

PRIVILEGED AND CONFIDENTIAL

**ACQUISITION OF 1064 LOCOMOTIVES FOR TRANSNET'S GENERAL
FREIGHT BUSINESS ("TRANSACTION"): INQUIRY
REPORT**

VOLUME I



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INTRODUCTION: SUMMARY OF FINDINGS AND RECOMMENDATIONS

This is the Werksmans report on what is colloquially referred to as the 1064 locomotive acquisition, which traverses the relevant legal and governance aspects in relation to the transaction.

A self standing report from the forensic auditor ("**Forensic Audit Report**") instructed by Werksmans, deals with certain relevant financial aspects of the matter, and is filed with this report.¹ The Werksmans report must be read in conjunction with the forensic auditors report.

To avoid undue prolixity only limited extracts from the forensic auditors report have been included in this report.

To facilitate an expeditious consideration of the Werksmans report and the documentation referenced therein the Werksmans' report is constituted by:

- I. The report itself together with the Forensic Audit Report, attached as Annexure A, is contained in volume I; and
- II. The appendices referenced in this report are contained in volume II and following.

The Werksmans report identifies serious breaches of statutes, regulations, corporate governance and unlawful conduct in relation to the transaction-involving billions of rand.

As is evident from the forensic auditors report to be read with this report, the forensic auditor's finding are seriously adverse and involve vast sums of money. The forensic auditor identified inter alia that:

- I. materially misleading, incorrect and inadequate information was provided to the Board of Transnet;
- II. there was a lack of appreciation of and application of mind (at the very least) by the executives and the Board to the actual 1064 Business Plan and to the interest of Transnet;
- III. part of the increase of almost R16 billion over the estimated and originally approved total estimated cost appears inexplicable, unreasonable and excessive; and

¹ The Forensic Audit Report is appended to this report as Annexure A.



- IV. various instances of suspicious conduct suggesting at the very least wasteful expenditure and or a wilful disregard for the interest of Transnet and a cavalier waste of vast sums of money were identified.

This Werksmans' report recommends inter alia that:

- I. an appropriately empowered judicial inquiry be initiated investigate the unlawful conduct referenced in both this report and the forensic auditors report (collectively "the reports")
- II. Transnet take immediate steps to:
- a) recover wasteful expenditure from those responsible and/or unlawfully benefiting from the transaction and aspects relating thereto as identified in the reports;
 - b) institute appropriate disciplinary action against those individuals as identified in the reports; and
 - c) request each of the HAWKS and the National Intelligence Agencies ("NIA") to investigate each of the matters as identified in the reports.



CHAPTER I: BACKGROUND

- 1 Transnet SOC Limited ("**Transnet**") is a company as contemplated in Item 2 of Schedule 5 of the Companies Act, 71 of 2008 ("**Companies Act**"), and exists in accordance with the Legal Succession to the South African Transport Services Act, 9 of 1989 or any legislation that replaces it. Transnet is a State Owned Entity ("**SOE**") by virtue of its listing as a public entity in Schedule 2 of the Public Finance Management Act, 1 of 1999, as amended ("**PFMA**"). Transnet is thus subject to the Companies Act and the PFMA, as well as to the King Report on Governance for South Africa and the King Code on Governance Principles for South Africa (collectively "**King Code III**").
- 2 Transnet is wholly owned by the South African Government and operates as a corporate entity. With the Government as its sole Shareholder, the rights attached to its shares are exercised by the Minister of Public Enterprises ("**Shareholder Minister**") in her capacity as the representative of the Government and the Executive Authority, as defined in the PFMA.
- 3 Transnet is the largest and most crucial part of the freight logistics chain that delivers goods to each and every South African. It is said to carry on business in all aspects and branches of transport and harbour operations and its mission is to be a focused freight transport company, delivering integrated, efficient, safe, reliable and cost-effective services to promote economic growth in the Republic South Africa ("**RSA**").
- 4 The Accounting Authority of Transnet, as defined in section 1 of the PFMA, is its Board of Directors ("**BOD**"). The BOD is thus the governing body of the Transnet and as such, it has absolute responsibility and is fully accountable for Transnet's performance.
- 5 The BOD at their meeting of 25 April 2013 approved a proposed investment to acquire 1064 locomotives for its General Freight Business ("**GFB**")² at an Estimated Total Cost ("**ETC**") of R38,6 billion over a seven year period ("the **Transaction**").³ This investment, in conjunction with investing in related infrastructure and wagons, would

² See copy of a version the 117 page business case tabled for approval 25 April 2013, appendix 1.

³ See copy of the resolution of the BOD's approval, appendix 2.



facilitate the planned ramp up in GFB volumes from 80mt to 170mt over seven years, as anticipated in the Market Demand Strategy ("**MDS**") aligned to Transnet's 2013/14 Corporate Plan.⁴

- 6 On 17 March 2014 Transnet consummated the Transaction through the conclusion of four separate supply agreements ("**Transaction Agreements**") with the Original Equipment Manufacturers ("**OEMs**") who had successfully tendered for the supply of aforesaid 1064 locomotives.
- 7 Pursuant to the conclusion of the Transaction Agreements, allegations surfaced in relation to alleged irregularities in the procurement process and the Transaction. The allegations were primarily contained in media publications. During June 2017 the current Group Chief Executive ("**GCE**"), Siyabonga Gama ("**Gama**"), briefed Werksmans with a pro-forma charge sheet which was released by the Economic Freedom Fighters ("**EFF**") into the public domain ("**EFF pro-forma charge sheet**"). The EFF pro-forma charge sheet was a precursor to the EFF's advice that it intended to lay criminal charges against, amongst others, the BOD in relation to the Transaction.
- 8 The allegations are summarised in our mandate as follows:

"R17.4 billion of taxpayers' money was lost in inflated prices on the purchase of 1064 locomotives;

The money was lost to corruption during the procurement of the locomotives;

The EFF dossier points fingers at various people as having influenced the process;

the final offers, per locomotive, to Transnet by the 4 suppliers after negotiations had taken place as follows:

- *China North Rail: R27,360,000;*
- *General Electric: R24,312,000;*
- *Bombadier: R28,788,150;*
- *China South Rail: R28,900,900;*

However a month after negotiations had concluded, Gupta companies who served as advisers to Transnet proposed an accelerated delivery schedule and rocketed the prices from the suppliers and pocketing R10 million from each R50 million locomotive that Transnet was buying.

The Guptas entered through Regiments Capital and Trillian. When they started with their work, the prices shot up. Regiments Capital prepared a financial and risk analysis for

⁴ See copy of Transnet's application in terms of section 54 of the PFMA of 30 April 2013 to the Shareholder Minister, along with the corresponding notification to the Minister of Finance, appendices 3 and 4



Transnet. The analysis compares the costs of the original delivery schedule of the locomotives and an accelerated delivery schedule. It takes into account drivers and forex costs before arriving at a conclusion that an accelerated delivery schedule would be cheaper. They did not reduce prices but increased it and pocketed billions in the process through corruption."

- 9 As a result of the above, the BOD of Transnet mandated Werksmans Inc. ("**Werksmans**") to prepare a report on, amongst others, the allegations of impropriety levelled in relation to the Transaction in accordance with the mandate below.



CHAPTER II: WERKSMANS MANDATE, SCOPE, FORMAT AND QUALIFICATIONS TO THE REPORT

10 Mandate

10.1 Werksmans has been requested to consider and advise on the Transaction pursuant to a written mandate issued by the BOD on or about 3 July 2017, as supplemented by the representations made by the current GCE on the same date, ("**Mandate**").

10.2 In terms of the Mandate,⁵ Werksmans is to provide a report covering the following:

"SCOPE OF WORK"

The scope of work will address but not limited to the following:

1. Whether the process followed in procuring the 1064 locomotives was in compliance with the company's procurement policies and procedures as well as the applicable National Treasury Regulations;

2. To identify all persons, companies and timelines involved in the procurement process including identification of each person's role or company's role and the relationships thereof;

3. Review, verify and validate the submissions (relating to this the 1064 loco "Transaction") made to the Acquisitions and Disposal Committee (ADC) and the Board. Should there be exceptions noted, appropriate follow up investigation procedures should be implored.

4. As regards the price of the "Transaction", ascertain the reasons for the increase (if there was an increase) in the estimated total cost ("ETC") and whether such reasons are reasonable and/or justified; this will include an investigation into the allegations made in various media reports including (but not limited to) the allegations in the article by the Huffpost 09 June 2017 and also the allegations by the EFF summarised as follows:

*RI 7.4billion of taxpayers' money was lost in inflated prices on the purchase of
1064 locomotives;
The money was lost to corruption during the procurement of the locomotives;
The EFF dossier points fingers at various people as having influenced the process; The final offers, per locomotive, to Transnet by the 4 suppliers after negotiations had taken place was as follows:*

⁵ See copy of Werksmans' Mandate, appendix 5.



China North Rail: R27,360,000

- *General Electric:*
R24,312,000

- *Bombadier: R28,788,150*

China South Rail: R28,900,900

However a month after negotiations had concluded, Gupta companies who served as advisers to Transnet proposed an accelerated delivery schedule and rocketed the prices from the suppliers and pocketing R10-million from each R50-million locomotive that Transnet is buying.

The Guptas entered through Regiments Capital and Trillion. When they started with their work, the prices shot up. Regiments Capital prepared a financial and risk analysis for Transnet. The analysis compares the costs of the original delivery schedule of the locomotives and an accelerated delivery schedule; It takes into account drivers and forex costs before arriving at a conclusion that an accelerated delivery schedule would be cheaper. They did not reduce prices but increased it and pocketed billions in the process through corruption.

5. Establish whether prices were inflated after hedging, and determine whether contingencies and escalations were added.

6. Establish what governance processes were employed in implementing the "Transaction" and the appropriateness/effectiveness thereof;

7. Review of Transnet policies to the extent that the investigation recommends such;

8. Conduct interviews with the chairpersons of the various adjudication committees to ascertain the business case and/or motivation for the "Transaction" and their understanding of the financial and governance implications that are involved in the "Transaction" including their understanding of the price increase and governance of the "Transaction";

9. Interview the team that dealt with the Treasury/Financing package for the "Transaction".

10. Interview officials of the Secretariat of Transnet to understand their role in the safekeeping, access and distribution of all documents pertaining to the "Transaction";

11. Where necessary, interview all other parties involved in the negotiation of the "Transaction";

12. Investigate whether the existence of a contract between Tequesta, allegedly owned by Salim Essa and CSR Hong Kong;

13. Provide recommendations to Transnet on the findings that arise from the investigations and on the possible actions to be taken against anyone, if any;

14. Provide recommendations to Transnet on how to prevent further occurrences of the findings and on compliance with applicable government laws, rules, regulations, policies and procedures;



15. Present format and informal written and/or oral opinions concerning the findings;"

11 Scope and Report Format

- 11.1 Werksmans requested access to all underlying evidence, including but not limited to documentation such as board-packs, BOD minutes, Board Acquisitions and Disposals Committee ("**BADC**") minutes (and not merely extracts/excerpts thereof), memoranda and submissions submitted to the BOD and BADC and other Transnet governance structures that were prepared and/or produced in relation to the Transaction.
- 11.2 The documentation furnished by several sources include, but is not limited to:
- 11.2.1 documentation under the control of Transnet Freight Rail ("**TFR**"), both hardcopy (21 lever arch files) and further/ additional electronic versions (2.13 GB);
- 11.2.2 documentation received from the office of the Group Secretariat, both hardcopy (3 lever arch files) and further/additional electronic versions (535 MB), as well as from the office of the current GCE (3 lever arch files);
- 11.2.3 a compact disc from the South African Reserve Bank ("**SARB**") comprising of documents in excess of 5000 pages relating to the Transaction (552 MB); and
- 11.2.4 other information which Werksmans has obtained from third parties including representatives of Transnet, such as the current Group Chief Financial Officer ("**GCFO**"), Garry Pita ("**Pita**") (51 MB).
- 11.3 Over and above the documentation referred to above, Werksmans and the forensic auditor engaged to assist in relation to certain financial aspects relevant to Transaction, requested the documentation mentioned in an appendix hereto,⁶ this was not furnished. In order to meet the time deadline, conserve costs and to avoid multiple interviews with the same witnesses, a decision was taken to,

⁶ See list of documents/information requested but not received, appendix 6.



where possible, delay the interview of key witnesses until such time that the documentation requested had been received and analyzed.

11.4 Due to non-cooperation and the delay occasioned thereby, Werksmans resolved to interview a number of persons in relation to the Transaction.⁷ Werksmans was advised by the legal representatives of McKinsey & Company ("**McKinsey**") and Anoj Singh ("**Singh**") to communicate with such representatives as opposed to their clients directly, ostensibly to protect their clients. This is dealt with fully in chapter V below.

11.5 This report is structured in the following manner:

11.5.1 Chapter III, contains a summary of Werksmans' findings in relation to the Transaction;

11.5.2 Chapter IV provides an outline of the legislative framework and policy considerations applicable to the Transaction;

11.5.3 Chapter V sets out the work Werksmans has performed; and

11.5.4 Chapter VI embodies Werksmans' conclusions.

12 **Qualifications to the report**

12.1 Werksmans' Preliminary Observations, which precede this report, were issued on 1 October 2017. In order to avoid the current report becoming prolix the Preliminary Observations are included in the appendices.⁸ This report supersedes Werksmans' Preliminary Observations and is based on evidence that was obtained up to Monday 27 November 2017. Whilst it was envisaged that this report would be delivered by the end of November 2017, the lack of co-operation as detailed in this report rendered this impossible. It has been expeditiously completed in the context of the constraints mentioned herein, certain of which are detailed immediately below.

⁷ See schedule of interviewees, appendix 7.

⁸ See copy of the Preliminary Observations, appendix 8.



- 12.2 It is necessary to indicate that the scope of our investigation has been limited in certain key aspects as set out hereunder.
- 12.3 Although Transnet facilitated the procurement of certain of the limited documentation referenced herein above, Transnet did not volunteer or offer/tender any documentation to Werksmans throughout this entire investigation supporting an inference that the flow material evidence may have been deliberately withheld or sanitized.
- 12.4 In compiling this report, Werksmans has, where necessary, relied on representations from, amongst others, the employees of Transnet and proceeded from the assumption that the documentation relied upon is authentic. The integrity of the documentation, including submissions, memoranda, correspondence between Transnet and the relevant Ministers, has been considered at face value on the premise that the documents are what they purport to be.
- 12.5 In accordance with the Mandate by the BOD, Werksmans initially subcontracted the analysis of the financial architecture of the Transaction to PwC South Africa ("**PwC**"). It became apparent in the second month of the assignment that PwC was subject to a potential conflict of interest, given that they were advisors to Transnet on aspects of the Transaction during January 2014. PwC were, amongst other, given the *"scope of review ... to assess the readiness of Transnet Engineering (TE) to start production of 1064 Electric and Diesel Locomotive order"*. Furthermore, PwC retains a mandate in relation to the Transaction as further detailed in Chapter V below.
- 12.6 Consequently, PwC was requested to withdraw from the assignment and Professor Wainer was appointed to cover aspects of the Mandate that relate to the financial architecture of the Transaction. The Forensic Audit Report by Professor Wainer was provided to Werksmans on 24 November 2017.
- 12.7 Should the requested material information be made available, Werksmans reserves the right to amend and/or supplement this report.⁹ As appears from

⁹ See appendix 6.



the Forensic Audit Report referenced above, certain documentation requested has not been provided.

- 12.8 As a consequence of the fact that information and documentation as detailed in the exhibit appended to this report,¹⁰ has not been provided reliance was placed on other less satisfactory sources which was not capable of being validated.
- 12.9 The additional constraints in the investigation process have been exacerbated by Werksmans' inability to consult with key persons/witnesses, including:
- 12.9.1 Singh, Group Chief Financial Officer up to 2015;
 - 12.9.2 Salim Essa ("**Essa**"), alleged owner of Tequesta Group Pty Ltd ("**Tequesta**") and signatory to agreement allegedly concluded between Tequesta and CSR (Hong Kong) Co. Ltd ("**CSR (Hong Kong)**") ("**Tequesta Agreement**");
 - 12.9.3 Niven Pillay of Regiments Capital ("**Regiments**"), Regiments having been the financial advisor in the Transaction;
 - 12.9.4 Guo Bingqiang a representative of CSR (Hong Kong), a wholly owned subsidiary of CRRC Corporation Limited, and a signatory to the Tequesta Agreement; and
 - 12.9.5 Mathane Makgato, Group Treasurer at Transnet, who early in 2015 tendered her resignation.

¹⁰ See appendix 6 above.



CHAPTER III: EXECUTIVE SUMMARY

13 Background

13.1 Transnet issued two tenders in 2012 for the Transaction as was outlined in the locomotive deployment plan to ensure that TFR would be in a position to provide the required traction capacity in support of the MDS. The tender evaluation process was concluded in January 2014, whereupon:

13.1.1 on the basis of two memoranda of 17 January 2014 from the then Group CEO, Brian Molefe ("**Molefe**"), the BADC recommended approval by the BOD of the evaluation process as well as the allocation of locomotives between the preferred bidders: for the diesel locomotives on a 50/50 split basis (and accordingly, 233 locomotives were awarded to General Electric South Africa Technologies (Pty) Ltd ("**GE**") and 232 locomotives to CNR Consortium ("**CNR**")); and for the electric locomotives on a 60/40 split (and accordingly 359 were awarded to CSR E-Loco Supply (Pty) Ltd ("**CSR**") and 240 to Bombardier Transportation South Africa (Pty) Ltd ("**BT**"));¹¹ and

13.1.2 on 24 January 2014 and based on the above BADC recommendation, the BOD approved the results of the evaluation process and required that negotiations commence with the preferred bidders namely, **GE** and **CNR** for the total of 465 diesel locomotives tender, as well as **BT** and **CSR** for the total of 599 electric locomotives tender.¹²

13.2 Negotiations with the preferred bidders commenced in February 2014. During and or immediately after the negotiations two of the OEMs, BT and CNR, were informed by Transnet that they had to relocate from Transnet Engineering ("**TE**") facilities located in Koedoespoort Pretoria, to those situated in Durban ("**Relocation**"). Negotiations were completed in March 2014, and the locomotive contracts with the successful bidders were signed on 17 March 2014.

¹¹ See respective memoranda for both the 599 electric locomotives and the 465 diesel locomotives, appendices 9 and 10.

¹² See copy of the BOD resolution of 24 January 2014, appendix 11.



On 28 May 2014, the BOD approved an increase in the ETC of the Transaction from R38.6 billion to R54.5 billion.¹³ Negotiations for the Relocation were finalised in or about September 2015. The Relocation is to best of Werksmans' knowledge, still ongoing as at the date of this report, more than 2 years later.

- 13.3 The BOD of Transnet comprises of directors, who as a collective and individually, are ultimately accountable and responsible for the performance and the affairs of Transnet. The unitary board structure remains collectively and individually responsible to provide effective corporate governance. From the matters reported on below, it is apparent that the exercise of corporate governance, integrity and judgment in accordance with the provisions of the PFMA and fiduciary duties has been lacking.
- 13.4 The principle of *audi aletram partem* and the confinement of the scope of work to that prescribed in the mandate supports the advice below that all of the matters traversed in this report will require investigation by a judicial inquiry with prosecutorial and inquisitorial powers, including the authority and jurisdiction to compel witnesses to provide relevant documentation and evidence.
- 13.5 The above notwithstanding, from information and documentation examined and interviews conducted, as described in more detail in Chapter V below, and the appendices to this report, it is evident that various provisions of the PFMA have been breached.¹⁴
- 13.6 We highlight certain aspects of the Transaction that support an inference of impropriety including:
- 13.6.1 the manner of the increase in ETC by R15.9 billion after Ministerial approval of the Transaction had been granted on 3 August 2013, by the Shareholder Minister at the value of R38.6 billion. We note in this regard the Forensic Audit Report observes that the application made on 30 April 2013 did not in itself indicate whether the R38.6 billion was exclusive or inclusive of the

¹³ See BOD resolution of 28 May 2014, appendix 12.

¹⁴ See chapter IV where the applicable sections are quoted.



cost of forex hedging and escalations, although this application records that it attached the 1064 Business Case ("**1064 Business Case**");

- 13.6.2 the payment to Regiments during February and March 2014, in the aggregate amount of R100 million excluding VAT, appears unjustifiable having regard to the fact that McKinsey withdrew from the process on or about 4 February 2014, on the basis that it was unable to add value at that late stage of the Transaction;
- 13.6.3 we pause to note that the facts revealed regarding the Regiments' fee generation raise concerns as to the rationality of the conduct of Molefe and Singh. It is Werksmans' view that proceedings should be instituted to recover this amount forthwith;
- 13.6.4 the commercial rationale and costs for the Relocation between the period 9 March 2014 to May 2015, and the vast and peculiar cash prepayment made in relation to such costs, and the manner in which payment in the aggregate amount of R1.2 billion arose appears to at least constitute a contravention of section 51(1) read with section 83(3) of the PFMA;
- 13.6.5 in relation to the award of a confinement (a process opposite to an open tender process, as detailed below) to CSR for the acquisition of 100 electric locomotives, which confinement was requested on the basis that the 1064 Transaction was delayed by a year, which posed a risk to achieving the targeted MDS volumes that the 1064 Transaction was intended to meet and such confinement would mitigate said risk, Werksmans has analysed the evidence including but not limited to:
- 13.6.5.1 the content of the Chairperson's letter of 31 March 2015 in response the Minister of Finance's letter of 29 September 2014 relating to the PFMA application to the Shareholder Minister for the acquisition of 100 Dual Voltage Electric Locomotives for Export Coal Line;¹⁵
- 13.6.5.2 memoranda, submissions and email correspondence, as well as interviews with members involved in the preparation of the 1064

¹⁵ See copies of letters under consideration, appendices 13 and 14.



Business Case for the confinement which lacks details of the rationale for this acquisition. Furthermore, we have been advised that reasons proffered for expedited delivery of the 100 locomotives through confinement, on the basis that the 1064 Transaction was delayed by a year, are unsupported the changes to the confinement business case, as explained in more detail in Chapter V below. The manner of award of the 100 electric locomotive confinement to CSR appears to contravene Transnet's procurement policies and legislation, including the PFMA and the Companies Act.

- 13.7 Based on these findings and despite the limitations of scope, the Transaction Agreements, which were entered into on or about 17 March 2014, may constitute wasteful expenditure. The facts revealed by this investigation raise concerns as to the conduct of the erstwhile and current executives and other officials of Transnet. This conduct requires further investigation by a judicial inquiry with prosecutorial and inquisitorial powers, including the authority and jurisdiction to compel witnesses to provide relevant documentation and oral evidence.
- 13.8 The nature and extent of the allegations of malfeasance at Transnet, based on the findings set out above, and, notwithstanding the limitations imposed on Werksmans, warrants a "deep dive" by the Shareholder Minister, to identify and those responsible for the conduct particularised herein and in the Forensic Audit Report. In addition, we recommend consideration be given to:
- 13.8.1 suspending all or certain of the Transaction Agreements and possibly review and set aside the said agreements under the principle of legality, in particular in relation to CNR and BT; and
- 13.8.2 the Shareholder Minister establishing an enquiry in accordance with applicable legislation, into the affairs of Transnet in relation to the Transaction.
- 13.9 In accordance with Transnet's employment and labour policies, the immediate suspension of employment of those persons who are still in the employ of Transnet ought to be considered. Such suspension will ensure that there is no



undue interference and/or influence of any investigations to be undertaken with the investigation and/or further interrogation recommended herein.



CHAPTER IV: LEGISLATIVE FRAMEWORK AND POLICY CONSIDERATIONS RELEVANT TO THE TRANSACTION IMPACTING ON THE CONDUCT OF TENDER/ THE TRANSACTION

14 General

- 14.1 Section 217 of the Constitution of the Republic of South Africa, 1996, ("**Constitution**") and, amongst others, section 51(1)(a)(iii) of the PFMA stipulate that Transnet must have and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective.
- 14.2 The Treasury Regulations issued pursuant to section 76 of the PFMA require the development and implementation of an effective and efficient supply chain management system for the acquisition of goods and services that must be fair, equitable, transparent, competitive and cost-effective.
- 14.3 In the case of procurement through a bidding process the supply chain management system must provide for the adjudication of bids through a bid adjudication committee, the establishment, composition and functioning of bid specification, evaluation and adjudication committees, the selection of bid adjudication members, bidding procedures and the approval of bid evaluation and/or adjudication committee recommendations.
- 14.4 The Accounting Officer or Accounting Authority, as defined in the PFMA, must ensure that the bid documentation and the general conditions of contracts are in accordance with the instructions of the National Treasury. Further, that the bid documentation includes evaluation and adjudication criteria, including criteria prescribed by the Preferential Procurement Policy Framework Act, 5 of 2000, as amended ("**PPPFA**") and the Broad-Based Black Economic Empowerment Act No. 53 of 2003, as amended.
- 14.5 The provisions we intend to cover in relation to the Transaction, as well as transactions ancillary thereto include the PFMA and its subordinate legislation, the Companies Act, Transnet's policies and procedures, as well as the provisions



of the Prevention and Combating of Corrupt Activities Act, 12 of 2004 ("PreCCA"), if and where applicable.

Legislative enactments

15 PFMA

15.1 As regards the PFMA, its object is to secure transparency, accountability and sound management of the revenue, expenditure, assets and liabilities of the institutions to which it applies. The following provisions are worth noting at present:

15.1.1 as per the definition section:

"fruitless and wasteful expenditure" means expenditure which was made in vain and would have been avoided had reasonable care been exercised;

...

"irregular expenditure" means expenditure, other than unauthorised expenditure, incurred in contravention of or that is not in accordance with a requirement of any applicable legislation, including –

(a) This Act

(b) The State Tender Board Act, 1968 (Act No. 86 of 1968), or any regulations made in terms of that Act;

(c) Any provincial legislation providing for procurement procedures in that provincial government"

15.1.2 as per chapter 6, styled "Public Entities":

"49. Accounting authorities.—(1) Every public entity must have an authority which must be accountable for the purposes of this Act.

(2) If the public entity—

(a) has a board or other controlling body, that board or controlling body is the accounting authority for that entity;

...

50. Fiduciary duties of accounting authorities.—(1) The accounting authority for a public entity must—

(a) exercise the duty of utmost care to ensure reasonable protection of the assets and records of the public entity;

(b) act with fidelity, honesty, integrity and in the best interests of the public entity in managing the financial affairs of the public entity;

(c) on request, disclose to the executive authority responsible for that public entity or the legislature to which the public entity is accountable, all material facts, including those reasonably discoverable, which in any way may influence the decisions or actions of the executive authority or that legislature; and

(d) seek, within the sphere of influence of that accounting authority, to prevent any prejudice to the financial interests of the state.

(2) A member of an accounting authority or, if the accounting authority is not a board or other body, the individual who is the accounting authority, may not—



- (a) *act in a way that is inconsistent with the responsibilities assigned to an accounting authority in terms of this Act; or*
- (b) *use the position or privileges of, or confidential information obtained as, accounting authority or a member of an accounting authority, for personal gain or to improperly benefit another person.*
- (3) *A member of an accounting authority must—*
 - (a) *disclose to the accounting authority any direct or indirect personal or private business interest that that member or any spouse, partner or close family member may have in any matter before the accounting authority; and*
 - (b) *withdraw from the proceedings of the accounting authority when that matter is considered, unless the accounting authority decides that the member's direct or indirect interest in the matter is trivial or irrelevant.* (Own emphasis)

...
51. General responsibilities of accounting authorities.—(1) *An accounting authority for a public entity –*

- (a) *must ensure that that public entity has and maintains-*
 - (i) *effective, efficient and transparent systems of financial and risk management and internal control;*
 - (ii) *a system of internal audit under the control and direction of an audit committee complying with and operating in accordance with regulations and instructions prescribed in terms of sections 76 and 77; and*
 - (iii) *an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective;*
 - (iv) *a system for properly evaluating all major capital projects prior to a final decision on the project;*
- (b) *must take effective and appropriate steps to—*
 - (ii) *prevent irregular expenditure, fruitless and wasteful expenditure, losses resulting from criminal conduct, and expenditure not complying with the operational policies of the public entity; and*
- (e) *must take effective and appropriate disciplinary steps against any employee of the public entity who—*
 - (i) *contravenes or fails to comply with a provision of this Act;*
 - (ii) *commits an act which undermines the financial management and internal control system of the public entity; or*
 - (iii) *makes or permits an irregular expenditure or a fruitless and wasteful expenditure;*
- (h) *must comply, and ensure compliance by the public entity, with the provisions of this Act and any other legislation applicable to the public entity.*

...
54. Information to be submitted by accounting authorities –

...
(2) *Before a public entity concludes any of the following transactions, the accounting authority for the public entity must promptly and in writing inform the relevant treasury of the transaction and submit relevant particulars of the transaction to its executive authority for approval of the transaction:*

- (d) *acquisition or disposal of a significant asset;*

...
(3) *A public entity may assume that approval has been given if it receives no response from the executive authority on a submission in terms of*



subsection (2) within 30 days or within a longer period as may be agreed to between itself and the executive authority."

15.1.3 as per chapter 10, styled "*Financial Misconduct*":

"83. Financial misconduct by accounting authorities and officials of public entities.—(1) *The accounting authority for a public entity commits an act of financial misconduct if that accounting authority wilfully or negligently—*
(a) *fails to comply with a requirement of section 50, 51, 52, 53, 54 or 55; or*
(b) *makes or permits an irregular expenditure or a fruitless and wasteful expenditure.*
(2) *If the accounting authority is a board or other body consisting of members, every member is individually and severally liable for any financial misconduct of the accounting authority.*
(3) *An official of a public entity to whom a power or duty is assigned in terms of section 56 commits an act of financial misconduct if that official wilfully or negligently fails to exercise that power or perform that duty.*
(4) *Financial misconduct is a ground for dismissal or suspension of, or other sanction against, a member or person referred to in subsection (2) or (3) despite any other legislation."* (Own emphasis)

15.2 In Chapter V of this report wherein we deal with scope of the Mandate and the evidence analysed, the legislative provisions will be incorporated specifically where appropriate.

16 PPPFA

16.1 The PPPFA provides a framework for the implementation of a procurement policy, providing for categories of preference in the allocation of contracts and the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination as required by the Constitution.

16.2 Schedule 2 public entities per the PFMA, such as Transnet, are to comply with the provisions of the PPPFA, its regulations and instruction notes issued by National Treasury. Relevant to the Transaction, these legislative provisions provide an evaluation framework, including thresholds for functionality and local content. Further:

16.2.1 in terms of the PPPFA and its regulations the preference points systems is required to be applied. The evaluation framework is therefore prescriptive and appears not to permit any deviation, unless the Minister of Finance directs otherwise;



- 16.2.2 in terms of the regulations, functionality may only be included as a minimum qualifying criterion. Only those bids that achieve the set threshold for functionality will be evaluated further in terms of the applicable preference point system;
- 16.2.3 the preference point system requires that bids must be evaluated strictly in terms of price and the bidder's Broad-Based Black Economic Empowerment (B-BBEE) scorecard. The 80/20 preference point system is applicable to transactions up to the value of R 1 million and the 90/10 system to transactions over R 1 million in value;
- 16.2.4 the instruction note issued by National Treasury in line with regulation 9 regarding the invitation and evaluation of bids based on a stipulated minimum threshold for local production and content in designated sectors applies, as Rail Rolling Stock sector is included therein as a designated sector;
- 16.2.5 with regard to bids that are affected by designated sectors, the evaluation methodology that applies when local production and content forms part of the bid process, such bids are first evaluated for local content as a minimum threshold and only those bids which meet the set threshold for local content are then evaluated for technical compliance. Furthermore, only those bids which meet the minimum threshold for both local content and functionality will be further evaluated for price and preference;
- 16.2.6 the thresholds for functionality and local content are the only permissible thresholds in terms of PPPFA methodology. Thus, the use of further factors such Supplier Development ("**SD**"), Further Recognition Criteria ("**FRC**") or B-BBEE scorecard as a threshold in addition to functionality and local content is arguably not applicable.
- 16.3 Failure to adhere to any aspect of the PPPFA, its regulations and Instruction Notes could expose bid processes to legal challenges and result in irregular expenditure if contracts are awarded contrary to the requirements of the PPPFA.
- 16.4 Aspects of the application of the above provisions in relation to the Transaction that may require further interrogation are dealt with in Chapter V below.



17 Companies Act

17.1 The Companies Act applies to Transnet and, worth noting, is the following:

17.1.1 section 22(1) states that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.

17.1.2 the Companies Act further provides for liability of directors where they trade recklessly or conduct the company's business with the intention of defrauding a creditor;

17.1.3 sub-sections 77(3)(b) and (c) of the Companies Act state that any director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director:

17.1.3.1 having acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1) of the Act; or

17.1.3.2 being party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company or had another fraudulent purpose.

17.1.4 section 214 (1) (c) creates an offence which is, amongst other, in respect of a director who knowingly was a party to conduct of the company prohibited under section 22. The section precludes a director from knowingly being party to a company carrying on its business with intent to defraud or for any fraudulent purpose. In such a case a director can be held personally liable for acquiescing in or knowing about conduct that falls within the ambit of section 22 (1).

18 Fiduciary Duties



- 18.1 Governance principles regarding the role and responsibility of SOE Boards are contained in, amongst others the PFMA and are as prescribed in other authorities such as the King Code III on Governance and other provisions.
- 18.2 The individual directors and the Board of a SOE as a whole, both executive and non-executive, further carry full fiduciary responsibility in terms of the Companies Act and any other applicable law. Consequently, a board of directors owe an SOE certain duties and will have certain liabilities.
- 18.3 The Companies Act also regulates liabilities of directors. Section 66 is applicable in this regard in that it provides that the business and affairs of a company must be managed by or under the direction of its board of directors. The board of directors has the authority to exercise all of the powers and perform all of the functions of the company, except to the extent that the Companies Act or the company's Memorandum of Incorporation provide otherwise. In so far as liabilities of directors are concerned:
- 18.3.1 section 77 of the Companies Act prescribes certain statutory liabilities, which are placed on the directors of a company. In terms of section 77(2)(a) of the Companies Act, a director of a company may be held liable (in accordance with the principles of the common law relating to the breach of a fiduciary duty) for any loss, damages or costs sustained by the company as a consequence of any breach by the director of the duties contemplated in, amongst others, section 76 of the Companies Act;
- 18.3.2 any action taken that directly or indirectly purports to relieve a director of liability is considered void. A director of a company will, in addition, be held liable where that director purports to bind the company or authorise the taking of any action by or on behalf of the company without the requisite authority acts in the name of the company in a way that is false or misleading, or knowingly or recklessly signs or consents to the publication of a financial statement which is false or misleading;
- 18.3.3 the liability of a director is, in terms of section 77(6) of the Companies Act, joint and several with any other person who is or may be held liable for the same act. This means that a single director can be held liable for the totality of damages suffered by a third party as a result of the breach of fiduciary



duties. Proceedings to recover any loss, damages or costs for which a person is or may be held liable in terms of section 77 of the Companies Act may not be commenced more than three years after the act or omission that gave rise to that liability.

18.4 Section 214 of the Companies Act renders a director (or any person) guilty of a criminal offence if such director / person was **knowingly** (own emphasis) a party to an act or omission by a company calculated to defraud a creditor or employee of the company, or a holder of the company's securities or with another fraudulent purpose.

18.5 The Act however does make provision for directors to raise "honest and reasonable" behaviour on their part as a defence in these circumstances. Section 77(9)(a) of the Act states that in any proceedings against a director (other than for wilful misconduct or wilful breach of trust), the court may relieve the director, either wholly or in part, from any liability set out in this section, or on any terms the court considers just, if:

18.5.1 it appears to the court that the director has acted honestly and reasonably;
or

18.5.2 having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.

18.6 The intended effect of sections 76 and 77 of the Companies Act is to protect directors who, in carrying on the business of a company, have shown a genuine concern for its prosperity and have made decisions in its best interest. Directors should note that any inquiry into the conduct of the affairs of a company will always involve an evidential investigation.

18.7 To the extent that a director has fulfilled his or her fiduciary duties and conducted the affairs of the company in accordance with sound business practices that fall within the parameters of these expectations, the evidence should speak for itself. Compliance with what can reasonably be expected of a director when faced with similar circumstances will therefore constitute a defence to any action launched in terms of section 77 of the Act.



Other authorities

19 King Code III

19.1 In summary the prescripts of the King Code III as applicable to the Transaction are that the BOD:

19.1.1 has a collective responsibility to provide effective corporate governance that involves a relationship between the management of the company, its board, its shareowners and other stakeholders to determine the company's purpose and values;

19.1.2 should strive to focus on performance in directing the commercial and economic fortunes of the company;

19.1.3 should be composed of individuals of integrity who bring a blend of skill, knowledge, objectivity, experience and commitment to the board, under the firm and objective leadership of a chairperson;

19.1.4 should be able to exercise objective judgement on the corporate affairs of the business enterprise, independent from management but with sufficient management information to enable a proper and objective assessment to be made by directors collectively; and

19.1.5 should ensure that internal control procedures provide reliable and valid information for monitoring and evaluation. Internal controls include not only financial matters but also operational and compliance controls and management of the business risk associated with the company.

19.2 We record that further legislative and/or other applicable provisions will be addressed elsewhere herein.

20 Shareholder's Compact & DoA¹⁶

¹⁶ See copies of the Shareholder's Compact 2013/2014 and the DoA effective 1 June 2013, appendices 15 and 16.



20.1 The Shareholder's Compact is an agreement concluded between the Shareholder Minister and Transnet. This agreement is entered into in accordance with the provisions of the PFMA, and sets out the key performance measures and indicators to be attained in support of the statement of strategic intent and, to the extent necessary, seeks to clarify the objectives of Transnet in the context of the statement of strategic intent.

20.2 Given its annual review, we note that various versions of the Shareholder's Compact may be applicable to the Transaction depending on the relevant period in question. We note specifically that in terms of section 54 of the PFMA, the Shareholder's Compact sets out the standing and provides guidance for the determination of the materiality limit provided for therein. To that end and having regard to the Transaction (as an acquisition or disposal of a significant asset, per section 54(2)(d)), the Shareholder's Compact provides for exemption from section 54 of the PFMA in the following terms:

"If acquisition does not exceed 2% of the 31 December 2012 audited asset base value (which equates to R 3.9 billion), however the Department should receive a detailed notification for all acquisition and disposal of assets above R 2 billion."

20.3 The Delegation of Authority Framework ("**DoA**") approved by the BOD from time to time also has a bearing on the application of section 54(2) of the PFMA on the Transaction. We deal with both the provisions and our observation on the applicability of the Shareholder's Compact and the DoA below.

21 Transnet's Procurement Procedures Manual ("**PPM**")¹⁷

21.1 Transnet's Supply Chain Policy

21.1.1 *"The aim of Transnet's Supply Chain Policy is to ensure that Transnet gets value for money in the procurement of goods and services in order to fulfil its mandate whilst redressing the economic imbalances that have been caused by unfair discrimination in the past. The Policy ensures a coherent framework within which procurement principles and compliance controls*

¹⁷ See copy of the PPM effective 10 October 2012, appendix 17.



are applied across Transnet. The PPM seeks to operationalise the objectives of the Supply Chain Policy."

21.1.2 the PPM is applicable to all acquisitions across the Transnet Group regardless of the value of the transaction and it sets minimum standards for compliance. Furthermore, purchasing procedures in terms of the PPM cover the purchasing and supply of all goods, services (tangible and intangible), fixed assets and the appointment of consultants in respect of both Operational and Capital expenditure.

21.1.3 in relation to the Transaction, the following specific provisions of the PPM are worth mentioning:

21.1.3.1 Transnet prefers not to do business with any agents ("middlemen"), who do not add significant value to the supply chain; and

21.1.3.2 Transnet supports good corporate governance by ensuring the preservation of the highest standards of integrity, objectivity, fairness, efficiency and professionalism.

21.1.4 subject to certain exclusions, none of which apply to the Transaction at hand, all procurement within Transnet must be conducted in accordance with the PPM. To this end:

21.1.4.1 non-compliance with the PPM will be regarded in a serious light as it could result in Irregular Expenditure and/or Fruitless and Wasteful Expenditure in terms of the PFMA;

21.1.4.2 section 51(1)(e) of the PFMA places an obligation on Transnet to take the necessary appropriate action regarding acts of financial misconduct;

21.1.4.3 failure to comply with the provisions of the PPM will lead to disciplinary action and, depending on the severity of the non-compliance, possible dismissal and/or legal action. As a general rule, condonation of non-compliance with procurement policies and procedures is not permitted in terms of the PPM.



21.1.5 as regards Transnet's Integrated Supply Chain Management ("iSCM") control objectives in particular, this function is aimed at the following:

21.1.5.1 goods and services required are acquired from the most appropriate supplier at the right time, right cost and right quality;

21.1.5.2 transactions are properly accounted for and approved (timeously, accurately and completely);

21.1.5.3 accurate and timeous information will be produced for management, ensuring the integrity of the process; and

21.1.5.4 overall processes exhibit integrity and are efficient in meeting supply chain objectives in relation to strategy.

21.2 Code of Ethics

21.2.1 Transnet's Code of Ethics sets ethical standards for business practice and individual business conduct. It assists all Transnet stakeholders with their ethical deliberations and decisions. The objective of the Code of Ethics as it relates specifically to the Supply Chain environment is to set the standard by which all Transnet Board members and employees (including employees employed on fixed term contracts and temporary employees) are expected to act when engaging in any supply chain related activities. To this end all Transnet employees should uphold the following key values:

21.2.1.1 act with integrity and professionalism at all times;

21.2.1.2 be honest;

21.2.1.3 maintain accurate, honest and complete records in appropriate detail;

21.2.1.4 refrain from using a position of authority and / or facilities provided by Transnet to further their own interests or that of friends and relatives;



- 21.2.1.5 desist from allowing personal interests to influence business decisions or tasks and disclose any actual or potential conflict of interest;
- 21.2.1.6 honour the content and spirit of all business transactions and not abuse Transnet's name; and
- 21.2.1.7 maintain an attitude of zero tolerance toward any form of bribery, corruption and inducements.
- 21.2.2 while considering the advantages of maintaining a continuing relationship with a supplier, Transnet iSCM must avoid any arrangement, which in the long term might compromise fair competition or prevent Transnet from achieving optimal value.

21.3 Declarations of Interest

- 21.3.1 in terms of the "Declaration of Interest and Related Party Disclosures Policy" all employees are required to submit an annual declaration of interest, as set out below:
 - 21.3.1.1 all employees involved in the evaluation, Post Tender Negotiation ("**PTN**") or adjudication of Bids must sign a declaration of interest certificate indicating whether or not they have an interest in the matter at hand. This declaration must be placed on the relevant bid file; and
 - 21.3.1.2 non-compliance with the Code of Ethics is considered misconduct which may result in offending employees being subject to disciplinary procedures that could lead to dismissal, as well as criminal and/or civil action.

21.4 Delegation of Authority for procurement processes - Summary

- 21.4.1 Transnet Entities are required to develop trust and a sound interdivisional working relationship with one another in the interest of Transnet. To achieve this, such entities must be afforded the right of first refusal in the procurement of Goods and Services.



21.4.2 Transnet entities undertaking work on behalf of other entities should reciprocate by pricing and carrying out their Services in a way that promotes and develops a culture of interdivisional support. The pricing must be based on appropriate market analysis to benchmark fair and reasonable prices.

21.5 Determining bid evaluation criteria

21.5.1 evaluation criteria must be:

21.5.1.1 **Unambiguous.** The bid documents must provide a complete explanation of the scope of work as well as the criteria and sub-criteria that will be used in the evaluation of bids. Care should be taken to ensure that the Request for Proposal ("**RFP**") does not contain any contradictory clauses. Where drawings are included as part of the RFP, such drawings must be completely aligned to the written description of the goods or services required.

21.5.1.2 **Rational and justifiable.** Evaluation criteria must be rationally linked to the projected procurement outcomes.

21.5.1.3 **Quantifiable.** If a criterion cannot be measured, it should not be included as an evaluation criterion.

21.5.1.4 **Predetermined.** Evaluation criteria must be stated upfront in the RFP document. No evaluation criteria should be used in the evaluation process that were not stipulated in the RFP document.

21.5.2 the following must be borne in mind:

21.5.2.1 the evaluation of bids shall be based only on the information contained in Bid submissions, and, where relevant, from interviews, presentations and site visits;

21.5.2.2 when dealing with more complex bids, the evaluation of price must involve an evaluation of the Total Cost of Ownership ("**TCO**"). In such



cases, Bidders must be requested to provide all information relevant to the evaluation of TCO. It is recommended that Bidders be provided with a comprehensive pricing schedule to ensure that they all follow a standardised approach with pricing. This will facilitate uniformity in the evaluation of price; and

21.5.2.3 the weighting of the various components that [i.e.] Quality, Price, SD, and B-BBEE need to be considered on a case by case basis as each procurement event will differ. It is important that these be determined upfront and included in the RFP document. Once included in the RFP document one cannot deviate from that and the evaluation has to be done strictly in accordance with what was stated in the RFP document.

21.5.3 it is important that everything in relation to the determination of the bid evaluation criteria per the PPM should be carefully considered and included in the sourcing strategy, the RFP and RFP sign-off template prior to issuing the RFP to the market, as neither the evaluation criteria; the weightings; nor the evaluation methodology may be changed during the evaluation phase.

21.5.4 in the open bid process (RFP), before any bid document may be issued to the market, the person with the necessary delegated authority must provide written authority to approach the market. This must include approval of the evaluation methodology, evaluation criteria and the availability of funds. The evaluation team is also to be decided on at this point.

21.6 Confinements

21.6.1 a confinement is a departure from the norm of an open, competitive bidding process and, as such, must be treated with great circumspection ("**Confinement**"). The misuse of confinements has the potential to entrench monopolies and, as such, is at odds with the imperatives of the New Growth Path ("**NGP**") The NGP seeks to encourage open competition and the introduction of new entrants into the market, particularly those from previously disadvantaged communities.



- 21.6.2 confinements will only be considered on stated grounds for confinements.
- 21.6.3 depending on the circumstances, one of the following two Confinement routes will be applicable:
 - 21.6.3.1 the normal Confinement route:
 - 21.6.3.1.1 prior authority to confine must be obtained from the person with the relevant delegation;
 - 21.6.3.1.2 bids will close at the relevant Acquisition Counsel ("AC") (relevant AC to be indicated in the submission for approval); and
 - 21.6.3.1.3 the relevant AC will consider the award of business.
 - 21.6.3.2 confinement and award which is only to be used in cases where there is a sole supplier and/or cases of extreme urgency will take place in the following circumstances-
 - 21.6.3.2.1 prior authority to confine and award must be obtained;
 - 21.6.3.2.2 the submission to the person with Delegated Powers must fully motivate the reason for the urgency and provide an indicative / benchmark price;
 - 21.6.3.2.3 bids will close at the relevant AC (relevant AC to be indicated in the submission for approval);
 - 21.6.3.2.4 the business will be awarded by the person with the delegation to the relevant Bidder provided that the final price is within the benchmark as initially approved by the person with the delegation to approve the Confinement; and
 - 21.6.3.2.5 the AC must be informed after award.

21.7 Process



21.7.1 only if the reasons advanced for the proposed Confinement are supported and considered to be in the best interest of Transnet, should the Confinement of business to one or more contenders be escalated to Group.

21.7.2 the Confinement request must be considered by the Transnet GCSCO and the Group CFO each of whom shall indicate whether or not they support the request. The matter must then be submitted to the GCE, the BADC or to the Board itself for final approval depending on the value of the transaction.

21.8 Amendments to contracts awarded via confinement

21.8.1 where a Material Amendment (i.e. the price, duration or scope is increased by more than 10%) to a contract awarded via Confinement is required, the matter must be sent to the relevant AC for support. The AC must submit the amendment to the original approver of the Confinement for prior approval of the amendment. The same principle applies where the cumulative value of amendments equals or exceeds 10% of the original contract value.

21.9 Emergency

21.9.1 an emergency procedure is to be used under the following circumstances:

21.9.1.1 where the circumstances giving rise to the emergency were unforeseeable;

21.9.1.2 where engaging in normal bidding procedures or any other methods of procurement would be impractical; and

21.9.1.3 where the occurrence requires immediate action.

21.9.2 it should be noted that according to the PPM the concept of retrospective authority applies only in the context of emergencies, thus not to a condonation process (this process is outlined below). Where an emergency process is followed correctly, condonation is not required.



21.9.3 an emergency should not be attributable to a lack of proper planning. In such instances appropriate action must be taken against the individual(s) responsible for the bad planning.

21.10 High Value Tender Process ("HVTP")

21.10.1 the HVTP subjects all transactions falling within the High Value Tender threshold to independent scrutiny and validation of all commercial contractual, process and Governance aspects of the Bid process. The process enables the Supply Chain to detect any shortcomings at key gateways in the Bid Process and to make appropriate corrections before the award of business is made.

21.10.2 gateways that are reviewable -

21.10.2.1 demand review and development of specification;

21.10.2.2 business case development;

21.10.2.3 acquisition process;

21.10.2.4 evaluation process;

21.10.2.5 negotiations;

21.10.2.6 final approval process;

21.10.2.7 contract award; and

21.10.2.8 contract management.

21.10.3 entities must contact and involve the HVT team from the outset of the bidding process, which is at the demand review stage. The HVT team must attend to all procurement processes and advise entities during each phase of the process as follows:

21.10.3.1 review the demand and business case;



- 21.10.3.2 review the RFP document for accuracy and correctness before going to the market;
- 21.10.3.3 access the adequacy of the procurement proposed mechanism used, that is RFP/RFI/Confinement and determine if governance is being followed by ensuring that the approval process has been complied with;
- 21.10.3.4 ensure that in all high value bids, a cross functional sourcing team contains at least Technical, Financial, Operational and Legal Support;
- 21.10.3.5 advise on the scoring methodology and governance issues related to the evaluation process;
- 21.10.3.6 advise the teams during the evaluation process on all bids;
- 21.10.3.7 advise and support teams during the negotiation process of scores on all bids;
- 21.10.3.8 review AC documents for accuracy and correctness;
- 21.10.3.9 advise teams during the contracting process and also determine if governance processes have been followed;
- 21.10.3.10 the HVT team must report significant process breaches to Transnet management. Firstly at entity level, and, if still not satisfied with the outcome / corrective actions, such matters must be reported to the OD CPO before being escalated to the Group ISCM; and
- 21.10.3.11 the HVT team must document lessons learnt throughout the process and provide feedback so that processes may be improved.

21.11 Bid preparation

- 21.11.1 bid documents define the rights, risks and obligations of the parties involved in the bidding process and subsequent contract. Documents must



therefore clearly and precisely spell out all relevant aspects of the bid such as the work to be carried out, the goods to be supplied, the place of delivery or installation, the schedule for delivery or completion, minimum performance requirements and the warranty and maintenance requirements.

21.11.2 accordingly, such documentation should be legally and technically sound and should assign risk in an appropriate manner. The bid documents must provide Bidders with clear and comprehensive information necessary to enable them to submit responsive bids. The specifications, including the evaluation criteria and weightings, must be determined upfront, as bids may only be evaluated according to the criteria stipulated in the bid documentation. Bid documents must be drafted with care and precision so as to reduce the risk of legal challenge by unsuccessful bidders and avoid unintended consequences.

21.11.3 once the bid documentation has been compiled, the bid document must be reviewed and signed off as correct by the CPO or person to whom the power has been delegated, as a quality control measure. Once this sign-off has been obtained the media advert must be approved by Group Communications in terms of extant instructions issued by that office, before adverts may be placed in the media.

21.12 Amendments and communication after closing date

21.12.1 Transnet is entitled to amend any bid condition, validity period, specification or plan after the closing date of a bid. However, all parties who obtained bid documents and submitted valid Bids must be advised thereof in writing by fax or e-mail and be given the opportunity of bidding on the amended basis by an extended closing date and time. Proof of such written communication must be kept for record purposes. Bidders who did not submit valid Bids (e.g. submitted their Bids late, or who did not attend the compulsory briefing session/site inspection) cannot participate in the extended invitation. Authority for such communication must be obtained, and is dealt with in Chapter V below.



21.12.2 in the event of a material amendment to the specification or scope of work, to which other new Bidders could possibly respond, the RFP must be cancelled and a revised RFP must be advertised. This would give all other potential Bidders the opportunity to respond. This can only be done after approval had been obtained from both the person who signed off the RFP document and the relevant AC. The cancellation must be advertised in the same media where the initial advertisement was placed. If the cancellation and reissue happen simultaneously, they may be advertised together where the re-issue makes reference to the cancellation. In such instances, it will not be necessary to obtain AC approval for a non-award, as this will delay the matter unnecessarily at this critical stage. However, full details of this 'intervention' must be disclosed to the AC when the final award of business recommendation is made.

21.13 General

21.13.1 we note the DOA is defined in the PPM as "The extent of authority required in order to implement certain actions by or on behalf of the company, including any sub-delegation of authority where permitted. This includes the power to retrospectively authorise, condone or rescind a decision already taken by a sub-delegate."

21.13.2 in the application section at 3.2, the PPM provides:

"...all procurement within Transnet must be conducted in accordance with the PPM.

3.2.1 Non-compliance with the PPM will be regarded in a serious light as it could result in Irregular Expenditure and/or Fruitless and Wasteful Expenditure in terms of the PFMA.

3.2.2 Section 51(1)(e) of the PFMA places an obligation on Transnet to take the necessary appropriate action regarding acts of financial misconduct.

Failure to comply with the provisions of the PPM will lead to disciplinary action and depending on the severity of the non-compliance, possible dismissal and/or legal action. As a general rule, condonation of non compliance with procurement policies and procedures is not permitted in terms of the PPM."



CHAPTER V: SCOPE OF WORK

22 Summary of Transaction

- 22.1 Transnet commenced a tender process in or about 2012 for the acquisition of 1064 electric and diesel locomotives for its GFB. Due to its magnitude, the Transaction was set to undergo a High Value Tender Process as per an approved High Value Tender methodology. The process is provided for in the version of the PPM to hand. The methodology to be applied was not made available to Werksmans notwithstanding numerous requests.
- 22.2 The RFPs for the locomotives per the Transaction were issued to market in two parts, respectively, on 23 July 2012 and 11 December 2012. After various extensions, the bids closed on 30 April 2013, after bidders' responses were received and the evaluation process commenced.
- 22.3 Four bidders, CSR, CNR, GE and BT were eventually shortlisted for negotiations. Upon completion of negotiations, the Transaction was awarded to these four OEMs and the Transaction Agreements were concluded on 17 March 2014.
- 22.4 At paragraph 4.14 of the Forensic Audit Report, it is found that "it is clear *inter alia* from an examination of the actual workings of the estimated total cost of R38.6 billion in the Business Case that this amount *did* take into account both cost escalations, and the cost of forex hedging".
- 22.5 As stated above, the BOD approved the Transaction in 2013 on the basis of 1064 Business Case which states in its 'purpose' section:

"...it is recommended that the 1064 Locomotives Business Case be approved with estimated total costs of the acquisition of R38.6 billion as per the Corporate Plan (excluding the potential effects from forex hedging, forex escalation and other price escalations)."



- 22.6 The BOD then approved the increase in ETC for the Transaction on 28 May 2014.¹⁸ The merits of this increase and related decisions and/or actions that gave rise to same are discussed more fully below.
- 22.7 Documentation and material dates considered in compliance with the Mandate are tabled as an appendix hereto,¹⁹ along with a list of all persons and entities involved in the Transaction and a document that outlines the process the Transaction was intended to follow. Refer to appendix 9 and 10 a summary of the Transaction up to the short listing of the preferred bidders and include²⁰
- 22.8 What follows below is a recordal of certain aspects of the Transaction which, in our view and that expressed in the Forensic Audit Report, warrant consideration by a judicial body with the requisite prosecutorial and inquisitorial powers as set out herein above.

23 PPPFA Compliance

- 23.1 As regards the PPPFA, Transnet had sought to include SD and additional employment criteria (e.g. FRC, minimum B-BBEE thresholds and set asides) within its evaluation framework for the Transaction whilst still adhering to the prescripts of the PPPFA. Proposals to incorporate same were submitted to the BADC for approval in March 2013.²¹ The BADC approved the approach subject to a legal opinion from senior counsel. The following factual matrix in relation to this aspect of the Transaction applies:
- 23.1.1 on 7 December 2011, the Minister of Finance exempted all Schedule 2 public entities per PFMA from the application of the PPPFA and its regulations for a period of 12 months ("**Exemption**"). This period would therefore expire on 7 December 2012. The only regulations that remained applicable to Transnet in light of the exemption were those dealing with

¹⁸ See appendix 12 above.

¹⁹ See a chronology of noteworthy events and dates relating to the transaction, as well as list of persons and/or companies involved in the Transaction and a summary of the process the Transaction was intended to follow, appendix 18.

²⁰ See footnote 13 above.

²¹ See memorandum to BADC of 12 March 2013 requesting approval, appendix 19.



local production and content and Tax Clearance matters, that is regulations 9, 11(10) and 14;

23.1.2 on 16 July 2012, National Treasury issued a number of Instruction Notes in line with regulation 9 regarding the invitation and evaluation of bids based on a stipulated minimum threshold for local production and content in designated sectors. Of significance to Transnet, National Treasury's instruction note styled *"Invitation and Evaluation of Bids Based on Stipulated Minimum Threshold for Local Production and Content for the Rail Rolling Stock Sector"* ("**Instruction Note**") had the effect that the Exemption was withdrawn such that it would no longer apply;

23.1.3 at this stage, Transnet had been in the process of finalising the RFPs for the Transaction. Thus, on 17 July 2012, Transnet's iSCM met with officials of National Treasury to understand the implications of the Instruction Note in relation to the Transaction RFP's, which were due to be issued to the market on 23 July 2012. National Treasury clarified that the Exemption still applied to non-designated sectors, but not in respect of designated sectors (e.g. rail rolling stock). Transnet was thus required to follow the prescripts of the Instruction Note, in particular in regard to scoring preference strictly in accordance with the with 90/10 principle, as the Transaction was for a tender above R1 million;²²

23.1.4 Transnet resolved to continue with the issuing of the RFPs to the market, but that this would be done in two parts. Part 1 was issued on 23 July 2012, duly adhering to the prescripts of the PPPFA / Instruction Note and with the understanding that Transnet would approach National Treasury for full exemption while the RFPs were in the market;

23.1.5 on 7 December 2012, the Shareholder Minister wrote to Transnet,²³ advising Transnet that:

"There are a number of unresolved issues pertaining to the extension of the exemption to State Owned Companies (SOC) from Regulations... I believe that these issues can have a material impact on the ability of Transnet to extract

²² See memorandum to BADC signed on 23 July 2012, appendix 20.

²³ See Shareholder Minister's letter, appendix 21.



optimal commercial, developmental and transformational value from strategic procurements. ...

Given this situation, I am personally engaging with the Minister of Finance ... In the meantime, Transnet should continue to procure as if the extension to the exemption is in place. In addition no communication should take place between the SOC and National Treasury pertaining to the PPPFA until the situation has been resolved...

... With regards (sic) to the Instruction Note relating to the "Invitation and Evaluation of Bids Based Stipulated Minimum Threshold for Local Production and Content for the Rail Rolling Stock Sector" Transnet should procure taking the designation thresholds into account. However, Transnet should not feel constrained by Section 5.1.2 of the Instruction Note and should rather establish an evaluation framework that provides reasonable incentives to suppliers to support our industrialisation and transformation objectives. Should my agreement with the Minister of Finance require a change to this framework, Transnet can alert the bidders at that stage." (Own emphasis)

23.1.6 on 11 December 2012 Part 2 of the RFPs were issued in conformity with the BOD approved strategy and not the PPPFA, in coompliance with the Shareholder Minister's instruction of 7 December 2012. Thus, the RFPs were realigned to reflect that the local content requirements as stipulated in the Instruction Note on the designation of the Rail Rolling Stock Sector were taken into account, but no constraints were placed on Transnet's evaluation framework in terms of the 90/10 preference point system;²⁴

23.1.7 on 28 December 2012, Transnet responded to the Shareholder Minister's letter of 7 December 2012.²⁵ Of import, the letter records the following:

"Transnet has complied with your request regarding the issuing of the 1064 locomotive tenders, and has aligned both RFP's with your instruction...

It is our legal interpretations that, pending the outcome of your bilateral with the Minister of Finance, it is prudent for Transnet to comply with the PPPFA regulations given that no formal exemption has been granted at date. This is in order to mitigate against the risk of challenge by potential bidders and the risk of irregular expenditure in terms of the Public Finance Management Act. We request the Honorable Minister, to continue procuring generally on all other procurement events outside of the 1064 locomotives, strictly in line with Government Notice No R1027 of 7 December 2011..."

23.1.8 on 15 April 2013 Transnet again wrote to the Shareholder Minister,²⁶ recording amongst other the following:

²⁴ See Transnet's letter to the Shareholder Minister of 28 December 2012, appendix 22.

²⁵See appendix 22.

²⁶ See Transnet's letter to the shareholder Minister, appendix 23.



"The tender for the procurement of the locomotives was issued on the 23rd July 2012.

Transnet noted your correspondence relating to the application of the Preferential Procurement Policy Framework Act (PPPFA) to this acquisition, in particular the letter received on 7 December 2012. Transnet issued Part 2 of the Request for Proposals (RFPs) ... in compliance with your request... Local Content was included as a stipulated minimum threshold but Transnet did not consider itself bound by Paragraph 5.1.2 of the Instruction Note on Rail Rolling Stock.

The tenders' closing date has duly been extended to 30 April 2013...

Transnet was informed that National Treasury has indicated that exemptions from the PPPFA will be considered for strategic projects on a case by case basis...

Matters have, however, progressed to a point where the closing date is fast approaching and Transnet has not yet received confirmation with regard to the request for exemption in relation to this acquisition...

While Transnet is completely supportive of the Minister's position, there is a concern that unless an exemption is formally granted by the Minister of Finance, the evaluation process based on the tender documents that have been issued and the subsequent award of the tender will be in conflict with the PPPFA, thus creating significant legal risk for Transnet. Failure to adhere to any aspect of the Act, its regulations and Instruction Notes could expose Transnet's bid processes to legal challenges and also result in irregular expenditure if the contracts are awarded contrary to the requirements of the PPPFA. Hence, to place the process on sound footing, Transnet needs to either comply with the PPPFA or we require a letter from the Minister of Finance specifically exempting Transnet from the PPPFA, its regulations and the applicable Instruction Note in relation to this acquisition."

23.1.9 on 16 April 2013, the Shareholder Minister wrote to the Minister of Finance, requesting that Transnet be allowed to *"conclude this procurement process with exemption from the Instruction Note's re-instatement of the 90/10 provision of the PPPFA in SOC capital procurements"*.²⁷ This letter refers to a letter by the Minister of Finance received by the Shareholder Minister on 12 December 2012, which letter Werksmans has requested but has, to date, not received. In relation to the 12 December 2012 letter, the Shareholder Minister states:

"I refer to your letter received on 12 December 2012 regarding the extension of the PPPFA to State Owned Companies (SOC).

I would like to assure you of my support for the stance taken by the NT on the issues related to the PPPFA contained in your letter. Your suggestion on restricting exemptions to strategic projects which are to be addressed on a case by case basis is a pragmatic approach which needs to be explored as soon as possible. I am also of the view that a coherent, robust and transparent

²⁷ See the Shareholder Minister's letter to the Minister of Finance, appendix 24.



framework needs to be applied to these case by case assessments which will create a level of certainty in a complex SOC procurement environment ..."

23.1.10 V Soni SC ("**Soni SC**") provided Transnet with an opinion dated 19 April 2013,²⁸ in relation to the implication of the Instruction Note on the Transaction. This opinion concludes that Transnet complies with PPPFA since the RFPs were initially issued to the market on 23 July 2012, which was at a time that the Exemption was still in place. According to Soni SC, nothing turns on the fact that Part 2 of the RFPs were issued at a time when the exemption was no longer effective, being on 11 December 2012 (the exemption lapsed on 7 December 2012). This is so, as the argument goes, because Parts 1 and 2 of the RFPs remain one and the same tender, albeit split into two parts. They should therefore fall to be considered under the legislative provisions in force at the time of issue of Part 1 of the RFPs, which was in fact issued at the time that the Exemption was still operational; and

23.1.11 on 26 April 2013 the Minister of Finance responded to the Shareholder Minister's letter of 16 April 2013,²⁹ in which response the following is stated:

"...
On scrutiny of the tender document published in July 2012, it is noted that the tender was structured in a manner that is not in conflict with the National Treasury's instruction note issued in July 2012.

In light of the above, I am of the view that Transnet should proceed with the evaluation of the tender in terms of the criteria stipulated therein."

23.2 The Minister of Finance's letter of 26 April 2013 constitutes confirmation that the tender document issued in July 2012 does not contravene the Instruction Note. As regards this letter of 26 April 2013:

23.2.1 Werksmans requested confirmation from National Treasury of the authenticity of the letter. This was pursuant to a meeting conducted at National Treasury in September 2017, which office undertook to revert but has yet to do so;

²⁸ See Soni SC's opinion, appendix 25.

²⁹ See the letter from the Minister of Finance, appendix 26.



- 23.2.2 the Minister of Finance expressly states that he has had regard to the *"tender document issued in July"* and verifies that the evaluation criteria per this July document was not in conflict with the Instruction Note. Our observation is that this letter therefore addresses only Part 1 of the RFPs of the transaction.
- 23.3 The PFMA, in particular section 92 thereof, provides for exemption to be communicated by notice in the national Government Gazette. Werksmans has not been provided with nor has it been able to obtain such notice in respect of the exemption from the application of PPPFA, its Regulations and Practice Notes in relation of the Transaction.
- 23.4 The PPPFA aspect of the Transaction requires further investigation to verify that the evaluation process based on the tender documents that were issued and thus the subsequent award of the Transaction was in fact not in conflict with the PPPFA. This is required given that, as previously stated, failure to adhere to any aspect of the PPPFA, its regulations and Instruction Notes could expose Transnet's bid processes to legal challenges and constitutes irregular expenditure should the contracts be found to have been awarded contrary to the requirements of the PPPFA.

24 **1064 Business Case**

- 24.1 Having had regard to the evidence reviewed relating to the Transaction during the period 2011 to 2014, Werksmans identified that the BOD approved the recommendation of the 1064 Business Case on 25 April 2013,³⁰ at an estimated total cost of R38.6 billion.
- 24.2 Werksmans have considered and analysed a plethora of written evidence relating to the 1064 Business Case and during interviews ascertained the notion to replace the existing fleet at GFB gained traction around the period 2008/2009.

³⁰ See appendix 12 above.



- 24.3 This culminated in a TFR fleet strategy, which was conceptualized in 2011 and Transnet embarked upon a major project, which project included the Transaction under consideration, in order to achieve an increase in GFB volumes and to retire the existing fleet. To advance the TFR strategy and the resultant fleet plan of the Transaction, the genesis of the 1064 Business Case, came into being.³¹
- 24.4 An early version of the 1064 Business Case served before Transnet's various governance structures/internal approval bodies throughout the period March 2012 to April 2013. Chapter 24 of the PPM details the functions of governing structures and departments.³² This is evidenced by, amongst others, excerpts of minutes of Transnet Freight Rail Capital Investment Committee ("**TRFIC**") and Group Capital Investment Committee ("**CAPIC**").³³
- 24.5 On 21 May 2012 CAPIC, deliberated on the appointment of *"an external party to review the business case and provide a risk assessment"*.³⁴
- 24.6 On 22 August 2012, Molefe approved the appointment of the McKinsey consortium for the complete advisory services set out in the memorandum compiled by Yusuf Mahomed and recommended by Pita and Singh.³⁵
- 24.7 Werksmans sought to initiate a meeting with McKinsey in accordance with the Mandate, and was subsequently advised by McKinsey's attorneys of record to communicate through the said attorneys. As a consequence, Werksmans wrote the letter set out below to McKinsey's attorneys of record on 19 October 2017:

"Dear Sir

**ACQUISITION OF 1064 LOCOMOTIVES FOR TRANSNET SOC LIMITED'S
("TRANSNET") GENERAL FREIGHT BUSINESS ("TRANSACTION"): INQUIRY**

1 We refer to the above matter and your letter sent to us on Wednesday, 18 October 2017 October ("your letter"), on behalf McKinsey & Company ("your client").

³¹ See the 45 page business case, appendix 27.

³² See appendix 17 above.

³³ See excerpts of minutes of TFRIC and CAPIC, appendices 28 and 29.

³⁴ See excerpt of minutes of CAPIC, appendix 30.

³⁵ See copy of memorandum, appendix 31.



2 We hereby express our gratitude for your client's willingness to assist with the inquiry aforesaid. We kindly request confirmation that it is in order for the proposed meeting of 31 October 2017 from 13h30 with Mr Parbhoo (in your presence) to be conducted at our offices.

3 As regards the request for advise on particular aspects to be canvassed during the meeting, we note the matters to be discussed in relation to the Transaction include:

3.1 Your client's exact relationship with Regiments (or any company in the Regiments group and/or its predecessors) ("Regiments");

3.2 Splitting of work with Regiments and the extent of interaction in this regard;

3.3 Payments by your client to Regiments;

3.4 Your client's role in the tender evaluation of the Transaction;

3.5 Your client's role in the reduced delivery time, reducing order quantities per Original Equipment Manufacturers ("OEMs") and introduction of 2 further suppliers in the Transaction;

3.6 Your client's role in the relocation of two of the OEMs to Durban;

3.7 Your client's role in the Business Case including:

3.7.1 Calculation of locomotive costs including escalation and hedging;

3.7.2 Forecast Volumes;

3.7.3 Forecast Tariff increases; and

3.7.4 Additional 38+95+100 locomotives being bought said to mitigate risk of delays in contract award on MDS (without reduction of 1064);

3.8 We kindly request receipt of copies of the following documentation/information prior to the envisaged meeting:

3.8.1 All contracts concluded and correspondence exchanged with Regiments;

3.8.2 In so far as Transnet is concerned:

3.8.2.1 copies of any Terms of Reference/mandate/letter of appointment by Transnet to your client;

3.8.2.2 All deliverables produced by your client pursuant to paragraph 3.8.1, above;

3.8.2.3 All/any invoices and confirmation of payments issued to date; and

3.8.2.4 Total fees billed and received by your client.

4. Kindly note we also intend to clarify and establish whether your client interacted and/or was associated with any other third party advisor on the Transaction.

5. We note representatives of Werksmans as well as those of the Professional Group, led by Professor Harvey Prof Wainer, will be present.

6. We look forward to your client's favourable response hereto and now await your advise.

Yours sincerely"



- 24.8 Pursuant to a scheduled meeting with McKinsey's attorneys of record, Werksmans received the following:³⁶
- 24.8.1 a document styled "**Revised scope per request from Transnet 31 January, 2014**" (emphasis added);
- 24.8.2 a document styled "**Memorandum of withdrawal 04 February, 2014**" (emphasis added); and
- 24.8.3 a version of the 1064 Business Case comprising 102 pages, dated 18 April 2013.
- 24.9 The import of the appointment and withdrawal of McKinsey as set out in the documentation stated above is dealt with below.
- 24.10 We have had regard to an abridged version of a "*TOP SECRET*" minute of the meeting of the BOD held on 25 April 2012, wherein it was resolved that a process would be followed for the acquisition of the Transaction with reference to "*procurement strategy and process, Capital and Financial Risk, subject to PFMA approval*".³⁷
- 24.11 In a memorandum from Singh to Molefe dated 29 April 2013, it is stated that on 23 April 2013, the 1064 Business Case served before the BADC, and was tabled for a special BOD meeting held on 25 April 2013. The memorandum of 29 April 2013, also records that an interactive session had been arranged with representatives from the office of the Shareholder Minister for 25 April 2015.³⁸ The memorandum further states:

"The business case has been amended to incorporate all changes and suggested inclusions from the BADC meeting. The business case has also been updated to incorporate certain changes and informational requirements stemming from the session with the DPE.

...

It is recommended that the GCE sign off the final business case for the Acquisition of 1064 locomotives for GFB..."

³⁶See copies of documents from McKinsey's attorneys of record, appendices 32, 33 and 34.

³⁷ See excerpt of meeting of the BOD, appendix 35.

³⁸ See copy of the memorandum, appendix 36.



- 24.12 Werksmans have requested a copy of the signed version of the 1064 Business Case, this document has not been provided and could not be procured.
- 24.13 Email evidence of 26 April 2013, further shows that the Business Case was supplemented.³⁹ No evidence has been furnished that the final version of the 1064 Business Case, after supplementation and/or amendment post 25 April 2013, served before either the BADC or the BOD, as it should have.
- 24.14 On or about 30 April 2013, Transnet made an application in terms of section 54 of the PFMA to the Shareholder Minister and notified the Minister of Finance of that application on the same date ("**Section 54 Application**"). The Section 54 Application refers to the 1064 Business Case as an annexure thereto. Notwithstanding various requests from Werksmans to Transnet to provide a copy of the actual version of the business case attached to the Section 54 Application, a copy thereof had not been provided at the time of preparing and finalising this report.
- 24.15 The Shareholder Minister approved the Section 54 Application based on the 1064 Business Case submitted per a letter dated 3 August 2013.⁴⁰
- 24.16 Werksmans conducted interviews *inter alia* with Molefe (Group Chief Executive at the relevant time), Gama (TFR Chief Executive at the relevant time), and Thamsanqa Jiyane ("**Jiyane**", TFR Chief Procurement Officer ("**CPO**") at the time). Considering the recommendations in the Forensic Audit Report and the problems identified as to the extent of the financial commitment to which Transnet would be exposing itself, the conduct of the aforementioned executives must be investigated.
- 24.17 As is evident from the Forensic Audit Report, the findings are seriously adverse, and involve vast sums of money. He has identified *inter alia* that materially misleading and incorrect and inadequate information was provided to the BOD, and that there was a lack of application by the executives and the BOD to the actual 1064 Business Case. In addition, the Forensic Audit Report provides that part of the increase over the originally approved ETC appears excessive, and he

³⁹ See copy of email, appendix 37.

⁴⁰ See Shareholder Minister's approval, appendix 38.



identified instances of suspicious conduct suggesting bribery and/or at the very least wasteful expenditure.

25 Section 54 Approval

25.1 From what can be gleaned from the evidence and considering the communication amongst National Treasury, the Shareholder Minister and Transnet, the following matrix is relevant to the Transaction in relation to section 54(2) PFMA approval:

25.1.1 Transnet submitted the Section 54 Application to the Shareholder Minister and the concomitant notification to National Treasury, through the Chairperson of the BOD under documentation signed on 30 April 2013. It is apparent that the documentation was in fact lodged with the respective ministries on 3 May 2013;⁴¹

25.1.2 a due diligence process was undertaken by the office of the Shareholder Minister. This process seemingly included engagements with Transnet, on at least two occasions, and guidance was provided to Transnet by this office, ostensibly in relation to a PFMA questionnaire to be included in the Rolling Stock Acquisition Programme;⁴²

25.1.3 the shareholder Minister responded to the Section 54 Application on 3 August 2013, granting approval subject to certain conditions. Transnet duly provided a response the Shareholder Minister on 19 November 2013;⁴³

25.1.4 the Minister of Finance addressed a letter to Transnet on or about 31 October 2013,⁴⁴ noting the Section 54 Application and advising that National Treasury looks forward to finalisation of the project. The Minister of Finance further requested quarterly feedback on the status of the

⁴¹ See copy of Transnet memorandum of 21 February 2014, appendix 39.

⁴² See internal memorandum circulated within the Department of Public Enterprises on 13 June 2013 and PFMA Section 54 Questionnaire for inclusion in Rolling Stock Acquisition Programme, appendices 40 and 41.

⁴³ See Transnet's letter addressing conditions, appendix 42.

⁴⁴ See letter from the Minister of Finance to Transnet, appendix 43.



acquisition and mentioned other related issues, including a further section 54(2) "*disclosure on all relevant capital expenditure associated with the project*" having foreseen that the "*success of the project entails further capital expenditure*";

25.1.5 the Minister of Finance's letter of 31 October 2013, was received by Transnet's Group Capital Integration and Assurance on 14 January 2014,⁴⁵ which "*request*" was actioned immediately to Freight Rail for input, which was provided on 23 January 2014. Transnet responded to the Minister of Finance's letter of 31 October 2013 on 11 March 2014.⁴⁶

25.2 The PFMA, and its regulations (and/or other related legislative provisions) provide the following in relation to approval:

25.2.1 section 51(1)(c) of the PFMA provides that an Accounting Authority, as defined, for a public entity is responsible for the management, including safeguarding, of assets and for management of revenue, expenditure and liabilities of the public entity. The BOD is the relevant Accounting Authority *in casu* on the basis of 49(2)(a) of the PFMA;

25.2.2 section 54(2)(d) provides that before a public entity concludes a transaction, which amounts to the acquisition or disposal of a significant asset, the Accounting Authority for that public entity must promptly and in writing inform the relevant treasury of that transaction and submit relevant particulars of the transaction to its Executive Authority, as defined, for approval of the transaction. The Transaction in question falls within the ambit of this subsection;

25.2.3 in terms of section 54(3), a public entity "*may assume that approval has been given if it receives no response from the Executive Authority on a submission within 30 days or within a longer period as may be agreed to between itself and the executive authority*";

⁴⁵ See appendix 39.

⁴⁶ See Transnet's response letter to the Minister of Finance, appendix 44.



- 25.2.4 as foreshadowed, the PFMA works in tandem with other legislative provisions including the Treasury Regulations for departments, trading entities, constitutional institutions and public entities as amended ("**Regulations**") and National Treasury's practice note on applications under section 54 of the PFMA by public entities ("**Practice Note**"). National Treasury issued the Regulations and the Practice Note in terms of section 76 of the PFMA and any amendment thereof or substitution therefor from time to time. To this end:
- 25.2.4.1 clause 4 of Practice Note clarifies that applications in terms of Section 54(2) must be addressed to the public entity's own Executive Authority (for approval) and to the Minister of Finance (for concurrence) simultaneously;
- 25.2.4.2 the Practice Note provides guidance on determining whether a particular transaction should be approved in terms of section 54(2). Clause 3.4 of Practice Note clarifies that a transaction is a significant transaction, and thus subject to section 54(2)(d), if its rand value falls within the parameters outlined in clause 3.7;
- 25.2.4.3 clause 3.7 contains the following statement:
- "It should be noted that in terms of Treasury Regulation 28.3.1, acceptable levels of significance must be agreed with the Executive Authority. In arriving at acceptable levels of significance, the guiding principles set out below should be applied."*
- 25.2.4.4 the above clause is addressed in the Shareholder's Compact, being an agreement entered into in terms of the Regulations between the Shareholder Minister and the BOD, on an annual basis. The relevant provisions of the Shareholder's Compact will be addressed below; and
- 25.2.4.5 the Practice Note also clarifies that the 30 day period referred to in section 54(3) of the PFMA commences on the date of receipt by the Executive Authority of the application and provides details on the information which public entities must submit to their Executive Authorities in support of the said applications.



25.3 Subject to validation of the observations at paragraph 4.24 of the Forensic Audit Report, Transnet ostensibly adhered to section 54 of the PFMA insofar as the original ETC of R38.6 billion is concerned given that:

25.3.1 the Transaction in question was a significant transaction within the meaning of the applicable provisions and was therefore subject to approval in terms of section 54(2) of the PFMA. Such approval was accordingly sought on 3 May 2013, and given on 3 August 2013, subject to certain specified conditions which conditions appear to have been met regard being had to Transnet's letter of 19 November 2013;⁴⁷

25.3.2 as regards the content of the then Minister of Finance's letter of 31 October 2013:

25.3.2.1 specific concerns are raised in relation to the already submitted section 54 Application and further documents/information are required to be submitted;

25.3.2.2 Transnet is directed that certain actions are to be undertaken during the implementation and lifespan of the project; and

25.3.2.3 a further section 54(2) disclosure is required to be made on further capital expenditure associated with the project.

25.3.3 pursuant to an inquiry directed to Werksmans' forensic auditor relating to the content of Transnet's response of 11 March 2014 to the Minister of Finance's letter of 31 October, the forensic auditor made the following observations:

"TRANSNET 1064 LOCOMOTIVES INVESTIGATION

1. *You requested a short comment on the pack of documents provided to me on 25 October 2017, and in particular on the 11 March 2014 Transnet letter in response to the National Treasury queries.*
2. *Leaving aside the fact that certain of the questions posed by Treasury were not really directly addressed in the Transnet letter, the most pertinent issues appear to be the following:*

⁴⁷ See appendix 42.



2.1 para 3a of the Transnet letter of 11 March 2014 says that:

"Capital cost outflows for the procured locomotives have been structured with a payment strategy similar to previous locomotive transactions. Basically 10 % advance payment ..."

The purchase price ... with minimum premium for localisation capped at 2 % of the purchase price ..." (It is evident that the word "minimum" was meant to be "minimal");

2.2 as regards the "payment strategy":

2.2.1 my understanding of the contracts is that these do not evidence a 10 % advance payment, except for the GE contract;

2.2.2 the CNR contract provides for 10 % plus 5 % i.e. 15 % before any deliveries (thus being "advance payment"); the BT contract provides for 9 % + 9 % + 9 % i.e. 27 % before any deliveries (thus being "advance payment"); the CSR contract provides for 10 % plus 20 % i.e. 30 % before any deliveries (thus being "advance payment");

2.2.3 accordingly the statement that the payment strategy was "basically 10 % advance payment" appears to have been clearly incorrect;

2.2.4 note that in the CSR and CNR tenders, the total payments before locomotive acceptance (i.e. the prepayment element) was 2% and 1% respectively, for which each scored the maximum of 10 points in the CFET process. During the negotiation phase these terms improved significantly in favour of these bidders to 30 % for CSR and 15 % for CNR;

2.3 as regards the localisation premium said to be capped at 2 %:

2.3.1 by the date of the Transnet letter of 11 March 2014, the so-called clarification letters from the OEMs had been received in which the OEMs identified the premium that would be required if they were obliged to use TE as their local sub-contractor instead of other local sub-contractors;

2.3.2 the amount of the premiums amounted to billions and thus self-evidently were significantly beyond a cap of 2 % of the overall purchase price;

2.3.3 as examples, based on the information provided by the OEMs in the "clarification" responses, the effect of using TE as the local sub-contractor (instead of another local sub-contractor) added 12 % to the price (CSR) and 6.6 % (Bombardier);

2.3.4 the above was based on the original TE scope, which expanded later. Based on the final contract the effect of using TE as the local sub-contractor (instead of another local sub-contractor) added 15.9 % to the price (CSR) and 11.4% (Bombardier). [CSR R3.48m original TE scope + R1.113m additional scope = R4.593m divide R28.890m. Bombardier R1.905m original scope + R1.399m additional scope =



*R3.304m divide R29.049m]; This is for Electric locomotives.
The TE premium is not specified in Diesel costing schedules.*

- 2.3.5 *notably, this is not the total localisation premium – it is only the TE premium over and above another local supplier price. There is insufficient information to calculate the total localisation premium, but it was manifestly well above the percentages above;*
- 2.3.6 *thus the statement that there would be a “minimum” (meaning minimal) premium for localisation capped at 2 % of the purchase price appears to have been clearly factually incorrect;*
- 2.3.7 *the relocation cost of move to Durban of R1.2billion should probably also be included in the calculations -which would increase the TE “localisation” percentages above. The relocation costs would not have been known by 11 March 2014, but it is likely that the requirement for the relocation (which would obviously come with a cost) would have been known.”*

26 Post section 54 approval

26.1 Having regard to what is set out above the following matters warrant investigation:

- 26.1.1 whether the Transaction as approved by the Shareholder Minister requires a *de novo* application as a consequence of the acceleration of the delivery period and splitting of the batch size (discussed further below) which fundamentally changed the nature of the Transaction and resulted in the attendant further increase in ETC. These *essentialia* are not covered in the original application and require sanction and approval on their own merits in terms of section 54(2) of the PFMA;
- 26.1.2 during or about September 2017 Werksmans interviewed officials of National Treasury. When these observations were brought to the attention of National Treasury, it undertook to respond thereto. At the time of preparing and finalising this report, National Treasury had still not responded in terms of its undertaking;
- 26.1.3 the Forensic Audit Report opines that the truncation and splitting of the batch size were fundamentally important changes, which had a material effect on the Transaction and that the truncation and costs of splitting were not explicitly or accurately addressed in any submission to the BOD. In



addition, three of the six reasons provided in the submission to BADC supporting the split were irrational and were furthermore omitted from Molefe's May 2014 memorandum to the BOD;

26.1.4 the Corporate Plan, MDS, as well as submissions to the Shareholder Minister and to National Treasury are all based on the Transaction rolling out over a period of 7 years. There is no documentation which has been provided evidencing communication to either Ministries involved in the Transaction identifying the increase of capital expenditure, having had regard to the accelerated acquisition period;

26.1.5 as observed in the Forensic Audit Report in the section dealing with the analysis of reasons for increase and on the assumption that no written working papers or analyses exist for reasonableness of the conclusion of the Transaction Agreements in March 2014 and furthermore without BOD approval until 28 May 2014, then these are matters that justify an inquiry. As recorded in the Forensic Audit Report:

"5.14 The fundamental questions posed are whether the increases were reasonable and justified, and whether the prices were fraudulently inflated through corruption or other dishonest means i.e. whether the final prices and the amount of R54.5m were falsely inflated."

26.1.6 moreover, the increase in ETC becomes a further point of inquiry having regard to National Treasury's advice that the Transaction, as notified, will of necessity lead to further capital expenditure, and in respect of which further expenditure the Minister of Finance expected a further section 54 request.⁴⁸

27 Shareholder's Compact and DoA

27.1 As stated above, the Shareholder's Compact is an agreement concluded between a SOE and its Executive Authority on an annual basis. The Shareholder's Compact effective as of 25 June 2013 ("**Shareholder's Compact 2013/2014**"), is applicable to the Transaction insofar as the increase in ETC is

⁴⁸ See appendix 43.



concerned.⁴⁹ Its precursor (effective as of 26 April 2012) ("**Shareholder's Compact 2012/2013**") ceased to be operational as at 25 June 2013, and its substitute became effective on 8 May 2014. The relevant provisions of the Shareholder's Compact 2013/2014 include:

"8. SIGNIFICANCE AND MATERIALITY

In accordance with the provisions of Treasury Regulations 28.3, the framework for significance and materiality is set out in Annexure E.

9. PERIOD OF SHAREHOLDER'S COMPACT

9.1 This Shareholder's Compact is valid for period of one year.

9.2 The Parties hereby record and acknowledge that they are required, in terms of the Treasury Regulations, to annually conclude a shareholder's compact and agree that this Shareholder's Compact shall remain in full force and effect until a new Shareholder's Compact is concluded as required by the Treasury Regulations.

9.3 The process for the annual conclusion of a new Shareholder's Compact may be initiated by any one of the Parties through written notice. Upon receipt of such notice by the other Party, the Shareholder's Representative and the Board shall commence negotiation.

10. NO AMENDMENT

10.1 This Shareholder's Compact constitutes the whole agreement between the Parties relating to the subject matter hereof and supersedes any other discussions, agreements and/or understanding regarding the subject matter hereof.

...

ANNEXURE E: SIGNIFICANCE AND MATERIALITY FRAMEWORK

This appendix sets out the standing in terms of Sections 54 of the PFMA and provides guidance for the determination of the materiality limit in terms of section 55 (2) of the PFMA

...

Exemption from Section 54 of the PFMA

554(2) (d)... Acquisition or disposal of a significant asset..

If acquisition does not exceed 2% of the 31 December 2012 audited asset base value (which equates to R 3.9 billion), however the Department should receive a detailed notification for all acquisition and disposal of assets above R 2 billion."

27.1.1 the Shareholder's Compact 2012/2013, effective 26 April 2012, included the following provision:

"Projects approved by the Shareholder in terms (sic) S 54(2)(d), will be reported to the Shareholder, if the original cost is exceeded by 15%".

⁴⁹ See appendix 15.



- 27.1.2 the Shareholder's Compact 2013/2014, does not contain a similar provision. There is, in consequence, uncertainty whether to report to the Shareholder Minister in cases where original costs exceed 15% particularly having regard to the provision of the DoA effective as at 1 June 2013,⁵⁰ which is applicable to the Transaction and records:

"5.1.3 Increase in Estimated Total Cost (ETC) of Existing/Approved Projects

...

Increase in ETC of projects already approved by the Shareholder Minister must be reported to the Shareholder Minister if the increase is in excess of 15%.

...

Amounts indicated above exclude the capitalisation of borrowing costs. Increases in ETC of a project solely due to the capitalisation of borrowing costs may be approved by the OD Exco/CE. Project costs and capitalisation of borrowing costs are to be managed separately and may not be expended on projects interchangeably."

- 27.2 It appears from the above extract that the percentage referenced therein is measured without taking into account interest costs that might be capitalised. The wording of any Shareholder's Compact must conform to the prescripts of the PFMA and cannot circumvent, contradict, or undermine legislation. Paragraph 17 of Molefe's memorandum of 23 May 2014, in which he contends that the Shareholder Minister need only be notified for the sake of good governance, is contrary to legislation, the PFMA in particular having regard to its preamble and objectives. The PFMA required a further application in terms section 54, given the extent of the increase. Transnet's policy and/or the shareholder's compact and/or Molefe's assertions,⁵¹ all of which seem to suggest that such further approval was not required is not in accordance with the prevailing legal position. Further, given the following deliberations of the BADC on 26 February 2014, it may be inferred that Transnet already knew that the provisions of the PFMA were being transgressed:

"5.1.8 Mr Mkwanazi sought clarity on the sum total of R37bn. Ms Njeke stated that the total cost of the acquisition was not reflected for the Committee's consideration, therefore making the total costs unclear. She was concerned that some costs elements were missing from the presentation that was

⁵⁰ See appendix 16.

⁵¹ See Molefe's memorandum of 23 May 2014 at paragraph 17, as quoted further below in chapter V, appendix 45.



presented by Management, such as the Scope of Works for TE and the total value. She requested that TE's scope value be stated. She sought clarity whether the Company reviewed the number of locomotives being procured as it appeared that the Company had reached the target of 1066 locomotives. She further enquired if the Company was planning on using the R38bn in light of uncertainty with future amounts. She stated that National Treasury tolerated up to 11% on price differences. The Company's price difference amounted to 125% which far exceeded National Treasury's limit. In response to the Committee's request, Management submitted an updated schedule regarding the R52bn for relocation purposes." (Own emphasis)

27.3 In light of the above and the commentary in the Forensic Audit Report,⁵² the increase in ETC remained reportable to the Shareholder Minister. No evidence has been made available evidencing the reporting of the increase nor of a further section 54 approval.

27.4 In addition as regards the DoA, clauses 5.2.7 and 5.4 respectively provide:

"FX hedges to be hedged by external suppliers on their balance sheet for goods/services to be delivered to Transnet in respect of Rand agreements involving foreign content

... Business Units must always obtain quotes on FX forward rates and liaise with the Treasury Trading desk that will verify the rates to ensure it is market related. The Business Units can only enter into the FX hedges with the supplier once the rates are accepted by the Treasury Trading desk via e mail. Once the above approvals are obtained, the Treasury Traders will provide sign off on the rate acceptance

...

Procurement

All procurement transactions (including reverse logistics – selling of goods) must fully comply with the approved Transnet Supply Chain Policy and Procurement Procedures Manual (PPM) ... Any commercial agreement (for the purchase of goods or services) must be signed off by an authorised employee of Supply Chain Management (Procurement) prior to signing of the contract to indicate that all the steps as per clause 5.5 below have been followed and that all procurement related governance has been adhered to." (Own Emphasis)

27.5 Despite several requests, Werksmans has not been provided with any evidence that Treasury verified the rate submitted by the Bidders. On the information presently available, Werksmans is unable to take the matter further. This Transaction does not fully comply with the provisions of the PPM.

28 Splitting of batch sizes and implementing an aggressive delivery schedule

⁵² See the Forensic Audit Report, "Reasons for increase in cost" from page 40.



28.1 During the period September 2013 to May 2014, the following matters are relevant to determine the financial implications of the splitting of batch sizes and truncating the delivery period, which materially influenced the increase in ETC:

28.1.1 during or about 31 October 2013, the former Minister of Finance penned a letter to the Chairperson wherein the following is recorded:

"I have noted Transnet's intention to acquire 1064 locomotives over the next seven (7) years at an estimated costs of R38.6 billion. I am aware that the acquisition aims to facilitate the ramp up in volumes transported from the current 80 million tons to 170 million tons as envisaged in the Market Demand Strategy (MDS) which forms the basis of Transnet's 2013/14 Corporate Plan.

However, I am concerned that the profitability of the project is highly dependent on Transnet's General Freight Business (GFB) being able to grow the volumes transported at amounts above GDP growth and tariffs charged at above CPI. Failure to achieve these optimistic growth figures would have an adverse effect on the expected revenues and thus the profitability of the project. Moreover, potential fluctuations in the operational costs could also adversely affect the profitability of the project.

The success of the project entails further capital expenditure, including the purchase of wagons and other expansionary expenditure is incurred. Therefore, I will be expecting a further Section 54(2) disclosure on all relevant capital expenditure associated with the project. Furthermore, Transnet must submit a detailed implementation plan demonstrating how the above GDP growth volume increases and the above inflation tariff increases anticipated in the MDS will be achieved together with the possible mitigation strategies. In addition, operational costs must be monitored and rigorously controlled throughout the lifespan of the project to avoid any costs escalations.

Moreover, I have noted that, whereas Transnet is claiming that increasing locomotive capacity and efficiency will lead to lower tariffs for customers; real increases in tariffs are in fact being projected to sustain the project. Transnet must provide regular feedback to National Treasury on their initiatives to attract customers from the road to rail.

I look forward to the finalisation of the project and request that Transnet submit quarterly feedback to National Treasury on the status of the acquisition and the above mentioned related issues.

I trust that you will find the above to be in order."

28.1.2 on 23 December 2013, a memorandum was circulated from the then CPO and CFET Chairperson, Jiyane to Molefe, the then Group Chief Executive, Singh, the then GCFO and Gama then Chief Executive of TFR, recording:



"SUBJECT: REQUEST FOR APPROVAL TO REQUEST FOR THE FINAL AND BEST OFFER FOR THE SUPPLY OF 465 NEW DIESEL LOCOMOTIVES FOR THE GENERAL FREIGHT BUSINESS (GFB)

...

31) *The delivery of these locomotives is critical to TFR and the whole of Transnet in terms of the MDS volumes. TFR prefers that the award of business is split between 2 (two) tenderers in order to ensure that delivery is accelerated.*

32) *the challenge with the split is that price difference between the highest scoring tender and the next bidder is more than 13% higher."*

28.1.3 on 27 December 2013, a memorandum was circulated from Molefe, Singh and Gama to "The Chairperson (Mr. Thamsanqa Jiyane) and the Cross Functional Evaluation Team (CFET)" of the Transaction, wherein it is recorded:

"PURPOSE:

1) *The purpose of this memo is to;*

...

- *Authorize the CFET to issue a request for the best and final offer for both the tenders for 599 New Dual Voltage Locomotives (to only the top 2 highest scoring tenderers while the rest will be informed that Transnet will only engage them should negotiations with the top 2 be unsuccessful and 465 New Diesel Locomotives (all the 4 bidders) for the GFB;*
- *Note that the above actions are subject to the Board of Directors approval;*
- *Recommended to the Transnet Board of Directors to negotiate with 2 highest scoring tenderers and to award the business for the supply of 599 New Dual Voltage locomotives; and*
- *Recommend to the Transnet Board of Directors to negotiate with the 2 highest scoring tenderers and to award the businesses for the supply of 465 New Diesel locomotives.*

...

MOTIVATION

...

9) *The tenders will be split between 2 tenderers each i.e there will be 2 tenderers awarded the 599 New Dual Voltage Locomotives and 2 tenderers awarded the 465 New Diesel Locomotives.*

10) *The selection of 2 tenderers in our opinion reduces the delivery risk; allows for locomotive standardization and reduced complexity from a TE build perspective.*

11) *The request for the Final and Best offer on both tenders will be finalised after the final and best offers are received but before submission to Board for approval.*

12) *The Chairpersons of the BADC and Board of Directors of Transnet has been briefed on the above process and the recommended way forward and they are both in support of this process.*



13) TIA has also been has been (sic) briefed on the above process and the recommended way forward and they in support of this process."

28.1.4 on 17 January 2014, a memorandum by Molefe was addressed to the BADC, recording:

"SUBJECT: REQUEST FOR APPROVAL TO NEGOTIATE AND AWARD OF BUSINESS TO THE SHORT LISTED TENDERERS FOR THE SUPPLY OF 599 (COCO) NEW DUAL VOLTAGE LOCOMOTIVES FOR THE GENERAL FREIGHT BUSINESS

PURPOSE:

1) The purpose of this memo is to;

- Provide an update to Transnet Board Disposals and Acquisitions Committee the progress on the tender evaluation process;
- Note and recommend the approval of the tender evaluation process from step 1 up to step (sic) to the Transnet Board of Directors (BOD);
- Support the recommendation of the shortlist of tenderers as a result of the tender evaluation process for the negotiations and award of business to the BOD and
- Delegate all necessary powers to the Group Chief Executive to sign, approve and conclude all necessary documents to give effect to the above resolutions.

...

10) A sub-committee of the LSC was established to deal with the very confidential and detailed matters of the evaluation process (own emphasis added) and this committee comprised the GCE, GCFO and CE TFR.

11) The CFET reported its finding to this subcommittee for consideration.

...

37) However the pricing of the locomotives posed a commercial exposure for Transnet (own emphasis added) and also the National Treasury concern of not paying excessive premiums as outlined in the PPPFA guidelines of premiums not being more than 11% by the use of the 90/10 evaluation. (See letter penned by the Minister of Finance of 26 April 2013)

...

40) The outcomes of the best and final offer is as follows:

- T1 offered to increase procurement to small businesses by R50 million and technology transfer through skills development training and support by R10 million. In addition they offered a R455 000 reduction in price per locomotive based on a received foreign currency content percentage.
- T2 offered a discount of 2.25 million per locomotive, including a revised foreign currency content amount, thus offering the best price.

The above process has almost eliminated the premium on the transaction." (Own emphasis added).

MOTIVATION FOR SPLIT OF BUSINESS AWARDED

41) The original MDS volumes as promised in the corporate plan are significantly at risk.



42) *This is due to the lack of tractive effort at TFR due to the delays in the award of this tender mainly due to the PPPFA issues experienced.*

43) *In order to not further increase this risk it is suggested that more than one supplier be used to supply the required locomotive to reduce delivery risk and enhance our ability to meet MDS volume targets.*

44) *We recommended that two suppliers be used to manufacture the required locomotives.*

45) *This view is supported by the following reasons:*

- a) *Promotes standardization of the locomotive fleet to ensure TCO is minimized.*
- b) *Allows for critical mass that would enable successful negotiations on price and other critical commercial terms and conditions.*
- c) *Allows for critical mass that would promote localization and programmatic procurement*
- d) *Allows for flexibility in supplier options in future as it prevents monopoly behaviour*
- e) *Reduces the legal risk of the transaction and*
- f) *Reduces the overall contract risk of the transaction due to unforeseen circumstances*

46) *We further believe that the above will be achieved by a 60% allocation to T2 and a 40% allocation to T1 of the contracted locomotives.*

...

CONCLUSION

...

49) *Short list the award of business to T1 and T2 for the supply of 599 electric locomotives subject to successful contract negotiations.*

50) *Split the award of Business to T1 and T2 for the supply of 599 electric locomotives subject to successful contract negotiations."*

28.1.5 in "Excerpts from the Minutes of the meeting of the Board Acquisitions and Disposals Committee no 14/2 held on 26 February 2014", it is recorded:

"5.1.9 Ms Forbes stated that there was inconsistency in the completion of the scheduled and unscheduled maintenance. She sought clarity on the quantification of the schedules. She encouraged thoroughness in procurement. She stated that there were now 12 locomotives produced per bidder, from the 48 locomotives per month for 4 bidders on Diesel and Electric locomotives. She sought clarity if the Committee would have a constantly growing budget. Management stated that, the Company was below the R38bn target (i.e. R37bn) in terms of base price and the approved budget. Additional amounts included hedging and escalation which will be reviewed by Group Treasury. Management informed the Committee that the Company was within budget regarding the 1064 locomotives. "

28.1.6 on page 10 of the draft report of the Finance Negotiation Team to the TFR CE and the GCFO styled "Key outcomes from the negotiations for the



acquisition of 1064 new Locomotives concluded in March 2014", (upon which limited reliance can be placed) it is recorded:⁵³

"Notes:

The forecasts were based on using historical trends of appropriate indices as calculated by Regiments Capital. (own emphasis added)

The calculations above are based on information available at a point in time to Regiments. (own emphasis)

The above calculations were prepared to demonstrate the impact of reducing the batch size and will not tie up to the final negotiated position." (Own emphasis)

28.1.7 on 23 May 2014, Molefe addressed a memorandum to the BOD, recording:

"SUBJECT: INCREASE IN ESTIMATED TOTAL COSTS (ETC) OF THE ACQUISITION OF 1064 LOCOMOTIVE FOR TRANSNET FREIGHT RAIL'S GENERAL FREIGHT BUSINESS (GFB)

PURPOSE:

1) *The purpose of this memo is:*

...

g) *For the BOD to note the reasons for the increase in ETC*

h) *To request that the BOD approve an increase in the estimated total costs for the acquisition of 1064 Locomotives for the General Freight Business of Transnet Freight Rail from 38.6 billion to 54.5 billion.*

...

17) *Although the approval from the Minister was not subject to a final cost of 38.6 billion, for good governance and for information purposes a letter will be sent to the DPE advising of the final ETC.*

...

37) *A historical regression analysis conducted by Regiments Capital Indicates that the ZAR currency is on a trend of devaluation as indicated in Table 5 above.*

...

43) *The costs to hedge this exposure was obtained from banks by the suppliers. This was then vetted by Transnet Treasury and Regiments Capital for reasonability. They both found the rates and costs to be acceptable.*

28.1.8 the author of the 1064 Business Case advised that TFR contested implementation of an aggressive delivery schedule intended for the Transaction, on the basis that TFR did not have the ability to absorb the accelerated number of locomotives to be delivered by the successful OEMs

⁵³ See a copy of the draft key negotiations document, appendix 46.



over the shorter period.⁵⁴ The same author further confirmed that a document styled "*TFR Preliminary View on Expediting 1064 Locomotives*" was compiled at the instance of Singh and was intended to merely outline the risks associated with implementing the aggressive delivery schedule, thus not to state whether implementation of the aggressive delivery schedule and not to recommend implementation of an aggressive delivery schedule.

28.1.9 TFR in the correspondence below noted the following:

28.1.9.1 in the email from Francis Callard ("**Callard**") to Singh regarding "1064 delivery scenarios" of 18 February at 11h04:

"Hi Anoj

This is a challenge. Re our paper on the accelerated delivery. The best we can do is 300 locos per annum averaging 25 per month. We cannot get to peaks of 40, 50 or 60 per month. The constraints are technical commissioning staff, yards and lines to perform the acceptance tests and customer volume ramp up limitations.

*Tried to call but it went into voice mail.
Please advise.
Best*

Francis" (own emphasis)

28.1.10 in the email from Callard to Singh *et al* regarding "1064 Aggressive Schedule" of 26 February at 11h12:

"Hi Anoj /Mohammed

Apologies for the delay. My laptop joined the ranks of the unemployed and this new one is still bedding down. Only really online last night. I am not sure if you got the earlier mail. It was in the outbox but disappeared and is not in sent items.

*The files attached refer. Also a PDF for tablet reading.
The calcs are high level and relate to the differences in revenue only. The rand per NTK is from the 1064 business case. The locomotive productivity closely matches that of the 100 plus 60. Extracting the detail from the 1064model is more time consuming.*

*Three scenarios.
48 pm versus to Original
48 pm versus 300 per year*

⁵⁴ See appendices of emails in this regard and document styled "*TFR Preliminary View on Expediting 1064 Locomotives*", appendices 47 and 48.



300 per year versus original

Also factored in delivery to production.

Please note (NB) that we cannot absorb more than the 300 per year due to market and commissioning constraints per the earlier note.

Best and regards

Francis" (Own emphasis)

28.1.11 in the email from Pragasen Pillay ("**Pillay**") to Natasia McMahon ("**McMahon**") et al regarding "064 Accelerated profiles 27 Feb 14" of 3 March 2014 at 08h48 AM:

"Hi Natasia in a meeting with Anoj on Friday it was made clear that there is an affordability issue on these locomotives based on extenuating circumstances namely the Rand Dollar issue. The factor of increase is in the order of R10b from R38b to around R49b.

The situation is one that requires TFR to seriously look at how to deal with this. the factor of an accelerated delivery seems to be the only option as the costs is brought back to around what was put on the table originally. Note that this project has a 30 year depreciated life and it is a matter of R30b or R49b over 30 years. TFR may have a difficult year or 2 that needs to be managed but it is about the R10b overrun that is the issue as stated by Anoj.

My view is that we look at the 480 scenario it will have certain dependencies but the MDS original ton numbers will be brought back into play.

I have tasked my guys to get the tons that will talk to the original MDS."; and

28.1.12 in the email from McMahon to amongst others Pillay regarding "1064 Accelerated profiles 27 Feb 14" of 4 March 2014 at 22h24:

"Hi JD,

Thank you for the feedback.

I do however see major risks other than those mentioned in our meeting with Mahomed and team on Thursday, i.e. electricity, commissioning, resourcing, rail network constraints etc. The most glaring being that TFR will be forced to reduce the capital budget to accommodate the accelerated delivery. This would likely mean that TFR may have to look at deferring some strategic projects which would misalign the commissioning of the locomotives to the infrastructure ramp up where they are due to be deployed leading to idle assets anyway.

Should TFR decide NOT to defer the strategic projects it would mean that some harsh decisions will have to be made on whether to STOP projects already in execution or cancel other upgrade and/or replacement programmes.

We have constantly been cautioned by Group that Transnet does not have sufficient funds to accommodate the OD Capital budgets. Therefore if we are



to submit the 480 accelerated delivery we should also pre-empt the follow-up request that will most definitely come for Gci to cull or cut projects.

Regards,

Natasia"

28.2 It appears from what is set above that:

28.2.1 despite the fact that the Minister of Finance in the letter of 31 October 2013 required a further section 54 application approval, further capital was expended without such application;

28.2.2 that one of the memoranda of 23 December 2013 is the first document in time (with which Werksmans has been briefed) that makes reference to the award being split between OEMS and also refers to acceleration. We further refer in this regard to the Forensic Audit Report at paragraphs 40.38 and 4.40;

28.2.3 the view espoused in the Forensic Audit Report is that the reasons articulated in support of splitting in the memorandum of 27 December 2013, as outlined in paragraph 10 thereof, are misleading;

28.2.4 there is no evidence which explains why Best and Final Offers ("**BAFOs**") were requested from all 4 bidders for diesel locomotives, while only 2 of the 6 bidders for the electric locomotives, who all made it through the various evaluation stages, were requested to provide BAFOs. In interviews with certain members of the CFET (Finance), Werksmans was advised that the decision in question was taken without their input and they were merely informed. In an interview with Gama, he advised that he had suggested the split for the reasons outlined in the memorandum of 27 December 2013. This notwithstanding,⁵⁵ save for the recordal in the BADC submission which does not provide the costing, no evidence whether in the form of working papers and/or submissions to internal governing structures or otherwise which explains how or by whom the decision to split the award was taken has been provided. This requires further investigation, having

⁵⁵ We note in this regard a submission to the BADC of 17 January 2014, albeit without costing – see appendices 9 and 10.



regard to the views per the Forensic Audit Report on the financial implications of splitting the award;

28.2.5 further, as regards the memorandum of 27 December 2013, the statement regarding the report of the CFET of 23 December 2013 is misleading. The CFET (Finance) has informed Werksmans that their final report is dated 10 December 2013, and was signed by all members of CFET (Finance). Werksmans is in possession of two draft versions of this report.⁵⁶ Werksmans repeatedly requested a final version of this report as signed by all members on various occasions, particularly from Lindiwe Mdletshe ("**Mdletshe**"). On 27 October 2017, Jiyane advised that Transnet is not in possession of the signed version (nor a copy) of the CFET (Finance) final report, as Singh had taken the signed version and given it to Regiments on commencement of negotiations. This is an untenable explanation;

28.2.6 the memorandum of 17 January 2014, requires further investigation:

28.2.6.1 the existence of the terms of reference of the subcommittee of the Locomotive Steering Committee ("**LSC**") were established. The current GCE sought to distance himself from any such committee. Molefe, on the other hand, explained that he met both the then GCFO and the TFR CE to engage with them. In interviews conducted, TFR personnel and Transnet Internal Audit ("**TIA**") confirmed the existence of such subcommittee, but neither could confirm the validity of its establishment nor its terms of reference;

28.2.6.2 the Forensic Audit Report provides that National Treasury's concern regarding premiums not being more than 11% is disregarded in this Transaction, given that the actual premium is far greater than just 11%. The Forensic Audit Report further notes that 3 of the 6 reasons advanced motivating the split to the BADC actually have the contrary, and that these reasons were not included in the submission to the BOD of 23 May 2014; and

⁵⁶ See copies the draft reports received for both diesel and electric locomotives, appendices 49 and 50.



- 28.2.6.3 no documentation was provided in relation to negotiations of the Transaction despite numerous requests;
- 28.2.7 as set out above, Werksmans has analyzed and received evidence of TFR personnel in relation to acceleration of the award of the Transaction. The risks and recommendations were ignored and acceleration was implemented notwithstanding TFR's advice that an acceleration of that nature was simply not realistic. In emails exchanged,⁵⁷ TFR's position on the prospects and implications of the implementation of the envisaged aggressive delivery schedule, as outlined above, appears to have been excluded from the deliberations of the BADC in its meeting of 26 February 2014, per the excerpt at paragraph 5.1.3. According to Gama he was not even consulted in this regard and the truncated delivery schedule was presented to him as a *fait accompli*;
- 28.2.8 the Forensic Audit Report deals with the financial implication of the increase in ETC, as supposedly addressed in Molefe's memorandum of 23 May 2014 to the BOD, and the materially misleading information provided in Molefe's memorandum aforesaid. Further to the financial implications, Molefe sought retrospective approval/ratification for the increase in ETC in circumstances where the Transaction Agreements were concluded some 2 months prior, in March 2014. The PPM only permits or caters for the concept of retrospective authority/ approval in the case on of an emergency procedure as outlined in Chapter IV above. In this context, given that no aspect of the Transaction constitutes an emergency procedure, what the PPM allows is for a condonation process to be followed within 30 days of breach of a procurement procedure. No evidence has been provided that a condonation procedure was followed or that the BOD is entitled to ratify unauthorised actions in this manner; and
- 28.2.9 in Molefe's memorandum of 23 May 2014, CFET (Finance) advised that their calculations, be it in evaluations or negotiations, were based on numbers given to them and they computed their calculations solely on such numbers given, without questioning the veracity or reasonableness the said numbers given. The Group Treasury representative in the CFET (Finance)

⁵⁷ See *inter alia* appendix 47.



for both evaluation and negotiation stages, confirmed during interviews that this was the position and that verifying the veracity and/or reasonableness of the numbers involved in the Transaction was not part of the scope and mandate to the CFET (Finance).

- 28.3 The matters identified above require further investigation. This is so especially having regard to the fact that Transnet does not seem to have independently verified the accuracy, veracity and reasonableness of the numbers in the Transaction, which omission constitutes a contravention of *inter alia* procurement legislation. The Forensic Audit Report observes that the amounts of the increase attributed to forex hedging and escalation appear to be excessive.
- 28.4 Further, such investigations are necessary in light of TFR personnel having contended that the decision to implement the aggressive delivery schedule was made at Group level, despite TFR's recommendation to the contrary. Notably, even Gama, who was TFR CE at the time, advised that although he had recommended the split in the award of business, the decision to truncate the delivery period was imposed on him by Group without his knowledge of its genesis nor his input in any respect related to that decision, despite the fact that he was then the Chief Executive of the business for which the locomotives were being acquired.
- 28.5 The Forensic Audit Report determines that splitting of the award and truncation of the delivery period had a material impact on the increase in ETC. In addressing the reasons for the increase of the R38.6 billion, the Forensic Audit Report further determines that Molefe's memorandum of May 2014, is neither credible nor reasonable. In addition, the Forensic Audit Report records that the size of the actual increase is above that which can be assessed as reasonable. This is a matter that requires to be dealt with in an appropriate forum.
- 28.6 Moreover, Werksmans has observed that the truncation and acceleration in question constitute actions that fundamentally changed the nature of the Transaction, such that a separate section 54 PFMA request was warranted. No evidence has been provided that either the Shareholder Minister or the Minister of Finance were appraised of the fundamental changes discussed above.



29 TE Scope

29.1 The inclusion of the TE scope remains a controversial feature of the Transaction in its obfuscation of the commercial reality as observed in the Forensic Audit Report.

29.2 The salient chronology is outlined below:

29.2.1 Part 2 of the RFPs, issued on 11 December 2012, contain the following provision in relation to TE:

"TRE SUB-CONTRACTING

Participation of TRE in this locomotive procurement process will be prescribed and further details will follow after the issuance of Part 2 of RFP."

29.2.2 on 3 August 2013, the Minister of Public Enterprise penned a letter to the Chairman of the BOD wherein it was recorded:

"...I see Transnet Engineering (TE) playing a critical role in developing strategic and industrial capabilities relevant to the rail supply chain. In so doing, TE is expected to systematically support the development of the broader rail industrial cluster involving the private sector and position South Africa as a rail equipment manufacturing hub for Africa. In order to achieve this, the current locomotive procurement programme should be used to ensure that a world class enterprise and rail cluster is built. "

29.2.3 notwithstanding the Shareholder Minister's intimation that TE could play a critical role in developing strategy and capabilities as stated above, Transnet had mandated PwC in or about 21 February 2014, to report on TE's readiness to be involved in the Transaction. PwC rendered a presentation to Transnet,⁵⁸ the upshot of which was that using TE as a subcontractor would be very risky as TE was not ready. It is recorded in PwC's report:

"Reliance was placed on the written and verbal information provided, most of which could not be verified due time constraints given the need to report in time for the Original Equipment Manufacturer (OEM) negotiations process.

⁵⁸ See PwC's report on TE readiness for the Transaction, appendix 51.



...

TE does not have the required project management skills or experience to manage the ramp up of 4 OEM assemble lines"

29.2.4 it transpired during the evaluation stage that some bidders submitted proposals without using TE as the main subcontractor. To that end and on 2 December 2013, Gama addressed a memorandum to Molefe, requesting approval for clarifications to be issued to the bidders.⁵⁹ Relevant portions of this memorandum record:

"PURPOSE

- 1) *The purpose of the memo is to seek approval from the GCE to issue step 6 (financial) clarifications.*

...

DISCUSSION

- 7) *Whilst the Cross Functional Evaluation Team (CFET) is busy with the evaluations for step 6 financial, they (sic) were a number of challenges around Transnet Engineering being a subcontractor as prescribed the Request for Proposal.*
- 8) *Challenges around TE are as follows:*
- *certain tenderers did not reflect TE as a major subcontractor,*
 - *tenderers who used TE as a subcontractor did not indicate a separate price if another facility that is owned by the private sector were to be used,*
 - *the other tenderers that used TE as the prescribed subcontractor they also provided a price if they also provided a price if they were to use other subcontractor (sic).*
- 9) *Issuing clarifications will assist in making sure the CFET compare all the tenderers on the same basis and that the pricing information is being compared on the similar basis."*

29.2.5 annexure B to the memorandum of 27 December 2013 from Molefe, Singh and Gama to "The Chairperson (Mr. Thamsanqa Jiyane) and the Cross Functional Evaluation Team (CFET)" records:

"Note: 1. The BAFO prices requested from bidders was without the use of TE as a subcontractor. Therefore the impact of using TE as main subcontractor is already being factored into the initial BAFO price."

⁵⁹ See a copy memorandum, appendix 52.



29.2.6 pursuant to the clarification issued to bidders on 2 December 2013, requesting the Rand impact and price per locomotive if TE was not used as the local subcontractor, the bidders responded on 4 December 2013.⁶⁰ ⁶¹ On 9 January 2014, one bidder, Electro-Motive Diesel Africa (Pty) Ltd ("**EMD**"), wrote to Transnet raising the concern that the integrity of the tender process could be jeopardized if the clarification of 2 December 2013 allows a bidder who previously did not offer "*a non-Transnet Engineering option to now amend their bid to include a new "private sector" offer*".⁶² On 21 January 2014, Transnet addressed a letter in response to this concern in the following terms:

"Dear Sir,

REQUEST FOR BEST AND FINAL OFFER: TENDER No: TFRAC-HO-8609

- 1. The above matter, our letter dated 4 January 2014 and your letter in response dated 9 January 2014 refers.*
- 2. We wish to point out that the Request for Proposals in respect of the 465 Diesel Locomotives made it very clear that it is compulsory to use Transnet Engineering (TE) as a subcontractor.*
- 3. Based on the above requirement, bidders were not expected to submit a proposal using any private sector company as a subcontractor and it would be very unfair to even consider any offer which included such an option since TE was a compulsory option.*
- 4. Should Transnet now consider a private sector option/offer, it will only be fair to give all bidders an opportunity to provide such an offer which our request of 4 January 2014 has done.*
- 5. We therefore wish to advise that all bidders have been asked to submit an alternative private sector in their best and final offer in order to ensure that the process is fair to all bidders.*
- 6. Based on what is set out above, Transnet is of the view that the integrity of the procurement process has not been jeopardised.*

Yours faithfully

*Brian Molefe
Group Chief Executive
Date: 21.1.14."*

⁶⁰ See a copy of the clarification sent to all bidders 2 December 2013, appendix 57.

⁶¹ See copies of responses to the 2 December 2013 received from certain of the bidders and provided to Werksmans, appendix 54.

⁶² See letter from bidder along with Transnet's response thereto, appendix 55.



29.2.7 it is recorded in the "Excerpts from the Minutes of the meeting of the Board Acquisitions and Disposals Committee no 14/2 held on 26 February 2014", *inter alia*:

"5.1.3 Ms Mnxasana requested Management to elaborate on TE's Scope of Works as it was not included in the original amount. She sought clarity if the rolling of prices was extended to the additional non-shortlisted bidders and whether it had an impact on the outcome for the 2 existing bidders. Mr Mkwanaazie sought clarity on the hedging and the price fixing. He further requested the Group Chief Financial Officer to explain final locomotives costs of R38,6bn. Management informed the Committee that the delivery timeframes were significantly shortened and that 48 locomotives should be delivered per month. Management undertook to provide detail on the TE Scope of Works, in particular the methodology which will be submitted to the Office of the Group Chief Executive for approval. Management advised the Committee that the warranties that could conceivably reduce the price still had to be agreed upon.

...

5.1.8 Mr Mkwanaazi sought clarity on the sum total of R37bn. Ms Njeke stated that the total cost of the acquisition was not reflected for the Committee's consideration, therefore making the total costs unclear. She was concerned that some costs elements were missing from the presentation that was presented by Management, such as the Scope of Works for TE and the total value. She requested that TE's scope value be stated. She sought clarity whether the Company reviewed the number of locomotives being procured as it appeared that the Company had reached the target of 1066 locomotives. She further enquired if the Company was planning on using the R38bn in light of uncertainty with future amounts. She stated that National Treasury tolerated up to 11% on price differences. The Company's price difference amounted to 125% which far exceeded National Treasury's limit. In response to the Committee's request, Management submitted an updated schedule regarding the R52bn for relocation purposes.

...

5.1.10 Management informed the Committee that TE 's Scope of Works was agreed upon and signed off. Management still needed to agree upon the 20-25% allocation for TE. Management will negotiate with the OEMs. Management stated that in terms of TE's scope, the Company should treat the bidders with consistency. In relation to the RFP, escalation and Foreign Exchange batch pricing will be applied. The bidders were informed that they needed to form their expectations of TE. However, the Company will inform the bidders of its view regarding TE's role. Management informed the Committee that the "rolling of prices" excluded the non-successful bidders. The 2 bidders were competing against each other. The impact of forex on the amount of R312bn (sic) was that the price of the portfolio will be effected by the devaluation of the Rand etc. Forex amounted to 60% and 40% was local currency for this transaction, causing it to be affected hence the Hedging. The ETC including hedging and escalations costs is R52bn. Management advised the Committee that the ETC and locomotives pricing is subject to change pending confirmation of final TE Scope of Woks and any further potential discount negotiations." (Own emphasis)



29.3 Werksmans' observations in relation to the above events include:

- 29.3.1 the provisions of Part 2 of the RFPs as quoted above merely provide that TE (formerly referred to as TRE) "*will be prescribed*" and details would follow after date of issue. Werksmans notes that there is no evidence that such details were sent to the bidders. Molefe's statement at paragraph 2 of the letter of 21 January 2014, raises questions that require investigation. In this regard, if indeed the RFPs rendered use of TE as main subcontractor compulsory, then the following must be further investigated in light of further provisions of the RFPs to the effect that any compulsory element of the RFPs renders a bid disqualified if not adhered to:
- 29.3.1.1 the 599 Electric Locomotives CFET (Finance) dated 06/12/2013, on page 11 of 40 states that bidder 3 and 7 "*did not specify the use of TE as a main subcontractor and this could have a potential price adjustment*"; and
- 29.3.1.2 the 465 diesel locomotives CFET (Finance) report dated 09/12/2013, on page 23 of 37, states that "*bidder 1 has not quoted using TE as the main subcontractor*";
- 29.3.2 if Molefe's above statement is correct, then bidders 3 and 7 in the electric tender and bidder 1 in the diesel tender should have been disqualified for not having used TE as a main subcontractor. Werksmans further observes that bidders 3 and 7 were effectively disqualified, as BAFOs were not requested from them in the electric tender, though for no apparent reason. Bidder 1 was, however, ultimately one of the successful bidders in the Diesel tender. In any event, whether or not Molefe's statement was correct, the letter of 9 January 2014 from EMD questioned the integrity of the bid process;⁶³ and
- 29.3.3 as regards TE scope and as foreshadowed, the PwC report identified use of TE as a risk due to it not being ready to service the whole Transaction, yet TE was nevertheless imposed on the OEMs as a main subcontractor.

⁶³ See appendix 55.



Werksmans has further established during the course of this investigation and through interviews with, amongst others, TIA that some of the delays experienced in the delivery of the locomotives in accordance with the provisions of the Transaction Agreements is due to TE.⁶⁴ It is evident from the foregoing that TE's scope has remained unclear, notwithstanding that the BADC on 26 February 2014, raised this concern in regard to the TE scope of Works and value. Further, no evidence has been provide to date that *"TE's Scope of Works was agreed upon and signed off"* as submitted by management at the BADC meeting of 26 February 2014.

- 29.4 These aspects of the TE scope warrant further investigation, especially in light of the observations in the Forensic Audit Report that Molefe's memorandum of 23 May 2014 at paragraphs 62 (*"Strategically it was decided that for specific items within the build process where TE were within 10 % of the market price then it would be acceptable to allow TE to retain this scope"*) and 63 (*"The pricing as reflected above in Table 2 is inclusive of this additional scope for TE based on this principle"*) is inaccurate insofar as:

"4.61.1 it is evident that what was described as "TE Scope" was not a frank or proper description. The amount was a premium demanded by the suppliers (i.e. additional price payable to the OEMs by Transnet) for the suppliers using Transnet Engineering as their subcontractor instead of a local subcontractor of their own choice;

4.61.2 it is manifest from the size of the premium of R2.6 billion relative to the total subcontract prices agreed between the OEMs and TE that the premium was clearly not "within 10 % of the market price" in South Africa – it was multiples beyond 10 % of the market price;

4.61.3 based on the TE premium of R2.6 billion and the aggregate of the TE subcontract prices with the OEMs of approximately R7.3 billion..., the TE premium was over 35 %;

4.61.4 if the TE Scope amount (the premium) of R2.6 billion was to be within 10 % of other local suppliers, then the subcontract price would have to be approximately R26 billion;

⁶⁴ See in this regard a recent report by TIA (KPMG), appendix 56.



4.61.5 moreover, the R2.6 billion was understated as it excludes GE "original" scope (R247m) and CNR "original" scope (for which the information is not available)... Thus the 35 % premium referred to above is understated."

30 Changes in evaluation criteria

- 30.1 As set out in Chapter VI above, the PPM prohibits change in RFPs, including changes in evaluation criteria and/or framework contained in the RFPs, once issued. In this regard, the particular provision of the PPM provides:

"13.4 It is important that everything in relation to the determination of the bid evaluation criteria per the PPM, should be carefully considered and included in the sourcing strategy, the RFX and RFX sign-off template prior to issuing the RFX to the market, as neither the evaluation criteria, nor the weightings, nor the evaluation methodology may be changed during the evaluation phase."

- 30.2 In the context of the provision quoted above, the following is noted:

- 30.2.1 on 23 December 2013, a memorandum was made available by Jiyane to Molefe, Singh and Gama wherein it is recorded:

"SUBJECT: REQUEST FOR APPROVAL TO NEGOTIATE AND AWARD OF BUSINESS TO THE SHORT LISTED TENDERERS FOR THE SUPPLY OF 599 COCO NEW DUAL VOLTAGE LOCOMOTIVES FOR THE GENERAL FREIGHT BUSINESS (GFB)

...
23) The CFET (Finance) found numerous inconsistencies in the manner in which bidders chose to complete the scheduled and unscheduled maintenance portions of the TCO model. The CFET (Finance) recommended that the CFET (Technical) review the models for reasonability with the purpose of allowing the CFET (Technical) to guide the CFET (finance) in making decisions to score the TCO models submitted as well as to guide the CFET (Finance) in their deliberations as to whether the models submitted would actually meet the requirements to be scored fairly among bidders.

24) Four members of the technical team were made available to conduct a review of the scheduled and unscheduled maintenance regimes as supplied by bidders for reasonability. It emerged that the models required normalising and the CFET could not change the models on behalf of the bidders. The 3 scenarios show the difference if the subjective elements of the TCO are removed from the evaluations.

...

RECOMMENDATION

30) it is recommended that the GCE to:

- support the recommendation of scenario 3 where Total Cost of Ownership (TCO) excluding unscheduled and excluding scheduled



maintenance and excluding bonus point allocation which presented in paragraph 26 is to be used;

...

Approve the submission of the recommendation for award of business to the Transnet Board of Directors."

30.2.2 the memorandum of 27 December 2013 from Molefe, Singh and Gama to Jiyane records:

"PURPOSE:

1) *The purpose of this memo is to;*

...

- *Approve that option 3 (excluding unscheduled and excluding scheduled maintenance and excluding bonus point allocation) for evaluations will be considered for final evaluations including the final recommendations"*

30.3 The memoranda of 23 December 2013 raise questions of non-compliance with the provisions of the PPM. The request to Molefe that he approve option 3 to enable the CFET (Finance) to conclude the evaluation stage constitutes a change in evaluation criteria, which is prohibited.

30.4 As a consequence of the a foregoing, the Transaction may be challenged on the basis that the integrity of the tender process was jeopardized through implementation of the above recommendation and approval.

31 Relocation

31.1 On or about 22 July 2015, the Acting Chief Executive of TFR recommended in a memorandum the relocation of BT to TE's facilities in Durban, for the manufacture of 240 23E electric locomotives.⁶⁵

31.2 The BT memorandum requests the Acting Group Chief Executive ("**AGCE**") to:

- "a) Note the final outcome of the negotiation for the relocation to Durban with Bombardier Transportation SA (BT);*
- b) Approve variation order for the relocation to Durban to a maximum value of R618 457 125.00 with BT and*
- c) Sign-off a letter to be issued to BT to accept their final proposal."*

⁶⁵ See copy of the BT memorandum, appendix 57.



31.3 Werksmans has also had regard to a similar memorandum in respect of CNR, by Ravi Nair to Gama,⁶⁶ compiled by Mdletshe on 19 May 2015. The purpose of the Memorandum is stated as:

- "1. Request the Acting Group Chief Executive (GCE) to approve the following:
- a) The team to negotiate the relocation to Durban with CNR.
 - b) Variation order to finalise the relocation of the programme for the construction of 233 Class 45D locomotives to Durban to a maximum value of R669 784 286. Separate submission has been prepared for BT.
 - c) Letter to be issued CNR to commence negotiation for the relocation of the programme."

31.4 In this regard, the following evidence has been procured during the course of the investigation:

31.4.1 on 11 March 2014, a representative of the CNR, Rowen Von Geriecke, proposed a cost for relocation in the sum of approximately R9 million;⁶⁷

31.4.2 on or about 6 June 2014, BT addressed a letter to Transnet for the attention of Jiyane, acknowledging receipt of a letter addressed by Molefe to Dr Lutz Bertling dated 21 May 2014, in which the following is recorded:

"RE: Allocation of Bombardier Transportation to the Transnet Engineering Durban facility - letter of Mr. Brian Molefe to Dr. Lutz Bertling dated 21.05.2014

Dear Mr Jiyane

Further to our informal discussions, Bombardier has now received the letter above mentioned from your Group Chief Executive, Mr. Brian Molefe, via our Chief Operating Officer, Dr Lutz Bertling; on the 26th of May, 2014. Mr. Molefe officially informed us that Transnet Engineering's Durban facility should host our operations and asked Bombardier Transportation to agree. A response letter was provided by Dr. Bertling 5th of June 2014, confirming that our project team would contact TFR directly to confirm the next steps.

We understand the request of the South African Government and Transnet SOC Ltd to widen the railway industry hub from Gauteng to other regions of South Africa and we intend support this approach as much as possible. Obviously, this change of location represents a significant change to the Locomotive Supply Agreement - the TE facility is currently defined as Koedoespoort, Gauteng.

As you are aware, Bombardier has already made an initial visit of TE's Durban facility on the 19th of May when we extended the presence of three of our experts in South Africa following the kick-off meetings with Transnet Engineering (TE) in Koedoespoort on the 13th and 14th of May. This site visit

⁶⁶ See copy of the CNR memorandum, appendix 58.

⁶⁷ See a copy of the proposal made on behalf of CNR, appendix 59.



demonstrates our commitment to support Transnet as much as possible and to save time and money for all stakeholders.

Despite this initial informal visit, there remain several significant activities that must be completed to determine the full impact of the requested change. To kick off these activities, and to follow more closely the formal process of the Locomotive Supply Agreement, we would like to request that TFR send us a Notice of Company Proposed Variation (Schedule 8, Pro Forma 14). Although this process was not discussed previously in detail, we would prefer to receive the Pro Forms of Schedule 8 as word-documents.

Once the Notice of Company Proposed Variation is received, Bombardier will need to review not only the infrastructure of the Durban facility itself, but also to determine the consequences for our entire supply and logistics chain as well as the impact on our project team. Based on Bombardier's first impression of TE's Durban site, it is already clear that the infrastructure in Durban must be upgraded to enable TE to produce the bogie frames and to perform the final assembly of the locomotives as well as the testing and commissioning of the vehicles on schedule.

Given the expected impact of the requested change, Bombardier proposes the following two-stage process:

- 1. The detailed analysis of the Durban facility and potential supply and logistics chain impact will require a significant investment of time and resources by Bombardier. This will definitely impact our ongoing project activities, due to the diversion of key personnel from their current project responsibilities to this assessment process. There will therefore be an immediate impact to the project, just to calculate the ultimate impact of the change of site. This first stage impact should be agreed in advance, between TFR and BT.*
- 2. Once the detailed assessment is completed, TFR and BT can agree on the final expected increase or decrease in cost (as applicable), the extension of time (if any), changes to Supplier Development, and any other related amendment to the Locomotive Supply Agreement.*

We are available to discuss this approach at any time, and look forward to receiving your Notice of Company Proposed Variation in the near future."

31.4.3 two separate variation orders for BT's relocation to Durban are, respectively, styled "*Final Notice of Contractor Proposed Variation with respect to Transnet' request to move TE's Facility location from Koedoespoort to Durban*", dated 26 September 2014, and "*Notice of Company Proposed Variation with respect to Transnet' request to change TE's Facility location from Koedoespoort to Durban*" dated April 2015.

31.4.4 the memorandum compiled on 19 May 2015 is misleading. The reference to a "joint quotation" (own emphasis) as stated in subparagraph 4 thereof, to the knowledge of the author of the memorandum, was false given that Jiyane confirmed during a meeting with Werksmans held on 27 October 2017, that no such joint quotation exists.



31.5 Moreover:

31.5.1 no work was performed by TIA during the period 23 June 2015 to 16 July 2015. In this a regard, a memorandum from TIA records that *"No work was performed by TIA at this stage. TIA did not receive a request to review the reasons for extension"*;⁶⁸

31.5.2 TIA has stated:⁶⁹

"6. TIA was not invited for subsequent negotiation meetings where negotiations on relocation costs were discussed with the bidders in attendance, as required per the HVT methodology.

*...
8. Based on TIA's limited involvement in the process indicated above, a formal report to indicate adequacy and/or effectiveness of the processes undertaken in the Durban Relocation negotiations could not be produced."*

31.5.3 this is peculiar given that the relocation falls to be considered in terms of the HVTP, which requires that TIA be engaged in all aspects relating to relocation from inception up to and including approval;

31.5.4 Thato Mahlamvu and Emma Molotsane TIA (SKX) advised Werksmans at an interview of 31 August 2017 that Transnet instructed them to conduct a post review on Relocation. A draft had at that stage been completed and awaited Transnet management input, which according to them precluded it being released to Werksmans at that point. This report should have been disclosed with a qualification to say that management comments were awaited. This notwithstanding, TIA (SKX) informed Werksmans that there are several "red-flag" items in the draft which are a cause of concern that supports an inference that the Relocation process employed was not sound;

31.5.5 during October 2017, Werksmans met with the CNR's minority shareholders, at the latter's request. During this interview the following was established:

31.5.5.1 the existence of a reportable irregularity addressed to the Independent Board of Auditors by the auditors to CNR. According to

⁶⁸ See memorandum from TIA (SKX), appendix 60.

⁶⁹ See appendix 60.



information furnished to Werksmans, CNR's auditors have now withdrawn;

31.5.5.2 the crux of the above reportable irregularity is that the proposal which CNR prepared for Transnet in relation to the relocation to Durban *"significantly misrepresented to Transnet the cost of the relocation of a manufacturing facility from Pretoria to Durban"*; ⁷⁰ and

31.5.5.3 Rowlen Von Gericke, being a minority shareholder and director of CNR, informed Werksmans that the minority shareholders can, to date, not explain how the amount of about R600 million for the relocation was arrived at.

31.6 All the executives of Transnet associated with any misleading and or false recording as noted above, which gave rise to the decision to incur the expenditure relating to relocation of these OEMs, are required to be subjected to appropriate proceedings to determine *inter alia*, their appropriateness to continue to hold office. In addition, the reporting obligations contained in PreCCA are to be considered. The approval without any bill of material preceding verification by Transnet validating the so-called negotiations to relocate two of the four successful OEMs from Koedoespoort to Durban, amounting to the aggregate of R1.2 billion in expenditure, is a violation of provisions of the PPM, PFMA and principles corporate governance. As at end of July 2017, neither OEM that relocated had produced any locomotives despite advance payments in accordance with the Transaction Agreements in an aggregating to approximately R5.625 billion. ⁷¹

31.7 As regards the 19 May 2015 memorandum, the compiler of the memorandum misrepresented the position, together with those who recommended its approval by the AGCE of the variation order.

⁷⁰ See a copy of a letter from Hogan Lovells to KPMG re the reportable irregularity, appendix 64.

⁷¹ See copy of schedule detailing amounts paid and locomotives delivered by each OEM, appendix 62.



31.8 As a further indication of financial misconduct, Werksmans observed that views of Yousuf Laher as recorded in his emails of 21 and 25 June 2015, were ignored.⁷²

31.9 Section 51 of the PFMA provides that the Accounting Authority of an entity must take effective and appropriate steps to prevent losses resulting from unauthorized expenditure.

32 Conflict of Interest – Iqbal Sharma

32.1 In accordance with the Mandate, Werksmans has advised Transnet of the conflict of interest of Iqbal Sharma in relation to the Transaction, on the basis of a draft report prepared by PwC ("**draft report**"). The PwC draft report to the BOD and Werksmans' advice are appended hereto.⁷³

32.2 PwC had been mandated to investigate the veracity of an article of 4 July 2014 in the Mail and Guardian pertaining to Iqbal Sharma, who was at the time a non-executive member of the BOD and the Chairman of the BADC.

32.3 PwC found that Iqbal Sharma was conflicted in relation to the award of the Transaction in as far as he had acquired a share in VR Laser Services (Pty) Ltd ("**VR Laser Services**") shortly prior to announcement of winning bidders in the Transaction under the following circumstances:

32.3.1 he had at all relevant times been a non-executive director of the BOD and the Chairperson of the BADC, the latter having considered the results of the adjudication process in respect of the Transaction;

32.3.2 the successful bidders were required to source 55% and 60% of the components for the Transactions from the South African market;

32.3.3 VR Laser Services manufactures such components;

⁷² See copies of both emails, appendices 63 and 64.

⁷³ See copy of PwC's draft report and presentation, as well as Werksmans' advice, appendices 65 and 66.



- 32.3.4 certain of the winning bidders had performed a site visit at the premises of VR Laser Services shortly prior to the award of the Transaction; and
- 32.3.5 Sharma failed to declare his interest in VR Laser Services and had not, at any point, disclosed such interest in any of the meetings of the BADC. The only explanation proffered for such failure was an oversight on his part.
- 32.4 PwC found that there was insufficient evidence to make a deliberation as to whether Sharma had disclosed confidential information in relation to the Transaction.
- 32.5 The lead author of the PwC draft report informed Werksmans that the report remained a draft as PwC had not been afforded an opportunity to present the report to the BOD.
- 32.6 Werksmans has separately presented to the current Chairperson and delegated steering committee of the BOD, its views on breaches of corporate governance and detailed the provisions of the Companies Act that had been transgressed. The BOD has since 2014 failed to take appropriate action in terms of *inter alia* section 50(3) of the PFMA.
- 32.7 Werksmans has further established that Sharma refused to recuse himself from the meeting where the draft PwC report was to be discussed. It is Werksmans' recommendation that this matter be further investigated as recommended herein, on the basis that Transnet's directors have failed to discharge their fiduciary duty and to exercise their power in good faith, in the interest of Transnet.

33 100 Class 19E Electric Locomotives

- 33.1 Werksmans in an attempt to review and validate the submissions made to the BADC and the BOD relating to the Transaction, has independently and following its investigations as detailed herein, had regard to what follows below in relation to procurement by way of confinement of a 100 class 19E Electric Locomotives.
- 33.2 On 30 August 2013, Molefe addressed a memorandum styled "Mitigation of MDS Volumes at Risk through the Investment and Procurement of 100 class 19E



Equivalent Dual Voltage Electric Locomotives and Class 43 Diesel Locomotives" ("**August Memorandum**").⁷⁴

33.3 It is Werksmans' understanding that the August Memorandum was prepared on the basis of a business case authored in support of amongst others, the 100 class 19E Electric Locomotives confinement by Callard and his team ("**Initial Confinement Business Case**"). Callard explained that the August Memorandum recommended confinement to Mitsui & Co African Railway Solutions (PTY) LTD ("**MARS**"), given that it had manufactured locomotives to Transnet previously and therefore already had a design in place for locomotives required for the coal line. The significance of having a design in place is that 12 months would not have had to have been spent in preparation of the required design. Callard further explained that the locomotives MARS would produce offered interoperability with the locomotives that were already on the coal line. Callard pointed out that CSR had no design in place and the locomotives that were produced had no interoperability with the effect that they had to be adapted, which came with an additional cost as stated herein below.

33.4 The following are material portions of the August Memorandum as regards the confinement:

"PURPOSE

1. The purpose of this submission is to request the Transnet Board Acquisitions and Disposals Committee to recommend to the Transnet Board of Directors the following:

- a) Note the risk to TFR MDS volumes through insufficient traction power resulting from the delay in the procurement of the 1064 locomotives:*
- b) Note the investment in and procurement of 100 Class 19 E and 60 Class 43 Diesels will protect 24.5 nit of General Freight volumes at risk resulting from the delay in procurement of the 1064 locomotives.*
- c) the investment in and procurement of 100 Class 19E equivalent electric locomotives required for the Coal Export Line in the amount of R3 871 m (excluding borrowing costs): (**Annexure A**) [**This annexure was never disclosed to Werksmans**]*
- d) the confinement and award of the procurement for the 100 Class 19E equivalent electric locomotives to Mitsui & Co African Railway Solutions (PTY) LTD (MARS):*
- e) the investment in and procurement of 60 Class 43 diesel locomotives for General Freight in the amount of R1 826 m (excluding borrowing costs):*
- f) an extension of the current contract with General Electric South African Technologies (GESAT) for 60 Class 43 diesel locomotives:*
- g) The above awards will be conditional subject to paragraphs 78 and 79 and*

⁷⁴ See copy of the August Memorandum, appendix 67.



- h) The GCE be delegated the power to sign and conclude all relevant documents to give effect to the above resolutions

EXECUTIVE SUMMARY

2. The TFR locomotive fleet plan was first approved by the Transnet Board in April 2011 and updated with the 1064 GFB locomotive submission. The proposed locomotive acquisitions are in line with the fleet plan and have been budgeted for in the 7 Year Market Demand Strategy (MDS) 2013/14 - 2019/20. The delay in the 1064 fleet acquisition has put General Freight Business (GFB) MDS volumes at risk. The Class 19E dual voltage electric and Class 43 diesel locomotives recently delivered are modern capable locomotives. The Class 19E electric locomotives will be deployed on the Coal Export line which will enable the release (cascade) of 125 locomotives to General Freight. This submission proposes an accelerated procurement to mitigate General Freight MDS volumes at risk by confining 100 Class 19E electric locomotives to MARS and extending the current Class 43 Contract with GESAT by 60 locomotives. The accelerated acquisition will mitigate the MDS shortfall by at least a year with its full effect realised commencing 2014/15. The volumes mitigated increase from 6.2 mt (14/15) to 15.1 mt (16/17) and the cumulative income protected is R9 197 m (13/14 - 16/17).
3. The Class 19E dual voltage electric and Class 43 have proven themselves in service and will improve service quality through improved reliability and reduced maintenance costs.
4. This accelerated acquisition does not put the MDS cash flow at risk and the 1064 acquisition remain unaffected. The acquisitions are funded from the current MDS. The delay in the 1064 will extend its funding to beyond the 7 year period.
5. The proposed transactions do not increase the risk related to the 1064 tender process.
6. Socio-economic benefits will be realised in line with existing commitments and expectations.

GOVERNANCE PROCESSES

7. The following governance processes were followed in developing and approving the business case. In each case the queries and amendments were dealt with.
- a) The matter was tabled and recommended by Transnet Freight Rail Investment Committee on 15 July 2013
 - b) The matter was tabled and recommend by Transnet Capital Investment Committee (CAPIC) on 19 August 2013
 - c) c) The matter was tabled and recommended by Transnet EXCO on 21 August 2013.
- ...
48. Par a, c and d are relied upon with urgency (a) being the main reason as described in this memo in detail. The urgency is motivated on:
- a) The one year delay between the requirements of the locomotive fleet plan and the delivery and commissioning of 1064 locomotives for general freight, with its related threat to the MDS volumes. The early delivery of these locomotives will release capacity to general freight as outlined earlier and provide a partial buffer until there are material deliveries of the 1064 locomotives. It buffers the anticipated shortfall in volumes as described earlier.
 - b) The need for 60 Diesel locomotives and 100 Electric locomotives in order to deliver upon committed volumes in line with the MDS as a matter of extreme urgency.
49. In 2009, Transnet Freight Rail (TFR) entered into a contract with Mitsui & Co African Railway Solutions (PTY) LTD (MARS for the procurement of 110 new Class 19E electric locomotives for the Coal Export Line; TFR took delivery of the last locomotive in August 2012. MARS are also delivering the Class 15E locomotives for the Ore Export line and the last one is due to come of the factory line in September 2013:



- a) *Feedback from the Technical Engineering team is that the Class 19E and Class 15E locomotives are performing well and have proven to be both efficient and reliable.*

50. The Class 19E is a modern locomotive and the proposed 100 locomotives will be an extension of the current design. No prototyping or type testing is required conservatively saving 12 months or more."

33.5 Excerpts from the minute of the meeting of the BADC of 21 October 2013 record the following in relation to the above August Memorandum:⁷⁵

"5.1.5 Ms Tshepe sought clarity behind the withdrawal of the 100 + 60 Diesel submission from the current Agenda as the Committee had requested that it be tabled due to the urgency of the transaction. Management stated that the matter was previously tabled to the Committee; and certain concerns were raised. The request was based on a tender that was awarded in 2006 and subsequently confined in 2010. A request for further confinement was being made. Management indicated that upon reflection, it opted to withdraw the matter after considering that when the initiatory (sic) confinement was made in 2010, there were press reports alleging that the Company had entered into a R1.4bn locomotive procurement "secret deal" (that was concluded without being put to tender, which the then Deputy President Motlanthe's special adviser was set to benefit from). An article in relation to this matter was circulated in the meeting. Ms Tshepe was of the view that the press reports and the confinement ought to have been considered prior to the matter being tabled to the Committee. She stated that the antecedent submission was tabled on the basis of urgency to alleviate the risk relating to MDS volumes. Management stated that the withdrawal of the Agenda Item was due to potential governance risk relating to the transaction.

5.1.6 Mr Mkwana was of the view that the Committee should have been provided with the information prior to deliberating on the transaction to allow the Committee to adequately apply its mind to the matter. He further stated that the same information was not provided in 2011 and the communications intelligence was 'caught on the back foot'. Ms Tshepe enquired if a response to the media reports was issued and why the Board was not informed about the matter. She stated that the Committee enquired about the possible governance issues when the confinement was requested. The Chairperson stated that the Board was not provided with a holistic picture and implored upon Management to ensure that instances that may lead to a material risk to the reputation of the Company should be brought to the attention of the Committee."

33.6 On 22 January 2014, Molefe duly signed a memorandum dated 21 January and recommended Singh. The version of this memorandum provided to Werksmans remained unsigned by Gama.⁷⁶ The following are material extracts from this memorandum:

"PURPOSE

1. The purpose of this submission is to request the Transnet Board Acquisitions and Disposals Committee to recommend to the Transnet Board of Directors the following:

⁷⁵ See copy of the excerpts from the minute of the meeting, appendix 68.

⁷⁶ See a copy of this memorandum, appendix 69.



- a) Note the risk to TFR MDS volumes through insufficient traction power resulting from the delay in the procurement of the 1064 locomotives:
- b) To approve the investment in and procurement of 100 electric locomotives required for the Coal Export Line in the amount of R3 871 m (excluding borrowing costs):
- c) To approve the confinement and award of the procurement for the 100 electric locomotives.
- d) To approve the investment and change in the fleet plan to procure of 60 Class 43 diesel locomotives for General Freight in the amount of R1 826 m (excluding borrowing costs):
- e) To approve an extension of the current Class 43 diesel locomotives contract for 60 additional locomotives:
- f) an extension of the current contract with General Electric South African Technologies (GESAT) for 60 Class 43 diesel locomotives:
- g) The GCE be delegated the power to sign and conclude all relevant documents to give effect to the above resolutions, including the award and process approval.

EXECUTIVE SUMMARY

2. The TFR locomotive fleet plan was first approved by the Transnet Board in April 2011 and updated with the 1064 GFB locomotive submission. The proposed locomotive acquisitions are in line with the fleet plan and have been budgeted for in the 7 Year Market Demand Strategy (MDS) 2013/14 - 2019/20. The delay in the 1064 fleet acquisition has put General Freight Business (GFB) MDS volumes at risk.

3. This risk will be mitigated by the urgent acquisition of these locomotives.

- a) The heavy haul 100 Electric locomotives will be deployed in the Coal Export Line and will release 125 locomotives that will be used on GFB pending delivery from the 1064 program. The 100 locomotives form part of the already approved Fleet Plan
- b) The 60 Class 43 diesel locomotives also fill the gap pending delivery from the 1064 program. These 60 locomotives do not form part of the approved Fleet Plan and this submission requests an amendment to the Fleet Plan to include these 60 locomotives

...

5. This submission proposes an accelerated procurement to mitigate General Freight MDS volumes at risk by confining 100 electric locomotives to CSR (China South Rail) and extending the current Class 43 Contract with GESAT (General Electric South Africa Technologies) by 80 locomotives. The accelerated acquisition will mitigate the MRS shortfall by at least a year with its full effect realised commencing 2014/15. The volumes mitigated increase from 6.2 mt (14/15) to 15.1 mt (16/17) and the cumulative income protected is R9 197 m (13/14 - 16/17). (Own emphasis)

6. The confinement to CSR and extension of the GE contract is motivated on the basis of urgency.

7. This accelerated acquisition does not put the MDS cash flow at risk and the 1064 acquisition remains unaffected. The acquisitions are funded from the current MDS. The delay in the 1064 will extend its funding to beyond the 7 year period.

8. The 60 Class 43 locomotives are in addition to the approved Locomotive Fleet Plan but accord with the fleet strategy. With the year delay in the 1064 procurement, the 60 locomotives fill the gap of the first year. Post the 1064 procurement, the sustaining fleet requirements based on a 30 year life are approximately 80 locomotives per annum and the last year of the 1064 procurement moves into the sustaining phase.

...

History and Status of the 1064 Procurement

29. The 1064 program has slipped by at least a year against original expectations. The current RFP timelines are being reviewed by the Locomotive Steering Committee to ensure a compressed timetable to further mitigate volume risks to the MDC.



...

MOTIVATION

MDS Risk Mitigation

...

34. The prime motivators for this submission are to:

- a) Protect General Freight volumes through delivering diesel and electric locomotives earlier than is possible through the 1064 program.
- b) Ensure delivery earlier than the 1064 program by:
 - i. Confining the procurement of the electric locomotives
 - ii. Extending the current diesel locomotive contract.

...

40. The 100 Electric locomotives will sustain the Coal Line electric fleet for 81 million tons per annum capacity and standardize the coal fleet on Electric type locomotives with significant operational and cost advantages:

...

46. The 100 Electric locomotive business case articulates the benefits of the earlier than previously planned delivery of the locomotives to the Coal Export Line.

...

48. Other aspects more fully covered in the 100 Electric Locomotive submission are:

- a) Reliability and Operational efficiency based on past experience of electric locomotives of similar design
- b) Savings on operational expenditure and capitalised maintenance
- c) Energy Savings.

...

PROCUREMENT STRATEGY

Rationale for not being part of the 1064 process

58. The procurement process was carefully considered and was not taken into or part of the 1064 locomotive process. Aspects considered were:

- a) **Type:** The 100 electrics are 26 ton per axle locomotives for heavy haul use to be deployed on the coal line. The 599 electric locomotives in the 1064 tender are 22 ton per axle locomotives for GFB use
- b) **Delivery:** The 60 diesels are similar to the 465 of the 1064 but the motivation below for extension is one of urgency because of the overall delay in the 1064 program. Including the diesels in the 1064 does not address the delay or urgency.

...

62. Confine / Extend contract: This addresses the urgency of the proposal but has potential negative public implications. For the urgency already outlined and the reasons below this is not part of the 1064 process and will not impact on that process.

...

- c) The CSR facilities are available for immediate production which will result in significant delivery acceleration based on the learnings of the 95 loco processes. CSR has capacity to produce 2000 locomotives per annum.

...

Procurement of 100 Electric Locomotives

...

69. The project is motivated on the basis of Para (a) where a genuine unforeseeable urgency has arisen.

- a) Item 13 et al covering the "History and Status of the TFR Fleet Plan" and the "History and Status of the 1064 Procurement" demonstrates the reasonable and timeous steps taken to address to the Board the run out of the current fleet and the locomotive requirements required to address the volume ramp up of GFB.



b) Item 11 et al further indicates that the delay was not attributable to a lack of proper planning as the GFB locomotive requirements have remained consistent throughout.

c) Considering (a) and (b), no individual or group of individuals is responsible for bad planning.

70. Complementing the urgency is ground (d):

a) Locomotives are highly specialised with limited suppliers worldwide.

b) The locomotives would be largely identical with those already supplied and to be supplied and

c) Transnet would incur wasted time and money in approaching the market (b) and (c) are relevant due to the fact that:

i. CSR has been adjudicated as the best bidder during the 95 electric loco process as well as joint on the 1064 process. Both these tenders include the Board approved procurement methodology of maximising supplier development whilst ensuring highest standards of quality and best possible commercial offering. Transnet has just spent a large amount of time, human capital and money in the recent tenders and going through another tender process would not be efficient given the urgency

ii. Production of the current MARS contract has been completed and was based on previous procurement methodology where supplier development was not a key focus area and the Mitsui consortium did not fare well in the two most recent tenders issued by Transnet. Therefore continuation with Mitsui via confinement would pose unnecessary risk to the organisation. Furthermore, reputation risk exists, although subjective and places the company under unnecessary risk if it were to follow a confinement approach with Mitsui. This reputation risk involves speculation in the media around Mitsui's local partners and their political affiliations. Transnet would never entertain awards based on political prowess of any business partners to an OEM but the risk does need to be taken into account from a reputational perspective.

71. TE is currently maintaining and repairing the Class 19E Electric Series which means that they are accustomed to maintenance regimes are more modern electric dual voltage locomotives. Limited additional training will be required and optimum utilisation of the current maintenance facilities will be met. Simplified maintenance practises will result in shorter Mean Time to Repair. Common practices will be addressed through maintenance regimes of the 95 loco series, 599 elements that CSR is shortlisted for and this fleet.

...

73. Considering the volumes at risk and the urgent requirement for the coal line locomotives to cascade the current fleet to General Freight, it is proposed that the procurement be confined to CSR.

...

RECOMMENDATION:

13. It is recommended that the Transnet Board Acquisitions and Disposals Committee recommends to the Transnet Board of Directors the following:

a) Note the risk to TFR MDS volumes through insufficient traction power resulting from the delay in the procurement of the 1064 locomotives:

b) To approve the investment in and procurement of 100 Electric locomotives required for the Coal Export Line in the amount of R3 871 m (excluding borrowing costs):

c) To approve the confinement and award of the procurement for the 100 Electric locomotives.

d) To approve the investment and change in the fleet plan to procure of 60 Class 43 diesel locomotives for General Freight in the amount of R1 826 m (excluding borrowing costs):

e) To approve an extension of the current Class 43 diesel locomotives contract for 60 additional locomotives:



- f) *The GCE be delegated the power to sign and conclude all relevant documents to give effect to the above resolutions, including the award and process approval.*

33.7 On or about 22 January 2014, Callard observed material changes to the initial confinement business case for the 100 electric locomotives, as a consequence of which Callard raised his concerns by way of an email of 23 January 2014 to Gama and Jiyane, recording:

"Dear Siya and Thami.

This is a difficult mail to write. In helping to format a recent version of the 100 and 80 locomotive business case on Wednesday 22nd, I noticed that the case was changed from that which I had submitted on Monday. This mail is because of the nature of those changes and the implications. The implications are technical and in the rationale for the acquisition which was speedy delivery to mitigate MDS volumes at risk.

Project Shongololo was predicated on 19 Equivalent locomotives. These locomotives are 26 ton per axle, 311 kN at 34km/h and are equipped with Toshiba T-Ethernet interoperability. It is this equivalency of power and interoperability that was at the heart of the business case.

The locomotives proposed are not explicitly specified but if a current and delivered design is the criteria, then it is the 20E. This locomotive is a 22 ton per axle locomotive, 279kN at 40 km/h (284kN at 30 km/h) and uses IEC61375 Standard for interoperability. This was specified as a GF locomotive. The implications are that the locomotive is not a heavy haul locomotive, is not as powerful and the locomotive calculations for Operation Shongololo no longer hold and the project and volume targets may be at risk. Furthermore the locomotives cannot interoperate with the current 19E locomotives adding further complexity to operations. To have the 20E interoperate with the 19E will require that they be fitted with wired DP at an additional cost of around R1m per locomotive.

If the locomotives are of a new Co-Co design which will meet the power requirements then all the arguments relating to time saving using proven design and eliminating type testing no longer hold.

The TE assembly line for the current 20E has yet to produce a locomotive. If local assembly is the criteria then ramping up this line up to meet the 95 20E and this 100 delivery criteria is a risk that has not been – in my humble opinion – been visibly addressed. If imported as complete units then local content is problematic though the delivery program is achieved.

Respectfully for your information and consideration."

33.8 The BOD approved the confinement and award to CSR at a special meeting of 24 January 2014.⁷⁷ In an excerpt from the minutes of this Special BOD Meeting it is recorded that:

⁷⁷ See copy of excerpts of this special meeting of the BOD, appendix 70.



"4.1.2 Mr Sharma stated that the matter was dealt with at the Board Acquisitions and Disposals Committee ("Committee"). The request for a confinement had been on the Committee's agenda for 3 months, and the matter was extensively deliberated by the Committee. The Company currently has a contract with General Electric South Africa Technologies in terms of the Class 43 diesels. The proposal was to confine the 100 Electrics to China South Rail. There were adverse media reports on the previous Mitsui confinement's processes. To manage reputational matters, the Company seeks to advance to a new supplier. Management indicated that the TFR Locomotive Fleet Plan was first approved by the Board in April 2011, and updated with the 1064 GFB Locomotive submission. The proposed locomotive acquisitions are in line with the Fleet Plan and were budgeted for the MDS. The delay in the 1064 acquisition has placed GFB volumes at risk. The risk will be mitigated by the urgent acquisition of the locomotives. The heavy haul 100 Electrics will be deployed in the Coal Export line and will release 125 locomotives that will be used on GFB pending deliver from the 1064 programme. The 100 Electrics form part of the already approved Fleet Plan. The 60 Diesel also fill the gap penning delivery from the 1064 programme. The 60 Diesels were not part of the approved Fleet Plan and the submission requested an amendment to the Fleet Plan to include the 60 Diesels.

4.1.3 Management informed the Board that the 1064 Locomotives were delayed due to the withdrawal of the PPPFA exemption. The submission proposed an accelerated procurement to mitigate General Freight MDS volumes at risk by confining 100 Electrics to China South Rail and extending the current Class 43 Contract with General Electric South Africa Technologies by 80 locomotives. The accelerated acquisition will mitigate the MDS shortfall by at least a year with its full effect realised commencing 2014/15FY. The volumes mitigated increases from 6.2mt for the 2014/15FY to 15.1mt for the 2016/17FY and the cumulative income protected will be R9.1bn for the 2013/14FY to 2016/17FY. The confinement of China South Rail and extension to General Electric South Africa Technologies contract was motivated on the basis of urgency. The accelerated acquisition does not put the MDS cash flow at risk and the 1064 acquisitions remains unaffected. The acquisitions are funded from the current MDS. The delay in the 1064 locomotives will extend its funding to beyond the MDS period. The Diesels were in addition to the approved Locomotive Fleet Plan but accord with the fleet strategy. With a year's delay in the 1064 procurement, the 60 Diesels will fill the gap of the first year.

4.1.4 Management stated that the 100 Electrics business case articulated the benefits of the earlier than previously planned delivery of the locomotives to the Coal Export line. TFR was in the process of acquiring 143 Class 43 Diesels Locomotives from General Electric South Africa Technologies (which have been delivered over the past 2 years and have proven to be a capable locomotive). Given the MDS volume shortfall, it was proposed that 60 Diesels be acquired to further mitigate the volume risk as the 1064 programme is likely to come on stream in 2015. The procurement process was carefully considered, with the aspects considered articulated as follows:

*** Type:** the 100 Electrics are 26 ton per axle locomotives for heavy haul use to be deployed on the Coal Line. The 599 Electrics in the 1064 are 22 ton per axel locomotives for the GFB use.

*** Delivery:** the 60 Diesels were similar to the 465 of the 1064, but the motivation for the extension as contained in the submission was urgency due to an overall delay in the 1064 programme. Including the 60 Diesels in the 1064 will not address the delay or urgency.

...

4.1.7 Mr Gazendam sought clarity if the recommendation from the Committee was unanimous. He stated that the 60 and 100 locomotives were being awarded to the same entities recommended for the 1064 transaction, and requested Management to ensure that the matter is dealt with sensitively in the media. Mr Skosana stated



that the Committee extensively deliberated on the matter and requested the Committee to share critical matters that were an impediment on the Transaction. Mr Sharma informed that board that the Committee was of the view that the initial business case was not properly articulated (own emphasis). Further, the Committee had considered the reputational risk linked to confinement processes. However, the Committee was subsequently convinced by the revised business case and comforted by the fact that the 160 locomotives were awarded to the same entities that were being recommended for the 1064 transaction. Management informed the Board that the Committee had also requested the Company to explore alternative methods for acquisition eg leasing options for the locomotives. To this effect, the Company will procure 23 second hand locomotives from Australia."

33.9 During interviews initially with Pillay and subsequently with Callard, Werksmans was informed that the confinement of the 100 locomotives to CSR was not in accordance with their submissions as contained in the initial confinement business case. Neither of the two individuals was able to explain why the governance processes in terms of the PPM had not been adhered to. Further, insofar as the award to CSR by BOD on 24 January 2014 was approved, they could offer no satisfactory explanation as to why the BOD approved the confinement to CSR and not Mitsui as recommended in the Initial Confinement Business Case.

33.10 Werksmans has had regard to a letter from the Shareholder Minister of 23 May 2014, wherein it is recorded:⁷⁸

"The significance and materiality framework agreed to in the 2013/2014 Shareholder Compact, clearly stipulates that Transnet should provide me with notification on all acquisitions and disposal of assets above R2 billion..."

33.11 The Minister of Finance addressed a letter to Transnet on 29 September 2014 recording that:

"However, Transnet's submission has limited information on the procurement strategy to be adopted. The National Treasury requires reassurance that Transnet's preferred accelerated confinement procurement method was the most appropriate strategy given the circumstances. In order to establish this, Transnet must disclose the alternate suppliers that were considered and evidence of how and why China South Rail (CSR) was selected as the preferred supplier. In addition, the following information would be helpful to provide assurance that the proposed procurement strategy complies with all legislative requirements..."

⁷⁸ See copy of the letter from the Shareholder Minister, appendix 71.



- 33.12 During or about 31 March 2015 Linda Mabaso, Chairperson of the BOD, addressed a detailed response to the Minister of Finance and Courtesy copied the Shareholder Minister.⁷⁹ Werksmans, however, recommend that, amongst others, the following explanation be interrogated further:

"Confining the contract to Mitsui would result in them having a monopoly for the supply of locomotives to the Coal Line. Transnet found this concentration risk unacceptable as the downstream impact in terms of cost of spares, strategic spares and tooling would place Transnet in a vulnerable position."

- 33.13 A judicial inquiry should be convened by an entity which has the power to compel witnesses to give evidence and provide documentation. This is especially so when one has regard to the fact that the confinement was concluded on the same day as the Transaction Agreements, being 17 March 2014,⁸⁰ and according to Callard, CSR would need 12 months to complete designs, which detracts from the motivation of urgency. There is clearly a need for full exposure and accountability.

34 Consultants

- 34.1 In the course of Werksmans' analysis of the Transaction documents and in independent interviews, Werksmans was advised that independent advisory services were secured in relation to the Transaction. The GCFO prepared a memorandum to the GCE styled "*Appointment for Transaction Advisor on the 1064 Locomotive Tender*", approved and signed on 22 August 2012,⁸¹ which records:

"PURPOSE

1. The purpose of this memorandum is to request approval of the Group Chief Executive for the appointment of the McKinsey consortium for the complete advisory services and Webber Wenzel for the legal advisory work as Transaction advisors on the 1064 locomotive tender.

1.1 For the Group Chief Executive to note that McKinsey will be advised to partner with another firm with equal or better credentials than Letsema, for the procurement elements, due to the potential contact with Barloworld and Letsema.

BACKGROUND

⁷⁹ See copy of the 31 March 2015 letter, appendix 72.

⁸⁰ See the update of tender transactions approved memorandum of 15 May 2014, appendix 73.

⁸¹ See copy of this memorandum, appendix 74.



2. The GCE previously approved a confinement for transaction advisors, dated 10th May 2012, to KPMG, PWC, Aurecon, Letsema, McKinsey, Webber Wentzel, David Potter, Ledwaba Mazwai and MAC Consulting for the advisory services.

3. The objectives of this work is to assist Transnet in successfully awarding contracts for the manufacture and supply of diesel and electric locomotives while maximising value for Transnet and securing localization and industrialization benefits for South Africa.

DISCUSSION

4. The scope of the engagement for the transaction advisors include:

...

14. The Tender evaluation process was concluded whereby the McKinsey consortium consisting of McKinsey, Letsema, Utho, Kolkanyang, Nedbank, ENS-and ART (David Potter) were the preferred bidder for four categories (1) to (4), into which the evaluation criteria was categorized. Webber Wentzel was evaluated the highest amongst all bidders/consortia from a technical perspective and was the preferred bidder for the legal advisory work.

15. The Transnet Acquisition Council (TAC) awarded the McKinsey consortium the complete advisory services and split the award regarding legal advisory to Webber Wentzel. Refer to attached TAC resolution.

16. As the Locomotive RFP's have been advertised and will be issued in tranches and it is imperative that the RFP's be reviewed from all aspects by the transaction advisors before the supplementary RFPs are issued.

FINANCIAL IMPLICATIONS

The estimated value for locomotive advisory services required is R50 million. The %split of work is anticipated to be as follows:

17.1. McKinsey - 35%

17.2. Procurement partner - (Letsema replaced due to conflict with Barloworld- 2D %

17.3. Utho and Nedbank -10%

17.4. Webber Wentzel - 20%

17.5. Advanced Rail technologies - 15%

BUDGET IMPLICATIONS

18. Although these costs were not explicitly budgeted for, sufficient budget exists in the Corporate Centre budget.

RECOMMENDATIONS

19. It is recommended that the Group Chief Executive approve the appointment of the McKinsey consortium for the complete advisory services and Webber Wentzel for the legal advisory work as Transaction advisors on the 1064 locomotive tender.

19.1. It is recommended that the Group Chief Executive note that McKinsey will be advised to partner with another firm with equal or better credentials than Letsema, for the procurement elements, due to the potential conflict with Barloworld and Letsema."

- 34.2 Approval of the memorandum of 22 August 2012 culminated in Transnet and McKinsey concluding an agreement during or about December 2012 ("**LOI**").⁸²
The introductory paragraph defines the mandate as follows:

⁸² See copy of the LOI, appendix 75.



*"Pursuant to our Request for Proposal (RFP Number 12/05/0447), we wish to inform you that your offer has been accepted and that your consortium has been awarded the contract for the provision of **Advisory Services related to the Acquisition of the 1064 Locomotives Tender** (the **Services**) to Transnet, subject to the conditions precedent set out in section 1 below.*

The Parties to this agreement are:

...

*Transnet wishes to contract with the Supplier for the provision of **the Services** as outlined in clause 3.3 below, which, if mutually agreed by the Parties, will be documented and effected in accordance with a **9 (nine)** month Agreement between the Parties...*

...

*The purpose of this Letter of Intent (**LOI**) is to document the intention of the Parties in respect of the required Services for **the provision of Advisory Services related to the Acquisition of the 1064 Locomotives Tender** and it will remain in effect until the Agreement is signed by both Parties, or until 90 (ninety) days have elapsed from date of issue of this LOI, whichever event should occur first." (own emphasis)*

- 34.3 Werksmans received, with the assistance of the current GCFO, an execution version of an agreement styled:

"FOR THE PROVISION OF SERVICES RELATED TO THE ACQUISITION OF 1064 LOCOMOTIVES TENDER

<i>Agreement Number</i>	<i>GSM 12/05/0447</i>
<i>Commencement Date</i>	<i>15 JANUARY 2013</i>
<i>Expiry Date</i>	<i>31 MARCH 2014".</i>

- 34.4 The agreement was signed by the parties on or about 21 February 2014, David Fine for McKinsey and Singh for Transnet. The 33 page agreement was ostensibly concluded pursuant to the LOI,⁸³ which had arguably lapsed on its own terms.

- 34.5 Werksmans has ascertained that the appointment of consultants and/or independent experts are deliberated on in a manner which contradicts the express terms of the agreement above. In amplification of this assertion:

- 34.5.1 the minutes of a meeting of the BADC held on 28 June 2013, record:

"Procurement of the 1064 locomotives for the TFR General Freight Business: The terms of reference for the appointment of an independent expert will be formulated and finalised by the Board Steering Committee comprised of the Chairperson, Chairperson of Risk and Mr Singh. The Board Steering Committee will gauge the skills required and appoint a services provider. Going forward the expert will assist the Board. The matter is in progress. Mr Singh will liaise with the Chairperson of the Board."; (own emphasis)

⁸³ See copy of the 33 page agreement, appendix 76.



34.5.2 in the minutes of a meeting of the BADC held on 29 July 2013, the following is recorded:

"8.8 *Procurement of 1064 locomotives for the TFR General Freight Business: The terms of reference for the appointment of an independent expert will be formulated and finalised by the Board Steering Committee comprised of the Chairperson, Chairperson of Risk and Mr Singh. The Board Steering Committee will gauge the skills required and appoint a service provider. Going forward the expert will assist the Board. The matter is in progress. The Board raised concerns over and above the audit function. The GCFO will liaise with the Chairperson and will finalise." (Own emphasis). ("Extract 2")*

34.5.3 the minutes of a meeting of the BADC held on 20 August 2013 record:

"8.6 *Procurement of 1064 locomotives for the TFR General Freight Business: The terms of reference for the appointment of an independent expert will be formulated and finalised by the Board Steering Committee comprised of the Chairperson, Chairperson of Risk and Mr Singh. The Board Steering Committee will gauge the skills required and appoint a service provider. Going forward the expert will assist the Board.*" (own emphasis) ("Extract 3"); and

34.5.4 in the "Excerpts from the Minutes of the meeting of the Board Acquisitions and Disposals Committee no 14/2 held on 26 February 2014", it is recorded *inter alia*:

8.1 Procurement of 1064 locomotives for the TFR General Freight Business: the terms of reference for the appointment of an independent expert will be formulated and finalised by the Board Steering Committee comprised of the Committee Chairperson, Chairperson of the Risk and Mr Singh. The Board Steering Committee will gauge the skills required and appoint a service provider. Going forward the expert will assist the Board. Management will finalise the process of appointing an independent expert. A conversation on how the matter will be finalised will be communicated with the Chairperson (sic).

The matter was in-progress." (Own emphasis)

34.6 The considerations as observed in 8.1 of the BADC quoted above, are misleading as Regiments as a fact had been appointed as the Transaction adviser.



34.7 Further in relation to Regiments and in "joining the dots",⁸⁴ an explanation is required given the existence of a letter between Singh and McKinsey dated 19 November 2013, which records:

"19 November 2013

Reference: LAI/GSM/12/05/0447

Dear Mr. Michael Kloss

RE: LETTER CONFIRMING A CONFLICT OF INTEREST (NEDBANK CAPITAL) AND THE RECOMMENDED ALTERNATIVE (REGIMENTS CAPITAL) IN REGARDS TO ADVISORY SERVICES TO ACQUISITION OF THE 1064 LOCOMOTIVES TENDER OVER A PERIOD OF 5 MONTHS. REFERENCE NO; GSM/12/05/0447

1. *McKinsey Incorporated (McKinsey) and other members of the consortium was awarded the business to provide advisory advice to Transnet for the Acquisition of the 1064 locomotives.*
2. *McKinsey was awarded the business and Nedbank Capital (Nedbank) was its partner to provide financing, funding options and deal structures for the acquisition of the 1064 locomotives tender.*
3. *In May 2013 a potential conflict of interest was raised with McKinsey concerning Nedbank to which a response from McKinsey confirmed the conflict and an alternative solution to provide the services to Transnet was proposed in terms of Regiments Capital to provide the services.*
4. *The 1064 locomotives tender is entering Phase 2 which will now include the funding and deal structuring work envisaged by Transnet for the Acquisition of the 1064 Locomotives.*
5. *It is thus in the best interest of Transnet and McKinsey to confirm the proposed alternative of Regiments Capital.*
6. *This letter serves to confirm Transnet's agreement to McKinsey's request for Regiments Capital to provide the required service's in place of Nedbank.*

...

Anoj Singh

Group Chief Financial Officer

Date..."

⁸⁴ We note that the initial entrance of Regiments in the Transaction, through disqualification of Letsema from the McKinsey Consortium in 2012, due to an apparent conflict of interest with Barloworld, raises concern and falls to be investigated. This is more so given that the McKinsey consortium was selected as the Transaction advisor on the basis of the make-up of the consortium as was presented in the proposal submitted pursuant to the RFP for advisory services. It is important to note that the decision to appoint the McKinsey consortium would have been influenced by the make-up of the consortium and the motivation/reasons given for why particular entities/ persons were included as part of the consortium. Furthermore, we note that there is no evidence that show that the RFP went back on market once it was established that Letsema and Nedbank Capital could no longer form part of the consortium. It would further seem that replacement of either one of the parties aforementioned by Regiments did not serve before the requisite governance structures for approval/recommendation. We note that this instance is remarkably similar in form to the aspect of the 100 electric locomotive confinement addressed herein, insofar as MARS was replaced by CSR and the relevant business case was inexplicably amended without due procurement and other process being adhered to. These aspects require further investigation.



- 34.8 Singh should be given the opportunity to explain, or be compelled to do so during the course of a judicial inquiry convened for *inter alia* this purpose, the content of and the existence of the agreement, in relation to the above stated minutes and correspondence.
- 34.9 In further amplification of these observations is the conclusion of the agreement between McKinsey and Transnet on 31 January 2014, which, agreement rather curiously, was terminated within four days. Both this agreement and the withdrawal from the provision of advisory services are appended hereto.⁸⁵
- 34.10 A salient observation in the McKinsey withdrawal memorandum is the conclusion -

"CONCLUSION

The late stage of the transaction, few terms open for negotiation and limited buyer leverage suggests that McKinsey could not add significant value through this engagement, As McKinsey strives to serve Transnet only on issues where we can have an outsized impact, we must regretfully conclude that it is neither of our interests nor those of Transnet to continue this engagement."

- 34.11 In the course of the interviews, more specifically with Jiyane, we were advised that in early February 2014, in his presence there was a disagreement between Vikas Sagar ("**Sagar**") of McKinsey and Singh, which culminated in the termination of McKinsey. The memorandum of withdrawal addressed above is irreconcilable with Jiyane's explanation that McKinsey was openly fired.⁸⁶
- 34.12 Additional documentation evidences the fact that McKinsey "ceded and/or delegated to Regiment Capital" the mandate awarded to McKinsey, in accordance with an alleged agreement, between McKinsey represented by Sagar and Transnet represented by Singh. This is evidenced by a letter penned by Sagar on 16 April 2014, to Transnet addressed to Singh, wherein the following is recorded:

"Date: 16 April 2014

Reference: GSM/12/05/0447

Dear Anoj Singh,

⁸⁵ See appendices 32 and 33.

⁸⁶ See appendix 33.



RE: Transaction advisory services related to the acquisition of the 1064 locomotives ("the mandate")

Pursuant to our discussions and agreement on February 5, 2014 we hereby confirm that the mandate awarded to McKinsey Incorporated and all rights and obligations created thereby was, on February 5, 2014, ceded and/or delegated to Regiments Capital in accordance with such discussion and agreement. On account of, and pursuant to, the aforementioned cession and delegation, all work related to, and in respect of, the mandate was conducted by Regiments Capital and not by McKinsey Incorporated.

Regards,

...

*Vikas Sagar
Principal"*

34.13 In our further analysis and observation of the Regiments relationship with Transnet, it emerged that Singh addressed a memorandum to Molefe, amongst others, recommending an increase in the contract value.⁸⁷ The motivation and purpose for the increase is suspicious. See the observations in the Forensic Audit Report relating to Regiments.

34.14 The memorandum from Singh to Molefe of 17 April 2014 records, *inter alia*:

"PURPOSE OF SUBMISSION

1. *The purpose of this memorandum is to request that the Group Chief Executive to:*
 - 1.1 *Note the deliverables executed by the transaction adviser on the locomotive transaction compared to the original scope per the Letter of intent (LOI);*
 - 1.2 *Ratify the amendment in the allocation of scope of work from McKinsey to Regiments Capital;*
 - 1.3 *Ratify the amendment in the make-up in the transaction adviser consortium from Nedbank Capital with Regiments Capital;*
 - 1.4 *Approve a change in the remuneration model of the transaction adviser compared to the original remuneration model;*
 - 1.5 *Delegate power to the GCFO to give effect to the above approvals.*

BACKGROUND

...

6. *The entire scope of the engagement was allocated to Regiments with McKinsey only responsible for the business case and limited technical optimisation aspects.*
7. *On 4 February 2014 the LOI scope for Regiments Capital was extended to reflect the above and ensure better Implementation and management of risks (Annexure D).*

...

Value created by the Transaction advisor

10. *Regiments assisted Transnet in computing the effects of hedging and escalation based on the original delivery schedule compared to an accelerated/revised delivery*

⁸⁷See copy of the memorandum requesting the increase in fees, appendix 77.



schedule as well as optimising the foreign exchange hedge and guarantee bond pricing."

- 34.15 The current GCFO has made available an unsigned version of a memorandum dated 23 April 2014 addressed to Singh, wherein it appears he takes issue with the revised remuneration model per Singh's above memorandum approved on 17 April 2014 as appears from the extract below:

"PURPOSE:

1. The purpose of this submission to the Group Chief Financial Officer is to advise Group iSCM and Transnet Corporate Centre Procurement's position regarding the approval of the change of the remuneration model of 1064 Locomotive Transaction Advisory Services, GSM12/05/0447.

...

DISCUSSION:

9. On the 17th April the Group Chief Executive approved the various changes in scope and consortium members as well approved a revised remuneration model.

10. This revised remuneration model that was approved is a risk based model with a success fee.

11. The benefits that Transnet obtained from the Transaction Advisor contract was as a result of the contracted for deliverables being provided in terms of the current fixed fee agreement Transnet has with the service provider.

12. The fact that Regimens Capital operating model is based on a risk sharing model or success fee is irrelevant. Regimens Capital willingly accepted the rights and obligations of an existing contract, whose fee is a fixed fee for the delivery of the deliverables. Regimens also agreed to an increased fixed fee for the detailed deliverables that they delivered on.

13. Based on the above, notwithstanding the GCE's approval, we do not agree to the implementation of the change in remuneration model as the service provider has been sufficiently remuneration for the services provided as per the agreement."

- 34.16 Furthermore the fees of R267 750 000,00 as tabulated in an appendix hereto, with the supporting invoices from Regiments rendered during the period February 2014 to June 2015,⁸⁸ are required to be interrogated as to the justification and veracity of the expenditure in terms of the governance policies and relevant legislation. As indicated in the Forensic Audit Report, the approval to pay Regiments was not in the interests of Transnet and justifiable on a proper basis. It is commented in the Forensic Audit Report as follows:

"It would not be an overstatement to describe the Regiments calculations as absurd, obviously wrong and grossly misleading."

⁸⁸See table of fees and supporting invoices from Regiments, appendices 78.



35 **Tequesta**

- 35.1 As regards the existence of a contract between Tequesta, signed by Essa and a representative CSR Hong Kong, Werksmans met with representatives of SARB on 26 September 2017, who advised that they have been looking into the affairs of, amongst others, CSR following allegations of corruption and fraud in relation to the Transaction.
- 35.2 Pursuant to the meeting, SARB provided Werksmans with the full version of the Tequesta Agreement (Werksmans had prior to that been in possession of only the front page that was circulating in the media).⁸⁹
- 35.3 Further to the observations in the Forensic Audit Report relating to the agreement in question, Werksmans established from SARB that CSR (Hong Kong) is a subcontractor of CRRC SA Rolling Stock (Pty) Limited, the RSA CSR entity formerly referred to and defined above as CSR.⁹⁰ SARB further advised that it was unable to establish the veracity of the allegations of kickbacks paid or to 'follow the money', to CSR (Hong Kong) as this is not a South African based entity and is therefore outside of its jurisdiction.
- 35.4 The summation and views per the Forensic Audit Report on the features of the Tequesta/ CSR (Hong Kong) contract associated with "bribery and corruption",⁹¹ supports the imperative of an investigation as recommended in the Forensic Audit Report. It is Werksmans' view that further investigation is necessary given that the documentation obtained from SARB show that CSR (Honk Kong) is indeed a subcontractor of CSR (SA), yet CSR (SA) has in writing denied any knowledge and/or association with CSR (Hong Kong).⁹² The provisions of PreCCA may well need to be invoked, in particular section 34.

36 **Local Content ("LC")**

⁸⁹ See copy of the Tequesta Agreement, appendix 79.

⁹⁰ See a copy of a schedule detailing CSR's subcontractors, appendix 80.

⁹¹ See paragraph 5.38 of the Forensic Audit Report.

⁹² See copies of both letters respectively from Transnet and from CSR appendix 81.



36.1 During the course of the investigation, Werksmans established that LC commitments in relation to the Transaction are not being met, as explained by Johan De La Rey and Jaco Hoon of TIA (KPMG) at meeting held on 31 August 2017. In this regard we have had regard to the following:

36.1.1 on 21 November 2014, the Shareholder Minister wrote a letter to Transnet,⁹³ wherein the following is recorded:

"The Department is aware that supplier development and localisation plans should have been signed between each OEM and Transnet in September 2014. I would like to receive details of what has been committed in this regard as well as the delivery milestones.

The Department has been approached by the local Industry, which has indicated that OEMs are not meeting local content requirements on historical locomotive contracts with Transnet; and with specific reference to the 1064 locomotives, OEMs are planning to import technologies and components which would have been earmarked to be produced by local suppliers in South Africa. This is a very serious matter and the Department would like to engage Transnet thereon as a matter of urgency.

*...
Whilst the DPE acknowledges that there has been a fair exchange of Information between the Department and Transnet in relation to the fleet procurement, there are a range of issues relating to implementation; monitoring of the project; and supplier development commitments which remain vague. In this regard, I think it is appropriate to schedule a one day workshop between the DPE (chaired by myself) and Transnet, including Transnet Engineering and Transnet Freight Rail, whereby a comprehensive presentation is made to the Department on the entire procurement. My office will be in contact with yours to set up this meeting in the coming weeks.*

*In preparing for this meeting, please find attached **Annexure A** which provides a list of areas that the Department would like Transnet to focus on in responding to some of our concerns."*

36.1.2 in a report issued on 8 August 2017 covering a period of review from 1 April 2016 to 31 December 2016, authored by the Capital competency Leader TIA Account Lead: KPMG,⁹⁴ the following statement appears:

"No Local Content verification has been conducted to date on OEMs – Potential reputational risk to Transnet"; and

36.1.3 in discussions conducted on 31 August 2017 with a TIA member in this regard, Werksmans was advised that the requirements to have local

⁹³ See letter by the Shareholder Minister, appendix 82.

⁹⁴ See appendix 56.



content in a project of this nature are imposed by the Department of Trade and Industry. These requirements of local content are contractually agreed to between the OEMs and Transnet. Werksmans was also informed that certain OEMs are behind schedule whilst others have not achieved their local content requirements at all.

- 36.2 TIA informed Werksmans that the finding quoted above constitutes a material reputational risk, which risk was accordingly highlighted in a report circulated to an executive committee on or about 24 August 2017. TIA contends that on presentation of this report the committee in question insisted that the audit finding be omitted from the report as it was "factually incorrect".
- 36.3 We have been furnished with no evidence that the Shareholder Minister was engaged as requested in the letter mentioned above and TIA has further informed Werksmans during interviews that Transnet management has prevented TIA from conducting a full audit on LC, this notwithstanding that such activity falls within TIA's scope and preparations were already in place.
- 36.4 Furthermore, PwC has confirmed during an interview that they have recently been mandated to provide assurance in relation to LC compliance in the Transaction. PwC confirmed that such assurance is to be done in an advisory capacity, not as an audit. Pursuant to Werksmans' request for clarity as to the role PwC is to play in verification of LC going forward, Werksmans was advised that:

"The precise role (and thus scope) is yet to be clearly defined between ourselves and Transnet. Transnet have used the word "Reasonable Assurance" in their letter to suppliers (please find a copy of the letter to GE). We have assessed their requirement against the implications of this terminology (from an assurance perspective) and are of the opinion that we are unable to provide "Reasonable Assurance" but can provide a high-level verification of the current and proposed forecast of local content for each OEM against the stipulated minimum local content threshold. This would thus be a consulting assignment rather than an assurance assignment."

- 36.5 This aspect of the Transaction requires further investigation and clarification with the assistance of a forensic auditor. It is to be borne in mind that not only



have the OEMs and Transnet committed to LC through Transaction Agreements, but it is also legislatively required.



CHAPTER VI: CONCLUSION

37 Although the Werksmans' investigation is incomplete for the reasons articulated above, Werksmans subject to the qualification recorded herein is in a position to make recommendations, some of which have already been alluded to above.

38 In carrying out Werksmans' mandate in relation to the Transaction in the context of the applicable statutory regimes and policies, there is support for a conclusion that the Transaction is cloaked in corrupt and reckless activity. An appropriately empowered judicial inquiry is required to be instigated by Transnet to properly investigate the various suggestions of bribery and similar unlawful conduct.

39 Minister Brown, the current Shareholder Minister and Transnet's Executive Authority for PFMA purposes, is on record as having stated:

*"unless the parliamentary inquiry into allegations of malfeasance at state owned companies gives those who have been accused of wrong doing the opportunity to explain their actions, it will serve no higher functions than advancing political agendas and further undermining the economy."*⁹⁵

40 It is Werksmans' view that given the legislative provisions and regulations of the PFMA, the Executive Authority should in addition institute an independent inquiry into Transnet in relation to the Transaction, in order to prevent further undermining of the entity.

41 Those members of the BOD serving during the relevant period who failed to apply their minds with regard to the Transaction in the discharge of their responsibilities must be held accountable. The BOD failed to exercise objective judgment of the business enterprise and on its corporate affairs, independent from management. It would appear that the BOD was supine in its deliberations at best and in accordance with the judgment in *Howard vs Herrigl and another NNO 1992 2 (SA) 660 (A)*, such attitude may constitute reckless conduct. Whether such an inference could properly be drawn will depend on the facts to be established in terms of the process recommended above.

⁹⁵ See a copy of Eskom, minister Brown reject allegations by witnesses at the parliamentary inquiry, the Citizen 14/11/17, appendix 86.



- 42 Our observations contained in Chapter V, read together with the recommendations in the Forensic Audit Report, require the BOD to commence disciplinary procedures against all those currently in the employ of the enterprise who were associated with the misleading representations, submissions and memoranda referred to above.
- 43 Regard being had to corporate governance and ethical standards as codified, the submissions to the BADC and subsequently to the BOD, in particular during the period May 2013 to May 2015, were clearly driven by an agenda other than the interests of the entity. Accordingly, the BOD as the Accounting Authority should ensure that the provisions of section 51 of the PFMA are adhered to. The matters reported on in Chapter V all fall to be determined through the effective and appropriate processes. To the extent that this process is to be adopted, we recommend that the suspension of certain executives should be considered in order to ensure that the investigation and disciplinary enquiry is allowed to proceed without interference.
- 44 As is evident from the Forensic Audit Report to be read with this report, the findings are seriously adverse to the interest of Transnet and involve vast sums of money. In this context the HAWKS and NIA should be requested to investigate the Transaction. In addition, Transnet should institute action to recover wasteful expenditure from those responsible and/or unlawfully benefitting from the transactions.
- 45 We conclude with reference to the words of Ms Mathane Makgato, previous group Treasurer in Transnet's treasury department during adjudication of the Transaction, who left within mere months of her employ and has stated: "*I have arrived here with integrity, and I will leave with my integrity intact.*"⁹⁶ Besides the extent of media articles, the former Public Protector's report on 'State Capture' and Budlender's report on the Trillian Capital inquiry, the statement by Makgato gives first hand credence and corroboration to our observations that the Transaction requires an investigation as recommended herein above.

⁹⁶ See <http://amabhungane.co.za/article/2016-09-16-xhow-to-eat-a-parastatal-like-transnet-chunk-by-r600m-chunk>.



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GLOSSARY OF TERMS

AC	Acquisition Council
BADC	Board Acquisitions and Disposals Committee
BAFOs	Best and Final Offers
B-BBEE	Broad-Based Black Economic Empowerment
BOD	Board of Directors
BOM	Bill of Materials
CAPEX	Capital Expenditure
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CFET	Cross Functional Evaluation Team
CFST	Cross Functional Sourcing Team
CFT	Cross Functional Team
COE(s)	Centre(s) of Excellence
CPO	Chief Procurement Officer
DAC	Divisional Acquisition Council
DoA	Delegation of Authority
DPE	Department of Public Enterprise
DTI	Department of Trade and Industry
EME	Exempted Micro Enterprises
EOI	Expression of Interest
FRC Current	Further Recognition Criteria Current
FRC Future	Further Recognition Criteria Future
GCE	Group Chief Executive
GCFO	Group Chief Financial Officer
GCSCO	Group Chief Supply Chain Officer
HVTP	High Value Tender Process
ISCM	Integrated Supply Chain Management
LOA	Letter of Award
LC	Local Content
LOI	Letter of Intent
MDS	Market Demand Strategy
MOU	Memorandum of Understanding
NDA	Non-Disclosure Agreement
NGP	The New Growth Plan strategy sets out critical enablers for employment creation and growth and identifies, where viable, changes in the structure and character of production which can generate a more inclusive and greener economy over the medium to long run. The NGP emphasises the role that the State Owned



	Companies should play in national development by leveraging their procurement spend.
OD	Operating Division
OEM	Original Equipment Manufacturer
OPEX	Operational Expenditure
PFMA	The Public Finance Management Act (PFMA), 1 of 1999 as amended
PMO	Project Management Office
PP	Preferential Procurement
PPM	The Procurement Procedures Manual, an internal Transnet document stating the rules and procedures of procurement.
PPPFA	The Preferential Procurement Policy Framework Act (PPPFA), effective 7 December 2011. Transnet has exemption for 12 months for a majority of the Regulations.
PTN	Post Tender Negotiation
RFI	Request for Information
RFP	Request for Proposal
RFQ	Request for Quotation
RFX	A generic term which can be used interchangeably with either RFI, RFQ or RFP
SD	Supplier Development
SDP	Supplier Development Plan
SLA	Service Level Agreement
SOC	State Owned Company, SOCs (such as Transnet) were previously known as State Owned Enterprises (SOEs) before the Companies Act of 2008 came into May 2017
TAC	Transnet Acquisition Control
TCC	Transnet Corporate Centre – the Head Office of Transnet SOC Limited
TCO	Total Cost of Ownership is a calculation designed to compute the complete costs of goods/services from acquisition to disposal, rather than just considering the purchase price, in order to facilitate informed financial decisions.
TCP	Transnet Capital Projects
TEAR	Tender Evaluation and Recommendation Report
TFR	Transnet Freight Rail – an Operating Division of Transnet
TMPs	Total Measured Procurement Spend
TRE	Transnet Rail Engineering – an Operating Division of Transnet (Now Transnet Engineering ("TE"))

