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NEW PREFERENTIAL PROCUREMENT REGULATIONS LIKELY TO BE CHALLENGED

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In his State of the Nation Address in 2017, President Jacob Zuma noted the intention of the South African government to influence the behaviour of the private sector and to drive economic transformation. He stated that this objective would be achieved through the government playing a role in the economy through legislation, regulations, licensing, budget and procurement, as well as Broad-Based Black Economic Empowerment ('B-BBEE') imperatives.

Using the term 'radical socio-economic transformation', President Zuma referred to the need for fundamental change in the structure, systems, institutions and patterns of ownership, management and control of the South African economy in order to correct their skewed nature.

One of the most recent means to facilitate the government's drive for economic transformation is the promulgation of revised Preferential Procurement Regulations ('the Regulations'), which became effective on 01 April 2017, and which are surrounded by some controversy.

Background to the Regulations

The Regulations arise from the Preferential Procurement Policy Framework Act, 2000 ('PPPFA'), which gives effect to the constitutional mandate for the application of preferential procurement in South Africa. The PPPFA applies to those organisations -- both local and international -- wishing to do business with South Africa's 'organs of state'.

Even if organisations are not wanting to do business with organs of state, they may well form part of the supply chain of those organisations to whom the PPPFA applies directly, and therefore need to be aware of its scope and provisions.

According to the PPPFA, organs of state must implement their preferential procurement policies within a certain framework, which will stipulate that a preference point system must be followed. Specific points are allocated for specific goals, which include contracting with people who have been historically disadvantaged by unfair discrimination on the basis of race, gender or disability.

The PPPFA provides for regulations to be promulgated to achieve its objects. It is these regulations that give substance and meaning to preferential procurement in South Africa.

"We need to give more meaning to procurement processes and ensure that 30% of government Procurement is set aside for SMEs and 100% black-owned companies...Opportunities have been closed and taken away by existing big business and by monopolies...We need to look at ways of freeing that up."

Cyril Ramaphosa (Deputy President of South Africa)

06 February 2017

What has changed?

Since the previous iteration of the Regulations, which were signed into law in 2011, the *Codes of Good Practice for B-BBEE* ('the Codes') have come into effect and the *B-BBEE Act, 2003* ('B-BBEEA') has been amended; seeking to address the legacy of racist apartheid policies and to enhance the economic participation of black people in the South African economy.

The procurement element in the Codes is heavily weighted towards procuring from black-owned businesses and the revised Regulations are better aligned with the amendments to the B-BBEEA and the Codes, providing a mechanism to empower certain categories of tenderers through procurement and increasing the possibility of B-BBEE compliant enterprises with more favourable B-BBEE contributor levels to win higher value government contracts.

The Regulations which introduce the most significant deviations from the previous version are Regulation 4, Regulation 5, Regulation 6, Regulation 7 and Regulation 9. These Regulations *inter alia*:

- introduce pre-qualification criteria for procurement with the state and its organisations;
- provide for revised functionality scoring rules;
- increase the Rand value for the application of the preference point system in respect of the 80/20 principle from a maximum of R1 million to a maximum of R50 million;
- increase the threshold for the application of the preference point system in respect of the 90/10 principle from transactions above R1 million to transactions above R50 million; and
- make subcontracting compulsory where it is feasible for a minimum of 30% of the value of the contract to be subcontracted to specifically designated groups.

The Regulations are controversial

The Constitution of the Republic of South Africa, 1996 ('the Constitution') provides for and encourages preferential procurement. In fact, section 217 of the Constitution focuses on fair, equitable, transparent, competitive and cost-effective procurement by government, while allowing for preference to be given to certain designated groups in allocating contracts to protect or advance those people who have been disadvantaged by unfair discrimination. Section 217 is not in contravention of Section 9 of the Constitution -- which forms part of the Bill of Rights -- and which enshrines the right to equality of all people. Section 9 (2) states *inter alia* that, in order to promote the achievement of equality, legislative measures may be taken to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination.

The potential and resultant effect of the implementation of the new Regulations is that the preference afforded to, *inter alia*, black persons in advancing the economy and the objects of the PPPFA may lead to the possible exclusion of certain groups of people through the pre-qualification criteria. The new Regulations therefore signal a radical shift in favour of enforcing the B-BBEE project which has been slow, with the economy largely still in the hands of the white minority despite the B-BBEE Act being implemented already for six (6) years, with little impact.

The PPPFA specifically aims to limit the effect of a tenderer's B-BBEE status through the 80/20 and 90/10 weighting system, which must be used in evaluating and awarding tenders. However, the Regulations now allow higher priority to be given to B-BBEE status and specific goals of organisations to the extent that organs of state can effectively exclude certain categories of tenderers from submitting their bids at all. By contrast, the PPPFA clearly retains price as the primary factor in awarding government tenders, even though it does take cognizance of the B-BBEE status of bidders.

The retention of the 80/20 and 90/10 scoring principles implies that National Treasury will continue -- to an extent -- to encourage cost savings by organs of state, since price must still be the primary determiner in terms of which tenders are awarded; it must make up either 80% or 90% of the total points. The amendment to the upper threshold amount for the application of the 80/20 scoring principle to R50 million means that for all tenders below this amount, a price premium of 20% will be accepted. The B-BBEE status level of a great number more service providers will now become a much bigger determinant of who conducts business with the State. Those benefitting from the Regulations could obtain the full 20 points on the basis of their B-BBEE status. In addition, they could be awarded a contract as a result of the fact that they sub-contract to a designated group. The weight of the socio-economic factors could therefore be more than the 20% contemplated in the PPPFA. These factors will not have the effect of increasing price as the requirements of section 217 of the Constitution, which envision the procurement of goods in a manner that is cost effective, cannot be undermined or overridden by the need to promote representation. The State must be mindful to balance considerations of equity and cost-effectiveness. It is likely that this aspect of the Regulations -- and whether or not they are in accordance with the PPPFA -- will also be challenged in the future.

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