DRAFT PROPOSED

CODE OF GOOD PRACTICE

for

BLACK ECONOMIC EMPOWERMENT

in

PUBLIC PRIVATE PARTNERSHIPS

Following consultation on this draft Code of Good Practice for Black Economic Empowerment (BEE) in Public Private Partnerships (PPPs), the Public Private Partnership Unit (PPP Unit), National Treasury, will request the Minister of Finance to submit the final draft to the Minister of Trade & Industry for consideration by the BEE Advisory Council as a Code of Good Practice to be issued in terms of the Broad-based Black Economic Empowerment Act (BBBEE Bill), once enacted.

The targets set in this draft Code for BEE in PPPs are higher, and the approach more appropriate for PPPs than those provided for in the Preferential Procurement Policy Framework Act (PPPFA). The National Treasury will therefore apply to the Minister of Finance to exempt PPPs registered in terms of the Public Finance Management Act (PFMA) from the provisions of the PPPFA, in the event that this Code of Good Practice is issued by the Minister of Trade & Industry in terms of the BBBEE Act.

This Code of Good Practice for BEE in PPPs follows the release of the Financial Sector Charter, and complements its commitments.

Comments can be submitted to the PPP Unit, National Treasury by 30 January 2004 to: sue.lund@treasury.gov.za **and** sheila.themba@treasury.gov.za
PPP Unit tel: 27-12-315 5741/5060
This document is also available on www.treasury.gov.za

Definitions

Black enterprise	means one that is at least 50.1% owned by black people and in which black people have substantial participation in the management control of the enterprise
Black people	means African, Coloured, Indian South African citizens
Broad-based black economic empowerment	has the meaning defined in the Broad-based Black Economic Empowerment Bill, 2003 (BBBEE Bill)
Feasibility Study	has the meaning given in Treasury Regulation 16 to the Public Finance Management Act 1 of 1999 as amended (PFMA)
Institution	has the meaning defined in Treasury Regulation 16 to the PFMA
Management control	means an ability to direct or cause the direction of the business and management policies or practices of the enterprise
Private Party	has the meaning defined in Treasury Regulation 16 to the PFMA
PPP Agreement	has the meaning defined in Treasury Regulation 16 to the PFMA
Transaction Advisor	has the meaning defined in Treasury Regulation 16 to the PFMA

Preamble

In a concerted drive to redress the stifling economic effects of apartheid, the democratic South African government has adopted a policy of Black Economic Empowerment (BEE) which is broad-based, inclusive, and part of the country's overall growth strategy. Public-private partnerships (PPPs) are being used increasingly widely to implement national and provincial government's infrastructure and service delivery commitments. Regulated by the relevant Treasury (currently, the National Treasury) in terms of Treasury Regulation 16 to the Public Finance Management Act (PFMA), these PPPs offer valuable opportunities for strong and sustainable BEE.

South Africa's BEE policy is articulated in the 2003 "*Strategy for Broad-based Black Economic Empowerment*" (*BBBEE Strategy*) and is given effect in the Broad Based Black Economic Empowerment Bill, 2003 (BBBEE Bill). The *BBBEE Strategy* outlines government's policy instruments for achieving BEE and sets out a balanced scorecard to measure progress in all enterprises and sectors. The scorecard measures three core elements of BEE:

- direct empowerment through ownership and control of enterprises and assets;
- human resource development and employment equity; and
- indirect empowerment thorough preferential procurement and enterprise development.

The *BBBEE Strategy* notes that BEE criteria, reflecting the balanced scorecard, will be applied whenever government, *inter alia*, "*grants a concession to a private enterprise to operate an asset or enterprise on behalf of the state*" or "*enters into a public private partnership."*

The BBBEE Bill provides that the Minister of Trade & Industry may issue 'codes of good practice on BEE' (section 9). It provides further that "*every organ of state and public entity must take into account and, as far as it is reasonably possible, apply any relevant code of good practice*" in, *inter alia* "*determining qualification criteria for the issuing of licences, concessions…; developing and implementing a preferential procurement policy; ….and developing criteria for entering into partnerships with the private sector*." (section 10)

The *Code of Good Practice for BEE in PPPs* contains the following:

Part I: government's policy on BEE in PPPs, why PPPs are good for BEE, and challenges for BEE in PPPs;

Part II: how to apply PPP BEE policy in the structure of a PPP project, specifically: in equity shareholding, management, sub-contracting and local socio-economic impact;

Part III: how to apply PPP BEE policy at each phase of the PPP project cycle, specifically: in the appointment of transaction advisors to government, doing a feasibility study, running the procurement process, contracting, and contract management;

Part IV: the *PPP BEE Balanced Scorecard* which sets BEE elements that should feature in every PPP deal, indicative targets for each element, and recommended weightings of these in bid evaluation; and

Part V: proactive commitments by government to further support BEE in PPPs.

The *Code of Good Practice for BEE in PPPs* constitutes a module of the *National Treasury's PPP Manual,* and is reflected as appropriate in all other modules of the *Manual.* It is also reflected in National Treasury's *Standardised PPP Provisions* to ensure that BEE becomes contractually binding in PPP contracts.

PART I

1. Policy on BEE in PPPs

BEE is a key component of South African PPP projects, each of which is structured on a careful combination of **financial, technical and BEE** components in order to achieve optimal value-for-money in government's delivery of infrastructure and services. **The BEE component of a PPP bid will constitute no less than 15% and no more than 20% of the three components of bid evaluation in a PPP.** The financial and technical components will constitute the remaining 80% - 85% as appropriate to the project. A lower proportion on BEE components would reduce its importance to the project, while a higher proportion could compromise the financial and technical components.

Government institutions hire Transaction Advisors to provide financial, legal and technical support through the PPP project cycle, and their appointment is also subject to BEE policy. **The BEE component of a Transaction Advisor bid will constitute no less than 20%** of the evaluation, with the price and technical elements constituting the remaining 80%. In addition, there is a **12% threshold** on the BEE component of a Transaction Advisor bid. If the Transaction Advisor bid passes the technical threshold but fails to pass the BEE threshold, it will not be further considered for selection.

In keeping with the principles and policy objectives of the *BBBEE Strategy*, PPP BEE policy is devised to ensure a broad-based and sustainable BEE outcome in every PPP project undertaken in terms of Treasury Regulation 16 to the PFMA. The BEE elements to be included in each PPP project, and the indicative targets for each element are elaborated in **Part II** of this C*ode of Good Practice.*

No PPP may be issued to the market by a government institution without a clear and appropriate set of BEE elements, targets and weightings, duly approved as part of Treasury Approvals I and IIA in terms of Treasury Regulation 16 to the PFMA. Bids received thereafter are evaluated by the institution, *inter alia*, for substantiation of the private party's BEE commitments. The quality of the BEE component of the preferred bid forms an important element of the value-for-money report to be submitted by the Institution for Treasury Approval IIB, prior to the commencement of negotiations. Negotiations that follow must seek to maximise BEE benefits in the final terms of the deal, and to tie up appropriate provisions for contract management post signature. These BEE commitments are part of the motivation for the final Treasury Approval III, allowing the parties to sign the agreement. The PPP Agreement binds the parties to their BEE commitments for the duration of the PPP, stipulating the consequences of default. [1]

These phases of the PPP project cycle, as they apply to the BEE component of a PPP, are elaborated in **Part III** of this *Code of Good Practice*. Detailed guidance on all components of each phase in the PPP project cycle is issued as the *National Treasury's PPP Manual,* of which this *Code of Good Practice* forms part. *Standardised PPP Provisions* issued by National Treasury provide the BEE contractual terms that reflect the *Code*.

---

[1] Refer: ***Standardised PPP Provisions*** and the ***National Treasury PPP Manual****, South African National Treasury, 2004*

Government's policy objectives for BEE in PPPs are as follows:

- To achieve meaningful and beneficial **direct ownership of substantial equity interests** in the Private Party to a PPP Agreement by black people, black women and black enterprises;
- To achieve effective **participation in the management control** of the Private Party and its sub contractors by black people and black women;
- To ensure that a substantive proportion of the Private Party's **sub-contracting and procurement** is to black people, black women and black enterprises;
- To ensure effective **employment equity and skills development** in the Private Party and its sub-contractors throughout the PPP project;
- To promote positive **local socio-economic impact** from the project to the benefit of small and medium enterprises, the disabled, the youth, and non-government organisations within a targeted area of project operations;
- To create **jobs**; and
- For institutions of government to be represented in all PPP transactions by **financial, legal and technical advisors** who generally reflect South Africa's diverse population, and to build the professional skills and number of black people and black enterprises in these fields.

The *PPP BEE Balanced Scorecard*, set out in **Part IV** of this draft *Code of Good Practice*, reflects these objectives in respect of **PPP projects**, and will be used by government institutions as a benchmark throughout the PPP project cycle.

The selection of PPP **Transaction Advisors** by government institutions will follow the guidance given in **Part III (1)** of this draft *Code of Good Practice.*

In addition to the BEE requirements in every PPP structure and at every phase of the PPP project cycle, government is making a number of **proactive commitments** to further support BEE in PPPs. These are elaborated in **Part V** of this *Code of Good Practice.*

2. Legal basis for PPP BEE policy

This PPP BEE policy is developed with reference to the following legislation:

- The Constitution of the Republic of South Africa, Act 108 of 1996, enables organs of state to implement *"procurement policy for (a) categories of preference in the allocation of contracts and (b) the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination*" (section 217(2)).
- Treasury Regulation 16, issued in terms of the Public Finance Management Act (PFMA) for the purposes of regulating national and provincial PPPs, states that the procurement procedure for a PPP "***must*** *include a preference for the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination."* (Treasury Regulation 16.5.3 (b)).
- The BBBEE Bill, whose objective is "*to facilitate broad-based black economic empowerment"* and which provides for the issuing of codes of good practice which must be applied by organs of state and public entities, inter alia, *"in developing criteria for entering into partnerships with the private sector.*"

- The Employment Equity Act, which provides for improving employment equity for the benefit of historically disadvantaged individuals (as defined therein).

3. Why PPPs are good for BEE

There are key features of PPPs that make them inherently excellent for achieving BEE objectives:

- The **long term nature** of PPPs provides an opportune instrument to grow black equity and black management over time;
- **Risk is clearly identified** in PPPs, clearly costed and appropriately allocated, so black participants know in advance what they are committing to;
- The formation of **private consortia** in the form of special purpose vehicles (SPV) for many PPPs facilitates long-term beneficial partnerships between new black enterprises and experienced, resourced companies – both as equity partners and in project management, and both at the Private Party SPV and sub-contracting levels;
- Where government is the buyer of a service, and insofar as the service is provided to the agreed standards, there is a **secure revenue steam** to the Private Party, reducing risk to new black enterprises;
- Principal equity sponsors in a PPP are often also primary sub-contractors, building **incentives for optimal risk management**;
- PPPs provide significant subcontracting opportunities for black enterprises, where **early cash flow benefits** can be derived as delivery commences;
- PPPs have far-reaching **broad-based** BEE potential: through the sub-contracting and procurement mechanisms they can involve a full spectrum of large, medium and small enterprises, and bring tangible local economic development benefits to targeted groups of people;
- **Return on equity** to the Private Party is competitive where risk is properly assumed;
- There is an increasingly strong demand for **black professionals** as transaction advisors to both public institutions and private parties in PPPs;
- PPPs develop **skills**; and
- PPPs create **jobs.**

4. Challenges for BEE in PPPs

There nevertheless remain obstacles to achieving sustainable BEE in PPPs:

- There is a **small pool of black equity** in South Africa. Historically black people have not accumulated capital and it is a challenge for black enterprises to raise required levels of equity at reasonable prices;
- Sources of BEE funding are generally **expensive,** reflecting lenders' assessment of risk associated with new black enterprises whose balance sheets may be relatively small, or whose experience may be relatively limited;
- Costs of **independent financial and legal advice** to black enterprises are an inhibiting factor in the preparation of bids, during contract negotiation, and during start-up, often leaving black partners in a consortium vulnerable to concluding disadvantageous arrangements;
- There is **limited black experience and skill** in PPPs resulting in an uneven playing field with established company partners;

- Established companies in the consortia often become obliged to provide **sponsor security** for the committed BEE capital and to guarantee performance of the black partners, contributing further to the uneven playing field for consortium members;
- **Dividend distributions** are seldom structured to provide returns on equity in the earlier years of the project, with detrimental consequences for new black enterprises;
- There are few black South African **PPP transaction advisors**, and those who are there are over-committed.

It is in recognition of both the value in PPPs for sustainable BEE, and the challenges entailed therein, that this *Code of Good Practice* has been devised.

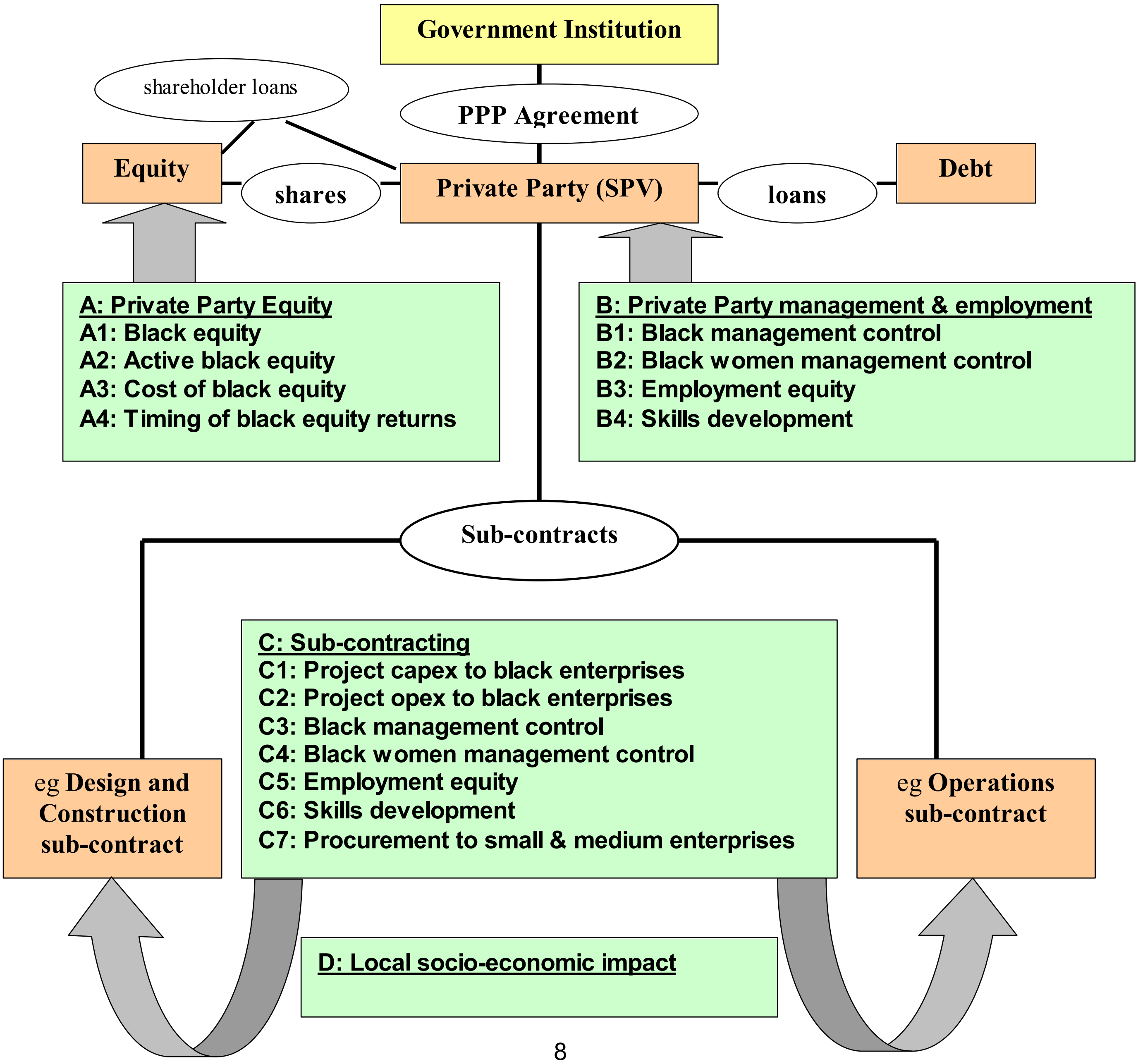
PART II

How to apply BEE PPP policy in the typical structure of a PPP

Many PPP projects are structured in the manner depicted below. The illustration seeks to show the areas where PPP BEE policy should be affected in all PPP Agreements. Where alternative or simpler PPP structures are developed, they should seek to achieve an appropriately equivalent BEE effect. While PPP projects differ, and the BEE elements identified are not exhaustive, at least **those elements listed as A1-4, B1-4, C1-7 and D** should **be appropriately incorporated in the structure of PPP projects undertaken in terms of Treasury Regulation 16 to the PFMA.** The remainder of **Part II** elaborates on each **PPP BEE element.**

Indicative targets for each element are given where appropriate. Targets for a project should always be determined during the Feasibility Study phase, in recognition of the capacity of black enterprises in the sector, and where appropriate, be structured to attain stronger BEE outcomes over time.

The identified elements and their indicative targets are reflected in the *PPP BEE Balance Scorecard* in Part IV.



A. Private Party Equity

Substantial increases in black equity ownership of new enterprises is a central policy objective of government's BEE Strategy. PPPs offer a real opportunity to grow new black ownership in long-term sustainable businesses.

In all PPP Agreements, there will be a lock-in provision, to contractually bind the agreed percentages and conditions of black equity (both passive and active), requiring the Private Party not to effect any changes in its capital structure that will result in the dilution of that equity at any time in the lock-in period.

Four specific elements of private party equity are identified for ensuring that this part of the BEE Strategy is captured in a sustainable way in PPPs:

- **A1:** the percentage of black equity ownership in the Private Party;
- **A2:** the percentage of black equity ownership which has an active role in the project;
- **A3:** the cost of black equity; and
- **A4:** the timing of black equity returns.

A1. Black equity ownership

BEE must be reflected in the percentage of black equity ownership in the Private Party special purpose vehicle (SPV). The actual percentage set will vary from project to project. Many PPP projects will be able to attain a 'high' black equity threshold from the outset. However, due to the scale of funding required in some large PPP projects, or by virtue of the sector, it may be necessary to start out at an initially 'lower' black equity threshold, with timeline-linked milestones to grow the percentage of black equity in the Private Party through the life of the PPP.

The black equity commitment sought by the institution must be clearly costed in its feasibility models, clearly presented to the private sector in the bid documentation, clearly identifiable in the financial models presented by bidders, committed in the PPP Agreement, and demonstrated in the Private Party's shareholders agreement. The source/s of the committed black equity must be substantiated by bidders and verified by the Institutions during bid evaluation.

	PPP indicative target
A1: *Black equity ownership in Private Party SPV*	40%

A2. Active black ownership

In keeping with government's intention that black ownership should have a broad-based impact, be sustainable, active, and grow over time, black equity in the Private Party should also be reflected in the operational control of the project. While pure equity investment in business by black partners is recognised as an important element of BEE, a significant percentage of the black shareholders should not be passive participants only, but should take responsibility and operational risk in the project and secure direct benefits also in the management of the Private Party's delivery undertakings. This active BEE shareholders' role may be achieved in a variety of ways, but must be clearly identifiable in both the management arrangements of the Private Party and in the sub-contracting agreements. Passive equity would normally have no role in management and operations, but would involve representation on the Private Party board.

	PPP indicative target
A2: *Active black ownership*	55% of A1

A3. Cost of black equity

Black people and black enterprises wishing to participate as shareholders in Private Parties to PPP Agreements often find it difficult and expensive to raise the capital necessary to purchase shares. Funding for black equity is thus commonly raised through loans. These either take the form of shareholder loans, based on the strength of the project cash flow, or take the form of loans to the black enterprises, based on their company balance sheets. Over time, growing black enterprises will have an increasing option to invest their own funds as they build a capital base

The price of equity in a PPP deal has an impact, not only on the potential returns for shareholders, but also on the cost of the project to government. For the purpose of evaluating value-for-money in the financial component of the PPP, the cost of BEE equity must therefore be clearly shown as a separate component of the Institutions' feasibility study models (see Part III), and in the financial offers presented by bidders.

Due to the difficulty of placing a value on the BEE equity that is not funded through borrowing, points will not be awarded under the BEE component of the PPP bid evaluation for the assumed value of the black equity in the SPV. However, the overall cost of equity in the deal will have a direct bearing on the Institution's value-for-money considerations in the evaluation of the overall bid price, and will be negotiated with the preferred bidder accordingly.

Government is committed to facilitating the establishment of a PPP BEE equity fund to address this constraint (see Part V).

A4. Timing of black equity returns

In typical funding structures, operating expenditure and debt service take first call on project cash flows, and shareholders are the last in line to receive returns on their investment. This has an obviously debilitating effect for new black enterprises, which in such arrangements have capital tied for the long haul and cannot expect dividends until late in the project life.

The challenge to advisors, sponsors, banks and the black enterprises in PPPs is therefore to find innovative ways of unlocking value to black participants in project cash flow, particularly in structuring early cash flows for black shareholders. How this is to be achieved will not be prescribed, but points will be awarded to bids whose funding structure effectively unlocks value for black shareholders early and throughout the project life. This must be clearly demonstrated in the bidders' financial models and reflected in the shareholders' agreement. It will also become a contractual obligation in the PPP Agreement.

B. Private Party management and employment

The *BBBEE Strategy* identifies further BEE objectives to increase the number of black people in executive and senior management of enterprises, to increase the number of black-engendered enterprises, to increase income levels of black people, and reduce income inequalities. Human resource development and employment equity are also targeted elements of the *BBBEE Strategy's* balanced scorecard. All PPP Agreements will bind the Private Party to concrete commitments in these matters.

Four specific elements of the Private Party's management and employment regimes are therefore identified to enable PPPs to meet these objectives in a meaningful and sustained way:

- **B1:** the percentage of black management control in the Private Party;
- **B2:** the percentage of black women in management control in the Private Party;
- **B3:** the quality of the employment equity plan of the Private Party; and
- **B4:** skills development expenditure as a proportion of Private Party payroll.

B1. Black management control in Private Party
The percentage of management control by black people in the Private Party SPV must be at least commensurate with the black equity shareholding (passive and active) in the SPV. Preferably, the initial percentage of black management should be designed to grow by specified milestones in the project.

	PPP indicative target
B1: *Black management control in Private Party*	commensurate with A1 and A2

B2. Black women in management and employment in the Private Party
The percentage of black women managers in the Private Party must be targeted and committed appropriately. Preferably, the initial percentages of black women managers should be designed to grow substantively by specified milestones in the project.

	PPP indicative target
B2: *Black women in management in the Private Party*	10% of B1

B3. Employment Equity in the Private Party
The Private Party must be in compliance with the Employment Equity Act and therein produce a comprehensive employment equity plan as part of its bid, showing how historically disadvantaged individuals (as defined by that Act) will benefit in the company over time. Innovation should be encouraged by the Institution by awarding points for bids that demonstrate creative, committed and deliverable employment equity plans.

B4. Skills development in the Private Party
The Private Party must deliver a clear skills development plan for its managers and employees as part of its bid, and must commit a percentage of its payroll for expenditure on this plan each year.

	PPP indicative target
B4: *Percentage of payroll on skills development*	5%

C. Subcontracting

Significant opportunities for BEE reside in the sub-contracting arrangements of a typical PPP structure, where ownership, management, women, employment equity, skills development, and procurement commitments can all be targeted for strong BEE results. Preferably, initial target percentages should be set, and, where appropriate, designed to grow substantively by specified milestones over the life of the project. All commitments will be contractually binding obligations in the PPP Agreement.

Six specific elements of the PPP sub-contracting arrangements are identified for ensuring broad-based and sustainable BEE in PPPs:

C: Sub-contracting	**PPP indicative target**
C1: *Percentage of total project capex assigned to black enterprise sub-contractors in the first tier*	30%
C2: *Percentage of total project opex assigned to black enterprise sub-contractors in the first tier*	30%
C3: *Percentage of black management control in each of the first-tier sub-contractors*	25%
C4: *Percentage of black women in management control of each first-tier sub-contract*	10% of C3
C5: *Quality of employment equity plans of each first-tier sub-contractor*	
C6: *Percentage of all sub-contractors' payrolls to be spent on skills development per annum*	5%
C7: *Percentage of procurement budget committed by each first-tier sub-contractor to small and medium black enterprises.*	30%

D. Local socio-economic impact

PPP projects must be seen, and tangibly experienced, as directly beneficial to the people in whose neighbourhoods they operate. Every PPP must therefore be designed, and proactively seek to produce, positive local socio-economic impact in any way that is appropriate to the project and its location. This must be done taking cognisance of relevant Integrated Development Plans. The targets that may be set in this element need not be limited only to black people or black enterprises, but in targeting local communities, must directly benefit the poor and the marginalised, and must effect local economic upliftment.

This final set of PPP BEE elements must be determined by the Institution on a project-by-project basis during the Feasibility Study phase (see Part III), communicated with bidders during procurement, proposed by bidders in their plans with costs reflected in their financial models, negotiated with the preferred bidder, and thereafter committed in the PPP Agreement.

Listed below is an indication of beneficial local impacts that may be targeted under PPP element D, any of which may be qualifications to BEE elements A, B or C. Such elements may be itemised individually or, on larger projects, incorporated under a requirement that the Private Party devise and implement an innovative and effective social responsibility programme as part of its operations.

- Involvement of, and direct benefits to, non-government organisations, religious institutions, civics, clinics, child-care centres, and the like;
- Employment preference for youth in a targeted geographic area;
- Employment targets for disabled people;
- Preference for contracting with suppliers of materials and/or services in a targeted geographic area;
- Initiatives that will support HIV/Aids education;
- Other local socio-economic impacts appropriate to the project and its location.

PART III

How to apply BEE PPP policy at each phase of the PPP project cycle

The PPP project cycle reflects the phases of a PPP prescribed by Treasury Regulation 16 to the PFMA, including specific Treasury Approvals required therein. PPP BEE policy objectives will be pursued at every phase, namely:

- Appointment of a Transaction Advisor by the Institution;
- Feasibility Study for Treasury Approval I;
- PPP procurement, including: bid documentation preparation for Treasury Approval IIA; PPP procurement and value-for-money report on the preferred bid, for Treasury Approval IIB; negotiations with the preferred bidder; and Treasury Approval III for the final terms of the PPP Agreement and the Institution's Contract Management Plan;
- Contract management for the term of the PPP Agreement.

Detailed modules on each of these phases is provided in the *National Treasury PPP Manual*. Set out below is the approach to be adopted in each to ensure that PPP BEE policy objectives are appropriately achieved in every PPP project undertaken in terms of Treasury Regulation 16.

1. Appointment of the Institution's Transaction Advisor

The Institution's Transaction Advisor is a consortium of professionals with appropriate skills and experience to assist the Institution with the preparation and conclusion of a PPP Agreement. The Transaction Advisor is a key player in the success of a PPP. While at present there are few black PPP Transaction Advisors, it is government's intention:

- to be represented in its PPP transactions by teams of skilled and experienced professional financial, legal and technical advisors who generally reflect South Africa's diverse population;
- to be confident that its Transaction Advisor thoroughly knows, supports and will seek to optimise the *PPP BEE Code of Good Practice* in the PPP project; and
- to proactively grow the professional skills and number of black people and black enterprises active in PPP transactions.

National Treasury's PPP Manual contains a module giving detailed guidance to Institutions on the how to appoint PPP Transaction Advisors. The Transaction Advisor is hired by the Institution through an open and competitive bidding process, after the registration of the PPP project with the National Treasury. The selection is made on a combination of technical, BEE and price considerations. A two-envelope system is used, and threshold scores are set for both the technical and BEE elements. Only those bids that meet or better the technical AND BEE thresholds are considered in respect of their price. The Transaction Advisor contracts with the Institution through a lead Transaction Advisor company, and all other members of the consortium participate either through sub-contracts with the lead company or via a joint venture arrangement.

To comply with this *Code of Good Practice*, an Institution must ensure that **20% of the Transaction Advisor bid evaluation is allocated to the BEE credentials** of the proposed professional consortium. In addition, there is a **BEE threshold of 12%.**

If the bid passes the technical threshold, but fails to pass the BEE threshold, it will not be further considered for selection.

The BEE element must be allocated in respect of four sub-elements for the 20% points allocation:

Transaction Advisor bid evaluation BEE elements		**Scoring**	**Points total = 20 pass = 12**
1	The number of black professionals playing leading roles in the Transaction Advisor consortium	<25%= 1 25-50% = 3 >50% = 5	
2	The percentage of black equity in the Transaction Advisor consortium	<20%= 1 20-45%=3 >45% = 5	
3	Demonstrated understanding of, skill and experience within the team on concluding effective black participation in PPPs	poor = 1 acceptable = 3 excellent = 5	
4	Skills transfer plan within the consortium to directly benefit black professionals	poor = 1 acceptable = 3 excellent = 5	

The Transaction Advisor bids must therefore show

- how black professionals are included in all aspects of the work (legal, financial, technical and at all phases of the PPP project cycle), and must specifically indicate those aspects where they are designated to play leading roles. Fronting of black people for the purpose of winning contracts will not be tolerated and will lead to contract termination by the Institution. Black members are therefore expected to perform the work they were assigned to, and the fee sharing structure must reflect the actual work, risk and responsibility assumed by each of the team members. The cash flow earmarked for each member of the consortium must therefore also be shown in the price envelope, indicating how the black members will benefit ;

- the percentage of black ownership in the Transaction Advisor consortium;

- which member(s) of the consortium are to be responsible for structuring the empowerment elements of the PPP project throughout the assignment, and must demonstrate their insights into the *Code of Good Practice for BEE in PPPs.* References should be provided to substantiate claims of skills and experience in this regard, specifically in structuring BEE in PPPs; and

- that the skills transfer plan includes concrete mechanisms to enable the Institution to see the success being achieved in this respect throughout the Transaction Advisor assignment. The intention is to actively grow the number of black professionals in the PPP Transaction Advisor market, and the experience of working on a PPP deal from feasibility to financial closure carries significant learning value.

Government's commitment to achieving a growing number of skilled black PPP Transaction Advisors is reflected further in Part V.

2. The PPP Feasibility Study

Detailed guidance to Institutions and their Transaction Advisors on how to conduct a PPP Feasibility Study is given in a separate module of the *National Treasury PPP Manual*. Each of the PPP BEE elements set out in Part II above and reflected in the *PPP BEE Balanced Scorecard* in Part IV must be taken into consideration in the preparation of the Feasibility Study in order to establish the BEE targets that can realistically be achieved in the project, and specifically to determine their impact on project affordability, value-for-money and risk.

The key components of the Feasibility Study as they concern BEE are summarised in the table below. The BEE considerations to be taken into account in each component are noted alongside as a reference check-list. Importantly, the overall BEE analysis in the Feasibility Study must be sufficiently robust to enable the Institution to determine sound bench-marks for the BEE impact it can realistically expect to achieve, both in a Public Sector Comparator (PSC) model (if it were to procure the service by conventional means) and in a possible PPP project.

Relevant component of the Feasibility Study (note: not every component is listed)	**Brief description**	**BEE feasibility phase task**
Output specifications	To clearly identify what the Institution wants to deliver	Draw up a list of BEE outputs that the Institution wishes to achieve in the project, using the *PPP BEE Balanced Scorecard* as reference
Solution Options Analysis	To identify the pros and cons of each option that can meet the Institution's needs and output specifications; to examine the risks, benefits and impacts to govt of each; and to select a preferred option.	Set out a preliminary view of the impact of each option on the intended BEE outputs, and identify the possible BEE outcomes of the preferred option
Due diligence	To undertake a due diligence assessing all budgetary, institutional, legal, regulatory, site, and socio-economic factors that constrain and/or enable the project	Identify project-specfic BEE sectoral conditions, black enterprise strength, impact of sectoral BEE Charters, and any constraining factors to the achievement of the intended BEE outputs.
If the preferred option can be procured through a PPP, the Institution must then establish affordability, value-for-money and risk transfer. This entails constructing a Public Sector Comparator model, and a PPP Reference model, both risk-adjusted.		
		Draft a *proposed BEE Balanced Scorecard for the project*, based on the *PPP BEE Balanced Scorecard*, taking account of factors identified in due diligence.
Risk identification	To identify all possible risks in the construction and operation of the project, probability of each arising, the value of each risk, and strategies and costs of mitigation	Identify all possible BEE risks in the project, using the *proposed BEE Balanced Scorecard for the project* as reference, probabilities of each such risk arising, values for each, and the strategies and costs of mitigation.
Public Sector	Life-cycle cost model of the output	Cost the achievement of the

Comparator (PSC)	specifications where the public sector takes construction and operating risks.	project's identified BEE objectives if it were procured conventionally ie. Calculate preferential procurement as stipulated by the PPPFA's 90:10 formula, and include this in the model.
PPP Reference	Life-cycle cost model of the same output specifications where the private sector takes substantial construction and operating risk.	Cost the achievement of the project's identified BEE objectives by calculating how the private sector would cost <u>each</u> of the BEE elements of the *proposed PPP BEE Balanced Scorecard for the project* in the PPP Reference model.
Sensitivity analyses	To test the resilience of the models to changes in assumptions and risk over the project term.	Test varying BEE targets for the project, their costs, and their assumptions to assess the impact on affordability and value-for-money
Value Comparison Report	To reach a justified conclusion analysing the outcomes of the modelling as to which procurement route will achieve optimal value for the Institution	Write up a separate analysis of the BEE outcomes (quantitative and qualitative) of each procurement option, and which is going to best achieve the project's BEE objectives.
Thereafter, produce the optimal ***proposed BEE Balanced Scorecard for the project***, with appropriate targets for the project.		
Economic analysis	To establish the economic rationale for the project, where required	Identify economic benefits iro BEE, and opportunity cost to BEE of 'no-project' scenario

In providing these BEE inputs to the relevant components of the Feasibility Study as summarised above, the Institution should investigate and cost the following considerations in respect of each of the PPP BEE Balanced Score-card elements:

PPP BEE element	**Feasibility study considerations**
A: Private Party equity	Assess realistic targets by establishing: • Possible black equity participants • Extent, possible sources, and projected costs of black equity, impact of assumptions on affordability and value-for-money • Effect of phased increase in black equity on affordability and value-for-money • Effect on affordability and value-for-money of early cash flow to black partners • Impact of sectoral BEE Charters
A1: Black equity	
A2: Active black equity	
A3: Cost of black equity	
A4: Timing of black equity returns	
B: Private Party management & employment	
B1: Black management control	
B2: Black women management control	
B3: Employment equity	
B4: Skills development	
C: Sub-contracting	Assess realistic targets in sectoral analysis of: • black management capacity • black women in management • employment equity track-record • skills short-falls, existing initiatives to address these, training opportunities • sources of possible support
C1: Project capex to black enterprises	
C2: Project opex to black enterprises	
C3: Black management control	
C4: Black women management control	

PPP BEE element	**Feasibility study considerations**
C5: Employment equity	Assess realistic targets by establishing cost and risk implications of: • Number and capacity of existing black enterprises in the relevant sectors • Employment equity track record of enterprises in the relevant sectors • Range of black SMEs in the market for procurement opportunities, and nature and sources of support they may need
C6: Skills development	
C7: Procurement to black SMEs	
D: Local socio-economic impact	Cost all the local socio-economic objectives and assess impact on project affordability, value-for-money and risk assumption

The extent to which the Institution is able to produce a thorough and comprehensive Feasibility Study – resulting, *inter alia*, in the production of a proposed *BEE PPP Balanced Scorecard appropriate for the project* - will directly impact on its ability to produce sound bid documentation for a PPP, in which BEE targets are appropriately set for the maturity of the market in which the project takes place. Getting these targets right or wrong may significantly impact on the project's affordability, value-for-money and the private party's willingness to assume risk – and will certainly impact directly on the sustainability of BEE in the deal. The Feasibility Study stage is therefore crucial to ensuring a sound BEE outcome in a PPP.

Government is willing to pay a certain premium for its BEE targets to be met. This is a cost of essential economic transformation, which is well understood. At the same time, these costs have affordability constraints to the Institution concerned, and have value-for-money and risk considerations. The BEE targets established in the Feasibility Study must therefore be justified in value-for-money terms, and risk must be properly allocated in the achievement of all PPP BEE outcomes. In addition however, it is assumed that PPP competition will drive innovation by private sector bidders, from which the Institution can expect to receive the best possible costing of achieving its intended BEE targets.

3. PPP procurement

National Treasury's PPP Manual includes a detailed module on the PPP procurement phase, which entails Treasury Approvals IIA, IIB, and III in terms of Treasury Regulation 16 to the PFMA. These three Treasury Approvals will, respectively, entail careful scrutiny of the BEE components of the bid documentation, the BEE component of the preferred bid, and the BEE obligations contained in the final proposed terms of the PPP Agreement and in the Contract Management Plan.

Treasury's scrutiny of BEE terms during a PPP project's procurement phase will be benchmarked against:

- this *Code of Good Practice for BEE in PPPs,*
- *Standardised PPP Provisions,* and
- the *BEE Balanced Scorecard for the project* developed during the project's Feasibility Study phase.

The PPP project's BEE profile during PPP procurement phase must be based on the *BEE Balanced Scorecard for the project* developed during the Institution's Feasibility Study (as approved at Treasury Approval I) and will be adapted and refined as the procurement process unfolds.

The Institution should, at the outset of the procurement phase, ensure that specified members of its project team (from the Institution and its Transaction Adviser consortium) are dedicated to managing the BEE component of the procurement process throughout. This is essential to ensure that BEE elements are not lost and that the BEE policy objectives of government are not unduly compromised through ill-attention to detail.

No bid documentation (RFQ, RFP, draft PPP Agreement) may be issued to the market without Treasury Approval IIA. Negotiations with the preferred bidder may not commence without Treasury Approval IIB for a value-for-money report. Signature of the PPP Agreement may only take place after Treasury Approval III.

RFQ phase

The Request for Qualification (RFQ) phase is usually the first point at which there is formal project interaction with the market. It is imperative that all of the BEE elements and targets which the Institution intends for the project are communicated clearly with potential bidders at this early stage so that appropriate consortia can be formed and the necessary financing sourced. It is recommended that the proposed *BEE Balanced Scorecard for the project*, developed during the Feasibility Study, be provided in the RFQ, allowing the bidding consortia to comment on the proposed BEE targets in their RFQ submissions. In some projects it may be appropriate to grow the BEE targets between RFQ and RFP phases, but such intention must be clearly communicated to bidders in the RFQ.

The RFQ stage requires that bidders submit a range of information about their consortia, enabling the Institution to select those that are indeed suitably qualified to prepare bids. A key element of this qualification will be whether or not a private consortium has the requisite BEE characteristics and commitment for the project. Realistic, minimum BEE qualification standards must therefore be given to bidders at RFQ stage for the purposes of RFQ submission evaluation.

In order to pre-qualify in the BEE component of the RFQ, consortia should at least demonstrate:

- that they have memoranda of understanding in place for the required targets of BEE participation in the Private Party and the first-tier sub-contracts;
- that they have the ability to secure the targets of BEE management required for the Private Party and the first-tier sub-contracts;
- that relevant members of the consortia have demonstrable track records in devising and implementing local socio-economic plans as part of their operations;
- that the major sponsor companies have their own effective employment equity programmes in place, and can demonstrate their own track record in BEE.

Once consortia have been pre-qualified, they will need agreement from the Institution to change their consortia membership, and the qualifying BEE targets may not be compromised in any such change.

RFP Phase

The pre-qualified bidders will, in many projects, be issued with a draft Request for Proposals (RFP), containing the further refined *BEE Balanced Scorecard for the project.* This draft RFP facilitates detailed engagement with the pre-qualified parties to establish their feedback on the bid specifications and criteria. The BEE elements must be clearly presented, based on the outcome of the Feasibility Study and adapted from feedback obtained in the RFQ process. The BEE elements must also be reflected in the draft PPP Agreement, with contractual non-compliance linked to the project's penalty regime.

Comments received from pre-qualified parties on draft RFP documents must be assessed by the Institution and its transaction advisers, and a final RFP and draft PPP Agreement drafted and issued. The Institution must ensure in this process that the broad-based impact of its BEE scorecard is not compromised, and that it upholds its BEE policy intent throughout, based on the thorough assessment undertaken at Feasibility Study phase. Where appropriate, certain targets can be phased in over the project term to accommodate start-up capabilities within certain sectors.

Bids received from the pre-qualified parties must contain dedicated sections setting out the bidder's detailed response to how it will address each of the BEE elements of the project, and what targets it undertakes to meet over the project term.

In addition, the following components of the bid submissions must be clearly referenced by bidders in their BEE proposals, and closely examined by the Institution for substantiation of all BEE commitments:

The **funding structure** and **financing arrangements** reflected in the **financial models** must show:

- sources or type of black equity (eg. black enterprises' balance sheet funds, loans to black enterprises or shareholders, equity funds incl exit strategy, etc)
- costs of black equity
- timing on return on equity for black shareholders
- opex costing for all skills development, employment equity and socio-economic programmes

Shareholders agreements and any third party agreements thereto must show:

- terms for black shareholders
- sponsor support arrangements to black shareholders, if any
- black management commitments

First-tier sub-contracts must show:

- terms for black shareholders
- black management
- black women management
- skills development and employment equity commitments for first-tier sub-contractors and others tiers of sub-contracting
- black enterprise procurement commitments

The **marked-up PPP Agreement** must be checked for

- any proposed black-lining to Standardised PPP BEE provisions
- draft schedules capturing all BEE commitments

Negotiations

The Institution's intention to contractually commit the bidders to the targets submitted by them in response to the RFP should be made clear throughout the procurement process. The negotiation and finalisation of the PPP Agreement must therefore ensure that this transpires. The Institution should specifically guard against claw-back during negotiations.

The PPP Agreement

Standardised PPP Provisions issued by National Treasury sets out South Africa's required PPP contracting terms in respect of BEE. These reflect this *Code of Good Practice for BEE in PPPs,* specifically making provision for BEE by, *inter alia*:

- itemising all **elements** of the *PPP BEE Balanced Scorecard* to be made contractually binding;
- providing schedules that commit the private party to its BEE **targets** for each element;
- establishing **performance monitoring** arrangements;
- specifying private party **reporting** requirements;
- setting up the **dispute resolution** system;
- establishing the framework for a **penalty regime**; and
- setting up **termination** arrangements.

Any proposed deviation from *Standardised PPP Provisions* requires specific justification by the Institution as part of its relevant Treasury Approval application. The final terms of the PPP Agreement for a project must obtain Treasury Approval III prior to signature.

4. PPP Contract management

The *National Treasury PPP Manual* contains a module on *PPP Contract Management*, elaborating on three main functions:

- Partnership management
- Service delivery management
- Contract administration

In each of these, the Institution and the Private Party will need to establish systems for managing the BEE obligations in the project throughout the development and delivery phases of PPP implementation.

Reporting obligations are substantively on the Private Party for all its contractual commitments, including BEE. The Institution must however, establish in its service delivery management arrangements and contract administration system, the ability to check and verify such reporting, to manage remedy periods that may be provided for, to effect contractual penalties in relevant events of poor performance, and to manage termination should this arise. In some projects, it may be valuable for the parties to establish a joint independent monitor for BEE.

Above all, the quality of the PPP partnership management, the parties' ability to identify impediments to BEE and to resolve disputes effectively, is paramount to the PPP's success, not least in respect of BEE. As a general guide, the penalty regime should be deployed only after genuine efforts have been made by the parties to address the impediments to compliance.

PART IV

The PPP project BEE balanced scorecard

The PPP BEE balanced scorecard is a tool for use in PPP projects. It provides a quick-reference benchmark to measure the extent to which a PPP project – in any of its phases – is successfully achieving BEE in terms of this *Code of Good Practice*.

The PPP BEE **elements** (A,B,C,D) and their sub-elements shown in column 1 should be reflected in all PPP Agreements as appropriate to the project, but in making any adjustments to these, the broad-based effect of the scorecard's elements should not be compromised.

The indicative **targets** shown in column 2 are guidance, and will need to be adjusted according to the outcomes of the PPP feasibility study and procurement process, as appropriate to each project. In making these decisions, the parties may also usefully agree that such BEE targets will grow incrementally through the life of the project.

The recommended PPP bid evaluation **weightings** shown in column 3 guide the Institution on a balanced allocation of points out of 100 for the BEE component of the whole bid evaluation.

Note that this *BEE PPP Code of Good Practice* allocates **no less than 15% and no more than 20% of total PPP bid evaluation points to BEE**, with the remaining 80% - 85% being split as appropriate in each PPP project between financial and technical elements. Readers should refer to relevant modules of the *National Treasury PPP Manual* for further guidance on the financial and technical elements of PPP bid evaluation.

PPP BEE element	**Indicative PPP project Target**	**Recommended bid evaluation weighting**
A: Private Party equity		**20%**
A1: Black equity	40%	
A2: Active black equity	55% of A1	
A3: Cost of black equity	Value-for-money	
A4: Timing of black equity returns	Early and ongoing returns	
B: Private Party management & employment		**15%**
B1: Black management control	Commensurate with A1 & A2	
B2: Black women management control	10% of B1	
B3: Employment equity	Strong plan	
B4: Skills development	5% of payroll	
C: Sub-contracting		**50%**
C1: Project capex to black enterprises	30%	
C2: Project opex to black enterprises	30%	
C3: Black management control	25%	
C4: Black women management control	10% of C3	
C5: Employment equity	Strong plan	
C6: Skills development	5% of payroll	
C7: Procurement to black SMEs	30%	
D: Local socio-economic impact	Sustainable, effective plan	**15%**

PART V

Government's further commitments to take BEE in PPPs forward

In recognition of the current challenges to BEE in PPPs, in recognition of the positive BEE impact that PPPs can achieve, and complementary to the commitments of the ***Financial Sector Charter***, government undertakes proactively to pursue the following initiatives:

- To establish a PPP BEE equity fund;
- To provide a facility to support independent financial and legal advice to black enterprises bidding and negotiating in PPP projects; and
- To establish an internship programme to grow the number and quality of black transaction advisers in South Africa's PPP market.

Together with the strong BEE measures articulated in this *PPP BEE Code of Good Practice*, the implementation of these three steps will establish PPPs as leading contributors to South Africa's BEE over coming years.