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24 June 2016

Honourable Minister Gordhan
Minister of Finance

C/o. Ms Blessing Sokhulu
Personal Assistant to the Minister of Finance
Per email: minreg@treasury.gov.za / blessing.sokhulu@treasury.gov.za

Dear Minister Gordhan

Corruption Watch Request: Investigation into Procurement Irregularities at Eskom

1. We refer to the above matter.
2. Corruption Watch (CW) is a civil society organisation that opened its doors to the public in January 2012. We are registered as a non-profit company in terms of the Companies Act.
3. Corruption Watch seeks to expose corruption and the abuse of public funds. We aim to expose those who engage in corrupt activities, nepotism and abuse of public funds in both the public and private sector.
4. As part of our mandate, we are committed to strengthening the criminal justice system, including efforts to address financial crime; to the refinement of our planning and procurement systems; and to supporting and strengthening the ability of private and public bodies to better detect and address corruption in their spheres of operation.
5. In this regard, we recognise that National Treasury plays a pivotal role in addressing corrupt procurement practices and to holding those responsible to account. We are therefore writing to you about alleged procurement irregularities at Eskom, a matter

which, we respectfully submit, deserves urgent attention from your office because of the nature and scale of the irregularities and the potential impact of such wanton irregularities on our national economy.

Eskom's pre-payment for Coal Supply to Tegeta

6. We understand from the media sources identified below that Eskom pre-paid Tegeta Exploration and Resources (“Tegeta”); whose major shareholder is Oakbay Investments (“Oakbay”) an amount of R586 787 000 for the supply of coal from Optimum Mine (“Optimum”) to the Arnot Power Station (“Arnot”).
7. We are concerned about this particular pre-payment because of the risks which have been identified by banking institutions and an auditing firm in respect of Oakbay Investments (major shareholder of Tegeta) and because of what we believe to be serious procurement irregularities and unscrupulous or negligent fiscal governance at Eskom. We have had regard of the following:
 - 7.1. Media statements released by Eskom on 11 and 12 June 2016;¹
 - 7.2. Interviews conducted on M-Net’s Carte Blanche with the CEO of Oakbay Investments, Mr Nazeem Howa (“Howa”) and Eskom’s Head of Generation, Mr Matshela Koko (“Koko”);²
 - 7.3. Various media articles on this issue.
8. In this regard, Eskom anticipated that it’s 40 year contract with Exxaro Arnot Colliery (“Exxaro”) for the supply of coal to Arnot would expire in December 2015 and that it had no intention of renewing the contract because the coal supplied by Exxaro was below the required contractual volumes and presumably because Exxaro charged an excessively high amount for the supply of coal to Eskom. In this regard, the cost of coal on expiry of the contract between Eskom and Exxaro was R1132/ton.
9. It was only August in 2015 that Eskom issued a Request for Proposals for the supply of coal to Arnot and several bids were received by interested parties by the closing date of October 2015. These bidders did not include Tegeta. However,

¹ <http://www.eskom.co.za/news/Pages/Jun11C.aspx>

² <http://carteblanche.dstv.com/player/1064084/>

Eskom chose to approach Tegeta, among others, in December 2015 in order to procure an emergency supply of coal due to concerns about the deficit in their winter supply plan.

10. The bidding process was due to be finalised by January 2016, given that Eskom would have had since October 2015 to finalise the bid process. However on Eskom's own admission, the tender is now expected to be awarded only by September 2016.
11. It is worth noting that in light of the failure of Eskom to award the tender timeously, this self-created emergency resulted in them concluding a contract with Tegeta for the emergency supply of coal until September 2016. We understand that this contract was concluded in December 2015 and that the pre-payment was made in April 2016.

Eskom's supply chain management violations including negligent contract management

12. We submit that Eskom had anticipated the expiry of the Exxaro contract in December 2015, and should have made provision for the expiry of this contract and its non-renewal but failed to do so timeously, thus prompting the invocation of emergency procurement procedures in order to obtain the requisite supply of coal at Arnot. This was a self-created emergency and in violation of paragraph 3.5.2 of Eskom's own supply chain management policy, relevant sections of the PFMA and section 217 of the Constitution.
13. In our view, Eskom cannot rely on a self-created emergency in order to justify the pre-payment made to Tegeta. Eskom's supply chain policy requires Eskom to develop supply plans and manage demand which includes the development of commercial strategies, forecasting and estimation. It is clear that if Eskom had adhered to its own policies and planned ahead for the expiry of the Exarro contract, it would not have had to take irregular steps to procure additional coal supply.
14. Although Eskom has stated that such pre-payments are made in the ordinary course, we are also concerned about whether a pre-payment or advance payment is in accordance with Eskom's supply chain policy, the PFMA and regulations thereto,

and if so, whether all the requirements for making a pre-payment or advance payment have been met.

15. The delay in awarding the permanent contract for the supply of coal to Arnot is also excessive and we submit not in line with basic requirements for procurement to be fair, equitable, competitive, cost effective and efficient. Those who bid for the supply of coal to Arnot are potentially prejudiced by Eskom's delay in making such award and by making a temporary award to an entity which never bid for the tender.

16. Further to this, we are uncertain about whether Eskom conducted a proper due diligence, both in respect of the quality of coal being supplied by Optimum and the risks involved in doing business with Tegeta, whose major shareholder is Oakbay. In this regard,

16.1. Under Optimum's previous ownership, Eskom had fined the owners for failing to ensure the requisite quality of coal. It is not clear that Eskom took measures to ensure that the coal quality would be of the requisite and acceptable standards. Awarding a temporary contract to a supplier whose mine had previously failed to meet required standards appears to have been a negligent act and certainly not one that meets procurement policy requirements. Paragraph 3.8.8.2 of the supply chain policy provides for Eskom to block registered suppliers from their supplier database if the supplier is under business rescue proceedings. Eskom may not award any further contracts or place any orders with such an entity. We submit that in accordance with good governance and risk assessments, this should equally apply to *any* legal entity supplying goods or services to Eskom.

16.2. South Africa's four major banks no longer conduct business with Oakbay and in a letter from Standard Bank to Oakbay, the following was stated:

“Without waiving our right not to furnish reasons for our decisions, without inviting any debate about the correctness of our decisions, I point out that the law, inclusive of South Africa's Companies Act, Regulation 43, the Prevention of Organised Crime Act, the Prevention and Combatting of Corrupt Activities Act, the Financial Intelligence Centre Act, the United States Foreign Corrupt Practices Act and the UK's Bribery Act, prevents us from having dealings with any persons or entity where a reasonably diligent

and vigilant person would suspect that such dealings could directly or indirectly make us a party to or accessory to contraventions of that law.

We have conducted an enhanced due diligence of the Oakbay entities and as required by the FICA Act, and concluded that any bank or customer relations with them would increase the risk of exposure to contraventions of the mentioned law to an unacceptable level.”

17. In addition, in an internal email circulated to staff and partners, the CEO of KPMG South Africa, Trevor Hoole said that they had no audit reason in support of the decision to terminate business relations with Oakbay but stated that:

“the recent media and political interest in the Gupta family together with comments and questions from various stakeholders ... has required us to evaluate the continued provision of our services to this group...we have decided that we should terminate our relationship with the group immediately and can assure you that this decision was not taken lightly, but in our view the association risk is too great for us to continue...it is with heavy hearts that we have reached our conclusion, and there will clearly be financial and potentially other consequences to this, but we view them as justifiable.”

18. As appears from the above, a South African Bank recognised that continued business relations with Oakbay was an unacceptable risk and intimated that there was a reasonable possibility that certain national and international laws may have been violated by Oakbay. An established audit firm also terminated business relations with the group due to there being a high association risk, yet Eskom continued to conclude multi-million rand transactions with a company owned by Oakbay. We are very concerned about how and whether Eskom vets suppliers or conducts requisite due diligence in respect of them. In this regard, Eskom’s supply chain management policy makes special provision for the management of risk and governance matters and paragraph 3.2.6 specifically provides for Eskom to conduct a due diligence on suppliers.
19. In respect of procurement irregularities at Eskom, the examples highlighted above appear to be one of many, with some irregularities pertaining to procurement for sponsorship deals and IT services.

20. Finally, Eskom has acknowledged the excessive prices charged by Exxaro, and Howa has repeatedly referred to the excessive prices charged by the major coal suppliers to Eskom over the last few years. Concerns have also been raised by the Public Enterprises Minister and experts in this field about export parity pricing and the excessive prices being charged by those supplying coal to Eskom. We are therefore concerned about whether Eskom has engaged in cost-effective procurement in respect of the supply of coal and the extent to which tax payer's money has been spent wastefully or negligently.

National Treasury Mandate to Investigation irregular procurement practices

21. We submit that the Honourable Minister has the mandate and indeed duty to investigate the alleged procurement irregularities. Section 6(1)(g) of the PFMA, relating to the functions and powers of National Treasury, states that the National Treasury must promote and enforce transparency and effective management in respect of revenue, expenditure, assets and liabilities of departments, public entities and constitutional institutions. Importantly, section 6(2)(e)-(f) states that the National Treasury:

“(e) may investigate any system off financial management and internal control in any department, public entity or constitutional institution;

(f) must intervene by taking appropriate steps, which may include steps in terms of section 100 of the Constitution or the withholding of funds in terms of section 216 (2) of the Constitution, to address a serious or persistent material breach of this Act by a department, public entity or constitutional institution.”

Corruption Watch Request

22. We kindly request you to investigate the manner in which Eskom manages its contracts with existing suppliers and its general adherence to supply chain processes including its vetting and due diligence processes. We firmly believe that Eskom has breached its own supply chain policy, the PFMA and the requirements of section 217 of the Constitution in failing to ensure that goods and services are

procured in a manner which is fair, equitable, transparent, competitive and cost-effective.

23. We look forward to your response, including an indication of whether the Honourable Minister will conduct the requested investigation.

Yours faithfully,

David Lewis
Executive Director

Leanne Govindsamy
Head: Legal and Investigations
Corruption Watch
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