



DODGY ENERGY DEALS

Combating corruption and improving procurement practices in South Africa

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The South African state is set to spend R3.2-4 trillion over the next eight years through its Strategic Infrastructure Projects (SIPs) as part of an ambitious solution to address poverty and economic development in South Africa. Given that South Africa has a problem with procurement corruption, improper expenditure through the SIPs could burden current and future generations with unnecessary debt, poor trade-offs and environmental and social harm.

This report focuses on providing guidance to policy makers for sound, effective and socially just public procurement for the SIPs energy projects. We also encourage civil society and the broader public to use this report to push for reforms that ensure that they have greater oversight and say over the use of public funds.

The report establishes the constitutional and legislative principles of transparent, fair, equitable, cost effective, competitive public procurement as benchmarks for best practice with an emphasis on how these can be practically achieved to ensure optimal outcomes. It also provides advice on how to make public procurement corruption-resistant.

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DODGY ENERGY DEALS: Combating corruption and improving procurement practices in South Africa

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EXECUTIVE SUMMARY

The South African state is set to spend R3.2-4 trillion over the next eight years through its Strategic Infrastructure Projects (SIPs) as part of an ambitious solution to address poverty and economic development in South Africa. The allocation for energy infrastructure is by far and away the most sizeable at R2.3 trillion or 67.6% and includes the building of mega coal and nuclear plants and some renewable infrastructure. Given that South Africa has a problem with procurement corruption, improper expenditure through the SIPs, particularly the energy infrastructure, could burden current and future generations with unnecessary debt, poor trade-offs and environmental and social harm.

This report focuses on providing guidance to policy makers for sound, effective and socially just public procurement for the SIPs energy projects. We also encourage civil society and the broader public to use this report to advocate for reforms that ensure they have greater oversight and say over the use of public funds.

The report establishes the constitutional and legislative principles of transparent, fair, equitable, cost effective, competitive public procurement as benchmarks for best practice with an emphasis on how these can be practically achieved to ensure optimal outcomes. It also provides advice on how to make public procurement corruption-resistant.

Our recommendations are informed by:

- Legal understandings of the public procurement framework
- Reflections on recent experience in the procurement of coal, nuclear and renewables
- Civil society and labour perspectives
- Insights from international best practice in public procurement

The combined efforts, whilst not exhaustive, offer indicative insights into the nature of the procurement system as it is outlined and practised. The internationally articulated and utilised strategies are meant to strengthen and improve public procurement processes. These international precedents are valuable for ensuring best practice for local public procurement.

Key ingredients for sound, effective and socially just public procurement for energy:

- Transparency is essential in public procurement as a first step towards increasing accountability in public spending and towards socially and environmentally just investments. There is a democratic imperative for energy contracts to be transparent because the public has a right to know how the government is selling their (especially non-renewable) resources and what their public funds are being spent on
- Accountability is the cornerstone of a sound public procurement framework in a democracy and is a measure of the responsiveness of the government to national needs. Civil society has a key role to play in monitoring public procurement, particularly for mega projects in energy where there are high stakes and keen public interest, and can 'blow the whistle' on corrupt deals and assist with keeping the process accountable to the public and societal goals
- Cost effectiveness through a prudent public procurement approach will ensure that energy investments advance the country's sustainable development goals, including poverty reduction and environmental sustainability
- Sustainability by means of the sustainable public procurement (SPP) approach is gaining traction worldwide as a sound and beneficial way to integrate environmental, social and economic considerations into public procurement processes and decision making. SPP will ensure cost savings, efficiencies, environmental protection and wider social benefits in the long term for society

Top 12 policy recommendations to make public procurement in energy corruption-resistant:

1. Develop and use public procurement portals which house openly accessible data online, such as the one in Slovakia, for driving public oversight and creating trust in procurement processes
2. Monitor and apply effective sanctions in the disclosure of public officials' interests so that corruption in the awarding of tenders is curbed
3. Regulate party political funding to avoid the unfair and corrupt practice of government contracts being awarded to political parties
4. Make energy contracts transparent, as they are in Peru, because the public has a right to know how the government is selling their resources and what their public funds are being spent on
5. National Treasury needs to provide greater oversight over parastatals including Eskom to ensure that they procure energy in the public's interest
6. Substantially revise the Department of Energy's New Generation Regulations to minimise the allowance and application of discretionary power in the procurement of energy
7. Allow civil society observers to have access to all relevant procurement documents and to monitor the entire process as it is legislated in the Philippines and as prescribed by the Integrity Pact, an anti-corruption tool which provides for civil society oversight on the tender process
8. Follow a prudent approach to public procurement in which an electricity plan follows, and is developed in the context of, the national development plan, as well as sectoral policies, strategies and plans so that it coheres with overall goals and prevents flawed and costly decisions which lock us into long-term trajectories from being made
9. Undertake accurate, complete and up-to-date energy demand projections and costing, through a regular revision of the Integrated Resource Plan – the country's 20 year electricity plan - for sound, cost effective investment decisions
10. Apply whole/full life costing, as part of a sustainable public procurement (SPP) approach that is being adopted in countries across the world, for determining the consequences or impacts of investments across the supply chain and which will prevent the undertaking of risky investments
11. Maintain the integrity of Environmental Impact Assessments, with due attention to their related social impact assessment dimension, when making strategic energy investments
12. Promote renewable energy that is socially owned and controlled at best, and that ensures local job creation at a minimum

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List of Abbreviations

| | |
|---------|---|
| AG | Auditor-General |
| BBBEE | Broad Based Black Economic Empowerment |
| CAPEX | Capital Expenditure |
| CEO | Chief Executive Officer |
| CER | Centre for Environmental Rights |
| DME | Department of Minerals and Energy |
| DWE | Department of Water and Environment |
| EIA | Environmental Impact Assessment |
| EITI | Extractive Industries Transparency Index |
| FIFA | International Federation of Association Football |
| GCC | General Conditions of Contract |
| IISD | International Institute for Sustainable Development |
| IP | Integrity Pact |
| IEP | Integrated Energy Plan |
| IPP | Independent Power Producer |
| IRP | Integrated Resource Plan |
| LRC | Legal Resources Centre |
| MYPD | Multi-Year Price Determination |
| NEMA | National Environment Management Act |
| NERSA | National Electricity Regulator of South Africa |
| NDP | National Development Plan |
| NNR | National Nuclear Regulator |
| NUMSA | National Union of Metalworkers of South Africa |
| OECD | Organisation for Economic Cooperation and Development |
| OSFSA | Open Society Foundation-South Africa |
| PAIA | Promotion of Access to Information Act |
| PBMR | Pebble Bed Modular Reactor |
| PPA | Public Private Partnership |
| PPPA | Preferential Public Procurement Act |
| PFMA | Public Finance Management Act |
| REBID | Renewable Energy Bids |
| REFIT | Renewable Energy Feed-In Tariff |
| REIPPPP | Renewable Energy Independent Power Producer Procurement Process |
| SA | South Africa |
| SAWEA | South African Wind Energy Association |
| SCOPA | Standing Committee on Public Accounts |
| SPP | Sustainable Public Procurement |
| SIPS | Strategic Infrastructure Projects |
| SCM | Supply Chain Management |
| TI | Transparency International |
| UNCAC | United Nations Convention Against Corruption |

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§1 INTRODUCTION: MEGA PROJECTS, ENERGY, AND THE PUBLIC PROCUREMENT FRAMEWORK IN SOUTH AFRICA

The infrastructure on the scale needed to transform our economy and social landscape will not come cheap. The costs of the Strategic Infrastructure Projects or SIPS are estimated at about four trillion Rands over the next 15 years.

South African President Jacob Zuma,
Presidential Infrastructure Investment Conference
19 October 2012¹

1.1 South Africa's mega projects and the focus of this report

South Africa is embarking on a multi trillion Rand² new build programme. The public investment includes a number of mega projects called Strategic Infrastructure Projects or SIPS that will go towards increasing services and building social infrastructure. But the allocation for energy infrastructure is by far and away the most sizeable, accounting for 67.6% or R2.3 trillion of the R3.2 trillion spending envisaged by National Treasury.³ The electricity infrastructure plan, as a subset of the energy projects, includes a fleet of six nuclear plants projected at R300 billion and five coal fired power plants with a R351.7 billion price tag.⁴

The SIPS constitutes a major part of public procurement - the state's acquisition of infrastructure, goods, and services - that President Zuma states will be a catalyst to "sustainable economic development" and the "betterment of lives".⁵ This view is reflected in the large budgetary allocations worldwide for public procurement, estimated to be 45–65%, and in developing countries at 43% in India, and 47% in Brazil⁶. It is also supported by an international recognition of the importance of public procurement for achieving social and economic objectives in a country.

In a country with deepening poverty, high levels of inequality and a poor climate and environmental profile it is crucial that infrastructure provision such as the SIPS supports wider sustainable development goals. We therefore focus on how best the SIPS projects, particularly those for energy, can deliver on its objectives. More to the point, are there key ingredients or guidelines to ensure that the SIPS live up to the hallmarks of sound, effective and just public procurement? In order to do this we first have to confront the flip side, basically four key assumptions that underpin the grand development project constituting the SIPS and the views that support it: First is that poor and previously disadvantaged people will necessarily benefit from these projects; second, public procurement occurs in a politically free context; third, big, costly investments today will necessarily or automatically benefit people in the long-term; and finally, environmental considerations are irrelevant, neutral or indirectly accounted for.

Our sketchy recent history with mega project procurement shows up these assumptions as largely misplaced. The controversial arms deal is a striking case in point. The public were assured that the dodgy deal would cost them R28-30 billion, but warnings of a far higher price tag have proven accurate, with a costing today of R70 billion, money which could have been spent to address severe backlogs in social services and infrastructure provision.⁷ In fact, it is estimated that one million jobs were lost because of the deal. The impact of the arms deal spanned four administrations and involved a myriad politicians all linked and drawn into deals with connections to the global arms trade. The involvement of the ruling party meant that the party rather than individuals saw itself as benefiting, which made the corruption nexus deeper and more insidious as it allowed individuals to deflect responsibility by deploying the assertion of a 'greater good'. It led to lack of transparency of parliamentary sub-committees with the affordability report being vital yet still officially inaccessible. The deal also saw the rise of the shadow state characterised by a greater reliance on the security sector for exerting control over the political space locking down deals.

The Soccer World Cup mega project was also riddled with problems of cost escalations, crony capitalism and marginal benefits for the poor. The 70,000-seater stadium in Durban, for example, cost most more than R2.75 billion and more than R1.6 billion over-budget.⁸ Benefits for the mega tender deals through the government or FIFA accrued to either local political elites or their families. It is estimated that in 2005, one in every three South Africans hoped to personally benefit from the World Cup, with this number falling to one in every 100 by 2010.⁹ The problems, albeit localised, also point to a wider corruption problem within the construction industry. In 2002 Transparency International estimated that the amount lost globally to corruption in infrastructure procurement amounted to US\$3.2 billion per year.¹⁰ In *Player and Referee: Conflicting Interests and the 2010 FIFA World Cup*, monograph editor Collette Schulz-Herzenberg¹¹ argues that time becomes a disproportionate measure of performance when constructing for mega events, and this “creates opportunities for corrupt officials and business people to argue that we cannot afford the ‘luxury’ of oversight – and very soon contracts are awarded to companies who are ‘known’ and can be ‘trusted’. Jobs for pals may follow.” This logic makes way for an opaque tender system that is prey to all sorts of opportunistic abuse. Similar arguments of opportunity costs arising from narrow electricity reserve margins are being made in support of urgently proceeding with large energy infrastructure projects, particularly the nuclear fleet.

The SIPS itself stands in danger of violating key constitutional rights to a safe and healthy environment. In government’s hubris to fast track the SIPs it has developed the draft Infrastructure Bill which disregards policy and articulations on sustainable development and government’s own commitments to integrated environmental management and planning. The New Generation Regulations for Energy similarly run roughshod over constitutional, National Treasury and PFMA principles of transparency, accountability, fairness and cost-effectiveness (see below for details), while favouring processes that entrust the Minister of Energy with the power to decide on key procurement deals.

In these notorious examples, not only were the poor and previously disadvantaged sidelined and mistreated, almost all the benefits accrued to a wealthy elite who brazenly traversed the divide between the politics and business. The result was to raise the cost of procurement, promote ill-advised choices and poor trade-offs, and engender mistrust and lack of goodwill in government ultimately causing harm to democracy building.

1.2 Energy procurement in the South African context

At R1.945 trillion the new build for electricity represents 61% of the total SIPs programme (see Table 1 below). Infrastructure for liquid fuels will cost R312 billion, or 6.6% of this budget. Together they will cost the public R2.275 trillion.

Table 1: South African Infrastructure Projects (SIP) 2012-2020

| (R billion) | Concept | Pre-feasibility | Feasibility | Financing | Detailed design | Tender | Construction | Ongoing programmes* | Total |
|---------------------|--------------|-----------------|-------------|------------|-----------------|------------|--------------|---------------------|--------------|
| Water | 20 | — | — | 32 | — | 5 | 18 | — | 74 |
| Transport | 310 | — | 78 | 17 | 12 | 88 | 8 | 71 | 583 |
| Electricity | 720 | 268 | 314 | — | 95 | 103 | 345 | 101 | 1,945 |
| Liquid fuels | — | — | 211 | — | 2 | — | — | — | 213 |
| Education | 20 | — | — | 40 | — | — | — | 125 | 185 |
| Health | — | — | 50 | 29 | — | — | — | 31 | 110 |
| Telecommunication | 12 | — | — | — | — | — | 3 | — | 15 |
| Human settlement | — | — | — | 78 | — | — | — | — | 78 |
| Total | 1,082 | 268 | 653 | 195 | 109 | 195 | 374 | 328 | 3,204 |
| % total expenditure | 33.8% | 8.4% | 20.4% | 6.1% | 3.4% | 6.1% | 11.7% | 10.2% | 100% |

* Ongoing programmes include multiple projects at different stages of development, such as universal access to electricity and school building programme

Source: National Treasury 2012 Budget Review¹²

The electricity new build programme takes its cue from the Integrated Resource Plan 2010 (IRP2010), the electricity plan setting out power requirements for the next 20 years (as discussed below). But South Africa experienced an energy crisis in 2008 in which shortages of supply led to rolling blackouts. A capital expenditure programme or CAPEX focusing on recovering baseload was hurriedly put in place as a resolution to the crisis. The CAPEX included the building of mega coal plants Medupi, Kusile and a nuclear fleet. The IRP2010 thus took the CAPEX as an assumption based on the rationality of under-supply. But critics no doubt argue that this approach is driven by fear and defies proper and prudent planning.

The coal new build project under the SIPs is projected to cost R351.7 billion (see Table 2 below).¹³ The committed plan includes the 4800MW mega plants Medupi and Kusile, said to rank in the top 5 biggest plants worldwide, and the bringing of two plants back into commission. A coal 3 project is in the pipeline (See Table 3 overleaf) and will either involve the building of another massive plant or a number of smaller plants. Forty new mines will be developed to provide coal to the new power stations. Significant port and rail expansion for export purposes is also being planned.

Table 2: Major infrastructure energy projects already committed

| Project name/ implementing agent | Total project cost R billion | Project objective and completion target date | Status |
|--|---------------------------------|---|--|
| Kusile power station (Eskom) | 121.0 | Build 4,800MW coal-fired power station. First unit commissioned by 2014 | Under construction |
| Medupi power station (Eskom) | 99.0 | Build 4,788 MW coal-fired power station. First unit commissioned by 2013 | Under construction |
| Grootvlei (Eskom) | 7.8 | Return to service of 1,180MW power station, scheduled for completion in 2012 | Civil works complete, commissioning in progress |
| Komati (Eskom) | 12.9 | Return to service of 1,000MW power station, scheduled for completion in 2012 | Civil works complete, commissioning in progress |
| Ingula pump-storage scheme (Eskom) | 21.4 | Build 1,332MW hydroelectric power station to begin operating in 2014 | Dam constructed, pipe installation in progress |
| Renewable energy (independent power producers) | 120.0 | 3,725MW of renewable energy procured into national grid by 2016 | Tender process underway, 1,415MW of bids in first procurement round confirmed |
| Open-cycle gas turbine (independent power producers) | 15.4 | Build 1,000MW power plant, scheduled completion in 2021 | Tendering process undertaken |
| Distribution backlog (Eskom and municipalities) | 27.5 | Refurbishment and new distribution network | Ongoing programme |
| New transmission lines (Eskom) | 95.0 | Upgrade and new transmission lines over 5 years | Work in progress |

There are some obvious problems with this plan. In order to keep global temperature levels to a two degree limit we will need to start seriously constraining the burning of fossil fuels. A recent report *Unburnable Carbon 2013: Wasted capital and stranded assets*¹⁴ indicates that to stay within a two degree limit for global warming we can only burn 20% of fossil fuel reserves. Furthermore, implementing new clean coal technologies such as Carbon Capture and Storage (CCS) will not make much difference to these calculations. With power plants lasting an average of 40-60 years (and assuming the rational economic model will keep them active for their full term) SA's carbon limits would be blown. Massive investment in coal also locks in the technology, and effectively prevents investment in cleaner technologies. The impact of the new mines in a severely water stressed region of the country will be devastating, particularly when considering that local consumption for drinking and irrigation should be prioritised.

The construction of Medupi and Kusile faces serious corruption challenges, in which the big boiler contract benefits the ruling ANC party's investment company Chancellor House. Since party funding is not regulated in South Africa, this blatant conflict of interest was not addressed and has been allowed to go through without sanction. Medupi is also at the epicentre of a highly contested and what will likely be a protracted battle by fenceline communities over health impacts and displacements. A NUMSA memo to Eskom¹⁵ also lists labour grievances at Medupi that include oppressive management, racism, militarised security, low pay, no training, conditions conducive to alcohol abuse and the failure to deliver on corporate social responsibility undertakings. These conditions have resulted in repeated strikes – and a seven week shut-down in February / March 2013 – which may delay completion (in an already delayed project) and hence raise funding costs. With 17,000 mostly male workers on site and many more work seekers, the project tears into the local social fabric. It creates a local economic boom with highly uneven results, for example raising rents to the benefit of landlords and at the expense of tenants, enriching the rich, impoverishing the poor and entrenching brutally unequal gender relations. The economic collapse that follows will compound many of the ill effects. The details of some of these contentious issues are included in the report.

The nuclear procurement vision of the Department of Energy proposes a fleet of nuclear power stations amounting to 9600MW (see Table 2).¹⁶ It will be the biggest state tender in South Africa's history and could potentially create an onerous financial burden on the State for many decades to come. Minister of Energy Dipuo Peters has made it clear that the Department intends to invite bids for the construction of up to six nuclear reactors along South Africa's southern coastline. Cost estimates vary, but even a conservative R300 billion estimate is five times larger than the infamous arms deal.¹⁷ Factoring in typical time and cost overruns, as well as the associated runaway interest repayment rates, one energy economist calculated that the cost could exceed R1.4 trillion – roughly double the country's projected tax revenue for the 2011-2012 financial year.¹⁸ Given South Africa's dubious history with regard to the procurement of megaprojects there are well-founded fears that a new nuclear-build tender will ignite a feeding frenzy, opening up unprecedented opportunities for corruption, political patronage and the abuse of state power for party political gain. Further issues on the lack of transparency and accountability and challenges to cost effectiveness are raised in the report.

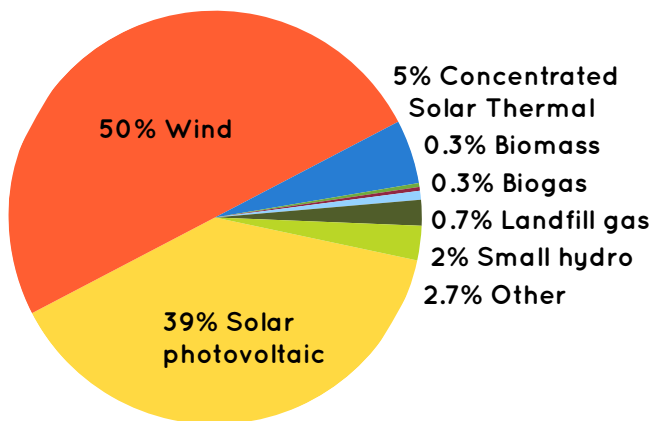
Table 3: Major infrastructure projects for electricity being planned

| Project name/ implementing agent | Total project cost R billion | Project objective and completion target date | Status |
|---|---------------------------------|--|--|
| Nuclear fleet build (Eskom) | 300.0 | Generation of 9,600MW scheduled for completion by 2029 | Final stages of consideration before financial proposal can be determined |
| Grand Inga (Government of the Democratic Republic of Congo) | 200.0 | First phases of hydroelectricity project of 40,000MW | South Africa assessing support options |
| Imported hydroelectricity options (Eskom) | 52.2 | Hydroelectric, gas and coal projects in Southern African countries | Options of off-take agreements and financial support for projects being considered |
| Solar park (Central Energy Fund) | 200.0 | Build 5GW scale solar park in the Northern Cape | Feasibility study to be completed in 2012 |
| Closed cycle gas turbine (Independent Power Producers) | 13.6 | Construction of 2,450MW of additional gas turbines by 2029 | Option under the Integrated Resource Plan |
| Coal Three (Eskom) | 111.0 | Build third coal-fired power plant | Feasibility aspects being considered |

Source: 2012 National Treasury Review¹⁹

South Africa's renewable energy independent power producer's programme (RE IPPPP) launched in August 2011, was initially conceived in 2007 as the renewable energy feed-in tariff (REFIT). RE IPPPP is the first renewable energy initiative in South Africa to have gained traction at the national level,²⁰ and will facilitate the entry of privately generated renewable energy into the country's electricity grid. RE IPPPP allocates 3725 megawatts (MW) for renewable energy sources, of which 1850MW is for wind, 1450 MW for solar photovoltaic, 200 MW for concentrated solar thermal, 12.5 MW for biomass, 12.5MW for biogas, 25MW for landfill gas, 75MW for small hydro and 100MW for other small projects (see Figure 1).

Figure 1: Renewable Energy Independent Power Producer Procurement Process allocation by technology, 2011-2013



The selection of the first and second round of successful projects took place in December 2011 and May 2012, with the subsequent submission date now scheduled for 19 August 2013. In 2011 it was estimated that RE IPPPP will add an average incremental cost of \$660 million to South Africa's yearly electricity bill up to 2044 which will be borne by electricity consumers under the MYPD 2 and tariff hikes.²¹ Construction of the first round of projects started in early 2013 and the final round of projects must begin commercial operation before end 2016. Although the inclusion of renewables into the energy mix comes as a welcome sign of investment in clean technologies and diversifying of energy base, the procurement programme is not without flaw. These issues are discussed in the report.

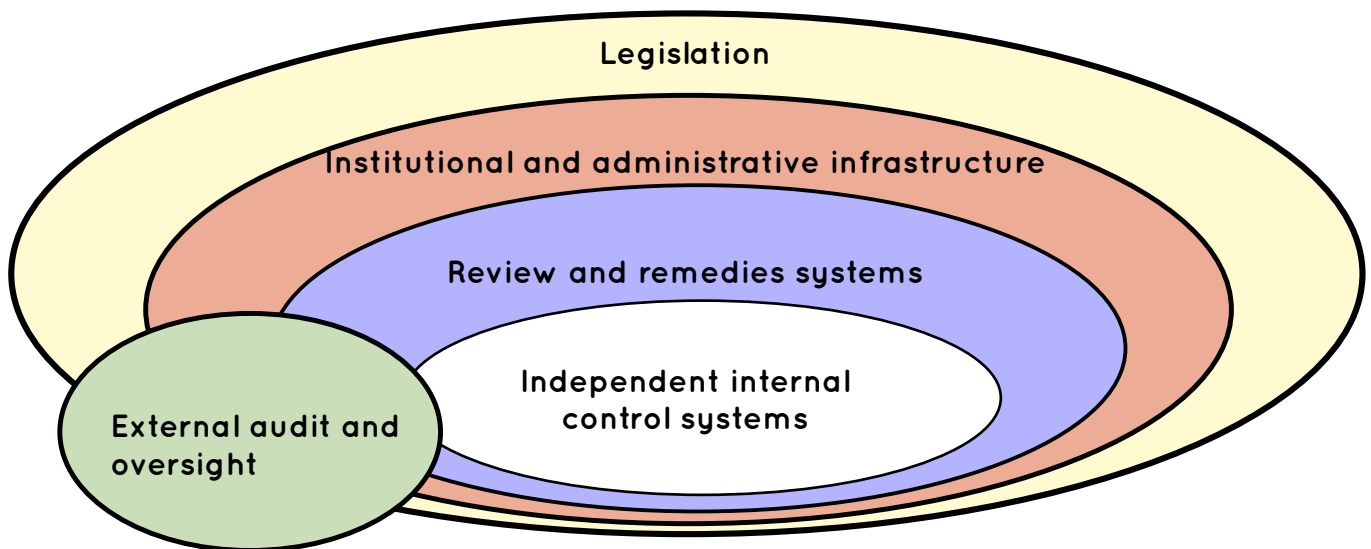
At face value, the expense incurred for the provision of energy is worth it. Electricity provision is a critical development need in a country with almost 2.5 million households still unconnected to the grid. But aside from some of the contentions described above, the new build programme sits within a deeper context. South Africa's industrial policy favours large industrial users of electricity, such as the mining houses, the steel plants, the smelters and refineries and coal-to-oil conversion plants. In fact, 70% of electricity is consumed by industry as compared to just 13% of residential users. Smelting companies alone use up five percent of the country's power.²² Incentives are also provided to industry without any factoring in decarbonising the economy or energy efficiency approaches. According to David Fig²³, "Instead of better planning and incentivising adaptation towards smarter and greener industrial expansion, it continues to emphasise traditional approaches and expects the energy utility (Eskom) to meet the resulting increased demand for energy." The incentives include special electricity price tariffs which are secured by secret contracts. When smelting company, BHP Billiton eventually lost a court case to Media 24 in the Supreme Court of Appeals in March 2013 to keep their contract secret, it was disclosed that they were being charged for electricity at a cost lower than the generation cost.²⁴ The artificially low pricing implies a subsidy to BHP Billiton of about R3 billion a year.²⁵ Industry has also been fighting to keep those contracts in place so that they can be shielded by tariff hikes imposed because of the infrastructure new build plan.

The new build programme takes place in the context of a global recession which began in 2008. As David Hallows²⁶ laments, "We've possibly seen the first two of a five act tragedy. Act 1: Wall Street. Act 2: Europe. The flighty rand gets flightier and the risks of foreign debt escalate." Costly public investments become more risky in this climate. Buttressed by this are predictably new regional and international emissions standards²⁷ which will either make new plants install cleaner technologies or to shut down plants to comply. A longer-term approach to investments must be seen in this light for all risks and costs to be fully factored into decision making.

1.3 The Public Procurement Framework²⁸

The procurement framework is the fundamental structure in which procurement operates. Its components include legislation, institutional and administrative infrastructure, review and remedies system, independent internal control system and external audit and oversight (see Figure 2) which are essential in promoting transparency, accountability and proper management and which mitigates against corruption risks.²⁹ Country legislation creates the overall framework in which the process takes place, which is bolstered by international anti-corruption treaties such as the United Nations Convention Against Corruption (UNCAC). As shown in Figure 2 public transparency and citizen oversight are important cross cutting aspects³⁰ which assist in corruption detection and advocating for reforms.

Figure 2: The Public Procurement Framework



Source: OECD Toolbox³¹

1.3.1 South Africa's legal and ethical framework - *Fair, equitable, transparent, competitive and cost effective*

Procurement is governed by the Constitution, the *Public Finance Management Act 1999 (PFMA)*, and the *Treasury Regulations 2005*. The Treasury has also laid down further guidelines in the form of instruction notes and procurement guidelines.³² Moreover, since each Department has its own obligations to ensure its actions are compliant with the Constitution, each Department may have promulgated further regulations governing procurement. For our purposes, the Department of Energy has set down regulations to govern procurement agreements for new generation capacity, though this explicitly excludes nuclear power from its ambit.³³

Section 217 (1) of the Constitution establishes the underlying fundamental requirement that procurement must be done in accordance with a system which is "fair, equitable, transparent, competitive and cost effective". The Treasury itself has also acknowledged the importance of these underlying constitutional values, stating that successful government procurement is dependent upon "Five Pillars of Procurement", namely: value for money, open and effective competition, ethics and fair dealing, accountability and reporting, and equity, and the absence or failure of one means the procurement process is broken.³⁴

Each Department and public entity must give effect to this provision, and this key phrase is echoed in the *PFMA*, *Treasury Regulations* and Treasury guidelines.³⁵ In this respect, the *PFMA* requires that each Department or public entity appoint an accounting officer.³⁶ The accounting officer is generally the head of the Department and has a variety of duties relating to the financial management of the Department.³⁷ More relevantly, the accounting officer must ensure that the Department maintains "an appropriate procurement and provision system which is fair, equitable, transparent, competitive and cost effective".³⁸ In furtherance of this requirement, the *Treasury Regulations* stipulates that the accounting officer "must develop and implement an effective and efficient supply chain management system in his or her institution for (a) the acquisition of goods and services",³⁹ where similarly, again, the supply chain management (SCM) system must be "fair, equitable, transparent, competitive and cost effective".⁴⁰ To achieve such a system, the *Treasury Regulations* have elaborated upon the minimum information which must be provided at different stages in the procurement process, which are discussed in greater detail below.⁴¹ The Treasury has also set out a *Supply Chain Management: A Guide for Accounting Officers/ Authorities 2004*.⁴²

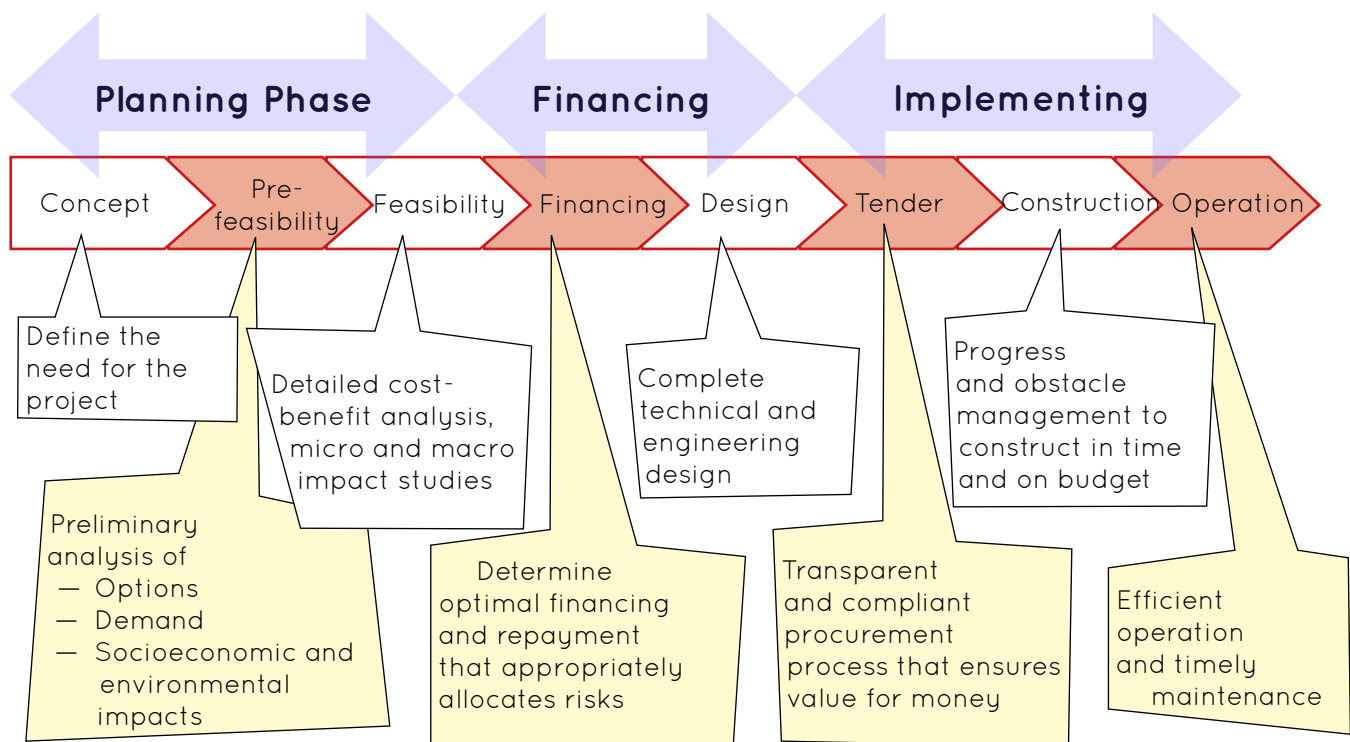
Moreover, a Supply Chain Management Office has been established in the National Treasury to oversee the implementation of the policy.⁴³ The functions of the SCM Office include, *inter alia*, providing a link between central government, National Treasury and different SCM units in the various organs of State, investigating complaints received from the public regarding bid procedures and irregularities,

assisting SCM units in instituting remedial steps, maintaining a database of non-preferred suppliers, and maintaining a database to support the monitoring of the extent to which the government's procurement reform objectives are met.⁴⁴ The *Treasury Regulations* also specifically regulates the situation where procurement occurs via a public private partnership.⁴⁵

1.3.2 Phases of project development and the procurement process

Project development is an encompassing term for the range of activities that take place from project concept to operation (see Figure 3 overleaf). The procurement process occurs within project development as three discrete elements namely; planning, tendering and operation or contract maintenance. These elements also represent stages or steps in the procurement process. The pre-feasibility stage which includes conducting Environmental Impact Assessments is usually seen to occur prior to actual procurement but is an essential part of determining whether a project will protect or cause harm to the environment, as stipulated in the National Environmental Management Act of 1998 or NEMA. Each constituent part of project development is important not only from an administrative point of view, but also in terms of strategic decision making to meet national objectives, accountability and public participation which are all integral to democracy building

Figure 3: The phases of project development



Source: National Treasury

The procurement process can be separated into three stages:

Planning – This involves determining whether there is a need for the goods or services in question, ensuring that the Government has the legal powers to acquire such goods or services; obtaining the necessary authorisation for the transaction; and arranging financial support;

Tendering – This is the process of selecting a contractor to provide the goods or services, and the conclusion of a contract with that party. It involves drawing up specifications to explain to potential contractors the needs of the government; deciding on the method of procurement (call for tenders or getting quotations), selecting a winner, debriefing, and signing a formal agreement.

Contract maintenance or contract administration – This involves the supervision of contractual performance to ensure the proper delivery of goods or services, dealing with or resolving disputes and arranging for payment.

1.4 The research and report structure

It is not a foregone conclusion that the SIPs will benefit people. The case history of mega projects, the trajectory of the SIPs, and energy context in which the SIPs sits, provide compelling evidence to this end. In fact, it is more likely that people will have to face the nasty consequences of dodgy energy deals that drive people deeper into poverty and contaminate their natural environments. And yet, as the CER argue in their response to the controversial draft bill for the SIPs, people are “entitled to infrastructure development that is responsible, well-conceived, enjoys high levels of public support, does not prejudice their health and well-being, and does not cause environmental damage that will slow these projects down and generate long-term liabilities for the state. The SIPs in particular require massive investments with far reaching long-term impacts, so careful planning and roll out of procurement is vital for positive outcomes.” With the size and scope of government’s spending activity it is also critical that everyone has confidence in the public procurement process.⁴⁶

For the SIPS energy projects to contribute to sustainable development they will need to address these vexing issues and to engender democracy building. The constitutional and legislative principles for sound, effective and just public procurement are a guiding light and should be used to bring the endeavour back in line. The reform initiatives of National Treasury, the Department of Public Service and Administration and Auditor-General are also recognised and should be supported. Our study provides additional guidance to reform public procurement and, in particular, to ensure that the energy projects meet with social, environmental and economic goals. The research blends legal understandings of the procurement framework and recent experience in the procurement of coal, nuclear and renewables. Two roundtables were held in Johannesburg and Cape Town in mid-March 2013 to solicit perspectives from civil society and labour and served to complement the desktop research. The combined efforts, whilst not exhaustive, offer indicative insights into the nature of the procurement system as it is outlined and practised. In addition, our recommendations offer internationally articulated and utilised strategies to strengthen and improve public procurement processes. These precedents are valuable for engendering best practice for local public procurement and for synergising with international reform trends.

The research dovetails with work we are conducting in partnership with Legal Resources Centre and the Open Society Foundation-South Africa (OSFSA) which will map the public procurement framework for South Africa. Therefore, whilst this report covers the basics of the procurement framework, the OSF report will cover other neglected aspects. When published, both reports should ideally be read together to get a complete picture of the system, weaknesses, and possible remedies. It is envisaged that this work will inform a third phase focusing on more specific targets for reform.

The report is structured as follows:

Section 1 provides a general overview and framework for understanding reform approaches to public procurement for energy. It details the SIPs within the context of South Africa’s experience of mega project and energy procurement. It also broadly maps out South Africa’s public procurement framework with a specific focus on the legislation and phases on procurement.

Section 2 highlights the value and needs for transparency in the public procurement framework. Anecdotal evidence of weaknesses in the system are provided and remedies using international best practice are suggested.

Section 3 provides an exposition of accountability deficits in the system, with a particularly focus on those impacting on the energy sector. The section also provides avenues in which there can be greater internal and external accountability

Section 4 looks at relevant values and approaches to guide the maintenance of cost effectiveness in public procurement decisions. It points to instances of weakness in current energy procurement and suggests specific methods to remedy them

Section 5 introduces issues of sustainability into the public procurement discourse and offers ways to take into consideration environmental, economic and social needs in investment decision making

Section 6 provides a summary of the report and offers practical policy advice to guide best practice in public procurement for energy

§2 ENHANCING TRANSPARENCY

2.1 Key messages

- **Transparency is essential in public procurement as a first step towards increasing accountability in public spending and towards socially and environmentally just investments**
- **Access to information legislation in a democracy is meant to support the freedom of information so that the public can monitor public procurement, but can and has often been used in South Africa's energy sector to restrict access and foster a culture of secrecy**
- **Public procurement portals which house openly accessible data online, such as the one in Slovakia, are a useful tool for driving public oversight and creating trust in procurement processes**
- **It is mandatory for public officials involved in public procurement to disclose their interests so that conflicts of interest and corruption in the awarding of tenders are curbed, but it needs to be closely monitored and effective sanctions for offenders applied if it is to serve its purpose**
- **Party political funding should be regulated to avoid the unfair and corrupt practice of government contracts being awarded to political parties**
- **There is a democratic imperative for energy contracts to be transparent because the public has a right to know how the government is selling their resources and what their public funds are being spent on**
- **In Peru, contract transparency has attracted rather than deterred investment, been one way to thwart corruption, and has created national dialogue over the use of the country's natural resources**

2.2 Transparency and access to information

Transparency is essential in public procurement. The public needs open, accessible information that is provided in a timely manner so that they can make an informed assessment of how their money is being spent by government in activities such as public procurement. Transparency can engender trust in the public procurement system (as compared to mistrust when decisions are taken in secret) and can therefore encourage public goodwill. It can also be used as a basis for civil society engagement in the process. Transparency is therefore seen as an important first step towards engendering greater democratic accountability. For energy procurement, transparency can be a vehicle to ensuring that socially and environmentally sound investments are made and so that it is clear how natural resources are being sold. Practical business benefits also include increased competition and better value for goods and services.

Giving effect to the right to access information in Section 32 of Constitution is the Promotion of Access to Information Act 2 of 2000 or PAIA. PAIA protects the public's right to access any information held by the State, provided that certain requirements are met and it doesn't contravene any other laws. The burden is meant to be on the State to prove that information should be kept secret. However, many have argued that the energy sector has often used PAIA to foster a culture of secrecy rather than to promote openness. Evidence of this can be seen in the practice of developing the IRP2010. A secret task team was appointed by the Department of Energy to develop the plan with its functions opaque. Requests to make this information public were denied even though this process was of high public interest given decisions on investments in mega projects for electricity. It was only after civil society lodged PAIA applications that the names of the team members was revealed. Minutes of the meetings were still kept secret. This has in part led to the conclusion of the Electricity Governance Initiative that "Even though the official policy process is ostensibly transparent, the actual policy process is often non-transparent."⁴⁷

Similarly, the constitutional and statutory requirements for transparency are so far lacking in the proposed process for procuring 9600MW of nuclear energy, as indicated in the SIPs. Only minimal

information has been provided to the public. The nuclear expansion programme was not discussed in the national budget speech of 2013, the 2011 and 2012 Medium Term Budget Policy Statements, the Minister of Finance's 2012 Budget Speech or the President's 2012 State of the Nation address.⁴⁸

The National Nuclear Energy Executive Co-ordinating Committee, a body created in 2011 to lead and oversee the nuclear expansion, has not yet met.⁴⁹ Even state-owned entities such as the National Nuclear Regulator,⁵⁰ the South African Nuclear Energy Corporation,⁵¹ and Eskom⁵² have protested the lack of guidance provided by the Department of Energy regarding nuclear procurement. Yet the Energy Minister Dipuo Peters made a declaration last year about the intention to procure the nuclear fleet with details to be provided by June 2013. The latest indications from the Minister are that cabinet has endorsed the programme.⁵³

The Department has also refused to cooperate with civil society groups that seek transparent administration of this process. In February 2012, Earthlife Africa-Jhb wrote a letter to the Department questioning the constitutionality of the procurement of the entire fleet of nuclear reactors at one time. The letter asked for clarification of the Department's intentions regarding the number of reactors and amount of energy to be procured, and when such procurement would take place. In June 2012, Earthlife Africa submitted a PAIA request to learn the results of a readiness and safety assessment of South Africa's nuclear infrastructure. Greenpeace Africa and Koeberg Alert Alliance also submitted PAIA applications for this information. None of these requests received a reply from the Department.

A further instance of non-disclosure relates to the failed Pebble Bed Modular Reactor Project. Eskom refused to release into the public domain information on deliberations on the PBMR at its board meetings. In June 2005, Earthlife Africa was refused access by Eskom to the board minutes that it suspected would reveal Eskom's disquiet about the PBMR. Earthlife decided to litigate to obtain the minutes, as allowed by PAIA. The case was heard in August and judgement delivered in December 2005 against Earthlife with costs awarded to Eskom. The non-disclosure of information made it very difficult for civil society to contest the viability of the project.

The Protection of Information Bill, dubbed the 'Secrecy Bill' that was recently passed by Parliament and is awaiting President Zuma to sign it into law,⁵⁴ serves to further halter free and easy access to information. The Bill effectively puts the burden of proof on the individual and imposes severe penalties of up to 25 years imprisonment for leaking documents, and up to 10 years imprisonment for intentionally accessing classified information. It involves more wide ranging classification of secret documents which impinges both the media's and the public's ability to act as watchdog of corruption.

Box 1: International best practice — Public Procurement Portals in Slovakia as a way to enhance transparency

Transparency Slovakia decided in 2010 to build an internet-based portal on public procurement called Open Public Procurement (available at <http://tender.sme.sk/en/>) with the aim of creating a single-stop shop for procurement data, its visualization and some business-intelligence-like features. In the past, it was virtually impossible for researchers and the public in general to identify the major contracting authorities and vendors in Slovakia and how much money was in the system. Above all, Transparency Slovakia felt that civil society, government and businesses needed to work with decent, good quality data in order to effectively analyse the problems in Slovak public procurement. While the portal does not necessarily see the general population as its main beneficiary, the accessibility of good quality reporting data does indeed provide an important platform for citizen-driven monitoring activities.⁵⁵

The portal brings together a massive amount of public procurement data dating back to 2005 on roughly 35,000 contracts worth almost €23 billion (US \$31 billion). It includes: 11 structures data along the main dimensions of purchaser, vendor, sector (area of procurement), region, procurement procedure, procurement criteria and date, provides a breakdown and visual overview of any combination of the above, mentioned dimensions, displays procurement details for each individual procurement deal as submitted by the purchaser (such as a detailed contract purpose, the number of bidders and contact information); and exports processable data for anyone interested.

2.3 Disclosure of interests and political party funding

For procurement officials to be ethical in their conduct they need to avoid engaging in any activity that creates a conflict of interest with their role. Such common unethical conduct includes awarding a tender to a company that the procurement official has a business interest in, or awarding tenders to friends (cronyism) or relatives (nepotism). ‘Moonlighting’ in which the official holds a similar job at the same time as his full time paid position, is also considered unethical conduct.

National Treasury has adopted disclosure of interests regulations to manage unethical behaviour in public procurement. The regulations include a Code of Conduct for SCM officials and other role players which includes provisions for conflicts of interest. Specifically, these actors must recognise and disclose any conflict of interest that may arise in a contract that will be awarded.⁵⁶ Conflict of interest extends to an official or any close family member, partner or associate who has any private or business interest in the contract to be awarded.⁵⁷ Where such conflict of interest arises, that interest must be disclosed and the official must withdraw from participating in any manner whatsoever in the process.⁵⁸

Experience in awarding of coal contracts has shown up poor management of conflicts of interest. Chancellor House, an investment company set up to fund the ANC, is Hitachi Africa’s accredited BEE partner with a 25% shareholding. The ANC consequently gets a very large rent off the deal. At the time that the boiler contract was awarded, Valli Moosa was both chair of the Eskom board and on the ANC’s National Executive Committee. The then Public Protector, not known for making findings which discomfort the ruling party, found that Moosa’s conduct was improper in that he did not manage the conflict of interests appropriately. The turbines and boilers were specifically excluded from the World Bank’s loan for Medupi but specifically funded by the African Development Bank. These loans were clearly coordinated to evade World Bank rules against funding projects that benefit a political party. This particular case brings up the necessity for political party funding regulation in which parties disclose their funding so that conflicts of interest are mitigated.

In fact, conflicts of interest has become so pervasive that the term tenderpreneur has been coined by local people to describe “individuals who enrich themselves through corrupting the awarding of government tender contracts, mostly based on personal connections and corrupt relationships - although outright bribery might also take place - and sometimes involving an elected or politically appointed official (or his or her family members) holding simultaneous business interests.⁵⁹ Although disclosure regulations exist to manage this situation and to prevent corruption, often there is no real monitoring of the disclosures and sanctions not applied for offenders.

Box 2: International best practice – Ethics and the Integrity Pact

The Integrity Pact (IP) is a tool developed by Transparency International to help governments, business and civil society to combat corruption in public procurement. It is essentially a ‘pact’ or agreement that is made between a government or government departments and the bidders for a public sector contract.

“The IP sets out rights and obligations to the effect that neither side will pay, offer, demand or accept bribes, or collude with competitors to obtain the contract, or while carrying it out. In addition, the bidders are required to disclose all commissions and similar expenses paid by them to anybody in connection with the contract. If violations occur then sanctions apply. These sanctions range from loss or denial of contract, forfeiture of the bid or performance bond and liability for damages, to blacklisting for future contracts on the side of the bidders, and criminal or disciplinary action against employees of the government.”⁶⁰

These features allow the IP to act as “an anti-corruption tool for the Government, by casting suitable responsibilities on the buyers and the sellers; as a bid-protest tool for dissatisfied bidders, by embedding provisions regarding fair evaluation of bids; and as a dispute resolution tool for the contractor at the contract-administration stage”.

Practical experience from selected projects in Germany, Colombia and Argentina shows that when properly implemented IPs have proven to create transparency in specific transactions and to reduce corruption. More than 15 countries worldwide have contextualised and piloted the model with varying but notable degrees of success.⁶¹

2.4 Contract transparency

There is a democratic imperative for energy and mining contracts (as with all other government contracts) to be open to the public because citizens have a right to know how their government is selling their resources. “Even as they conduct business, governments have duties, obligations and interests that go well beyond profit maximisation. As such, the same secrecy afforded to contracting parties is out of place in such contracts. Governments must be held accountable for all contracts they enter, be they for the provision of roads or the purchase of goods. And when the contracts concern non-renewable resources, the need for scrutiny is even more pressing... Without contract transparency, fears of the worst flourish, and mistrust and conflict are magnified among stakeholders, Rosenblum and Maples argue.⁶²

‘Investment contracts are crucial to define the terms of an investment project and the extent to which it advances – or undermines – sustainable development goals like poverty reduction and environmental sustainability. The capacity of governments to negotiate and manage investment contracts and the capacity of civil society, parliamentarians and the media to scrutinise government dealings with incoming investors can make a real difference to designing and implementing deals that are favourable to people in the host country.’ Investment Contracts and Sustainable Development’, Lorenzo Cotula, IIED, 2010

According to Rosenblum and Maples, “governments in a number of countries require oil, gas or mining contracts to be voted on publicly by the parliament, while other countries without such parliamentary requirements—including East Timor, Peru and Ecuador—have nonetheless made contracts publicly available in one or more of their extractive sectors. A few countries explicitly support contract transparency as a fundamental principle in managing their extractive sector; examples include Liberia, in its EITI bill, and Ghana, in its nascent but rapidly developing oil sector where contracts are discussed openly in Parliament. Yet in South Africa, as is the case for electricity pricing, contracts are kept secret. It is only through PAIA applications and persistence with court cases on individual contracts which need to argue why disclosure is in the public interest, that these contracts can be made publicly accessible.

Box 3: International best practice — Making contracts transparent and accessible to the public in Peru

The Peruvian government created a free online legal search engine, Poder Judicial de Peru, making many legal documents accessible. Peruvian legislation regarding access to information for citizens to monitor public officials is considered quite robust. However, the far more significant mining sector contracts are not available online. They are available to the public, but a requester must approach the relevant government agency to obtain a copy.⁶³ The experience has led to the following three conclusions:

1. *Companies bid on the contracts knowing the tenders/bids will be publicly available. Peru has attracted more companies in successive bidding rounds, as well as higher royalty rates. Thus, ‘contract transparency has not been a deterrent, and it may have attracted more investment.’*
2. *Contract transparency is one means among many to deter corruption*
3. *Citizens, activist groups and parliamentarians have proven ‘very eager to learn about the contracts in order to act as monitors and influence policy’, and has attracted nationwide media attention, and has allowed civil society to play a greater role in the nationwide debate over how to use its non-renewable resources, providing, at least, an avenue for constructive dialogue to resolve differences over development.*



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§3 BUILDING ACCOUNTABILITY

3.1 Key messages

- **Accountability is the cornerstone of a sound public procurement framework in a democracy and is a measure of the responsiveness of the government to national needs**
- **National Treasury needs to provide greater oversight over parastatals including Eskom to ensure that they procure energy in the public's interest**
- **The Department of Energy's new generation regulations need to be substantially revised to minimise the allowance and application of discretionary power in the procurement of energy**
- **Civil society has a key role to play in monitoring public procurement, particularly for mega projects where there are high stakes and keen public interest**
- **Civil society observers should be allowed to have access to all relevant procurement documents and to monitor the entire process as it is legislated in the Philippines and as prescribed by the Integrity Pact tool**

3.2 Accountability and the oversight of parastatals

Accountability is the cornerstone of a sound public procurement framework in a democracy and serves as a measure of responsiveness of the government to national needs. There are basically two types of accountability that are relevant to public procurement, namely internal and external accountability. Internal accountability is provided by different organs of the state which hold some responsibility for overseeing the adherence to policies and laws and performance. National Treasury and the Department for Public Service and Administration are usually seen as providing some of the oversight responsibilities with Parliament in charge of overall oversight. Other institutions like the Auditor-General and Standing Committee on Public Accounts or SCOPA also have a role to play. External accountability is provided broadly by the public or through dedicated oversight by civil society as discussed below.

The PFMA is constitutionally mandated legislation which prescribes measures for transparency and financial control. In terms of section 6(1)(g) the Treasury must promote and enforce transparency and effective management in respect of revenue, expenditure, assets and liabilities of departments, public entities and constitutional institutions. Section 6(2) provides that to the extent necessary to perform these functions the Treasury must prescribe uniform treasury norms and standards and monitor, investigate and appropriately intervene in order to fulfil its responsibilities effectively. However section 6(1)(g) and (2) are applicable to public entities listed in Schedule 2 of the PFMA only to the extent provided for in this Act. Treasury is therefore limited in its oversight role over parastatals, which would include the energy supplier ESKOM which is a parastatal listed in Schedule 2

The general functions of accounting officers are set out in section 38 and include ensuring that the entity over which it presides has an effective, efficient and transparent system of financial and risk management and internal control and an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost effective.

Chapter 6 of the PFMA sets out the provisions of the act applicable to all public entities listed in Schedule 2 of the Act. Section 49 requires every such entity to have an accounting officer and 49(2) states that if a schedule 2 public entity has a board or other controlling body that board or controlling body is the accounting authority for that entity.⁶⁴ Since Eskom has a board in terms of the Eskom Act, this board is its accounting authority. According to section 49(3) however the Treasury may in exceptional circumstances approve or instruct that another functionary of a public entity must be the accounting authority for that public entity.

Box 4: Lessons in failed public procurement: Pebble Bed Modular Reactor Project⁶⁵

On February 18, 2010 the government decided to cut its financial support of the Pebble Bed Modular Reactor (Pty) project, so named because it uses a technology involved pebble-shaped fuel elements and can be constructed in multiples called modules. The PBMR absorbed R8,67 billion of taxpayers money through its 11-year development period. Shutting down the project means dismissing over 75% of its 800 strong workforce although some staff are to be redeployed to other parts of the nuclear industry. By the end, the PBMR ceased to have a local or foreign investor or customer.

The company was first created in 1999 and is originally the aim of the PBMR project was to deliver energy to industry and households, both locally and for export. It was foreseen that it would export 20 reactors a year and build about ten for domestic use. However, the technology has proven difficult for the South African team to master and the prospect of building a demonstration model has repeatedly been postponed. After initially setting the date for completion at 2003, the company continually deferred this and in 2009 announced it had rescheduled completion to 'round about 2020', a delay of at least 17 years.

The design of the reactor itself has also been modified five times. At first the reactor was set to deliver 110 megawatts of electricity. Later, versions of 125 and 137 megawatts were claimed. In 2005 the design was further changed to allow for an output of 165 megawatts. This change was regarded as significant enough to have to reinitiate the environmental impact assessment (EIA) process to take the new design into account. However during the course of this EIA, a further significant modification to the design was announced. The PBMR company stated in February 2009 that the latest version would only generate 80 megawatts of electricity. It no longer claimed that the only rationale for the pebble bed reactor was the delivery of electricity. Instead, its purpose was said to have extended to the generation of heat for industry, the possible extraction of oil from tar sands, hydrogen production and the desalination of sea water. South Africa was hit by an electricity shortage in 2008 with rolling blackouts for months. The electricity utility, Eskom, quickly drew up plans for new nuclear and coal plants to meet the shortage. However, nowhere did the PBMR feature in these plans.

The history of the project reveals that Eskom pursued the project with relative autonomy, despite the fact that the broader plans of the State, as encapsulated within the White Paper on Energy, published in 1998, and its planning processes were far more circumspect on nuclear energy.

An important nod to gaining an independent view of the viability of the pebble bed was the appointment in 2001 by the DME of a panel of experts. Their findings were supposed to be fed to the South African Cabinet so that it could make a strategic decision about the future of the PBMR. Much of the information provided to the 15 international experts arose from the Detailed Feasibility Study conducted by the PBMR company in 2001–2002. Members of the panel were given complete access to the data they required and two of them were tasked with reviewing the economic feasibility of the project. Their report was submitted in early 2002. However, after seven years this has yet to be revealed publicly and panellists were sworn to secrecy, despite their sources all being in the public domain. Findings remain with Cabinet and the DME (since May 2009 split into two separate departments, Department of Mining and Department of Energy) and these were not even disclosed to Eskom or the PBMR company. Later the then Department of Environmental Affairs and Tourism (now Department of Water and Environment, DWE) established a review panel to assess the Draft Scoping Report issued in the first environmental impact assessment process. This review has also not seen the light of day.

Not only has it been impossible to get an accurate picture of the full economic costs of the programme, but this has also foreclosed informed public debate on the future of the PBMR. The company has only revealed figures when asked to do so by parliamentary portfolio committees, which have the right to scrutinise the spending of public funds. Another source of information was the documentation produced by the company for the EIA process (described in the section on regulatory controls and revolving doors, page 22). In general, the disclosed information has seldom been comprehensive, and always leaves room for uncertainty and speculation.

3.3 Regulations for new power generation

In addition to the *Treasury Regulations* and its associated guidelines and policies governing procurement, each Department has responsibility to ensure that its procurement system is in compliance with the Constitution and these regulations. In this regard, the Department of Energy has itself promulgated regulations to govern the adoption of all new generation capacity, except that concerning nuclear power.⁶⁶ These regulations have been made in accordance with the obligations set out in section 34 of the *Electricity Regulation Act 2006*, which requires that any new generation capacity must be established through a tendering procedure which is fair, equitable, transparent, competitive and cost-effective and provides for private sector participation. Accordingly, these regulations aim to facilitate planning for the establishment of new generation capacity and set the minimum standards or requirements for any power purchase agreements.⁶⁷ It is under these regulations that the IRP 2010 was developed and published.⁶⁸

3.3.1 Feasibility studies

Following the publication of any such IRP, the Minister of Energy has the discretion to undertake or commission another party to undertake feasibility studies in respect of the new generation capacity requirement.⁶⁹ A feasibility study should consider:

- The anticipated cost of the proposed new generation capacity;
- The proposed allocation of financial, technical and operational risk between the buyer and the generator;
- The demonstration of the anticipated value for money to be achieved;
- The material legal, financial and technical requirements, including consents required in order to procure the new generation capacity; and
- Whether the appropriate generator should be Eskom as part of its services as the national electricity producer, another organ of state or an independent power producer (IPP).⁷⁰

It is important to note that in the previous New Generation Capacity Regulations of 2009, the feasibility study was *required* rather than discretionary.⁷¹ Moreover, under the previous regulations, the Minister of Finance was required to approve the outcome of the feasibility study, before the Minister of Energy could determine that new generation capacity was needed.⁷² Thus, under the previous regulations, there was a more comprehensive system of checks-and-balances than under the current system.

3.3.2 Making a determination

Under the current *New Gen Regulations*, the Minister, simply in consultation with the National Energy Regulator,⁷³ has the power to make a determination that new generation capacity is needed. In this respect, the Minister of Energy may also determine the identity of the buyer and the procurer and such a determination would have the effect to be binding on those parties.⁷⁴ It is also unclear what constitutes a “determination”. For instance, does it suffice for the Minister to make a public statement to the media, a written statement to the Executive, Parliament or National Treasury of the intent to procure, or something altogether different? The lack of meaning provided for the “determination” leaves it open to interpretation and is therefore highly problematic in terms of the discretionary power it affords to the Minister and the associated lack of accountability.

Under these new regulations, the Minister of Energy has much greater power. This has certainly restricted the oversight capacity of the Treasury and has made the system less transparent. It raises concerns with how appropriately the Minister of Energy can assess the cost-effectiveness of the procurement process, without another party monitoring his behaviour.

3.3.3 Tender process

The tender process under the 2009 regulations through a selective tendering method (stage 1: request for prequalification; stage 2: request for proposals; and stage 3: negotiation with the preferred bidder).⁷⁵ However, under the current *New Gen Regulations*, the Minister of Energy is permitted to determine the tendering process as he so chooses, and if he does not make any such determination, the procurer may determine the form of the IPP procurement programme.⁷⁶ It is unclear how this discretion interacts with the requirements imposed by the Treasury, in that procurement for a contract value greater than R10 million must be through the process of competitive bidding.

3.3.4 Entering into the procurement contract

In concluding the procurement contract, the *New Gen Regulations* reiterate the requirements of the *Treasury Regulations*, that is, value for money, appropriate technical, operational and financial risk transfer to the generator, effective mechanisms for implementation, management, enforcement and monitoring of the power purchase agreement, and satisfactory due diligence in respect of competence and capacity to enter into the power purchase agreement.⁷⁷

It is at this stage where additional safeguards have been put in place, and that before concluding the procurement contract, the buyer must ensure that the buyer has a contract management plan (explaining mechanisms and procedures to implement, manage, enforce, monitor and report on the agreement to the Treasury and the Minister of Energy on a regular basis) and to put in place arrangements to ensure that its financial obligations in respect of the new generation capacity projects will be met.⁷⁸

Finally, it should also be noted that, like the *Treasury Regulations*, regulation 11 of the *New Gen Regulations*, empowers the Minister of Energy to waive the application of the regulations. It is again unclear why this exemption would apply, and clearly would reduce the transparency or effect of the regulations altogether.

Box 5: Renewables – New Generation Regulations and turf battles

The evolution of South Africa's New Generation Regulations for electricity which are central to the procurement of privately generated renewable energy reveals how the DoE, backed by National Treasury seized control of the RE IPPPP from NERSA, ultimately securing a much greater level of Ministerial discretion over the selection of power projects.

On 30 January 2009, the then DME introduced a consultation paper entitled *Electricity Regulation*, under the Electricity Regulation Act of 2006 to deal with the procurement process of new generation of electricity for IPPs.⁷⁹ The paper which failed to mention the feed-in tariff for which the consultation process had already begun, ran contrary to REFIT because it was to establish a bidding system, as opposed to a tariff system⁸⁰ and shifted "strategically important planning responsibilities from NERSA to Eskom, and [gave] the Minister of Energy wide discretion regarding NERSA's REFIT process"⁸¹

Then in March 2009 NERSA published its approved REFIT guidelines with minimal reference to the DME's electricity regulations.⁸² Five months later in August 2009 the DME's *Electricity Regulations on New Generation Capacity* were approved, which by then had a dedicated section on procurement of renewable energy and cogeneration.⁸³ A second version of these Regulations revised with technical assistance from Danish consultants, was promulgated for public comment in the government gazette on 30 November 2010.⁸⁴ This in effect transferred powers away from NERSA and Eskom to the DoE and National Treasury.⁸⁵ Finally in May 2011 a third version of these regulations this time with all references to REFIT removed.⁸⁶

In August 2011, National Treasury declared that South Africa's REFIT was illegal following an audit carried by Webber Wentzel that "showed that the predetermined tariff would fall foul of South Africa's procurement rules".⁸⁷ In an admission of defeat, on 23 August 2011 *Engineering News online* reported: "NERSA's Thembani Bukula said that the regulator had moved ahead with the design of a REFIT in line with government policy and national legislation. But he said that framework changed on May 4, 2011 when the New Regulations on New Generation Capacity were promulgated and made no reference to REFIT. Therefore, on July 29, 2011, NERSA concurred with government's competitive bidding process".⁸⁸

3.4 Civil society oversight

Civil society has a key role to play in monitoring public procurement, particularly for mega projects where there are high stakes and keen public interest. Together with oversight from Parliament and independent bodies such as Auditor-General, civil society bodies can, and often does, serve a watchdog function blowing the whistle on corrupt practices and helps to keep the process accountable to the general public. It should be noted that transparency is a key precondition for civil society monitoring. Box 6 provides some insight into deficits around decision making for nuclear energy.

Box 6: Nuclear energy – Policy changes, promises and decision-making

In the early 1990s, Trevor Manuel, then the head of the ANC's economic desk, said at a conference on the future of the nuclear industry: "We shall not tolerate circumstances in which policy on issues as critical as a nuclear programme be confined to experts in dark, smoke-filled rooms. The debate must be public and the actions transparent."⁸⁹ In the final White Paper, published in July 1998, specific reference was made to the expansion of the nuclear industry, which, it stated, would only occur in the context of: "an integrated energy policy planning process with due consideration given to all relevant legislation, and ... subject to structured participation and consultation with all stakeholders."⁹⁰

The White Paper also signalled that there would be some restructuring of the nuclear industry "necessary to ensure the environmental sustainability and cost-efficiency of South Africa's energy economy, while seeking maximum benefit from historical investment." This restructuring would be undertaken in 'a participatory fashion', and, before any final decision was made on the future of Koeberg, there would be a full-scale investigation into its financial and technical performance 'made available for public scrutiny and comment'.⁹¹

However, taken together with Trevor Manuel's earlier pronouncements guaranteeing transparency, these promises in the White Paper have not materialised. There has thus been no broad stakeholder consultation on the future of the nuclear industry; nor has this applied specifically to the future of the Koeberg power station, the only nuclear power plant in South Africa, as promised in the 1998 White Paper. Most of the decision making on the industry has been centred on the DME (Department of Energy since May 2009), and the Department of Public Enterprises, which oversees Eskom.

The decision making has been from the top down, without any significant stakeholder participation. What appears to be government policy has been formulated without any policy debate on these matters having taken place within the policy arenas or local structures of the ruling ANC party.⁹²

This lack of transparency is symptomatic of how the executive branch of government has come to dominate national policy making. Cabinet has become susceptible to the special pleading and some of the false claims of the industry.⁹³ As a result, the nuclear lobby has retained its highly subsidised place in the sun at the expense of cleaner technologies, human health and the environment.⁹⁴



Box 7: International best practice — Civil society procurement observers in the Philippines and through the Integrity Pact

Advocacy from a coalition of 26 organisations concerned with corruption and governance in the Philippines led to the promulgation of the Procurement Reform Act in January 2003. This Act provides for NGO observers to the procurement process. Procurement observers have access to minutes of bids and awards committee meetings, abstract of bids, post qualification summary report, annual procurement plan and project management plan and opened proposals.⁹⁵

A local NGO, Procurement Watch Inc now conduct trainings in public procurement monitoring for NGOs from 2004-present. PWI has conducted training sessions of Ombudsman staff on the new procurement law and publicize information on procurement law to the public through its civil society network. At the same time, PWI is building the larger civil society capacity to monitor the public procurement processes. PWI has established a mechanism for Ombudsman to respond to information from citizens observers about potential frauds and abuse. This has been critical, considering citizens sometimes hesitate to report complaints to government officers for fear of harassment.⁹⁶

The IP mechanism also serves as an advocacy tool for greater citizen participation, by allowing members of the public to closely observe the process. Ideally, there should be a forum in which civil society can discuss the procurement process. However, TI acknowledges that there may be a necessity for restricted access based on proprietary information.⁹⁷ Therefore, as a solution civil society may select an *independent monitor(s)* of unquestionable integrity, who reports directly to the civil society organisations. The monitors have *free access* to all relevant government documents, meetings and officials, and to all documents submitted by the bidders. They should review the tender documents, the evaluation reports, the award selection decision and the implementation supervision reports (technical as well as financial). Monitors regularly inform the leadership of the government office of any *corruption risks or possible irregularities detected*. The monitors should suggest preventive/corrective measures to all parties. Where any corruption risks or possible irregularities are reported by the monitor to the government office and no steps have been taken (or such steps are inadequate) within a reasonable period of time, then the Monitor is entitled to inform the public and/or the public prosecutor's office about this situation. In addition, the civil society organisations must be entitled to *withdraw* from the pact process and explain in a public statement the reasons for the withdrawal.⁹⁸

§4 MAINTAINING COST EFFECTIVENESS

4.1 Key messages

- **A prudent public procurement approach will ensure that energy investments advance the country's sustainable development goals, including poverty reduction and environmental sustainability**
- **An electricity plan should follow, and be developed in the context of, the national development plan, and sectoral policies, strategies and plans so that it coheres with overall goals and prevents flawed and costly decisions from being made which lock us into long-term trajectories**
- **The 'learning curves' model should be applied to all energy technologies and will account for the changes in costs with new and improved technologies and economies of scale**
- **Accurate, complete and up to date energy demand projections and energy costing will make for sound, cost effective investment decisions**
- **There should be coherence between policy and practice with respect to competitive bidding with Public-Private Partnerships to create trust between business, government and the public, confidence in the system, and to prevent delays in the process**
- **The General Conditions of Contract should set out clearer conditions that require monitoring and inspection of contractual performance under a works or service contract**

4.2 Prudent procurement

Big investment decisions should be based on a sound and rigorous approach to issues of cost, risks and benefits, and intergenerational stewardship with regard to environmental goods.⁹⁹ This 'prudent' approach to public procurement takes place in the planning phase and helps to ensure that investments advance the country's sustainable development goals like poverty reduction and environmental sustainability.

For energy, the decision to procure new build has been based upon the *Integrated Resource Plan 2010-2030 (IRP 2010)*, which was promulgated on 6 May 2011. The IRP 2010 outlined a cost-optimised energy mix to meet South Africa's energy needs.¹⁰⁰ Toward that end, the IRP 2010 recommended a number of commitments to certain levels of nuclear, coal and renewable energy. However, the IRP2010 is contested on a number of grounds, most significantly on that of prudent procurement.

For starters, any plan for large scale public procurement for energy infrastructure should follow a broader national economic and social development vision, strategy and action plan.¹⁰¹ In our context, this takes the form of the National Development Plan (NDP) as developed by the National Planning Commission.¹⁰² However, the NDP was published well after the IRP2010 and in fact contains energy choices that conflict with that of the IRP2010, for example gas is preferred over nuclear energy. Once the NDP is formulated, several other intersectoral policies and plans need to be publicly consulted and formulated. The Climate Change Response Policy, for example, would need to be done ahead of, and inform, an Integrated Energy Plan (IEP), which would then inform the IRP2010. However the climate change policy was done concurrently and in fact, finalised after the IRP2010. The IRP2010 was finalised ahead of the IEP, which has yet to be developed almost two years later. This upside down policy defies prudent planning and can have staggering long term consequences for the economy, development and sustainability.

Further challenges include not adopting the 'learning curves' model to all energy technologies.¹⁰³ This model was only applied to renewable energy where costs are expected to go down with economies of scale and over time. "The reasons are unclear for reluctance to incorporate this crucial variable into the modelling process, and one is left to speculate concerning rationale and motive. This is an

undesirable and most unsatisfactory position when the country is being called upon to make difficult – and potentially vastly expensive – choices and trade-offs requiring decisions about the allocation of sacrifices and benefits across the most unequal society in the world.”¹⁰⁴ Some may argue that the learning curves model only applies to renewables because it is a relatively new and untested technology whilst coal and nuclear are well established. However ‘clean coal’ technologies such as Carbon Capture and Storage’ are also untested and could drive prices for coal up. Nuclear energy on the other hand can be described as an “anti-learning technology”¹⁰⁵ because it is notorious for massive cost overruns which are never accounted for in initial costing of plants.¹⁰⁶ In fact, the Minister of Finance has acknowledged that infrastructure projects have often experienced “significant cost over-runs”¹⁰⁷, a history that required improved planning, costing, and project management. The rest of the world has seen these types of overruns in nuclear power projects specifically. Generation III nuclear technology, which the IRP 2010 seems to promote¹⁰⁸, has been beset with cost overruns¹⁰⁹. This likelihood should be accounted for in the learning model type of approach.

The IRP2010’s demand projections for electricity also appear to be overestimated and outdated as they take inadequate account of historical experience that show that higher electricity prices tend to depress demand.¹¹⁰ The slow-down in production owing to the unfolding global depression is also a likely factor in decreasing rather than increasing demand. Energy efficiency measures can also reduce demand significantly.

The determination of the cost of nuclear power in the IRP 2010 is inadequate – it does not take into account the full/whole life cycle costs (more detail of this approach below) of nuclear reactors, which can amount to billions of Rand per reactor. Furthermore, the 2011 Fukushima nuclear disaster and the State’s Integrated Nuclear Infrastructure Review have led to changes in the approach to nuclear safety that increases the cost per reactor to build and maintain. A full appraisal of all life cycle costs of nuclear power includes waste management, decommissioning, project financing, insurance, and operational costs. The IRP 2010 itself acknowledges that it did not employ sufficient research to appropriately cost nuclear technology, particularly regarding decommissioning and waste management.¹¹¹ The IRP 2010 also does not factor in the probability or the cost of a nuclear disaster and the creating of emergency plans. The chances of a nuclear disaster simply cannot be ignored when weighing the value of nuclear power against its potential costs.

Box 8: Revising the Integrated Resource Plan is key to enabling cost effective procurement

Up to date and comprehensive information regarding the cost of procuring nuclear energy, and other energy choices, is needed making an iteration of the Integrated Resource Plan essential. The IRP 2010 explicitly acknowledged the many uncertainties in future planning, including uncertainties over demand and the cost of nuclear power. To compensate for these uncertainties, the IRP 2010 envisioned a maximum of two years between revisions. To facilitate the revision process, the IRP 2010 called for a “detailed mechanism or policy on revision.” The IRP 2010 also recommended the creation of a “permanent governance arrangement for the IRP” with “larger participation from civil society, business and labour.” To date, this revision policy has not been promulgated, and no IRP governance structure has been created. The scheduled revision of the IRP 2010, however, could account for the deficiencies outlined. When the IRP appropriately takes account of all relevant costs of a nuclear programme, it can provide the government with a recommended energy mix that accurately reflects the most cost-effective scenario.¹¹²

The dramatic expansion of the nuclear programme will have effects throughout the nuclear regulatory structure and will require expenditure beyond the simple construction of new nuclear reactors. Firstly, the CEO of the NNR said that the proposed nuclear build would require the regulator to increase technical capacity by 50 percent. He noted this increase would require a proportional increase in the NNR’s budget.¹¹³ Treasury’s allocations to the NNR, however, are stable through 2014.¹¹⁴

Without accurate information, it is impossible for the government to fulfil the requirement of cost-effective decision-making regarding large-scale energy provision.

4.3 Public Private Partnerships

Organs of the state generally have the choice to provide goods or services themselves (in-house) or to use an external provider. In compliance with the tenet of cost-effectiveness,¹¹⁵ the choice to procure from an external provider should only be made if it will bring about cost savings.¹¹⁶ Procuring from an external party is essentially a commercial transaction between an institution and a private party, where the private party performs an institutional function on behalf of an institution, known as a public-private partnership (PPP).¹¹⁷ Where a PPP is deemed appropriate by the procuring Department, there are three additional stages of Treasury oversight and approval that must be complied with.

Once a procurement contract for a PPP has been entered into, the accounting officer has ongoing responsibilities with respect to the implementation of the PPP. Moreover, the accounting officer still has a duty to ensure that the Department is functioning effectively and efficiently in the public interest.¹¹⁸ Finally, any amendments to the PPP agreement can only be made with the approval of the Treasury, and the Treasury will only agree to do so if the amendment will continue to provide value for money, affordability and substantial technical, operational and financial risk transfer to the private party.¹¹⁹ Ultimately, without the requisite Treasury approvals described above, a PPP agreement will not bind the State.¹²⁰ However, the Treasury may also, upon written request, exempt an institution from complying with any or all of those requirements.¹²¹ It is unclear how or why exemption would be given.

Box 9: Experience of the Renewable Energy Independent Power Producer Procurement Process (REIPPPP) with competitive bidding¹²²

Tender versus tariff

From the outset there was significant national conflict over whether a tender system which eventually won out, or a feed-in tariff system should be implemented for the REIPPPP. At the Department of Minerals and Energy (DME)-organised Renewable Energy Summit in March 2009, the then DME proposed a tender system as the preferred model, while private sector representatives, the South African Wind Energy Programme, the National Energy Regulator of South Africa (NERSA) and the Danish Embassy argued in favour of a feed-in tariff system (Renewable Energy Summit 2009). A feed-in tariff sets a fixed price for the purchase of renewable energy, which pays generators a higher rate than that of the retail price for each unit of electricity fed into the grid. Its aim is to “help spur technological development through rapid deployment and economies of scale, thus decreasing generation costs of renewable energy sources and improving their competitiveness compared to conventional electricity systems based on coal, gas, oil and nuclear”.¹²³

A tender system meanwhile is based on competitive bidding and means that potential project developers are invited to bid for a renewable energy contract.¹²⁴ In South Africa’s case, bids must demonstrate firstly how they will meet socio-economic development criteria and secondly offer a price below a certain cap. The bid that meets the requirements at the lowest price wins the contract. Eskom is excluded from bidding with its role confined to the buyer of power and connecting the projects to the grid.

NERSA: the ‘activist regulator’

The initial push for REFIT in 2006/7 came from individuals within NERSA’s Electricity Regulatory Division. In developing REFIT, NERSA was acting beyond its mandate given that under the 2006 Electricity Regulation Act, it is the DoE’s role to make policy and NERSA’s to implement it through licensing and regulation (RSA 2006). However by late 2010 REFIT had become high profile and apparently irreversible, with an estimated potential of 13000 MW of wind projects for an allocation of 700 MW. At this point the DoE supported by National Treasury who cited concerns over the programme’s financial implications altered national legislation in order to remove it from the jurisdiction of NERSA.

The Development Bank of South Africa (DBSA)¹²⁵ and the Danish, German and Spanish embassies provided technical and/or financial assistance for this process. Meanwhile the DoE released terms of reference for transaction advisors to the government for the procurement of independent power under REFIT. These advisors were to be appointed through the DBSA and managed by Johannesburg based law firm Webber Wentzel, who took up the role of legal advisor for the government-managed procurement process.¹²⁶ In December 2010 the government subsequently advertised for “a team of legal professionals with extensive knowledge of the regulatory environment and the licensing of activities needed to govern the electricity sector and enable private sector investment in the generation of renewable energy”.¹²⁷

4.4 Monitoring and inspection of contracts

Once the procurement contract is entered into, there are obligations on the state to ensure that the contract is running smoothly and that the cost-effectiveness of the procurement is maintained. In this regard, there are still various regulations to govern this part of the procurement process. The General Conditions of Contract (GCC), which provides for general conditions applicable to bid documents, provide two particularly relevant clauses for contract maintenance. First, the GCC provides that the contractor must furnish performance security within 30 days of being notified of the award of contract.¹²⁸ This security is intended to cover any loss suffered by the State as a result of the contractor's failure to comply with the terms of the contract.¹²⁹ Second, the GCC also provides for delays in contractual performance. The GCC states that should a contractor be prevented from performing on time, it must notify the organ of state, in writing, of the delay, the likely duration of the delay and the reasons for the delay, as soon as possible.¹³⁰

Thus, the GCC does anticipate some of the problems that may arise in the procurement process. However, a shortcoming of the GCC is that it proceeds on the basis that inspections, tests and analyses of the procurement contract are discretionary.¹³¹ While it is acknowledged that inspection and monitoring is not appropriate for all contracts, for example, one-off purchase transactions, long-term ongoing contracts would necessitate monitoring and inspection. Monitoring and inspection is necessary, not only to ensure compliance with the contract, but also act as a safeguard against objectionable or fraudulent behaviour.¹³²

It is proposed that the GCC should set out clearer conditions that require monitoring and inspection of contractual performance under a works or service contract.¹³³ Indeed, the State carries greater risk of incurring extra costs due to a failure to monitor and inspect timely contractual performance compared to the time and costs incurred as a result of carrying out regular inspections.¹³⁴

In the *National Treasury Instruction Note on Enhancing Compliance Monitoring and Improving Transparency and Accountability in Supply Chain Management*, the Treasury has observed that the absence of a prescribed threshold for the expansion or variation of orders against the original contract awarded had led to gross abuse of the procurement system.¹³⁵ Thus, to address this abuse, and mitigate against such practices, the Treasury has adopted the policy of only permitting variations of not more than 20% or R20 million for construction related goods, works and/or services and 15% or R15 million for all other goods and/or services of the original value of the contract, whichever is the lower amount.¹³⁶ Moreover, previously, any deviation in excess of these thresholds required written approval of the Treasury and would only be permitted where "good reasons exist".¹³⁷ However, in the recent SCM Circular of 24 April 2012, the Treasury postponed the implementation of this stipulation.¹³⁸ This postponement is unfortunate as it takes away much of the force of the policy.

In terms of costing the PBMR, Dave Nicholls, an early leader of the project, estimated in 1998 that the cost of getting the pilot reactor and fuel plant running would be R1,1 billion. In May 2005 this had escalated to R14,9 billion. Estimates doubled within four years, reaching R32 billion in August 2009. These estimates do not include operational costs, fuel costs, security provision, ultimate waste disposal, decommissioning or insurance. Given that we can expect real costs to rise (for example, the cost of electricity is set to escalate significantly between 2010 and 2014), it is highly likely that the 2009 estimate will be greatly surpassed should the facilities ever materialise. The poor record of financial management is also reflected in the runaway escalation of the costs of constructing the PBMR demonstration power plant and its fuel fabrication plant.

Box 10: Cost escalations for coal new build

The coal plants include the three mothballed plants but centre on Medupi and Kusile. These are 'lumpy' mega project investments and turn out to be typical with major cost escalations and time over-runs. First estimates (maybe thumb-sucks) were R30 billion for a big 'six-pack'¹³⁹ and the first was to be up and running by 2008. By 2007, the price tags on Medupi and Kusile were put at R79- and R84 billion respectively. They are now put at R118 and R158 billion including finance. Construction delays and the falling rand means it won't stop there. Total new build costs are in the order R700 or 800 billion.

Major loans from public sources: US\$ millions

| | Medupi | Kusile | Majuba | Renewable | Totals |
|--------------------------|--------|--------|--------|-----------|--------|
| World Bank | 3,000 | | 490 | 260 | 3,750 |
| African Development Bank | 2,600 | ? | | | 3,100 |
| Clean Technology Fund | | | | 250 | 250 |
| French & German ECAs | 850 | 850 | | | 1,700 |
| US ExIm | | 805 | | | 805 |
| Total | 6,450 | 1,655 | 490 | 510 | 9,605 |

National Treasury provided a R60 billion 'subordinated loan' (effectively equity) and put up guarantees of R176 billion which did little more than cover Medupi and had to double it to R350 billion to enable Eskom to raise money for Kusile. The first set of guarantees was in response to World Bank requirements. Having previously avoided loans of this nature from the Bank, the South African government embraced it when the easy money dried up in 2008. The table shows loans and guarantees (even the guarantees are guaranteed by National Treasury) from foreign public sources.

A large number of private banks provided funding with European banks generally being covered by ECA guarantees. South Africa's major banks are also major (presumably rand) funders and the PIC is also betting public service pensions on Eskom.

The big foreign contracts are with Alstom of France for the turbines and Hitachi Africa for the boilers to be built by Hitachi Europe in Germany. These contracts are for both Medupi and Kusile. This 'fleet' option was said to reduce costs compared with issuing separate tenders for each plant – suggesting that turbines and boilers come cheaper by the dozen. But this would have raised the cost of cancelling Kusile when it looked unaffordable. Effectively it meant that, instead of two lumpy mega projects, Medupi-Kusile became a single double-mega project. In so far as they were trapped by the fleet deal, Eskom (and Treasury) were then vulnerable to further escalations in borrowing costs.

Construction for coal mega projects consumes vast quantities of material – 350,000 tons of reinforced concrete at Medupi. Sand winning on a massive scale from the Mokolo River has severely affected the river ecology. Following a two year free for all, the Department of Environmental Affairs has issued a compliance order against the largest sand miner and is acting to stop seven other operators. This seems an extraordinarily cumbersome approach since operators can be formed, or renamed, overnight. If the sand does not come from the Mokolo, it will have to come from somewhere else.

§5

MEETING SUSTAINABILITY NEEDS

5.1 Key messages

- Sustainable public procurement (SPP) is gaining traction worldwide as a sound and beneficial way to integrate environmental, social and economic considerations into public procurement processes and decision making
- SPP will ensure cost savings, efficiencies, environmental protection and wider social benefits in the long term for society
- Whole/Full life costing is important for determining the consequences or impacts of investments across the supply chain and can prevent the undertaking of risky investments
- The integrity of Environmental Impact Assessments must be maintained when making strategic energy investments
- Use of the 'precautionary approach' to planning in public procurement will ensure that significant intergenerational impacts on environmental safety, climate change and public expenditure are taken into account
- Renewable energy can be 'people's power' if it promotes social ownership and control at a best, and local job creation at a minimum

5.2 Sustainable public procurement (SPP)

Given the threat of climate change and environmental collapse there is a growing demand for governments' to adopt an approach to procurement that favours sustainability. Sustainable public procurement is essentially about spending the public's money in a way that benefits society in the long run. As such, it involves the integration of environmental, social and economic considerations into its processes and decision-making¹⁴⁰ so that 'responsible' choices are made when procuring infrastructure, goods and services. The focus until recently has been on environmentally preferable alternatives or 'green procurement' but social sustainability is also coming into focus.¹⁴¹ Whole life costing is a key component of SPP and is key to establishing the 'hidden' impacts or consequences on the environment such as the costs for decommissioning a nuclear plant, cleaning up acid mine drainage and health impacts of coal plants. For SPP and whole life costing to become standard practice in public finance widespread reforms to public expenditure management and budgeting are needed.¹⁴² However, this approach will ultimately ensure cost savings and improve efficiencies in the long term.¹⁴³

Table 4: Countries leading the way in the use of Sustainable Public Procurement-IISD Survey¹⁴⁴

| | |
|-------------|---|
| Switzerland | <ul style="list-style-type: none"> • Sustainable public procurement is identified as a part of the national sustainable development strategy • Procurement targets have been established which are based on reducing environmental and social risk assessment across the product life-cycle. Countries of origin, and a list of "risk countries" has been compiled. • Procurement staff is provided with training on sustainable procurement. • Mechanisms are in place for each administration to monitor and audit their performance in meeting procurement targets, though there is no requirement for performance disclosure. |
|-------------|---|

| | |
|---------|---|
| Austria | <ul style="list-style-type: none"> • The Austrian Procurement Act makes provisions for environmental targets and standards to be included in tender specifications and award criteria. The act also states conditions under which social responsibility elements can be included. These are based on compliance with national and international labour and consumer protection laws. • Each administration is also required to provide training on sustainable procurement to all procurement staff. • There are no provisions for performance monitoring and reporting. |
| Finland | <ul style="list-style-type: none"> • Interest in sustainable procurement began in 2005 through a multi-stakeholder working group set up by the Ministry of Trade and the Ministry of the Environment. While the primary focus of the working group was to promote broad-based thinking on design for the environment and promote the uptake of environmental technologies, the working group also proceeded to make proposals to the government suggesting that SPP would be an important boost to the wider commercialization of low-impact products. • This saw the birth of the national program on sustainable procurement, which is working to establish procurement criteria for a range of products. The national procurement program is to be implemented by 2010 |

Box 11: Implications of South Africa's draft Infrastructure Development Bill for sound, participatory and environmentally sensitive planning

The Environment and Infrastructure Development Bill has been developed to expedite the SIPs in which a process flow for authorisation of the projects must occur within 220 days, from "approval of the project plan" to "regulatory decision". Whilst fast tracking development projects have merit in delivering long needed services and infrastructure support to poor households, according to the Centre for Environmental Rights the Bill, "effectively disregards decades of national policy development in relation to environmental management and sustainable development, and existing government commitments to sustainable development and environmental management." Despite constitutional, legislative and planning repeated exhortations, the Bill does not contain a reference to sustainable development.

CER also points out its fundamental challenges to Constitutional rights. The Bill contains a potential violation of the right to an environment not harmful to health or well-being, and to have the environment protected for future generations through reasonable legislative and other measures as contained in the [National Environmental Management Act, 1998](#) and its EIA regulations, already in their third iteration. The Bill contradicts procedures for the EIA's and also provides insufficient time for proper scientific assessments of impact on the environment and gauging the opinions of affected parties.¹⁴⁵ In the latter instance it also poses a potential violation of the right to just administrative action. There is also a potential violation of the cooperative governance provisions in the Constitution, including by giving insufficient recognition of local authorities' Constitutional powers to regulate local land use planning.

EIA's help to ensure that environmental issues are identified as early as possible in planning processes. This saves later costs, delays and re-work, and costly and slow legal challenges.¹⁴⁶ Yet the EIA's have already been watered down since the first democratic regulations to streamline and speed up processes which poses significant problems for environmental protection.¹⁴⁷ This new bill will effectively turn EIAs into a rubber stamping exercise and poses a threat to efforts to integrate SPP into procurement processes.

5.3 The precautionary approach

The precautionary approach is a well-established and respected environmental principle which can and must be applied to public procurement for energy. The [Rio Conference](#) or "[Earth Summit](#)" in 1992 established a global foundation for the principle and articulated as follows:

*"In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation."*¹⁴⁸

Key elements of the precautionary principle that are particularly relevant to public procurement include the following:

- *Taking anticipatory action to prevent harm in the face of scientific uncertainty*
- *Exploring alternatives, including the alternative of “no action.”*
- *Considering the full cost of environmental and health impacts over time*
- *Increasing public participation in decision making*
- *Shifting the responsibility for providing evidence to the proponents of an activity*¹⁴⁹

The IRP2010, however, violates the precautionary approach for procurement planning¹⁵⁰ by deciding on a fleet of nuclear power stations and mega coal power plants. These choices incur significant intergenerational impacts on environmental safety, climate change and public expenditure and a more measured approach taking into consideration changes in the global environment would have been preferable.

Apart from carbon emissions, these projects will add substantially to local air pollution. Kusile is the first Eskom plant that will be built with sulphur scrubbers. Eskom promises that Medupi will be retrofitted – after 6 years of unmitigated pollution. Lephalale has been declared the latest air quality priority area (i.e. pollution hotspot) in anticipation. Scrubbed sulphur will need to be dumped. Scrubbers are water intensive and will double Medupi’s consumption to 12 mm³ – equal to the present consumption of both Matimba and the town of Lephalale which is already water stressed. Water Affairs promises to deliver the water through a series of ‘augmentation’ schemes and the engineering stretches back to the Lesotho Highlands. This bill is not included in the price of Medupi. Come 2018, we will see whether Eskom deems the scrubbers to be ‘feasible’.

5.4 Localisation

Public procurement needs to serve local needs for sustainable job creation as well as safeguarding human health and safety. In South Africa the Black Economic Empowerment Act 2003 provides for larger participation of black people in the economy, and procurement. According to the IISD, “The act makes reference to the establishment of an “Economic Empowerment Advisory Council,” which could advise on codes of good practice, which includes qualification criteria for procurement. This entails that in the process of sustainable procurement, preference could be given to black people in order to enhance their employment opportunities, which could contribute towards the “sustainable development” of the black community.”¹⁵¹

However, affirmative action policies that are applied to procurement in South Africa are often subverted giving rise to the significant corruption and the manipulation of tenders. These policies include the Preferential Procurement Policy Framework (PPPFA) Act No 5 of 2000 and the Broad Based Economic Empowerment (BBBEE) Act No 53 of 2003.

The PPPFA was legislated to favour the awarding of tenders to previously disadvantaged groups. As such, it introduces a dual scale preferential points system in which government can take into account other factors other than price when awarding contracts. The law does anticipate the problem of ‘fronting’ where false information is presented in order to be favoured and win the tender. However, the problem of ‘fronting’ goes deeper than accounted for by the law. According to Pienaar,¹⁵² “Business entities are incentivised by preferential procurement laws to permanently restructure themselves in such a way as to position themselves to be able to compete effectively for lucrative state tenders. Frequently, these restructuring exercises take the form of ‘empowerment’ deals involving the allocation of large share options to black ‘empowerment partners’. Often it is alleged that these partners offer little expertise, but do offer significant access to state business by reason of connections with influential public servants, or with the ruling party.”

The objectives of the BBEE Act are to “facilitate broad based black economic empowerment in ways that extend ownership and management to new entrants to the economy, including women and rural communities.”¹⁵³ The Act’s characterisations of black empowerment are both descriptive and vague and likely result in the experienced misuse of the Act to serve a narrow capitalist elite instead of broad based black empowerment.

The resulting unintended effect of these affirmative action policies is a kind of crony capitalism characterised by a small number of wealthy individuals, some of whom are in ruling party, that collude with the state to win tenders. Encouraging and legislating more openness, transparency, internal and public oversight to encourage greater accountability seems an obvious way to untangle this kind of politico-economic corruption. Disclosure of interests regulations (discussed previously) are particularly pertinent. But severe sanctions also need to support such regulations.

Box 12: Industry reaction and concerns of Bidwatch to the Renewable Energy Independent Power Purchase Procurement¹⁵⁴

Industry reaction

Following the launch of RE IPPPP the South African Wind Energy Association (SAWEA) stated that the original REFIT was relatively speaking less complex, lower in compliance costs and greater in investor certainty. “While REFIT was “exhaustively workshopped”, RE IPPPP was “unilaterally handed down”.¹⁵⁵ The alignment and trust with the renewable energy industry engendered by the NERSA’s REFIT process was compromised by RE IPPPP’s “unilateral process without any public consultation and with uncoordinated statements in the press” (ibid.). Moreover when the process was under NERSA many of the relevant documents were publicly available and followed by public hearings but the final RE IPPPP documents are subject to a fee of R15000 and stringent confidentiality requirements. Despite such complaints, SAWEA still conceded that it had not yet found a single issue of ‘unbankability’ and hoped the programme would succeed,¹⁵⁶ a tacit indication that a compromise had evidently been reached. SAWEA also declared that the localisation and socio-economic requirements were “very high”¹⁵⁷ and saddled a young industry with a heavy and unanticipated compliance burden. Since then stakeholders have highlighted the challenges to increasing localisation targets, to include the vertically integrated nature of the global wind industry, problems of transport and infrastructure, and lack of national expertise and experience.¹⁵⁸ That said, since financial close was reached in November 2012 IPPs have commended government for providing greater clarity over the process and upholding their commitment to renewable energy.¹⁵⁹

Current concerns: ‘Bidwatch’

In February 2012 the National Union of Metal Workers of South Africa (NUMSA) said that workers and communities are at risk of being left behind and “being forced to pay the costs of the sector’s expansion”.¹⁶⁰ At the Union’s 2012 annual conference its president Cedric Gina asked “Do communities stand to benefit or is this another capitalist grab to enrich a few?” He continued, “for whom is the renewable energy being produced? Is it for big corporations who get the electricity at a discount or is it to give access to those who presently do not have access?”¹⁶¹ In response to this, NUMSA has set up a ‘RE-BID Watch’ in order to monitor the REIPPPP process and calls for social ownership and control to be at the centre of the emerging renewable energy industry. In particular renewable energy enterprises must have service provision and basic human needs as part of their core mandate and should ensure that an equitable dividend accrues to communities and workers directly involved in production and consumption of energy.¹⁶² Socially-owned renewable energy entities should also be given priority access to the grid.

COSATU¹⁶³ states that a campaign to protect jobs and support workers whose livelihoods will be affected by a “just transition” to a low carbon economy is needed, and that “if we do not do that, then these workers will resist the transition”. Similarly, Cock¹⁶⁴ states that “we also have to ensure that the development of new, green industries does not become an excuse for lowering wages and social benefits. New environmentally-friendly jobs provide an opportunity to redress many of the gender imbalances in employment and skills”. Andre Otto of SAWEA endorsed this concern, “the unions (in South Africa) should be concerned. In Denmark the first developers of wind turbines were farmers – then it became big. The question here (in South Africa) is how we bring communities (into the fold). We need to take (the development) to those communities – to see how we can assist them.”¹⁶⁵

§6 CONCLUSION: TOWARDS GUIDELINES FOR BEST PRACTICE IN ENERGY PROCUREMENT FOR SOUTH AFRICA

6.1 Summary

The Strategic Infrastructure Project Programme or SIPs is an ambitious solution to address poverty and economic development in South Africa. The SIPs electricity project calls for an unprecedented amount of public spending that will go into building nuclear, renewables and coal fired power plants in the order of trillions of Rands and will no doubt have massive ramifications on the fiscus and other spheres. South Africans are already facing the effects of staggering electricity price hikes which is making electricity unaffordable for the poor and effectively making the case that increased provision of electricity will not necessarily improve access. In any case, big industrial users will likely be the principal beneficiaries of the new electricity, as the biggest consumers that are secured by preferentially low electricity prices. Expansion of coal fired power will further damage the country's poor climate profile – SA is one of the top twenty polluters in the world - and will create long term environmental damage that future generations will be forced to suffer. Nuclear energy is also risky technology for the environment. The construction of plants is vastly expensive, particularly given costly time over-runs and the implementation of new safety standards post-Fukushima nuclear disaster. The 20 year power plan does not even include a halfway decent costing of the nuclear project, which should additionally include full life costing so that decommissioning of plants is factored in.

The new build programme for electricity also sits within a context of an increasing lack of transparency and accountability that insulates and enriches a group of wealthy political and business elite. The brazen flouting of conflicts of interest regulations is reflected in the creation of a breed of, what ordinary citizens call, *tenderpreneurs* who traverse the state and business divide and collude with each other in order to benefit from mega project deals. In this instance, bribes are common to win tenders but other forms of political corruption such as rigging the tender process also flourish. Notorious examples include the arms deal and soccer world cup. Big energy construction projects, as with other mega projects, are also susceptible to abuse because there are such big amounts of money flowing that corruption is easier to hide.

For the SIPS energy projects to contribute to sustainable development they will need to address these vexing issues and to engender democratic building. The constitutional and legislative principles for sound, effective and just public procurement are a guiding light and should be used to bring the endeavour back in line. The reform initiatives of National Treasury, the Department of Public Service and Administration and Auditor-General are also recognised and should be supported. Our study provides additional guidance to reform public procurement and, in particular, to ensure that the electricity projects meet with social, environmental and economic goals. Our recommendations are informed by understandings of the procurement framework and recent experience in the procurement of coal, nuclear and renewables. As such they offer insights into the nature of procurement system as it is outlined and practiced. In addition, our recommendations offer internationally articulated and utilised strategies to strengthen and improve public procurement processes. These precedents are valuable for engendering best practice for local public procurement and for synergising with international trends for reform.

In summary, we are guided by the following key insights:

- Transparency is essential in public procurement as a first step towards increasing accountability in public spending and towards socially and environmentally just investments
- There is a democratic imperative for energy contracts to be transparent because the public has a right to know how the government is selling their resources and what their public funds are being spent on
- Accountability is the cornerstone of a sound public procurement framework in a democracy and is a measure of the responsiveness of the government to national needs

- Civil society has a key role to play in monitoring public procurement, particularly for mega projects where there are high stakes and keen public interest, where they can 'blow the whistle' on corrupt deals and assist with keeping the process accountable to the public and developmental societal goals
- A prudent public procurement approach will ensure that energy investments advance the country's sustainable development goals, including poverty reduction and environmental sustainability
- Sustainable public procurement (SPP) is gaining traction worldwide as a sound and beneficial way to integrate environmental, social and economic considerations into public procurement processes and decision making. SPP will ensure cost savings, efficiencies, environmental protection and wider social benefits in the long term for society
- Use of the 'precautionary approach' to planning in public procurement will ensure that significant intergenerational impacts on environmental safety, climate change and public expenditure are taken into account

6.2 Policy recommendations towards best practice for energy procurement

We encourage critical engagement with our policy advice and recommend that the following initiatives be implemented to enable a sound, effective and just public procurement for energy:

To enhance transparency:

- Public procurement portals which house openly accessible data online, such as the one in Slovakia, should be used for driving public oversight and creating trust in procurement processes
- The disclosure of public officials' interests must be closely monitored and effective sanctions for offenders applied so that corruption in the awarding of tenders is curbed
- Party political funding should be regulated to avoid the unfair and corrupt practice of government contracts being awarded to political parties
- Energy contracts should be transparent, as it is in Peru, because the public has a right to know how the government is selling their resources and what their public funds are being spent on

To build accountability:

- Civil society observers should be allowed to have access to all relevant procurement documents and to monitor the entire process as it is legislated in the Philippines and as prescribed by the Integrity Pact tool
- National Treasury needs to provide greater oversight over parastatals including Eskom to ensure that they procure energy in the public's interest and not to seek profit maximisation like a corporate entity.
- The Department of Energy's new generation regulations need to be substantially revised to minimise the allowance and application of discretionary power in the procurement of energy

To maintain cost effectiveness:

- An electricity plan should follow, and be developed in the context of, the national development plan, and sectoral policies, strategies and plans so that it coheres with overall goals and prevents flawed and costly decisions from being made which lock us into long-term trajectories
- The 'learning curves' model should be applied to all energy technologies and will account for the changes in costs with new and improved technologies and economies of scale
- Accurate, complete and up to date energy demand projections and energy costing, to be undertaken through a regular revision of the Integrated Resource Plan, will make for sound, cost effective investment decisions
- There should be coherence between policy and practice with respect to competitive bidding with Public-Private Partnerships to create trust between business, government and the public, confidence in the system, and to prevent delays in the process
- The General Conditions of Contract should set out clearer conditions that require monitoring and inspection of contractual performance under a works or service contract

To meet sustainability needs:

- Whole/Full life costing is important for determining the consequences or impacts of investments across the supply chain and can prevent the undertaking of risky investments
- The integrity of Environmental Impact Assessments must be maintained when making strategic energy investments
- Renewable energy should promote social ownership and control at a best, and local job creation at a minimum

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