models. The checklist below needs to be carefully refined for each project.

The model must:

- have a base date[10] as specified in the RFP

10. As the value of money changes, the RFP must set a specific point in time which is common to all bids. This is the base date.

- be presented in electronic (computer disk) and hard copy formats and be compatible with a specified software programme
- disclose clearly all macro, micro and general assumptions
- be presented on a monthly basis for the development period, and thereafter on a semi-annual basis. Annual summaries are to be provided for each year through to the period of the PPP agreement
- present all required data in nominal, real and net present value (NPV) terms (using the discount rate required in the RFP).

The model must show:

- the bidding consortium structure or corporate project structure, in detail
- the funding structure of the project, including types and proposed levels of debt and equity
- the likely equity input of each member of the consortium, showing the percentage of total equity of sub-debt to be provided by each member. Equity and shareholders' loan details must include the source of funds, amount of funds that shareholders are prepared to commit, and the timing of their contribution. Alternatively, in a corporate finance structure, a full set of financial statements for the companies providing funding must be provided
- the cost of debt in a project finance structure or a ring-fenced corporate finance structure, clearly detailing the level of fees and margin, and full details on the basis for and factors comprising these fees and what the margins are based on and what went into them.

The model must provide:

- a thorough and detailed explanation of the model and how to operate the model
- the basis and costs of proposed interest rate hedging arrangements
- the basis and costs of proposed currency hedging arrangements
- inflation assumptions. Since inflation risk is shared, it may be appropriate to set inflation rates in the RFP as common to all bidders so as to make comparison easier.
- foreign currency exposure and hedging strategies and Rand exchange rate computations
- capitalisation of interest
- a comprehensive and detailed explanation of all VAT and other tax treatments assumed in the model
- all the key output ratios and return categories
- a detailed source and application of a funds table for the project
- capital expenditure according to the component category breakdown set out in the RFP
- project start-up costs
- a funding plan and funding assumptions schedule identifying all sources, amounts and application of finance, conditions, terms, base costs, margins and fees
- a debt schedule for each credit facility, including a draw-down schedule, interest

paid, fees and repayment schedules
- total equity (including standby and subordinated facilities)
- balances of all reserve accounts and insurance structures
- total operating cost and maintenance assumptions, including replacement schedules
- forecast balance sheets, profit and loss, and cash-flow statements
- identification of any foreign denominated goods or services
- details of all taxation assumptions and treatment and the ability to enable or disable any or all such assumptions or treatments in the model
- net present value (NPV) of real revenues using discount rate required in RFP
- projected internal rate of return (IRR) before financing and tax in both real and nominal terms
- real and nominal return on equity as compensation to reflect the base case return on equity for the entire duration of the PPP agreement[11]
- interest cover
- sensitivity analysis of capex
- sensitivity analysis opex
- sensitivity analysis interest rates
- sensitivity analysis: grace periods of principal repayment
- sensitivity analysis: maturity of debt
- sensitivity analysis: inflation
- sensitivity analysis: devaluation of Rand and currency treatment
- risk pricing
- assumptions on penalty deductions
- gains from refinancing.

For project finance PPPs, the model must set out:
- debt to equity ratio
- annual debt service cover ratios (DSCR), including and excluding cash
- loan life cover ratio (LLCR)
- project life cover ratio (PLCR)
- any other ratios required by funders
- in the case of retendering the PPP agreement following private party default, what percentage of the total debt outstanding bidders believe should be repaid in the event that, on retendering, the highest tender price is less than the debt
- in the case that the PPP agreement is not retendered following private party default, what percentage of the debt bidders believe should be repaid in the event that the adjusted estimated project value is less than the debt.

8. Evaluation criteria

Give broad categories of evaluation, but in sufficient detail to focus bidders' attention on the value-for-money areas of the RFP. Detailed scoring methodologies

11. See *Standardised PPP Provisions*: Part 64

and point allocations should not be given, as this leads to proposals being tailored to the evaluation and not to the best value for the project. The number of points allocated to each category or sub-category should not be disclosed in the RFP. The process and evaluation methodology should, however, be set out so that bidders take comfort from an auditable process with checks and balances.

The RFP should specify that the technical, BEE and price elements of the bid will each be scored out of 100 points. The scores achieved will be calculated into the bidder's overall score, using the following formula:

a* (technical score/100) + b* (BEE score/100) + c* (price score/100) = d
where:
a is the weighting for technical (between 50% and 70%)
b is the weighting for BEE (10%)
c is the weighting for price (between 20% and 40%), and
d is the total score achieved by the bidder.

For the purposes of applying the abovementioned formula, 'technical' refers to all project factors under evaluation other than the price and BEE elements, and is synonymous with the PPPFA regulation's term 'functionality'.

The alternative technical and price weightings (together making 90 per cent) will vary from project to project, determined during feasibility study and preparation of procurement documents. Ten per cent is the maximum weighting allowed in terms of the PPPFA for BEE elements in a contract valued above R500 000. The calculation of price points will be done using the prescribed price formula set in the regulations to the PPPFA.

Minimum evaluation categories under the technical, BEE and price elements are set out below. Suggestions are given for further sub-categories that need to be refined on a project-by-project basis.

The evaluation will also consider the overall integrated solution offered by each bid.

Technical

8.1 Technical solution

8.1.1 The development phase

- extent, quality, safety, cost effectiveness, functionality and innovation of designs
- level of design and robustness of cost estimates
- impact on social and biophysical environment
- deliverability and time schedules
- integration of design, development and operations with a clear commissioning programme
- quality management systems proposed by the bidders

8.1.2 The delivery phase

- extent to which proposed performance targets and measurement systems exceed minimum specifications
- operating methodology
- quality and type of proposed services to end users
- extent to which asset management and maintenance philosophy support the project objectives and maximise value for money
- quality of proposed management structure, staffing, systems and practices
- quality and extent of proposals on branding, promotion and public relations
- quality of safety plans
- integration of PPP with existing services
- integration of PPP information into existing IS system
- quality management system proposed by the bidders
- compliance with institution's monitoring and reporting requirements

8.2 Legal solution

- bidders' SPV structures
- robustness of the bidders' structures: Are bidders' responses or representations in the proposal reflected in their structures and shareholders' agreements? The evaluation would include the level of commitment to and undertakings of each consortium member to the consortium, and the equity participation of each member.
- mark up of the draft PPP agreement and its risk impact

8.3 Financial solution

- total project cost in relation to the affordability constraints of the PPP
- realism of operating and capital expenditure, including an assessment of whether the quality management systems have been costed in the financial model
- robustness of the financial proposals, including their sensitivity to changes in operating and maintenance costs, currency fluctuations, inflation and interest rates, and changes in the cash-flow profiles
- robustness of the funding structure
- level and nature of equity in the funding structure
- cost of BEE commitments
- level of commitment demonstrated by the debt and equity providers and the terms and conditions linked to the provision of this funding
- level of risk assumed, and deviation from the terms of the tender documentation
- cost, level and nature of insurance cover proposed
- risk allocation: the risk profile proposed by bidders in their proposals will be tested in relation to:
  - the nature and extent of the risk
  - the likelihood of risk
  - passing down of the risk and obligations assumed by the private party in the PPP agreement to the other key contractors.

- consistency between the financing arrangement and the draft PPP agreement, as well as the extent of acceptance by the financiers of the terms of the draft PPP agreement
- what percentage of total debt outstanding the bidder believes should be repaid as compensation on private party default

BEE

Each PPP project's BEE elements, minimum targets per element, bid evaluation points for each element, criteria for awarding points, the weightings to be given to each element, and the overall minimum threshold score of 50 per cent, will all be set out unambiguously in the BEE balanced scorecard for the project in the final RFP. Bidders' responses will be evaluated accordingly.

Figure 5.3: Example of BEE scorecard

BEE element	Project target	Bid evaluation weighting
A: Private party equity		20%
A1: Black Equity	40%	
A2: Active equity	55% of A1	
A3: Cost of Black Equity	Value for money	
A4: Timing of project cash flow to Black Shareholders	Early and ongoing	
B: Private party management and employment		15%
B1: Black Management control	Commensurate with A1 & A2	
B2: Black Women in management control	15% of B1	
B3: Employment equity	Compliant with law	
B4: Skills development	1% of payroll	
C: Subcontracting		50%
C1: Capital expenditure cash flow to Black people/Black Enterprises	30%	
C2: Operating expenditure cash flow to Black People/Black Enterprises	30%	
C3: Black Management control	25%	
C4: Black Women in management control	15% of C3	
C5: Employment equity	Compliant with law	
C6: Skills development	1% of payroll	
C7: Procurement to Black Enterprise SMMEs	30%	
D: Local socio-economic impact	Sustainable, effective plan	15%

Price

The PPPFA requires that price be taken into account as a distinct element in the evaluation of bids. In PPPs, the price is closely linked to qualitative elements of the bid and often has explicit conditionalities. It is thus essential that there is reasonable certainty as to what price is attached to the bid before price points are allocated. Lack of certainty should be addressed through a BAFO (refer to Stage 3

Part 2). The institution's RFP must therefore prescribe the form in which the price should be presented by bidders, for example, a net present value with a set discount rate may be prescribed. In addition, the qualitative financial evaluation categories set out in 8.3 above must be closely scrutinised.

Overall integrated solution

Do all the components of the proposal add up to a single integrated solution capable of delivering value for money to the institution?

9. Bid formalities

Spell out all bid formalities, including:

- the time, place and manner of bid submission (proposals for large projects may take up substantial space and separate secure facilities may be required for submitting bids)
- how proposals will be opened
- bid bonds
- period required for bid validity
- formal requirements for filling out bid forms
- formal processes for communication with bidders
- the institution's reservation of the right to terminate the process, including the right to terminate negotiation with the preferred bidder if it is unlikely that an agreement will be concluded, in which case negotiations with other bidders may begin. In addition the institution should state that it is not bound to enter into a contract with any bidder.
- a discretion to be exercised by the bid evaluation panel in the event of non-compliance in any of the bids
- reservation of the institution's right to conduct a BAFO process.

Step 2: Get TA:IIA

The complete set(s) of RFP and draft PPP agreement documentation – both in their draft form (for bidder participation as set out in Part 1 above) and the final versions completed by the institution thereafter – must be submitted by the institution's accounting officer/authority to the relevant treasury with an application for TA:IIA. None of these documents may be distributed to pre-qualified bidders until the approval has been obtained.

STAGE 3: CHOOSE THE PREFERRED BIDDER

Critical considerations for managing the bid process

Summary
1. Experienced bid managers
2. Anti-corruption
3. Prohibited suppliers
4. Security environment
5. Clarification meetings
6. Bidders' notes
7. Changes to consortia during bidding
8. Bidder due diligence
9. Bid validity period

1. Experienced bid managers

Both the bidders and the institution require experienced and committed bid managers, who should be formally identified and their contact details provided. On larger projects these will be full-time positions. For the institution, the bid manager should be the project officer, whose tasks will have been set out in the procurement plan.

2. Anti-corruption

Due to their size and complexity, PPPs are at considerable risk of being affected by some corrupt activity, or at least by the harmful perception that corrupt activity is going on. The accounting office/authority must sign off on an anti-corruption policy for the project, with clear requirements and processes for dealing with corrupt activities by project team members or bidders. The procurement plan and the bid processes must have the built-in safeguards of disclosure, a code of conduct, structured oversight and internal and external audit.

Disclosure

All members of the project team and bid evaluation panel, including the transaction advisor, must disclose any potential conflict between their personal and family interests and those of the project. This disclosure must be evaluated by the accounting officer/authority or delegated representatives. An appropriate response must be formulated and implemented, such as recusal of the official from any position where the conflict of interest could affect a decision.

See 'Annexure 3: Template declaration of interest'.

Code of conduct

All the institution's project team members, including the institution's advisors, and all members of the institution's technical evaluation committees, evaluation coordinating committee and project evaluation committee must sign a code of conduct that requires compliance with a range of ethical requirements in the best interests of the project. All pre-qualified bidders must also sign a similar code of conduct, developed by the institution for the project.

See 'Annexure 2: Template code of conduct for bid evaluation panel members' and 'Annexure 3: Template declaration of interest'.

Structured oversight

A person other than the one who carried out the task should review all documents, all communication with bidders, and all evaluations. In addition, a project review committee, appointed by the accounting officer/authority, should sign off on all documentation and processes.

Internal and external audit[12]

Provide for an internal and external audit of the bid process against the procurement plan. This is particularly relevant when proposals are being evaluated. The emphasis should be on compliant processes. For example, were the evaluation criteria established before the RFP was issued? Such processes are easily audited for compliance, and should be managed rigorously.

3. Prohibited suppliers

The Office of the State Tender Board (and its successor/s after its demise in 2004) maintains a list of prohibited suppliers of goods and services. These blacklisted companies are not allowed to compete for government business, including PPPs, for prescribed periods of time.

4. Security environment

Include in the procurement plan a security plan to prevent all forms of industrial espionage, including the protection of document confidentiality, secure meeting rooms and the like. The National Intelligence Agency provides services like this to institutions.

5. Clarification meetings

As part of the bid process, it is advisable to hold bidder clarification meetings during their preparation of proposals. These will allow bidders to get clarity on issues in the RFP, and the institution to gauge bidder participation and commitment. These meetings should be scheduled well in advance, should allow for one-on-one meetings with bidders, and there must be a formal process for recording all such meetings and confirming points made during the meetings.

12. See *Module 7: Auditing PPPs*.

6. Bidders' notes

Formal correspondence between bidders and the institution must always be in writing. Questions from bidders should indicate how confidential the response needs to be. Confidential answers only go to the relevant bidder; others go to all bidders together with the question. Bidders' notes are also used to communicate decisions or confirm points from clarification meetings, and any changes to the RFP.

The institution and bidders must keep a register of bidders' notes to ensure a complete record of information and formal correspondence. Consecutive numbering should be used. A bidder must submit its register with its proposal.

7. Changes to consortia during bidding

In many instances consortia formed in response to an RFQ change during the bidding stage. This is more acceptable to an institution than a complete withdrawal of a consortium, provided that the consortium maintains its strength at least to the same level as before the change. A consortium change is never allowed without written consent from the institution, and the substance of a bid already submitted is never allowed to change.

The process should be set out in the RFP, as described:

1. The consortium advises the institution of the proposed change, in writing, with full details of the reason for the change, the parties involved and the impact on the consortium.
2. The institution applies the same RFQ evaluation criteria to re-assess the consortium, using, where possible, the same evaluation processes. The required standard is that the changed consortium should score at least the same number of points it scored during pre-qualification.
3. If satisfactory, the institution advises the consortium in writing.
4. If not satisfactory, the institution advises the consortium in writing and gives it a certain amount of time to propose an alternative. Failing this, the consortium is disqualified.

8. Bidders' due diligence

Bidder due diligence requires time, and access to the project site and existing facilities, and the products of the institution's own due diligence (given without any warranty). Communication protocols for the due diligence must be defined in the RFP. These must specify how and when communication and access occurs. Where access is restricted, this must clearly be stated.

9. Bid validity period

Bidders will set a bid validity period on their proposals. The institution may suggest such a period in the RFP.

Part 1: Evaluate the bids

Treasury Regulation 16 to the PFMA requires the following:

16.5.1 Prior to the issuing of any procurement documentation for a PPP to any prospective bidders, the institution must obtain approval from the relevant treasury for the procurement documentation, including the draft PPP agreement.

16.5.2 The treasury approval referred to in regulation 16.5.1 shall be regarded as Treasury Approval: IIA.

16.5.3 The procurement procedure –

(a) must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective; and

(b) must include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination in compliance with relevant legislation.

In line with this, the accounting officer/authority must ensure that:

- the evaluation process will ensure compliance with the procedural fairness provisions of the Promotion of Administrative Justice Act, 2000
- the evaluation criteria and processes are established before bidders submit proposals
- the evaluation teams and committees are appointed in writing, and that all declarations and codes of conduct are signed
- the Code of Good Practice of BEE in PPPs is applied.

There are three levels of evaluation

- Technical evaluation teams (TETs)
- Evaluation co-ordination committee (ECC)
- Project evaluation committee (PEC)

Each level has its own built-in checks and balances.

Evaluate the bids
Step 1: Technical evaluation teams Step 2: Evaluation co-ordination committee Step 3: Project evaluation committee Step 4: Clarification Step 5: Evaluate variant bids Step 6: Choose the preferred and reserve bidders

Step 1: Technical evaluation teams

In the technical evaluation, TETs analyse at least five streams of evaluation criteria: **technical** (comprising technical solution, legal solution, financial solution), **BEE**, and **price**. The overall, integrated solution is evaluated by the ECC. There is no prescribed sequence of the TETs' evaluation, as almost all elements of proposals are inter-dependent. The TETs need to be made up of suitably qualified professionals, at least from within the institution and from the transaction advisor.

Communication between the TETs, and between the TETs, the ECC and the PEC is very important.

Step 1: Technical evaluation teams

1. Preliminary work
   - Separate variant bids for evaluation as separate proposals
   - Check for completeness
   - Check for compliance
2. Detailed analysis
   - Technical solution
   - Legal solution
   - Financial solution
   - BEE
   - Price
3. Reports to the evaluation co-ordination committee

1. Preliminary work

The first function of the TETs is to do the preliminary work to establish what bids to take forward in the evaluation:

Separate variant bids for evaluation as separate proposals.

Check for completeness

Completeness refers to whether the bidder has submitted all required documents (for example, original tax clearance certificates, NIPP certification, consortium formation documents and the like). All these formalities must have been set out clearly in the RFP. Each RFP requirement should be listed, with a reference to its place in the RFP and its description. Record incomplete bids.

Figure 5.4: Example of how to establish and sign off on completeness

Where in RFP	Description	Included		Comments by bidder	Where in proposal	Cross reference
		YES	NO			
Vol.2 Cl.34.2	Submit GANTT chart for construction programme	✔		None	Vol.2 Ann.1	

Check for compliance

Compliance refers to whether the bidder has met the essential minimum requirements set out in the RFP. Use the same format as for bid completeness. Great care must be taken to ensure that the essential minimum requirements are fully met, including the specified minimum thresholds for BEE. Record non-compliant bids.

Figure 5.5: Example of how to establish and sign off on the essential minimum requirements						
Where in RFP	Description	Comply		Comments	Where in proposal	Cross reference
		YES	NO			
Vol.2 Cl.21.1.2	Construction 'all risks insurance cover' to set amounts	✔		ABC underwriter	Vol.6 p.34	Mark up 64 of PPP agreement Vol.2

2. Detailed analysis

The bids that are deemed to be complete and compliant are then subjected to detailed analysis by the separate TETs.

Technical solution

- Is the project deliverable?
- Will the required outputs be delivered?
- A solution due diligence must be carried out by this team on whether or not the solution can become a reality.
- Each element of the system service specification must be assessed from the design, development and operational perspectives. More than merely evaluating the bids, the objective here is to:
  - confirm that the system service specification is, given bidder responses, an accurate reflection of the institution's needs
  - capture the particular perspective of the proposal
  - capture the deficiencies or added benefits
  - evaluate the response on a simple scale of inadequate/adequate/good to carry through to scoring
  - compile a list of questions that need answering before the bid is awarded
  - assess a value-for-money impact.
- The proposal must be checked against the requirements of the standard specifications. This check is required to ensure that bidders commit to meeting applicable standards specifications, such as ISO and SABS.

Figure 5.6: Example of how to set out a system service specification evaluation									
Eval. aspect	RFP ref.	Impact level	Requirement	Proposal	Bid ref.	Deficiencies or added benefits (Risk transfer)	Rating: 0 = Inadequate 1 = Adequate 2 = Good	Notes	Value-for-money impact
Layout of ICU wards	Vol.1 Ann.5 Cl.4.1	High	Does the design meet R158 for space and functionality?	Offers 5m^2 per bed	Vol.3 p.3	R158 standard not met	0	Will place bidder in breach of PPP agreement Cl.34.2: compliance	Estimate R400k additional floor area

- Scoring: National Treasury does not suggest or prescribe a scoring methodology other than that the ratings for all the technical criteria should be applied to pre-determined weightings. This means that each technical evaluation will generate:
  – a weighted score
  – a report on the number of 'inadequate' ratings. This means that a weighted score that has some overall respectability does not disguise a number of inadequacies
  – notes requiring resolution.

Legal solution

There are two tasks in the legal evaluation:

- Legal due diligence on the bidding consortium, its structure, legal status, BEE credentials, and the status of individual firms (including any record of insolvency or crime)
- Evaluation of the marked up draft PPP agreement
  – capturing all marked up amendments to the PPP agreement
  – assessing the mark-up against the risk matrix prepared in the feasibility study
  – capturing the value-for-money implications that were determined in the feasibility study, and commenting on them
  – working with the financial evaluation team to assess value for money on issues not identified in the feasibility study.

In neither of these two tasks is the output necessarily a score. In fact, it can be highly misleading to calculate a score for legal compliance or PPP agreement mark-up. National Treasury suggests that the legal evaluation be focused instead on presenting notes requiring resolution and updating the institution's risk matrix in respect of each bidder, in conjunction with the financial evaluation team.

Financial solution

The financial evaluation of a bid is complex. It requires a complete understanding of the project costs over its whole term, the structure of the bidding consortium and its funding, and, most importantly, the key value-for-money deficiencies or additions in each bid. The financial team thus requires inputs from the technical, legal and BEE teams in assessing or identifying the following:

- affordability
- certainty of project costs (development and operational)
- certainty, nature and costs of funding
- project participants and overall structure
- all items omitted by bidders from the financial model
- project value for money
- project bankability, which is a function of the consortium's composition, structure, risk distribution, and funding plan.

The financial team must then:

- produce a composite score for financial evaluation
- produce a series of notes showing matters that need resolution.

BEE

National Treasury suggests that the evaluation of the BEE component be given predetermined levels for inadequate, adequate and good ratings for each element of the project's BEE scorecard. Bidder responses are then evaluated against these levels. National Treasury is not prescriptive about how the ratings are converted into a score, but a minimum threshold of 50 per cent for BEE must be set, as pescribed by the *Code of Good Practice for BEE in PPPs.*

Figure 5.7: Example of how to do a BEE and socio-economic evaluation

RPF ref.	Response area	Inadequate	Adequate	Good	Bidder response	Where in bid proposal	Rating	Notes
Vol.3 Cl.9.1	Black Equity in the private party	<20%	20 to 30%	>30%	40%	Vol.9 p.23	1	Check equity sources & cost in financial response

Price

The distinct price evaluation is required in terms of the PPPFA. In PPPs, price is closely linked to qualitative elements. The RFP will have prescribed the form in which price is to be presented, but the price offered by the bidder must be scrutinised with the financial solution evaluation before price points are allocated. Price points will be allocated according to the formula prescribed by the PPPFA.

3. Reports to the evaluation co-ordination committee

Each TET produces its own report and score sheets and passes these through to the ECC.

Step 2: Evaluation co-ordination committee

The work of the TETs will be disjointed without the ECC's very hands-on role.

The role of the ECC is to:

- co-ordinate the TETs during their analysis through regular meetings with team leaders
- approve all correspondence and direct communication with bidders on clarification matters
- receive and pass through to the project evaluation committee the TET reports on completeness and compliance, including a recommendation on which bidders to take to further analysis as compliant bids
- receive the analysis reports from the TETs and interrogate these until the committee is satisfied that each report is fully substantiated
- prepare its recommendations on further processes such as BAFO
- evaluate the overall integrated solution for the project, taking into account all TET reports

- score the overall integrated solution, and provide notes to be resolved before entering into a PPP agreement
- compile the total project evaluation notes and reports into a single recommendation on process and outcome (preferred and reserve bidders) to pass through to the PEC.

National Treasury recommends that final scoring is not done by the ECC.

Step 3: Project evaluation committee

The PEC is the accounting officer/authority, supported by committee members appointed by him or her.

The role of the PEC is to:

- accept bids as complete and compliant
- receive and evaluate the report and recommendations from the ECC
- score the bids
- decide on a BAFO process
- select a preferred and reserve bidder.

Step 4: Clarification

The PPP procurement process allows for clarification during evaluation so that the evaluation reflects a full understanding of each proposal. The constitutional requirement of fairness and transparency means that any form of change to a bid or negotiation with individual bidders during the evaluation process is prohibited. The line is easily crossed if the term 'clarification' is not defined and the process for clarification not clearly set out.

Clarification must involve written questions and responses. The questions must refer to a specific element of the proposal and must not solicit any change to the proposal. The response must be vetted before being accepted as a clarification. If the response sets out a change to the proposal, it must be set aside and its contents ignored. In such a case, or if the response does not resolve the matter on which clarity was sought, then the interpretation of the response that results in the lowest score or the production of an evaluation note for that element of the evaluation should be used.

Step 5: Evaluate variant bids

The evaluation of variant bids that meet the requirements of the RFP takes place after the compliant bids have been evaluated. A variant bid should be evaluated as a stand-alone proposal. In practice this must be done by amending the score given to the compliant bid in the specific areas of variation.

However, to leave the evaluation as a simple add or subtract process will result in a gross oversimplification. Variant bids invariably impact on a range of other elements in the proposal and materially affect the overall risk transfer for the project. For example, a variant bid may offer a lower margin on debt should debt service be untouched by any penalties under the payment mechanism, resulting in a substantially different risk profile for the institution with implications for more than a mere decrease in the project cost. The financial and performance impacts of variant bids must be identified and evaluated, as well as quantified as far as possible. The aim here is to quantify the change in value for money that flows from any part of the variant bid. Thus while the same form of evaluation should be used, emphasis should be placed on the evaluation notes produced by the TETs and the ECC, and on the value for money generated, and not just on the actual score.

Step 6: Choose the preferred and reserve bidders

The evaluation should generally result in the selection of one preferred bidder and one or more reserve bidders.

The preferred and reserve bidders may not be announced until TA:IIB has been obtained by the institution for the value-for-money report. (See Part 3 below.)

Part 2: BAFO

When is BAFO appropriate?
Following the evaluation of bids, there may not be a clear preferred bidder and procurement may have to go into a best and final offer (BAFO) process. There are two main reasons to extend the bidding process: • the bids are identical or too similar to choose a clear preferred bidder • no single bid meets the institution's defined project objectives. The reasons for the second scenario may include: bidder misunderstanding of the objectives; evaluation criteria or processes that are not aligned with the institution's priorities and objectives; bids may have contrasting strengths and weaknesses. These circumstances may arise if the bidders do not fully understand or acknowledge the project objectives or evaluation criteria, do not fully elaborate on their offers, or adopt different commercial approaches to the project. A well-structured RFP with bidder interaction – and not BAFO – is the first way of preventing such problems. Bidders cannot use a BAFO to complete incomplete bids, and institutions should not plan for a BAFO to compensate for weak RFPs. Bidders should not assume that there will be a BAFO stage. If bidders anticipate that there will be further rounds of bidding, they may build allowances into initial bids. Under no circumstances should the BAFO process be used as a substitute for the other requirements of the bidding stage as set out in this module. If the RFQ and RFP are properly written, there should be no BAFO process. Most projects should not need a BAFO process and the decision to seek BAFOs should not be taken lightly. The bidding process is expensive for the private sector, and it has a legitimate desire for the preferred bidder stage to be reached as soon as possible. However, the institution must balance these factors with the need to ensure that the best bid is chosen. The BAFO process gives the public sector an opportunity to extract the maximum benefit out of the bids. It puts competitive pressure on the bidders before a choice is made about the preferred bidder. A BAFO may just be used as a mechanism to confirm price or other key bid parameters. It may also fundamentally change the risk allocation, or the bid prices may change.

Lessons from BAFOs

There are many local and international examples of BAFOs. Several South African and UK projects were used to draw up the following list of lessons.

- Reach a conclusion on key contractual provisions and price during BAFO, while bidders are still under competitive pressure.
- Lenders need to reconfirm their level of commitment during BAFO.
- Bidders must not be rushed during the BAFO stage. A properly managed BAFO will save time during negotiations.
- BAFO must not be used as a replacement for thorough due diligence. The needs of the institution must be fully developed long before BAFO is applied.
- Preferred bids in evaluation provide the best value for money.
- The process must have a deadline to avoid 'negotiating drift'. Bidders may lose interest in the project, and thus no longer provide a credible negotiating alternative.
- The BAFO document must be a comprehensive description of the needs of the institution.
- Communicate clearly to bidders that the BAFO proposal is irrevocable and forms part of the bidder proposal.
- Promote an atmosphere of collaboration and partnership. This applies as much in the BAFO as in the RFP stage. For example, a restrictive due diligence period during the RFP phase may constrain the responsiveness of the proposals.
- Consider the costs of a BAFO to the private sector. If it is significant, the institution may agree to reimburse the costs of the unsuccessful BAFO bidders. This is a value-for-money consideration and National Treasury's position is that such compensation should not be automatically provided.
- Assure the private sector in good faith that the process will end on time. Set a realistic timetable.
- Describe the required outcomes clearly.
- There should be only two BAFO bidders, except in very unusual circumstances.
- Alert bidders as soon as possible to the possibility that the bid could enter into BAFO.
- BAFOs consume considerable resources and time.

The following detailed description outlines the process of carrying out a BAFO, drawing on South African and international best practice.

BAFO

Step 1: Inform the bidders
Step 2: Prepare a revised RFP (RfBAFO) and roadmaps for each bidder
Step 3: Get TA:IIA
Step 4: Distribute the RfBAFO and the roadmaps
Step 5: Provide further clarification
Step 6: Bidders respond
Step 7: Evaluation and choosing the preferred bidder

Step 1: Inform the bidders

Inform the short-listed bidders and explain the BAFO process. Remind them that their initial offers remain valid, because, in theory, the BAFO is a refinement of the initial offer.

Debrief the bidders that will not enter the BAFO process.

Step 2: Prepare a revised RFP (RfBAFO) and roadmaps for each bidder

Revise the RFP and replace it with the request for best and final offers (RfBAFO). The RfBAFO is largely a clarification of the original RFP. It sets out changes common to the short-listed (commonly only two) bidders. Try to keep the RfBAFO document layout consistent so that it is easy to compare it with the RFP. It may be a good idea to use the original RFP with a different colour font to indicate where the document differs from the RFP.

The reasons for requiring the BAFO will usually be different for each bid. For this reason, the RfBAFO is accompanied by separate 'roadmaps' for each short-listed bidder. This roadmap must set out, in specific terms, the institution's view of what each bidder needs to do to get to where the institution needs it to be in relation to the objectives of the project. The roadmap for a bidder is confidential to that bidder. It gives the bidder a description of the shortcomings of its particular bid and explains the specific areas which require clarification. This focuses the bidder for preparing the BAFO proposal. The roadmap document may be presented in bullet point paragraphs. As long as the points are explicit, a great deal of narration is not necessary.

Suggested contents of the RfBAFO

Introduction to the BAFO process

Begin with an explanation of the BAFO process to initiate the bidders into the process and facilitate its success. Describe the events leading to the BAFO stage as well as the institution's reason for deciding to extend the bidding process.

Description of the RfBAFO structure

Outline the volumes included in the RfBAFO and explain how bidders need to respond to the document.

Introduction to the roadmaps

Inform bidders that a separate roadmap will be distributed to each short-listed bidder that will ask specific and individual questions that each bidder needs to answer. Describe the common contents of the roadmap and how it should be used. The questions will be divided into separate functional areas.

The institution's expectations

Specify what responses the institution expects from bidders, that a full response is required as the revised bid will be evaluated on this basis, and the deadline for submission. Remind bidders that they may improve their original bid if they are offering better value to the institution.

Interaction and communication protocol
Set the parameters for interaction and communication between bidders and the institution during the preparation of the BAFO bids. This communication is vital for bidders to prepare high quality and targeted responses. Explain that bidders may either schedule meetings with the institution or submit written questions. Point out that these questions and answers may be made available to the other bidders.

Confidentiality disclaimer
Remind bidders that:
- the information provided is confidential and should only be used for the purpose for which it was provided
- any copies of any documents made available by the institution or its advisors should be returned to the institution on demand
- bidders may not communicate with the press about the project without the institution's prior consent.

Information disclaimer
Include a disclaimer excluding liability for incomplete and inaccurate information provided to the bidders. Inform bidders that they are responsible for verifying facts.

Rules for changes to bidding consortia
Indicate that changes in the makeup of a consortium are not permitted. The BAFO stage is intended to be a clarification of the proposals and not an opportunity to make substantive changes to the bidding team.

Acceptance of the BAFO process
Specify that by participating in the BAFO process, bidders accept the rights and discretionary privileges of the institution during the process. Reconfirm the RFP position that the institution may terminate the negotiation process if it is unlikely that an agreement will be concluded. In such a case, negotiations with other bidders may begin. Remind bidders that the institution is not bound to enter into an agreement with any bidder.

Schedule
Set out the deadlines, including:
- when the RfBAFO was distributed
- when discussions about the BAFO stage take place
- when requests for interaction are submitted
- any additional bidder due diligence required to reduce uncertainty and provide

better value for money
- the deadline for receiving BAFO proposals
- when proposals will be evaluated and the preferred bidder selected
- when negotiations with the preferred bidder will be initiated.

Explain that the institution reserves the right to change the dates, form and substance of the process at its discretion and is not liable to bidders. Indicate any changes to the schedule will be communicated as soon as possible.

Step 3: Get TA:IIA

The institution must get a TA:IIA from the relevant treasury for the BAFO documents – as these are procurement documents – before issuing them to bidders. Follow the same processes as for RFP approval.

Step 4: Distribute the RfBAFO and the roadmaps

Schedule a BAFO conference with the short-listed bidders. During the conference, distribute the RfBAFO as well as each bidder's individual roadmap.

The conference gives the institution the opportunity to describe the BAFO process to the bidders. The institution may answer questions related to the RfBAFO, but questions related to a specific bidder's roadmap should be answered in one-on-one meetings.

Point out that the BAFO proposal will be evaluated as a complete response to the requirements of the RfBAFO and that the institution cannot be expected to cross-reference the bidders' original RFP proposals. The bidders' initial responses to the original RFP remain valid in their own right.

Step 5: Provide further clarification

The bidders may request further clarification after they have reviewed the RfBAFO and roadmap. They may submit questions to the institution in a one-on-one meeting or in writing. Meetings may also be held jointly between the institution and both bidders, for all functional areas such as legal, financial and technical. The institution must reserve the right to refuse to answer any question that would compromise the competitive nature of the process. A bidder may request that a question be asked in confidence, but the institution reserves the right to distribute the questions and answers to the other bidder if they are common to both bidders. Minutes must be kept of all meetings, both joint and one-on-one.

Step 6: Bidders respond

The BAFO bidders respond to the RfBAFO and roadmap with fully revised proposals, which should meet all the requirements in the RfBAFO. The institution will only evaluate these new proposals. Although the BAFO proposal and the initial proposal may be fundamentally the same, specifically in relation to the solutions offered, bidders are allowed to change their original proposal if they believe that doing so will offer the institution a better deal. Bidders must guide the institution to recognise such changes.

The BAFO proposals should be submitted in writing, but the institution may also ask for oral presentations. Oral presentations should follow shortly after the written proposals have been submitted, after the TETs and ECC have had an opportunity to read them. The institution may ask for further clarification of the bids following the presentation.

Step 7: Evaluation and choosing the preferred bidder

After the oral presentations, the evaluation process will begin, following the same route as for the RFP evaluation, and resulting in the selection of a preferred and reserve bidder by the PEC.

Evaluation criteria should stay the same, because changing them could create the impression that one bidder is being favoured. Accurately selected evaluation criteria in the RFP stage are therefore essential for PPP success – a BAFO will not save a project that has inadequate evaluation criteria.

Part 3: The value-for-money report

Treasury Regulation 16 to the PFMA requires the following:

16.5.4 After the evaluation of the bids, but prior to appointing the preferred bidder, the institution must submit a report for approval by the relevant treasury, demonstrating how the criteria of affordability, value for money and substantial technical, operational and financial risk transfer were applied in the evaluation of the bids, demonstrating how these criteria were satisfied in the preferred bid and including any other information as required by the relevant treasury.

This report is known as the value-for-money report.

Step 1: Write the value-for-money report

A well-constructed bid evaluation process will write its own value-for-money report.

Before the preferred bidder is announced and appointed, the value-for-money report has to be written and submitted to the relevant treasury for approval. There can be no negotiation with the preferred bidder before it has been approved.

The value-for-money report is not an approval of the procurement process or its outcome, but rather an approval that the preferred bidder provides the best value for money for the project and that the bid is affordable.

Suggested contents of the value-for-money report

Covering letter applying for TA:IIB

Section 1: Introduction

- Project background

- The bid process to date
- Evaluation criteria
- Evaluation approach
- Evaluation committees
- Summary of compliant and variant bids submitted

Section 2: Evaluations
- Completeness
- Compliance
- Analysis of bids
  - Technical
    - Technical solution
    - Legal solution
    - Financial solution
  - BEE
  - Price
  - Total integrated solution
- Consolidation of analyses

Section 3: Affordability assessment
Set out the cost of each proposal to the institution, including the proposal cost with adjustments where appropriate, and motivations for the full cost of the proposed solution.

Section 4: Value-for-money assessment
This section must tie in very closely with the feasibility study. Value for money is the comparison of proposals with the PSC, and considerable work is required to risk-adjust each proposal to a risk status and equivalent level of service that compares with the PSC. In addition, the risk retained by the institution must be accounted for.

Section 5: Risk transfer assessment
Set out the risk matrixes of the bidders with particular focus on the risk matrix of the preferred bidder.

Section 6: Notes raised and bid deficiencies
Set out the bid deficiencies as captured in the PEC's evaluation notes on the preferred bidder, with an assessment of the kinds of deficiencies and anticipated difficulties in resolving them.

Section 7: BAFO consideration
Report on the BAFO process (if applicable), evaluation and results in the same way as the RFP analysis.

Section 8: Negotiation plan

The negotiation plan must set out the negotiation strategy and all teams, processes and issues.

Section 9: Conclusion

Step 2: Get TA:IIB

The institution's accounting officer/authority must submit the value-for-money report to the relevant treasury with an application for TA:IIB. Only when this approval has been received may the preferred and reserve bidders be announced and negotiations commence with the preferred bidder.

Both the preferred and the reserve bidders should be required to accept the appointment and extend their bid bonds as a commitment to the process. The bonds are released when the PPP agreement has been successfully closed.

The reserve bidder is crucial. The institution may require the preferred bidder to be replaced if the bidder withdraws or if negotiations compromise value for money as approved in TA:IIB.

STAGE 4: NEGOTIATIONS

Negotiations are an integral part of the procurement phase. They are a process, not an event. Successful negotiations culminate in awarding the contract, concluding the procurement phase, and starting implementation.

The institution and the private party have different perspectives on the negotiations stage. The private party wants to reduce risk and increase its margins, while the institution wants to reduce its costs and maximise the value of the services provided through the PPP.

The output of the negotiations must be a PPP agreement with all ancillary agreements containing the service level agreements and payment mechanism.

Basic principles of successful negotiations[13]

- Focus on interests, not positions.
- Separate the people from the problem.
- Do your homework – know what you want.
- Be fair – build trust.
- Be prepared to commit.
- Be an active listener.
- Respect the other side's priorities.
- Be prepared to compromise.
- Leave it aside – resolve immaterial sticking points later.
- Never feel that the preferred bidder has a monopoly position.
- Don't feel pressured to take a decision at any given time.
- Never be emotional and reactive.

Negotiations
Step 1: Preparatory work Step 2: Initial contact Step 3: Engagement Step 4: Ongoing management Step 5: Resolution Step 6: Final bargaining Step 7: Formal settlement

Step 1: Preparatory work

Outline the objectives of the negotiations

- to bridge gaps, eliminate confusion, and formally clarify terms and conditions
- to structure a durable agreement that protects the interests of both parties

13. The list is not exhaustive, and prospective negotiators should refer to further literature on the subject.

Prepare a schedule for starting and concluding the negotiations within the bid validity period

Establish a negotiation team

- Define skill mix requirements.
- Assign a lead negotiator. This person does not have to be the project officer, but must take guidance from the project officer and must have direct access to the accounting officer/authority via the project officer.

Strategise

- Anticipate the private party's positions and interests.
- Carefully review bid evaluation reports, proposal implementation plans and performance schedules, and financial analyses and projections.
- Design a detailed negotiation plan. Pre-define certain positions (fall back, alternative or BATNA [best alternative to a negotiated agreement], and no-go positions).

Step 2: Initial contact

- Invite the bidder, in writing, to a meeting.
- Specify the issues to be discussed, the institution's suggested approach to resolution, and any additional information required for the meeting.
- Provide the date, time, location, and expected duration.
- Request the names and positions of each person on the bidder negotiation team.

Step 3: Engagement

- Begin the first negotiation meeting by making opening statements and introductions, and by clarifying roles and responsibilities.
- Create a climate of trust and co-operation.

Step 4: Ongoing management

- Continually define issues and set an agenda for each meeting.
- Identify shared, compatible, and conflicting interests.
- Jointly refine agendas to include action items and keep the meetings on track. Each meeting should focus on interests rather than positions or personalities.
- Carefully manage the tracking of evolving documentation:
  - appoint an assigned drafter
  - track, number and date changes on every document being negotiated
  - keep the main draft in read-only format and create password access to documents.

Step 5: Achieving resolution

Generate options for settlement.

Concentrate first on common and easily resolved issues to establish a collaborative process.

Assess the options

Choose an option by using objective criteria and which is based on concepts, standards or principles that the parties believe in and which will not be under the control of either party alone.

Step 6: Final bargaining

Final bargaining requires compromises so that both parties see the settlement as the best possible one under the circumstances. Be prepared to bridge affordability gaps as commercial details become clearer. Some output specifications may need to be reduced to keep the project affordable, provided that quality and value for money are maintained.

The institution must strive to make the funding agreements unconditional. *Standardised PPP Provisions* require that conditions precedent in the PPP agreement be limited as far as possible. This refers to matters that need to be resolved, failing which the agreement, if signed, is not enforceable. There may be some conditions that cannot be met before signing the PPP agreement, but these must be minimised.

Step 7: Formal settlement

- Record details of negotiated points and resolutions.
- Agree on how any potential conditions precedent can be minimised.
- Agree to the required follow-up in contract management (of outstanding issues that do not impact on negotiated settlement) and the timeframe.
- Establish a preliminary schedule for signing the PPP agreement.

Take note

Every negotiation is different. There are different people involved and perhaps different cultures, and risks. A good negotiation process should be customised for that particular negotiation's unique needs.

STAGE 5: TA:III

The institution's application for TA:III should be a continuation of the value-for-money report. It establishes the final negotiated project costs, the value for money, the final terms of the PPP agreement, and the contingent liabilities incurred by the institution. It also provides the institution's plan for managing the PPP agreement, and confirms the legal due diligence on the competency of the parties to enter into the PPP agreement.

Extract from Treasury Regulation 16

16.6 Contracting PPP agreements – Treasury Approval: III

16.6.1 After the procurement procedure has been concluded but before the accounting officer or accounting authority of an institution concludes a PPP agreement, that accounting officer or accounting authority must obtain approval from the relevant treasury –

- *(a) that the PPP agreement meets the requirements of affordability, value for money and substantial technical, operational and financial risk transfer as approved in terms of regulation 16.4.2 or as revised in terms of regulation 16.4.4;*
- *(b) for a management plan that explains the capacity of the institution, and its proposed mechanisms and procedures, to effectively implement, manage, enforce, monitor and report on the PPP; and*
- *(c) that a satisfactory due diligence including a legal due diligence has been completed in respect of the accounting officer's or accounting authority and the proposed private party in relation to matters of their respective competence and capacity to enter into the PPP agreement.*

16.6.2 The treasury approval referred to in regulation 16.6.1 shall be referred to as Treasury Approval: III.

TA:III
Step 1: Prepare the PPP agreement management plan Step 2: Complete the legal due diligence Step 3: Compile and submit the TA:III report

Step 1: Prepare the PPP agreement management plan[14]

Preparing the PPP agreement management plan should send a clear message to the institution that while choosing the private party represents the end of the complex and challenging procurement phase, it also heralds the beginning of a new phase that requires a different level of institutional capability.

14. Detailed guidance on the preparation of the PPP agreement management plan is given in *Module 6: Managing the PPP Agreement*.

The plan is one of the pillars of effective PPP agreement management, and the project officer will need to ensure that adequate time and resources are devoted to its preparation.

The preferred bidder should be closely involved in the development of the PPP agreement management plan during the negotiation stage, and this involvement should be used to develop good working relations between the two parties.

The main purpose of the PPP agreement management plan is to:

- demonstrate to the relevant treasury the institution's capacity to effectively enforce the PPP agreement
- provide a strategic management tool to guide the contract management activities that the institution and the private party will undertake during each stage of the project
- clarify the key roles and responsibilities of the institution during each stage of the project, and identify the resources that the institution will require to undertake these responsibilities
- provide information on the contract management approach and contract management arrangements, which can be used to assess the performance of the institution in discharging its obligations and responsibilities as set out in the agreement and government legislation such as the PFMA
- provide a vehicle for addressing issues that cannot be dealt with adequately in the PPP agreement (such as attitudes and behaviour).

Take note

After the initial PPP agreement management plan has been prepared as part of the TA:III process, the approach to contract management should be updated regularly in consultation with the private party, to respond to changing policies, industry requirements, environmental standards, technology and end-user expectations.

Step 2: Complete the legal due diligence

A legal opinion must be signed by the legal advisors of both the private party and of the institution, covering legal compliance, competence and capacity to enter into the PPP agreement. This is essential in ensuring that the parties enter into a valid PPP agreement. Some examples of the contents of the legal opinion are:

- The project is a PPP as defined in the Act.
- The treasury approvals have been validly obtained.
- The procurement process complies with specified legislative requirements.
- All future financial commitments and guarantees have been authorised.
- The institution has the capacity to enter into the agreement.
- The authorised signatory has the capacity to enter into the agreement on behalf of the institution.

Step 3: Compile and submit the TA:III report

The application for TA:III must be signed by the accounting officer/authority and submitted in the form of a report.

Suggested contents of application for TA:III

1. The project
- Background, aims, why procured as a PPP
- Complete history of the procurement process
- PPP description, scope, responsibilities of parties

2. Affordability
- The unitary payment and any pass-through or additional costs
- The basis of indexation. If the index is not CPIX the report must justify the alternative method.
- Confirm budget sources with a written statement of affordability by the accounting officer/authority.

3. Sources and conditions of funding

4. Value for money
- Details of the project infrastructure, operations, BEE
- Value-for-money table (comparison with PSC)

5. Contingent liabilities[15]

6. Risk transfer
- A comprehensive risk analysis summary, tracking risks as they developed through the procurement phase since the feasibility study. It is closely linked to the value-for-money calculation, and must therefore show risk values as estimated or fixed at contractual closure.

7. Legal due diligence
- Confirming the capacity of the parties to contract

8. Institution's capacity to manage the PPP agreement
- A confirmation of the institution's established capacity to fulfil its contractual obligations and manage the relationship with the private party

9. Conclusion reached and justification

10. Annexures
- Annexure 1: Final draft PPP agreement
- Annexure 2: PPP agreement management plan

15. A contingent liability is a liability that accrues to the institution through the PPP agreement but only has an actual, financial impact if a future, uncertain event occurs. An example is compensation payable upon early termination of the PPP agreement.

STAGE 6: THE CLOSE-OUT REPORT AND CASE STUDY

The terms of reference for PPP transaction advisors[16] require that, following financial closure, the transaction advisor must produce:

- a close-out report for the confidential and complete records of the institution
- a case study which will become available to the public.

Take note

Transaction advisors would do well to compile these documents continuously through each phase of the PPP project cycle.

The difference between the two documents is in the detail and confidential information which must be included in the close-out report and not in the case study.

The purpose of the PPP close-out report is to provide a comprehensively summarised institutional record, with all project documentation properly annexed, giving the details of the transaction, and including all confidential negotiated, contracted and financing matters. This is a key document for managing the PPP agreement,[17] and for the institution's reference in future deals.

The purpose of the PPP case study is to build a public library of South African PPP experience that will:

- secure for public record an accurate, summarised history of each PPP project from inception to financial closure, systematically documenting all salient facts
- identify best practice and instances of value-adding innovation, for incorporation into *National Treasury's PPP Manual* and future sector-specific toolkits, and for application in future projects
- identify deficiencies in legislation, policy, guidelines, approach, management practice or skill that impeded the attainment of value for money by the public sector, and which warrant appropriate corrective action for future deals
- be a resource for PPP training and business development.

The case studies will be posted on National Treasury's PPP website for public access. The close-out reports will be confidentially lodged in the institution and in National Treasury's PPP Unit, and will be available to the Office of the Auditor-General for auditing purposes.

Template for PPP close-out report and case study

While there is a single template for both documents to ensure consistency, two distinct documents must be produced, and it is recognised that the nature and scale of each project will shape the documents. Writers should tailor the project

16. See *Module 3: PPP Inception*, 'Annexure 2: Template transaction advisor terms of reference'.
17. See *Module 6: Managing the PPP Agreement*.

material and shape the template in such a way that the final product meets the two sets of objectives above. Writing style is to be concise and factual, and the analytical aspects are to be confined to crisp conclusions, lessons and recommendations. The use of tables and summary boxes is encouraged.

Section 1: Project summary

- Project name
- Project description
- Project deliverables
- Project location
- Sector
- Sphere of government
- Institution
- Accounting officer/authority: name and contact details
- Project officer: name and contact details
- Transaction advisor: name and contact details
- Relevant treasury's PPP Unit project advisor
- Signatories to the PPP agreement
- Signature date
- Structure of the PPP (diagram)
- Agreement term
- Private party special purpose vehicle (SPV): name and contact details
- Shareholders in the SPV: names and contact details
- First-tier subcontractors to the SPV: names and contact details
- BEE profile of the private party and first-tier subcontractors
- Lenders and underwriters: names and contact details
- Lead arranger: name and contact details
- Total capital investment in NPV, specifying public and/or private sector sums
- Debt: equity ratio and sums in private finance structure
- NPV of unitary payments by the institution, or revenue receivable by the institution, specifying discount rate applied and the indexing treatment
- Value for money achieved over the public sector comparator (PSC)
- Total cost of transaction advice, from inception to financial closure, relative to value achieved
- Projected annual cost of institution's PPP agreement management post financial closure
- Risk allocation summary table
- Jobs created/retained/lost
- Local socio-economic impacts
- Summary BEE scorecard achieved for the project
- Timetable from inception to financial close, referenced to each phase of the PPP project cycle
- List of all project documents with brief description of each
- Alphabetically listed project definitions.

Section 2: Introduction
- Description of institution's needs analysis that led to the PPP
- Status of public service prior to PPP
- Relevant political, economic, infrastructural, legal, and budgetary context within which the project was initiated

Section 3: Inception
- Project initiation process
- Date of registration of project with the relevant treasury
- Institution's management and decision-making mechanisms
- Characteristics and mandate of the project officer and relationship with the accounting officer/authority
- Other institutional stakeholders and their roles in this phase
- Key elements of the transaction advisor terms of reference
- Transaction advisor appointment procedure
- Transaction advisor appointed (firms and individuals)
- Transaction advisor payment mechanism

Box: Lessons in point form

Section 4: Options analysis
- Solution options considered
- Solution option selected and why
- Institutions' decision-making mechanisms and timing on option choice

Box: Lessons in point form

Section 5: Feasibility study
- Affordability levels determined
- PSC model
- Risk adjusted PSC
- PPP reference model
- Risk allocation and costing
- Indicative value for money
- Institution's decision-making mechanisms and timing on feasibility study
- Role of other institutions
- TA:I: process, conditions

Box: Lessons in point form

Section 6: Bid documentation
- RFQ specifications
- RFP: key features, particularly output specifications and bid evaluation criteria
- BAFO process, if applicable

- PPP agreement: key features that deviate from *Standardised PPP Provisions*
- Summary of key features in respect of risk, payment mechanism, penalties
- TA:IIA: process, conditions

Box: Lessons in point form

Section 7: Procurement
- Description of procurement process design
- Institution's decision-making arrangements
- Roles played by all parties to the procurement process
- Procurement timetable
- Process of bidder engagement that occurred at each stage, noting any changes to planned process and why
- Market response
- Characteristics of qualifying consortia
- Quality of response: strengths and deficiencies
- Contested features of the PPP agreement in bids
- Bid evaluation procedure, scoring system, decision-making mechanism
- Requests for reasons and any other responses from unsuccessful bidders
- Requests for information and any other responses from stakeholders and the general public
- Whether there was a BAFO stage, and if so why
- Changes to the leading bids that resulted from the BAFO stage
- Summary of value-for-money report recommending preferred bidder
- TA:IIB: process, conditions

Box: Lessons in point form

Section 8: Negotiations
- Negotiations arrangements
- Roles played by all parties
- Resolutions to obstacles or disagreements
- Deal breakers and how they were resolved
- TA:III: process, conditions

Box: Lessons in point form

Section 9: PPP agreement management
- Summary of PPP agreement management plan[18]
- Personnel dedicated: skills, authority, numbers
- Projected annual cost of PPP agreement management

18. See *Module 6: Managing the PPP Agreement*.

Box: Lessons in point form

Section 10: Financial closure (for close-out report only[19])

- Issues that hindered closure and how these were resolved
- Key legal opinions and correspondence
- Summary of final PPP agreement and financing agreements in respect of risk, affordability and value for money for the institution, referenced to TA:I and TA:IIB
- Description of key features of financial closure
- Schematic representation of final project structure, showing all parties and relationships in all final project documents

Box: Lessons in point form

Section 11: Conclusions and recommendations

Draw together the lessons from each of the preceding sections, concluding with an assessment of project quality. Findings should cover at least:

- value for money achieved
- best practice process highlights for inclusion in the *PPP Manual* and sectoral *PPP toolkits*
- recommendations for improvements needed regarding:
  - legislation, regulations, policy
  - institution's approach
  - sponsors' approach
  - lenders' approach
  - *National Treasury's PPP Manual*
  - public sector management practice
  - skills

Annexures to close-out report

- All project documentation, including base-case financial models, duly referenced throughout main text

Annexures to case study

- Transaction advisor terms of reference
- RFQ
- RFP
- PPP agreement (with confidential clauses and schedules blacked out)
- Electronic presentation of case study (45 minutes duration) for use in training, conferences, and public accountability hearings

19. The close-out report will be a confidential document of the institution, and will also be lodged with National Treasury.

ANNEXURES

THE PAYMENT MECHANISM

Introduction

- 'Payment mechanism' means the way the unitary payment and other payment amounts are determined or made up, and the way deductions are calculated for inferior performance.
- 'Unitary payment' is the amount payable to the private party for the performance of its obligations in terms of the PPP agreement.
- 'Output' means the usable result arising from the performance of the private party's obligations.

The unitary payment

A unitary payment must be set by the institution for all PPPs where the institution makes a payment to the private party for its performance in accordance with the service level agreement contained in the PPP agreement. This excludes revenue-generating PPPs and user-charge PPPs where there is no such service level agreement.

Types of charges over and above the unitary payment

Rate-card charges

Typically, rate-card charges are for items or services that are certain to be incurred in the PPP, for example, for service-related consumables where the institution has sole control over usage levels and where it is inappropriate to place risk for usage and cost of supply with the private partner. Most sensibly, rate-card charges are made by the private partner within the context of the PPP agreement on a 'demand/pay' basis, rather than as part of the unitary payment. Rate-card items or services must be pre-specified and pre-priced.

Charges for additional activities or items

Be very careful about entering arrangements which include charges for additional activities or items. There may be cases where this will, in fact, better protect the institution's interests, such as for activities that are within the scope of the project but cannot be exactly defined when the arrangement begins, and where placing the risk and cost of supply with the supplier is not economically viable. Such arrangements may also be required where, for example, additional work may arise in the term of the PPP, which can only be performed by the private partner (for technological or confidentiality reasons, for example). In such instances, it is essential for the institution to define the exact rules for determining the pricing and payment for these additional items.

Pass-through costs

Pass-through costs are paid by the supplier on behalf of the institution, but are not included in the unitary payment. The supplier passes through the cost to the institution in accordance with rules defined in the agreement. The definition of these rules is important for avoiding conflict. For example, it must be clear what the cost of money is between the supplier's payment and the complementary payment by the institution to the supplier.

The elements of the payment mechanism

1. A single, indivisible unitary payment for full availability and performance of the services
2. An appropriate indexation
3. A mechanism for penalising partial or complete failure of the availability and performance of the service by means of penalty deductions
4. No limit to deductions for non-availability
5. A mechanism for dealing with changes to service requirements
6. Provisions for any sharing of excess profits, if applicable

1. A single, indivisible unitary payment for full availability and performance of the services

Whatever service is provided must be available to the users and must meet performance standards. Broadly speaking this applies to all PPPs.

Availability and performance are both usually defined in the negative. For example, a particular facility is unavailable when it has ambient lighting below a specified level, or a performance failure might be the failure to maintain a facility in a specified state of cleanliness. The premise is that the absence of any availability or performance failure results in the full payment of the unitary payment.

Where a single indivisible unitary payment is not practical (and it is acknowledged that projects vary to the extent that this will occur) – for example, there may be a number of discrete output components – the unitary payment may be divided into a number of components, all of which must be subject to indexation only and not to other kinds of adjustment over the project term.

There should be no adjustment of or variation to the payment mechanism for anything not related to the services provided by the PPP. This includes any adjustments resulting from any component of the financing of the PPP.

Payment mechanisms may also take into account additional types of charges that may be included in the PPP agreement. These are dealt with below.

2. An appropriate indexation

Standardised PPP Provisions state clearly that, except for inflationary increases, there should be no other increases in the unitary payment.

The reasons are:

- The institution is limited to budget indexation and cannot afford sustained increases outside this indexation.
- Other forms of indexation are invariably complex and difficult to monitor.
- Each institution is charged with inflation targeting as an overall government objective.

As with all standardised provisions, value-for-money considerations may allow for deviating from the principle, but these deviations will be limited and will require clear justification.

The budget index used by government is the GDP deflator, but National Treasury prefers CPIX (Consumer Price Index, excluding interest rates on mortgage bonds as published monthly by Statistics South Africa) for use in PPP agreements, although this index differs slightly from the GDP deflator. CPIX is also used in cases where the ability to match the financing mechanisms to this index provides value for money.

3. A mechanism for penalising partial or complete failure of the availability and performance of the service by means of penalty deductions

The unitary payment is based on the provision of deliverables in accordance with the service level agreement contained in the PPP agreement. However, the PPP agreement must allow for partial or complete failure by the private party to deliver consistently, and thus provide for deductions for such failures.

The PPP agreement should be based on a self-monitoring system established by the private party – in other words, the private party reports failures and monitors their rectification. The institution monitors and audits the private party's system. A help desk system may be established where users or providers of the services report failures to a central information system.

The payment mechanism should:

- differentiate between categories of availability areas and performance components, and clearly identify critical or key areas and components
- allocate penalty deductions according to categories
- focus the penalties on lack of availability for whatever reason, and make ancillary and lower monetary value deductions for performance-related failures
- provide that continued performance failures escalate into unavailability
- identify rectification times during which no penalty accrues (the rectification time is also a function of the category of availability or performance component)
- penalise repeated failures in either availability or performance on a ratchet system, namely, where the penalties increase with repeated failures
- allocate penalty deductions for monitoring failures
- specify a minimum penalty deduction amount
- set a maximum penalty for unavailability of all the services.

User-fee PPPs

In user-charge PPPs, the general rule is that partial or non-availability or mal- or non-performance is penalised by reduced revenue from users, and there is no need to create any payment deduction regime. Instead, non-monetary penalties are applied, such as an accumulation of penalty points which may ultimately result in termination. National Treasury prefers this approach because of the very high levels of demand risk in this kind of project.

In very limited circumstances, it may be necessary for the institution to make deductions from the user charges paid to the private party as a simulation of a unitary payment-type penalty mechanism.

The following factors need to prevail for an institution to consider this kind of penalty mechanism:

- substantial government contribution to capital works
- significant socio-economic goals for the project (where the termination of the contract for non-compliance is not warranted)
- non-performance does not affect revenue (typically a monopolistic environment or where users are not sensitive to reduced service standards)
- the institution requires services outside the scope of services which generate revenue.

4. No limit to deductions for non-availability

Some argue that there should be a core of the unitary payment that is never attacked by deductions. This core consists of all debt service amounts and operating costs (leaving operating profits and returns on equity). The argument is based on the premise that there is no value for money in punishing parties not responsible for the poor service, and that appropriate deductions can be made without having to reduce the debt service capacity.

The problems with this approach are that the debt service amounts are dependent on the gearing on the project, and operating costs are within the control of the private party. It is therefore essential that there be no core of the unitary payment that cannot be affected by the deductions. Rather, the institution and its advisors need to structure a payment mechanism that makes deductions for the non-availability of defined performance components. However, the maximum deduction should not exceed the amount of the unitary payment payable in the period of deduction.

5. A mechanism for dealing with changes to service requirements

National Treasury acknowledges that there is an inherent contradiction between requiring a fixed, indivisible unitary payment and a mechanism for dealing with changes to service requirements. This contradiction must be managed by thoroughly analysing possible changes during the feasibility study phase, in the preparation of the RFP, and during the process of negotiating with a preferred bidder.

The institution must consider:

- how the project will be affected by change
- how the effect of the change is reviewed and accommodated within the payment mechanism
- what effect this has on risk transfer within the PPP.

The PPP must envisage change from the moment it is conceived. The sources and probability of changes vary from project to project. For example, in information and communication technology PPPs, technology changes are dramatic. These and other PPPs with equipment components must be expected to change over the long term of a PPP agreement.

If insufficient flexibility is allowed in the payment mechanism then a mismatch between service expectations and outcomes will grow over the term of the PPP agreement. The other extreme is too much flexibility in the payment mechanism. The institution may end up being forced to negotiate with a sole supplier, thus making the PPP less affordable over time.

Take note

Any material change to a PPP agreement requires approval from the relevant treasury. Where particular types of changes have been anticipated in the agreement, approval will not be required because the agreement itself will not be changing.

Some potential changes

- **Daily operating requirements** may change, for example, volumes of consumables or catering requirements.
- **Emerging service requirements**, which were not originally envisaged, may become necessary and may only be able to be delivered by the service provider in the context of the agreement.
- **The institution's focus:** For example, strategic direction, objectives, key performance areas or key performance indicators may all change.
- **Economic factors:** The long-term nature of PPPs requires institutions to take a broad view of all economic factors that may influence affordability and value for money.
- **Market change:** This particularly affects projects that have relatively low capital investment, but are highly dependent on ongoing operation and maintenance, including a refreshment of technology based on current market circumstances. In addition, standards of service that were acceptable at the beginning of the PPP may become materially below generally accepted market standards and less acceptable over time.

Institutions must review the impact of all types of change on the payment mechanism, and set down exactly how the payment mechanism may or may not be adjusted.

National Treasury's guiding principles for dealing with change

- All possible change scenarios must be tested at the feasibility study phase and in the design of the payment mechanism.
- A specified and definite unitary payment is preferred. All deviations from such an indexed-only type payment mechanism must be justified, and value for money and clear treatment of the mechanism for dealing with price changes in the PPP agreement clearly demonstrated.
- Factors such as the type of service to be provided through the PPP, the variation in usage rates, and the possibility of changes in law may be taken into account in justifying deviations.
- Flexibility must be allowed in variations to the scope of service, provided that the method of variations, cost determinations and absolute cost limits on such variations are established. In addition, the institution's approval process must be established, and management systems for implementing any changes to payment mechanisms during the agreement period must be in place.

Methodologies for amending unitary payments

Where an institution can demonstrate that there is value for money in not having a unitary payment varied only by an inflation index, the following methodologies for amending unitary payments may be used.

Benchmarking

Benchmarking involves comparing the quantity and type of the private party's work, as well as quality and cost, with the market, and then adjusting the unitary payment either up or down to correlate better with current market quality and costs. In practice, the private party is able to amend the unitary payment throughout the agreement period to the market cost norm.

Difficulties in establishing benchmarks and managing the benchmarking process make this unattractive to most institutions, and benchmarking should only be used for determining the cost of a new service or facility. Where it is used for amending unitary payments, institutions should not only ensure that the benchmarking concept is documented in the agreement, but also include the specific implications for payment mechanisms and their adjustment.

In preparing the RFP, ensure a competitive subcontracting environment. Where possible, consider requiring cost component rates at the time of bids and include variation scenarios in the bid evaluation.

6. Provisions for any sharing of excess profits, if applicable

Value for money requires that the institution pay a fair price for the service that, in turn, affords the supplier the profit that is reasonably aligned with the risks that it bears. Normally, both parties enter into the agreement from a competitive tender basis followed by negotiation. But due to the long-term nature of the typical PPP agreement, competition and negotiation alone do not eliminate the possibility of a supplier making profits in excess of what was envisaged. Develop a view on reasonable profit levels, and ensure that the payment mechanism provides determinations for what will happen if the supplier makes excess profits.

Two forms of creating excess profits

Generating excess revenue
Excess revenue applies only to user-charge type projects, where there is no unitary payment and hence no payment mechanism. The private party takes significant downside risk, so be sensitive about excessive interference by the institution with higher than expected returns. The RFP can encourage a suitable arrangement, in which profit made in excess of a certain return on equity (RoE) is shared. This is justifiable because: the threshold RoE can be based on the bidder's financial proposal (including a detailed financial model); excessive profits made on government services are prejudicial to the sustainability of the project; and the institution is incentivised to maximise project revenues.

Reduced operating costs
Reducing operating costs on unitary payment type PPPs is more problematic. Ensure that the specified levels of performance and availability are met, which means applying the payment mechanism rigorously. A well-structured, unitary payment type PPP, with a tested payment mechanism, should not need a provision for excess profits.

Checklist for developing the payment mechanism

Institutions need to research payment mechanisms, especially where they do not have much experience in developing them.

1. Does the payment mechanism support the objectives of the agreement?

- Does the payment mechanism have a clear relationship with the specified outputs of the project? In other words, the institution and the supplier should be clear about what is being paid for and why.
- Does the payment mechanism cover the full range of payments and deductions to be made under the PPP agreement? Are there rate-card charges, charges for additional activities and items, pass-through costs, and other extras?
- Does the payment mechanism take into account longer-term questions on affordability and value for money? Can additional costs arise later that may seriously impact on affordability for the institution or the ability of the private party to generate a reasonable return in the longer term?
- Has the payment mechanism been tested by reviewing the impacts on affordability and value for money of all the changed circumstances allowable under the agreement? (These may include, for example, increased or reduced requirements for deliverables, and reasonable changes in the institution's circumstances.)

2. Is the payment mechanism workable and will it stand the test of time?

Transparency

Is the payment mechanism transparent in that it is understood and supported by all stakeholders, including other spheres of government, financiers, the institution's users, the private party and the public?

Complexity/simplicity

- Is the payment mechanism too complex in that key performance areas are not separated from less important facets of the service?
- Is the payment mechanism based on output specifications rather than processes wherever possible?
- Has it been scenario-tested during development?

Relevance

- Is it relevant to the market and aligned to current practice in that market?

Administration

- Has any subjective opinion crept into determining a particular payment mechanism? Payment mechanisms should only be based on objective verifiable fact, whether for the completion of a deliverable, or a deduction for inadequate service.
- Does the payment mechanism require disproportionate amounts of administrative effort? Payment mechanisms should avoid excessive administrative procedures and should not require gathering too much information. Requiring too much information from diverse sources will increase administration and audit/control requirements, and increase the chances for mistakes.
- Are the payment mechanisms simple and clear? Can both the institution and the supplier's administrative staff easily understand the mechanisms? Where complexity is required, aids must be developed to ensure that administrative staff can make correct calculations with little effort.

Originality

- Do the payment mechanisms have a proven track record, rather than creating such mechanisms anew? Where a suitable model in the specific local market does not exist, look for parallel markets: for example, the equivalent international market, or a local market that, although different, has common characteristics with the target market. Be cautious about mapping models directly onto the project. The institution's transaction advisor must establish whether the proposed mechanism will, in fact, be workable in the project's target market. Market testing in the feasibility study is essential, and can be followed by bidder interaction before the final RFP is issued.

Behaviour motivator

- Does the payment mechanism encourage the institution's own stakeholders, like staff and clients, to make positive and proper use of the PPP's outputs? Equally important, the mechanism should discourage stakeholders from any bypassing of the specifications.[1]
- Does the payment mechanism influence the private party's behaviour? It is useful to consider this question broadly by incorporating, for example, private party employees, subcontractors and financiers.

Manipulation

- Can the payment mechanism be manipulated by any party to the PPP agreement to achieve a particular outcome?
- Has it been tested for possible manipulation?

Take note

The RFP must not be issued without a specified payment mechanism.

1. The classic South African example of this is a hospital where patients are wheeled from the ward to a room next to the operating theatre by the private party and to the theatre by the institution's staff, because the payment mechanism left out the item of transporting patients from ward to theatre.

CODE OF CONDUCT FOR BID EVALUATION PANEL MEMBERS

This code of conduct is to be signed by members of bid evaluation panels appointed by institutions to evaluate:
- transaction advisor bids
- PPP bids.[1]

1. Background

In terms of the Constitution of the Republic of South Africa, 1996, section 217:

> *When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.*

This code of conduct is issued by National Treasury to instil standards of integrity, ethical conduct, and professionalism in the South African government's adjudication and evaluation of all procurement undertaken by institutions governed by Treasury Regulation 16 to the Public Finance Management Act, 1999 (PFMA), in relation to public private partnerships (PPPs). It is to be applied by institutions in the evaluation of:
- transaction advisor bids
- PPP bids.

Every member of a bid evaluation panel appointed by an institution to act on behalf of the state in the adjudication and evaluation of these bids is required to sign this code of conduct before receiving bids.

In addition, each member has to sign the attached declaration of interest statement once the institution has announced and recorded the identities of the bidding parties.

The aims of the code

This code of conduct does not address every possible situation that may arise. It also cannot serve as a substitute for the responsibility of the accounting officer/authority and the bid evaluation panel members to:
- exercise sound judgment
- act with exceptional standards of moral integrity
- abide by all applicable laws.

1. For the evaluation of PPP bids, this code of conduct must be signed by all members of the technical evaluation teams (TETs), the evaluation co-ordination committee (ECC), and the project evaluation committee (PEC).

This code of conduct is intended to:

- confirm the member's commitment to all its prescripts
- guide members who are faced with ethical dilemmas in an increasingly complex operational environment
- provide a reference for disciplinary and/or prosecuting procedures if a member is found guilty of fraud or corruption
- serve as a public commitment by the institution to the highest standards of ethical and professional conduct in the evaluation of bids.

Breaching the code

A member will be found guilty of breaching the code of conduct if he or she

- contravenes or fails to comply with any provision in it
- when declaring interests, wilfully gives incorrect or misleading details.

In these cases, a member will be liable for disciplinary action in terms of public service regulations to the Public Services Act, 1994, and may also be liable for criminal prosecution.

The accounting officer/authority, acting on his or her own or on a complaint by any person, may investigate any alleged breach of this code by a member of an evaluation panel and may withdraw the member from the panel during the investigation.

2. Definitions

"Family member" means a parent, sibling, child or spouse of a member;

"Member" means a person appointed by the accounting officer/authority to a bid evaluation panel, either as the chairperson, or as an ordinary member or secretariat, for purposes of conducting the evaluation of either transaction advisor bids or PPP bids as a representative of the institution;

"Privileged or confidential information" means any information:
- determined by the institution to be privileged or confidential
- discussed in closed session by the bid evaluation panel
- which, if disclosed, would violate a person's right to privacy
- declared to be privileged, confidential or secret in terms of any law, including, but not limited to, information contemplated in sections 34(1); 35(1); 36(1); 37(1)(a); 38(a); 39(1)(a); 40 or 43(1) of the Promotion of Access to Information Act, 2000.

3. Code of conduct

I, [insert name of member of bid evaluation panel], acting in my capacity as member of the [insert name of institution] evaluation panel for the adjudication and evaluation of bids for transaction advisors/private parties (delete which is not applicable) under [insert tender number] hereby undertake:

1. to act at all times with fidelity, honesty, integrity and in the best interests of the state and the general public it serves
2. to perform diligently the duties of a member efficiently, effectively and strictly in accordance with the rules of bidding and bid evaluation, as set out in the bid documentation and according to all relevant instructions given by the institution
3. to prepare properly for and attend each meeting of the bid evaluation panel, and failing this to withdraw as a member
4. to act at all times in accordance with the relevant legislation and regulations, including the public service regulations, the PFMA, National Treasury regulations, and directives given by the institution
5. specifically, to comply with the *Code of Conduct for the Public Service,* in Chapter 2 of the public service regulations
6. to recognise the public's right to access to information in the interests of administrative justice
7. to take the utmost care in ensuring that there is reasonable protection of the records of the institution and all bid documentation
8. not to misuse the position or privileges of a member, or privileged or confidential information obtained as a member
9. to carry out duties with the skill and care expected from a person of knowledge and experience, and to exercise due judgement
10. not to discriminate unfairly against any bidder on the grounds of race, gender, ethnic or social origin, colour, sexual orientation, age, disability, religion, political persuasion, conscience, belief, culture or language
11. not to abuse any position in the public service to promote or prejudice the interest of any political party or interest group
12. to give the Auditor-General all the information and explanations it requires to carry out its functions
13. to report to the appropriate authorities any case of fraud, corruption, nepotism, maladministration and any other acts which constitute an offence or which are prejudicial to the public interest, arising during the bid evaluation panel proceedings
14. to declare, diligently, accurately and honestly in the declaration of interest statement, all personal and/or business interests that I or a family member may have in any business of any bidder, and to abide willingly by any decision of the chairperson of the bid evaluation panel or the accounting officer/authority to withdraw as a member of the panel because of this

15. to be open and honest about all decisions and actions taken regarding the bid evaluation, and to give clear reasons for these, which can be accurately recorded
16. not to make any dishonest allegations about any bidder
17. not to make any false or misleading entries into the records of the bid evaluation panel
18. to make no contractual commitments related to the bid, to any bidding party, on behalf of the institution
19. to protect proactively privileged or confidential information of the bid evaluation panel from theft, unauthorised disclosure or inappropriate use, and specifically:

19.1 not to respond to any queries relating to the bid evaluation on behalf of the institution, unless expressly authorised in writing by the accounting officer/authority to do so

19.2 not to speak to or correspond carelessly with any person (fellow member, colleague, friend, family member or otherwise) on any matter related to the bid evaluation

20. not to request, solicit or accept any reward, gift or favour in return for voting or not voting in a particular way on any matter, or for disclosing privileged or confidential information
21. not to accept or agree to accept later, any 'kickbacks' in the form of money, favours, inappropriate gifts or anything else of value from a member of the public, government, a political or social movement, or any stakeholder or potential stakeholder which is or may be viewed as aimed at influencing or directing my evaluation of the bids
22. to disclose immediately to the chairperson or the accounting officer/authority any attempted inducement or offers of perks that may be construed as aimed at influencing or directing the evaluation of the bids
23. to report to the chairperson of the panel any invitations to any kind of entertainment by any party that may be construed as being associated in any way with the outcome of the bid evaluation
24. not to vote, attend or participate in any other way in any meeting or hearing in relation to any matter before the bid evaluation panel, if any interest prevents me from carrying out my member functions in a fair, unbiased and proper way in accordance with this code of conduct.

Signed: ________________________ Date: ____________________
[signature of member] [insert date]

Witnessed: ____________________
[signature of witness]

TEMPLATE DECLARATION OF INTEREST STATEMENT

The table below shows the full list of all the bidders, including the names of all the consortium members of each bid, who have responded to the [insert name of institution] call for a transaction advisor/PPP (delete as appropriate) bids for [insert name and tender number of project].

As a member of the bid evaluation panel,[1] you are required to declare any interest, as far as you are aware that you have, in any of the bidders and their consortium member companies.

An interest includes, but is not limited to:

- your shareholding in a bidding company or any of its consortium member companies. Clearly indicate the extent of your shareholding and links to this bid.
- family members, friends or associates employed by a bidding company or any of its consortium members. Clearly indicate the extent of this relationship and links to this bid.
- family members, friends or associates' shareholding in a bidding company or any of its consortium members. Clearly indicate the extent of their shareholding and links to this bid.
- family members, friends or associates contracted to provide services to a bidding company or any of its consortium members. Clearly indicate these individuals' links to this bid.
- you, or any of your family members, friends or associates receiving, or in agreement to receive, any gifts, favours, payments, sponsorships, subsidies, or any other benefits from any bidders or any members of any of the consortia, within the last 12 months of the date of this declaration.
- any other personal interest that may reasonably be deemed relevant to protecting the integrity of the bid evaluation.

All bidders' names and names of all consortium member companies	Interest (Yes / No)	Extent of interest

1. For the evaluation of PPP bids, this declaration of interest must be signed by all members of the technical evaluation teams (TETs), the evaluation co-ordination committee (ECC) and the project evaluation committee (PEC).

I, [insert name of member], a member of the bid evaluation panel for the [insert name of institution and name and number of project] declare that the above information is true and correct to the best of my knowledge. I declare further that in the event of any such interests arising during the course of bid evaluation, these shall be promptly and accurately declared in writing to the accounting officer/ authority.

Signed: ________________________
[signature of member]

Date: ____________________
[insert date]

Witnessed: ____________________
[signature of witness]