TRANSACTION ADVICE AND DEVELOPMENT OF ENERGY PERFORMANCE CONTRACT PROCUREMENT DOCUMENTS FOR PUBLIC SECTOR ENERGY EFFICIENCY (“Project”)

ESCO PROCUREMENT OPTIONS REPORT

Prepared for Deutsche Gesellschaft für Internationale Zusammenarbeit by Pinsent Masons Africa LLP

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GLOSSARY

BBBEE	Broad-based Black Economic Empowerment
Constitution	The Constitution of the Republic of South Africa, Act 108 of1996
CSD	The Central Supplier Database
DMRE	Department of Mineral Resources and Energy
EE	Energy Efficiency
EEDSM Grant	Energy Efficiency Demand Side Management Grant as specified in the annually gazetted Division of Revenue Act
EEPBIP	Energy Efficiency in Public Buildings Infrastructure Programme
EEPSU	The Energy Efficiency Project Support Unit within the DMRE
EME	An exempted micro enterprise in terms of a code of good practice on black economic empowerment issued in terms of section 9(1) of the Broad-Based Black Economic Empowerment Act
EnPC	Energy Performance Contract
ESCO	Energy Services Company
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
IDC	Industrial Development Corporation
MFMA	Local Government: Municipal Finance Management Act 53 of 2003
Municipal SCM Regulations	Municipal Supply Chain Management Regulations published under GenN 868 in GG 27636 of 30 May 2005 and with effect form 1 July 2005
OCPO	Office of the Chief Procurement Officer within the National Treasury.
PFMA	Public Finance Management Act 1 of 1999
PPPFA	Preferential Procurement Policy Framework Act 5 of 2000
PPPFA Regulations	Preferential Procurement Regulations published under Government Gazette No. 40553 of 2017 in terms of section 5 of the PPPFA
Procurement Threshold Instruction	National Treasury PFMA SCM Instruction No. 2 of 2021/2022: Threshold Values for the Procurement of Goods and Services by Means of Petty Cash, Written Price Quotations or Competitive Bids
QSE	A qualifying small business enterprise in terms of a code of good practice on black economic empowerment issued in terms of section 9(1) of the Broad-Based Black Economic Empowerment Act
RFP	Request for proposal

SCM	Supply chain management
SCM Instruction	SCM Instruction No. 02 of 2021/22
SCM Guide	Supply Chain Management: A Guide for Accounting Officers, National Treasury, February 2004
TR16	Treasury Regulation 16 (Public-private Partnerships) of the Treasury Regulations to the PFMA
TR16A	Regulation 16A (Supply Chain Management) of the Treasury Regulations to the PFMA
Transversal Contract Circular	National Treasury Circular No. 3 of 2016 on Utilization of Transversal Term Contracts
Transversal Contract Guide	Guide to Participation in Transversal Term Contracts Facilitated by National Treasury, March 2017

1. INTRODUCTION

1.1 We understand that the EEPBIP is made up of the following phases: Phase 1: Project Development; Phase 2a: Tendering and Contracting; Phase 2b: Financing; and Phase 3: Commissioning and Operation.

1.2 Phase 1 (Project Development) commences the engagement between DMRE (with support from GIZ) and relevant institutions. We understand that once projects are identified they will advance to project development under the EEPBIP (although "small cap" municipal projects can also instead apply for direct funding under the EEDSM grant). Where projects proceed through EEPBIP project development, they will undergo an energy audit i.e. measurement and verification (M&V) which will inform the development of a concept note. The concept note is then developed into a business case by a consultant (procured by the relevant institution). Where the institution takes a decision to procure using an EnPC, the project is then packaged for Phase 2a.

1.3 Under Phase 2a (Tendering and Contracting) before going to market, some preparatory work is envisaged in the form of (a) developing a tender document (which will be tailored from a standard set of tender templates and contracts depending on the recommendations under the business case) and (b) developing a procurement methodology which is efficient enough to roll out to numerous institutions, which may entail the relevant institution or a central body establishing a panel of ESCOs, open competitive bidding, or transversal contracts. During the tendering and contracting process, procuring institutions will receive technical support and assistance from the EEPSU within DMRE.

1.4 Where the duration of the EnPC will extend beyond 3 years, then at local government level they will first need to comply with the process under section 33 of the MFMA before releasing the tender document. Tender documents will be made available to a pre-appointed panel of ESCOs who will be asked to prepare a fully developed technical proposal to meet the tender requirements. Proposals will be evaluated by the procuring institution and a short-list of ESCOs invited to submit financial proposals in support of their technical proposal. The financial proposals will be evaluated, and the preferred bidder(s) announced, followed by the signing of the EnPC.

1.5 Under Phase 2b, once an ESCO has a signed EnPC it will need to raise the finance for funding the EE interventions. Some preparatory work will have been done during Phase 2a in that the shortlisted ESCOs will have had preliminary engagements with financial institutions in order to set out their financial offer. Once appointed under an EnPC, ESCOs will be required to prepare and submit their application for funding to the relevant financial institution. Where the funding institution is the IDC, such funding may be underwritten by a Partial Credit Guarantee facility which is separately administered by another team in the IDC. Once the loan application is approved and the finance agreement concluded, the project will be ready for Phase 3, that is, commissioning and operations.

1.6 While the proposed process as explained above is broadly understood to be the steps or stages in each Phase of the roll out of the EEPBIP, it is part of our mandate to not only confirm whether the envisaged process is legally feasible, but how best to optimise these processes. This Report addresses Phase 2a of the EEPBIP process, and in particular the regulatory framework as it relates to (i) the establishment of the procurement process, including options for the use of transversal contracts, ESCO panels, or two-stage open competitive bidding, and (ii) the tender documentation based on a performance-based contracting model. In particular, the Report seeks to:-

1.6.1 determine the most efficient and effective way in which to structure the procurement of ESCOs, in an effort to reduce the lead time between releasing a tender document into the market at the beginning of Phase 2a and signing an EnPC. In essence, this involves an upfront vetting of ESCOs' capability both technically and financially to supply, finance, install and maintain the EE interventions. We have set out three different mechanisms within the South African procurement law framework which allow for the establishment of an ESCO panel, or variation thereof; and

1.6.2 consider how best to structure the EE interventions and / or technology specifications to be contained in the tender documents, as arising from the recommendations in the business case. In other words, whether it is possible, and if possible, desirable to provide ESCOs with the autonomy to determine the EE interventions to achieve the greatest saving or whether it is desirable for procuring institutions to be more prescriptive as to the scope or specification of such EE interventions. We consider the balance between performance-based contracts which seek to achieve significant risk transfer to the private sector and thus should encourage innovation as far as possible, with the broad approach of supply chain management in South Africa which requires a clear and certain input scope.

2. OPTIONS FOR STREAMLINING THE EEPBIP PROCUREMENT PROCESS: ESTABLISHMENT OF A PANEL OF ESCOS

2.1 Option 1: Transversal term contract

2.1.1 A transversal term contract can be defined as a "*centrally facilitated contract arranged by the National Treasury [or relevant treasury] for goods or services that are required by one or more than one institution*".[1] Thus, transversal term contracts are distinguished by being (i) centrally negotiated, meaning that rather than an individual procuring institution running the procurement process (preparing documents, advertising for bidders, evaluating and awarding the contract), this is instead done by a central, senior institution which appoints the service provider under a framework agreement; and (ii) "transversal" in nature, meaning that they are "cross cutting" contracts for goods or services which are relatively homogenous and which a significant number of institutions will require on the same or similar basis.

2.1.2 Public institutions can choose to participate in transversal contracts both in terms of national / provincial legislation and municipal legislation:-

(a) TR16A dealing with supply chain management provides that an "*accounting officer or accounting authority may opt to participate in transversal term contracts facilitated by the relevant treasury. Should the accounting officer or accounting authority opt to participate in a transversal contract facilitated by the relevant treasury, the accounting officer or accounting authority may not solicit bids for the same or similar product or service during the tenure of the transversal term contract*".[2]

(b) TR16A is only applicable to national and provincial departments, constitutional institutions, and public entities listed in Schedules 3A (national public entities other than major public entities and national government business enterprises) and 3C (provincial public entities other than provincial government business enterprises) of the PFMA.[3] Thus, any such institutions are permitted to participate in transversal term contracts where arranged by either National

Transversal Contract Guide at page 3.
[2] TR16A6.6.
[3] TR16A2.1.

Treasury or, at the provincial level, by the relevant provincial treasury.

(c) Major public entities listed in Schedule 2 of the PFMA and national and provincial government business enterprises (listed in Schedules 3B and 3D of the PFMA respectively), although not bound by TR16A, are able to participate in transversal term contracts through approval from their accounting authorities being its board or governing structure.[4]

(d) At the municipal level, transversal term contracts are permitted in terms of the Municipal SCM Regulations. Regulation 32 provides that a municipality's SCM policy may allow for that municipality (through its accounting officer being its municipal council) to procure goods or services under a contract procurement by another organ of state.

(e) Regulation 32 in fact applies more broadly than to transversal term contracts alone, but National Treasury has noted that "*Municipalities or Municipal entities derive their mandate to participate in a transversal term contract (as a contract secured by another organ of state) facilitated by the National Treasury / relevant treasury from [Regulation 32]*".[5]

2.1.3 The OCPO, which houses the Transversal Contracting Office in National Treasury,[6] has issued the Transversal Contract Circular,[7] setting out the mechanisms through which an institution can participate in a transversal term contract arranged by National Treasury, as well as the institutional structures and procurement processes for such contracts:-

(a) Contracts which are designated as transversal in nature will be facilitated centrally by the relevant treasury (e.g. National Treasury). Once a contract has been designated as a transversal contract, government institutions are then obliged to participate in these contracts.[8]

(b) Institutions are also required, as part of their procurement planning, to undertake a thorough analysis of their requirements for goods and services over the medium term in line with their strategic objectives. Goods to be procured through transversal contracts must be identified.[9] In addition, institutions must (i) allocate appropriate funding for the procurement spend in terms of their budgeting process; (ii) provide personnel or experts to participate in the cross-functional team established to coordinate the contract; and (iii) assist with the provision of required technical specifications for the contract.

(c) For municipalities and municipal entities, they must also comply with the additional requirements set out in Regulations 32(a) to (d) of the Municipal SCM Regulations. These stipulate that (i) the contract

[4] Transversal Contract Guide at page 4.
[5] Transversal Contract Guide at page 5.
[6] See http://ocpo.treasury.gov.za/About_Us/Strategic_Areas/Pages/Transversal-Contracting-.aspx accessed on 16 March 2022.
[7] National Treasury Circular No. 3 of 2016 on Utilization of Transversal Term Contracts.
[8] Paragraph 3.2 of the Transversal Contract Circular. A Transversal Contract Guide which provides additional guidance was also issued by National Treasury.
[9] Transversal Contract Guide at paragraph 7.a.

must have been procured through a relevant competitive bidding process; (ii) the municipality must have no reason to believe that the contract was not validly procured; (iii) there are demonstrable benefits for the municipality to participate in the transversal term contract; and (iv) the original procuring organ of state must consent to the municipality / municipal entity's participation. The Transversal Contract Guide states that National Treasury will consider whether these requirements are met and that municipalities must elaborate on these factors in making an application.[10]

(d) National Treasury itself will coordinate the procurement of the transversal term contract, including through inviting and receiving bids. It is also responsible for coordinating the relevant institutional functions, awards the contract, and administrates the transversal term contract which is essentially a framework contract, with individual institutions being responsible for individual orders or "call-offs" under the contract.

2.1.4 At an institutional level, irrespective of the level of government, transversal term contracts are managed by National Treasury as follows:-[11]

(a) A cross-functional team is established by Treasury, which is constituted from officials of various participating institutions and is responsible for among others, the drafting of terms and conditions of contracts, industry and end user analysis through strategic sourcing and compilation of the bid documentation.

(b) A bid specification committee is established, from officials of various participating institutions. An institution may appoint officials with the necessary technical expertise and external advisors to serve on the committee. The role of this committee is to compile bid specifications which it would draw from the submissions by the various participating institutions.

(c) A bid evaluation committee and bid adjudication committee are established as would be the case under standard competitive bidding processes under TR16A6.2. These are again constituted from the various participating institutions.

2.1.5 Transversal term contracts are relied upon by National Treasury as well as provincial treasuries because they both provide positive benefits and can address certain problematic issues where individual institutions are carrying out the procurement. These include the following:-[12]

(a) economies of scale can be leveraged to achieve an overall unit price for the goods or service;

(b) suppliers are locked into providing a certain price over a fixed period, which enhances certainty for budgeting and ensures consistency of pricing and standards of service across different institutions;

(c) reduced efforts and duplicated costs from having multiple institutions run the same or similar procurement process;

[10] Transversal Contract Guide at paragraph 3.f.
[11] Transversal Contract Guide at paragraph 8.
[12] Transversal Contract Circular at paragraph 2.2.

(d) poor assessment of the need for goods and services and poor definition of procurement scope can be addressed through centralisation of functions such as the bid specification committee;

(e) contract management and inventory management can be improved through National Treasury exercising an oversight function over participating institutions; and

(f) tender irregularities and corruption can be reduced by centralising the part of the process which is most open to corruption (i.e. preparing tender documentation and making the tender award) such that there is greater transparency and scrutiny.

2.1.6 Thus, transversal term contracts are typically utilised in situations where the demand for goods and service can be aggregated to minimise procurement costs and maximise better pricing and quality of goods. This will usually arise where:-[13]

(a) the goods or services have a high volume requirement;

(b) the goods or services are required over a fixed period; and

(c) where the agreed requirements for goods and services can be approximated over an agreed time-scale, using a call-off arrangement.

2.1.7 In considering the suitability of the usage of transversal term contracts (in particular National Treasury transversal term contracts) for the procurement of ESCOs or a panel of ESCOs under EEPBIP, the following would support a process whereby National Treasury concludes various transversal term contracts with ESCOs:-

(a) EEPBIP targets a wide array of public institutions, although ultimately the requirements for various types of interventions are relatively homogenous. For example, regardless of whether an institution is a public entity, national department, or municipality, the EE interventions and technological requirements would be very similar (LED light bulbs, HVAC etc). Accordingly, economies of scale are readily achieved for various forms of EE intervention through centralised procurement.

(b) Many of the institutions targeted by the EEPBIP, in particular municipalities, may lack the capacity and know-how to carry out a procurement process culminating in a EnPC. Utilising a transversal term contract can take some of this burden off municipalities. In addition, through participating in the cross-function team and bid specification committee, the municipality will benefit from skills transfer and capacity building during the process.

(c) The Transversal Contract Guide does not distinguish between institutions at the national and provincial level from those at municipal level insofar as their participation in transversal term contracts is concerned (only that municipalities and municipal entities have certain heightened requirements when applying).

[13] Western Cape Provincial Treasury Circular No. 05/2007 Re: Provincial Treasury Circular on Transversal Contracts.

Thus, the use of transversal term contracts across all participating institutions in the EEPBIP would be feasible.

2.1.8 By contrast, there are reasons why transversal term contracts would not be well suited in pre-selecting a group of ESCOs under EEPBIP:-

(a) Transversal term contracts are best used for a fixed or clearly defined product or service. They are typically based on a simple call-off system whereby a participating institution puts in a request for the relevant goods or services for a specified volume, under the transversal term contract which sets out the expected levels of service and price. Where they would not be suitable, is where the supplier / service provider is required to use innovation or seek additional efficiencies as part of the procurement process or contract. Thus, where ESCOs are expected to identify the optimal EE interventions or technologies, these are not suited to a transversal term contract which is premised on a standardised and one-size-fits-all approach.

(b) With the main benefit of transversal term contracts being to leverage economies of scale, this is primarily suited to large suppliers with a wide geographical footprint that is readily able to service all participating institutions. It is less suitable for EMEs and QSEs who cannot achieve the volumes required to justify the transversal term approach, and are unlikely to be able to provide a country-wide service. The ability of the EEPBIP to benefit ESCOs who are ESE and QSE especially at local government level is severely diminished under this model as they cannot compete with large ESCOs with stronger sheets that can support one of the main objectives of transversal term contracting, being cost efficiency through bulk purchasing.

2.1.9 Drawing on the above, our view is that the conclusion of transversal term contracts with ESCOs by a centralised institution is best suited for EnPCs which are procured as guaranteed savings contracts (see the Task 1A report for more details on the contracting forms) where the EE interventions are being directly funded through the institution's capital projects budget. Under a guaranteed savings contract, the institution will be funding the EE interventions and so usually retains control and hence risk in respect of the choice of EE interventions and usually stipulates the technology or supplier to be utilised by the ESCO. Moreover, as the EE interventions are usually known at the end of the development phase once the business model is finalised and approved (Phase 1 above), there are time efficiencies in clustering projects with similar business cases. The trade-off of forgoing innovation and pricing competitiveness is that this approach enables faster procurements *en masse* and at bulk discounted prices. In such circumstances, National Treasury will be able to ensure consistency of pricing, standardisation of technical specifications and reduced procurement overheads for institutions through a transversal term with minimum downside to institutions.

2.2 Option 2: Pre-selection: appointing pre-selected panels and restricted tender process

2.2.1 A further procurement option is where an institution appoints a panel of ESCOs for a fixed period (say 2 / 3 years) which meets certain technical and financial criteria in advance of the institution determining the detailed technical requirements of its EE interventions.

2.2.2 Pre-selection of ESCOs allows for the streamlining of a procurement process by calling for prospective ESCOs to apply for inclusion on a panel or pre-approved / accredited list by a procuring institution. When the institution then wishes to procure the relevant EE interventions from the ESCO, it will do so through a restricted tendering process whereby it will first request detailed technical proposals form ESCOs based on the recommendations in the business case and approved by the accounting officer, and if short-listed, price quotations from the short-listed ESCOs. The ESCO with the most competitive price will be awarded the contract.

2.2.3 The above-mentioned three-stage process i.e. pre-selection of an ESCO panel, pre-qualification on the basis of technical responses, followed by pricing proposals or written quotations by short-listed ESCOs is the provisional tendering and contracting process envisaged for Phase 2a of the EEPBIP. We have considered whether the above approach is feasible under our legislative framework and in particular the first stage relating to the use of pre-selected ESCO panels.

2.2.4 At the national and provincial level, neither the PFMA nor TR16A explicitly permits the appointment of pre-selected panels, although TR16A does permit restricted bidding through written quotations[14] for contracts below a threshold value to be prescribed by National Treasury.

2.2.5 Previously, the compilation of lists of prospective suppliers for the purpose of requesting such written quotations was authorised by National Treasury in terms of National Treasury Practice Note No. 8 of 2007/2008, which also set the threshold value for written quotations as R500,000.[15] An invitation for applications for inclusion on the list of prospective suppliers was to be advertised annually by each institution (per commodity and per service type). Applicants were then to be evaluated and listed if they satisfied evaluation requirements.

2.2.6 However, this Practice Note was repealed by the Procurement Threshold Instruction, issued by National Treasury in 2021. This removed any reference to lists of prospective suppliers, and instead made it a requirement that written quotations must be requested from minimum 3 suppliers registered in the Central Suppliers Database administered by National Treasury.[16] In addition, the Procurement Threshold Instruction raised the threshold for written quotations to R1,000,000 (one million Rand).[17]

2.2.7 The Procurement Threshold Instruction goes on to stipulate that an institution's SCM policy must prescribe the process to be followed for invitation of price quotations, and this includes, among other things setting a "*methodology for the selection of suppliers from the Central Suppliers Database (CSD) for invitation to quote*". In our view this means that an institution can establish its own list of prospective suppliers (i.e. pre-selection or panel), as long as this is provided for in its SCM policy, and further provided that any suppliers appointed to the list / panel would have to be registered on the CSD.

2.2.8 At the municipal level, the establishment of panels is provided for under the Municipal SCM Regulations:-

[14] TR16A6.1.
[15] Paragraph 5 of Practice Note 8 of 2007/2008.
[16] Paragraph 3.2.1 of the Procurement Threshold Instruction.
[17] Paragraph 3.2 of the Procurement Threshold Instruction.

(a) Regulation 12(1)(a) provides that the municipality's SCM policy must allow for written price quotations for procurement of a transaction which has a value between R10,000 and R200,000.

(b) Regulation 14 provides that a municipality's SCM policy must provide for a municipality's accounting officer to keep a list of accredited prospective service providers for the purpose of procurement through written quotations, and this list is to be maintained per commodity and per type of service.[18] Invitation to apply for inclusion on the list must be carried out annually, and the criteria for inclusion must be specified.[19]

(c) Regulations 17 and 18 set out the procedural requirements for obtaining written quotations. Quotations must be sought from at least three suppliers from the accredited list (or otherwise who meet the requirements for listing).[20] Further, "ongoing competition" must be ensured through inviting quotations on a rotational basis.[21]

2.2.9 From the above, it is clear that the regulatory framework only recognises the pre-selection of panels / the compilation of lists of prospective suppliers in the context of and for the purposes of obtaining written quotations.[22] This makes the appointment or pre-selection of a panel of ESCOs poorly suited to Phase 2a of the EEPBIP for the following reasons:-

(a) the low threshold values for the use of written quotations / panels (R1,000,000 at national and provincial level and maximum of R200,000 at municipal level) mean that many EE projects would not have the benefit of appointing from the panel as they are likely to exceed these thresholds; and

(b) pre-selected suppliers or panels are only intended for use with repeated, routine procurement, and therefore only provides for two steps: (i) inviting and evaluating applications for inclusion on the panel or list; and (ii) requesting written price quotations from the listed suppliers for a specified quantity of goods or for a clearly defined service. There is no scope in the legislated process for the additional step of issuing technical specifications to listed suppliers, receiving and evaluating bid responses from listed bidders, and only then requesting price quotations form short-listed suppliers or panellists, and accordingly a panel approach in the manner envisioned under Phase 2a of the EEPBIP is not feasible under the current regulatory framework.

2.3 **Option 3: Pre-qualification as part of two stage bidding process**

2.3.1 A third option for streamlining the ESCO procurement processes is simply to conduct the pre-selection process as part of one integrated two-stage procurement. Under traditional two-stage procurement request for

[18] Regulation 14(1)(a) read with (3).
[19] Regulations 14(1)(a)(ii) and (1)(b).
[20] Regulations 17(1)(a) and (b).
[21] Regulation 18(b).
[22] It should be noted that the establish of panels for consultants is treated somewhat differently from procurement for goods or services. The SCM Guide at paragraph 5.11 deals with the establishment of such panels, although these are to be used "*Where consultancy services are required on a recurring basis, … usually for services that are of a routine or simple nature where the scope and content of the work to be done can be described in detail*". The unique nature of consultancy services which are usually professional services, and also the nature of how such services are scoped and priced, means that panel appointments may be appropriate even above the usual threshold values applied to goods and services.

qualifications ("**RFQ**") is issued to the market generally as part of a competitive tender process, with the strongest bidders being shortlisted based on their technical and financial capabilities. The shortlisted bidders are then invited to submit their specific technical solution and price / BEE proposals at the request for proposals stage.

2.3.2 The possibility of utilising a two-stage process is provided for in the National Treasury's SCM Guide.[23] This details that two-stage bidding is most appropriate where the project entails large / complex work where it is difficult to provide detailed technical specifications in advance and where significant effort is required to evaluate individual bids. The shortlisting process thus allows for serious bidders only to be evaluated based on full technical solutions.

2.3.3 The key advantage of using a two-stage approach is that it allows for the technical experience and balance sheet of the potential bidders to be evaluated in advance. As there may be a number of inexperienced ESCOs attempting to participate in more complex or sophisticated projects requiring innovative solutions, this allows for participants to be filtered in advance and ultimately reduces the burden on institutions at the RFP stage as fewer complex technical bids need to be evaluated.

2.3.4 The procurement process suggested by DMRE for the EEPBIP is a slight variation on the traditional two-stage procurement process and introduces a third phase so that after pre-qualifying, there is a further short-listing after ESCO's prepare and submit their technical proposals, and thereafter short-listed ESCOs are in turn asked to prepare pricing quotations. This process envisages splitting out the technical proposal and the financial proposal stages.

2.3.5 Our view is that the current envisaged EEPBIP procurement approach could be made more efficient by pre-qualifying ESCOs initially based on technical experience and financial capacity. This pre-qualification process can also be tailored for the specific context of the procuring institution, for example if the institution wishes to encourage the participation of locally based ESCOs teaming up with more established ESCOs in an effort to advance local content and local skill development. These are the kinds of specific requirements that become more difficult under a pre-selected panel or a transversal term arrangement.

2.3.6 A further advantage of a pre-qualification process is that it is likely to attract greater interest from a larger range of bidders as it will not require extensive financial investment in preparing a RFQ response.

2.3.7 More recently there has been a trend in a number of larger infrastructure procurements to collapse the RFQ and RFP process, such that bidders are required not only to submit their pre-qualification documentation with their bids, but also develop a full technical and financial proposal on the basis of a non-negotiable contract issued with the RFP and delineating the risk allocation.

2.3.8 Under certain circumstances, this may well be a more suitable procurement approach rather than to split into two stages, however it may also serve to lessen the competition and the quality of the responses due to a smaller number of responses being received as ESCOs may be loathe to put in the costs of developing a full technical and pricing proposal without the security of

[23] SCM Guide at paragraph 4.9

knowing that they meet the qualification requirements. Whether this is a concern will need to be considered in each individual case.

2.3.9 In short, our view is that the current EEPBIP process which consists of 3 stages could be made more efficient by collapsing the submission of the technical and financial proposal into a single engagement and applying a traditional two-stage bidding process when procuring ESCOs under EnPCs. In other words, in the first instance for ESCOs to pre-qualify on the basis of their technical experience and financial capability, and then for the shortlist of pre-qualified ESCOs to prepare both a technical and a financial response to the institution's request for proposal, the outcome of which will be to appoint a preferred bidder with whom to conclude an EnPC. . Alternatively, where appropriate, for the process to be collapsed into a single-stage process where the RFQ and the RFP are combined into a single document.

2.3.10 Moreover, our general view is that the use of a two-stage bidding process is most appropriate for the appointment of ESCOs where the EnPCs are based on a shared savings model.

3. STRUCTURING THE PROCUREMENT DOCUMENTS: INNOVATION AND PERFORMANCE VERSUS CERTAINTY IN PERFORMANCE BASED CONTRACTING

3.1 The second part of this Report considers how best to structure the tender documents when it comes to specifying EE interventions and / or technology specifications arising from the recommendations in the business cases. Performance based contracting traditionally requires bidders to be given more leeway to innovate, relying on the competitive bidding process to make bidders provide the best responses. This approach is a deviation from the approach of supply chain management in South Africa which favours a clear and certain input scope. A conceptual disconnect therefore exists between, on the one hand, output based procurement and performance-based contracting, and on the other, the detailed input specification-based procurement.

3.2 Performance-based contracting presupposes not only that a service provider is incentivised under its contract to perform mainly because payment is linked to meeting performance standards, but also that the service provider's contracted "solution" to driving performance and system efficiencies should be left to the service provider to scope – that is, it should remain in the service provider's discretion rather than being prescribed by the procuring institution.

3.3 A further consideration is that where the institution prescribes the scope of the intervention and the measures to be taken by an ESCO, this has the effect of transferring risk back to the institution and reduces innovation which in turn impacts on the efficiency of the solution. Thus, a true output-based approach to procuring an EnPC entails the procuring institution simply stating its desired output – for example, a stipulated kWh energy saving per month – and then evaluating the bidders' proposals on the basis of which proposal will best achieve the desired output.

3.4 This approach is contrasted with our procurement laws. A key rationale for a supply chain management system which is prescriptive and clearly defines the need as well as the inputs in reaching a desired output, is so that the officials evaluating the tenders can do so fairly and comparatively, that is, to compare tenders on a like-for-like basis. This approach stems from the requirements of the section 217(1) of the Constitution, as reflected in the PFMA and MFMA, that contracting for goods and services must be in accordance with a system that is fair, equitable, transparent, competitive and cost-effective.

3.5 A purely output-based tender requirement however, is more difficult to evaluate and potentially opens the procurement process to system abuses and delays. This in turn opens the process up to challenges by disgruntled bidders (through the mechanisms for judicial review as set out in the Promotion of Administrative Justice Act No 3 of 2000) where there is a perception of subjectivity in the otherwise objective evaluation process, and as such process could be deemed either substantively or procedurally unfair.

3.6 Accordingly, the level of input or detail in the tender requirements for an EnPC exists on a continuum or scale, ranging from a highly prescriptive, input-based approach on the one end, to an output-based approach that actively seeks to promote innovation and risk transfer to the private sector on the other. There are clear benefits to both approaches, but how does this fit within the framework of our procurement legislation which contains certain requirements for structuring and evaluating bids:-

3.6.1 TR16A requires that when an institution prepares bid documentation, this must specify the evaluation and adjudication criteria, and further that the PPPFA must be adhered to (in other words price and preference points evaluation must be used).[24]

3.6.2 For municipalities, similar requirements are stipulated in the Municipal SCM Regulations, which state that a municipal SCM policy must provide that bidding documentation must "*include evaluation and adjudication criteria, including any criteria required by other applicable legislation*".[25]

3.6.3 The PPPFA, which applies to all organs of state when carrying out procurement, then specifies that a preference points system must be used when evaluating bids.[26] Under this system, depending on the threshold value of the contract, either 90 points are awarded for price and 10 points for "specific goals" – usually assessed as the BBBEE Contributor Status Level of the bidder – on a pro-rata basis, or 80/20 (this threshold being R50 million per the PPPFA Regulations, 2017).[27]

3.6.4 The PPPFA Regulations, 2017 also require that tender documents must provide for bids to be evaluated based on functionality criteria, which is defined as "*the ability of a tenderer to provide goods or services in accordance with specifications as set out in the tender documents*".[28] The bidders compliance with these functionality criteria must be evaluated, and only bidders meeting the minimum functionality threshold are then evaluated on price and preference points.[29]

3.7 Accordingly, a typical competitive bidding process will usually be structured to have (i) mandatory compliance criteria (usually administrative documentation, including incorporation documents, tax documentation etc); (ii) functional criteria (e.g. information on the technical capabilities of the bidder, track record) in respect of which a minimum threshold must be met; and (iii) evaluation criteria which, per the PPPFA, must provide for an evaluation of the price and "specific goals" such as black-economic empowerment, with each bidder being ranked on its price and specific goal submissions. As can be seen from this typical structure, the design of each stage of the evaluation process – from functionality to price and BBBEE – essentially "forces" procuring institutions into the use of prescriptive, input-based criteria in order to provide a readily determinable comparison between bidders.

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[24] TR16A6.3(b).
[25] Regulation 21(b) of the Municipal SCM Regulations.
[26] Section 2(1) of the PPPFA.
[27] See our Task 1B Report regarding the status of the PPPFA Regulations, 2017.
[28] Regulation 5 read with Regulation 1 of the PPPFA Regulations, 2017.
[29] Regulation 5(7) of the PPPFA Regulations, 2017.

3.8 The question is then – how can bids instead be evaluated and awarded on an output basis? The answer lies in section 2(1)(f) of the PPPFA. Although this states that the highest ranked bidder based on price and specific goals score must be awarded the bid, it allows in the alternative for the procuring institution to award the bid on the basis of "*objective criteria … to justify the award to another tenderer*".

3.9 Accordingly, it is recognised under South African law that price (and specific goals / BBBEE) is not the only basis on which contracts can be awarded, with the judgement in *Rainbow Civils CC v Minister of Transport and Public Works, Western Cape*[30] recognising that quality can instead be both a functional criterion and an award criterion.

3.10 This approach, whereby tenders can either be purely judged on price (which necessitates an input-based approach), or on a broader concept of value to the procuring institution, is supported in international procurement practice.[31] For example, in the European Union, it is recognised that:-

> "*The criteria on which the contracting authorities shall base the award of public contracts shall be either:*
>
> *(a) when the award is made to the tender most economically advantageous from the point of view of the contracting authority, various criteria linked to the subject-matter of the public contract in question, for example, quality, price, technical merit, aesthetic and functional characteristics, environmental characteristics, running costs, cost-effectiveness, after-sales service and technical assistance, delivery date and delivery period or period of completion, or*
>
> *(b) the lowest price only*."[32]

3.11 However, our Courts have also sounded a note of caution by recognising the pitfalls of a tender process which is too subjective (as can often be the case when output based functional criteria result in significantly different solutions to the output, making like for like comparison difficult). Thus, in *Westinghouse v Eskom Holdings*,[33] the Supreme Court of Appeal simultaneously (i) recognised the ability for Eskom to implement "overall value" to Eskom as the basis for a contract award, but (ii) ruled that Eskom, in taking into account "strategic considerations" including the successful bidders status as original equipment manufacturer and certain IP rights issues, it had based its tender award on criteria that were not explicitly stated in the tender documentation, and that accordingly, the aggrieved tenderer's right to administrative action which is lawful, reasonable and procedurally fair was violated.[34]

3.12 Drawing on the above, the key considerations for implementing an output-based approach for procuring an EnPC are as follows:-

3.12.1 The regulatory framework does allow for the use of output based functional criteria and the award of bids on the basis of factors other than the preference points system, such as quality and overall value to the procuring institution.

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[30] 2013 ZAWCHC 3.

[31] Best Practice Guideline A4: Evaluating quality in tender submissions Page 12 December, 2007: Edition 3 of CIDB document 1004.

[32] Article 53 (1) (Contract award criteria) of the European Union Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts and Public Service Contracts.

[33] [2015] ZASCA 208.

[34] Specifically, the Court found that "irrelevant considerations were taken into account or relevant considerations were not considered" which is one of the grounds for review under section 6(2)(e)(iii) of the Promotion of Administrative Justice Act. *Westinghouse v Eskom Holdings* at [65].

3.12.2 This is important for procuring ESCOs under EnPCs which are structured as energy savings contracts, as it allows for the procuring institution to stipulate a desired energy saving as the output without being presentative as to the EE interventions, but then also allows for factors other than the energy saving (which is the basis of the price assessment) to be taken into account to ensure that the EnPC provides overall value to the procuring institution. For example, long term cost-impacting factors can be included in the tender requirements such as the expected life of the EE equipment before replacement or the maintenance requirements of the EE intervention, in order to ensure that innovation is still subject to quality control.

3.12.3 However, it must also be recognised that different degrees of prescriptiveness will be appropriate for different EE interventions. For example, there may be little space for innovation when procuring solar panels to power a waste water treatment plant with a known energy requirement. Allowing bidders an unnecessary amount of autonomy around the EE intervention or failure to specify the required EE equipment in such circumstances may be counter-productive and increase the risk of the process being abused without increasing the savings benefits to the procuring institution.

3.12.4 In addition, to the extent that objective criteria are to be relied on for a contract award, or generally where output specifications are used, it is important to ensure that the criteria are still clear and objective. Subjectivity in evaluating bids can lead to either abuse or, where institutions are inexperienced or lack expertise with more complex contracting, can lead to mistakes or irrelevant considerations being taken into account, or other procedurally or substantively unfair practices. This would render the ESCO procurement process vulnerable to judicial review. To the extent that subjective assessments are unavoidable, the officials in the Bid Evaluation Committee and Bid Adjudication Committee should be provided with guidelines for exercising discretion and the limits of the discretion must be unambiguous.

4. SUMMARY OF KEY FINDINGS

Set out below is a summary of our key findings:

	Issue	Finding / Recommendation
1.	Transversal term contracts	• Transversal term contracts are best used for a fixed or clearly defined product or service. They would not be suitable in circumstances where the supplier / service provider is required to use innovation or seek additional efficiencies as part of the procurement process or contract. • Transversal term contracts are suited to large suppliers with a wide geographical footprint that is readily able to service all participating institutions. In other words, they are less suitable for EMEs and QSEs, who cannot achieve the volumes required to justify the transversal term approach and are unlikely to be able to provide a country-wide service. • The conclusion of an ESCO transversal term contracts by a centralised institution is best suited for EnPCs which are procured as guaranteed savings contracts where the EE interventions are being directly funded through government budgets

		or grants, and not suited to a shared savings contract.
2.	Pre-selection	• The regulatory framework only recognises the pre-selection of panels / the compilation of lists of prospective suppliers in the context of and for the purposes of obtaining written quotations. • Thus, the appointment or pre-selection of a panel of ESCOs is poorly suited to Phase 2a of the EEPBIP which envisages a split in the process between first receiving and evaluating technical proposals prepared by a list of ESCOs and then evaluating financial proposal.
3.	Pre-qualification as part of two stage bidding process	• The current envisaged EEPBIP procurement approach is unnecessarily protracted. • It would make sense to pre-qualify ESCOs initially based on technical experience and financial capacity as part of a composite two-stage bidding process and not in advance of a specific project procurement. • The alternative is for the process to be collapsed into a single-stage process where the RFQ and the RFP are combined into a single document, which is more commonly seen on recent infrastructure tenders. • The use of a two-stage bidding process is most appropriate for the appointment of ESCOs where the EnPCs is based on a shared savings model.

4.	Structuring of the Procurement Documents	• The regulatory framework does allow for the use of output based functional criteria and the award of bids on the basis of factors other than the preference points system. • This is important for procuring ESCOs under EnPCs which are structured as energy savings contracts, as it allows for the procuring institution to stipulate a desired energy saving as the output and also gives flexibility to ESCOs in determining how the saving will be achieved. • Different degrees of prescription of the EE interventions will be appropriate for projects. • To the extent that objective criteria are to be relied on for a contract award, or generally where output specifications are used, it is important to ensure that the criteria are both clear to bidders and objectively determined.

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18 March 2022