

CHAPTER 6

SELECTION OF PRIME CONTRACTORS: SUBMARINES

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CHAPTER 6

SELECTION OF PRIME CONTRACTORS: SUBMARINES

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

6.1 BACKGROUND

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6.2 SCOPE OF INVESTIGATION

6.2.1 The scope of the investigation covered the following:

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

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

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

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

6.3 INDUSTRIAL PARTICIPATION (IP)

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

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

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

6.3.1.3 Defence Industrial Participation Confirmation by Bidder Form.

6.3.1.4 Format for DIP business plans.

6.3.1.5 Format for DIP target planning schedule.

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

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

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

6.4 NON-DEFENCE INDUSTRIAL PARTICIPATION (NIP)

6.4.1 NIP evaluation results

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

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

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

6.4.2 Review of the NIP evaluation working papers

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

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

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

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

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

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

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

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

6.4.3 NIP contract values vs NIP offered values

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

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

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

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

* Refer to note 3 on table in paragraph 6.4.1

** Based on contract values

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

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

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

6.4.4 Investment credits

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

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

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

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

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

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

6.4.5.1 Approval of the NIP value system

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

6.4.5.2 Exclusion of 50% of DCN

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

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

6.4.5.3 *The business concept phase*

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

6.4.5.4 *Acceptance and rejection of projects*

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

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

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

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

6.4.5.6 Strategic considerations

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

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

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

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

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

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

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

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

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

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

6.4.5.7 Initial independent assessment of steel industry projects

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

6.4.5.8 Substitution of the Coega stainless steel project

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

- The submission also indicated that Columbus Stainless would be Ferrostaal's operating partner.
- The submission recommended that EXCO should consider *"the GSC latest proposal and accept that: the following are to the satisfaction of the committee, indicate commitment, and adequate equity contributions in respect of the NIP Project, thus enabling the triggering of the purchase contract:*

- (i) Cold Mill [Par. 5.1]*
- (ii) Downstream projects [Par.5.2]*
- (iii) Additional Projects – subject to full business plans [Par.5.3]*

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

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

6.4.5.9 Presentation by DoD to Cabinet dated 18 November 1998

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

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

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

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

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

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

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

6.4.6 Defence industrial participation

6.4.6.1 Summary of DIP value system

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

6.4.6.2 Approval

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

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

6.4.6.3 *General provisions*

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

6.4.6.4 *Organisation structure of the DIP evaluation team*

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

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

6.4.6.5 Evaluation team

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- x i) *No specific details were given on how they planned to fulfil the indirect DIP, although there were many intentions.*
- x ii) *GSC again confirmed that, at that stage, they were only prepared to commit themselves to a firm 7% DIRECT DIP (\$59 million) and 12% INDIRECT DIP (\$102 million) as overall figures without any allocation to any individual activity, although they felt confident that they could exceed these figures as time passed."*
- (b) The reasons furnished by the DIP evaluation team for requesting a legal opinion regarding the Kockums offer were, *inter alia*, the following:
- "Kockums submitted business proposals containing:*
- *Three direct projects valued at \$152 million; and*
 - *Twelve indirect DIP projects valued at \$1 094 028.*
- i) *The company did not submit a completed "Bidders Confirmation" form and accordingly all the information called for in this form was non-existing (i.e. percentages split, details of guarantee, acceptance of general conditions, target planning schedule, etc.)*
- ii) *Following their verbal committal to the individual amounts making up the totals under the first bullet above it was possible to evaluate the 15 projects as submitted, although there seemed to be a very high risk on some of the projects such as sale of Rooivalk for \$700 million."*

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

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

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

(b) *RE: SUBMARINE - KOCKUMS*

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

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

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

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

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

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

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

“Deviations

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

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

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

6.4.7 Finance evaluation

6.4.7.1 Approval of value system

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

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

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

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

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

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

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

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

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

6.4.7.6 *Flaw in the value system*

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

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

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

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

6.4.8 Technical evaluation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6.5 APPROVAL PHASE

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

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

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

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

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

6.6 NEGOTIATION PHASE

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

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

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

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

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

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

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

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

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

6.7 CONTRACTING PHASE

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

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

6.7.3 The delivery periods for the submarines are:

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

6.7.3.2 Second submarine: six years after EDC.

6.7.3.3 Third submarine: seven years after EDC.

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

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

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

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

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

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

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

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

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

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

6.8 FINDINGS

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

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

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

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

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

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

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

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

6.9 RECOMMENDATIONS

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