

## CHAPTER 5

### SELECTION OF PRIME CONTRACTORS – LIGHT UTILITY HELICOPTERS

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## CHAPTER 5

### SELECTION OF PRIME CONTRACTORS – LIGHT UTILITY HELICOPTERS

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

#### 5.1 BACKGROUND

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

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

5.1.3 Three companies were short-listed, namely:

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

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

5.2.2 Staff Target 3/95

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

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

5.3 ACQUISITION PHASE

5.3.1 Staff Requirement 3/95

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

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

(a) Finances

The following table indicated the breakdown of costs:

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

### (b) Facilities

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

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

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

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

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

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

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

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

### 5.3.2 User Requirement Statement

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

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

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

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

### 5.3.3 Request For Information (RFI)

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

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

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

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

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

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

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

- Agusta.
- Bell Textron Canada.
- Eurocopter.

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

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

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

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

**5.3.4 RFI evaluation results: September 1997**

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

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

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

5.3.4.4 Results of the RFI technical evaluation were as follows:

(a) The operational effectiveness index (OEI)

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

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

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

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

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

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

### 5.3.5 Project Study Report

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

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

### 5.3.6 Acquisition Plan

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

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

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

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

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

### 5.3.7 RFO

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

- Agusta
- Bell Textron Canada
- Eurocopter

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

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

### 5.3.8 Technical evaluation

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

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

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

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

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

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

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

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

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

5.3.8.10 Evaluation results

(a) Operational effectiveness index

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

(b) Life-cycle cost calculation

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

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

### (a) Product maturity

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

### (b) Technology

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

### (c) Qualification

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

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

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

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

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

### 5.3.9 Financial evaluation

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

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

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

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

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

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

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

- A complete set of the relevant RFO financing proposals.

5.3.9.6 The financing team developed a value system against which the proposals would be evaluated. The criteria were detailed in the Request for Best and Final Offer.

5.3.9.7 The value system contained a set of critical criteria and discriminating criteria that had to be addressed by the bidders and assessed by the evaluation team (Refer to chapter 4).

5.3.9.8 The bidders were required to submit specific financial information in their proposals. The findings of the evaluation team regarding non-conformance by the bidders in this regard were reported at a SOFCOM meeting held on 3 June 1998. The team tabled a number of non-conformances, shortfalls in cash flow and general issues that impacted on the financing evaluation.

5.3.9.9 The finance report dated 29 June 1998, confirmed: *"several non-conformances even with our critical criteria and that it did not seem practical to disqualify most of the proposals. These non-conformances were reported to the SOFCOM on 3 June 1998. The SOFCOM indicated that we should continue and evaluate as much of the proposals as possible with indication of their non-conformances "*

5.3.9.10 As has been discussed in chapter 4, the best value formula has been changed, based on sound reasons.

### 5.3.10 DIP evaluation

5.3.10.1 Agusta, Bell and Eurocopter submitted the required DIP proposals.

5.3.10.2 The following investigation procedures were performed in respect of the DIP evaluation process:

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

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

### 5.3.11 NIP evaluation

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

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

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

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

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

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

## 5.4 APPROVAL PHASE

### 5.4.1 Procedures performed in respect of the approval phase

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## 5.5 NEGOTIATION PHASE

### 5.5.1 Introduction

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

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

### 5.5.2 Investigation procedures performed in respect of negotiation phase

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

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

### 5.5.3 Ministerial briefing presentation – 31 August 1998

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

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

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

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

### 5.5.4 DoD presentation to the Cabinet – 18 November 1998

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

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

### 5.5.5 IONT progress report – August 1999

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

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

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

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

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

### 5.5.6 Cabinet briefing – 15 September 1999

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

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

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

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

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

**5.5.7 LUH contracts – 3 December 1999**

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

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

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

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

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

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

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

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

## 5.6 CONTRACT PHASE

### 5.6.1 Decision of Cabinet meeting of 1 December 1999

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

*"The Cabinet*

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

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

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

### 5.6.2 Defence Industrial Participation terms of agreement

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

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

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

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

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

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

### 5.6.3 National Industrial Participation terms of agreement

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

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

### 5.6.4 Financing buyer credit agreement

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

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

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

### 5.6.5 Changing of contracting parties

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

### 5.6.6 Programme Plan

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

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

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

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

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

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

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

## 5.7 FINDINGS

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

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

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

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

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