Water services franchising partnerships: Review of policy, regulation and legal aspects

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This report forms part of a series of seven reports. The reports in the series are:

- Going with the franchise flow: An exploration of franchising partnerships for the operation and maintenance of water services infrastructure. **(Report TT 432/1/10)**
- Water services franchising partnerships: Overview of the concept of franchising and its relevance to water services. **(Report TT 432/2/10)**
- Water services franchising partnerships: Review of policy, regulation and legal aspects. **(Report TT 432/3/10)**
- Water services franchising partnerships: Modelling of selected water services operational elements. **(Report TT 432/4/10)**
- Water services franchising partnerships: Institutional review for the application of franchising. **(Report TT 432/5/10)**
- Water services franchising partnerships: Establishing criteria for the selection of water service franchisors, partnerships and franchisees. **(Report TT 432/6/10)**
- Water services franchising partnerships: Business analysis case study: schools sanitation O&M. **(Report TT 432/7/10)**

Report TT 432/1/10 (*Going with the franchise flow: An exploration of franchising partnerships for the operation and maintenance of water services infrastructure*) is the only one in the series that has been printed. The rest are available on the WRC web site (www.wrc.org.za) from where they can be downloaded.

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Executive summary

Background to the project

The rapid rate of construction and commissioning of new water services infrastructure is severely challenging the institutions responsible for operating and managing this infrastructure. Innovative approaches to water service delivery are required. But even if all the existing institutions were coping with the water services delivery responsibility, there would be good reason to investigate alternative institutional models, on the grounds that it needs to be found out if alternatives:

- could be more cost-effective, and/or
- could allow existing role-players to focus on their other responsibilities, and/or
- could offer a range of other advantages (including greater local economic development).

There is an alternative service delivery institutional model that is suited more for the ongoing operation and maintenance of water services systems than for investment in new infrastructure, and, importantly, that is friendly to small business and local economic development. This alternative is the franchising of water services. However, there is little experience of this approach anywhere in the world, and no experience in South Africa, although some existing partnerships have some of the characteristics of the franchise partnerships approach.

The barriers to entry for the smaller or start-up company are substantial. But if these could be overcome, – and franchising is a way to mitigate them – then there will be many opportunities for improved water services and for local economic development. The twin driving forces of the franchising concept are the existence of a successful business model that can be copied widely (there are currently no such models for the water sector) and the profit motive.

Franchising is a way of accelerating the development of a business, based on tried and tested methodology. The franchise system firstly correlates and systematises the business, and then facilitates the setting up of the business, and supports and disciplines it thereafter.

The key is the incentive, to water services authority, franchisor and franchisee alike, to improve efficiency – and to provide improved service reliability and quality.

To investigate this, the Water Research Commission (WRC) initiated a study (completed in 2005) that explored the concept of franchising, its relevance to the water services sector, and its prospects as an institutional option for water services operations and management. The study found that the franchising partnerships concept, if applied to water services delivery, could in favourable circumstances both alleviate problems encountered in and raise the efficiency of water services delivery. At the same time, franchising would have the added advantage of stimulating small business activities. (Wall, 2005)

The study described at a conceptual level how a water services franchise model could be made available to emerging entrepreneurs, and concluded that this could be the basis of a viable business. The franchise would be in respect of a component of the value chain that is suitable for small business because it can be readily systematised.

The study found an indisputable need for alternative water services provider systems, and for local economic development, and that there is potential through water services franchising partnerships to simultaneously:

- more consistently deliver water services to specification;
- improve water services efficiency; and
- promote local economic development, small-, medium- and micro-enterprise (SMME) development and black economic empowerment (BEE).

Objectives of the project

- To further explore the concept of franchising and its relevance to the water services delivery chain.
- To identify and determine those elements in the water services delivery chain which offer the greatest scope for franchising partnerships.
- To review the legal, technical, financial, regulatory, etc. aspects which would impact on franchising partnerships.
- To develop franchising partnership models for a selection of the areas identified by the research, with consideration for the legal, regulatory, etc. aspects.
- To conduct a case study of an element in a hypothetical situation, to see how the model will work.
- To set out the way forward to eventual pilot implementation of franchising partnerships, and inter alia recommend areas for further research.

In summary, the ultimate objective of the project is to identify the scope for franchising partnerships for the operation and maintenance of selected water services infrastructure, to establish the viability of franchising partnerships, and to make a case for outsourcing to franchises to be considered by water services authorities and water services providers.

The context in all instances is South Africa.

Focus of this report

This report:

- describes and discusses the policies, statutes, legal issues, financial issues, regulations, etc. that could affect water services franchising;
- describes and discusses relevant issues of procurement;
- describes and discusses SMME and BEE issues that could well affect water services franchising;
- draws conclusions; and
- makes recommendations.

Each of these is summarised below.

Policies, statutes, legal issues, financial issues, and regulations

The following statutes, regulations and policies are those most relevant to water services franchising:

- The Water Services Act governs the approval of water services providers and promotes access to information:
  - The Water Services Act provides for, and in fact encourages, water boards to provide water services to municipalities:
  - In addition the Water Services Act provides requirements for a contract between a WSA and a WSP.
- Water Services Provider Contract Regulations set out the contents of WSP agreements. These regulations thus provide a scope or checklist for the contractual relationship between the franchise operator and the municipality.

- Regulations Gazetted under s9 of the Water Services Act provide for the annual submission of a water services audit by the WSA and is a key to regulation of water services by the Department of Water Affairs and Forestry (DWAF).

- DWAF's Strategic Framework for Water Services (SFWS) sets out the water services sector's vision, goals and targets as well as the institutional framework, the financial framework, the planning framework, national norms and standards, the regulatory framework and the support and monitoring framework. The SFWS recognises that a process of institutional reform is required. This reform process opens up a window of opportunity to explore different options for water services provision.
    - The SFWS insists that all providers of water services to or on behalf of WSAs must do this in terms of a service delivery agreement (contract) with the WSA.
    - The SFWS also insists that where WSPs provide retail services to consumers, they must do so in terms of a consumer charter and consumer contracts.

- Sections 76 through 82 of the Municipal Systems Act is the most authoritative set of requirements that must be observed by municipalities in determining mechanisms for the procurement of service providers.

- The Department of Provincial and Local Government (DPLG) compiled the Green Paper on Municipal Services Partnerships (MSPs) in order to create a policy environment that enhances the viability and feasibility of MSP service delivery.
    - The Green Paper on MSPs describes typical contractual arrangements between the services provider (in the case of water services, the WSP) and the municipality (in the case of water services, the WSA). Service contracts and management contracts can be relatively simple forms of MSP. Build-Operate-Transfer (BOT) and concessions are typically the most complex of MSP arrangements, and can impose heavy demands on a municipality's management and systems capacity. Even relatively simple forms of MSPs could deliver services cost-effectively, and may merit consideration.

- The Local Government Municipal Finance Management Act (MFMA) stipulates conditions to be complied with and processes to be followed when entering into public-private partnerships:
    - The MFMA requires that a municipality must show, though a feasibility study, that a public-private partnership (PPP) is superior to an in-house approach to providing the service before entering into such a partnership.
    - The MFMA also stipulates requirements for services (and goods) contracts procured by municipalities.

- Municipal PPP Regulations add to the conditions to be complied with and processes to be followed when entering into PPPs.

- The governance of companies is primarily regulated under the Companies Act.

A very significant challenge to outsourcing, especially outsourcing to SMMEs, is the financial state of many municipalities. The SFWS highlights the weak financial position of many WSAs.

Procurement

Legislation requires that a municipality undertakes a feasibility study to compare the private sector option with an in-house option before procuring a MSP. The main policies, legislation and regulations that guide procurement of providers are:

- The Water Services Act sets out requirements that must be observed by WSAs before entering into contracts with private sector water services providers.

- DWAF has published a "consolidated guideline" for selecting water services providers. These guidelines amplify Sections 78 to 81 of the Municipal Systems Act.

- The Green Paper on MSPs describes the feasibility study required before appointing, or entering into an MSP.

- The Municipal Systems Act sets out a competitive bidding procedure that must be followed in procuring an external service provider, if the decision is taken to follow the external provider route.

- The MFMA sets out requirements that must be complied with before municipalities may enter into contracts that have future budgetary implications.

- Additional procurement requirements for public-private contracts are set out in Municipal PPP Regulations

- The Prevention and Combating of Corrupt Activities Act makes a criminal offence of certain activities relating to the awarding of contracts and the procuring and withdrawing of tenders.

BEE and Local Economic Development (LED) issues

The key pieces of legislation governing BEE and preferential procurement are:

- The Preferential Procurement Policy Framework Act; and

- The Broad-Based Black Economic Empowerment Act which aims to promote economic transformation in order to enable meaningful participation of black people in the economy.

Report conclusions

The conclusions of the report with respect to the possible outsourcing and procurement of water services operation and management, but not specific to franchising, can be summarised as follows:

There appears to be nothing in DWAF, DPLG and National Treasury policy, legislation or regulations preventing outsourcing of water services operation and management. (This outsourcing can be a public-public partnership or a public-private partnership, or a partnership with a non-governmental organisation (NGO) or community-based organisation (CBO).)

However, numerous requirements must be met before any aspect of water services operation can be outsourced. Even simple municipal service or management contracts need to be procured in accordance with the legislation and regulations. The fact that these contracts do not necessarily fall within DWAF's Water Services Act's relatively narrow (compared to that in legislation originating from National Treasury and DPLG) definition of an all-encompassing WSP does not mean that they are not private sector municipal service providers or external providers in terms of Section 76 of the Municipal Systems Act.

Legislation relating to outsourcing and procurement by municipalities mainly relates to procurement of private sector service providers. The rules relating to feasibility studies, etc. do not all apply where public sector providers (e.g. water boards) are procured.

The municipality must make the effort to undertake the Section 78 process before it can consider outsourcing. However a municipality is not required to demonstrate that it can provide the service in-house better than any outsourcing alternative could. **This must be challenged.**

In practice few municipalities feel that they have to go to the trouble of seriously considering alternatives to in-house, and thus only a minority of municipalities do make the effort. The current researchers feel that all municipalities must be encouraged to undertake Section 78 investigations in order to determine to what extent they are able to best carry out their responsibilities in-house – and thereafter to determine to what extent they should outsource as opposed to what extent they should use in-house service provider solutions. By denying themselves the opportunity to explore alternatives through an objective Section 78 process, these municipalities may have no reliable financial or information-supported rationale for the decisions they need to take in the interests of improving services to their customers.

The bias evident in many municipalities against the procurement of private sector, NGO and CBO water services providers cannot be addressed through legislation or regulations – it can only be addressed by clear political leadership.

A major potential source of information, and also a regulatory tool, is the water services audit which should be enforced by DWAF.

Legislation does not prejudice SMMEs. In fact, the procurement legislation favours small procurements. In particular, procurement of service providers offering services for contracts under R200 000 is simplified. However, procurement of service providers for all contracts of a value above R200 000, regardless of whether SMME, CBO or NGO, and BEE or not, must be in accordance with the municipality's supply chain management policies compiled in accordance with National Treasury regulations.

Other than that, SMMEs would normally only be advantaged by the procurement policy if they have a substantial portion of black and/or female ownership.

Company legislation gives important guidance for the screening of potential MSPs.

The financial affairs of many municipalities are not in order. Many medium and low capacity municipalities are unable to report on their financial status. Inability to always follow acceptable accounting and payment procedures, including inability to process invoices and pay them on time, is much in evidence. Many municipalities are not able to recover all of the revenues due to them. Sometimes they cannot even recover most of the revenues due to them. This does not bode well for private sector involvement in the provision of water services. Furthermore:

- Private enterprises will only survive if they are paid.
- If municipal inability to process invoices and pay them on time presents considerable problems for outsourcing even to larger MSPs, it would very likely be fatal to SMMEs, which have much have less (maybe minimal) financial resources and might be dependent on only a few clients or even on only one client.
- It is unlikely that the private sector will be able to collect revenue on behalf of the municipality if there is no political will to support such efforts.

There are indications that some unions will resist any outsourcing of municipal service provision. They would do this on the grounds that it could lead to retrenchment of their members or to downscaling due to higher private sector efficiencies.

The conclusions of the report specific to the franchising of water services can be summarised as follows:

The policy, statutory, and regulatory regime with respect to water services franchising is a subset of the wider environment determining and controlling water services providers (WSPs).

Franchisees are SMMEs of a particular type, and SMMEs in turn are part of a wider private sector, so anything that affects outsourcing to the private sector would affect franchising partnerships as well.

There appears to be nothing in national policy, legislation or regulations preventing franchising of water services.

That franchising is not specifically mentioned in the procurement-related material that is reviewed in the current report would seem to be only because national government has regarded it unnecessary to have specific provisions relating to franchising.

DPLG, National Treasury and DWAF support will be required for the franchising approach.

Some water boards could be in a good position to fulfil the role of franchisor.

What is good or bad for SMMEs is good or bad for franchising partnerships. But the converse doesn't necessarily apply or, putting it differently, a franchisee SMME, given the support it would receive from the franchisor, would in all likelihood find it easier to meet some regulatory and other requirements than would a standalone SMME, everything else being equal.

The franchise approach does have the potential to substantially lever up the black ownership component of the contractor through a real contribution by the franchisee, and is clearly not fronting.

Report recommendations

The recommendations of the report can be summarised as follows:

The National Treasury and DPLG legislation and regulations relating to procurement are aimed at transparent and equitable procurement and include anti-corruption measures, such as sequential approval responsibility for evaluation and adjudication committees, etc. There are also measures to depoliticise procurement, for example, through barring councillors from membership of certain committees. This legislation is strongly supported.

- Nonetheless policies, legislation and regulation relating to procurement need to be harmonised.

At present, the easy, default, option for a municipality is to attempt to deliver services in-house, and to not consider outsourcing. Should it wish to consider outsourcing, it has to initiate processes such as the Section 78 process. While it would be going too far to recommend at this time that each and every municipality be compelled to demonstrate, through such a process, that the in-house option is better than any alternative (and should it fail to do that, then it would have to outsource), there is a need to start a move away from the in-house option being the line of least resistance. At very least, municipalities should be compelled to assess the real costs of the in-house option, so that these costs can be better understood (and controlled).

- It is understood that there are significant capacity constraints in most municipalities that could prevent them doing this kind of analysis at all, never mind doing it properly. On the other hand, if a municipality cannot even do the analysis, it probably cannot perform the service properly in-house either, and that should be good enough reason for investigating alternatives.

Thus it is recommended that national political leadership should encourage every municipality to view outsourcing of operation of infrastructure as an opportunity to improve infrastructure service operation, and also as an opportunity:

- to retain income in the local economy;
- to develop human capital in the community (develop skills focused on the needs of the local infrastructure); and

- to facilitate the participation of communities in using the opportunities and stimulating the establishment of new businesses or the growth of existing ones.

Also, means need to be found to support municipalities in their efforts to procure and contract with private sector providers. Specific tools are mentioned in this report. Some of these tools, such as model contracts, could be specifically geared towards franchise arrangements, if the remainder of the current project provides grounds for believing that there is merit in the franchising approach. For example, contract clauses specific to franchise arrangements could be compiled to make it easier for municipalities to consider the franchising partnerships option.

Given that there are in existing legislation and regulation a number of procurement measures that favour SMME, LED and BEE approaches when they are appropriate, no attempt should be made to open the way for exceptions for CBOs, NGOs or for franchising partnerships. Any such attempt will degrade the controls that National Treasury is attempting to put in place.

Whereas it is likely that municipalities will often require contractual recourse not only to the franchisee but also to the franchisor, contract provision must be made for this where necessary. Especially this is so if the franchisor's expertise or track record is a significant reason for contracting with the franchisee. This "closing of the contractual loop" requires further investigation.

A key obstacle to successful franchising is the state of municipal financial accounting and cost recovery. The extent to which franchising partnerships can help to address a municipality's financial shortcomings (such as through saving cost and improving revenue), or operate despite these financial shortcomings, is an open question, much dependent on individual circumstances. Nonetheless, the state of municipal finances must be addressed for reasons over and above anything to do with services procurement.

Acknowledgements

The help and guidance of the following is much appreciated:

- Peter Ramsden Consultants, Pretoria: Peter Ramsden and
- all the members of this project's reference group.

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Notes

Words or passages enclosed by square brackets [ ], within quotations from other texts, are the current researchers' interpolations.

All references to or quotations from policy, statutes, regulations and so forth are to the best understanding of the researchers up to date to October 2006. Developments (if any) since that time have not been captured.

"the researchers", or "the current researchers", or "the team" means the team appointed by WRC to undertake the current project.

"the project", or "the current project" means WRC Research Project K5/1610, the "Water Services Franchising Partnerships" project

"the report", or "the current report" means "WRC Report TT 432/3/10: Review of policy, regulation and legal aspects"

Abbreviations and acronyms

Amanz' abantu	Amanz' abantu Services (Pty) Ltd
BEE	Black Economic Empowerment
BOO	Build-Own-Operate
BOT	Build-Operate-Transfer
CBO	community-based organisation
CCMA	Commission for Conciliation, Mediation and Arbitration
COSATU	Congress of South African Trade Unions
CSIR	Council for Scientific and Industrial Research
DPLG	national Department of Provincial and Local Government
DWAF	national Department of Water Affairs and Forestry
FARMSP	Framework Agreement for Restructuring Municipal Service Provision
FSATU	Federation of South African Trade Unions
IDP	integrated development plan
IMATU	Independent Municipal and Allied Trade Union
IMESA	Institution of Municipal Engineering of Southern Africa
KPI	key performance indicator
LED	local economic development
LRA	Labour Relations Act
MFMA	(Local Government) Municipal Finance Management Act
MSP	Municipal services partnership
NCTU	National Council of Trade Unions
NFA	National Framework Agreement
NGO	non-governmental organisation
PFMA	Public Finance Management Act
PPP	public-private partnership or public-public partnership
PSP	private sector participation
S (or s)	Section (of an item of legislation or regulation)
SALGA	South African Local Government Association
SALGBC	South African Local Government Bargaining Council
SETA	Sector Education and Training Authority
SFWS	Strategic Framework for Water Services
SMME	small, medium and micro enterprise
Waterbility	Waterbility Water and Sanitation Solutions (Pty) Ltd
WRC	Water Research Commission
WSA	water services authority
WSP	water services provider

Definitions used in this report

Frequent reference is made in literature to "**community-based**" or organisations that are "based in the community". It is often not clear if it is intended that these terms exclusively refer to non-profit organisations, or could include profit-seeking organisations. Is the intention of referring to an organisation as "based in the community", to indicate that it is geographically located in the community that it serves, and draws most if not all of its personnel (whether they be volunteers or paid) from that same community? SALGA has in a recent document made its interpretation clear. A "community-based organisation (CBO)" is "a not-for-profit organisation within a specific community, with community representatives, that provides a service to that community with the community's mandate or is representing the overall interests of the community." (SALGA 2005:3)

For the purposes of this report, the term "small, medium and micro enterprise", or SMME, indicates a profit-seeking organisation – that might or might not be based in a community, drawing personnel from that community, and serving that community. Usage by the researchers in this report of "community-based organisation", abbreviated CBO, is less rigid, but is generally intended to indicate a non-profit organisation. If, however, the reference to CBOs is a quotation or a paraphrasing from another document, then the meaning intended by the authors of that document is that which rules.

“**Delivery**” embraces not just the placing in service of infrastructure, but the appropriate operation, including maintenance, of that infrastructure for the whole of its designed life.

“**Maintenance**" is in this report used as a generic term to include repair of infrastructure, refurbishment and renewal, and provision for replacement of that infrastructure.

The following definitions are direct quotations from the Water Services Act (South Africa 1997:10).

- “"**Water services**” means water supply services and sanitation services.
- "**Water services authority**" means any municipality, including a district or rural council as defined in the Local Government Transition Act (South Africa 1993), responsible for ensuring access to water services.
- "**Water services institution**" means a water services authority, a water services provider, a water board and a water services committee. This institution can be a statutory authority, private company, group of individuals, or an individual, or any combination of these.
- "**Water services provider**" means any person who provides water services to consumers or to another water services institution, but does not include …… any person who is obliged to provide water services to another in terms of a contract where the obligation to provide water services is incidental to the main object of that contract.”

Note that whereas all WSAs are municipalities or groups of municipalities, not all municipalities are WSAs. Nonetheless, in this report the terms “WSA” and “municipality” are used interchangeably unless only one of “WSA” or “municipality” is intended and these specific instances are clearly indicated.

Similarly, in this report the terms "customer" and "end user" are used interchangeably unless only one or the other is particularly intended – these specific instances are clearly indicated.)

1. Introduction

1.1 The purpose of Chapter 1

The purpose of Chapter 1 is:

- to briefly motivate the research project;
- to state the objectives and phasing of the project, and introduce the project team; and
- to outline the objectives and structure of this report.

1.2 Background to and objective of the project

1.2.1 Rationale and motivation for the project

In the past decade local government, assisted by DWAF and other players, has been remarkably successful in answering the challenge of services provision. Large numbers of households are now supplied with water services of a wide variety as a result of massive investments in infrastructure and institutional development. Although there are many who are still not able to access services, this achievement is exemplary.

However, this very success provides the seedbed for future problems. As the number and complexity of water services systems increases, so does the operations and maintenance workload escalate. The rising challenge now is to ensure that local government WSP organisations can manage all the new systems sustainably.

Conventional wisdom, supported by research, indicates that the capacity of many local governments in South Africa to adequately provide even basic levels of water services to all their citizens on a sustainable basis is in question. The challenge of exploring a range of options to support these organisations also represents an opportunity to selectively incubate innovations on an experimental basis, following a tradition of South African leadership in public sector-driven partnerships with the private sector, for optimum development impact.

Both Rand Water and DWAF have for a number of years considered that the potential for franchising in the water services industry water ought to be investigated. For various reasons this has never been done.

The barriers to entry for the smaller or start-up company are substantial. But if these could be overcome, perhaps through franchising, then there will be many opportunities for local economic development. The twin driving forces of the franchising concept are the profit motive and the existence of a successful business model that can be copied widely – neither of these is currently in evidence in the water services sector.

Franchising is a way of accelerating the development of a business, based on tried and tested methodology. The franchise system firstly correlates and systematises the business, and then facilitates the setting up of the business, and supports and disciplines it thereafter.

The WRC and CSIR during the course of the 2003/2004 and 2004/2005 financial years undertook pioneering research into the concept of water services franchising in South Africa. (Wall, 2005). The study explored the concepts of franchising and its relevance to the water services delivery process. The outcome indicated opportunities in the water services delivery chain, and recommended that these be further explored.

1.2.2 Objectives of the project

- To further explore the concept of franchising and its relevance to the water services delivery chain.
- To identify and determine those elements in the water services delivery chain which offer the greatest scope for franchising partnerships.
- To review the legal, technical, financial, regulatory, etc. aspects which would impact on franchising partnerships.
- To develop franchising partnership models for a selection of the areas identified by the research, with consideration for the legal, regulatory, etc. aspects.
- To conduct a case study of an element in a hypothetical situation, to see how the model will work.
- To set out the way forward to eventual pilot implementation of franchising partnerships, and inter alia recommend areas for further research.

In summary, **the ultimate objective of the project was to identify the scope for franchising partnerships for the operation and maintenance of selected water services infrastructure, to establish the viability of franchising partnerships, and to make a case for outsourcing to franchises to be considered by water services authorities (WSAs) and water services providers (WSPs).**

In this report, WRC Research Project K5/1610, the "Water Services Franchising" project, is referred to as "the current project" or "this project".

1.2.3 Methodology

The project was divided into two phases, in order to facilitate the achievement of the objectives of the research project in an ordered and logical way over the contract period. (Refer also to "project schematic" (Figure 1.1) on the next page).

The first phase consisted inter alia of:

- identifying those elements in the water services delivery chain which offer the greatest scope for franchising partnerships for the operation and maintenance of their infrastructure, and
- setting out the results of the business analysis (i.e. modelling) of possible franchising of selected elements.

The second phase included:

- Definition of a franchise structure, and preliminary identification of potential franchisors and other key role-players; and
- A case study of an element in a hypothetical situation, to see how the model would work

Note that a further two phases, not part of this project, would be needed in order to take the work into pilot implementation. These phases comprise pilot project preparation, and then pilot project implementation.

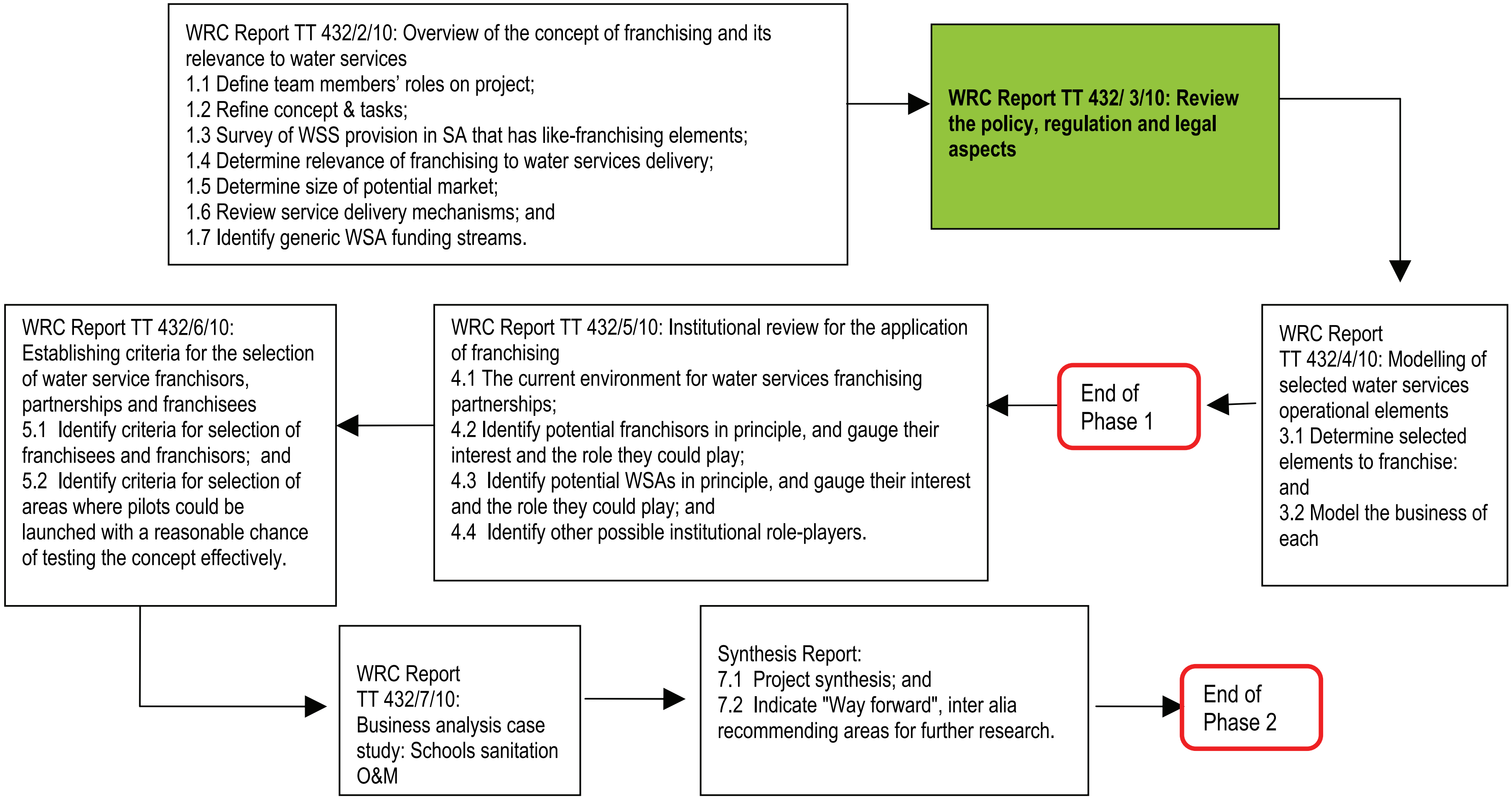

Figure 1.1: Water services franchising partnerships: project schematic

1.3 About this report

1.3.1 Specification

This report was to review “the legal, technical, financial, regulatory, etc. aspects which impact on the concept of franchising of water services”.

Subsequently:

- "Technical" was removed from the original phrasing, which listed “legal, technical, financial, regulatory, etc.”. (Whereas the technology of water services management in any area to be considered is clearly highly pertinent to consideration of the most suitable institutions to undertake that management, technical (or, if preferred, “technology”) issues are dealt with in other parts of the project, and need not be considered in this report.)
- Instead, policy and statutory issues were added to this report along with consideration of the legal, financial and regulatory issues.
- The hugely important topic of procurement was also added.
- The word "desktop" was added to the title so as to clarify the scope of the report and to manage the expectations of its readers.
- Finally, "impact" was more broadly interpreted as "could impact", or "could affect".

More specifically, that these aspects could impact on franchising of water services in various ways needed to be reviewed. For example, WSA procurement policy might make it more difficult to appoint a SMME as a WSP, than a CBO, say, as a WSP.

1.3.2 Purpose of this report

In a nutshell, the purpose of this report is:

- to identify policy, statutory, legal, financial, regulatory, procurement and similar non-technology issues that could affect water services franchising, and
- to draw conclusions in order for recommendations to be made with respect to these topics in so far as they could (or do) affect formulation and implementation of the water services franchising concept in South Africa.

In a sense, this report is a scoping of a set of issues (policy, legal, etc.) that can make or break water services franchising partnerships, or can circumscribe its potential, or can increase its potential reach. This scoping is essential to the ultimate objective of the project, *viz.* to identify the scope for franchising, and to identify the viability of franchising partnerships and/or to make a case for franchising to be considered by WSAs and water services providers (WSPs).

Commentary on the implications for water services franchising of the above-named set of issues there certainly is in this report, but discussion and inferences are left for Phase 2 of the current project. For example, discussion of the effects of the procurement regulatory regime, taken together with other constraints on (and possible prejudices of) municipal councils, on the ability and willingness of WSAs to consider the franchising of water services, is left until then.

This "WRC Report TT 432/3/10: Review of policy, regulation and legal aspects” is hereinafter referred to as "the report" or "this report" or "the current report".

1.4 Structure of this report

The structure of this report reflects its purpose (described in Section 1.3.2 above). Thus Chapter 1 of the report consists of an introduction and description of the methodology adopted for the policy and legal research. This is followed by three chapters which set the policy, legal and procurement scene, and discuss the implications for water services franchising.

The three chapters are respectively:

- Chapter 2 describes and discusses the policies, statutes, legal issues, financial issues, and regulations that could affect water services franchising;
- Chapter 3 describes and discusses relevant issues of procurement; and
- Chapter 4 describes and discusses SMME and BEE issues that could well affect water services franchising.

Chapter 5 draws conclusions, and makes recommendations.

All significant policies, statutes, etc. are in this report reviewed through desktop research, so that an understanding of the constraints and opportunities that they provide to implementation of the water services franchising concept in South Africa can be understood. An understanding of the policy processes and management practices of WSAs, and the WSAs' relationship with WSPs, is also explored through desktop research.

1.5 Notes on the inclusion of legislation and regulations

The bulk of the volume of this report consists of relevant abstracts from legislation, regulations, and policies.

It will be seen that the legislation is mainly in the form of checklists, or lists of mandatory requirements that must be complied with.

It would be a mistake to summarise or simplify these lists of requirements. All the items are equally mandatory. An attempt is made in the report to reference each piece of legislation. This will facilitate the finding of the original text by an interested party who wishes to read the legislation in context. Certain documents, such as the Municipal Services Partnership (MSP) Green Paper and the tables from National Treasury are not easy to reference as they have been included in the respective web pages without cross-reference to dates of publication or specific reports.

Fortunately South African drafters of legislation since 1994 have made a conscious effort to draft it in a way that is understandable to people without legal training. WRC officials, DWAF officials, municipal officials, private sector contractors and consultants who are for the most part already involved with water services, should be able to understand the descriptions in this report of the legislation and regulations.

2. The policies, statutes, legal issues, financial issues, and regulations

2.1 Introduction to the policy and legal environment, and the purpose of Chapter 2

2.1.1 Water responsibilities

The National Water Act (South Africa 1998) governs the water resources part of the water and sanitation business cycle, while the Water Services Act (South Africa 1997) governs the water services part. The current project is, with minor exceptions, concerned only with the latter.

Figure 2.1 sets out a delineation of the interface between the statutory background to water resources responsibilities, on the one hand, and the statutory background to water services responsibilities, on the other. All are part of the "water and sanitation business cycle". (DWAF 2001:34)

Franchising is in the current project considered only in the context of water services, except that the door is left open for the possibility that the operation and maintenance of very small water resources schemes (e.g. borehole extraction, small-scale river abstraction, and the like) could also possibly be franchised.

2.1.2 Water services responsibilities

The responsibility for water services provision rests in the first instance with municipalities. The Water Services Act (South Africa 1997) assigns to municipalities the water services authority (WSA) function. (Note that in terms of the Water Services Act, s (1) (xix), "water services" means "water supply services and sanitation services".)

The actual delivery of services is undertaken by distinct entities known as "water services providers" (WSPs). These WSPs can be selected by the WSAs from a range of institutional options and are appointed by the WSAs. Whilst the majority of municipalities retain a direct involvement in the delivery function through internal departments that are their own WSPs, some municipalities utilise municipal entities (Johannesburg Water, ERWAT (Ekurhuleni)), water boards or contracted service providers (e.g. CBOs or private sector operations contractors) as their WSPs.

Municipalities may disaggregate the service delivery functions into components that are separately outsourced, for instance, for construction, for maintenance, or for billing and revenue collection.

The Water Services Act provides that every WSA must:

- **ensure access** to efficient, affordable, economical and sustainable water services for all consumers;
- **regulate** locally (including enforcing bylaws);
- prepare a water services development **plan** (WSDP); and
- either perform the function of **water services provider** (WSP) itself or contract a water services provider.

Figure 2.2 shows how these legislative responsibilities lie in two key areas.

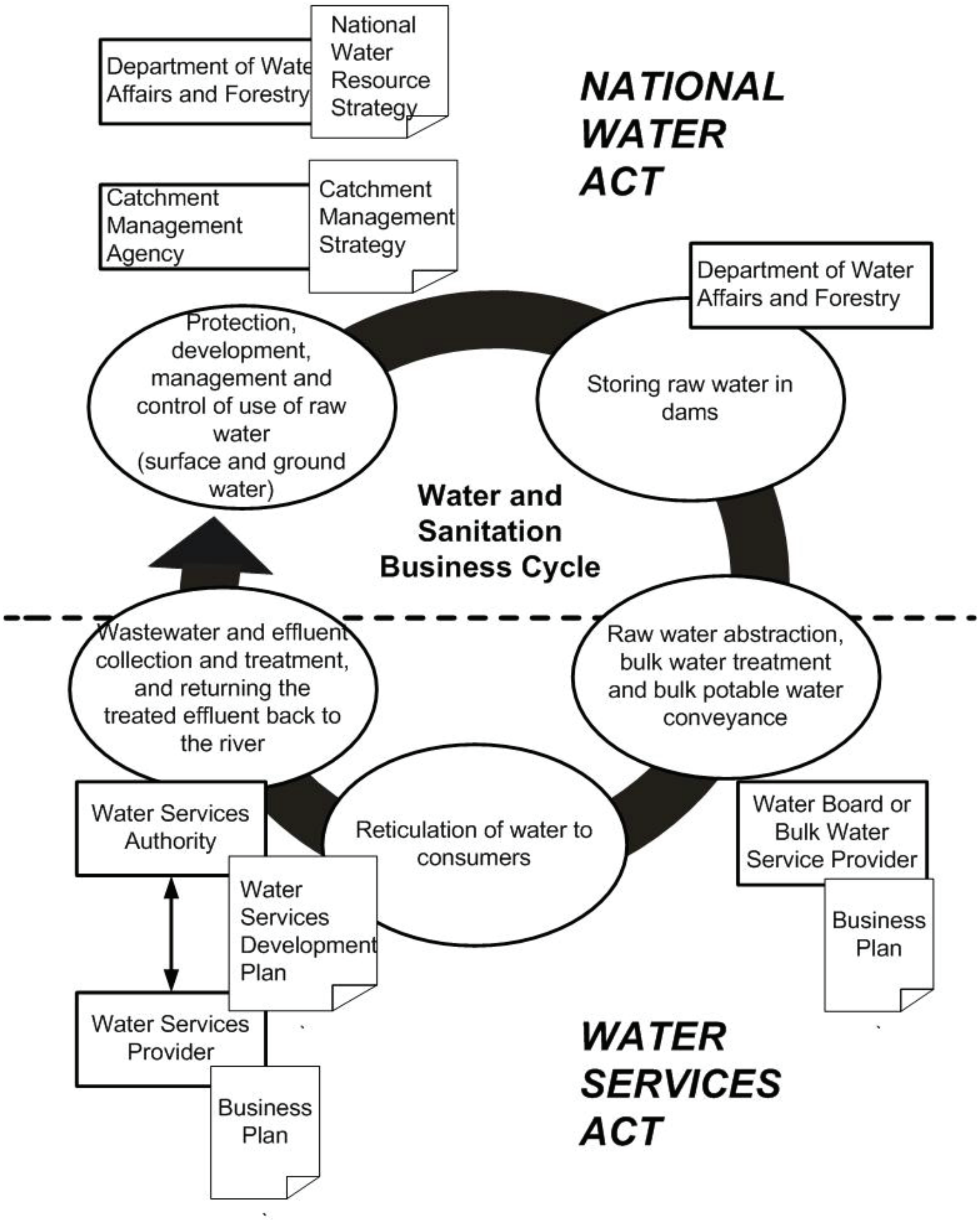

Figure 2.1: The water and sanitation business cycle

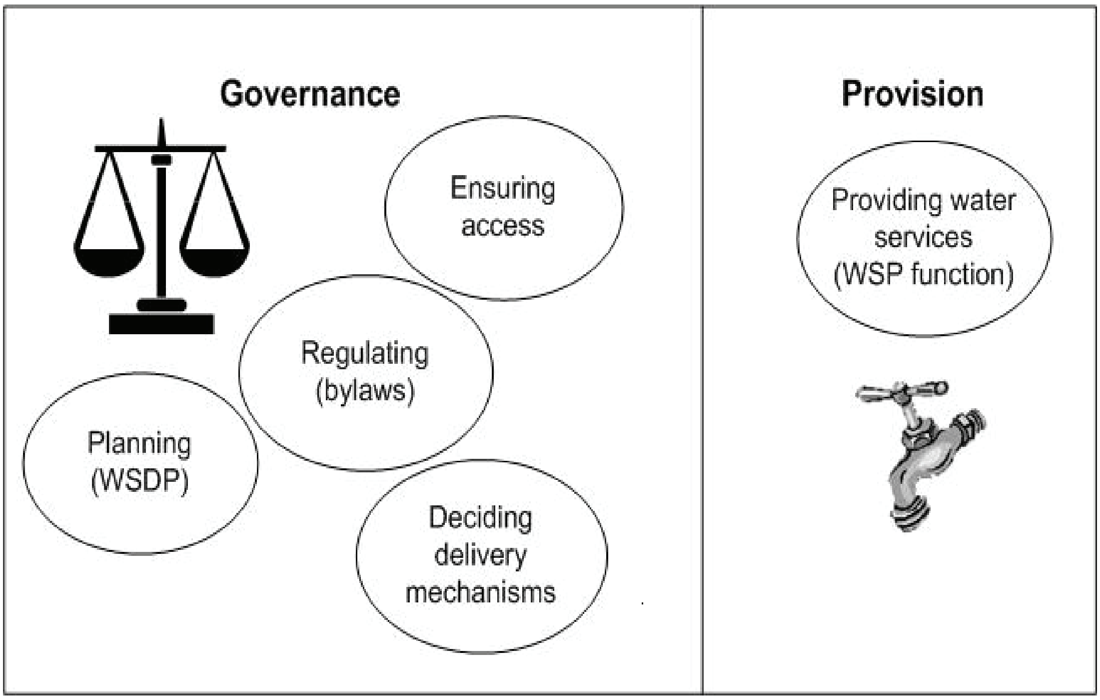

Figure 2.2: Key areas of legislated responsibilities

The **governance functions** cannot be delegated to any other local entity. However the WSA can contract support to assist it with some governance functions.

If the WSA also performs the WSP functions, the governance functions must be managed and be accounted separately from the provision functions.

The **provision function** is the actual provision of the water services to consumers, for example operating and maintaining the infrastructure, consumer relations, revenue collection, administration and financial management. A WSA has a choice. It may carry out the functions of a WSP itself or it may enter into a contract or form a joint venture with another WSP. (Figure 2.3 refers.)

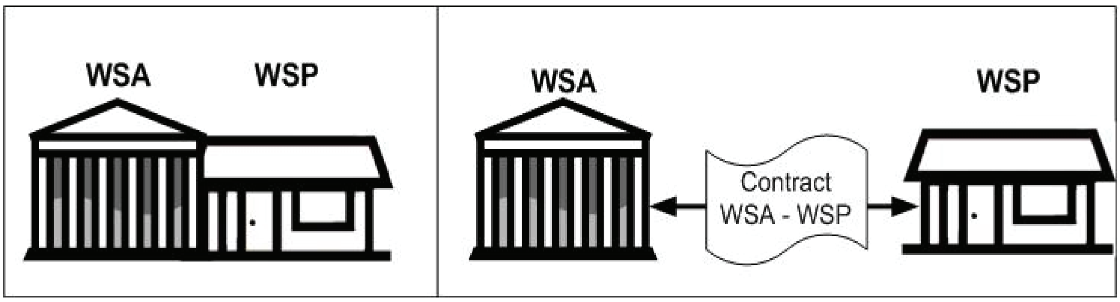

Figure 2.3: Water Services Authority (WSA) and provider alternatives

2.1.3 Chapter 2 and the objectives of this report

This introduction, Section 2.1, firstly endeavours to circumscribe the scope of the core environment in which outsourcing by a WSA of water services or a component thereof could take place, and within which the WSP would operate. In other words to identify the relevant policy, statutory, regulatory, financial and procurement regime to which the franchising operation would be subjected. Secondly, it considers the particular circumstances surrounding outsourcing that involves franchising.

Hardly any of the water policy and legislation discussed in this report makes specific mention of franchising, or even of SMMEs. This is because the applicable issues are those relating to WSAs, WSPs, public-public partnerships (PPPs), public-private partnerships (PPPs) and the municipal environment generally. For example, procurement of SMMEs, CBOs and small NGOs is subject to a statutory and regulatory regime that is for the most part designed for all forms of PPPs, not distinguishing in respect of the size of the partners (i.e. no distinction is made between say SMMEs and other, larger, enterprises) or whether they are profit-seeking as opposed to non-profit-seeking. In that context, franchisees are just one of the forms of SMME, CBO or NGO.

Water services franchising would fall within the definition of a service provider operating in the municipal water services sector. Whether a franchisee WSP is contracted directly to a WSA, or is subcontracting to another WSP that is contracted to a WSA, is not of material difference as far as this report is concerned.

It is anticipated that the targeted franchising participants (franchisor and franchisee) would normally be members of the private sector, but could just as easily include CBOs or NGOs, Public Entities such as Water Boards, or other organ of state[1] such as municipal owned entities, or could on occasion also involve Traditional Leadership[2]. A PPP arrangement could also be structured with franchisor support.

The relationship between the franchisor and franchisee, and that between the franchisee and the WSA, would both be governed by the law of contract and would normally have the *essentialia* of *locatio conduction operarum* (contract of employment) or *locatio conductio operis* (the contract for a specific piece of work).

As a water services provider in the municipal sector, the franchisee (and franchisor) would also be governed by water services and municipal legislation.

The operation of the franchisee would be subject to labour law and to the scrutiny of organised labour.

Private sector participants would normally be subject to company law while public entities would be governed by their founding legislation or founding constitutions and the Public Finance Management Act (PFMA).

The franchise operation would also be subject to oversight and regulation by the Cabinet Ministers who hold the water and municipal services portfolios.

It is evident from the above that due consideration would need to be given to the following policy, statutory, legal, financial and regulatory areas when determining how best to structure and implement a water services franchising arrangement:

- in the first instance, issues relating to operations, irrespective of institutional type or financial matters; and

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1 SA Constitution S239
2 SA Constitution S212(1)

- in the second instance, institutional and financial issues.

Within the second instance, the principal institutional and financial issues concern those relating to outsourcing partnerships, and especially the nature of the contractual arrangements.

This Chapter 2 is accordingly arranged as follows:

- a background is set of the relevant DWAF policies and strategies (Section 2.2);
- the regulatory regime of DWAF with respect to water services operation is then discussed (Section 2.3), including broadly sketching out what DWAF can regulate;
- the relevant policies, statutes and regulatory regime of national government departments governing municipalities and WSAs, and specifically the partnerships they can enter into, alternative WSP institutional forms, choice between these, and their procurement (Section 2.4);
- relevant comments on water boards (Section 2.5);
- contractual relationship between the WSA and WSP (Section 2.6); and
- contractual relationship between a franchisor and a franchisee (the franchise agreement) (Section 2.7).

Financial issues surrounding municipalities are highly relevant to the sustainability of all municipal activities, among them those activities that could be outsourced, and these are discussed in Section 2.8.

Of the above, only Section 2.7 is specific to franchising. Because the policy and legislation described makes no specific mention of franchising, or even of SMMEs, Sections 2.3 through 2.6, and also 2.8, make no mention of them either other than that made in the comment within the sections, or in the analysis or recommendation at the end of each section, where the relevance of the material just presented in that section to PPPs in general, and SMMEs and franchising in particular is discussed.

Section 2.9 concludes the chapter.

Issues governing companies in general are relevant, but of lesser direct interest, and have therefore been placed in Annexure B.

A review of the legislation shows that in many instances the legislation has been drafted as codified policy and in fact has superseded the policy on which it is based. For example, the Water Services Act, 1997, together with its regulations, has to a significant extent superseded the White Paper on Water Services of 1994. (South Africa 1994)

Note that:

- In the context of this report, the terms "WSA" and "municipality" can be used interchangeably unless specifically stated otherwise.
- SMMEs can be outsourced to by WSAs directly or by WSPs. The latter, given the size and capacity of SMMEs, is much more likely. Nevertheless, where this report discusses outsourcing to SMMEs, reference to outsourcing by WSAs can be interchanged with outsourcing by WSPs unless specifically stated otherwise.

2.2 DWAF policies and statutes specific to the provision of water services

2.2.1 White Paper and SFWS

The policies and strategies of DWAF most directly impacting on the provision of water services include the White Paper on Water Services and the Strategic Framework for Water Services (SFWS) of September 2003 (DWAF 2003), and approved by the Cabinet in that month.

The White Paper on Water Services has largely been codified into legislation (South Africa: Water Services Act 1997) and the targets set in 1994 have also to a large extent been updated by the SFWS. It will thus not be necessary to deal with the White Paper on Water Services.

The SFWS sets out the water services sector's vision, goals and targets as well as the institutional framework, the financial framework, the planning framework, national norms and standards, the regulatory framework and the support and monitoring framework. While the whole of the SFWS is relevant to the provision of water services, only a few items of particular relevance to the structuring and operation of a water services provider franchise will be highlighted herein.

As a key challenge, the SFWS[3] recognises that a process of institutional reform is required. This reform process opens up a window of opportunity to explore different options for water services provision:

> *In order to promote greater effectiveness and efficiency, a process of institutional reform of water services provision will be initiated. This is necessary to specifically address water services provision across water services authority boundaries and the integration of bulk and retail water services provision where appropriate so as to improve the coherence of the sector and to realise economies of scale.*

The SFWS[4] sets out a number of sector goals that stress regulation and cost effectiveness:

> 3 *Water and sanitation services are provided:*
> - *equitably (adequate services are provided fairly to all people);*
> - *affordably (no one is excluded from access to basic services because of their cost);*
> - *effectively (the job is done well);*
> - *efficiently (resources are not wasted);*
> - *sustainably (services are financially, environmentally, institutionally and socially*
> - *sustainable); and*
> - *gender sensitively (taking into account the different needs and responsibilities of women and men with regard to water services and sanitation).*
>
> 4. *All water services authorities are accountable to their citizens, have adequate capacity to make wise choices (related to water services providers) and are able to regulate water services provision effectively.*
> 5. *All water services providers are accountable, cost-effective, efficient, and viable, and implement appropriate employment and gender equity policies.*
> 6. *The prices of water and sanitation services reflect the fact that they are both social and economic goods (that is, pricing promotes access to a basic safe service, encourages the wise and sustainable use of resources and ensures financial sustainability).*
> 7. *Water and sanitation services are effectively regulated with a view to ensuring the ongoing achievement of these goals.*

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[3] Strategic Framework, September 2003, s1.1

[4] Strategic Framework, September 2003, s2

The SFWS[5] also sets a number of quantified targets which specifically include the need for WSP contracts, business plans and key performance indicators (KPIs).

> 16. *All external water services providers are rendering services in terms of a contract with the applicable water services authority by 2005.*
> 17. *All water services providers are rendering services in terms of a business plan by 2005.*
> 18. *All water services authorities have adopted a set of key performance indicators that include those set out in Annexure 2 by 2005 and report on these annually.*

The SFWS[6] sets a number of key principles, namely:

> 2. *Separation of regulatory and operational responsibilities. There is a clear separation of the activities of regulation and operation. This reduces the potential for conflicts of interest inherent in self-regulation and will help to improve the clarity of objectives and responsibilities. Regulation will seek to protect the interests of consumers and balance these with the need for sustainable institutions.*
> 3. *Local government is responsible for ensuring water services provision. Provision of water services is the constitutional responsibility of local government. Developmental and democratic local government is in the best position to make accountable decisions related to how services should be provided, taking into account the social and environmental aspects of water services.*
> 4. Flexibility. A key characteristic of the institutional vision is that the precise institutional form of water services provision is not specified but rather is flexible with respect to both the scale of provision and the type of service provider. With respect to the scale of the provision of services, a water services provider could serve one small rural community, one or more towns, a large metropolitan area or a whole region. With respect to the type of water services provider, a water services provider could be a municipality, a public utility (owned by local and/or national government), a community-based organisation or a private organisation. (This is not a comprehensive list.) This flexibility recognises the diverse realities of the water services sector in South Africa which includes large metropolitan areas, major and minor towns scattered across South Africa, dense and sparsely populated rural *settlements, small distributed systems of supply using springs and boreholes serving a few people, surface water systems supplying a few towns, and large regional schemes serving many towns and cities.*
> 5. *The private sector has a role to play in assisting local government and other water services institutions in the water services sector.*
> 7. *Building on existing capacity. The skills and resources within established and capable water services institutions will be protected and enhanced, recognising the potential impact of HIV/Aids on human resources.*
> 8. *Transformation. Through the institutional reform process, assisted by the support framework, water services institutions will be transformed in order to ensure effective, efficient and sustainable services provision, and taking cognisance of the need to reflect the cultural, gender and racial diversity in South Africa.*

5 Strategic Framework, September 2003, s2
6 Strategic Framework, September 2003, s3.1

9. *Gender mainstreaming. Women often bear the brunt of absent or poor water services and hence are key stakeholders in the sector. The needs and responsibilities of women and men in relation to water services and sanitation are often different. There will be a targeted effort to enable women to play a meaningful role at all levels in consultations, planning, decision making and in the operation and management of water services.*
10. *Civil society has an important role to play in, amongst others, planning, monitoring and advocacy.*

2.2.2 Water Services Act

The Water Services Act[7], 1997 governs the approval of WSPs and promotes access to information by the WSA, presumably to facilitate regulation by the WSA:

Approval to operate as water services provider

22. (1) No person may operate as a water services provider without the approval of the water services authority having jurisdiction in the area in question.
    (2) Any approval in terms of subSection (1) –
        (a) must be for a limited period; and
        (b) may be granted subject to conditions.
    (3) Any person who, at the commencement of this Act, was acting as a water services provider without approval from the water services authority having jurisdiction in the area in question, may continue to do so until the expiry of reasonable notice, which notice must not be longer than one year, given by that water services authority –
        (i) that it requires the provider to enter into a contract; or
        (ii) that the continuation will be subject to approval as contemplated in subSection (1).

Water services provider must give information

23. A water services provider must give such information concerning the provision of water services as may reasonably be called for by –
    (a) the water services authority having jurisdiction in the area in question;
    (b) the relevant Province;
    (c) the Minister; or
    (d) a consumer or potential consumer.

2.2.3 Comment: DWAF and PSPs

The attitude of DWAF, and its will to encourage (or discourage) private sector participation (PSP), are clearly of the utmost importance. As long as key legislation (such as municipal procurement legislation) is (as is shown below) permissive and not prohibitive of private sector involvement under specific circumstances, it is DWAF that is crucial to ensuring an appropriate role for the private sector in water services delivery.

The two most important documents in this regard are the Strategic Framework for Water Services (SFWS) (DWAF 2003b) and the Water Services Act (South Africa 1997).

This Act and the SFWS make several direct references to the possible role of the private sector. The SFWS does this in particular, and outlines the ground rules for PSP. In the opening statement

7 Act 108 of 1997, s22

to SFWS, under the name of the Minister, it is acknowledged that the capacity to provide services effectively and efficiently is a critical constraint in many areas in South Africa. Inter alia, "the role of the private sector in the provision of water services is welcomed, provided that consumer interests are protected." (DWAF 2003b:ii) The private sector can be involved in a wide range of ways, including but not limited to the following: acting as an external water services provider in terms of a contract (service delivery agreement) with a water services authority, investing in a public utility (provided (that the) ownership control vests with national government), and supporting other water services providers as water services agents." (Ibid:Section 3.4.7) "Privatisation", in the sense of "private investment and perpetual ownership of assets", is completely ruled out. "In terms of South African law and policy for water services, this is not allowed at all." The Minister is quoted on this topic: "While privatisation is an emotional and very much political issue in South Africa, the private sector has played and will continue to play an important role in water services. The challenges facing us are simply too big to be addressed by government alone. We will, however, not sell our public water services infrastructure to the private sector, but **this is no obstacle to the private sector getting involved in a whole range of activities**." (Ibid:Section 3.4.7 – emphasis added by the current researchers)

The above seems to rule out any alternative service delivery concepts that involve ownership of existing infrastructure by the private sector. There does, however, appear to be room for private sector investment in new infrastructure. The official statements almost invariably refer to opposition to "selling to" the private sector. While the quotations immediately above rule out private "investment and perpetual ownership", it does allow private "investing in" infrastructure, providing that the infrastructure does not then become privately owned. (As an aside: the ruling out of "perpetual ownership" appears not to preclude forms of ownership by the private sector for a period of 10 or 20 or more years, after which the assets are in terms of the contract handed over to the public sector. Such forms of ownership could be Build-Operate-Transfer (BOT) and Build-Own-Operate (BOO).

The requirements with which a water services authority must comply before appointing "a public or private external WSP" are laid down in the SFWS, including the need to "make a sound business case for the benefits to be achieved" (ibid:Section 3.4.3). And then comes the bald statement: "Public preference. The provision of water services by public institutions is preferred." (Ibid:Section 3.4.4) The promise is made that DWAF will in due course "provide guidelines to assist WSAs in selecting appropriate institutional arrangements for the provision of water services."

In summary, the WSP options set out in the above and in other literature available (i.e. DWAF publications, policy documents, ministerial speeches, etc.) invariably comprise the municipality itself (either the district or the local municipality), other public sector or parastatal agencies, CBOs, and combinations of these in the form of MSPs. In special circumstances private sector WSPs will also be considered. But when MSPs are discussed in the literature, it is clear that, aside of community-level schemes, only public sector or NGO or CBO partners are envisaged at the moment.

2.2.4 Comment: DWAF and franchising

The SFWS promotes:

- the separation of the regulatory and operations functions,
- institutional flexibility, and
- the role of women and civil society.

The key principles set out in SFWS are thus not incompatible with the institutional vision of franchising.

2.3 DWAF regulatory regime with respect to water services operation

2.3.1 Pertinent DWAF regulations – SFWS, Water Services Act and regulations

The SFWS[8] envisages a regulatory role for DWAF in that DWAF will oversee the activities of all water sector institutions and will regulate water resources and water services.

The SFWS also envisages a regulatory role for water services authorities in that:

> *water services authorities have the constitutional responsibility for planning, ensuring access to, and regulating provision of water services within their area of jurisdiction. They may provide water services themselves and/or contract external water services providers to undertake the provision function on their behalf. Water services authorities are responsible for securing from DWAF (or CMAs where they are established and where this function is delegated) licences to abstract water from, and to discharge wastewater to, the water resource. (Regional water services providers secure licences directly from DWAF or CMAs.)*
>
> *Water services authorities may regulate the provision of water services within their local area through by-laws and contracts. They may delegate the responsibility for obtaining licences through contracts.*

The Water Services Act,[9] also provides for the WSA to monitor the WSP.

> Monitoring performance of water services providers and water services intermediaries
> 27. Every water services authority must monitor the performance of water services providers and water services intermediaries within its area of jurisdiction to ensure that –
>   (a) standards and norms and standards for tariffs prescribed under Sections 9 and 10 are complied with;
>   (b) any condition set by a water services authority under Sections 6, 7 and 22 is met;
>   (c) any additional standards set by a water services authority, for water services intermediaries are complied with; and
>   (d) any contract is adhered to.

The Water Services Act[10] also provides for both the Minister and the Province to regulate the WSP, in that the WSP is a water services institution:

8 Strategic Framework for Water Services, September 2003, s3.1
9 Act 108 of 1997, s27
10 Act 108 of 1997, s62

Monitoring of water services institutions

62. (1) The Minister and any relevant Province must monitor the performance of every water services institution in order to ensure-
   (a) compliance with all applicable national standards prescribed under this Act;
   (b) compliance with all norms and standards for tariffs prescribed under this Act; and
   (c) compliance with every applicable development plan, policy statement or business plan adopted in terms of this Act.
(2) Every water services institution must-
   (a) furnish such information as may be required by the Minister after consultation with the Minister for Provincial Affairs and Constitutional Development; and
   (b) allow the Minister access to its books, records and physical assets to the extent necessary for the Minister to carry out the monitoring functions contemplated in subSection (1).

The full scope of regulation of water services comprises the following:

- Technical regulation of water services authorities. Monitoring compliance with respect to specified national minimum norms and standards for performance, and ensuring that appropriate planning is taking place. This also covers the social aspect to legislation which will include consumer services, free basic water and sanitation provision, etc.
- Economic regulation. Review of WSP investment decisions and of tariffs set. Are investments appropriate (not over-investment and not under-investment)? Are prices appropriate (neither too high not to low)? Are services provided efficiently?
- Contract regulation. Ensuring that all contracts established between water services authorities and water services providers conform to national regulations. Oversight of the management and enforcement of contracts, including support related to dispute resolution and interventions in terms of the contract. (DWAF 2004a: Annexure A)

The intention of regulations is clearly, inter alia, to prescribe and enforce norms and standards. Section 9 of the Act (quoted here in full) states the Minister's powers in this respect:

"9 (1) The Minister [of Water Affairs and Forestry] may, from time to time, prescribe compulsory national standards relating to –
   (a) the provision of water services;
   (b) the quality of water taken from or discharged into any water services or water resource system;
   (c) the effective and sustainable use of water resources for water services;
   (d) the nature, operation, sustainability, operational efficiency and economic viability of water services;
   (e) requirements for persons who install and operate water services works; and
   (f) the construction and functioning of water services works and consumer installations.
(2) The standards prescribed under subsection (1) may differentiate between –
   (a) different users of water services; and
   (b) different geographic areas, taking into account, among other factors, the socio-economic and physical attributes of each area.
(3) In prescribing standards under subsection (1), the Minister must consider –
   (a) the need for everyone to have a reasonable quality of life;
   (b) the need for equitable access to water services;
   (c) the operational efficiency and economic viability of water services;
   (d) any norms and standards for applicable tariffs for water services;
   (e) any other laws or any standards set by other governmental authorities;
   (f) any guidelines recommended by official standard-setting institutions;
   (g) any impact which the water services might have on the environment; and

(h) the obligations of the National Government as custodian of water resources.

(4) Every water services institution must comply with the standards prescribed under subsection (1)." *(End of quote)* (South Africa 1997:s9)

Turning now to regulation that is for the most part technical regulation of water services operation.

"Compulsory national standards and measures to conserve water", gazetted as regulations under s9 of the Water Services Act[11], require the WSA to annually submit a water services audit. This is the key regulatory tool of DWAF.

Water services audit as a component in the Water Services Development Plan

10. (1) A water services authority must include a water services audit in its annual report on the implementation of its water services development plan required in terms of Section 18(1) of the Act.

(2) A water services audit must contain details for the previous financial year and, if available, comparative figures for the preceding two financial years of –

(a) the quantity of water services provided, including at least –
   (i) the quantity of water used by each user sector;
   (ii) the quantity of water provided to the water services institution by another water services institution;
   (iii) the quantity of effluent received at sewage treatment plants; and
   (iv) the quantity of effluent not discharged to sewage treatment plants and approved for use by the water services institution;

(b) the levels of services rendered, including at least –
   (i) the number of user connections in each user sector;
   (ii) the number of households provided with water through communal water services works;
   (iii) the number of consumers connected to a water reticulation system where pressures rise above 900 kPa at the consumer connection;
   (iv) the number of households provided with sanitation services through consumer installations connected to the sewerage system;
   (v) the number of households with access to basic sanitation services;
   (vi) the number of new water supply connections made; and
   (vii) the number of new sanitation connections made;

(c) the numbers provided in compliance with paragraph (b) expressed as a percentage of the total number of connections or households;

(d) cost recovery, including at least –
   (i) the tariff structures for each user sector;
   (ii) the income collected expressed as a percentage of total costs for water services provided; and
   (iii) unrecovered charges expressed as a percentage of total costs for water services provided;

11 GN R509 in GG 22355 of 8 June 2001, regulation 10

(e) meter installation and meter testing, including at least –
  (i) the number of new meters installed at consumer installations; and
  (ii) the number of meters tested and the number of meters replaced expressed as a percentage of the total number of meters installed at consumer connections;

(f) the water quality sampling programme contemplated in regulation 5(1), the results of the comparison set out in regulation 5(3) and any occurrence reported in compliance with regulation 5(4);

(g) water conservation and demand management, including at least –
  (i) the results of the water balance as set out in regulation 11;
  (ii) the total quantity of water unaccounted for;
  (iii) the demand management activities undertaken; and
  (iv) the progress made in the installation of water efficient devices.

2.3.2 Analysis

A WSP is regulated by the WSA but also by the Minister of Water Affairs and the government of the province.

The primary method of regulation by the WSA is through the WSA-WSP contract and through legislated access to information by the WSA. The monitoring of performance through the annual submission to DWAF of a water services audit could be a significant facilitator of regulation by the Minister. However the "Compulsory national standards and measures to conserve water" gazetted as regulations under s9 of the Water Services Act for water services auditing have never been enforced by DWAF. This water services audit could be a key facilitator of regulation by DWAF and would also provide an objective measurement of how different service provider options are actually performing.

Specifically, the water services audit would provide an objective way of measuring the performance nationally of franchise operations.

The minimum content of the WSA-WSP contract is formally stipulated in regulations and legislation. The details thereof are discussed in Section 2.6 below.

2.4 Policies, statutes and regulatory regime governing municipalities and WSAs, and the partnerships they can enter into

2.4.1 Introduction to Section 2.4

Section 2.4 describes the relevant policies, statutes and regulatory regime of national government departments governing municipalities and WSAs, and specifically the partnerships they can enter into, alternative WSP institutional forms, choice between these, and their procurement.

The sequence is:

- DPLG definitions of MSPs and types of MSPs (Section 2.4.2 and 2.4.3);
- MFMA conditions, and conditions set out in regulations in terms of MFMA, and processes to be complied with when entering PPPs (Section 2.4.4 and 2.4.5); and
- analysis and recommendations (Section 2.4.6 and 2.4.7).

It is understood from DPLG officials that, whereas the term "municipal services partnership" is seldom used other than by DPLG, an MSP can be a municipality-public partnership or a municipality-private partnership. There is no generic difference between these types of partnership and the generic public-public partnerships and public-private partnerships is understood in other legislation and by other departments. It's simply that DPLG prefers the term "MSP" when a municipality is involved.

2.4.2 DPLG Green Paper on Municipal Service Partnerships, 1999

Government's policy on MSPs is set out in the Green Paper on MSPs, 1999. (DPLG 1999).

DPLG recognises through the Green Paper that MSPs provide municipal councils with an option for meeting the particular municipal service needs of their communities. However, DPLG also recognises that merely declaring that MSP is a service delivery option does not ensure that it is a practical or accessible approach for most councils. Accordingly, DPLG compiled the Green Paper in order to create a policy environment that enhances the viability and feasibility of MSP service delivery.

The Green Paper defines MSPs very broadly:

An MSP is a contractual arrangement with another body or organisation for the delivery or performance of any municipal service. The municipal services covered by this MSP policy include:

- *All services listed in Schedule 4, part B and Schedule 5, part B of the Constitution.*
- *All services listed in Schedule 4, part A, and Schedule 5, part B of the Constitution that may, from time to time, be assigned by a provincial government to a municipal council in terms of Section 156(4) of the Constitution.*
- *Other services that may be, from time to time, assigned by national or provincial legislation to a municipal council.*

Forms of MSPs
An MSP involves a contractual arrangement with a service provider other than the municipality itself. Such contractual arrangements for municipal service delivery may be in the form of:

- *A public-private partnership: a contract between a council and an individual or a privately-owned or controlled partnership, company, trust, or other for-profit legal entity.*
- *A public-public partnership: a contract between a council and any public sector entity, including another council or a parastatal.*
- *A public-NGO/CBO partnership: a contract between a council and a not-for-profit non-governmental organisation (NGO) or community-based organisation (CBO).*

Nearly all, if not all, WSA-WSP relationships would fall within the definition of MSPs.

2.4.3 Types of MSP contracts identified in the DPLG Green Paper on Municipal Services Partnerships

The Green Paper[12] on MSPs describes typical contractual arrangements between the Services Provider (in the case of water services, the WSP) and the Municipality (in this case the WSA):

[12] Green Paper on Municipal Services Partnerships, 1999; s2

Service contract: *the contractor receives a fee from the council to manage a particular aspect of a municipal service. Service contracts are usually short-term (one to three years). Common examples include repair and maintenance or billing and collection functions.*

Management contract: *the contractor is responsible for the overall management of all aspects of a municipal service, but without the responsibility to finance the operating, maintenance, repair, or capital costs of the service. Management contracts are typically for three to five years. Payment under management contracts typically specifies the payment of a fixed fee plus a variable component, the latter being payable when the contractor meets or exceeds specified performance targets. The management contractor assumes no risk for collection of tariffs from service consumers, although high collection rates can trigger incentive payments for the management contractor. An example is the management of a water utility.*

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Lease*: the contractor is responsible for the overall management of a municipal service, and the council's operating assets are leased to the contractor. The contractor is responsible for the operating, repair, and maintenance costs of those assets. In some cases, the contractor is also responsible for collecting tariffs from consumers of the service, and assumes the collection risk. The contractor pays the council rent for the leased facilities, sometimes including a component that varies with revenues or profits. Generally, the contractor is not responsible for making any new capital investments or for replacement of the leased assets. Leases are typically for eight to 15 years. Examples include the lease of a municipal market, port or water system.*

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Build-operate-transfer (BOT): *the contractor undertakes to design, build, manage, operate, maintain, and repair, at its own expense, a facility to be used for the delivery of a municipal service. The council becomes the owner of the facility as soon as it is completed. A BOT may be used to develop a new facility, or expand an existing facility. In the latter case, the contractor assumes the responsibility for the operating and maintenance costs of the existing facility, but may or may not (depending on the contract) assume responsibility for any replacement or improvement of the facility. Typically, a BOT requires the council to pay the contractor a fee (which may include performance incentives) for the services provided, leaving responsibility for tariff collection with the council.*

Concession*: the contractor undertakes the management, operation, repair, maintenance, replacement, design, construction, and financing of a municipal service facility or system. The contractor often also assumes responsibility for managing, operating, repairing, and maintenance of related existing facilities. The contractor collects and retains all consumer tariffs, assumes the collection risk, and pays the council a concession fee (sometimes including a component that varies with revenues or profits). The municipality still remains the owner of any existing facilities operated by the concessionaire, and the ownership of any new facilities constructed by the concessionaire is transferred to the municipality at the end of the concession period.*

Any other contractual arrangement or any variant of the contractual arrangements described in this Section ("Types of MSP contracts") between a council and an MSP service provider is also an MSP.

A service contract can be a relatively simple form of MSP, while a management contract is somewhat more complex. Leases, BOTs, and concessions are typically the most complex of MSP transactions and can impose heavy demands on a council's management and systems capacity

The Green Paper[13] arranged the different types of MSP contracting arrangements in order of complexity:

Type of contract	Duration of contract	Monetary value	Political sensitivity	Complexity of procurement	Complexity of contracting	Complexity of performance monitoring
Service contract	Short-term	Low	Low	Low	Low	Low
Management contract	Short-term	Low to moderate	Low	Low to moderate	Low	Low to moderate
Lease	Medium-term	Moderate to high	Moderate	Moderate	High	Moderate to high
Build-operate-transfer	Long-term	High	High	High	Moderate to high	High
Concession	Long-term	High	High	High	High	High

As the table shows, service contracts and management contracts can be relatively simple forms of MSP. BOTs and concessions are typically the most complex of MSP arrangements, and can impose heavy demands on a council's management and systems capacity. Even relatively simple forms of MSPs can deliver services cost-effectively and merit consideration. The main limitation of simple MSPs is that their impact on service delivery and infrastructure backlogs is generally small. In contrast, BOTs and concessions have greater potential for improving and extending services, but are much more complicated to plan and implement.

It is important to note that the Green Paper makes encouraging mention of SMMEs. Under the heading of "service contract (not a WSP contract)", it is stated that "Evidence suggests that this type of arrangement [service contract] is a starting point for involving CBOs and NGOs in municipal service provision, with the other arrangements [as in the table above] being considered as capacity and experience developed over time." (DWAF 2003a: Section B.4.2.)

As will be shown in the following sub-section, the MFMA goes a long way to establishing clarity on the process to be followed in procuring such a private sector provider, or for entering into public-private partnerships.

2.4.4 MFMA conditions for public-private partnerships

The Local Government: Municipal Finance Management Act[14] 2003 (MFMA) stipulates conditions to be complied with and processes to be followed when entering into PPPs:

Part 2
Public-private partnerships (s 120)
120 Conditions and process for public-private partnerships

(1) A municipality may enter into a public-private partnership agreement, but only if the municipality can demonstrate that the agreement will-
- *(a) provide value for money to the municipality;*
- *(b) be affordable for the municipality; and*
- *(c) transfer appropriate technical, operational and financial risk to the private party.*

(2) A public-private partnership agreement must comply with any prescribed regulatory

[13] Green Paper on Municipal Services Partnerships, 1999; s2
[14] Act 56 of 2003, s120

framework for public-private partnerships.

(3) If the public-private partnership involves the provision of a municipal service, Chapter 8 of the Municipal Systems Act must also be complied with.

(4) Before a public-private partnership is concluded, the municipality must conduct a feasibility study that-

(a) explains the strategic and operational benefits of the public-private partnership for the municipality in terms of its objectives;

(b) describes in specific terms-

(i) the nature of the private party's role in the public-private partnership;

(ii) the extent to which this role, both legally and by nature, can be performed by a private party; and

(iii) how the proposed agreement will-

(aa) provide value for money to the municipality;

(bb) be affordable for the municipality;

(cc) transfer appropriate technical, operational and financial risks to the private party; and

(dd) impact on the municipality's revenue flows and its current and future budgets;

(c) takes into account all relevant information; and

(d) explains the capacity of the municipality to effectively monitor, manage and enforce the agreement.

(5) The national government may assist municipalities in carrying out and assessing feasibility studies referred to in subSection (4).

(6) When a feasibility study has been completed, the accounting officer of the municipality must-

(a) submit the report on the feasibility study together with all other relevant documents to the council for a decision, in principle, on whether the municipality should continue with the proposed public-private partnership;

(b) at least 60 days prior to the meeting of the council at which the matter is to be considered, in accordance with Section 21A of the Municipal Systems Act-

(i) make public particulars of the proposed public-private partnership, including the report on the feasibility study; and

(ii) invite the local community and other interested persons to submit to the municipality comments or representations in respect of the proposed public-private partnership; and

(c) solicit the views and recommendations of-

(i) the National Treasury;

(ii) the national department responsible for local government;

(iii) if the public-private partnership involves the provision of water, sanitation, electricity or any other service as may be prescribed, the responsible national department; and

(iv) any other national or provincial organ of state as may be prescribed.

(7) Part 1 of this Chapter applies to the procurement of public-private partnership agreements. Section 33 also applies if the agreement will have multi-year budgetary implications for the municipality within the meaning of that Section.

[Date of commencement of s. 120: 1 December 2004.]

2.4.5 Municipal Public-Private Partnership Regulations, conditions when entering partnerships

Municipal Public-Private Partnership Regulations, GN R309 in GG 27431 of 1 April 2005 [15] in terms of Section 168 of the MFMA, adds to the conditions to be complied with and processes to be followed when entering into public-private partnerships as set out in Section 120 of the MFMA:

2 Initiation of feasibility studies

(1) Before a municipality initiates a feasibility study for a public-private partnership contemplated in Section 120(4) of the Act, the accounting officer of the municipality must-

- *(a) notify the National Treasury and the relevant provincial treasury in writing of the municipality's intention, together with information on the expertise within the municipality to comply with that Section of the Act; and*
- *(b) if requested to do so by the National Treasury or the relevant provincial treasury, appoint a person with appropriate skills and experience, either from within or outside the municipality, as the transaction advisor to assist and advise the municipality on the preparation and procurement of the public-private partnership agreement.*

(2) Subregulation (1) also applies when a municipality in terms of Section 78(2) of the Municipal Systems Act explores the provision of a municipal service through an external mechanism to be appointed in terms of a public-private partnership agreement.

3 Additional matters to be addressed in feasibility studies

(1) A feasibility study conducted in terms of Section 120(4) of the Act, in addition to the matters specified in that Section, must-

- *(a) identify and define the activity which the municipality proposes to outsource to a private party;*
- *(b) assess the needs of the municipality in respect of such activity, including-*
  - *(i) the various options available to the municipality to satisfy those needs; and*
  - *(ii) the advantages and disadvantages of each option;*
- *(c) assess the projected impact of the proposed outsourcing of the activity to a private party on the staff, assets, liabilities and revenue of the municipality or a municipal entity under the sole or shared control of the municipality, which must include an assessment of-*
  - *(i) the number of officials of the municipality or such municipal entity that would become redundant as a result of the outsourcing of the activity;*
  - *(ii) the cost to the municipality or such municipal entity of any staff retrenchments or the retention of redundant staff;*
  - *(iii) any assets of the municipality or such municipal entity proposed to be placed under the control of the private party;*
  - *(iv) any assets of the municipality or such municipal entity that would become obsolete as a result of the outsourcing of the activity;*
  - *(v) any liabilities of the municipality or such municipal entity proposed to be assigned to the private party;*
  - *(vi) any debt of the municipality or such municipal entity attributed to the activity to be outsourced which the municipality or such municipal entity would retain; and*
  - *(vii) any revenue to be foregone by the municipality or such municipal entity as a result of the outsourcing of the activity; and*
- *(d) recommend an appropriate plan for the procurement of the proposed public-private partnership agreement, if outsourcing of the activity is the preferred option.*

(2) An assessment in terms of subregulation (1)(b) must show comparative projections of-

- *(a) the full costs to the municipality for the activity if that activity is not outsourced through a public-private partnership agreement; and*

15 Regulation 2 and 3 of GN R309 in GG 27431 of 1 April 2005

(b) the full costs to the municipality for the activity if that activity is outsourced through a public-private partnership agreement.

(3) Subregulations (1) and (2) need not be complied with if the activity which the municipality proposes to outsource is a municipal service in respect of which an assessment in terms of Section 78(3)(b) and a feasibility study in terms of Section 78(3)(c) of the Municipal Systems Act have already been carried out, provided that-

(a) such assessment and feasibility study cover the matters referred to in subregulations (1) and (2); and

(b) the documents reflecting the results of such assessment and feasibility study are included in the documents submitted to the council in terms of Section 120(6)(a) of the Act.

2.4.6 Analysis

The most stringent and most logical requirement is that a benefits evaluation or feasibility study is required before a public-private partnership arrangement can be procured.

In essence, the law requires that a municipality interested in outsourcing must show, though a feasibility study, if a public-private partnership is superior to an in-house approach to providing the service.

Feasibility studies are inherently subjective. Outside costs are difficult to predict while in-house costs can be underestimated or not fully counted and in-house efficiencies and capabilities are almost always overestimated. It is normal for government or for local government to set strategic objectives, or even concrete objectives such as the servicing of people or the building of houses, and not to achieve them in the estimated time. Failures in local government water services provision, as highlighted by the President, also show that municipalities are under-capacitated.

It would thus be an easy matter, if it so wished, for a municipality to determine through a feasibility study that services could be provided cheaper in-house than through external mechanisms.

A municipality politically motivated to provide services through in-house mechanisms will therefore almost inevitably find that the in-house mechanism is superior.

Moreover (and at this point deserves more attention) a municipality is <u>not required</u> to demonstrate that it can provide the service in-house better than any outsourcing alternative could do. If the municipality is not interested in outsourcing, the matter is not taken further.

This should be challenged.

2.4.7 Recommendations

A franchise operation providing water services or a sub-function of water services would comfortably fall within the definition of a MSP and would be an approach for which DPLG has a stated intention of preparing a supportive policy environment. It would thus be useful to gain DPLG's support for the franchise approach. It might also be considered whether the franchise approach could not be used for municipal activities other than water services.

To initiate the franchise process it would be wise to aim for establishing franchised support to a municipality through the relatively simple service contract or management contract rather than attempting a BOT or lease approach which is accompanied by far greater complication and much larger investment by the contractor.

It will also be easier to include an escape clause in a service contract or management contract if the franchise operation does not perform because the capital outlay is much less.

2.5 Policies, statutes and regulatory regime governing water boards

2.5.1 Water boards activities and duties

The Water Services Act[16] provides for, and in fact encourages, water boards to provide water services to municipalities:

> *29 Primary activity of water boards*
> *The primary activity of a water board is to provide water services to other water services institutions within its service area.*
> *[a108y1997s30]*
>
> *30 Other activities of water boards*
> *(1) A water board may perform an activity other than its primary activity only if-*
> *(a) it is not likely to limit the water board's capacity to perform its primary activity;*
> *(b) it is not likely to be to the financial prejudice of itself, any water services institution, existing consumers and other users serviced by it within its service area;*
> *(c) it is in accordance with the board's policy statement; and*
> *(d) it is provided for in a business plan.*
> *(2) Other activities of a water board may include, but are not limited to-*
> *(a) providing management services, training and other support services to water services institutions, in order to promote co-operation in the provision of water services;*
> *(b) supplying untreated or non-potable water to end users who do not use the water for household purposes;*
> *(c) providing catchment management services to or on behalf of the responsible authorities;*
> *(d) with the approval of the water services authority having jurisdiction in the area-*
> *(i) supplying water directly for industrial use;*
> *(ii) accepting industrial effluent; and*
> *(iii) acting as a water services provider to consumers;*
> *(e) providing water services in a joint venture with water services authorities; and*
> *(f) performing water conservation functions.*
> *(3) The Minister must, in consultation with the Minister of Finance, the Minister of Trade and Industry and the Minister of Public Enterprises and by notice in the Gazette, determine-*
> *(a) the nature of the activities that a water board may perform outside the borders of the Republic;*
> *(b) the countries in which such activities may be performed; and*
> *(c) the maximum amount of capital that a water board may take out of the Republic when an activity contemplated in subSection (4) is performed.*
> *[Sub-s. (3) added by s. 1 of Act 30 of 2004.]*
> *(4) The Minister may, in consultation with the Minister of Finance, authorise a water board to perform an activity outside the borders of the Republic.*
> *[Sub-s. (4) added by s. 1 of Act 30 of 2004.]*

16 Act 108 of 1997, s29, s30, s42

32 Duties of water boards
Every water board-

(a) must give priority to its primary activity;
(b) must enter into written contracts when performing its primary and other activities;
(c) must consider every request by a water services institution for the provision of water services within its service area and may only refuse such request if, for sound technical and financial reasons, it would not be viable to provide those water services;
(d) must provide water services and other services to water services institutions, consumers and users in accordance with Section 4 and any conditions set in terms of Section 33; and
(e) must obtain a permit, authorisation or licence from the relevant authority or abstracting water or discharging any effluent.

42 Different activities to be managed as separate units
(1) A water board must manage its primary activity and each of its other activities as separate units.
(2) A water board must maintain separate and itemised financial accounts for its primary activity and each of its other activities.
(3) All transactions between units of a water board engaged in different activities of the water board must be carried out on terms and conditions which could be expected to apply to similar transactions between unrelated businesses.

2.5.2 Analysis

While the provision of bulk services is the primary domain of water boards, it is clear from s32(c) above that water boards will not lightly be able to refuse assisting a WSA with the provision of water services, should they be so requested.

However, a number of water boards have expressed the opinion that the Municipal Systems Act S78 process (discussed in detail in Sections 3.5 and 3.6) is often used to deter any expanded participation of water boards in their area of jurisdiction. Whether this perception will be substantiated by the actual experiences of the DWAF-driven institutional reform programme will need to be closely monitored.

The national institutional reform programme entails a review of institutional arrangements at a regional level across South Africa by all concerned parties in order to develop optimal water supply institutions. This programme will result in a National Institutional Reform Strategy that may include the merging or disestablishment of some water boards and the establishment of new municipal owned institutions, depending on the findings.

The national institutional reform strategy is referred to in target 11 of the SFWS.

2.5.3 Recommendations

Some (by no means all) water boards could be in an excellent position to play the role of franchisor. Many boards have the required expertise in that they are already providing bulk and sometimes retail services to municipalities.

If it is decided to use water boards as MSPs or, in particular, as franchisors, then it would be necessary, before making a large investment in setting up water board to SMME franchise arrangements, to ascertain from SALGA and the WSAs that the involvement of water boards is welcome.

2.6 Contractual and legal arrangements between the municipality/WSA and the WSP

2.6.1 Introduction to Section 2.6

A sound contractual relationship between the municipality/WSA and the WSP is essential. Section 2.6 describes the legislative and regulatory requirements that the contracts must meet.

In sequence, going from the legislation to the regulations, and from requirements of all municipal services contracts to the requirements of water services contracts:

- the MFMA requirements for services contracts procured by municipalities (Section 2.6.2);
- additional requirements for public-private contracts set out in regulations in terms of MFMA (Section 2.6.3);
- the SFWS requirement that WSAs must have contracts with all their WSPs (Section 2.6.4);
- the Water Services Act requirement for contract provisions in WSA/WSP contracts (Section 2.6.5); and
- analysis and recommendations (Sections 2.6.6 and 2.6.7).

2.6.2 MFMA requirements for services contracts procured by municipalities

The Local Government Finance Management Act[17] (Act 56 of 2003) stipulates requirements for services (and goods) contracts procured by municipalities.

116 Contracts and contract management

(1) A contract or agreement procured through the supply chain management system of a municipality or municipal entity must-
  - *(a) be in writing;*
  - *(b) stipulate the terms and conditions of the contract or agreement, which must include provisions providing for-*
    - *(i) the termination of the contract or agreement in the case of non- or under-performance;*
    - *(ii) dispute resolution mechanisms to settle disputes between the parties;*
    - *(iii) a periodic review of the contract or agreement once every three years in the case of a contract or agreement for longer than three years; and*
    - *(iv) any other matters that may be prescribed.*

(2) The accounting officer of a municipality or municipal entity must-
  - *(a) take all reasonable steps to ensure that a contract or agreement procured through the supply chain management policy of the municipality or municipal entity is properly enforced;*
  - *(b) monitor on a monthly basis the performance of the contractor under the contract or agreement;*
  - *(c) establish capacity in the administration of the municipality or municipal entity-*
    - *(i) to assist the accounting officer in carrying out the duties set out in paragraphs (a) and (b); and*
    - *(ii) to oversee the day-to-day management of the contract or agreement; and*
  - *(d) regularly report to the council of the municipality or the board of directors of the entity, as may be appropriate, on the management of the contract or agreement and the performance of the contractor.*

[17] Act 56 of 2003, s116(1)

(3) A contract or agreement procured through the supply chain management policy of the municipality or municipal entity may be amended by the parties, but only after-
(a) the reasons for the proposed amendment have been tabled in the council of the municipality or, in the case of a municipal entity, in the council of its parent municipality; and
(b) the local community-
(i) has been given reasonable notice of the intention to amend the contract or agreement; and
(ii) has been invited to submit representations to the municipality or municipal entity.
[Date of commencement of s. 116: 1 December 2004.]

2.6.3 Municipal Public-Private Partnership Regulations, additional requirements for public-private contracts

The Municipal Public-Private Partnership Regulations[18] in terms of Section 168 of the MFMA set out additional (basic) requirements with which public-private agreements must comply:

5 Basic requirements to which public-private partnership agreements must comply
(1) A public-private partnership agreement between a municipality and a private party must-
(a) provide value for money to the municipality;
(b) be affordable for the municipality;
(c) describe in specific terms the nature of the private party's role in the public-private partnership;
(d) confer effective powers on the municipality-
(i) to monitor implementation of, and to assess the private party's performance under, the agreement;
(ii) to manage and enforce the agreement;
(e) impose financial management duties on the private party, including transparent processes relating to internal financial control, budgeting, accountability and reporting;
(f) provide for the termination of the agreement if the private party-
(i) fails to comply with terms or conditions of the agreement; or
(ii) deliberately provides incorrect or misleading information to the municipality;
(g) restrain the private party, for the full period of the agreement, from offering otherwise than in accordance with the agreement an employment, consultancy or other contract to a person-
(i) who is an official of the municipality or a municipal entity under the sole or shared control of the municipality; or
(ii) who was such an official at any time during a period of one year before the offer is made; and
(h) restrain the private party, for a period of three years, from offering an employment, consultancy or other contract to an employee of the municipality directly involved in the negotiation of the agreement;
(i) comply with Section 116(1) of the Act. (2) Any municipal employee participating in the negotiation of the public-private partnership agreement may not be employed by the private party in the public-private partnership for a period of three years.
9 Amendment of public-private partnership agreements

18 Regulation 5 and 9 of GN R309 in GG 27431 of 1 April 2005

(1) A public-private partnership agreement may be amended by the parties provided-
(a) Section 116(3) of the Act has been complied with; and
(b) the amendment is consistent with the basic essentials of public-private partnership agreements set out in regulation 5 and other applicable provisions of these Regulations.
(2) At least 60 days before a public-private partnership agreement is amended, the accounting officer must solicit the views and recommendations of the National Treasury and the relevant provincial treasury on the reasons for the amendment. The period may be shortened if the National Treasury and relevant provincial treasury respond earlier.

The Municipal Public-Private Partnership regulations[19] also place responsibility for monitoring the public-private agreements:

7 Project officers
(1) As soon as a municipality initiates a project that may be a public-private partnership, the accounting officer must appoint a person with appropriate skills and experience, either from within or outside the municipality, as the project officer for the public-private partnership.
(2) The project officer is responsible for performing-
(a) the duties set out in Section 116(2)(c)(i) and (ii) of the Act; and
(b) any other duties or powers delegated by the accounting officer to the project officer in terms of Section 79 of the Act.
8 Responsibilities of accounting officers
The accounting officer of a municipality which has entered into a public-private partnership agreement must, in addition to complying with Section 116(2) of the Act, take all reasonable steps to ensure-
(a) that the outsourced activity is effectively and efficiently carried out in accordance with the agreement;
(b) that municipal property which is placed under the control of the private party in terms of the agreement is appropriately protected against forfeiture, theft, loss, wastage and misuse; and
(c) that the municipality has contract management and monitoring capacity.

2.6.4 SFWS requirement that WSAs must have contracts with all WSPs

The SFWS[20] insists that all water services providers that provide water services to or on behalf of water services authorities must do so in terms of a service delivery agreement (contract) with the water services authority.

The SFWS[21] also insists that where water services providers provide retail services to consumers, they must do so in terms of a consumer charter and consumer contracts.

The SFWS[22] defines water services providers as:

19 Regulations 7 and 8 of GN R309 in GG 27431 of 1 April 2005
20 Strategic Framework for Water Services, September 2003, s3.1
21 Strategic Framework for Water Services, September 2003, s3.1
22 Strategic Framework for Water Services, September 2003,s3.3.2

- any person who has a contract with a water services authority or another water services provider to sell water to, and/or accept wastewater for the purposes of treatment from, that authority or provider (bulk water services provider); and/or
- any person who has a contract with a water services authority to assume operational responsibility for providing water services to one or more consumers (end users) within a specific geographic area (retail water services provider); or
- a water services authority that provides either or both of the above services itself.

The SFWS[23] places the following responsibilities on WSPs:

<u>Duty to provide water services</u>. *The main duty of water services providers is to provide water services in accordance with the Constitution, the Water Services Act and the by-laws of the water services authority, and in terms of any specific conditions set by the water services authority in a contract.*

<u>Effectiveness and efficiency</u>. *Water services providers must provide water services in an effective and efficient manner, striving to meet and exceed recognised best-practice benchmarks.*

<u>Consumer charter.</u> *All water services providers must publish a consumer charter which is consistent with by-laws and other regulations, is approved by the water services authority, and includes the duties and responsibilities of both the water services provider and the consumer, including the conditions of the supply of water services and payment.*

<u>Consumer relations.</u> *Water services providers must communicate the contents of the consumer charter with all consumers to whom they provide services. All water services providers must make themselves accessible to consumers and provide the necessary facilities to receive consumer payments, queries, complaints and suggestions for improvements.*
Consumer friendly billing. Water services providers must present consumers with accounts that are clear and easy to understand. Wherever practical the account should be presented in the consumer's home language.

2.6.5 Water Services Act contract provision requirements

The Water Services Act[24] lays down the contract provisions that must be in a contract between a WSA and a WSP.

23 Strategic Framework for Water Services, September 2003, s3.3.2
24 Act 108 of 1997, s19

Contracts and joint ventures with water services providers

19. (1) A water services authority-

(a) may perform the functions of a water services provider itself; and

(b) may-

(i) enter into a written contract with a water services provider; or

(ii) form a joint venture with another water services institution, to provide water services.

(5) The Minister may, after consultation with the Minister for Provincial Affairs and Constitutional Development, prescribe-

(a) matters which must be regulated by a contract between a water services provider and a water services authority;

(b) compulsory provisions to be included in such a contract; and

(c) requirements for a joint venture between a water services authority and a water services institution,

to ensure-

(i) that water services are provided on an efficient, equitable, cost-effective and sustainable basis;

(ii) that the terms of the contract are fair and equitable to the water services authority, the water services provider and the consumer; and

(iii) compliance with this Act.

(6) As soon as such a contract or join venture agreement has been concluded, the water services authority must supply a copy thereof to the relevant Province and to the Minister.

(7) The Minister may provide model contracts to be used as a guide for contracts between water services authorities and water services providers.

Water Services Provider Contract Regulations[25] have been promulgated under s19 of the Water Services Act, 1997 which set out the contents of WSP agreements. These regulations thus provide a scope or check list for the contractual relationship between the franchise operator and the municipality. The key points of these regulations are as follows:

Objects of contract

2. The contents of a contract must be consistent with –

(a) the main objects of the Act as determined in Section 2 of the Act; and

(b) provisions of the Local Government: Municipal Systems Act.

Scope of contract

3. A contract must describe the scope of the water services to be provided by the water services provider and must –

(a) set forth the manner in and the means by which any relevant portion of the water services development plan will be implemented;

(b) designate the contract area in which the water services are to be provided and determine a procedure by means of which the contract area may be changed;

(c) determine the conditions under which other water services providers, both within and outside the jurisdictional boundaries of the water services authority, may have access to and utilise any part of the water services works;

(d) describe the levels of service and standards of service to be provided which, if variable, shall be defined for different geographic areas in the contract area accompanied by

[25] GN R980 in GG 23636 of 19 July 2002, Regulations 2, to 25

specific requirements, including time frames and where appropriate, accompanied by a capital development plan to achieve the target levels of the service; and

(e) identify the water services works which shall form part of the contract and the process by which the water services provider gains access to such water services works.

Water use licence

4. A contract must set forth the obligations of each party to obtain any licence required for the use of water under Section 22(1) of the National Water Act, 1998 (Act No. 36 of 1998). [South Africa 1998]

Performance targets and indicators

5. A contract must provide for –

(a) performance targets and indicators developed after consultation with consumers, including those relating to the levels of service and standards of service to be achieved by the water services provider over fixed periods;

(b) periodic performance reviews; and

(c) a process whereby performance targets and indicators may be renegotiated in consultation with consumers.

Obligations of the Water Services Authority

A contract must set forth the obligations of the water services authority that are a necessary condition for the achievement by the water services provider of any performance target, including those relating to the achievement of any level of service or standard of service.

Cession

7. A contract must include a provision in terms of which the water services provider is prohibited from ceding any of its rights or assigning any of its obligations under the contract to any person without the prior permission of the water services authority.

Arrangements in respect of existing employees

8. A contract must provide for an arrangement in terms of which the existing employees of the water services authority involved in water services affected by the contract are to be managed in accordance with the employment law.

Commencement, amendment, breach and termination

9. A contract must provide for –

(a) the duration of the contract, which may not exceed a maximum of 30 years calculated from the date of signature of the contract;

(b) the manner and means by which the contract will be reviewed as part of the Integrated Development Planning process required under Chapter 5 of the Local Government: Municipal Systems Act;

(c) a procedure for earlier termination of the contract;

(d) notification by an aggrieved party to the other party of any breach of contract within a specified period and the legal remedies available to the aggrieved party where such breach of contract is not rectified within the period stated by the aggrieved party in its notification to the other party;

(e) a procedure upon the termination of the contract –

(i) for the efficient and orderly return of the water services works and any other assets, rights and obligations held by the water services provider under the contract, to the water services authority; and

(ii) for the settlement of all outstanding debts between the parties;

(f) the effect on the contractual rights and obligations of the parties in the event of force majeure;

(g) a procedure, should clearly prescribed circumstances have changed materially –

(i) for effecting an amendment to tariffs, remuneration or a modification of levels of

service or standards of service; and

(ii) that includes public disclosure of the amendments or modifications contemplated in subparagraph (i); and

(h) any specified penalties which may be applied by either party for non-performance.

Property rights

10. A contract must require that any plan, manual, data base, inventory, survey, financial and other record, and all other information compiled in terms of the contract shall remain the property of the water services authority.

Assets

11. A contract must –

(a) prohibit the disposal, alienation, or encumbrance of any existing or future immovable asset of a water services authority, including any component of the water services works, unless such disposal, alienation, or encumbrance is –

(i) provided for in the water services authority's development plan; or

(ii) approved by a council resolution of the water services authority;

(b) provide for the furnishing of asset management and maintenance plans to demonstrate that the water services works are being maintained in a reasonable condition in accordance therewith; and

(c) provide procedures for the procurement, disposal, alienation, and encumbrance of assets.

Financial

12. A contract must provide for a method by which the water services provider shall receive payment for its performance in terms of the contract and that method must –

(a) provide an incentive for the water services provider to perform efficiently and effectively;

(b) take into account the requirement for a reasonable rate of return on any investment made by the water services provider in terms of the contract and that rate of return must –

(i) be commensurate with the risks involved;

(ii) be based on information provided during the procurement process; and

(iii) when based on a price index or on a cost of capital, be specified and based on one that is readily available from a reputable source and regularly published;

(c) provide for the periodic financial review of the method; and

(d) provide for the sharing of any financial benefit to be achieved by the efficient and effective performance of the water services provider.

Consumer charter

13. Where the contract provides for the water services provider to provide services directly to consumers, a contract must –

(a) require a water services provider to prepare and publish a consumer charter that at least –

(i) fulfils the requirements for conditions for provision of water services as contemplated in Section 4 of the Act;

(ii) provides a system for dealing with consumers' complaints;

(iii) sets out a consumer's right to redress;

(iv) is consistent with the provisions of Section 95 of the Local Government: Municipal Systems Act; and

(b) provide for procedures to enable consumers in the contract area to participate in the preparation of the consumer charter, and must for that purpose provide for –

(i) public meetings and hearings that take into account the language preferences and usage in the contract area; and

(ii) the receipt, processing and consideration of comments and other inputs on the proposed charter by consumers.

Disclosure and monitoring

14. A contract must provide for the manner in and the means by which the water services authority must monitor the performance of the water services provider in order to comply with the provisions of Section 27 of the Act.

Information required by authority

15. A contract must provide for the water services provider to provide the water services authority with such information as may be reasonably required for the water services authority to monitor the contract and to comply with its obligations to report to the Minister and the Province on compliance by the water services provider with the Act and these Regulations.

Financial records

16. A contract must require the water services provider to –

(a) prepare and maintain financial records and statements in accordance with the Generally Accepted Accounting Practice publication adopted in the Republic of South Africa or, in the case of a sphere of government, in accordance with the relevant financial management legislation; and

(b) allow the water services authority access to all financial records and statements reasonably required for the monitoring and regulation of the contract.

Operational records

17. A contract must require a water services provider to prepare and maintain –

(a) a record of all existing and past consumers of water services dealt with in terms of the contract;

(b) an asset inventory including the condition and geographical location of all water services works covered by the contract; and

(c) a record of operations, maintenance, inspections and technical auditing.

Access to information

18. A water services provider must be required in terms of the contract to ensure access to such information as may be reasonably called for by a consumer or a potential consumer.

Annual reports

19. A contract must require a water services provider to annually publish at least –

(a) a report on performance against targets and indicators required under regulation 5;

(b) a situation report in respect of the appropriate Sections of the water services development plan;

(c) details of any penalties levied by either party for non-performance by the other party in terms of the contract or disputes that have arisen due to the alleged non-performance of either party;

(d) audited contract accounts of the water services provider; and

(e) the tariff rates and structure.

Warranties

20. A contract must set out any warranties or performance guarantees to be furnished by the water services provider in respect of its ability to fulfil its contractual obligations.

Insurance

21. A contract must set forth the nature and the level of insurance to be taken by the parties.

Dispute resolution

22. A contract must provide for a dispute resolution process.

Prevention of corruption

23. (1) A contract must require each party to identify and take all reasonable steps to prevent either party, its employees, its sub-contractors, its agents or anybody under its control from –

(a) causing to be received, receiving or agreeing to receive any payment, bribe, gift, gratuity or commission as an inducement or reward for doing or forbearing to do any action not provided for in a contract; or

(b) showing undue favour to any person in relation to a contract.

(2) A contract must provide for the disqualification of organisations entering into corrupt practices in accordance with conditions developed by the National Framework Agreement Sectoral Forum.

General

24. Should any of the provisions of subSection 19(2) of the Act or subSection 76(b), of the Local Government: Municipal Systems Act apply, a contract must record that there has been due compliance with subSections 19(2), 19(3) and 19(4) of the Act as well as Part 2 and Part 3 of Chapter 8 of the Local Government: Municipal Systems Act.

Law of the contract

A contract must require that the contract shall be governed and interpreted by the law of South Africa.

2.6.6 Analysis

It is evident that the contract between the municipality/WSA and a partner service provider is an important regulatory tool, and that this is the reason that it has received so much attention in legislation and in regulations.

There appears to be nothing in the requirements for the contract as set out in the above legislation and regulations that precludes the use of the franchise arrangement.

An additional contract, one that closes the loop between the franchisor and the WSA, will also need to be considered, as the WSA may require contractual assurance that the franchisee will be supported by strong management, and that the franchisor is able to make alternative arrangements that will ensure continuity of service should the franchisee fail to meet its contractual obligations to the WSA.

2.6.7 Recommendations

A sound contract between the WSA and the WSP is fundamental to the success of the contractual arrangement. Exactly when a service provider that only provides a clearly delineated sub-function of a WSP falls within the definition of a WSP will be debatable, but nevertheless it is also in the best interests of all contractors (including SMMEs and SMME franchisees) to WSPs that there is this sound contractual relationship. It is thus recommended that the regulations under s19 of the Water Services Act be complied with as far as they are relevant, even if it is only a sub-function of the water services provision that is being outsourced.

Should the WSP be a franchisee, how the contract includes the services of the franchisor would be novel to the municipality, and it is likely that no current standard or pro-forma contract would deal with such an arrangement.

Many municipalities that should consider water services franchising would not be capable of initiating suitable investigations. It is thus, inter alia, recommended that the current project consider drawing up pro-forma contracts, for example, a contract between a WSA and franchisee WSP, or at least drawing up those sections of the contract that are peculiar to a franchise arrangement. That would make it easier for the franchise route to be followed – if indeed franchising were appropriate and the WSA were willing in principle to consider franchising.

2.7 Contractual relationship between the franchisor and franchisee

2.7.1 Analysis

The importance of the contractual and legal arrangements between the municipality/WSA and the WSP is discussed in the previous section. If the WSP is a franchisee, then the contract between the franchisor and the franchisee (the "franchise agreement")) is also important.

Legislation could not be found that sets out the requirements for the franchisor-franchisee agreement. Agreements have however been the subject of much litigation, as is evidenced by the cases included in ***Annexure C***. Inevitably, these cases are drawn from outside the water services sector, as there is no experience of franchising within the water services sector in South Africa.

Company legislation and case law is large and complex. It is easy to overlook certain prohibitions when formulating a franchise arrangement. The franchise agreement must be fair and equitable to the franchisee but must also safeguard the franchisor from mal-performance of the franchisee.

2.7.2 Recommendations

Many municipalities that should consider water services franchising would not necessarily be fully capable of initiating suitable investigations. It is thus, inter alia, recommended that the current project consider drawing up a pro-forma franchise agreement for franchising in the water services sector. Were the current project to at least draw up a framework for such an agreement, this would give flesh to the franchising concepts being mooted, i.e. highlight the real challenges and make the concepts less abstract.

It is also recommended that firm selection criteria be developed for potential franchisees and that these criteria be rigidly applied. Rather no franchise arrangement than a problematic franchise arrangement.

2.8 Financial considerations

2.8.1 Introduction to Section 2.8

Financial issues surrounding municipalities are highly relevant to the sustainability of all municipal activities, among them those activities that could be outsourced, and these are discussed in Section 2.8.

In sequence:

- a general comment on financial viability of municipalities (Section 2.8.2);
- more detail on municipal revenue management (Section 2.8.3); and
- analysis and recommendations (Section 2.8.4 and 2.8.5).

2.8.2 Financial viability of municipalities

A highly significant challenge that water services partnerships will face is the financial viability of municipalities.

The SFWS highlights this current lack of financial viability of WSAs and WSPs as one of the motivations for the demarcation of municipalities that ended with the authorisation of municipalities who are WSAs, effective from 1 July 2003. According to the SFWS[26]:

> ***Financial viability***. *Some water services providers, as presently constituted, are not financially viable.*
>
> ***Under-investment***. *Poor revenue collection, rising input costs and downward pressure on retail water tariffs are placing many water services providers under financial pressure and are resulting in inadequate spending on maintenance and under-investment in rehabilitation. This will result in the deterioration of assets over time and a breakdown in service provision.*
> ***Revenue management***. *Late payment and poor rates of payment are critical issues for many water services providers in South Africa. The physical functions of service provision are separated from revenue management in the case of most municipal water services providers. This often hinders effective consumer and revenue management.*
>
> ***Financing***. *Considerable ongoing investment is required to expand and sustain water services infrastructure in South Africa. This investment is of both a social nature (to meet basic needs) and an economic nature (to meet economic demands). It is important that the water services sector has the ability to attract financing in the form of loans, bonds or equity particularly for investments necessary to meet economic demand. The development of financially strong water services providers will greatly assist in this.*
>
> ***Lack of capacity***. *The capacity required for effective water services provision is in short supply in many parts of the country, and particularly in rural areas. It is important, therefore, to make the best use of existing capacity, particularly in the light of potential losses in human resource capacity through HIV/Aids.*
>
> ***Inefficiencies and economies of scale***. *The current institutional framework for water services provision is highly fragmented, with a substantial number of water services institutions acting as water services providers. These include district and local municipalities, water boards, municipal entities, national government, water user associations, community-based organisations and private companies. This fragmentation may result in the loss of economies of scale, duplication of administration and technical functions, inability to attract and retain good management and technical staff, and inability to invest in the development and training of specialist skills.*

To this list so crisply set out in the SFWS can be added the challenge to the municipality of providing free basic water and free basic sanitation, especially where the majority of the users fall within the category of being entitled to receive free services.

Revenue management is considered in more detail immediately below.

[26] Strategic Framework for Water Services, September 2003, s3.4.1

2.8.3 Municipal revenue management

Before assessing municipal revenue management, as measured by the extent of the municipal arrears, it is important to note that capital expenditure is on average (for all South African municipalities) 18% of total municipal expenditure.

Budgeted total expenditure from budgets submitted to National Treasury by all municipalities for **2004/05** is as follows:

Table 2:1: Operational and capital budgeted municipal expenditure

	Operational budget (R'000)	**Capital budget (R'000)**	
E Cape	7,231,070	2,223,423	
Free State	4,186,989	659,315	
Gauteng	29,238,902	4,764,911	
KZN	13,971,899	4,052,955	
Limpopo	2,834,782	997,056	
Mpumalanga	2,816,836	626,123	
North West	3,072,260	823,109	
N Cape	1,543,338	387,129	
W Cape	15,335,623	2,519,078	
Total	**80,231,699**	**17,053,099**	**97,284,798**
	82%	**18%**	**100%**

Note: The information in this and the following tables is stored on the National Treasury data base. A report on municipal finance will be issued by National Treasury later in 2006.

Many municipalities, especially those furthest away from the major urban areas, are primarily dependent for their operating income on subsidies and grants and other forms of transfer from national and provincial government (especially Equitable Share). However, most municipalities are heavily dependent on service charges and property assessment rates (the latter including the rent portion "in lieu of rates" in respect of properties owned by the municipality and rented out by it – in particular low-income housing estates).

The table below shows the importance of service charges and rates for the operational funding of municipal services:

Sources of operational funding from budgets submitted by all municipalities to National Treasury for 2004/05 are as follows:

Table 2:2: Sources of municipal operational budgets

Source of operational funding	**R '000**	**%**
Water	10,686,067	13%
Sanitation	2,739,145	3%
Regional levies	5,728,064	7%
Property rates	15,653,351	19%
Electricity	22,622,325	27%
Refuse removal	2,803,005	3%
Other income	11,947,670	14%
Sub-total: property rates, service charges and other income	**72,179,627**	**86%**

Subsidies and grants (mostly transfers from other spheres of government)	**12,078,966**	**14%**
Total	**84,258,593**	**100%**

However, most municipalities are not nearly recovering the levels of internal funding budgeted for. The percentage and amount of debtors over 90 days of the better managed municipalities who are sufficiently capacitated to actually report to National Treasury are shown in the table below. It is noticeable that even the Metros have a serious problem with arrears. It can be assumed that arrears over 90 days are not going to be recovered. It is also noticeable that Tshwane Metro was one of those municipalities unable to report on arrears.

Water arrears and total municipal account arrears at June 2004/05 by municipal debtors are[27]: (Table 2.3 reflects two years' worth of arrears, as most municipalities write off arrears after two years)

Table 2:3: Municipal account arrears

	Actual water service charges for the year (R '000)	**Water arrears over 90 days (R '000)**	**Water arrears over 90 days as percent of annual water charges**	**Total arrears over 90 days (not only water) (R '000)**
Eastern Cape				
Nelson Mandela	244,703	228,535	93%	698,194
Buffalo City	146,368	119,825	82%	306,897
Free State				
Mangaung	189,723	164,105	86%	367,886
Gauteng				
Ekurhuleni	1,015,016	1,284,403	127%	5,809,020
City Johannesburg	2,758,899	3,599,186	130%	7,818,727
City Tshwane		Could not report		
KZN				
eThekwini	1,195,586	434,806	36%	1,961,730
Umhlathuze	73,605	9,280	13%	36,253
Mpumalanga				
Emalahleni	22,812	67,848	297%	242,924
Steve Tshwete	26,370	5,200	20%	23,391
Mbombela	7,881	13,390	170%	105,230
North West				
Rustenburg	168,605	166,687	99%	403,673

27 Based on June 2004/05 reporting by selected municipalities to National Treasury on municipal in-year outcomes

Western Cape				
Cape Town	903,210	1,190,635	132%	3,094,174
Swartland	30,734	1,931	6%	6,975
Drakenstein	32,251	24,886	77%	98,186
Knysna	24,129	10,001	41%	25,234
Total reported	6,839,892	7,320,718	107%	20,998,494

The reported arrears do not include the substantial amounts already written off by municipalities since 1994. It can be extrapolated that the arrears written off over a 10-year period by this sample of municipalities alone probably exceeds R100 bn. It is clear that the level of arrears is totally unacceptable.

It can be assumed that most municipalities who did not report on their in-year outcomes and those that did report but could not include figures have more severe unpaid debtor problems. For example City of Tshwane was not able to report on arrears as they have implemented a new financial system and it can be assumed that the municipality also has a high level of arrears due to reported billing problems.

The ± R20 bn level of arrears reported as outstanding for longer than 90 days for the above selection of better performing municipalities is thus likely to be a substantial underestimate of the national arrear situation.

2.8.4 Analysis

Financial unsustainability of a municipality is a likely obstacle to any proposed outsourcing arrangement. If it doesn't have the funds to pay all of its expenses, payments to contractors would probably be among the last to be addressed. Another problem might be that it does have the funds, but cannot administer its finances properly, including that it is unable to process invoices and pay them on time.

Even if the outsourcing is actually assisting the municipality to reduce costs and/or improve revenue, such as by improved cost recovery (and it would in any case not be advisable for contractors to rely on this), the contract will be at the mercy of the municipality's ability to manage costs and revenue, its ability to follow acceptable accounting and payment procedures, and its political will to recover costs through user charges.

The municipalities most needing the assistance that partnerships can bring are probably those least capacitated. This lack of capacity could even lead to a municipality defaulting on its payment obligations, despite that the partnership arrangement, by reducing costs and increasing revenue, could (if only it were permitted to do so) contribute to the financial sustainability of the municipality.

2.8.5 Recommendations

Any contractor considering whether to bid for an outsourcing contract needs to consider if the municipality can meet its payment obligations. Unless the municipality can, outsourcing will be a non-starter.

2.9 Chapter 2 conclusions

2.9.1 Introduction to Section 2.9

Of the preceding sections in Chapter 2, only Section 2.7 is specific to franchising. Because the policy and legislation discussed makes no specific mention of franchising, or even of SMMEs, these sections make no mention of them either – other than that made in the comment, analysis or recommendation at the end of each section, where the relevance to SMMEs and franchising of the material just presented in that section is discussed.

This section, Section 2.9, however, focuses specifically on the implications for franchising of the policies, statutes, legal issues, financial issues and regulations discussed in this Chapter 2.

The context throughout Section 2.9 is water services operation and management – not the ownership of water services infrastructure. The reason for this is clearly set out in Section 2.2.3. Government has expressed its opposition to private sector ownership of existing water services infrastructure. And ownership of, and the capital funding of, new infrastructure of any significance is clearly beyond the capability of SMMEs, including franchisee SMMEs.

2.9.2 There appears to be nothing in policy, legislation or regulations preventing franchising of part of water services operation and management, and much that would be permissive of it

The key principles set out in all of the (national) policies, statutes, legislation and regulations set out in this chapter are not incompatible with the institutional vision of franchising. Furthermore, a franchise option providing water services operation and management (not ownership) or that of a sub-function of water services would comfortably fall within the definition of a MSP and would be an approach for which DPLG has a stated intention of preparing a supportive policy environment.

Summing up, **there appears to be nothing in national policies and legislation that would prevent franchising of part of water services, and much that would be permissive of it.** (But note Section 2.9.7's caution, below, on financial grounds.)

The review of policy, legislation and regulations shows that, rather than prevent private sector participation in water services operation and management, detailed procedures have been legislated how such participation should be approached and contracted. These policies, legislation and regulations would apply equally to a franchised arrangement. That franchising is hardly ever, if at all, mentioned in these, is no more than a reflection of the fact that water services franchising has not hitherto been drawn to the attention of national government.

To initiate the franchise process it would be wise to aim for establishing franchised support to a municipality through the relatively simple service contract or management contract, rather than attempting a BOT or lease approach which is accompanied by far greater complication and much larger investment by the contractor.

A SMME standalone or SMME franchise approach will have to be cost-competitive and just as well regulated as other approaches to providing water services. One cannot argue that, because of the other merits of SMMEs or CBOs, drawing them into the water services operation can justify higher costs or substandard work.

2.9.3 Regulation

The water services audit as set out in the "Compulsory national standards and measures to conserve water"[28], gazetted as regulations under s9 of the Water Services Act, 1997 have never been enforced by DWAF.

This water services audit could be a key facilitator of regulation by DWAF. Also, the information it would provide could be used to benchmark the service provider options being used (how they are actually performing in practice), with a view to measuring alternative service provider options against them. Specifically, the water services audit would provide an objective way of measuring the performance (and nationally monitoring this) of in-house options as opposed to standalone SMME options as opposed in turn to SMME franchise options.

2.9.4 Consider water boards as franchisors

Some (by no means all) water boards could be in a good position to play the role of franchisor. Many boards have the required expertise in that they are already providing bulk and sometimes retail services to municipalities.

If it is decided to use water boards as MSPs or, in particular, as franchisors, then it would be necessary to confirm with the specific WSA, and with SALGA, that the involvement of water boards is welcome.

2.9.5 Compile contractual frameworks and contracts suitable for franchise circumstances

A sound contract between the WSA and the WSP is fundamental to the success of the contractual arrangement. Exactly when a service provider that only provides a clearly delineated sub-function of a WSP falls within the definition of a WSP will be debatable, but nevertheless it is also in the franchisee's best interests to have a sound contractual relationship with the municipality.

Should the WSP be a franchisee, how the contract includes the services of the franchisor would be novel to the municipality, and it is likely that no current standard or pro-forma contract would deal with such an arrangement. Many municipalities that should consider water services franchising would not be fully capable of initiating suitable investigations. The current project should therefore consider drawing up pro-forma contracts, for example a contract between a WSA and franchisee WSP, or at least drawing up those sections of the contract that are peculiar to a franchise arrangement. It should also consider drawing up a pro-forma franchise agreement for franchising in the water services sector.

It is also recommended that firm selection criteria be developed for potential franchisees and that these criteria be rigidly applied.

2.9.6 Make information available to support easy feasibility study as part of procurement process

A benefits evaluation or feasibility study will be required before a public-private partnership arrangement can be procured. Municipalities do not have information on the potential benefits of a franchise operation. The current project should make such information available to municipalities, perhaps in the form of guidelines, in order that the franchise approach can be considered on its merits.

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[28] GN R509 in GG 22355 of 8 June 2001, regulation 10

2.9.7 Address poor municipal revenue management, and the need for a financial model

Lack of cost recovery by municipalities is a likely obstacle any outsourcing arrangement, franchising included.

Unless the franchisee is actually assisting with cost recovery (in which case over-optimism must be guarded against), it will be at the mercy of the municipality's political will to recover costs through user charges and also its ability to manage revenue.

It is recommended that the current project develop a financial model that can prove how or whether the municipality will be able to financially sustain the services provided by franchising. Unless a financial solution can be found, the franchise arrangement will be a non-starter.

2.9.8 Response to the argument for changes to legislation and regulations in order to make the statutory environment more favourable to SMMEs and particularly franchisee SMMEs

The analysis clearly shows that current legislation does not prejudice SMMEs. In fact the procurement legislation favours small procurements and the legislation sets out in detail the steps required to evaluate and procure the private sector.

The question therefore is not whether the legislation and regulations are favourable or not favourable. The real questions are:

- whether all of the legislation is absolutely necessary, or is the municipal sector not overregulated; and
- whether the legislation permits municipalities too readily not to have to go to the trouble of seriously considering alternatives to in-house.

The first of these is addressed here. The second is discussed in Section 2.9.9.

The current researchers consider that less regulation and not more regulation would often promote the participation of the private sector and in particular of SMMEs. Where the choice is between regulating and not regulating the latter route should be preferred.

Legislation that may have come to duplicate other legislation, or even conflict with it, such as those sections of the Water Services Act that have been included in a different form in the Municipal Systems Act and MFMA, should be harmonised, and redundancies eliminated.

It is also evident that much of the legislation pertaining to municipal services reads like a policy document or guideline manual rather than as essential, impliable, law. For example, the step by step outlines of procurement and contractual arrangements could have been better included in guidelines rather than in legislation and regulations. While there is a contrary argument that the poor capacity in some municipalities requires more detailed regulations, in this instance the validity of that argument is questionable.

2.9.9 The need for political leadership to view the utilisation of SMMEs as opportunity

As introduced above, the solution to the lack of private sector involvement might not lie with creating more legislation and regulations or in amending (other than scrapping all duplication or non-essential legislation) the already apparently permissive legislation, or in less legislation and regulations. It might instead lie with addressing the lack of SMME (and NGO) focus by the municipality, either through the municipality's lack of capacity or as a reflection of political bias. Experience with S78 studies shows that, where municipal bias is discernable, it is a bias towards developing in-house capacity and against the procurement of private sector and NGO providers and contractors. (Municipal attitudes will be further investigated in Phase 2 of this project.) This bias is evidently supported by organised labour.

The bias can only be addressed through clear political leadership. It cannot be addressed through additional legislation or regulations.

Specifically it is recommended that national political leadership should encourage every municipality to view outsourcing of operation of infrastructure as an opportunity to improve infrastructure service operation, and also as an opportunity:

- to plug leaks in the local economy (retaining income in the local economy);
- to develop human capital in the community (skills development focused on the needs of the local infrastructure);
- to facilitate the participation of the population in using the opportunities and stimulating the establishment of new businesses or the growth of existing ones; and
- to organise the network of local actors for preparing and elaborating projects and initiatives.

This approach is subscribed to in DPLG's Local Economic Development Guidelines of March 2005.

The establishment of local business associations and labour desks can also contribute towards local business development and local business retention around water service provision. (Labour desks are offices established in communities by local government, where labour or SMMEs can register their interest in being involved in municipal projects. This facilitates the procurement of local labour and local SMMEs by contractors and local government.)

However the possibility that these associations and desks can, like clubs, also bend towards the exclusive and create even more barriers to entry by SMMEs than already exist must be safeguarded against.

The SETAs also could have a role to play in skilling SMMEs.

The private sector thrives in an environment of low government interference. (How, for instance, could government have established the taxi network that developed in reaction to the clear commercial need of commuters?)

In a nutshell, the main recommendations of Chapter 2 are –

- that the already permissive legislation and regulations not be amended, other than that all relevant legislation and regulations should be regularly reviewed, that it be harmonised, and all that is non-essential be deleted; and
- that this approach of paring down the legislative environment should be supported by firm political leadership that drives municipalities, in the interest of improved service operation and developing local human capital, towards identifying all feasible opportunities for outsourcing, especially to local SMMEs (and NGOs).

3. Procurement

3.1 Purpose of Chapter 3

The pre-procurement and procurement legislation and regulations selected, and discussed in this chapter, are those which have the most impact on the procurement and regulation of private sector service providers by municipalities.

Legislation and regulations that do not impact directly on procurement, but fulfil water services operational functions (such as regulations relating to the quality of effluent that may be discharged by treatment works, or regulations that relate to the environment or water abstraction), are not considered in this chapter.

Chapter 3 is arranged as follows:

- legislation and regulations governing pre-procurement and procurement procedures are described and discussed (Section 3.2);
- labour considerations are described and discussed (Section 3.3); and
- Section 3.4 concludes the chapter.

Institution of Municipal Engineering of Southern Africa (IMESA) magazine recently published a good, if very brief and not specific to municipalities, summary of the framework for government's tender process. (Jacobs, 2006)

3.2 Legislation and regulations governing pre-procurement and procurement procedures

3.2.1 Pre-procurement feasibility described in Green Paper on MSPs

As indicated in Section 2.4, legislation requires that a municipality undertakes a feasibility study to compare the private sector option with an in-house option before procuring a partner, whether that be in terms of a public-private partnership or a public-public partnership.

The Green Paper on MSPs[29], 1999 describes the feasibility study required before appointing, or entering into an MSP:

> *An MSP feasibility study is an examination of a potential MSP project's technical and financial viability, its environmental sustainability, and its probable risks and benefits for the municipal council, service consumers, ratepayers, and other key stakeholders. A feasibility study will be more or less detailed and exhaustive, depending on the complexity of the proposed MSP. Councils may wish to prepare more detailed and exhaustive feasibility studies for simpler MSPs, if, for example, the MSP is one of the first being undertaken by the council, or one of the first in a particular sector in the municipality, or if it is politically controversial.*
>
> *The output of such a feasibility study should include data, analyses, and recommendations that are sufficient to guide a council's decisions regarding:*
>
> - *Whether the project is potentially viable as an MSP.*
> - *If the project appears not to be viable as an MSP, whether it should be restructured in some*

29 Green Paper on Municipal Services Partnerships, 1999; s4

way in order to enhance its viability as an MSP, or whether other means of service delivery should be considered.

- *If the project appears viable as an MSP, what form of MSP (public-public, public-private, or public-NGO/CBO) it should take, and what type of contractual arrangement (service contract, management contract, lease, BOT, or concession) is most appropriate.*

  Instead of selecting a particular form of MSP, the feasibility study may also recommend that the municipal council invites tenders from a variety of public and private service providers (including its own municipal department) in order to better determine what is the most effective proposal for delivering services and implementing the IDP.

3.2.2 Water Services Act pre-procurement requirements

The Water Services Act[30], 1997 sets out requirements that must be observed by WSA's before entering into contracts with private sector water services providers:

20(2) A water services authority may only enter into a contract with a private sector water services provider after it has considered all known public sector water services providers which are willing and able to perform the relevant functions.

20(3) Before entering into or renewing-

(a) a contract with a water services provider; or

(b) a joint venture with another water services institution other than a public sector water services institution which will provide services within the joint venture at cost and without profit, the water services authority must publicly disclose its intention to do so.

20(4) Any water services provider entering into a contract or joint venture with a water services authority must, before entering into such a contract or joint venture, disclose and provide information on-

(a) any other interests it may have, which are ancillary to or associated with the relevant water services authority; and

(b) any rate of return on investment it will or may gain by entering into such a contract or joint venture.

3.2.3 Municipal Systems Act pre-procurement requirements

Chapter 8 "Municipal services" (Section 73 et seq, and especially S76 to s82) of the Municipal Systems Act[31], 2000 is probably the most authoritative source of requirements that must be observed by municipalities in determining mechanisms for the provision of services. (For convenience, this set of requirements is elsewhere in the current report referred to as the "Section 78 procedure" or "Section 78 process".)

While this Act does not make reference in as many words to the private sector as an alternative service provider, Sections 77 and 78 lay down the procedure to be followed by a municipality when it is deciding upon "the appropriate mechanism to provide a municipal service". Issues to be taken into account include capacity of the municipality, direct and indirect costs and benefits of the alternatives, the likely impact on development and job creation in the municipality, and the views of the community and of organised labour. (Ibid Section 78).

30 Act 108 of 1997, s20

31 Act 32, 2000, s76 to s82

Provision of services (ss 76-82)

76 Mechanisms for provision of services

A municipality may provide a municipal service in its area or a part of its area through-

(a) an internal mechanism, which may be-

(i) a department or other administrative unit within its administration;

(ii) any business unit devised by the municipality, provided it operates within the municipality's administration and under the control of the council in accordance with operational and performance criteria determined by the council; or

(iii) any other component of its administration; or

(b) an external mechanism by entering into a service delivery agreement with-

(i) a municipal entity;

(ii) another municipality;

(iii) an organ of state, including

(aa) a water services committee established in terms of the Water Services Act, 1997 (Act 108 of 1997);

[Item (aa) substituted by s. 40 of Act 51 of 2002.]

(bb) a licensed service provider registered or recognised in terms of national legislation; and

(cc) a traditional authority;

(iv) a community based organisation or other non-governmental organisation legally competent to enter into such an agreement, or

(v) any other institution, entity or person legally competent to operate a business activity.

77 Occasions when municipalities must review and decide on mechanisms to provide municipal services

A municipality must review and decide on the appropriate mechanism to provide a municipal service in the municipality or a part of the municipality-

(a) in the case of a municipal service provided through an internal mechanism contemplated in Section 76, when-

(i) an existing municipal service is to be significantly upgraded, extended or improved;

(ii) a performance evaluation in terms of Chapter 6 requires a review of the mechanism; or

(iii) the municipality is restructured or re-organised in terms of the Municipal Structures Act;

(b) in the case of a municipal service provided through an external mechanism contemplated in Section 76, when-

(i) a performance evaluation in terms of Chapter 6 requires a review of the service delivery agreement;

(ii) the service delivery agreement is anticipated to expire or be terminated within the next 12 months; or

(iii) an existing municipal service or part of that municipal service is to be significantly upgraded, extended or improved and such upgrade, extension or improvement is not addressed in the service delivery agreement;

(c) when a review is required by an intervention in terms of Section 139 of the Constitution;

(d) when a new municipal service is to be provided;

(e) when requested by the local community through mechanisms, processes and procedures established in terms of Chapter 4; or

(f) when a review of its integrated development plan requires a review of the delivery mechanism.

[S. 77 substituted by s. 41 of Act 51 of 2002.]

78 Criteria and process for deciding on mechanisms to provide municipal services

(1) When a municipality has in terms of Section 77 to decide on a mechanism to provide a municipal service in the municipality or a part of the municipality, or to review any existing

mechanism-

(a) it must first assess-

(i) the direct and indirect costs and benefits associated with the project if the service is provided by the municipality through an internal mechanism, including the expected effect on the environment and on human health, well-being and safety;

(ii) the municipality's capacity and potential future capacity to furnish the skills, expertise and resources necessary for the provision of the service through an internal mechanism mentioned in Section 76 (a);

(iii) the extent to which the re-organisation of its administration and the development of the human resource capacity within that administration, as provided for in Sections 51 and 68, respectively, could be utilised to provide a service through an internal mechanism mentioned in Section 76 (a);

(iv) the likely impact on development, job creation and employment patterns in the municipality, and

(v) the views of organised labour; and

(b) it may take into account any developing trends in the sustainable provision of municipal services generally.

(2) After having applied subSection (1), a municipality may-

(a) decide on an appropriate internal mechanism to provide the service; or

(b) before it takes a decision on an appropriate mechanism, explore the possibility of providing the service through an external mechanism mentioned in Section 76 (b).

(3) If a municipality decides in terms of subSection (2) (b) to explore the possibility of providing the municipal service through an external mechanism it must-

(a) give notice to the local community of its intention to explore the provision of the municipal service through an external mechanism;

(b) assess the different service delivery options in terms of Section 76 (b), taking into account-

(i) the direct and indirect costs and benefits associated with the project, including the expected effect of any service delivery mechanism on the environment and on human health, well-being and safety;

(ii) the capacity and potential future capacity of prospective service providers to furnish the skills, expertise and resources necessary for the provision of the service;

(iii) the views of the local community;

(iv) the likely impact on development, job creation and employment patterns in the municipality; and

(v) the views of organised labour; and

(c) conduct or commission a feasibility study which must be taken into account and which must include-

(i) a clear identification of the municipal service for which the municipality intends to consider an external mechanism;

(ii) an indication of the number of years for which the provision of the municipal service through an external mechanism might be considered;

(iii) the projected outputs which the provision of the municipal service through an external mechanism might be expected to produce;

(iv) an assessment as to the extent to which the provision of the municipal service through an external mechanism will-

(aa) provide value for money;

(bb) address the needs of the poor;

(cc) be affordable for the municipality and residents; and

(dd) transfer appropriate technical, operational and financial risk;

(v) the projected impact on the municipality's staff, assets and liabilities;

(vi) the projected impact on the municipality's integrated development plan;

(vii) the projected impact on the municipality's budgets for the period for which an external mechanism might be used, including impacts on revenue, expenditure, borrowing, debt and tariffs; and

(viii) any other matter that may be prescribed.
[Sub-s. (3) substituted by s11(a) of Act 44 of 2003.]
(4) After having applied subSection (3), a municipality must decide on an appropriate internal or external mechanism, taking into account the requirements of Section 73(2) in achieving the best outcome.
(5) When applying this Section a municipality must comply with-
(a) any applicable legislation relating to the appointment of a service provider other than the municipality; and
(b) any additional requirements that may be prescribed by regulation.
(6) The national government or relevant provincial government may, in accordance with an agreement, assist municipalities in carrying out a feasibility study referred to in subSection (3) (c), or in preparing service delivery agreements.
[Sub-s. (6) added by s11(b) of Act 44 of 2003.]
79 Provision of services by municipality through internal mechanisms
If a municipality decides to provide a municipal service through an internal mechanism mentioned in Section 76 (a), it must-
(a) allocate sufficient human, financial and other resources necessary for the proper provision of the service; and
(b) transform the provision of that service in accordance with the requirements of this Act.
80 Provision of services through service delivery agreements with external mechanisms
(1) If a municipality decides to provide a municipal service through a service delivery agreement in terms of Section 76 (b) with-
(a) a municipal entity or another municipality, it may, subject to subSection (3), negotiate and enter into such an agreement with the relevant municipal entity or municipality without applying Part 3 of this Chapter;
(aA) a national or provincial organ of state, it may enter into such an agreement with the relevant organ of state without applying Part 3 of this Chapter; or
(b) any institution or entity, or any person, juristic or natural, not mentioned in paragraph (a) or (aA), it must apply Part 3 of this Chapter before entering into such an agreement with any such institution, entity or person.
(2) Before a municipality enters into a service delivery agreement with an external service provider it must establish a programme for community consultation and information dissemination regarding the appointment of the external service provider and the contents of the service delivery agreement. The contents of a service delivery agreement must be communicated to the local community through the media.
(3) *(a) Where a municipality decides to enter into a service delivery agreement with another municipality as contemplated by Section 76 (b) (ii), that other municipality must conduct or commission a feasibility study, which it must take into account, before the service delivery agreement is entered into.*
(b) The feasibility study referred to in paragraph (a), must include-
(i) an assessment on the impact on the budget of that other municipality, and on its assets, liabilities and staff expenditure, for each of the financial years that it intends to serve as an external service provider;
(ii) an assessment on whether it will be necessary to increase the number of staff to enable that other municipality to be an external service provider, and whether it will be necessary to transfer or second any staff from the appointing municipality to that other municipality;
(iii) an assessment on the ability of that other municipality to absorb any commitments, liabilities or employees involved, if and when the appointment as external service provider ends; and
(iv) any other relevant information as may be prescribed.
[S. 80 substituted by s. 12 of Act 44 of 2003.]
81 Responsibilities of municipalities when providing services through service delivery agreements with external mechanisms
(1) If a municipal service is provided through a service delivery agreement in terms of Section

76 (b), the municipality remains responsible for ensuring that that service is provided to the local community in terms of the provisions of this Act, and accordingly must-

(a) regulate the provision of the service, in accordance with Section 41;

(b) monitor and assess the implementation of the agreement, including the performance of the service provider in accordance with Section 41;

(c) perform its functions and exercise its powers in terms of Chapters 5 and 6 if the municipal service in question falls within a development priority or objective in terms of the municipality's integrated development plan;

(d) within a tariff policy determined by the municipal council in terms of Section 74, control the setting and adjustment of tariffs by the service provider for the municipal service in question; and

(e) generally exercise its service authority so as to ensure uninterrupted delivery of the service in the best interest of the local community.

(2) A municipality, through a service delivery agreement-

(a) may assign to a service provider responsibility for-

(i) developing and implementing detailed service delivery plans within the framework of the municipality's integrated development plan;

(ii) the operational planning, management and provision of the municipal service;

(iii) undertaking social and economic development that is directly related to the provision of the service;

(iv) customer management;

(v) managing its own accounting, financial management, budgeting, investment and borrowing activities within a framework of transparency, accountability, reporting and financial control determined by the municipality, subject to the Municipal Finance Management Act;

[Sub-para. (v) substituted by s13(a) of Act 44 of 2003.]

(vi) the collection of service fees for its own account from users of services in accordance with the municipal council's tariff policy in accordance with the credit control measures established in terms of Chapter 9;

(b) may pass on to the service provider, through a transparent system that must be subject to performance monitoring and audit, funds for the subsidisation of services to the poor;

(bA) must ensure that the agreement provides for a dispute-resolution mechanism to settle disputes between the municipality and the service provider;

[Para. (bA) inserted by s13(b) of Act 44 of 2003.]

(c) may in accordance with applicable labour legislation, transfer or second any of its staff members to the service provider, with the concurrence of the staff member concerned;

(d) must ensure continuity of the service if the service provider is placed under judicial management, becomes insolvent, is liquidated or is for any reason unable to continue performing its functions in terms of the service delivery agreement; and

(e) must, where applicable, take over the municipal service, including all assets, when the service delivery agreement expires or is terminated.

(3) The municipal council has the right to set, review or adjust the tariffs within its tariff policy. The service delivery agreement may provide for the adjustment of tariffs by the service provider within the limitations set by the municipal council.

(4) A service delivery agreement may be amended by agreement between the parties, except where an agreement has been concluded following a competitive bidding process, in which case an amendment can only be made after the local community has been given-

(a) reasonable notice of the intention to amend the agreement and the reasons for the proposed amendment; and

(b) sufficient opportunity to make representations to the municipality.

(5) No councillor or staff member of a municipality may share in any profits or improperly receive any benefits from a service provider providing a municipal service in terms of a service delivery agreement.

82.[S. 82 repealed by s. 14 of Act 44 of 2003.]

3.2.4 Comment and recommendations on s78 procedure

It is clear that the s78 process is only a barrier to employing the private sector to the extent that the municipality must make the effort to undertake the process before it can outsource operational responsibilities. It seems, however, that only a minority of municipalities are willing to make the effort. This topic is discussed further in Chapter 5.

There is no obligation on municipalities to ever make use of the process. The current researchers feel however that all municipalities should be encouraged to undertake a s78 in order to determine to what extent they are able to best carry out their responsibilities in-house – and thereafter to determine to what extent they should outsource as opposed to what extent they should use in-house service provider solutions. (In the context of this project, the responsibilities in question are their water services operation and management responsibilities.)

The s78 procedure is required when an external mechanism is under consideration for service provision. The question of what is an external mechanism is answered by the definitions of an internal mechanism in S76, i.e.

(a) an internal mechanism, which may be-

- *(i) a department or other administrative unit within its administration;*
- *(ii) any business unit devised by the municipality, provided it operates within the municipality's administration and under the control of the council in accordance with operational and performance criteria determined by the council; or*
- *(iii) any other component of its administration;*

However, in all or nearly all circumstances it is the responsibility of the municipality alone to decide whether it wishes to commence the "under consideration" of an external mechanism. If it feels that it is adequately discharging its responsibilities using in-house provider solutions, even if there is strong evidence that its performance is not adequate, that is where the matter generally rests.

Incidentally whereas the meaning of a "department or administrative unit" is sufficiently well understood to not require further definition, the meaning of a "business unit … operating within the municipality's administration" may cause interpretation problems. A case has been recounted by a consultant where "strict interpretation" was used by a municipality to justify its not having to undertaking a s78 analysis when choosing to employ a private sector organisation to support the administrative unit. In other words it would seem that in some instances municipalities have sought to bypass the s78 process when procuring a private sector service provider to provide only portions, albeit significant portions, of a service.

This approach may be short sighted. By denying themselves the opportunity to explore alternatives through an objective s78 process, these municipalities may have no reliable financial or information-supported rationale for determining the extent to which the service should be procured from the private sector, nor may these municipalities have thoroughly explored the impact on staff and institutional design. Proper arrangements for contract management may also not have been put in place. In other words by side-stepping the s78 process through strict interpretation of s76, the municipality may well prove to be adopting a sub-optimal and improperly structured institutional arrangement.

It is strongly recommended that municipalities should be encouraged to undertake thorough fact-based and impartial s78 studies whenever there are grounds to do so – for example if the municipality is underperforming, or if a private enterprise of substance makes an unsolicited bid to provide operational capacity. (This leaves open the question of how, without a s78 study being undertaken, the municipality itself determines that it is "underperforming" – or how those with an interest in assessing if the municipality is or isn't underperforming can determine this and bring it to the opinion of the municipality. This question is returned to in Chapter 5.)

On the other hand, it is not required in law (and the cost of doing the study would not justify the possible advantage) that a well-functioning municipality considering whether or not to use the private sector need undertake a full blown s78 if its intention is to outsource only a small portion of a service, such as procuring an external laboratory to test water,. A very focused feasibility study, covering the implications of procuring only that small component from the private sector, would suffice.

3.2.5 Municipal Systems Act competitive bidding procedure

The Municipal Systems Act[32] also sets out a competitive bidding procedure that must be followed in procuring an external service provider, if it is decided to follow the external provider route.

It is evident that a municipality is obliged to follow these procedures when procuring a private sector franchised operator. Given the current perception that corruption in municipal procurement is widespread, it is unlikely that this approach will be softened – not even in order to achieve special objectives such as easier procurement for SMMEs. (As is usual in procurement legislation, there is currently no shorter route for SMMEs.) (See also Section 3.2.14.)

Part 3: Service delivery agreements involving competitive bidding (ss 83-84)
83 Competitive bidding
(1) If a municipality decides to provide a municipal service through a service delivery agreement with a person referred to in Section 80 (1) (b), it must select the service provider through selection processes which-
(a) comply with Chapter 11 of the Municipal Finance Management Act;
[Para. (a) substituted by s. 15 of Act 44 of 2003.]
(b) allow all prospective service providers to have equal and simultaneous access to information relevant to the bidding process;
(c) minimise the possibility of fraud and corruption;
(d) make the municipality accountable to the local community about progress with selecting a service provider, and the reasons for any decision in this regard; and
(e) takes into account the need to promote the empowerment of small and emerging enterprises.
(2) Subject to the provisions of the Preferential Procurement Policy Framework Act, (Act 5 of 2000), a municipality may determine a preference for categories of service providers in order to advance the interest of persons disadvantaged by unfair discrimination, as long as the manner in which such preference is exercised does not compromise or limit the quality, coverage, cost and developmental impact of the services.
(3) The selection process referred to in subSection (1), must be fair, equitable, transparent, cost-effective and competitive, and as may be provided for in other applicable national legislation.
(4) In selecting a service provider a municipality must apply the criteria listed in Section 78 as well as any preference for categories of service providers referred to in subSection (2) of this Section.
84 Negotiation and agreement with prospective service provider
(1) After a prospective service provider has been selected, the municipality must on the basis of the bidding documents, and any addenda, amendments or variations thereto that were provided to all the bidders, negotiate the final terms and conditions of the service delivery agreement with the preferred service provider and, if successful, enter into such an agreement with the selected service provider on the terms and conditions specified in the bidding documents, as modified or supplemented in the negotiations, if such modifications

[32] Act No32, 2000, s83, 84

do not materially affect the bid in a manner which compromises the integrity of the bidding process.

(2) If the municipality and the selected service provider fail to reach agreement within a reasonable time allowed by the municipality for negotiations, the municipality may negotiate with the next-ranked prospective service provider.

(3) When a municipality has entered into a service delivery agreement it must-

(a) make copies of the agreement available at its offices for public inspection during office hours; and

(b) give notice in the media of-

(i) particulars of the service that will be provided under the agreement;

(ii) the name of the selected service provider, and

(iii) the place where and the period for which copies of the agreement are available for public inspection.

3.2.6 DWAF Consolidated Guideline for WSAs relating to selecting WSPs

The Department of Water Affairs and Forestry has published a "Consolidated guideline for water services authorities relating to selecting water services providers" (DWAF 2003). These guidelines amplify s78 to s81 of the Municipal Systems Act.

This states clearly that "service contracts" and "management contracts" (defined in Section 2.4.3 above) "are not WSP contracts", and it refers to the Green Paper in support of this view. In its view, they are therefore by implication not subject to s78. This point of view rests on the "important differentiation between appointing a water service provider and outsourcing certain activities". (DWAF 2003a: Section B.4.2.)

The requirement to apply Section 78 of the Municipal Systems Act relates to the definition of what is a 'municipal service'. Water services, as defined in the Draft White Paper for Water Services, are a municipal service and therefore the selection of the body to provide such water services (the WSP) must be undertaken in terms of Section 78. DWAF, in the Consolidated guideline, is in essence contending that service contracts and management contracts deal only with <u>part</u> of the water service. These contracts are therefore not considered to be water service provider contracts, and are thus not subject to the requirements of Section 78.

If the view of the Consolidated guideline and the Green Paper prevail, then the municipality does not, after all, have to go to the trouble of undertaking the s78 process before it can contemplate outsourcing management of its infrastructure or part thereof. This area hasn't yet been adequately tested in practice.

3.2.7 Requirements of the MFMA for contracts that have future budgetary implications

It is assumed that most franchise arrangements would be established for multi-year contracts, i.e. contracts which have budgetary implications that continue beyond the current financial year.

The MFMA[33] sets out requirements that must be complied with before municipalities may enter into contracts that have future budgetary implications:

[33] Act 56 of 2003, s33

33 Contracts having future budgetary implications

(1) A municipality may enter into a contract which will impose financial obligations on the municipality beyond a financial year, but if the contract will impose financial obligations on the municipality beyond the three years covered in the annual budget for that financial year, it may do so only if-

(a) the municipal manager, at least 60 days before the meeting of the municipal council at which the contract is to be approved-

(i) has, in accordance with Section 21A of the Municipal Systems Act-

(aa) made public the draft contract and an information statement summarising the municipality's obligations in terms of the proposed contract; and

(bb) invited the local community and other interested persons to submit to the municipality comments or representations in respect of the proposed contract; and

(ii) has solicited the views and recommendations of-

(aa) the National Treasury and the relevant provincial treasury;

(bb) the national department responsible for local government; and

(cc) if the contract involves the provision of water, sanitation, electricity, or any other service as may be prescribed, the responsible national department;

(b) the municipal council has taken into account-

(i) the municipality's projected financial obligations in terms of the proposed contract for each financial year covered by the contract;

(ii) the impact of those financial obligations on the municipality's future municipal tariffs and revenue;

(iii) any comments or representations on the proposed contract received from the local community and other interested persons; and

(iv) any written views and recommendations on the proposed contract by the National Treasury, the relevant provincial treasury, the national department responsible for local government and any national department referred to in paragraph (a) (ii) (cc); and

(c) the municipal council has adopted a resolution in which-

(i) it determines that the municipality will secure a significant capital investment or will derive a significant financial economic or financial benefit from the contract;

(ii) it approves the entire contract exactly as it is to be executed; and

(iii) it authorises the municipal manager to sign the contract on behalf of the municipality.

(2) The process set out in subSection (1) does not apply to-

(a) contracts for long-term debt regulated in terms of Section 46 (3);

(b) employment contracts; or

(c) contracts-

(i) for categories of goods as may be prescribed; or

(ii) in terms of which the financial obligation on the municipality is below-

(aa) a prescribed value; or

(bb) a prescribed percentage of the municipality's approved budget for the year in which the contract is concluded.

(3) (a) All contracts referred to in subSection (1) and all other contracts that impose a financial obligation on a municipality-

(i) must be made available in their entirety to the municipal council; and

(ii) may not be withheld from public scrutiny except as provided for in terms of the Promotion of Access to Information Act, 2000 (Act 2 of 2000).

(b) Paragraph (a) (i) does not apply to contracts in respect of which the financial obligation on the municipality is below a prescribed value.

(4) This Section may not be read as exempting the municipality from the provisions of Chapter 11 to the extent that those provisions are applicable in a particular case.

3.2.8 Tender requirements in accordance with the MFMA

The MFMA[34] also stipulates municipal procurement and tender requirements:

CHAPTER 11
GOODS AND SERVICES (ss 110-120)
Part 1
Supply chain management (ss 110-119)
110 Application of this Part

(1) This Part, subject to subSection (2), applies to-
- *(a) the procurement by a municipality or municipal entity of goods and services;*
- *(b) the disposal by a municipality or municipal entity of goods no longer needed;*
- *(c) the selection of contractors to provide assistance in the provision of municipal services otherwise than in circumstances where Chapter 8 of the Municipal Systems Act applies; and*
- *(d) the selection of external mechanisms referred to in Section 80 (1) (b) of the Municipal Systems Act for the provision of municipal services in circumstances contemplated in Section 83 of that Act.*

(2) This Part, except where specifically provided otherwise, does not apply if a municipality or municipal entity contracts with another organ of state for-
- *(a) the provision of goods or services to the municipality or municipal entity;*
- *(b) the provision of a municipal service or assistance in the provision of a municipal service; or*
- *(c) the procurement of goods and services under a contract secured by that other organ of state, provided that the relevant supplier has agreed to such procurement.*

(3) The disposal of goods by a municipality or municipal entity in terms of this Part must be read with Sections 14 and 90.

[Date of commencement of s110: 1 December 2004.]

111 Supply chain management policy
Each municipality and each municipal entity must have and implement a supply chain management policy which gives effect to the provisions of this Part.
[Date of commencement of s. 111: 1 December 2004.]

112 Supply chain management policy to comply with prescribed framework

(1) The supply chain management policy of a municipality or municipal entity must be fair, equitable, transparent, competitive and cost-effective and comply with a prescribed regulatory framework for municipal supply chain management, which must cover at least the following:
- *(a) The range of supply chain management processes that municipalities and municipal entities may use, including tenders, quotations, auctions and other types of competitive bidding;*
- *(b) when a municipality or municipal entity may or must use a particular type of process;*
- *(c) procedures and mechanisms for each type of process;*
- *(d) procedures and mechanisms for more flexible processes where the value of a contract is below a prescribed amount;*

[34] Act 56 of 2003, s110 to 119

(e) open and transparent pre-qualification processes for tenders or other bids;
(f) competitive bidding processes in which only pre-qualified persons may participate;
(g) bid documentation, advertising of and invitations for contracts;
(h) procedures and mechanisms for-
  (i) the opening, registering and recording of bids in the presence of interested persons;
  (ii) the evaluation of bids to ensure best value for money;
  (iii) negotiating the final terms of contracts; and
  (iv) the approval of bids;
(i) screening processes and security clearances for prospective contractors on tenders or other bids above a prescribed value;
(j) compulsory disclosure of any conflicts of interests prospective contractors may have in specific tenders and the exclusion of such prospective contractors from those tenders or bids;
(k) participation in the supply chain management system of persons who are not officials of the municipality or municipal entity, subject to Section 117;
(l) the barring of persons from participating in tendering or other bidding processes, including persons-
  (i) who were convicted for fraud or corruption during the past five years;
  (ii) who wilfully neglected, reneged on or failed to comply with a government contract during the past five years; or
  (iii) whose tax matters are not cleared by South African Revenue Service;
(m) measures for-
  (i) combating fraud, corruption, favouritism and unfair and irregular practices in municipal supply chain management; and
  (ii) promoting ethics of officials and other role players involved in municipal supply chain management;
(n) the invalidation of recommendations or decisions that were unlawfully or improperly made, taken or influenced, including recommendations or decisions that were made, taken or in any way influenced by-
  (i) councillors in contravention of item 5 or 6 of the Code of Conduct for Councillors set out in Schedule 1 to the Municipal Systems Act; or
  (ii) municipal officials in contravention of item 4 or 5 of the Code of Conduct for Municipal Staff Members set out in Schedule 2 to that Act;
(o) the procurement of goods and services by municipalities or municipal entities through contracts procured by other organs of state;
(p) contract management and dispute settling procedures; and
(q) the delegation of municipal supply chain management powers and duties, including to officials.

(2) The regulatory framework for municipal supply chain management must be fair, equitable, transparent, competitive and cost-effective.

[Date of commencement of s. 112: 1 December 2004.]

113 Unsolicited bids

(1) A municipality or municipal entity is not obliged to consider an unsolicited bid received outside its normal bidding process.

(2) If a municipality or municipal entity decides to consider an unsolicited bid received outside a normal bidding process, it may do so only in accordance with a prescribed framework.

(3) The framework must strictly regulate and limit the power of municipalities and municipal entities to approve unsolicited bids received outside their normal tendering or other bidding processes.

[Date of commencement of s. 113: 1 December 2004.]

114 Approval of tenders not recommended

(1) If a tender other than the one recommended in the normal course of implementing the supply chain management policy of a municipality or municipal entity is approved, the accounting officer of the municipality or municipal entity must, in writing, notify the Auditor-General, the relevant provincial treasury and the National Treasury and, in the case of a municipal entity, also the parent municipality, of the reasons for deviating from such recommendation.

(2) SubSection (1) does not apply if a different tender was approved in order to rectify an irregularity.

[Date of commencement of s. 114: 1 December 2004.]

115 Implementation of system

(1) The accounting officer of a municipality or municipal entity must-

(a) implement the supply chain management policy of the municipality or municipal entity; and

(b) take all reasonable steps to ensure that proper mechanisms and separation of duties in the supply chain management system are in place to minimise the likelihood of fraud, corruption, favouritism and unfair and irregular practices.

(2) No person may impede the accounting officer in fulfilling this responsibility.

[Date of commencement of s. 115: 1 December 2004.]

116 Contracts and contract management

(1) A contract or agreement procured through the supply chain management system of a municipality or municipal entity must-

(a) be in writing;

(b) stipulate the terms and conditions of the contract or agreement, which must include provisions providing for-

(i) the termination of the contract or agreement in the case of non- or under-performance;

(ii) dispute resolution mechanisms to settle disputes between the parties;

(iii) a periodic review of the contract or agreement once every three years in the case of a contract or agreement for longer than three years; and

(iv) any other matters that may be prescribed.

(2) The accounting officer of a municipality or municipal entity must-

(a) take all reasonable steps to ensure that a contract or agreement procured through the supply chain management policy of the municipality or municipal entity is properly enforced;

(b) monitor on a monthly basis the performance of the contractor under the contract or agreement;

(c) establish capacity in the administration of the municipality or municipal entity-

(i) to assist the accounting officer in carrying out the duties set out in paragraphs (a) and (b); and

(ii) to oversee the day-to-day management of the contract or agreement; and

(d) regularly report to the council of the municipality or the board of directors of the entity, as may be appropriate, on the management of the contract or agreement and the performance of the contractor.

(3) A contract or agreement procured through the supply chain management policy of the municipality or municipal entity may be amended by the parties, but only after-

(a) the reasons for the proposed amendment have been tabled in the council of the municipality or, in the case of a municipal entity, in the council of its parent municipality; and

(b) the local community-

(i) has been given reasonable notice of the intention to amend the contract or

agreement; and
(ii) has been invited to submit representations to the municipality or municipal entity.
[Date of commencement of s. 116: 1 December 2004.]

117 Councillors barred from serving on municipal tender committees
No councillor of any municipality may be a member of a municipal bid committee or any other committee evaluating or approving tenders, quotations, contracts or other bids, nor attend any such meeting as an observer.

118 Interference
No person may-
(a) interfere with the supply chain management system of a municipality or municipal entity; or
(b) amend or tamper with any tenders, quotations, contracts or bids after their submission.

119 Competency levels of officials involved in municipal supply chain management
(1) The accounting officer and all other officials of a municipality or municipal entity involved in the implementation of the supply chain management policy of the municipality or municipal entity must meet the prescribed competency levels.
(2) A municipality and a municipal entity must for the purposes of subSection (1) provide resources or opportunities for the training of officials referred to in that subSection to meet the prescribed competency levels.
(3) The National Treasury or a provincial treasury may assist municipalities and municipal entities in the training of officials referred to in subSection (1).
[Date of commencement of s. 119: 1 July 2006.]

3.2.9 Additional procurement requirements for public-private contracts, in the Municipal Public-Private Partnership Regulations

Additional procurement requirements for public-private contracts in Municipal Public-Private Partnership Regulations GN R309 in GG 27431 of 1 April 2005 in terms of Section 168 of the MFMA[35] set out further requirements for procuring public-private partnership agreements:

4 Procurement of public-private partnership agreements
(1) When complying with Part 1 of Chapter 11 of the Act, the accounting officer of the municipality must solicit the views and recommendations of the National Treasury and the relevant provincial treasury on-
(a) the proposed bid documentation at least 30 days before bids are publicly invited; and
(b) the evaluation of the bids received and of any preferred bidder at least 30 days before any award is made.
(2) An award of a public-private partnership agreement-
(a) may be made only after the process set out in Section 120(6) of the Act has been completed; and
(b) is subject to compliance with Section 33 of the Act.
(3) When complying with Section 120(6)(c)(i) of the Act, the municipality must specifically solicit the views and recommendations of the National Treasury on-

[35] Regulations 4, 6 and 10 of GN R309 in GG 27431 of 1 April 2005

(a) the proposed terms and conditions of the draft public-private partnership agreement;
(b) the municipality's plan for the effective management of the agreement after its conclusion; and
(c) the preferred bidder's-
(i) competency to enter into the public-private partnership agreement; and
(ii) capacity to comply with his or her obligations in terms of the public-private partnership agreement.
(4) A provincial treasury is a prescribed organ of state for purposes of Section 120(6)(c)(iv) of the Act, and when complying with this Section the municipality must specifically solicit the views and recommendations also of the relevant provincial treasury on the matters set out in paragraphs (a) to (c) of subregulation (3).
6 Signing of public-private partnership agreements
(1) Only the accounting officer of a municipality may sign a public-private partnership agreement on behalf of the municipality.
(2) The accounting officer may not sign a public-private partnership agreement unless Section 33 of the Act has been complied with.

10 Municipal entities
No municipal entity may initiate, procure or enter into a public-private partnership agreement on its own or on behalf of its parent municipality, but may be a party to a public-private partnership agreement initiated, procured and entered into by its parent municipality.

3.2.10 Additional procurement requirements in respect of the Municipal Supply Chain Management Regulations

Additional procurement requirements in respect of municipal supply chain management are set out in the Municipal Supply Chain Management Regulations[36] published in terms of Section 168 of the MFMA, Act 56 of 2003:

CHAPTER 1
ESTABLISHMENT AND IMPLEMENTATION OF SUPPLY CHAIN MANAGEMENT POLICIES
2 Supply chain management policies
(1) Each municipality and each municipal entity must in terms of Section 111 of the Act have and implement a supply chain management policy that-
(a) gives effect to-
(i) Section 217 of the Constitution; and
(ii) Part 1 of Chapter 11 and other applicable provisions of the Act;
(b) is fair, equitable, transparent, competitive and cost effective;
(c) complies with-
(i) the regulatory framework prescribed in Chapter 2 of these Regulations; and
(ii) any minimum norms and standards that may be prescribed in terms of Section 168 of the Act;
(d) is consistent with other applicable legislation;
(e) does not undermine the objective for uniformity in supply chain management systems between organs of state in all spheres; and
(f) is consistent with national economic policy concerning the promotion of investments

[36] GN R868 of 2005 in GG 27636 of 30 May 2005, Chapter 1

and doing business with the public sector.

(2) The supply chain management policy of a municipal entity must, in addition to complying with subregulation (1), and to the extent determined by the parent municipality, also be consistent with the supply chain management policy of the parent municipality. If the supply chain management policy of an entity is not consistent with the supply chain management policy of its parent municipality, the council of the parent municipality must take appropriate steps to ensure consistency.

(3) No municipality or municipal entity may act otherwise than in accordance with its supply chain management policy when-

(a) procuring goods or services;

(b) disposing of goods no longer needed;

(c) selecting contractors to provide assistance in the provision of municipal services otherwise than in circumstances where Chapter 8 of the Municipal Systems Act applies; or

(d) in the case of a municipality, selecting external mechanisms referred to in Section 80(1)(b) of the Municipal Systems Act for the provision of municipal services in circumstances contemplated in Section 83 of that Act.

(4) Subregulations (1), (2) and (3) do not apply in the circumstances described in Section 110(2) of the Act except where specifically provided otherwise in these Regulations.

3 Adoption and amendment of supply chain management policies

(1) The accounting officer of a municipality or municipal entity must-

(a) promptly prepare and submit a draft supply chain management policy complying with regulation 2 to the council of the municipality or the board of directors of the municipal entity for adoption;

(b) at least annually review the implementation of the policy; and

(c) when the accounting officer considers it necessary, submit proposals for the amendment of the policy to the council or the board of directors.

(2) (a) The accounting officer may for purposes of subregulation (1)(a) make use of any Treasury guidelines determining standards for municipal supply chain management policies, and submit to the council or board of directors that guideline standard, or any modified version thereof, as a draft policy.

(b) If the accounting officer submits a draft policy to the council or board of directors that differs from the guideline standard, the accounting officer must ensure that such draft policy complies with regulation 2.

(c) The accounting officer must report any deviation from the guideline standard to the National Treasury and the relevant provincial treasury.

(3) When preparing or amending its supply chain management policy, a municipality or municipal entity must take account of the need for uniformity in supply chain practices, procedures and forms between organs of state in all spheres, particularly to promote accessibility of supply chain management systems for small businesses.

(4) The accounting officer of a municipality must in terms of Section 62(1)(f)(iv) of the Act, and the accounting officer of a municipal entity must in terms of Section 99(2)(h) of the Act, take all reasonable steps to ensure that the municipality or municipal entity has and implements a supply chain management policy as set out in regulation 2.

4 Delegation of supply chain management powers and duties

(1) The council of a municipality and the board of directors of a municipal entity must delegate such additional powers and duties to the accounting officer so as to enable the accounting officer-

(a) to discharge the supply chain management responsibilities conferred on accounting officers in terms of-

(i) Chapter 8 or 10 of the Act; and

(ii) the supply chain management policy of the municipality or municipal entity;

(b) to maximise administrative and operational efficiency in the implementation of the supply chain management policy;
(c) to enforce reasonable cost-effective measures for the prevention of fraud, corruption, favouritism and unfair and irregular practices in the implementation of the supply chain management policy; and
(d) to comply with his or her responsibilities in terms of Section 115 and other applicable provisions of the Act.

(2) Sections 79 and 106 of the Act apply to the subdelegation of powers and duties delegated to an accounting officer in terms of subregulation (1).

(3) No municipal council, board of directors of a municipal entity or accounting officer may delegate or subdelegate any supply chain management powers or duties-
(a) in the case of a municipality-
(i) to a person who is not an official of the municipality; or
(ii) to a committee which is not exclusively composed of officials of the municipality; or
(b) in the case of a municipal entity-
(i) to a person who is not an official of the municipal entity; or
(ii) to a committee which is not exclusively composed of officials of the municipal entity.

(4) This regulation may not be read as permitting an official to whom the power to make final awards has been delegated, to make a final award in a competitive bidding process otherwise than through the committee system provided for in regulation 26.

5 Subdelegations

(1) An accounting officer may in terms of Section 79 or 106 of the Act subdelegate any supply chain management powers and duties, including those delegated to the accounting officer in terms of regulation 4(1), but any such subdelegation must be consistent with subregulation (2) and regulation 4.

(2) The power to make a final award-
(a) above R10 million (VAT included) may not be subdelegated by an accounting officer;
(b) above R2 million (VAT included), but not exceeding R10 million (VAT included), may be subdelegated but only to-
(i) the chief financial officer;
(ii) a senior manager; or
(iii) a bid adjudication committee of which the chief financial officer or a senior manager is a member; or
(c) not exceeding R2 million (VAT included) may be subdelegated but only to-
(i) the chief financial officer;
(ii) a senior manager;
(iii) a manager directly accountable to the chief financial officer or a senior manager; or
(iv) a bid adjudication committee.

(3) An official or bid adjudication committee to which the power to make final awards has been subdelegated in accordance with subregulation (2) must within five days of the end of each month submit to the official referred to in subSection (4) a written report containing particulars of each final award made by such official or committee during that month, including-
(a) the amount of the award;
(b) the name of the person to whom the award was made; and
(c) the reason why the award was made to that person.

(4) A written report referred to in subregulation (3) must be submitted-
(a) to the accounting officer, in the case of an award by-
(i) the chief financial officer;

(ii) a senior manager; or
(iii) a bid adjudication committee of which the chief financial officer or a senior manager is a member; or
(b) to the chief financial officer or the senior manager responsible for the relevant bid, in the case of an award by-
(i) a manager referred to in subregulation (2)(c)(iii); or
(ii) a bid adjudication committee of which the chief financial officer or a senior manager is not a member.

(5) Subregulations (3) and (4) do not apply to procurements out of petty cash.

(6) This regulation may not be interpreted as permitting an official to whom the power to make final awards has been subdelegated, to make a final award in a competitive bidding process otherwise than through the committee system provided for in regulation 26.

(7) No decision-making in terms of any supply chain management powers and duties may be delegated to an advisor or consultant.

6 Oversight role of council of municipality or board of directors of municipal entity

(1) The council of a municipality and the board of directors of a municipal entity must maintain oversight over the implementation of its supply chain management policy.

(2) For the purposes of such oversight the accounting officer must-
(a) (i) in the case of a municipality, within 30 days of the end of each financial year, submit a report on the implementation of the supply chain management policy of the municipality and of any municipal entity under its sole or shared control, to the council of the municipality;
(ii) in the case of a municipal entity, within 20 days of the end of each financial year, submit a report on the implementation of the municipal entity's supply chain management policy to the board of directors, who must then submit the report to the accounting officer of the parent municipality for submission to the council in terms of subparagraph (i); and
(iii) whenever there are serious and material problems in the implementation of the supply chain management policy, immediately submit a report to the council of the municipality or in the case of a municipal entity, to the board of directors, who must then submit the report to the accounting officer of the parent municipality for submission to the council.

(3) The accounting officer must, within 10 days of the end of each quarter, submit a report on the implementation of the supply chain management policy to the mayor of the municipality or the board of directors of the municipal entity, as the case may be.

(4) The reports of a municipality must be made public in accordance with Section 21A of the Municipal Systems Act. The reports of a municipal entity must be made public in a similar way.

12 Range of procurement processes

(1) A supply chain management policy must, subject to regulation 11(2), provide for the procurement of goods and services by way of-
(a) petty cash purchases, up to a transaction value of R2 000 (VAT included);
(b) written or verbal quotations for procurements of a transaction value over R2 000 up to R10 000 (VAT included);
(c) formal written price quotations for procurements of a transaction value over R10 000 up to R200 000 (VAT included); and
(d) a competitive bidding process for-
(i) procurements above a transaction value of R200 000 (VAT included); and
(ii) the procurement of long term contracts.

(2) A supply chain management policy may allow the accounting officer-
(a) to lower, but not to increase, the different threshold values specified in subregulation (1); or

(b) to direct that-
   (i) written or verbal quotations be obtained for any specific procurement of a transaction value lower than R2 000;
   (ii) formal written price quotations be obtained for any specific procurement of a transaction value lower than R10 000; or
   (iii) a competitive bidding process be followed for any specific procurement of a transaction value lower than R200 000.

(3) A supply chain management policy must state-
(a) that goods or services may not deliberately be split into parts or items of a lesser value merely to avoid complying with the requirements of the policy; and
(b) that when determining transaction values, a requirement for goods or services consisting of different parts or items must as far as possible be treated and dealt with as a single transaction.

19 Competitive bids

A supply chain management policy must specify-
a) that goods or services above a transaction value of R200 000 (VAT included) and long term contracts may be procured by the municipality or municipal entity only through a competitive bidding process, subject to regulation 11(2); and
b) that no requirement for goods or services above an estimated transaction value of R200 000 (VAT included), may deliberately be split into parts or items of lesser value merely for the sake of procuring the goods or services otherwise than through a competitive bidding process.

20 Process for competitive bidding

A supply chain management policy must provide procedures for a competitive bidding process for each of the following stages:
a) the compilation of bidding documentation;
b) the public invitation of bids;
c) site meetings or briefing sessions, if applicable;
d) the handling of bids submitted in response to public invitation;
e) the evaluation of bids;
f) the award of contracts;
g) the administration of contracts; and
h) proper record keeping.

21 Bid documentation for competitive bids

A supply chain management policy must determine the criteria to which bid documentation for a competitive bidding process must comply, and state that in addition to regulation 13 the bid documentation must-
a) take into account-
   i) the general conditions of contract;
   ii) any Treasury guidelines on bid documentation; and
   iii) the requirements of the Construction Industry Development Board, in the case of a bid relating to construction, upgrading or refurbishment of buildings or infrastructure;
b) include evaluation and adjudication criteria, including any criteria required by other applicable legislation;
c) compel bidders to declare any conflict of interest they may have in the transaction for which the bid is submitted;
d) if the value of the transaction is expected to exceed R10 million (VAT included), require bidders to furnish-
   i) if the bidder is required by law to prepare annual financial statements for auditing, their audited annual financial statements-

aa) for the past three years; or
bb) since their establishment if established during the past three years;

ii) a certificate signed by the bidder certifying that the bidder has no undisputed commitments for municipal services towards a municipality or other service provider in respect of which payment is overdue for more than 30 days;

iii) particulars of any contracts awarded to the bidder by an organ of state during the past five years, including particulars of any material non-compliance or dispute concerning the execution of such contract;

iv) a statement indicating whether any portion of the goods or services are expected to be sourced from outside the Republic, and, if so, what portion and whether any portion of payment from the municipality or municipal entity is expected to be transferred out of the Republic; and

e) stipulate that disputes must be settled by means of mutual consultation, mediation (with or without legal representation), or, when unsuccessful, in a South African court of law.

22 Public invitation for competitive bids

(1) A supply chain management policy must determine the procedure for the invitation of competitive bids, and must stipulate-

(a) that any invitation to prospective providers to submit bids must be by means of a public advertisement in newspapers commonly circulating locally, the website of the municipality or municipal entity or any other appropriate ways (which may include an advertisement in the Government Tender Bulletin); and

(b) the information a public advertisement must contain, which must include-

(i) the closure date for the submission of bids, which may not be less than 30 days in the case of transactions over R10 million (VAT included), or which are of a long term nature, or 14 days in any other case, from the date on which the advertisement is placed in a newspaper, subject to subregulation (2); and

(ii) a statement that bids may only be submitted on the bid documentation provided by the municipality or municipal entity.

(2) A supply chain management policy may allow the accounting officer to determine a closure date for the submission of bids which is less than the 30 or 14 days requirement, but only if such shorter period can be justified on the grounds of urgency or emergency or any exceptional case where it is impractical or impossible to follow the official procurement process.

(3) Bids submitted to the municipality or municipal entity must be sealed.

(4) Where bids are requested in electronic format, such bids must be supplemented by sealed hard copies.

23 Procedure for handling, opening and recording of bids

A supply chain management policy must determine the procedure for the handling, opening and recording of bids, and must-

(a) stipulate that bids-

(i) may be opened only in public; and

(ii) must be opened at the same time and as soon as possible after the period for the submission of bids has expired;

(b) confer on any bidder or member of the public the right to request that the names of the bidders who submitted bids in time must be read out and, if practical, also each bidder's total bidding price; and

(c) require the accounting officer-

(i) to record in a register all bids received in time;

(ii) to make the register available for public inspection; and

(iii) to publish the entries in the register and the bid results on the website of the municipality or municipal entity.

24 Negotiations with preferred bidders

(1) A supply chain management policy may allow the accounting officer to negotiate the final terms of a contract with bidders identified through a competitive bidding process as preferred bidders, provided that such negotiation-
  - *(a) does not allow any preferred bidder a second or unfair opportunity;*
  - *(b) is not to the detriment of any other bidder; and*
  - *(c) does not lead to a higher price than the bid as submitted.*

(2) Minutes of such negotiations must be kept for record purposes.

25 Two-stage bidding process

(1) A supply chain management policy may allow a two-stage bidding process for-
  - *(a) large complex projects;*
  - *(b) projects where it may be undesirable to prepare complete detailed technical specifications; or*
  - *(c) long term projects with a duration period exceeding three years.*

(2) In the first stage technical proposals on conceptual design or performance specifications should be invited, subject to technical as well as commercial clarifications and adjustments.

(3) In the second stage final technical proposals and priced bids should be invited.

26 Committee system for competitive bids

(1) A supply chain management policy must provide for-
  - *(a) a committee system for competitive bids consisting of at least-*
    - *(i) a bid specification committee;*
    - *(ii) a bid evaluation committee; and*
    - *(iii) a bid adjudication committee;*
  - *(b) the appointment by the accounting officer of the members of each committee, taking into account Section 117 of the Act; and*
  - *(c) an attendance or oversight process by a neutral or independent observer appointed by the accounting officer when this is appropriate for ensuring fairness and promoting transparency.*

(2) The committee system must be consistent with-
  - *(a) regulations 27, 28 and 29; and*
  - *(b) any other applicable legislation.*

(3) A supply chain management policy may allow the accounting officer to apply the committee system to formal written price quotations.

27 Bid specification committees

(1) A bid specification committee must compile the specifications for each procurement of goods or services by the municipality or municipal entity.

(2) Specifications-
  - *(a) must be drafted in an unbiased manner to allow all potential suppliers to offer their goods or services;*
  - *(b) must take account of any accepted standards such as those issued by Standards South Africa, the International Standards Organisation, or an authority accredited or recognised by the South African National Accreditation System with which the equipment or material or workmanship should comply;*
  - *(c) where possible, be described in terms of performance required rather than in terms of descriptive characteristics for design;*
  - *(d) may not create trade barriers in contract requirements in the forms of specifications, plans, drawings, designs, testing and test methods, packaging, marking or labelling of conformity certification;*
  - *(e) may not make reference to any particular trade mark, name, patent, design, type, specific origin or producer unless there is no other sufficiently precise or intelligible way of describing the characteristics of the work, in which case such reference must be*

accompanied by the words 'equivalent';
(f) must indicate each specific goal for which points may be awarded in terms of the points system set out in the supply chain management policy of the municipality or municipal entity; and
(g) must be approved by the accounting officer prior to publication of the invitation for bids in terms of regulation 22.
(3) A bid specification committee must be composed of one or more officials of the municipality or municipal entity, preferably the manager responsible for the function involved, and may, when appropriate, include external specialist advisors.
(4) No person, advisor or corporate entity involved with the bid specification committee, or director of such a corporate entity, may bid for any resulting contracts.

28 Bid evaluation committees
(1) A bid evaluation committee must-
(a) evaluate bids in accordance with-
(i) the specifications for a specific procurement; and
(ii) the points system as must be set out in the supply chain management policy of the municipality or municipal entity in terms of regulation 27(2)(f) and as prescribed in terms of the Preferential Procurement Policy Framework Act;
(b) evaluate each bidder's ability to execute the contract;
(c) check in respect of the recommended bidder whether municipal rates and taxes and municipal service charges are not in arrears; and
(d) submit to the adjudication committee a report and recommendations regarding the award of the bid or any other related matter.
(2) A bid evaluation committee must as far as possible be composed of-
(a) officials from departments requiring the goods or services; and
(b) at least one supply chain management practitioner of the municipality or municipal entity.

29 Bid adjudication committees
(1) A bid adjudication committee must-
(a) consider the report and recommendations of the bid evaluation committee; and
(b) either-
(i) depending on its delegations, make a final award or a recommendation to the accounting officer to make the final award; or
(ii) make another recommendation to the accounting officer how to proceed with the relevant procurement.
(2) A bid adjudication committee must consist of at least four senior managers of the municipality or municipal entity which must include-
(i) the chief financial officer or, if the chief financial officer is not available, another manager in the budget and treasury office reporting directly to the chief financial officer and designated by the chief financial officer;
(ii) at least one senior supply chain management practitioner who is an official of the municipality or municipal entity; and
(iii) a technical expert in the relevant field who is an official of the municipality or municipal entity, if the municipality or municipal entity has such an expert.
(3) The accounting officer must appoint the chairperson of the committee. If the chairperson is absent from a meeting, the members of the committee who are present must elect one of them to preside at the meeting.
(4) Neither a member of a bid evaluation committee, nor an advisor or person assisting the evaluation committee, may be a member of a bid adjudication committee.
(5) (a) If a bid adjudication committee decides to award a bid other than the one recommended by the bid evaluation committee, the bid adjudication committee must prior to awarding the bid-

> *(i) check in respect of the preferred bidder whether that bidder's municipal rates and taxes and municipal service charges are not in arrears; and*
> *(ii) notify the accounting officer.*
> *(b) The accounting officer may-*
> *(i) after due consideration of the reasons for the deviation, ratify or reject the decision of the bid adjudication committee referred to in paragraph (a); and*
> *(ii) if the decision of the bid adjudication committee is rejected, refer the decision of the adjudication committee back to that committee for reconsideration.*
> *(6) The accounting officer may at any stage of a bidding process, refer any recommendation made by the evaluation committee or the adjudication committee back to that committee for reconsideration of the recommendation.*
> *(7) The accounting officer must comply with Section 114 of the Act within 10 working days.*

3.2.11 Comment on the procurement and tendering legislation

The legislation is very detailed and very comprehensive, allowing for very little discretion on process by the individual municipality.

The question is not whether the legislation is correct or incorrect. The question is whether it is all required, and whether guidelines that could be adapted by the individual municipality in their own bylaws would not have been more appropriate.

The challenge faced by the law-maker is the vastly different capacities of the various municipalities. Even National Treasury categorises the capacity of municipalities into High, Medium, and Low. It appears that a belt and braces approach that suits the lowest capacitated municipality was followed.

However, aspirant PSPs would generally prefer uniformity. Because of the national nature of the regulations, they need not be concerned that each municipality will pass its own unique procurement, tendering and contracting regulations. The PSP need primarily match its business model to the national legislation and regulations, with only minor modifications for local bylaws, which will in any case have to be compatible with model bylaws issued by national government. On the other hand, this uniformity could be inhibitive of innovation and of unsolicited bidding.

3.2.12 Corrupt procurement practices

The Prevention and Combating of Corrupt Activities Act, 2004 (Act 12 of 2004) makes certain corrupt activities relating to the awarding of contracts[37] and the procuring and withdrawing of tenders[38] a criminal offence:

[37] Act 12 of 2004, s12
[38] Act 12 of 2004, s13

12 Offences in respect of corrupt activities relating to contracts

(1) Any person who, directly or indirectly-

(a) accepts or agrees or offers to accept any gratification from any other person, whether for the benefit of himself or herself or for the benefit of that other person or of another person; or

(b) gives or agrees or offers to give to any other person any gratification, whether for the benefit of that other person or for the benefit of another person-

(i) in order to improperly influence, in any way-

(aa) the promotion, execution or procurement of any contract with a public body, private organisation, corporate body or any other organisation or institution; or

(bb) the fixing of the price, consideration or other moneys stipulated or otherwise provided for in any such contract; or

(ii) as a reward for acting as contemplated in paragraph (a), is guilty of the offence of corrupt activities relating to contracts.

(2) Any person who, in order to obtain or retain a contract with a public body or as a term of such contract, directly or indirectly, gives or agrees or offers to give any gratification to any other person, whether for the benefit of that other person or for the benefit of another person-

(a) for the purpose of promoting, in any way, the election of a candidate or a category or party of candidates to the legislative authority; or

(b) with the intent to influence or affect, in any way, the result of an election conducted for the purpose of electing persons to serve as members of the legislative authority,

is guilty of an offence.

13 Offences in respect of corrupt activities relating to procuring and withdrawal of tenders

(1) Any person who, directly or indirectly, accepts or agrees or offers to accept any gratification from any other person, whether for the benefit of himself or herself or for the benefit of another person, as-

(a) an inducement to, personally or by influencing any other person so to act-

(i) award a tender, in relation to a contract for performing any work, providing any service, supplying any article, material or substance or performing any other act, to a particular person; or

(ii) upon an invitation to tender for such contract, make a tender for that contract which has as its aim to cause the tenderee to accept a particular tender; or

(iii) withdraw a tender made by him or her for such contract; or

(b) a reward for acting as contemplated in paragraph (a) (i), (ii) or (iii), is guilty of the offence of corrupt activities relating to procuring and withdrawal of tenders.

(2) Any person who, directly or indirectly-

(a) gives or agrees or offers to give any gratification to any other person, whether for the benefit of that other person or the benefit of another person, as-

(i) an inducement to, personally or by influencing any other person so to act, award a tender, in relation to a contract for performing any work, providing any service, supplying any article, material or substance or performing any other act, to a particular person; or

(ii) a reward for acting as contemplated in subparagraph (i); or

(b) with the intent to obtain a tender in relation to a contract for performing any work, providing any service, supplying any article, material or substance or performing any other act, gives or agrees or offers to give any gratification to any person who has made a tender in relation to that contract, whether for the benefit of that tenderer or for the benefit of any other person, as-

(i) an inducement to withdraw the tender; or

(ii) a reward for withdrawing or having withdrawn the tender, is guilty of the offence of

(i) award a tender, in relation to a contract for performing any work, providing any service, supplying any article, material or substance or performing any other act, to a particular person; or
(ii) upon an invitation to tender for such contract, make a tender for that contract which has as its aim to cause the tenderee to accept a particular tender; or
(iii) withdraw a tender made by him or her for such contract; or
(b) a reward for acting as contemplated in paragraph (a) (i), (ii) or (iii), is guilty of the offence of corrupt activities relating to procuring and withdrawal of tenders.
(2) Any person who, directly or indirectly-
(a) gives or agrees or offers to give any gratification to any other person, whether for the benefit of that other person or the benefit of another person, as-
(i) an inducement to, personally or by influencing any other person so to act, award a tender, in relation to a contract for performing any work, providing any service, supplying any article, material or substance or performing any other act, to a particular person; or
(ii) a reward for acting as contemplated in subparagraph (i); or
(b) with the intent to obtain a tender in relation to a contract for performing any work, providing any service, supplying any article, material or substance or performing any other act, gives or agrees or offers to give any gratification to any person who has made a tender in relation to that contract, whether for the benefit of that tenderer or for the benefit of any other person, as-
(i) an inducement to withdraw the tender; or
(ii) a reward for withdrawing or having withdrawn the tender, is guilty of the offence of corrupt activities relating to procuring and withdrawal of tenders.

3.2.13 Analysis

The legislation relating to procurement by local government has the following characteristics:

- There should be no undue influence (interference) by councillors in the bidding process;
- Corruption is outlawed;
- Procurement procedures must be developed and followed;
- All tenderers are evaluated against the same criteria;
- The use of the private sector must be motivated through a feasibility study.

A municipality must compile a supply chain management policy that, amongst others, provides procedures for a competitive bidding process for procurement of goods or services of above R200 000. The municipality must have a bid evaluation committee and a bid adjudication committee.

The supply chain management policy must be in accordance with the National Treasury Regulations. These regulations are very specific and are clearly aimed at transparent governance and anti-corruption.

3.2.14 Comment on possible preference for SMMEs

There is no scope for SMMEs to receive preferred treatment over other private sector organisations other than on grounds of race or gender, and in the sense that procurement of service providers offering services for contracts under R200 000 is simplified. (Procurement of service providers for all contracts of a value above R200 000, regardless of whether SMME, CBO or NGO, and BEE or not, must be in accordance with the regular procurement procedures.)

It was speculated at the outset of this project that the researchers might consider additional ways in which legislation could be changed to facilitate the procurement of SMMEs. A review of the legislation and especially the implied objects shows that this approach would be a non-starter. The legislation attempts to enable appointment of the most suitable and cost-effective provider. There is no realistic possibility that the legislation would be further changed to prefer SMMEs. SMMEs must compete on merit and cost (except on race and gender) against all comers. This would also be in the best interests of consumers, that the most effective and efficient approach is procured. It would be against the objectives of procurement legislation for it to be changed to prefer SMMEs.

The procurement of private sector service providers can be a long drawn out process, but might start with an urgent tender. Tenders for private sector providers are also not that frequent. The potential franchise arrangement, if there is one, will need to be ready to respond quickly to a tender but still have the endurance required to see out a protracted negotiation, or long periods between tenders. SMMEs aspiring to be MSPs undertaking multi-year operation and management contracts will need to have an existing portfolio of work. Times between tenders may be long, and after the flurry of the initial bid, final appointment can also take a long time (counted in months not days).

The current researchers support the approach of equity and transparency taken in these regulations. The private sector needs procurement rules to be uniform and certain. Once exceptions are made, whether for generic types such as NGOs, CBOs or SMMEs, and even more so if exceptions are made on individual case-by-case basis, the credibility of the procurement system is placed in jeopardy and the door is open for nepotism and other types of unethical behaviour that equate with corruption.

3.3 Labour considerations

Outsourcing to a MSP involves a shift of some direct responsibility for service delivery from a municipality to an MSP service provider. Such a shift can have an impact on municipal employees, including changes in the municipality's labour requirements, and changes in the organisation of work. Labour unions have expressed their concerns about the potential impact of MSPs on municipal employees and consumers of municipal services. They have also stressed the need for consultation with employees and their union representatives in the process of deciding whether and how to engage in public-private MSPs.

Before taking this discussion further, some background on the institutional structure of municipal labour relations, and the principal provision in labour legislation relating to consultation with labour, such as consultation around possible MSPs, is useful.

The South African Municipal Workers' Union (SAMWU) and the Independent Municipal and Allied Trade Union (IMATU) are the principal labour unions representing municipal employees in South Africa. Samwu, Imatu, and various municipal employers' organisations have reached an agreement on the constitution of the South African Local Government Bargaining Council (SALGBC). When its constitution is registered with the Registrar of Labour Relations, SALGBC will become the national bargaining council between the unions and the South African Local Government Association (SALGA), representing all municipal employers, including those employers who are not members of the organisations that are parties to the SALGBC.

Collective agreements between unions and employers reached at SALGBC set minimum salaries and terms and conditions for employment for municipal employees throughout South Africa. However, local union chapters retain the right to bargain with their municipal employers in the attempt to reach collective agreements that provide wages and terms and conditions of employment that exceed those reached at SALGBC.

The National Framework Agreement (NFA) of 1996 between government, the Congress of South African Trade Unions (Cosatu), the Federation of South African Labour Unions (FSATU), and the National Council of Trade Unions (NCTU) provides that, in the restructuring of public enterprises, organised labour in general and the employees of the relevant enterprises in particular, should participate in the formulation of the restructuring policy.

Labour Relations Act (Act No. 66 of 1995)

Section 84 of the Labour Relations Act, 1995 (LRA) requires municipal employers to "consult" but not negotiate with the affected employees regarding "restructuring the workplace", "changes in the organisation of work", or other matters with respect to which consultation is required by the relevant collective agreement. This provision of the LRA is sufficiently broad to require municipal councils to consult with affected municipal employees and their union representatives regarding most MSPs.

Section 85 of the LRA briefly describes the consultation process. The employer must consult and "attempt to reach consensus" with the workplace forum, if any (or, presumably the union representatives of the affected employees if there is no workplace forum) regarding these matters before implementing any such proposal. The employer must consider and respond to representations and alternative proposals put forward by the employees' representatives and, if it disagrees with them, state its reasons for disagreeing. If the employer and the employees or their representatives do not reach a consensus, the employer must follow any mutually agreed procedure to resolve the differences before implementing its proposal. In the absence of any such agreed procedure, or if that procedure does not result in agreement, the employer is free to go forward with its proposal. The LRA does not impose any time constraints on the consultation process.

The LRA also distinguishes between "consultation" and "joint decision-making" or negotiation. Section 86 of the LRA limits joint decision-making between employers (including municipal employers) and their employees to specified matters, such as disciplinary codes and procedures, and measures to protect and advance persons disadvantaged by unfair discrimination, unless otherwise required by a collective agreement. This list does not include workplace restructuring or any of the other matters for which consultation is required under Section 84.

Section 86 also describes the procedure for "joint decision-making". It requires unresolved matters either to be submitted to arbitration in terms of any agreed procedure, or to be referred to the Commission for Conciliation, Mediation and Arbitration (CCMA). If the matter remains unresolved by the CCMA conciliation procedure, the employer may request that the dispute be resolved through arbitration. Unlike the case of matters listed in Section 84 for which "consultation" is required, the employer is expressly enjoined from implementing its proposal for any matter described in Section 86 without having reached a consensus with the employees, or prevailing in arbitration.

Municipal councils have a constitutional mandate to ensure the delivery of municipal services, and are accountable to the electorate and to consumers regarding their service delivery decisions. Given that responsibility and accountability, the requirement of the LRA, Section 84 to "consult", rather than "negotiate", with employees regarding MSPs (to the extent the implementation of an MSP involves any of the matters listed in Section 84) is appropriate.

Municipal councils may be bound currently, or be bound in the future, by national or local collective agreements providing for consultation on matters in addition to those described in

Section 84 of the LRA, or for more extensive joint decision-making than is required by Section 86 of the LRA.

In the absence of contrary provisions in a collective agreement, the LRA permits municipal councils to determine the points in the MSP development process at which consultation with employees and their union representatives should begin, and when it has come to an end. Like other municipal council decisions, however, such decisions would be subject to constitutional and common law requirements of "fairness" and "reasonableness" (see Municipal council decision-making). Such municipal council decisions should also be made with the legislative purposes of the LRA in mind. Those purposes include:

- *Giving the effect to the right, under Article 23 of the Constitution, to "fair labour practices" (LRA, Section 1(a)).*
- *Promoting "employee participation in decision-making in the workplace" (LRA, Section 1(d)(iii)).*

Now returning to the topic of outsourcing service delivery.

In December 1998, Cosatu and Salga signed a Framework Agreement for Restructuring Municipal Service Provision (FARMSP) that sets out the broad policies and principles that will govern restructuring municipal service delivery. The FARMSP recognises the need for consultation by municipal councils with employees and organised labour at the local level in connection with municipal decision-making regarding MSPs. In terms of the FARMSP, government and labour have established a sectoral forum which will clarify certain outstanding matters regarding MSPs, and monitor compliance with the FARMSP. The DPLG has committed itself to ensuring that the basic provisions of the FARMSP, which are also set out in this policy document, are put into legislation.

3.4 Chapter 3 conclusions

3.4.1 Nothing in procurement legislation that prevents MSPs

There appears to be nothing in the (national) procurement legislation and regulations that prevents outsourcing to MSPs to provide or partially provide water services. In fact the legislation actually sets out the detailed procedure that should be followed in procuring services providers from the private sector.

A good case can be made that the sector is over-regulated, that legislation and regulations are at times ambiguous, and that the sheer quantity of regulation is itself an obstacle to efficient procurement. However, the low capacity of many municipalities was probably an important consideration for the law-makers when they decided to what extent procedures for procurement, tendering, contracting, etc. should be rigorously set out and regulated from a national level.

The s78 process is a barrier to outsourcing to the extent that the municipality must make the effort to undertake the process before it can consider outsourcing operation and management responsibilities. It seems, however, that only a minority of municipalities are willing to make the effort.

The current researchers nonetheless feel that all municipalities should be encouraged to undertake s78 processes in order to determine to what extent they should outsource and to what extent they can use in-house service provider solutions. By declining to explore alternatives through an objective s78 process, these municipalities are denying themselves the opportunity to obtain a reliable financial- or information-supported rationale for determining the extent to which the service should be outsourced.

3.4.2 Resistance to the private sector

Legal cases (see Annexure E) show that the SAMWU on principle invariably resists any "privatisation" of municipal service provision on the grounds that it could lead to retrenchment of its members or other loss of benefits. SAMWU defines privatisation very broadly.

Many councillors are also not comfortable with procuring the private sector to operate and manage municipal services, especially basic services. It is understood that this is a major reason why investigations, such as the s78 process, are not more often undertaken.

Strong political leadership will be required to address this problem.

3.4.3 SMME perspective

Nothing of significance (other than preference at the smaller end of contract sizes) could be discovered that differentiates in law or regulation between MSPs of various sizes or types. Those doors that are open (or closed) to private sector procurement make no specific mention of SMMEs, much less of SMME franchisees.

Granted that there will be the occasional exception, it is generally unlikely that many WSP functions will be totally procured from the private sector. It is more realistic to assume that sub-functions of the provider function (e.g. billing, water meter reading and replacement, pipeline repair, etc.) may be procured from the private sector, rather than the whole provider function.

If ease of procurement is an important consideration (and it is), provisions to enhance or increased SMME participation in water services provision should most readily be tailored to these sub-functions of the provider function and not to the whole provider function, even in a small area. The barriers to entry to undertaking these sub-functions are also less as regards upfront bidding and establishment costs.

SMMEs aspiring to be services contractors will need to have an existing portfolio of work and/or financial staying power. Times between tenders may be long, and after the flurry of the initial bid, final appointment can also take a long time.

4. BEE and LED issues

4.1 The purpose of Chapter 4

The purpose of Chapter 4 is to summarise current legislation on Black Economic Empowerment (BEE), Local Economic Development (LED) and SMME development, and to explore their implications (if any) for water services franchising.

4.2 Legislation governing BEE

4.2.1 Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000)

The aim of the Preferential Procurement Policy Framework Act is as follows:

> *To give effect to Section 217 (3) of the Constitution by providing a framework for the implementation of the procurement policy contemplated in Section 217 (2) of the Constitution; and to provide for matters connected therewith.*

The framework[39] for implementing a preferential procurement policy is as follows:

> *2 Framework for implementation of preferential procurement policy*
>
> *(1) An organ of state must determine its preferential procurement policy and implement it within the following framework:*
>
> *(a) A preference point system must be followed;*
>
> *(b) (i) for contracts with a Rand value above a prescribed amount a maximum of 10 points may be allocated for specific goals as contemplated in paragraph (d) provided that the lowest acceptable tender scores 90 points for price;*
>
> *(ii) for contracts with a Rand value equal to or below a prescribed amount a maximum of 20 points may be allocated for specific goals as contemplated in paragraph (d) provided that the lowest acceptable tender scores 80 points for price;*
>
> *(c) any other acceptable tenders which are higher in price must score fewer points, on a pro rata basis, calculated on their tender prices in relation to the lowest acceptable tender, in accordance with a prescribed formula;*
>
> *(d) the specific goals may include-*
>
> *(i) contracting with persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender or disability;*
>
> *(ii) implementing the programmes of the Reconstruction and Development Programme as published in Government Gazette 16085 dated 23 November 1994;*
>
> *(e) any specific goal for which a point may be awarded, must be clearly specified in the invitation to submit a tender;*
>
> *(f) the contract must be awarded to the tenderer who scores the highest points, unless objective criteria in addition to those contemplated in paragraphs (d) and (e) justify the award to another tenderer; and*
>
> *(g) any contract awarded on account of false information furnished by the tenderer in order to secure preference in terms of this Act, may be cancelled at the sole discretion of the organ of state without prejudice to any other remedies the organ of state may have.*
>
> *(2) Any goals contemplated in subSection l (e) must be measurable, quantifiable and monitored for compliance.*

39 Act 5 of 2000, s2

4.2.2 Broad-Based Black Economic Empowerment Act, 2003 (Act 53 of 2003)

The objectives[40] of the Act are as follows:

2 Objectives of Act

The objectives of this Act are to facilitate broad-based black economic empowerment by-

- *(a) promoting economic transformation in order to enable meaningful participation of black people in the economy;*
- *(b) achieving a substantial change in the racial composition of ownership and management structures and in the skilled occupations of existing and new enterprises;*
- *(c) increasing the extent to which communities, workers, cooperatives and other collective enterprises own and manage existing and new enterprises and increasing their access to economic activities, infrastructure and skills training;*
- *(d) increasing the extent to which black women own and manage existing and new enterprises, and increasing their access to economic activities, infrastructure and skills training;*
- *(e) promoting investment programmes that lead to broad-based and meaningful participation in the economy by black people in order to achieve sustainable development and general prosperity;*
- *(f) empowering rural and local communities by enabling access to economic activities, land, infrastructure, ownership and skills; and*
- *(g) promoting access to finance for black economic empowerment.*

The Act is implemented through the publication of various Codes[41] of Good Practice:

9 Codes of good practice

(1) In order to promote the purposes of the Act, the Minister may by notice in the Gazette issue codes of good practice on black economic empowerment that may include-

- *(a) the further interpretation and definition of broad-based black economic empowerment and the interpretation and definition of different categories of black empowerment entities;*
- *(b) qualification criteria for preferential purposes for procurement and other economic activities;*
- *(c) indicators to measure broad-based black economic empowerment;*
- *(d) the weighting to be attached to broad-based black economic empowerment indicators referred to in paragraph (c);*
- *(e) guidelines for stakeholders in the relevant sectors of the economy to draw up transformation charters for their sector; and*
- *(f) any other matter necessary to achieve the objectives of this Act.*

(2) A strategy issued by the Minister in terms of Section 11 must be taken into account in preparing any code of good practice.

(3) A code of good practice issued in terms of subSection (1) may specify-

- *(a) targets consistent with the objectives of this Act; and*
- *(b) the period within which those targets must be achieved*

(4) In order to promote the achievement of equality of women, as provided for in Section 9 (2) of the Constitution, a code of good practice issued in terms of subSection (1) and any targets specified in a code of good practice in terms of subSection (3), may distinguish between black men and black women.

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40 Act 53 of 2003, s2

41 Act 53 of 2003, s9, s10

> *(5) The Minister must, before issuing, replacing or amending a code of good practice in terms of subSection (1)-*
> *(a) publish the draft code of good practice or amendment in the Gazette for public comment; and*
> *(b) grant interested persons a period of at least 60 days to comment on the draft code of good practice or amendment, as the case may be.*
>
> *10 Status of codes of good practice*
> *Every organ of state and public entity must take into account and, as far as is reasonably possible, apply any relevant code of good practice issued in terms of this Act in-*
> *(a) determining qualification criteria for the issuing of licences, concessions or other authorisations in terms of any law;*
> *(b) developing and implementing a preferential procurement policy;*
> *(c) determining qualification criteria for the sale of state-owned enterprises; and*
> *(d) developing criteria for entering into partnerships with the private sector.*

The definitions[42] of black people and broad-based black economic empowerment are critical to the understanding of the Act:

> *1 Definitions*
> *In this Act, unless the context indicates otherwise-*
> - 'black people' is a generic term which means Africans, Coloureds and Indians;
> - 'broad-based black economic empowerment' means the economic empowerment of all black people including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies that include, but are not limited to-
>   *(a) increasing the number of black people that manage, own and control enterprises and productive assets;*
>   *(b) facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises;*
>   *(c) human resource and skills development;*
>   *(d) achieving equitable representation in all occupational categories and levels in the workforce;*
>   *(e) preferential procurement; and*
>   *(f) investment in enterprises that are owned or managed by black people;*

4.2.3 Comment on BEE and water services franchising

While the franchising concept has no specific bias, simply by virtue of the fact that franchising presents an excellent entry-level opportunity to aspirant entrepreneurs, it will be in due course be the basis for many back-owned small businesses. This is borne out by the experience of franchising in other sectors – some franchisors report that the majority of their franchise operations are black-owned.

When it comes to providing water services to municipalities, black-owned SMMEs would gain preferential points in municipal tendering, enhancing their competitiveness.

It can thus be argued that the franchise concept is fully compatible with BEE policy.

[42] ct 53 of 2003, s1

Care will however have to be taken to transparently declare the actual ownership composition of the franchisor-franchisee arrangement when tendering. This would need to be done in order to forestall potential later claims (by the municipality or by commercial opposition) that the franchise arrangement was used merely as a front to avoid disclosing the white management component of the franchisor in the tendering process. This may require the tenderer to add an alternative BEE score card reflecting that portion of the management of the supporting franchisor apportioned to the franchisee.

4.3 Local Economic Development Policy and SMME development

4.3.1 Policy guidelines on LED

LED is the process by which public, business and non-governmental sector partners (CBOs and NGOs) work collectively to create better conditions for local economic growth and employment generation.

LED policy at a local level is described in DPLG's "Policy Guidelines for implementing Local Economic Development in South Africa, March 2005" (DPLG 2005).

The Policy Guidelines[43] describes in the following terms how municipalities should achieve LED:

Developmental LED, which seeks to ensure that all sectors of the population derive benefit from LED actions, requires local actors to be innovative and to find new ways of dealing with development challenges. It is focused on the initiative of local actors and the mobilisation of local resources rather than being solely dependent on external investment and assistance. The key challenge for local actors is to be proactive and seize development opportunities, and tap into various government programmes and business networks. Local government must play a leading role in this process.

Whether or not a Local Economic Development Agency or similar body exists in the area of a Municipal District or Metro, every municipality should apply itself to ensuring, directly or indirectly, that the following [inter alia] is done as a sine qua non for LED:

- To render operational the local socio-economic environment in order to facilitate the creation and the development of local economic activities;
- Plugging the leaks in the local economy (retaining income in the local economy);
- Development of human capital (skills development focused on the needs of the local economy);
- Development of social capital (encouraging and developing the presence and capacity of all relevant collective stakeholders in the local economy: chambers of commerce, bodies building and grouping coops, NGOs , CBOs , development agencies, local tourism structures, etc.);
- Community economic development (community-based initiatives targeted at community businesses and cooperatives, municipal-community partnerships especially in respect of infrastructure and service delivery);
- SMME development (provision of business infrastructure, financial and non financial services, access to affordable finance and start up grants, technical support, involvement of SMMEs in government procurement **especially in relation to infrastructure delivery**) [emphasis added], with special reference for the part of the population which currently has limited access to these services;
- To identify and support business clusters and business opportunities;

43 Policy Guidelines for Local Economic Development, March 2005, pg 30

- To facilitate the participation of the population in using the opportunities and stimulating the establishment of new businesses or the growth of existing ones;
- To encourage the formation of appropriate partnership and coalition structures.
- To introduce preferential procurement policies aimed at broad-based black economic empowerment and promoting local suppliers and contractors.

4.3.2 Comment on LED and SMME development, and water services franchising

It is evident that government has as a LED objective and an objective of developing SMMEs through government procurement and especially in relation to infrastructure delivery in those areas where the population currently has limited access to these services.

The envisaged franchising partnership model would increase the potential for SMMEs to be procured by local government for work relating to the operations of water services, particularly water services serving those with limited access.

Water services franchising supports one of the key drivers of LED, i.e. SMME development, and is thus compatible with the objectives of the policy on LED.

5. Conclusions and recommendations

5.1 The sequence of Chapter 5

The sequence of Chapter 5 is as follows:

- So much legislation, etc. has been presented in the preceding three chapters, that it is useful to summarise their main points before drawing conclusions for the report as a whole. This is done in Section 5.2.

- Section 5.3 draws conclusions that are not specific to the franchising of water services, whereas Section 5.4 draws conclusions which are specific to the franchising of water services.

- Recommendations follow in the last section, Section 5.5.

To reiterate (from Sections 2.1 and 2.4.1) that:

- In the context of this report, the terms "WSA" and "municipality" can be used interchangeably unless specifically stated otherwise.
- In the context of this report, the terms "MSP" (municipal services partnership) and "PSP" or "PPP" (public-private partnership and, in some circumstances, public-public partnership) can be used interchangeably unless specifically stated otherwise.
- SMMEs can be outsourced to by WSAs directly or by WSPs. The latter, given the size and capacity of SMMEs, is much more likely. Nevertheless, where this report discusses outsourcing to SMMEs, reference to outsourcing by WSAs can be interchanged with reference to outsourcing by WSPs unless specifically stated otherwise.

5.2 Summary of the policies, statutes, legal issues, financial issues, regulations, etc., including procurement, BEE and preferential procurement, that could affect water services franchising

5.2.1 Chapter 2 deals with policies, statutes, regulations and financial issues

The following statutes, regulations and policies are those most relevant:

- The Water Services Act[44] governs the approval of WSPs and promotes access to information:

  The Water Services Act[45] provides for, and in fact encourages, water boards to provide water services to municipalities:

  In addition the Water Services Act provides requirements for a contract between a WSA and a WSP.

- Water Services Provider Contract Regulations[46], been promulgated under s19 of the Water Services Act, set out the contents of WSP agreements. These regulations thus provide a

[44] Act 108 of 1997, s22
[45] Act 108 of 1997, s29, s30, s42

scope or check list for the contractual relationship between the franchise operator and the municipality.

- Regulations Gazetted under s9 of the Water Services Act[47] provide for the annual submission of a water services audit by the WSA and is a key to regulation of water services by DWAF.

- The Strategic Framework for Water Services (SFWS) sets out the water services sector's vision, goals and targets as well as the institutional framework, the financial framework, the planning framework, national norms and standards, the regulatory framework and the support and monitoring framework. The SFWS recognises that a process of institutional reform is required. This reform process opens up a window of opportunity to explore different options for water services provision.

  The SFWS[48] insists that all WSPs that provide water services to or on behalf of WSAs must do this in terms of a service delivery agreement (contract) with the WSA.

  The SFWS[49] also insists that where WSPs provide retail services to consumers, they must do so in terms of a consumer charter and consumer contracts.

- S76 to s82 of the Municipal Systems Act is the most authoritative set of requirements that must be observed by municipalities in determining mechanisms for the procurement of service providers.

- DPLG compiled the Green Paper on Municipal Services Partnerships, 1999 in order to create a policy environment that enhances the viability and feasibility of MSP service delivery.

  The Green Paper on MSPs describes typical contractual arrangements between the Services Provider (in the case of water services, the WSP) and the municipality (in this case the WSA). Service contracts and management contracts can be relatively simple forms of MSP. BOTs and concessions are typically the most complex of MSP arrangements, and can impose heavy demands on a municipality's management and systems capacity. Even relatively simple forms of MSPs could deliver services cost-effectively, and may merit consideration.

- The Local Government Municipal Finance Management Act[50] (MFMA) stipulates conditions to be complied with and processes to be followed when entering into PPPs:

  The MFMA requires that a municipality must show, though a feasibility study, that a PPP is superior to an in-house approach to providing the service before entering into such a partnership.

  The MFMA[51] also stipulates requirements for services (and goods) contracts procured by municipalities.

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[46] GN R980 in GG 23636 of 19 July 2002, Regulations 2, to 25
[47] Act 108, 1997, s9
[48] Strategic Framework for Water Services, September 2003, s3.1
[49] Strategic Framework for Water Services, September 2003, s3.1
[50] Act 56 of 2003, s120
[51] Act 56 of 2003, s116(1)

- Municipal Public-Private Partnership Regulations[52] add to the conditions to be complied with and processes to be followed when entering into PPPs as set out in Section 120 of the MFMA.

  Additional requirements for public-private contracts are also set out in the regulations.

- The governance of companies is primarily regulated through under the Companies Act, 1973 (South Africa 1973). The Companies Act has established a Registrar of Companies and inspectors whose primary function is the regulation of companies.

For example, the Companies Act[53] prohibits certain arrangements (share ownership) and assistance (e.g. loans) between holding companies and their subsidiaries.

The Companies Act disqualifies certain persons from acting as directors of companies.

Financial considerations

A very significant challenge to outsourcing, especially outsourcing to SMMEs, is the financial state of many municipalities.

The SFWS[54] highlights the weak financial position of many WSAs. Financial viability played a role in determining which municipalities were declared WSAs, effective from 1 July 2003.

5.2.2 Chapter 3 deals with procurement

Legislation requires that a municipality undertakes a feasibility study to compare the private sector option with an in-house option before procuring a MSP. The main policies, legislation and regulations that guide procurement of providers are:

- The Water Services Act[55] sets out requirements that must be observed by WSAs before entering into contracts with private sector WSPs.

- The Department of Water Affairs and Forestry has published a consolidated guideline for WSAs relating to selecting WSPs. These guidelines amplify s78 to s81 of the Municipal Systems Act.

- The Green Paper on MSPs, 1999 describes the feasibility study required before appointing, or entering into an MSP.

- The Municipal Systems Act[56] sets out a competitive bidding procedure that must be followed in procuring an external service provider, if the decision is taken to follow the external provider route.

- The MFMA[57] sets out requirements that must be complied with before municipalities may enter into contracts that have future budgetary implications.

- Additional procurement requirements for public-private contracts are set out in Municipal Public-Private Partnership Regulations[58]

52 GN R309 in GG 27431 of 1 April 2005
53 Act 61 of 1973, s37 to s39
54 Strategic Framework for Water Services, September 2003, s3.4.1
55 Act 108 of 1997, s20
56 Act No 32, 2000, s83, 84
57 Act 56 of 2003, s33

- The Prevention and Combating of Corrupt Activities Act makes a criminal offence of certain activities relating to the awarding of contracts[59] and the procuring and withdrawing of tenders[60].

5.2.3 Chapter 4 deals with BEE and preferential procurement

The key legislation governing BEE and preferential procurement is:

- The Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000) which gives effect to Section 217 (3) of the Constitution by providing a framework for the implementation of the procurement policy contemplated in Section 217 (2) of the Constitution. (South Africa 2000b); and

- The Broad-Based Black Economic Empowerment Act, 2003 (Act 53 of 2003) which aims to promote economic transformation in order to enable meaningful participation of black people in the economy. (South Africa 2003).

5.3 Conclusions – not specific to the franchising of water services

The conclusions of the report with respect to the possible outsourcing and procurement of water services operation and management, but not specific to franchising, can be summarised as follows:

- There appears to be nothing in policy, legislation or regulations preventing outsourcing of water services operation and management, whether the outsourcing be a public-public partnership or a public-private partnership, or a partnership with a NGO or CBO.

- Simple service or management contracts are the easiest to procure and to contract.

- There are numerous requirements that must be met before any aspect of water services operation can be outsourced. Even simple municipal service or management contracts need to be procured in accordance with the legislation and regulations, and the fact that these contracts do not necessarily fall within DWAF's Water Services Act relatively narrow (compared to that in legislation originating from National Treasury and DPLG) definition of an all-encompassing WSP does not mean that they are not private sector MSPs or external providers in terms of s76 of the Municipal Systems Act.

- Legislation relating to procurement by municipalities mainly relates to procurement of private sector service providers. The rules relating to feasibility studies, etc. do not all apply where public sector providers are procured.

- Information must be made available to support the municipal feasibility study as part of the procurement process.

- The s78 process is only a barrier to outsourcing to the extent that the municipality must make the effort to undertake the process before it can consider outsourcing. It seems, however, that only a minority of municipalities feel they have to make the effort The current researchers nevertheless consider that all municipalities should be encouraged to undertake the s78 investigation in order to determine to what extent they are able to best

58 Regulations 4, 6 and 10 of GN R309 in GG 27431 of 1 April 2005
59 Act 12 of 2004, s12
60 Act 12 of 2004, s13

carry out their responsibilities in-house – and thereafter to determine to what extent they should outsource as opposed to what extent they should use in-house service provider solutions. By denying themselves the opportunity to explore alternatives through an objective s78 process, these municipalities may have no reliable financial or information-supported rationale for the decisions they need to take in the interests of improving services.

- A major potential source of information, and also a regulatory tool, is the water services audit which should be enforced by DWAF.

- Procurement of service providers offering services for contracts under R200 000 is simplified. However, procurement of service providers for all contracts of a value above R200 000, regardless of whether SMME, CBO or NGO, and BEE or not, must be in accordance with the municipality's supply chain management policies compiled in accordance with National Treasury regulations.

- Other than that, SMMEs would normally only be advantaged by the procurement policy if they have a substantial portion of black and/or female ownership.

- Company legislation gives important guidance for the screening of potential MSPs.

- The financial affairs of many municipalities are not in order. Many medium and low capacity municipalities are unable to report on their financial status. Inability to always follow acceptable accounting and payment procedures, including inability to process invoices and pay them on time, is much in evidence. Many municipalities are not able to recover all revenues due to them – sometimes they cannot even recover most of the revenues due to them. This does not bode well for private sector involvement in the provision of water services. Furthermore:
  - Private enterprises will only survive if they are paid.
  - If inability to process invoices and pay them on time presents considerable problems for outsourcing even to larger MSPs, it is a potentially fatal obstacle to procuring SMMEs, which have less (maybe minimal) financial resources and might be dependent on only a few clients or even on only one client.
  - It is also unlikely that the private sector will be able to collect revenue on behalf of the municipality if there is no political will to support such efforts.

- There are indications that the SAMWU will resist any so-called "privatisation" of municipal service provision. It would do this on the grounds that it could lead to retrenchment of its members or to downscaling due to higher private sector efficiencies. Case studies show that SAMWU's definition of "privatisation" is particularly broad and may include procurement regardless of whether infrastructure ownership or only the operation and management responsibility is transferred.

5.4 Conclusions – specific to the franchising of water services

The conclusions of the report specific to the franchising of water services can be summarised as follows:

- The policy, statutory, and regulatory regime with respect to water services franchising is a subset of the wider environment determining and controlling WSPs. Franchisees are SMMEs of a particular type, and SMMEs in turn are part of a wider private sector, so anything that affects outsourcing to the private sector would affect franchising as well.

- There appears to be nothing in policy, legislation or regulations preventing franchising of water services.

- That franchising is not specifically mentioned in the procurement-related material that is reviewed in the current report would seem to be only because national government has regarded it unnecessary to have specific provisions relating to franchising.

- DPLG, National Treasury and DWAF support will be required for the franchising approach.

- Some water boards could be in a good position to fulfil the role of franchisor.

- What is good or bad for SMMEs is good or bad for franchising. But the converse doesn't necessarily apply – or, putting it differently, a franchisee SMME, given the support it would receive from the franchisor, would in all likelihood find it easier to meet some regulatory, etc. requirements than would a standalone SMME, everything else being equal.
  - Meeting regulations with respect to quality and reliability of service is a good example. To illustrate, Section 4.3 of Report 1 describes how the franchisor can support a franchisee SMME's operating standards, and can also intervene directly if the franchisee fails to deliver.

- The franchise approach does have the potential to substantially lever up the black ownership component of the contractor through a real contribution by the franchisee, and is clearly not fronting.

5.5 Report recommendations

The recommendations of "WRC Report TT 432/3/10: Review of policy, regulation and legal aspects" can be summarised as follows:

- The National Treasury and DPLG legislation and regulations relating to procurement are aimed at transparent and equitable procurement and include anti-corruption measures, such as sequential approval responsibility for evaluation and adjudication committees, etc. There are also measures to depoliticise procurement, for example through barring councillors from membership of certain committees. This legislation is strongly supported.

- Nonetheless policies, legislation and regulation relating to procurement need to be harmonised.

- At present, the default option for a municipality is to deliver services in-house, and to not consider outsourcing. Should it wish to consider outsourcing, it has to initiate processes such as the Section 78 process. While it would be going too far to recommend at this time that each and every municipality be compelled to demonstrate, through such a process, that the in-house option is better than any alternative (and should it fail to do that, then it would have to outsource), there is a need to start a move away from the in-house option being the line of least resistance. At very least, municipalities should be compelled to assess the real costs of the in-house option, so that these costs can better be understood (and controlled).
  - It is understood that there are significant capacity constraints in most municipalities that would prevent them doing this kind of analysis at all, never mind doing it properly. On the other hand, if a municipality cannot even do the analysis, it probably cannot perform the service properly in-house either, and that should be good enough reason for investigating alternatives.

- The bias evident in many municipalities against the procurement of private sector, NGO and CBO WSPs cannot be addressed through legislation or regulations – it can only be addressed by clear political leadership.

- Thus national political leadership should encourage every municipality to view outsourcing of operation of infrastructure as an opportunity to improve infrastructure service operation, and also as an opportunity:
  - to plug leaks in the local economy (retaining income in the local economy);
  - to develop human capital in the community (develop skills focused on the needs of the local infrastructure); and
  - to facilitate the participation of communities in using the opportunities and stimulating the establishment of new businesses or the growth of existing ones.

- Means need to be found to support municipalities in their effort to procure and contract with private sector providers. Specific tools are mentioned at the end of the various chapters. Some of these tools, such as model contracts, could be specifically geared towards franchise arrangements, if the remainder of the current project provides grounds for believing that there is merit in the franchising approach. For example, contract clauses specific to franchise partnership arrangements could be compiled to make it easier for WSAs to consider the franchising option.

- Given that there are in existing legislation and regulations a number of procurement measures that favour SMME, LED and BEE approaches when they are appropriate, no attempt should be made to open the way for further exceptions for CBOs, NGOs or for franchising. Any such attempt will degrade the controls that National Treasury is attempting to put in place.

- Whereas it is likely that WSAs will often require contractual recourse not only to the franchisee but also to the franchisor, contract provision must be made for this where necessary. Especially this is so if the franchisor's expertise or track record is a significant reason for contracting with the franchisee. This "closing of the contractual loop" requires further investigation.

- A key obstacle to successful franchising partnerships is the state of municipal financial accounting and cost recovery. The extent to which franchising can help to address the municipal financial shortcomings (such as through saving cost), or operate despite these financial shortcomings, is an open question, much dependent on individual circumstances. Nonetheless, the state of municipal finances must be addressed for reasons over and above anything to do with services procurement.

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Annexures

Annexure A: Note on reading court case decisions or judgments

The South African legal system relies heavily on precedents to expand or interpret the common law or the legislation. Precedents are prior court judgements.

The purpose of including court judgements in this report is, however, merely to provide the reader with an overview of some of the issues that have been the cause of disputes. It is not anticipated, or necessary, that the reader would read these cases in depth, understand all of the Latin terms used by the Judge, or to be able to draw out the legal rules that could be used as legal precedents in future cases. The following pointers may, however, be helpful when reading the cases:

The judgements are from the Supreme Court of Appeal. The "court a quo" is the court where the case was heard previously, normally the High Court, while the "court of first instance" is the court where the case was first heard, which could either be the "court a quo" or the regional court.

The "J" following the judges name means judge (not all judges are John or Johan). "JA" means Judge of the Appeal Court while "JP" means Judge President and "AJA" means Acting Judge of the Appeal Court.

Two summaries precede the actual judgement or decision. These summaries are compiled by the compilers of the cases (in this case Jutastat) and is not part of the judgement although they prove very useful in searching for relevant cases.

The first summary contains key words and this summary is called the fly notes, the longer summary is called the head notes. The word "semble" appears in some summaries and means that the following can be concluded to be the following but the Judge did not specifically say so in as many words. The word "obiter" means that although the Judge said so it was by the way and not critical to the judgement and is thus merely persuasive in future cases and does not form a precedent.

The name of the case is followed by a reference. This reference indicates where a copy of the case can be obtained, e.g. "PAM GOLDING FRANCHISE SERVICES (PTY) LTD v DOUGLAS 1996 (4) SA 1217(B)" is found in the SA Law Reports, of 1996, volume 4 on page 1217, paragraph B.

Annexure B: Company Law

Regulation of companies by the Registrar

The governance of companies is primarily regulated through under the Companies Act, 1973. The Companies Act has established a Registrar of Companies and inspectors whose primary function is the regulation of companies.

253. Power of Registrar to call for information concerning shares and members

1) *The Registrar may from time to time by notice in writing require a company or external company to transmit to him within fourteen days after the date of such notice particulars of the transfer of any share or shares and a list of persons for the time being members of the company and of all persons who ceased to be members as from a particular date.*

2) *Any company or external company which fails to comply with any requirement of the Registrar under subSection (1) and every director or officer of such company who knowingly is a party to the failure, shall be guilty of an offence.*

257. Inspection of company's affairs on application of members

1) *The Minister may appoint one or more inspectors to investigate the affairs of a company and to report thereon in such manner as he may direct--*
   a) *in the case of a company having a share capital, on the application of not less than one hundred members or of members holding not less than one twentieth of the shares issued; and*
   b) *in the case of a company not having a share capital, on the application of not less than one-tenth of the number of persons on the register of members.*

2) *The application shall be supported by such evidence as the Minister may require showing that the applicants have good reason for desiring an investigation, and the Minister may, before appointing an inspector on any such application, require the applicants to give security to his satisfaction in an amount not exceeding two hundred rand towards the cost of the investigation.*

3) *Before appointing an inspector under subSection (1), the Minister shall, unless he is of opinion that to do so would defeat the objects of this Section, furnish in writing to the company concerned a statement setting out the substance of the complaint made and afford it a reasonable opportunity of replying thereto.*

Certain arrangements between holding companies and subsidiaries prohibited

Normally, in franchising operations the franchisee raises its own establishing capital and in fact buys a franchise from the franchisor.

It is, however, envisaged that certain parties to a water services franchising agreement (e.g.. SMMEs) may not be well established and not have sufficient financial resources to commence providing the service. Under these circumstances, it would be necessary for the franchisor to provide capital to the franchisee. Care must however be taken not to transgress the Companies Act when financially assisting the franchisee.

For example, the Companies Act[61], 1973 prohibits certain arrangements (share ownership) and assistance (e.g.. loans) between holding companies and their subsidiaries. It is evident that the franchise structure must be arranged in such a way that these prohibitions are observed, especially where the funding of the franchising arrangement involves the cross holding of shares or cross financing between holding company and subsidiaries. The following abstracts from the Companies Act could be particularly relevant:

Acquisition by Companies of own Shares
89. Subsidiaries may acquire certain shares in holding company
Subsidiary companies may mutatis mutandis in accordance with Sections 85, 86, 87 and 88, acquire shares in their holding company to a maximum of 10 per cent in the aggregate of the number of issued shares of the holding company: Provided that this Section shall not apply to the acquisition of shares by a holding company in a subsidiary of itself.

37. Loans made and security provided by a subsidiary
1) a) If-
i) any funds of a company were employed directly or indirectly (whether through the instrumentality of its subsidiary or otherwise) in a loan to any company which is its holding company or which is a subsidiary of that holding company but not a subsidiary of itself; or
ii) a company directly or indirectly (whether through the instrumentality of its subsidiary or otherwise) provided any security to another person in connection with an obligation of any company which is its holding company or which is a subsidiary of that holding company but not a subsidiary of itself, particulars of that loan or security, as the case may be, shall be stated in the annual financial statements of the company for every year during which such loan or security was in operation.
2 a) Any director or officer of a company who fails to take all reasonable steps to secure compliance with the provisions of subSection (1) shall be guilty of an offence.
3) a) Any director or officer of a company who authorizes or permits or is a party to the making of any loan or the provision of any security contemplated in subSection (1)(a), shall be liable to the company for any damage directly arising from the making of such loan or the provision of such security on terms or conditions which, at the time of the making of such loan or the provision of such security, were not fair to the company or failed to provide reasonable protection for its business interests: Provided that a director or officer who has paid any amount as damages by virtue of the provisions of this paragraph may recover such part of that amount as the Court considers equitable, from any other director or officer who is in terms of this paragraph also liable to the company for the same damage.
b) For the purposes of paragraph (a), "director or officer" of a company shall include any director or officer of a holding company of such company, and for the purposes of recovery of such damages as are contemplated in the said paragraph (a) the provisions of Sections 266, 267 and 268 shall mutatis mutandis apply as if a director or officer or past director or officer of such holding company was a director or officer or past director or officer of such company, respectively.
c) In enquiring, for the purposes of paragraph (a), whether or not any terms or conditions were fair to the company or failed to provide reasonable protection for its business interests, regard shall be had, without prejudice to the generality of the enquiry,
i) whether, in view of the financial position of the parties, the loan should have been made or the security should have been provided at all;
ii) in the case of a loan, whether security has been or should in the circumstances have been provided therefore, and whether any security provided therefore is adequate;

[61] Act 61 of 1973, s37 to s39

iii) the consideration for the loan or security, including any interest or other benefit received therefore;
iv) the term of the loan or security; and
v) the manner of repayment of the loan or discharge of the security.
d) The provisions of this subSection shall not derogate from any other rule of law relating to the liability of a director or officer of a company.
4) For the purposes of this Section-
a) "funds" includes money, shares, debentures or any other property;
b) "loan" includes any credit extended by a company, if the debt concerned is not payable or being paid in accordance with the normal business practice of the company in respect of the payment to it of other debts of the same kind;
c) "security" includes a guarantee.
5) The provisions of this Section shall not apply to anything done by a company with the consent of all its members.

38. No financial assistance to purchase shares of company or holding company
1) No company shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares of the company, or where the company is a subsidiary company, of its holding company.
3) a) Any company which contravenes the provisions of this Section, and every director or officer of such company, shall be guilty of an offence.
b) For the purpose of this subSection "director", in relation to a company, includes any person who at the time of the alleged contravention was a director of the company.
4) It shall be a defence in any proceedings under this Section against any director or officer of a company if it is proved that the accused was not a party to the contravention.

39. Company not to be a member of its holding company
1) Save as is provided in subSection (2), if shares in a company are acquired in accordance with Section 89 by its subsidiary, for as long as such shares are held by the subsidiary--
a) no voting rights attaching to such shares may be exercised; and
b) the percentage of votes able to be cast at any meeting of shareholders shall be reduced by the number of shares held by the subsidiary:
Provided that this subSection shall not apply where the shares are acquired in a subsidiary of the holding company which is also a subsidiary of the acquiring company.

226. Prohibition of loans to, or security in connection with transactions by, directors and managers
1) No company shall directly or indirectly make a loan to--
a) any director or manager or--
i) the company; or
ii) its holding company; or
iii) any other company which is a subsidiary of its holding company; or
b) any other company or other body corporate controlled by one or more directors or managers of the company or of its holding company or of any company which is a subsidiary of its holding company; or provide any security to any person in connection with an obligation of such director, manager, company or other body corporate.
1A) For the purpose of subSection (1)-
a) "loan" includes-
i) a loan of money, shares, debentures of any other property; and
ii) any credit extended by a company, where the debt concerned is not payable or being paid in accordance with normal business practice in respect of the payment of debts of the same kind; and

b) one or more directors or managers of a company contemplated in subSection (1)(b) shall be deemed to control another company or body corporate only if—

i) such director or manager or his nominee is a member or such directors or managers or their nominees are members of such other company or body corporate and the composition of its board of directors is controlled by such director, manager or nominee or such directors, managers or nominees, and such composition shall be deemed to be so controlled if such director or manager or his nominee or such directors or managers or their nominees may, by the exercise of some power and without the consent or concurrence of any other person, appoint or remove the majority of the directors concerned, and such director, manager or nominee or such directors, managers or nominees shall be deemed to have power to appoint a director where a person cannot be appointed as a director without his or their consent or concurrence; or

ii) more than one-half of the equity share capital of that other company or body corporate or, if that other body corporate is a corporation as defined in Section 1 of the Close Corporations Act, 1984 (Act No. 69 of 1984), more than 50 per cent of the interest in such corporation is held by such director, manager or nominee or such directors, managers or nominees; and

c) "security" includes a guarantee.

1B) The provisions of subSection (1) and of paragraph (b) of subSection (1A) shall not be construed as prohibiting a company from making a loan to, or providing security to any person in connection with an obligation of, its holding company or subsidiary or a subsidiary of such holding company;

2) The provisions of subSection (1) shall not apply-

a) in respect of-

i) the making of a loan by a company to its own director or manager;

ii) the provision of security by a company in connection with an obligation of its own director or manager;

iii) the making of a loan by a company to any other company or other body corporate controlled by one or more of the directors or managers of the first-mentioned company; or

iv) the provision of security by a company in connection with an obligation of any other company or other body corporate controlled by one or more of the directors or managers of the first-mentioned company, with the prior consent of all the members of the company or in terms of a special resolution relating to a specific transaction: Provided that in respect of any such loan made or security provided at any time before the date of commencement of the Companies Amendment Act, 1992, such consent shall be deemed to have been given if the transaction concerned has subsequently, whether before or after that date, been ratified by all the members of the company; or

b) subject to the provisions of subSection (3), in respect of anything done to provide any director or manager with funds to meet expenditure incurred or to be incurred by him for the purposes of the company concerned or for the purpose of enabling him properly to perform his duties as director or manager of that company; or

c) in respect of anything done bona fide in the ordinary course of the business of a company actually and regularly carrying on the business of the making of loans or the provision of security; or

d) to the provision of money or making of loans by a company for the purposes contemplated in Section 38 (2) (b) and (c); or

e) to the making of a loan or the provision of security with the approval of the company in general meeting for housing for its director or manager, or

f) in respect of-

i) the making of a loan by a company to a director or manager of its subsidiary; or

ii) the provision of security by a company to another person in connection with an *obligation of a director or manager of its subsidiary: provided such director or manager is not also a director or manager of such company itself.*

3) *No loan shall be made or security provided by virtue of the provisions of sub-Section (2) (b), except-*
   a) *with the prior approval of the company given at a general meeting at which the amount of the loan or the extent of the security and the purposes thereof are disclosed; or*
   b) *on condition that, if the approval of the company is not given as aforesaid at or before the next annual general meeting of the company, the loan shall be repaid or the liability under the security shall be discharged, within six months from the conclusion of that annual general meeting.*
4) *Any director or officer of a company who authorizes, permits or is a party to the making of any loan or the provision of any security contrary to the provisions of this Section, shall-*
   a) *be liable to indemnify the company and any other person who had no actual knowledge of the contravention, against any loss directly resulting from the invalidity of such loan or security; and*
   b) *be guilty of an offence.*
5) *For the purposes of subSection (4) "director or officer of a company" includes, where the company is a subsidiary, any director or officer of its holding company.*

Disqualification of certain persons as directors

The track records of the management of SMMEs who are recommended as franchisee by for example the municipality may not be well known to the franchisor. It may in fact prove to be difficult to fully investigate the potential directors of a franchisee during a compressed tender bidding period. There are, however, certain critical checks that need to be made before agreeing on the directors of an SMME.

For example, the Companies Act, 1973 disqualifies certain persons from acting as Directors of Companies and also makes those who should have known of their legal disability punishable (abstracts from the Companies Act follow):

218. Disqualifications of directors and others

1) *Any of the following persons shall be disqualified from being appointed or acting as a director of a company or, except for a body corporate, from being concerned or taking part, directly or indirectly, in the management of a company:*
   a) *A body corporate;*
   b) *a minor or any other person under legal disability, save a married women subject to the marital power of her husband whose written consent to her appointment as a director has, on the form referred to in Section 211(1)(a), been lodged with the company;*
   c) *any person who is the subject of any order under this Act or the repealed Act disqualifying him from being a director;*
   d) *save under authority of the Court--*
      i) *an unrehabilitated insolvent;*
      ii) *any person removed from an office of trust on account of misconduct;*
      iii) *any person who has at any time been convicted (whether in the Republic or elsewhere) of theft, fraud, forgery or uttering a forged document, perjury, an offence under the Prevention of Corruption Act, 1958 (Act No. 6 of 1958), or any offence involving dishonesty or in connection with the promotion, formation or management of a company, and has been sentenced therefore to imprisonment without the option of a fine or to a fine exceeding one hundred rand.*

iv) any person who has, in terms of an Act of Parliament, been removed from office for not being a fit and proper person to serve as a director or in the management or in any other position of trust of the body in question due to theft, fraud, forgery, uttering a forged document, corruption, whether in terms of the common law or not, or any other act involving dishonesty.

2) Any person disqualified from being appointed or acting as a director of a company and who purports to act as a director or directly or indirectly takes part in or is concerned in the management of any company, or any director or officer of the company in question who knew or who could reasonably be expected to know of the disqualification-

a) shall be guilty of an offence;

b) shall be liable, jointly and severally, for all debts incurred by the company for the period during which such person knew or could reasonably be expected to know of the disqualification.

3) Nothing in this Section shall be construed as preventing a company from providing in its articles for any further disqualifications for the appointment of or the retention of office by any person as a director of such company.

219. Disqualification of directors, officers and others by the Court

1) The Court may make an order directing that, for such period as may be specified in the order, a person, director or officer shall not without the leave of the Court be a director of or in any way, whether directly or indirectly, be concerned or take part in the management of any company when--

a) such person, director or officer, has been convicted of an offence in connection with the promotion, formation or management of a company; or

b) the Court has made an order for the winding-up of a company and the Master has made a report under this Act stating that in his opinion a fraud has been committed--

i) by such person in connection with the promotion or formation of the company; or

ii) by any director or officer of the company in relation to the company since its formation; or

c) in the course of the winding-up or judicial management of a company it appears that any such person--

i) has been guilty of an offence referred to in Section 424, whether or not he has been convicted of that offence; or

ii) has otherwise been guilty while an officer of the company of any fraud in relation to the company or of any breach of his duty to the company; or

d) a declaration has been made in respect of any person under Section

4) a) For the purposes of subSection (1) (b) (ii) the reference therein to an officer of a company shall be construed as including a reference to any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.

b) An order may be made under the said subSection (1) (b) (ii) whether or not criminal proceedings have been instituted in respect of any matter on which the order is based.

5) Any person who contravenes any order made under subSection (1), or any director or officer of the company in question who knew or who could reasonably be expected to know of the contravention-

a) shall be guilty of an offence;

b) shall be liable, jointly and severally, for all debts incurred by the company for the period during which such person knew or could reasonably be expected to know of the contravention.

Companies and individuals

The Companies Act[62], 1973 provides that companies may contract in the same way as individuals.

> *69. Contracts by companies*
>
> 1) *Contracts on behalf of a company may be made as follows:*
>   a) *Any contract which if made between individual persons would by law be required to be in writing signed by the parties to be charged therewith may be made on behalf of the company in writing signed by any person acting under its authority, expressed or implied, and may in the same manner be varied or discharged;*
>   b) *any contract which if made between individual persons would by law be valid though made orally only and not reduced to writing, may be made orally on behalf of the company by any person acting under its authority, expressed or implied, and may in the same manner be varied or discharged.*
> 2) *All contracts made in accordance with this Section shall be effectual in law and shall bind the company and its successors and all other parties thereto.*

[62] Act 61 of 1973, s69

Annexure C: Case law and the franchise agreement

No legislation could be discovered that specifies the requirements for a franchise agreement. There are, however, a number of aspects of the franchise agreement that have resulted in substantial litigation. One important aspect is the restraint of trade clause found in many of these agreements (challenged as an unfair business practice, or attempts to bypass it) and another important aspect are the financial issues such as the guarantee against insolvency. The judgements provided below are informative in that they demonstrate the care that is required in drafting a franchise agreement.

The independent capital letters appearing at even spaces through the judgements refer to a specific line of the typed up Law Report version of the judgement in the actual case and are left in for cross-reference purposes.

SEVEN ELEVEN CORPORATION OF SA (PTY) LTD v CANCUN TRADING No 150 CC 2005 (5) SA 186 (SCA)

The respondent had purchased a store and entered into a franchise agreement with the appellant, the operator of a number of A convenience stores. The respondent instituted action against the appellant in a Provincial Division claiming that the appellant should have passed on certain discounts to it. The Court held for the respondent in respect of one class of discount but dismissed its claim in respect of the other classes. The appellant appealed against the finding of liability and the respondent cross-appealed in respect of the Court's decision against it in respect of the finding B of non-liability. Before purchasing the store the respondent was given a 'disclosure document' which told prospective franchisees that it was not a contract and could not be relied upon to determine all the terms of the contract. The respondent studied the document carefully and had discussions with the appellant's representative and made an offer to purchase on the standard contract then used by the appellant. The impression the respondent got from the disclosure C document and the discussions was that he was entitled to all the benefits obtained by the appellant as a result of its bulk purchasing. At the time of contracting he did not, however, know of any benefits other than ordinary trade discounts and what the appellant's representative called 'kickbacks'. The respondent subsequently discovered that the appellant received other reductions in the prices D payable to the suppliers of goods sold in the store, namely, 'early settlement discounts' and certain rebates given to the appellant by its suppliers. The Court a quo held that the respondent was entitled to his share of the rebates but that the early settlement discounts were purely for the appellant. These two items formed the basis of the appeal and the cross-appeal respectively. The franchise E agreement regulating the relationship between the parties was silent on the issue of which discounts the respondent might have been entitled to. The respondent claimed that it was entitled to the discounts it claimed to be eligible for on four alternative grounds: (1) that it was entitled, on an interpretation of the franchise agreement, to receive the benefit of any discounts 'negotiated' with suppliers (wholesalers); (2) that as a result of 'quasi-mutual F assent' the contract provided that the appellant would pass on to the respondent any discounts so negotiated; (3) that there was a tacit or implied term to the effect that any discounts would be passed on to the respondent; or (4) that H, the managing director of the appellant, had falsely misrepresented to the respondent that discounts negotiated with suppliers would be passed on to the respondent. The Court a quo held that in interpreting G the term 'business support system' in the agreement, the Court could have regard to the background circumstances, especially the disclosure document, which stated that 'the benefits of belonging to the group are enormous' as 'head office buys in bulk and negotiates maximum discounts, which are passed on directly to the franchisee'.

Held, that the Court a quo had examined the words in isolation without having regard to the document as a whole: H particular attention was paid to dictionary definitions of the words *document as a whole: H particular attention was paid to dictionary definitions of the words 'discount' and 'rebate', without considering the entire business system set out in the document and in the projections on turnover and profit given to the appellant before the contracts were concluded, the Court considering that the word 'discount' included rebates. (Paragraph [24] at 195F - G.) I*

Held, further, that the evidence was that trade discounts that were passed on to franchisees were of a completely different nature from rebates: a discount was negotiated with a supplier before sales were made to the franchisees, and were thus reflected on the invoices given to the franchisee when goods are delivered to it. Rebates, on the other hand, were given by manufacturers or suppliers after sales had been made. They were given for reasons J 2005 (5) SA p188 unrelated to the individual franchisees: in general, they were given to a purchaser as a A reward for growth, for example, reaching a target of a certain number of stores, or because the purchases made over a period had grown. The fact of a rebate, and its quantum, were generally regarded as confidential. (Paragraph [26] at 196E - G.)

Held, further, that if one had regard to the contract in question, the disclosure document and the evidence of H, it became apparent that it could never have been intended that rebates be passed on to the respondent or any other franchisee. (Paragraph [28] at 197A - B.) B
Held, further, that insofar as early settlement discounts were concerned, no provision had been made in any of the documents concerned for passing on the benefit of these to franchisees. All payments for goods sold to franchisees by suppliers were paid for by the appellant. In certain cases if payment was made promptly or before C due date a discount would be given to the appellant. The Court a quo concluded that such discounts did not relate to bulk purchasing, but were a function of payment made timeously or early by the appellant. They therefore did not accrue to the respondent on any interpretation of the franchise contract. Having regard to the terms of the franchise agreement and the disclosure document it was clear that the parties did not intend that such discounts enured for D the benefit of the respondent, and accordingly the claim on this ground had to fail. (Paragraphs [29] - [30] at 197C - E.)

Held, further, that the claim based on quasi-mutual assent was in any event misconceived. In order to rely on quasi-mutual assent one had to show that the person who has relied on terms different from those appearing in the contract has done so reasonably. One had to ask E first whether there had been a misrepresentation as to one party's intention; secondly, who had made that representation, and thirdly, whether the other party was misled. Thus the essential question was whether, as a result of misrepresentation, the contract was different from what it appeared to be. This approach required that one looked for a misrepresentation as to the terms of the contract. Apart from the F fact that there was no credible evidence to show that the respondent had indeed been misled, the contract itself precluded reliance on any misrepresentation, in the absence of fraud. The action accordingly had to fail on this ground too. (Paragraph [32] at 197H - 198A.)

Held, further, that whether one looked at the matter on a subjective basis or on an objective test, there was no tacit term that the respondent was entitled to the benefit of early settlement G discounts or of rebates. (Paragraph [35] at 198G - 199A.)

Held, further, that the Court a quo had correctly held that H had not acted fraudulently and furthermore the respondent had not relied on any misrepresentation and the claim on this basis was also unfounded. (Paragraph [39] at 200B.) Appeal upheld and cross-appeal dismissed. H

FTCK CONSULTANTS CC AND OTHERS v SHOPRITE CHECKERS LTD 2004 (2) SA 504 (T)

The applicants brought an application in terms of s 19(2) of the Consumer Affairs (Unfair Business Practices) Act 71 of 1988 for the stay of an action by the respondent for R1 426 006 against the applicants. The amount allegedly owed related to a franchise agreement for a business between the respondent and the first applicant. The second and further applicants had signed as sureties and co-principal C debtors for the debts of the first applicant to the respondent. The first applicant lodged a counterclaim for an amount in excess of the amount claimed by the respondent. After problems were experienced in financing the first applicant's defence, the second applicant and 13 other franchisees with whom the respondent had concluded similar franchise agreements approached the Consumer Affairs Committee (CAC) in D terms of the Act. The CAC launched a preliminary inquiry in terms of s 4(1)(c) of the Act into the franchise model and the alleged unfair business practice on which the complainants alleged it had been based. In October 2002 the CAC came to the conclusion that the relevant business model was indeed based on an unfair business practice. In terms of s 9 of the Act, the CAC negotiated an arrangement with the respondent stating that the respondent E would discontinue certain practices in connection with the business model. The respondent, however, stated that it admitted no liability and that its undertaking to the CAC pertained only to future dealings. The CAC subsequently decided to investigate the business activities of the respondent in relation to the relevant franchise scheme in terms of s 8(1)(a) of the Act. F

Held, that the Minister of Trade and Industry was the administrative head and the first person authorised to declare an unfair business practice to be an offence. Once his decision in this regard is published in the Gazette, the decision may be taken on appeal to a special Court in terms of s 13 of the Act. The final say regarding whether the relevant practice indeed amounted to an unfair business practice rested with the special Court, which consisted G of a Judge of the High Court assisted by two experts in the field of consumer affairs appointed by the President. (Paragraph [8] at 509A - B/C.)

Held, further, that the situation in the present matter was that the CAC had negotiated an arrangement with the respondent in terms of s 9 of the Act but the Minister had not yet reacted to that arrangement by the time the present application was heard. (Paragraph [9] at 509C.) H
Held, further, that the CAC had the authority to inquire into the present business practice. 'Business practice' was not confined to dealings with natural persons and could also amount to a practice having a harmful effect on consumers indirectly. The CAC had the discretion in terms of ss 4(1)(c) and 8(1)(a) of the Act to inquire into a practice even where no complaint was received from the public. Furthermore, a complaint did not necessarily have to have been received from a 'consumer', as I defined in the Act, for the CAC to act. (Paragraph [11] at 511E/F - F/G.)

Held, further, that the fact that the respondent had made an undertaking for the future was irrelevant to the fact that an unfair business practice did exist according to the CAC. The arrangement did not obliterate the business practice which already existed. As the Minister had not yet exercised his J 2004 (2) SA p506 discretion as to whether to confirm the arrangement or not in terms of s 11(2) of the A Act, the matter remained open and a stay of proceedings in terms of s 19(2) remained relevant. (Paragraphs [12] and [14] at 512B - C and G/H - H.)

Held, further, that the fact that the undertaking by the respondent was said to have a bearing on future conduct only was irrelevant. The practice had been decided to be unfair in terms of s 4(1)(c) and for the purposes of civil law it was relevant B if it were found that a civil action was based on a business practice which was regarded as unfair by a committee. The fact that the contract with the first applicant had been cancelled two years ago was also irrelevant. What was relevant was that the respondent was presently relying on an unfair business practice, on which the arrangement was based, which could still be confirmed or set aside by the Minister in terms *of s 11(2) of the Act. Therefore it was also relevant for the C purposes of s 19(2) of the Act. (Paragraph [15] at 512I - 513B.)*

Held, further, that it was not the task of the Court to express an opinion as to whether there had been an unfair business practice. That was a matter for the CAC, the Minister or the special Court to decide. There was, nevertheless, no doubt that the respondent was, in essence, relying on the alleged unfair business D practice, as found by the CAC, for its claim against the applicants. Any attempt at the enforcement of a claim based on such a practice remained within the domain of the CAC as a present issue. The arrangement in terms of s 9 was in fact built on the finding by the CAC that the legal relationship between the respondent and the franchisees amounted to an unfair business practice. Until the Minister exercises his discretion, however, s 19(2) remained viable. (Paragraph E [23] at 514E/F - H/I and 515A/B.)

Held, accordingly, that it would be in the interests of justice to stay the present proceedings until the Minister or the Special Court, in an appeal against the Minister's decision, came to a decision in respect of the alleged unfair business practice in terms of the Act. A time limit of 15 months had to be placed on the staying of F the action in the interests of reasonableness, to be extended on application on good cause being shown. (Paragraphs [28] and [33] at 517F/G - G and 520G.) Application granted.

BELLVILLE PHARMACY CC AND ANOTHER v T NORTJE (PTY) LTD AND OTHERS 2004 (6) SA 442 (C)

The applicants, a pharmacy and the Pharmaceutical Society of South Africa, contending that the first and second respondents were conducting a pharmacy business in contravention of the Pharmacy Act 53 E of 1974 and regulations, applied in a Provincial Division for a final interdict prohibiting them from operating a pharmacy which traded using a trade name and signage indicating that it was associated with the P retail group (P) and from allowing P to hold any interest in the business of the pharmacy or from exercising any control over the management and operation of the pharmacy. The first and second F respondents' pharmacy was a franchise business and was situated alongside one of P's family supermarkets. It traded under the name of 'Parow Family Pharmacy'. The applicants contended that the franchise agreement and the contents of the franchise manuals to which the first and second respondents were required to adhere gave rise to a regime that contravened the provisions of the Act, the rules and the regulations made pursuant to the Act. In particular, the applicants G contended that the first and second respondents had granted to P (1) an improper interest in the business of the retail pharmacy conducted by the first and second respondents and an improper interest in the shares of the first respondent; (2) an impermissible degree of administrative or managerial control over the retail pharmacy business; and (3) the regime had also imposed upon the H first and second respondents an obligation to utilise a trading title which had not been authorised by third respondent.

Section 22(1) of the Act permitted a body corporate to 'carry on business …. as a pharmacist on the following conditions …. - (a) the body corporate shall have as the managing director of its business in the Republic a pharmacist who resides in the Republic and who is not, save as provided in ss (4), I engaged in the business of a pharmacist which does not belong to the said body corporate either alone or in partnership with another person; …. (c) a body corporate shall not carry on business as a pharmacist unless it holds a valid certificate …. of its registration and the registration of its managing director, and unless the person registered as managing director in fact manages the business of the body corporate and complies with the J 2004 (6) SA p444 requirements set out in para (a) in respect of such managing director.. ..; (d) every pharmacy in *which such body A corporate carries on business shall be conducted under the continuous personal supervision of a pharmacist whose name shall be displayed conspicuously over the main entrance of such pharmacy'. Section 22A provided for certain limitations on a body corporate acquiring a pharmacy business or any share therein. Regulation 3 of the Regulations relating to the Practice of Pharmacy, Government Notice R1158 of B 20 November 2000 set out what acts were regarded as acts specially pertaining to the profession of the pharmacist and reg 25(1) set out the duties of the managing director of a company or manager of a close corporation entitled to carry on the business of a pharmacist. Furthermore, in terms of the Rules relating to Acts or Omissions in respect of which the Council may take Disciplinary Steps (Government Notice R599 of 31 March 1989) a number of acts or omission were C deemed to be unethical or unprofessional conduct, subject to the disciplinary steps of third respondent, including adopting and using a trading title for a retail pharmacy without the prior written approval of third respondent (para 20), 'the use by a retail pharmacy as its trading title or as part of such title of the name of any other company, firm or business or any words indicating or D suggesting that the pharmacy is associated with, belongs to or is in any way connected with such other company, firm or business, unless such other company, firm or business is registered with the Council as the owner or part owner of the pharmacy. . .' (para 21).*

The applicants contended first that the first and second respondents had used the word 'HealthPharm', which indicated that the business was associated with P and signage employed by the first E and second respondents contained the words 'HealthPharm', 'Family Value Pharmacy', 'professional health care from the people who care', 'a member of the P franchise family'. It also included the HealthPharm logo and the P trade mark. The signage containing the name of the first or second respondents and Parow Family Pharmacy was to be found on a small notice above the entrance to the premises. F Secondly the applicants contended that the franchise agreement entered into between P and the first and second respondents conferred upon the franchisor, P, in contravention of s 22 of the Act, an interest in the shares of the first respondent as well as an interest in the retail pharmacy business operated by the first and second respondents. To this extent therefore, the first and second respondents had acted contrary to both the Act and the regulations. G In the third place, the applicants contended that the franchise agreement vested management and administrative control in P. The franchise agreement obliged the first and second respondents to commence operating the pharmacy business on a date specified in the franchise agreement but only once the franchisor was satisfied that the first and second respondents and their employees had 'satisfactorily undergone such training with the franchisor . . . as H the franchisor may reasonably determine' (clause 15.4.2.1). In terms of clause 15.4.2.2 the first and second respondents were obliged to operate and conduct the business 'strictly in accordance with the provisions of . . . the agreement, the HealthPharm system, the franchise manuals and the methods, system and standard procedures determined and directed by the franchisor, in its reasonable I discretion, from time to time and further in accordance with any other written or oral directives given by the franchisor, in its reasonable discretion, to the franchisee from time to time'. In addition the franchise manual sets out a comprehensive set of requirements for dispensing procedures, reporting and stock procedures and staff relations.

Held, as to the applicants' first contention, that there was clear evidence that J
2004 (6) SA p445
other pharmacies utilised brands to promote their businesses with the knowledge of the third respondent A (the South African Pharmacy Council) and that was a factor, albeit an extremely limited one in favour of the first and second respondents' contention that they had only used the word 'HealthPharm' as a brand name to associate their business with other pharmacies and thus boost their goodwill. (At 458G/H - J.)

Held, further, that this coupled with the uncontested evidence of the respondents, namely that the Parow Family Pharmacy B was employed regularly as its trading name, that this name appeared prominently on promotional leaflets and was the name with which contracts of supply were concluded, led to the conclusion that the argument that the provisions of Rule 20 or 21 of the Rules relating to Acts or Omissions in respect of which the Council may take Disciplinary Steps had been contravened could not be justified on the evidence C presented to the Court. (At 459A - B.)

Held, further, as to the applicants' second contention, that there was nothing in the evidence before the Court to suggest that the first and second respondents had divested of a whole or part of an interest in the retail pharmacy business to another person, that is no disposal of interest was effected of a kind that would bring the contractual arrangements between the first and second respondents D and P (the fourth respondent) within the scope of s 22(1)(b)(iv) of the Act. (At 459G - H.)

Held, further, that the applicants' case was based on clause 23 of the franchise agreement as well as the supply agreement in terms whereof the second respondent was prohibited from selling its shares unless it complied with certain requirements so specified. An examination of both the supply agreement and clause 23 of the franchise E agreement revealed that no such transfer of shares to the fourth respondent or any other entity within the P retail group was sanctioned by clause 23. The clear intention of clause 23 was to ensure that no franchisee shall sell or otherwise dispose of his or her shares unless certain conditions were met. The supply agreement contained a similar set of conditions. In no way did these two documents justify the applicants' argument. (At 459I - 460B.) F

Held, further, as to the applicants' third contention, that the critical question was whether, by concluding agreements which, by virtue of the nature of a franchise, were rigorously prescriptive as to the management of the commercial aspects of the pharmacy and the standards of service offered by the pharmacy, a pharmacist has ceased to manage the business for the purposes of the Act. (At 461C - D.) G

Held, further, that conceptually the agreements entered into by the first and second respondents did not constitute a restriction per se on the managerial powers of the registered pharmacist, the second respondent. (At 462C/D.)

Held, further, that, on the facts, it could not be said that the contractual arrangements amounted to a cessation by the second respondent of his ability to manage the first respondent. The H second respondent had bound himself to manage the first respondent in terms of a model which claimed to be 'the best practice system'. The fact that the second respondent would manage the first respondent in terms of this model was, in itself, insufficient to justify the conclusion that the Act or regulations had been contravened. (At 462D/E - F.) Application dismissed.

DIE DROS (PTY) LTD AND ANOTHER v TELEFON BEVERAGES CC AND OTHERS 2003 (4) SA 207 (C)

The first applicant operated a business known as the Dros Restaurant and Wine Cellar. The fourth respondent and one V were the original members of the first respondent. V was no longer a member of the first respondent. The fourth respondent and V had B entered into a franchise agreement with the first applicant, in their capacities as members of a close corporation yet to be formed. When the first respondent close corporation was incorporated, it adopted, ratified and confirmed the agreement. The fourth respondent's and V's obligations under the franchise agreement were limited to their being sureties and co-principal debtors in solidum with the first respondent to the first applicant for C the due performance of the first respondent's obligations in terms of the franchise agreement. After its incorporation, the first respondent occupied certain premises and conducted the franchise business from the premises until expiry of the franchise agreement. Clause 10.3 of the franchise agreement was a restraint of trade provision which restrained the franchisee from participating, either directly or indirectly, in the management or control of a business in D the nature of, or similar to, the franchisee business, within the territory, for a period of 12 months. The premises at which the first respondent conducted its franchise business were subsequently converted into a De Kelder Restaurant, operated under franchise by the third respondent close corporation. The fourth respondent's brother was the only member of the third respondent close E corporation.

The applicants contended that the provisions of clause 10.3 were being breached by the first and fourth respondents. They contended that the first and fourth respondents were bound by the provisions of clause 10.3 and that the fourth respondent was endeavouring to avoid those provisions by using the third respondent as a front to conduct the business of a De Kelder Restaurant at the premises where F the Dros Restaurant and Wine Cellar had previously been conducted. They based their contention that the fourth respondent was bound by the provisions of clause 10.3 on the further contention that the first respondent was a corporate manifestation of the fourth respondent's and V's interest in the franchise outlet, that the first respondent was merely the vehicle through which the fourth respondent conducted his business. They sought to disregard the G first respondent's separate legal personality and to equate it and the fourth respondent, with the result that the restraint also became binding on the fourth respondent. The fourth respondent disputed that the restraint of trade clause was binding on him personally and denied that he was, or intended to become, in any way, involved in the conduct of the De Kelder Restaurant. H

The applicants requested that the question whether the fourth respondent was involved in the business conducted by the third respondent, known as the De Kelder Restaurant, be referred to oral evidence in terms of Rule 6(5)(g) of the Uniform Rules of Court. The respondents opposed the application on the basis that such a referral would be pointless unless the applicants could first show that the fourth respondent was bound by the provisions of clause 10.3. I
Held, that, because the interdict sought by the applicants was final of nature, it would be granted only if the facts as stated by the respondents, together with the facts admitted in the applicants' affidavits, warranted the granting thereof. Implicit in the applicants' request that the factual issues be referred to oral evidence was that they accepted that they had not succeeded in J
2003 (4) SA p209
showing, on a balance of probabilities, that they were entitled to the relief A which they sought. (Paragraph [18] at 214A/B - C/D.)

Held, further, that the decision whether or not factual disputes should be referred to oral evidence depended on the outcome of two enquiries: The first was an assessment of the probabilities in respect of the disputed issues: the more the probabilities favoured a respondent's version, the less likely it was that a Court would exercise its discretion in favour of referring disputed factual issues B to oral evidence. The second was a consideration of the prospects of *viva voce evidence tilting the probabilities in favour of the party bearing the onus. (Paragraph [18] at 214C/D - E.)*

Held, further, that Courts did not have a general discretion to disregard a company's separate legal personality whenever they considered it just or convenient to do so. They did not lightly disregard a company's separate legal personality, but strove to give C effect to it. However, where fraud, dishonesty or other improper conduct was present, other policy considerations came into play, in which event the need to preserve the separate corporate personality of a company had to be balanced against policy considerations favouring the piercing of the corporate veil. (Paragraph [23] at 215G - I/J.) D

Held, further, that Courts permitted the separate legal personality of a close corporation or company to be disregarded where a natural person who was subject to a restraint of trade used a close corporation or company as a front to engage in the activity that was prohibited by an agreement in restraint of trade. On that basis, the fourth respondent could have been restrained if the applicants could prove, first, that clause 10.3 was binding on the fourth E respondent and, secondly, that the fourth respondent was using the third respondent as a front to engage in The first applicant operated a business known as the Dros Restaurant and Wine Cellar. The fourth respondent and one V were the original members of the first respondent. V was no longer a member of the first respondent. The fourth respondent and V had B entered into a franchise agreement with the first applicant, in their capacities as members of a close corporation yet to be formed. When the first respondent close corporation was incorporated, it adopted, ratified and confirmed the agreement. The fourth respondent's and V's obligations under the franchise agreement were limited to their being sureties and co-principal debtors in solidum with the first respondent to the first applicant for C the due performance of the first respondent's obligations in terms of the franchise agreement. After its incorporation, the first respondent occupied certain premises and conducted the franchise business from the premises until expiry of the franchise agreement. Clause 10.3 of the franchise agreement was a restraint of trade provision which restrained the franchisee from participating, either directly or indirectly, in the management or control of a business in D the nature of, or similar to, the franchisee business, within the territory, for a period of 12 months. The premises at which the first respondent conducted its franchise business were subsequently converted into a De Kelder Restaurant, operated under franchise by the third respondent close corporation. The fourth respondent's brother was the only member of the third respondent close E corporation.

The applicants contended that the provisions of clause 10.3 were being breached by the first and fourth respondents. They contended that the first and fourth respondents were bound by the provisions of clause 10.3 and that the fourth respondent was endeavouring to avoid those provisions by using the third respondent as a front to conduct the business of a De Kelder Restaurant at the premises where F the Dros Restaurant and Wine Cellar had previously been conducted. They based their contention that the fourth respondent was bound by the provisions of clause 10.3 on the further contention that the first respondent was a corporate manifestation of the fourth respondent's and V's interest in the franchise outlet, that the first respondent was merely the vehicle through which the fourth respondent conducted his business. They sought to disregard the G first respondent's separate legal personality and to equate it and the fourth respondent, with the result that the restraint also became binding on the fourth respondent. The fourth respondent disputed that the restraint of trade clause was binding on him personally and denied that he was, or intended to become, in any way, involved in the conduct of the De Kelder Restaurant. H

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the application on the basis that such a referral would be pointless unless the applicants could first show that the fourth respondent was bound by the provisions of clause 10.3. I
Held, that, because the interdict sought by the applicants was final of nature, it would be granted only if the facts as stated by the respondents, together with the facts admitted in the applicants' affidavits, warranted the granting thereof. Implicit in the applicants' request that the factual issues be referred to oral evidence was that they accepted that they had not succeeded in J
2003 (4) SA p209
showing, on a balance of probabilities, that they were entitled to the relief A which they sought. (Paragraph [18] at 214A/B - C/D.)

Held, further, that the decision whether or not factual disputes should be referred to oral evidence depended on the outcome of two enquiries: The first was an assessment of the probabilities in respect of the disputed issues: the more the probabilities favoured a respondent's version, the less likely it was that a Court would exercise its discretion in favour of referring disputed factual issues B to oral evidence. The second was a consideration of the prospects of viva voce evidence tilting the probabilities in favour of the party bearing the onus. (Paragraph [18] at 214C/D - E.)
Held, further, that Courts did not have a general discretion to disregard a company's separate legal personality whenever they considered it just or convenient to do so. They did not lightly disregard a company's separate legal personality, but strove to give C effect to it. However, where fraud, dishonesty or other improper conduct was present, other policy considerations came into play, in which event the need to preserve the separate corporate personality of a company had to be balanced against policy considerations favouring the piercing of the corporate veil. (Paragraph [23] at 215G - I/J.) D

Held, further, that Courts permitted the separate legal personality of a close corporation or company to be disregarded where a natural person who was subject to a restraint of trade used a close corporation or company as a front to engage in the activity that was prohibited by an agreement in restraint of trade. On that basis, the fourth respondent could have been restrained if the applicants could prove, first, that clause 10.3 was binding on the fourth E respondent and, secondly, that the fourth respondent was using the third respondent as a front to engage in the activities prohibited by the clause. (Paragraph [24] at 215J - 216B/C.)

Held, further, that, clause 10.3 bound 'the franchisee'. Ex facie its provisions, clause 10.3 was thus binding only on the first respondent. (Paragraphs [21] and [25] at 214I and 216C - C/D.) F
Held, further, that the fact that the fourth respondent had bound himself as surety and co-principal debtor to the first applicant for the due and proper fulfilment by the first respondent of all of its obligations in terms of, in connection with or arising out of the franchise agreement, in relation to clause 10.3, amounted merely to the guaranteeing of the performance of a negative obligation on the part of the first respondent and did not impose the G obligations embodied in clause 10.3 of the franchise agreement on the fourth respondent personally. (Paragraph [25] at 216C/D - E/F.)

Held, further, that, the applicants' description of the first respondent as merely a corporate vehicle through which the fourth respondent conducted business as a franchisee of the first applicant was redolent of the first applicant's being the alter ego of the fourth respondent. (Paragraph [26] at 216F - G.) H

Held, further, that it was trite law that the affidavits in motion proceedings served not only to define the issues between the parties but also to place the essential evidence before the Court. They had to contain factual averments that were sufficient to support the cause of action on which the relief that was being sought was based. Facts could be either primary or secondary. Primary facts were those capable of being used for the drawing of inferences as to the existence I or non-existence of other facts. Such further facts, in relation to the primary facts, were called secondary facts. Secondary facts, in the absence of primary facts, were nothing more than a deponent's own conclusions and, accordingly, did not constitute evidential material capable of supporting a cause of action. (Paragraph [28] at 217A/B - E.)

Held, further, that, there was an almost total absence of primary facts that showed J
2003 (4) SA p210
that the fourth respondent was using the first respondent as a mere instrumentality or business conduit for A the promotion of his personal affairs. The applicants' entire case was based on secondary facts. The applicants had failed to discharge the onus of showing, on a balance of probabilities, that the first respondent was the fourth respondent's alter ego. (Paragraph [29] at 217E - F and G.)

Held, further, that, in view of the aforegoing, the applicants had failed to show that the provisions of clause 10.3 of the B franchise agreement were binding on the fourth respondent. (Paragraph [30] at 217G/H - H.)

Held, accordingly, that, the resolution of the factual issues that the applicants wished to be referred to oral evidence, namely whether the fourth respondent was, in fact, carrying on the business of a restaurant at the premises under the guise of or in association with the first respondent would not have served any C purpose whatsoever. Accordingly, the application to have that issue referred for oral evidence could not be granted. (Paragraph [30] at 217H - I.)
Held, further, that, because the applicants had failed to show any act of interference with any clear right that vested in them, they were not entitled to an interdict in the terms sought. (Paragraph [31] at 217I - 218A). Application dismissed. D the activities prohibited by the clause. (Paragraph [24] at 215J - 216B/C.)

Held, further, that, clause 10.3 bound 'the franchisee'. Ex facie its provisions, clause 10.3 was thus binding only on the first respondent. (Paragraphs [21] and [25] at 214I and 216C - C/D.) F
Held, further, that the fact that the fourth respondent had bound himself as surety and co-principal debtor to the first applicant for the due and proper fulfilment by the first respondent of all of its obligations in terms of, in connection with or arising out of the franchise agreement, in relation to clause 10.3, amounted merely to the guaranteeing of the performance of a negative obligation on the part of the first respondent and did not impose the G obligations embodied in clause 10.3 of the franchise agreement on the fourth respondent personally. (Paragraph [25] at 216C/D - E/F.)

Held, further, that, the applicants' description of the first respondent as merely a corporate vehicle through which the fourth respondent conducted business as a franchisee of the first applicant was redolent of the first applicant's being the alter ego of the fourth respondent. (Paragraph [26] at 216F - G.) H

Held, further, that it was trite law that the affidavits in motion proceedings served not only to define the issues between the parties but also to place the essential evidence before the Court. They had to contain factual averments that were sufficient to support the cause of action on which the relief that was being sought was based. Facts could be either primary or secondary. Primary facts were those capable of being used for the drawing of inferences as to the existence I or non-existence of other facts. Such further facts, in relation to the primary facts, were called secondary facts. Secondary facts, in the absence of primary facts, were nothing more than a deponent's own conclusions and, accordingly, did not constitute evidential material capable of supporting a cause of action. (Paragraph [28] at 217A/B - E.)

Held, further, that, there was an almost total absence of primary facts that showed J
2003 (4) SA p210

that the fourth respondent was using the first respondent as a mere instrumentality or business conduit for A the promotion of his personal affairs. The applicants' entire case was based on secondary facts. The applicants had failed to discharge the onus of showing, on a balance of probabilities, that the first respondent was the fourth respondent's alter ego. (Paragraph [29] at 217E - F and G.)

Held, further, that, in view of the aforegoing, the applicants had failed to show that the provisions of clause 10.3 of the B franchise agreement were binding on the fourth respondent. (Paragraph [30] at 217G/H - H.)

Held, accordingly, that, the resolution of the factual issues that the applicants wished to be referred to oral evidence, namely whether the fourth respondent was, in fact, carrying on the business of a restaurant at the premises under the guise of or in association with the first respondent would not have served any C purpose whatsoever. Accordingly, the application to have that issue referred for oral evidence could not be granted. (Paragraph [30] at 217H - I.)
Held, further, that, because the applicants had failed to show any act of interference with any clear right that vested in them, they were not entitled to an interdict in the terms sought. (Paragraph [31] at 217I - 218A). Application dismissed. D

DE BEER v KEYSER AND OTHERS 2002 (1) SA 827 (SCA)

Held, as to the argument that the agreements were void for vagueness, that courts were generally reluctant to destroy agreements seriously entered into in the belief that they were capable of implementation. An agreement expressed in words that, when viewed in isolation, were capable of various meanings was not for that reason alone too vague to be enforced: the proper meaning of a word that at E first sight appeared to be ambiguous, ill-defined or otherwise vague often emerged when seen in its context, or against the background to the transaction, or when it was linked by admissible evidence to the circumstances in which it was intended to apply. Courts were even more reluctant to hold that clause in an agreement was void for uncertainty where the agreement was no longer executory but had been partly performed. (Paragraphs [12] - [14] at 834E/F - 835C/D.) F

Held, further, that where the subject of a franchise agreement that was to endure for many years was a method of doing business, as it was in the present case, the parties' intention was often that its content might vary from time to time to account for changed circumstances. The parties to such an agreement would be constrained in those circumstances to express their respective G obligations, and particularly those of the franchisor, in relatively broad and flexible terms if they wished to achieve the result that both of them intended. The fact that the specific content of those obligations were not spelt out in advance did not mean that such an agreement was too vague to enforce: the validity of an agreement did not depend on whether the obligations were described with such linguistic precision that their ambit was ascertainable solely by reference to the language in which they were couched - it sufficed that their ambit was capable of being identified by recourse to admissible H extrinsic evidence. (Paragraph [16] at 835E/F - H/I.)

Held, further, that the phrases 'technical assistance' and 'administrative support' were capable of being given definite content once they were seen in their context and measured against what was required for the conduct of a business of the kind to which they I related. It was clear from the agreement as a whole that the parties intended the agreement to relate to a business belonging to the franchisee: it was for the franchisee to do what was required of a person who conducted his own business. What the parties intended the appellant to furnish was expertise

and guidance that would enable the franchisee to go about doing so. Precisely what expertise and J
2002 (1) SA p829
guidance was required to be furnished by the appellant would necessarily depend A on what was required from time to time for the establishment and conduct of a business of that nature, and that was capable of being determined by extrinsic evidence. (Paragraph [17] at 835H/I - 836B/C.)

Held, further, that the fact that clause 9 obliged the appellant to furnish assistance and support 'as arranged with the franchisee' did not mean that the appellant was allowed to determine unilaterally the nature and extent of his obligations, thus rendering B the clause void for vagueness. The words 'as arranged with the franchisee' did not qualify the nature or extent of the appellant's obligations: their true function was to cater for the changing circumstances in which those obligations would have to be fulfilled over the ensuing years and for the fact that what might be required from a particular franchisee might not coincide with what was required by another. Read as a whole, and subject to a tacit term as to C reasonableness, clause 9 required the appellant to furnish all technical assistance and administrative support that was reasonably necessary to place the franchisee in a position to establish and thereafter conduct his business, but only if the franchisee had made arrangements with the franchisor to provide it. This construction was quite capable of being enforced with the assistance of extrinsic evidence to determine what assistance and support was reasonably D required for the establishment and conduct of a business of that nature. (Paragraphs [18] and [19] at 836C - J.)

GOLDEN FRIED CHICKEN (PTY) LTD v SIRAD FAST FOODS CC AND OTHERS 2002 (1) SA 822 (SCA)

The appellant (as franchisor) and the respondent (as franchisee) had on 24 October 1988 entered into a written F franchise agreement entitling the respondent to operate its fast food outlet under the name of 'Chicken Licken'. The agreement was to come into force on 1 November 1988 and was to endure for ten years. Provision was made for the possibility of extending the term of the agreement for a further period of five years upon substantially the same terms and conditions. The respondent's right to extend the G term of the agreement was subject to a number of conditions, two of which were that: (a) respondent had to serve a written notice on the appellant requiring the extension not later than six months before the expiry of the initial term and (b) a new agreement in the standard form then prevailing in the appellant's business had to be executed. As the respondent failed to give the required notice extending the agreement, no new agreement was executed, H with the result that the initial agreement terminated on 31 October 1998. However, the respondent continued to trade under exactly the same conditions as had applied under the initial agreement: royalty payments were effected, weekly quality control tests were conducted by the appellant and the respondent received its supplies as before. There was telephonic contact between the appellant's managing director and the respondent concerning the payment of I royalties and a promotional competition for 'Chicken Licken' customers. About August 1999, the respondent even received a letter from the appellant, instructing it to effect renovations to its premises (something catered for in the franchise agreement) and it complied. On 25 August 1999, however, the appellant, relying on the expiry of the initial agreement on 31 October J
2002 (1) SA p823
the previous year, gave the respondent notice to cease trading as a 'Chicken Licken' outlet by 1 October 1999. Thereafter the A appellant applied in a Provincial Division for an order interdicting the respondent from using its trade marks. The application was dismissed. In an appeal,

Held, that, after the termination of the initial agreement and prior to the notice of 25 August 1999, the parties had conducted themselves in a manner that gave rise to the inescapable inference that both desired the revival of their former contractual B relationship on the same terms as existed before. Taken together, those facts established a tacit relocation of a franchise agreement (comparable to a tacit relocation of a lease) between the appellant and the respondent. (Paragraph [4] at 825C/D - D/E.)

Held, further, that a tacit relocation of an agreement was a new agreement and not a continuation of the old agreement: the fact that the appellant had forgotten that the [old] agreement had lapsed C was beside the point because in determining whether a tacit contract was concluded a court has regard to the external manifestations and not the subjective workings of the mind. (Paragraph [4] at 825E - F.)

Held, further, that the reference to the revival of the parties 'former contractual relationship on the same terms as existed before' did not imply that each and every term of the initial D agreement formed part of the tacit contract: the right to use the trademarks and get-up of 'Chicken Licken' and the duty to pay royalties no doubt formed part of the new contract but apart from that it was not necessary for present purposes, and not possible in the light of the paucity of evidence, to make a finding relating to all the terms of the new agreement. (Paragraph [5] at 825F - G/H.) E

Held, further, as to a contention that the non-variation and non-waiver clauses of the initial agreement were binding and that the conditions for renewal of the initial contract were entrenched and had to be complied with in order for the contract to be extended, that, when the initial contract lapsed on 31 October 1998, its non-variation and non-waiver clauses likewise lapsed, simply because there was nothing left to vary or waive. The parties, in spite of the F clauses relied upon, could have entered into a new written franchise agreement for whatever term and in whatever form without the preceding notice as required by the original agreement. It followed that a tacit franchise agreement could likewise have been entered into. The initial contract did not preclude the conclusion of contracts, tacit or otherwise, at least not once it had expired. The conditions for extending the initial agreement cannot govern the conclusion of a new G and independent agreement. (Paragraphs [6] and [7] at 826B/C - F/G.) Appeal dismissed.

The decision in the Transvaal Provincial Division in Golden Fried Chicken (Pty) Ltd v Sirad Fast Foods CC and Others confirmed.

ACADEMY OF LEARNING (PTY) LTD v HANCOCK AND OTHERS 2001 (1) SA 941 (C)

The applicant was the registered owner of certain trademarks, including the trademark 'Academy of Learning', and franchised the operation of training colleges under such registered trademark. The franchise agreements concluded with the respondents provided that the franchisee was obliged to purchase all the products necessary I effectively to manage and operate the franchise college from the applicant at its current prices with payment to be made within 30 days from invoice. The applicant alleged that the respondents owed it various amounts pursuant to these provisions and that the failure to pay such amounts owing in accordance with the provisions constituted a breach on the part of the respondents entitling the applicant to cancel the franchise agreements. The applicant's attorneys had accordingly J
2001 (1) SA p942

formally demanded payment, allowing the 15 days stipulated A in the agreements for payment, and upon continued non-payment by the respondents, informed the franchisees that the franchise agreements had been formally cancelled. The validity of the cancellation was denied by the respondents and the applicant applied in a Provincial Division for an order declaring its cancellation of the franchise agreements valid.

The respondents alleged that the applicant had misrepresented the B cost of setting up the franchise college to them, which had resulted in them experiencing serious financial problems and being unable to pay the amounts owing to the applicant. The failure to pay was accordingly caused by the applicant's own wrongful conduct. The respondents claimed that the actual amounts owing to the applicant were, in any event, substantially less than those being claimed by it. The C respondents alleged further that both franchisees had counterclaims against the applicant which exceeded the amounts actually owing by them, therefore resulting in their failure to pay not constituting a breach of the franchise agreements on their part. The respondents contended that the parties had concluded an oral agreement prior to the purported cancellations in terms whereof the franchisees were allowed D to settle the outstanding amounts by payment of agreed monthly instalments. The respondents accordingly contended that the applicant was not entitled to cancel the franchise agreements on the basis of the franchisees' failure to pay the outstanding amounts.

Held, that the applicant's claims sounding in money could not be adjudicated on the papers as there were disputes of fact about the quantum of the applicant's claims against the E franchisees which were 'genuine disputes of fact' which could not be determined on the papers. Furthermore, as the respondents' alleged counterclaims were not liquidated, set-off could not apply. However, Rule 22(4) of the Uniform Rules of Court provided that a defendant could ask that judgment on a claim against it be postponed until judgment was given on the counterclaim. This Rule had been accepted as F applying to motion proceedings as well and consequently the Court, in the exercise of its discretion in favour of the respondents, should refer the determination of the applicant's claims sounding in money as well as the respondents' counterclaims to trial. (Paragraphs [26] and [27] at 950D - E, F - G and H - H/I.)

Held, further, that it was common cause that the franchisees G were in arrears with their payments to the applicant. Even on the assumption that the franchisees' counterclaims for damages and repayment were valid, these were unliquidated claims which could not be set off against the liquidated amounts owing to the applicant. The franchisees were accordingly in breach of the franchise agreements, whether their counterclaims were valid or not. Both franchise agreements provided for cancellation on failure of the franchisee to H rectify a breach of the agreement despite 15 days' notice to do so. (Paragraph [28] at 950J - 951B/C.)
Held, further, that a debtor could rely on a creditor's wrongful conduct as an excuse for his or her failure to perform if the facts of the case fell within the ambit of one or more of three broad categories: (1) where the wrongful conduct of the creditor made performance by the debtor objectively impossible; (2) where the I creditor's wrongful conduct could be ascribed to a deliberate intention on his or her part to prevent performance by the debtor; and (3) where the creditor's conduct complained of in itself constituted a breach of an express or implied term of the agreement. If these principles were applied to the present case it was apparent that applicant's conduct complained of by the respondents did not fall within any one of the three broad categories. (Paragraphs [33] and [34] at 952E/F - J and 953D/E - E/F.) J
2001 (1) SA p943

Held, further, that the franchisees had undertaken to make A payment for products acquired within 30 days from date of invoice. Furthermore, the agreements had non-variation clauses stipulating that changes to the agreements had to be in writing and signed by both parties. The oral amendments or changes regarding the payment of the outstanding amounts in instalments were accordingly not binding on the parties and were to be regarded as of no force and effect.

Even if the B respondents had been able to prove an amendment or waiver by the applicant in the circumstances, the evidence showed that they had failed to comply with the terms of the alleged amended agreement as well. (Paragraphs [35], [36] and [37] at 953J - 954A, 954C/D - D/E and H/I - I.) Applicant's cancellation of the franchise agreements declared valid and enforceable.

PAM GOLDING FRANCHISE SERVICES (PTY) LTD v DOUGLAS 1996 (4) SA 1217 (D)

The respondent purchased from the applicant, the franchisor, a franchise to operate an estate agent business under a certain name in a designated area. In terms of the C franchise agreement, the franchisee was to pay the franchisor a monthly royalty calculated as a proportion of the franchisee's gross income derived from the franchised business. The contract contained a restraint clause (12.1) which provided that the agent (i.e. the franchisee) would not during the existence of the agreement D and for a period of two years after the termination thereof be concerned in any business similar to or competitive with that carried on by the agent in the area without prior written consent from the franchisor. When a dispute arose between the applicant and the respondent as to payment of the royalties, the respondent intimated that she wished to dispose of the franchise, but the applicant did not agree to the disposal of E the business, and demanded payment of the royalties alleged to be in arrears, failing which it threatened cancellation of the agreement. The respondent thereupon closed the business premises where she had been trading from and moved her trading activities to another office where she managed another franchise under the name of a different estate agent. The applicant claimed that the activities of the respondent amounted to a repudiation of her obligations under the franchise agreement and F cancelled the agreement. The applicant instituted proceedings and was granted an interim order interdicting the respondent from carrying on any business as an estate agent in the area designated in the agreement for two years. The respondent's defence was that clause 12.1 of the franchise agreement constituted a covenant in restraint of trade of such a nature that it would be contrary to public policy to enforce it inasmuch as it would amount to an unreasonable restriction of her freedom of trade.
Held, as to the nature of the interest which the applicant claimed to be entitled to G protect, that the applicant was not itself trading as an estate agent; its trade was that of franchising the use by others of the name and other indicia of the specific operation to which the goodwill of that operation adhered. It further made available to franchisees appointed by it the expertise and sources of information available to members in order to facilitate their trading under the name. The franchises which it granted were exclusive in that it undertook not to permit anyone else to trade under a H similar franchise in the same area. The applicant's interest lay firstly in preserving or enhancing the value of the product which it had to offer to franchisees. That consisted essentially in the goodwill attaching to the name and insignia and the exclusivity of the right which it offered to the franchisee to use that name and insignia and so to derive the benefit of the goodwill attaching thereto within the prescribed area. It would also I have an interest in preserving the exclusivity of the know-how and sources of information made available to franchisees insofar as those were matters of confidentiality and peculiar to the operation. (At 1224D/E-I.)

Held, further, that clause 12.1 did not seek to prevent the respondent merely from making use of the name or insignia of the business after the termination of the agreement nor did it seek to restrain her from using any confidential information which might have come into her possession during the currency of the franchise; there was no allegation that she was doing any of those things. What she was doing and what the clause sought to prohibit her from doing was to conduct a business as an estate agent within the prescribed area under an entirely different name so that her activity would be in competition with that of any other estate agent to whom the applicant might decide to grant the franchise for that area. (At 1224I/J-1225B.)
J

1996 (4) SA p1219
HOWIE JA

A Held, further, that the present situation differed from that where the seller of a business with goodwill was restrained from trading in competition with that business after the sale: such trading would damage the goodwill adhering to the business which the purchaser had a legitimate interest to protect. The applicant in the present case had no such interest. (At 1225B/C-C/D.)

Held, further, as to the applicant's contention that the applicant did indeed have a legitimate and protectable interest in the business of any subsequent franchise for the B area inasmuch as it would be entitled to a royalty computed on the gross income of such franchisee and was thus vitally concerned with ensuring that the franchisee's business should be as profitable as possible, that, whilst the applicant undoubtedly had the right and obligation to ensure that that attractive power was not in any way diminished by competition under the same name, it had no obligation nor any right to protect the business of a subsequent franchisee against competition in general. (At C 1225C/D-F, paraphrased.)

Held, further, that the restraint clause was solely designed to eliminate competition unrelated to any matter which was the subject of the franchise agreement by an ex-franchisee against a subsequent franchisee in the same area, and as such, it constituted an unjustifiable inroad into the respondent's freedom to trade and its enforcement would be contrary to public policy. (At 1226B.) Rule nisi interdicting respondent from carrying on business as an estate agent discharged.

GERO AND ANOTHER v LINDER 1995 (2) SA 132 (O) A

The applicants sought an order prohibiting the respondent from breaching a restraint of trade covenant in a franchise agreement entered into between the parties. The agreement entitled the respondent to 'conduct . . . for (his) own account a business of teaching mathematics' by using a maths G tutoring programme called 'Master Maths' supplied to franchisees by the applicants. In terms of the covenant the respondent was restrained during the currency of the agreement from engaging in any business which offered any instruction in mathematics and after the termination thereof from doing so for a period of four years within a 160 kilometre radius of any existing 'Master Maths' centre, of which there were 42 countrywide at unspecified locations. Apparently the programme, being in English, proved unsatisfactory in tutoring Afrikaans-speaking students, which resulted in H a series of complaints by the respondent. About 18 months after the conclusion of the agreement the respondent informed the applicants that he was teaching his Afrikaans students directly out of the text books and that he was hardly using the franchise at all. A few months later he addressed the applicants requesting them to supply an Afrikaans version of the programme. The applicants failed to respond and the respondent purported to cancel the agreement.

I Held, that the business which respondent could set up and in which position applicants would place him by supplying the programme could not be limited only to a certain Section of the pupil population: it followed that the programme as was obtained by the respondent did not put the respondent in a position to establish the business as the parties envisaged at the time of the conclusion of the agreement. (At 134H-I.)

Held, further, that the respondent was therefore entitled to demand from the applicants that they remedy the deficiency, failing which he would be J obliged to withdraw from the agreement. (At 134I-I/J.) 1995 (2) SA p133

HATTINGH J

A Held, further, that this deficiency constituted grounds for the respondent to withdraw from the agreement as the deficiency constituted a vital part of the applicants' obligations, which deficiency went to the root of the contract. (At 134I/J-J.)

Held, further, that the respondent was accordingly entitled to address a demand to the applicants that they supply him with an Afrikaans version of the programme, and that when the applicants chose not even to reply thereto or to make any endeavour to rectify the position, the respondent B was legally entitled to cancel the agreement. (At 135A-A/B.)

Held, further, as to the clause restraining the respondent from being involved in maths instruction within 160 kilometres from any Master Maths centre for a period of four years, that this restraint on the probabilities covered the whole of South Africa. (At 135C-C/D.)

Held, further, that, having regard to all the circumstances, it would be unreasonable and contrary to public policy to enforce the restraint: no C restraint so oppressive in scope has ever been countenanced in our Courts. (At 135I-J.) Application accordingly dismissed.

LONGHORN GROUP (PTY) LTD v THE FEDICS GROUP (PTY) LTD AND ANOTHER 1995 (3) SA 836 (W)

The applicant and the first respondent had entered into a franchise E agreement concerning a restaurant business. It was a term of the agreement that the first respondent could not sell the business without the consent of the applicant, who was entitled to refuse its consent if the proposed buyer did not agree to be bound by the terms of the franchise agreement. The first respondent subsequently entered into an agreement for the sale of the business to the second respondent who refused to be bound by the franchise agreement and who intended to remove the Longhorn name, trademark and logo from the business premises. The applicant F applied for an order declaring that the agreement between the respondents was of no force and effect and interdicting the first respondent from implementing the agreement.

The first respondent contended that the franchise agreement had terminated. It contended further that, in any event, a franchise agreement was properly categorised as a contract either of partnership or of master and servant and that in neither case would a Court order specific performance, which was the nature of the relief sought.

Held, on the evidence in the affidavits, that the franchise agreement had G not terminated. (At 841E/F-G, summarised.)

Held, further, that there was no warrant for categorising the franchise agreement as a contract either of partnership or of master and servant. (At 842D/E-E/F and 842F-F/G, summarised.)
Held, further, that the relief sought did not amount to an order for specific performance in the conventional sense as it did no more than H require the first respondent to observe a negative provision in the franchise agreement; and that, even if it did amount to specific performance, the Court would exercise its discretion in favour of granting such order.

J PINTUSEWITZ (PTY) LTD v SOUTH AFRICAN PHARMACY COUNCIL 1994 (2) SA 68 (C) A

The applicant sought an order in a Provincial Division in terms of s 24 of the Pharmacy Act 53 of 1974 setting aside the respondent Council's decision to refuse to (a) register the applicant as a body corporate I entitled to carry on business as a pharmacy in terms of s 22 of the Act; (b) register the applicant's managing director in terms of s 22 of the Act; and (c) approve the applicant's adoption and use of the trading title 'Safeway Pharmacy (Plein Street)', alternatively 'Unicorn Pharmacy (Plein Street)'. The respondent had refused the application on two grounds: firstly, on the ground that, in the light of the franchise agreement to which the applicant was a party and which formed part of the application, the respondent had formed the view that the applicant's managing director J would not act as such, nor would he in fact
1994 (2) SA p69

A manage the applicant's business; and, secondly, on the ground that it could not approve either of the trading titles 'Safeway' or 'Unicorn' because the use of either of those titles would contravene the Council's ethical rules.

The franchise agreement in issue was between the applicant and H Goldin & Co (Pty) Ltd, a company which marketed a wide range of merchandise through a country-wide chain of retail stores trading under the name 'Clicks'. The Court found that, unlike the usual franchise agreements, the agreement in issue would, to all intents and purposes, deprive the applicant of a free B and unfettered right to conduct its proposed business on an independent basis and its managing director of the effective use of the powers of a managing director to manage every part of the applicant's business other than that relating exclusively to its purely pharmaceutical aspect. The Court held that the applicant's managing director's role in the proposed pharmacy would be comparable to that of a locum tenens in a pharmacy and that the franchise agreement had been a transparent and unsophisticated C attempt on the part of the franchisor to open, operate and effectively own a retail pharmacy. (At 76H, 76I-77A and 77B-C.)

Rule 21 of the respondent's ethical rules provides that 'the use by a retail pharmacy as its trading title or as part of such title of the name of any other company, firm or business or any words indicating or suggesting that the pharmacy is associated with, belongs to or is in any way connected with such other company, firm or business' is deemed to be D unethical or unprofessional conduct. (At 77F/G-H.)

When considering the 'Safeway' and 'Unicorn' applications, the respondent had before it (1) a draft sublease between H Goldin & Co (Pty) Ltd and the applicant, which indicated that the premises at which the applicant proposed conducting its business were either adjoining a branch of Clicks in Plein Street, Cape Town, or were those of that branch; and (2) plastic container bags for goods sold to customers at Clicks on which, in conjunction with the name 'Clicks' in large letters, were, in one instance, E the word 'Safeway' in large bold letters and, in each case, the stylised depiction of the head of a unicorn. The respondent concluded that both proposed trading names and the site at which the applicant proposed to trade would indicate or suggest that the applicant's pharmacy was associated with, or belonged to or was in some way connected with Clicks, in breach of rule 21. (At 77H-78C/D.)

The applicant did not pursue the Safeway application on appeal. As to the F Unicorn application, it was argued that, since the word 'unicorn' did not appear in any form in any documentation, logo, advertising or packaging material used by Clicks or on or in any premises

which Clicks occupied or at which it traded, and the word 'unicorn' was used by a number of entities, none of which dealt in any way with pharmaceutical goods or products, the use by the applicant of the title 'Unicorn' would not indicate any particular association with Clicks, still less so when that G title was qualified by the word 'Pharmacy'. (At 78D/E-E/F and G.)
Held, that for rule 21 to be invoked, an association or connection of some kind or other, to be found between a retail pharmacy and any other company, firm or business, brought about by the use of a particular word as part of a trading title was not required to be self-evident or to be spelt out in simple language: it was enough if such association was merely indicated or merely suggested by the use of the word in question. (At H 78H-I.)

Held, further, that the applicant's predilection for the word 'Unicorn' over any other word, and the proposed use of it as part of the trading title of its proposed retail pharmacy was indicative or suggestive of an association or connection with Clicks and had deliberately been so intended. (At 80B/C - C/D.)

Held, further, that insofar as the respondent was concerned, it had had before it for consideration both the 'Unicorn' and the 'Safeway' applications: its members could hardly have been unaware of the obvious identification of both applications, not only with each other, but with I Clicks, both as franchisor and as landlord; indeed, it would have been surprising if the respondent's members had failed to note the obvious connection between the word 'Safeway' and Clicks and the similarly obvious connection between the word 'Unicorn' and Clicks. (At 80D-F.)

Held, accordingly, that the respondent had correctly concluded that both proposed trading titles would contravene rule 21 of its ethical rules and that its refusal of both applications had therefore been justified

ILLINGS (ACCEPTANCE) CO (PTY) LTD v ENSOR NO 1982 (1) SA 570 (A)

At all material times the M company (which was provisionally liquidated on 25 July and finally wound up on 12 September 1975) operated on E overdraft facilities granted by the Standard Bank. On 13 April 1973 the company ceded to the bank its 'right, title and interest in and to all book debts and other debts... due... to the company' as security for all sums of money owing to, or which in the future might become owing to, the bank. The company would act as bank agent in collection, but the bank would be entitled at any time to terminate this authority F and take control of the company's records, books and accounts. On 11 July 1975 the bank notified the company that it was revoking the company's authority to receive on behalf of the bank payments made by the company's debtors. A similar notification was forwarded to the appellant. A Mazda franchise had been granted to the company by Illings Mazda (Pty) Ltd, but this franchise was cancelled on 18 July 1975. All G new Mazda vehicles which had previously been required by the company had been sold by Illings to the appellant (Illings (Acceptance) Co (Pty) Ltd) and resold by it to the company. This resulted in the company being indebted to the appellant. In terms of the franchise agreement Illings was entitled on termination of the agreement to repurchase from the company Mazda spare parts sold by it to the company. However, instead of repurchasing such parts from the company, a scheme was arranged in terms H of which Illings, as agent for the company, sold the company's spare parts to R (the new franchise holder). On 23 July the latter drew four cheques (some of them post-dated) in favour of the company in payment for the spares, and on the same day these cheques were negotiated to the appellant in part payment of the company's aforesaid indebtedness to appellant. In the Court a quo negotiation of the cheques to the appellant was held to constitute a voidable preference in terms of s 29 (1) of the Insolvency Act 24 of 1936. In an appeal,

Held, that, whether or not the debtor had knowledge of a cession when paying a cedent, the

amount paid became the property of the latter and
1982 (1) SA p571
the cessionary could not claim to be entitled to it by virtue of a lien, a right of preference or the like.

Held, therefore, that the company by negotiating the cheques transferred its rights as holder of the instruments to the appellant.

A Held, further, that such action constituted a disposition of property within the meaning of the definition contained in s 2 of Act 24 of 1936.

Held, further, on the facts, that negotiation of the cheques had the effect of preferring appellant above the bank or the other concurrent creditors.

Held, further, on the facts, that the negotiation of the cheques to the appellant was not a transaction in the ordinary course of business.
B Held, therefore, that the appeal should be dismissed with costs.

TAMARILLO (PTY) LTD v B N AITKEN (PTY) LTD 1982 (1) SA 398 (A)

A litigant is entitled to seek relief by way of notice of motion. If he has reason to believe that facts essential to the success of his claim will probably be disputed he chooses that procedure at his peril, for the Court in the exercise of its discretion might decide neither to refer the matter for trial nor to direct that oral evidence on the disputed facts be placed before it, but to dismiss the application. But E if, notwithstanding that there are facts in dispute on the papers before it, the Court is satisfied that on the facts stated by the respondent, together with the admitted facts in the applicant's affidavits, the applicant is entitled to relief (whether in respect of all his claims or one or more of them) it will make an order giving effect to such finding, with an appropriate order as to costs. The Court does not exercise a discretion in motion proceedings whether or not to F grant claims established by the admitted or undisputed facts; except perhaps in very extraordinary circumstances the applicant has a right to an order in respect of such established claims.
Not all contractual provisions which in some way or another might directly or indirectly have the effect of inhibiting another's freedom of trade are on that account 'covenants in restraint of trade'. G It is generally not for a plaintiff to anticipate in his declaration the possible defences a defendant might raise. And still less is it incumbent on a plaintiff who claims specific performance, the grant or refusal of which is in the final result in the discretion of the Court, to anticipate in his declaration the possible grounds which a defendant may advance to induce the Court to exercise its discretion against the H grant of specific performance.

In a case in which the defendant requires the consent of a third party to enable him to perform effectively, and at the end of the case, the defence of impossibility having been raised and canvassed, the probabilities in regard to that issue appear to be evenly balanced, the Court might justifiably take the view that refusal of specific performance was preferable to the grant of an order which as likely as not would prove to be ineffectual. A rule that a defendant pleading impossibility as answer to a claim for specific performance must necessarily discharge the onus of proving it if he is to avoid such a decree might hamper and inhibit the
1982 (1) SA p400
Court in the exercise of its discretion. The statement in Shill v Milner 1937 AD 101 at 106 that 'the onus would lie on him (the defendant) to prove impossibility' might well have been too generally and positively A stated. Whether or not it is necessary for the defendant to discharge

such onus in order to avoid a decree of specific performance, it certainly bears the burden of alleging impossibility and adducing evidence in support of it - evidence of the facts or circumstances upon which it asks the Court to exercise its discretion against the grant of the order prayed.

In terms of a franchise agreement concluded between respondent, as the B grantor, and appellant, as the grantee, appellant was accorded the right to market certain products under certain trade marks and trade names in return for the payment of a substantial sum as goodwill in respect of each 'outlet' or shop opened for the sale of such products, and substantial royalties at stipulated rates. Clause 3 (1) of the agreement provided that 'the grantee records that the marks and names are all the exclusive property of the company (the grantor) and will, C when called upon so to do by the (grantor), sign - (a) a registered user agreement in terms of the draft which is annexed marked 'A'; (b) a further registered user agreement mutatis mutandis in terms of annexure 'A' as soon as registration of the name 'Giant Size Burgers' is obtained.' Clause 13 (6) (d) of the agreement provided as follows: 'If this agreement is cancelled or terminates for any reason whatsoever -. D .. (d) in so far as the grantee leases any trading area from any person other than the company (the grantor), such lease shall be forthwith assigned to the company'. As a result of certain disputes between the parties, the respondent averred that the appellant had repudiated the agreement, which repudiation it accepted. The respondent then applied on notice of motion, in a Local Division, for an order E interdicting the respondent from being interested directly or indirectly in any business which prepares or in any way deals in the products and trademarks and names covered by the franchise agreement and ancillary relief. Prayer (d) of the relief claimed was for an order 'ordering and directing the respondent (the present appellant) to assign to the applicant the existing lease in respect of the premises situate in the OK Hyperama store, Durban'. The application was dismissed with F costs by the Local Division on the ground that there were material disputes of fact which the present respondent ought to have foreseen. In an appeal to the Full Bench of a Provincial Division it was ordered that the appeal be allowed in part and that an order in terms of prayer (d) be granted. The approach of the Provincial Division was that prayer (d) could be granted if, upon the facts which were common cause or not disputed, it appeared that the respondent was entitled to the relief G claimed in prayer (d). In a further appeal, the appellant contended (a) that the Provincial Division had erred in so approaching the matter; (b) that the franchise agreement 'had fallen away from its inception' by reason of the non-fulfilment: of a suspensive condition, viz clause 3 (1); (c) that respondent was obliged by clause 3 (1) of the agreement to have user agreements in respect of the marks or names registered, which H it had not done; (d) that the trade mark 'Giant Size Burgers' ought not to have been registered as a trade mark because of lack of distinctiveness in the name; (e) that the agreement was vitiated by fraud or misrepresentation as the agreement was unfair and one-sided, it having been represented to be the 'normal' or usual type of franchise agreement whereas it was not; (f) that clause 13 (6) (d) of the agreement was a penalty clause to which s 3 of the Conventional Penalties Act 15 of 1962 applied; (g) that clause 13 (6) (d) constituted a covenant in restraint of trade and was thus unenforceable because of its unreasonableness; and (h) that the Provincial Division should have exercised its discretion against the grant of specific performance.

1982 (1) SA p401

Held, as to (a), that the approach of the Provincial Division could not be faulted.

Held, further, as to (b), that the finding of the Court a quo that clause 3 (1) was no more than one of the terms of the agreement and not a suspensive condition was correct.

A Held, accordingly, that there was no substance in the contention that the franchise agreement 'fell away as from its inception'.

Held, further, as to (c), that, even if clause 3 (1) of the agreement imposed on the respondent

the obligations contended for, the respondent could not be held to have been in breach thereof unless and until it had been placed in mora: no time was fixed in the franchise agreement or at B all for performance of the obligation nor was there anything to suggest that time was of the essence in regard to the contemplated registration.
Held, further, that at no time did appellant call upon the respondent to sign user agreements or to make application for registration of such agreements.

Held, further, as to (d), that the conclusion of the Court a quo was C correct that the agreement could not be so construed as to require that the name, the use of which was allowed to appellant, had to be the subject of a valid trade mark.

Held, further, that clause 6 (3) of the agreement, which provided that respondent 'gives no warranty as to the validity of any mark or name', D upon which respondent relied, was incompatible with an intention by the parties that failure to register a valid trade mark in respect of the name 'Giant Size Burgers' would constitute a breach, whether 'fundamental' or otherwise, by respondent of the franchise agreement.

Held, further, as to (e), that the evidence was wholly inadequate to justify a conclusion that the franchise agreement was induced by fraud, or undue influence, or false representations, or that there were grounds E for rectification: there was also nothing in the agreement which was so offensive as to render enforcement of it unconscionable.

Held, further, as to (f), that clause 13 (6) (d) of the agreement clearly required appellant to 'deliver or perform' something for the benefit of respondent as required by the definition of penalty stipulation in s 1 of Act 15 of 1962, but it equally clearly did not require such delivery or performance 'by way of penalty or liquidated F damages', as required by such definition: respondent's clear purpose was to protect and nurture the value of the goodwill stemming from trade, carried on at the premises concerned, in the products bearing the names or marks in question; no stipulation in terrorem could be found in clause 13(6)(d).

Held, accordingly, that clause 13(6)(d) was not a penalty stipulation to which s 3 of the Act applied.

G Held, further, as to (g), that as between respondent and appellant the latter enjoyed the benefits of the lease subject to an obligation to convey by assignment the right of occupancy (and the obligations arising therefrom) to the former upon termination of the franchise.
Held, accordingly, that the 'restriction' of appellant's rights was, in effect, a restriction relating to the continuance of his rights of occupation of the leased premises and not a covenant in restraint of trade.

H Held, further, as to (h), that the Court had not been satisfied that the Court a quo had erred in exercising its discretion in the way it did on the question whether it should grant an order of specific performance on prayer (d).

Held, further, as to a contention that specific performance should not have been ordered on the ground that, as the consent of the lessor was necessary before the lease could be assigned to the respondent in terms of clause 13(6)(d), performance of that obligation was impossible, that no facts had been placed before the Court to support what might be called a
1982 (1) SA p402
theory advanced only in argument at this late stage (i.e. the appeal before the Appellate Division) that performance would be impossible. Appeal dismissed.

A The decision in the Natal Provincial Division in B N Aitken (Pty) Ltd v Tamarillo (Pty) Ltd and Others in which the decision in the Durban and Coast Local Division in B N Aitken (Pty) Ltd v Tamarillo (Pty) Ltd and Others was partly reversed, confirmed. B

B N AITKEN (PTY) LTD v TAM ARILLO (PTY) LTD AND OTHERS 1979 (4) SA 1063 (N)

A stipulation in a contract cannot properly be regarded as a suspensive condition (to avoid the terminology of the English law) unless its effect is to suspend the operation of the agreement or part of it until the happening of some uncertain future event.

There is no reason why a party to an agreement who signifies his intention not to perform when the time for performance arrives, but then decides to do so after all and notifies the other party accordingly before the latter elects to rescind the agreement, should be held to suffer the consequences D as if he is still unwilling to perform.

Questions relating to covenants in restraint of trade are to be approached along the lines of public policy and the public interest for that is the very basis on which their validity depends. But the maintenance of proper trade relations and the protection of individual freedom to engage in commercial activity are not the only subjects with which public policy is E concerned. It is also concerned inter alia with the legal and moral obligations of members of the community to accept and to carry out their responsibilities arising from agreements freely and voluntarily entered into and, when it comes to deciding upon the validity of agreements in restraint of trade, the law is concerned with the delicate balance between the freedom to trade and the sanctity of contracts, both as matters of public policy and the public interest.

It is the essence of a penalty stipulation in terms of s1(1) of the F Conventional Penalties Act 15 of 1962 that the amount of money to be paid or thing to be delivered or act to be performed, should be paid, delivered or performed "either by way of a penalty or as liquidated damages", i.e. it must be clear that it was the parties' intention at the time of the conclusion of the agreement that the stipulation be inserted therein in terrorem.

Appellant was the owner of two registered marks in connection with freshly G squeezed fruit juices called "Juicy Lucy" and hamburgers called "Giant Size Burgers". The marketing of these two products was largely done by franchise holders. Appellant had granted a franchise in terms of an agreement to the first respondent. The "trading areas" were prescribed. In terms of clause 13 (6) (d) of the agreement it was provided that, should the agreement be cancelled or terminated, "in so far as the grantee leases any trading areas from any person other than the company, such lease shall be forthwith assigned to the company". In addition there was a special H restraint clause in terms of which respondents and A were restrained, in the event of the termination of the agreement, for a period of 18 months from carrying on or engaging in or being concerned with or interested in any business which might conveniently be described as the type of business which first respondent conducted in terms of its agreement with the appellant. When the franchisee repudiated the agreement, the appellant accepted such repudiation. Appellant applied on notice of motion for an order (a) enforcing the restraint clause, (b) restraining the respondent from using the trade mark "Juicy Lucy" and (c) to procure the assignment to it of the leases in respect of three different addresses where "Juicy Lucy" outlets were said to have been operated. This application was dismissed. In an appeal (1979 (4) SA p1064) it was contended that, on the common cause facts, the appellant was entitled to the order directing the respondents to assign to it the lease in the H Market in a trading area. A The first respondent had relied on the "failure of the agreement" in that the appellant had failed to *have the user agreements of the marks registered and that it had breached the agreement by having had dealings with the H company and one M. The Court found that there was no substance in any of these grounds and held that the appellant was entitled to have the lease in respect of the H Market assigned to it. Held, further, that clause 13 (6) (d) did not constitute a penalty.*

Annexure D: Case law regarding municipal tendering and procurement

Although, or because, procurement and tendering is certainly well regulated by legislation and subordinate legislation, it remains a matter that attracts its share of litigation, usually by those who are of the opinion that they were not treated administratively fairly.

METRO PROJECTS CC AND ANOTHER v KLERKSDORP LOCAL MUNICIPALITY AND OTHERS 2004 (1) SA 16 (SCA)

As an organ of State in the local government sphere a municipality in awarding a tender is obliged to comply with s 10G(5)(a) of the Local Government Transition Act 209 of 1993 read with s 217(1) F of the Constitution of the Republic of South Africa Act 108 of 1996. These provisions mandate it to do so in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. The Preferential Procurement Policy Framework Act 5 of 2000 requires organs of State to establish a procurement policy, and also makes it obligatory for the first respondent, as an organ of State in the G local sphere, to follow a tender procedure for the procurement of goods and services. There is another reason why the tender procedure of a local authority must be fair. Invitations to tender by organs of State and the awarding of tenders where it is done in the exercise of public power is an administrative process. Section 3(2)(a) of the Promotion of Administrative Justice Act 3 of 2000 requires the process to be lawful, procedurally fair and justifiable. But primarily, in the case of a local authority, the process must be fair because H s 10G(5)(a) of the Local Government Transition Act 1993 requires it. Fairness must be decided on the circumstances of each case. It may in given circumstances be fair to ask a tenderer to explain an ambiguity in its tender; it may be fair to allow a tenderer to correct an obvious mistake; it may, particularly in a complex tender, be fair to ask for clarification or details required for its I proper evaluation. Whatever is done may not cause the process to lose the attribute of fairness or, in the local government sphere, the attributes of transparency, competitiveness and cost-effectiveness. (Paragraphs [11] - [13] at 20H/I - 21E.)

In the present case, an appeal from a decision in a decision in a Provincial Division dismissing an application for the review and setting aside of a J
2004 (1) SA p17
decision of the first respondent (a local authority) to award a tender to the ninth respondent, it appeared A that a high-ranking municipal official purported to give one of the tenderers an opportunity of augmenting its tender so that its offer might have a better chance of acceptance by the decision-making body of the first respondent, a local authority. The augmented offer was at first concealed from and then represented to the first respondent's mayoral committee as having been the tender offer. It was accepted on that basis. B

Held, that the deception stripped the tender process of an essential element of fairness: the equal evaluation of tenders. Where subterfuge and deceit subverted the essence of a tender process, participation in it was prejudicial to every one of the competing tenderers whether it stood a chance of winning the tender or not. (Paragraph [14] at 21F/G - G.) Appeal allowed.
The decision in the Transvaal Provincial Division in Metro Projects CC and Another v Klerksdorp Local Municipality and Others C reversed.

SOUTH AFRICAN POST OFFICE LTD v CHAIRPERSON, WESTERN CAPE PROVINCIAL TENDER BOARD, AND OTHERS 2001 (2) SA 675 (C)

Although not a municipality, the challenges faced by the provincial departments is very similar:

> *In April 1999 the second respondent (the provincial department of health and social services) called for tenders for a new computerised system for the payments of social security grants in the C Western Cape. It had cancelled a previous tender when it was discovered that the pricing structure of that tenderer, Nisec, had artificially been reduced and that its technology could not perform the functions it had been intended to perform. The applicant had taken over the payment of social security grants to some 40 000 beneficiaries who had formerly been paid by Nisec and continued paying out such grants to the D some 224 000 beneficiaries it had been paying on behalf of Nisec. This arrangement continued until 31 March 2000. In the light of the Nisec debacle the department undertook substantial investigations and consulted widely before and during its formulation of tender documents and specifications for the new system. The tender documents grouped the specifications into categories (finance, technology, client service and general) and recorded that tenders would be evaluated in four phases as E follows: (1) financial stability, adequacy of infrastructure and ability to provide security; (2) tenderers' compliance with the tender specifications on technology; (3) implementation and communication plan, and safety and security; and (4) a final evaluation according to certain criteria of only those tenderers who had met the criteria in the first three phases. All tenderers were obliged to attend a F compulsory information session at which the chief director of the social services branch of the department explained the tender document in detail. Tenderers were also informed of the criteria to be applied to the fourth phase of the evaluation process (namely price, technology, client service, migration period and general criteria); that weights would be allocated to such criteria; and that these G weights would not be disclosed. None of the tenderers present at the information session, including the applicant, asked any questions about or raised objections to the fourth phase of the evaluation process. In response to a specific enquiry the department replied in writing to all tenderers that no tender would be disqualified on the basis of either the inclusion or exclusion of fingerprint identification as part of the solution.*
>
> *Only the applicant and third respondent survived the first three H phases of evaluation. On 4 November 1999 the tender was awarded to the third respondent. Its tender had been for R13,09 per beneficiary as against a price of R18,53 per beneficiary tendered by the applicant. The applicant was later informed that a weighting of 50% had been allocated to the price component and 50% to the service components of the tenders during the fourth phase of evaluation. I*
> *In an application to review the first respondent's award of the tender the applicant's eventual case was that (1) the tender process had not been transparent in that the weighting to be attached to the various criteria in the evaluation process had not been disclosed to tenderers and that the scoring had been inconsistent; (2) the second respondent's decision not to disclose the weighting had indicated an inflexible adherence to a rigid policy or J*
> *2001 (2) SA p677*
> *practice; and (3) the failure to disclose the weighting to be applied to A different criteria had not been justifiable in relation to the reasons given for it.*
>
> *The first respondent's reason for not disclosing the weighting allocated to the various criteria was its wish to avoid price tampering of the kind that had occurred with the Nisec tender and to discourage tenderers from concentrating on criteria carrying greater weight at the B expense of others because it wished to obtain as comprehensive a service as possible at a reasonable and competitive price. It added that, by following the practice of not disclosing weightings, the department had been able to obtain a comprehensive service of the requisite quality for the*

payment of social security grants; it had obtained a service which used computerised fingerprint identification at a very reasonable cost; all tenderers had been treated fairly; and C the process itself had been open and transparent.

Section 217(1) of the Constitution of the Republic of South Africa Act 108 of 1996 provides that '(w)hen an organ of State in the … provincial … sphere of government … contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective'. Section 3 of the Western Cape Provincial Tender Board Law 8 of 1994 is to similar D effect.

Held, as to the applicant's first ground of attack, that the payment service offered by the applicant was virtually the same as that offered by the third respondent. The applicant's assertion that, had the weights accorded to the different criteria been disclosed to it beforehand, it would have concentrated on the criteria carrying the E greatest weight at the expense of the other criteria and that would therefore have meant that the department would not have been able to provide beneficiaries with as efficient a payment service as that offered by the third respondent. (Paragraph [16] at 688E/F - G.)

Held, further, that it was clear from the fact that, despite the significantly higher price tendered by the applicant, it had still been given a higher score on the service aspect of the tender than that F given to the third respondent that the procurement process could be said to have been fair. The award of the tender to the third respondent had undeniably been cost effective as it would have resulted in a saving of some R74 million to the province over the life of the tender. It was clear that all tenderers had been treated equally because none had received information which would have enabled it to gain any advantage over the others and all had been told that weights G had been allocated to the evaluation criteria. It was also clear that the system of procurement had been accessible, visible, subject to examination and enquiry and had been open and transparent. The indisputable fact was that, based on the information given to all the tenderers the applicant had tendered a price significantly higher than that tendered by the third respondent. (Paragraph [16] at 688H/I - 689B/C.) H

Held, accordingly, that the provisions of s 217(1) of the Constitution and of s 3 of the Western Cape Provincial Tender Board Law had been complied with. (Paragraph [18] at 690H - H/I.)
Held, further, as to the applicant's second ground of attack, that, given that there was nothing in the papers to contradict the first respondent's assertion that, had it been asked to reconsider its existing practice of not disclosing the weights attached to I different criteria, it would have applied its mind to the matter and that, in view of the full disclosure to the tenderers that the weighting would not be disclosed and in the absence of any query, it had had no obligation to reconsider the practice, it could not be found that the first respondent had adopted a rigid practice and that the practice had been exercised without applying its mind or discretion. (Paragraph [19] at 692B - F.) J
2001 (2) SA p678

Held, further, as to the applicant's third ground of attack A (that the failure to disclose the weightings had not been rational and justifiable), that, in determining whether a decision was justifiable in terms of s 33, read with item 23(2)(b) of Schedule 6, of the Constitution, it was the soundness of the process of reaching the decision that had to be determined, rather than second-guessing the policy choices made. (Paragraph [20] at 693F - G/H.)
Held, further, that a public authority could apply policies, B standards and precedents when (a) this would not totally preclude the exercise of discretion; (b) the policies, standards or precedents were compatible with the enabling legislation; and (c) they were disclosed to the person affected by the decision before the decision was reached. (Paragraph [20] at 693G/H - I.)

Held, further, that the first respondent had met all three requirements and that the process by which it had reached its C decision had been sound. The failure to disclose the weightings had accordingly been justifiable in relation to the reasons given for it. (Paragraph [20] at 694B - C.)

Held, further, that the crux of the applicant's case was that the first respondent had been obliged to disclose the weighting to the tenderers notwithstanding that it had made it clear to the tenderers that the weighting would not be disclosed. The first D respondent had established that it had adopted a practice of not disclosing the weights; that the tenderers had been informed that the weights would not be disclosed; that there was a rational explanation for the practice; that that which it had sought to achieve had been achieved in a manner which had not been arbitrary in that all the tenderers had been treated equally; and that the policy, viewed objectively, had not been irrational. The non-disclosure of the E weightings accordingly passed constitutional muster. (Paragraph [21] at 694C - E/F.) Application dismissed.

OLITZKI PROPERTY HOLDINGS v STATE TENDER BOARD AND ANOTHER 2001 (3) SA 1247 (SCA)

Where the legal duty to prevent loss sought to be invoked by a plaintiff derives from the breach of a statutory provision, the question whether the statute imposed such a duty must be assessed not on broad or even abstract questions of liability, but on a general criterion of reasonableness, based on considerations of morality and policy, and taking into account the legal convictions of the community I and constitutional norms, values and principles. The focal question, however, remains one of statutory interpretation, since the statute may on a proper construction thereof itself confer a right of action, or alternatively provide the basis for inferring that a legal duty exists at common law. The process in either case requires the consideration of the statute as a whole, its objects and provisions, the circumstances in J
2001 (3) SA p1249
which it was enacted, and the kind of mischief it was designed to prevent. But where a common-law duty is at issue, the answer depends A less on the application of formulaic approaches to statutory construction than on a broad assessment of whether it is 'just and reasonable' that a civil claim for damages should be granted. The determination of reasonableness here in turn depends on whether affording the plaintiff a remedy is congruent with the Court's appreciation of the sense of justice of the community. This B appreciation must invariably include the application of broad considerations of public policy determined also in the light of constitutional principles and the impact upon them that the grant or refusal of the remedy sought would entail. (Paragraphs [11] - [12] at 1256F - 1257F/G)

The interim Constitution of the Republic of South Africa Act 200 of 1993 enjoins the courts in interpreting fundamental rights to promote the values underlying an open and democratic society based on C freedom and equality (s 35(1)), and in interpreting 'any law' to have due regard to the spirit, purport and objects of the fundamental rights Chapter (s 35(3)). 'Any law' in s 35(3) includes, where appropriate, the other provisions of the Constitution itself. (Paragraph [13] at 1258B - D.)

In 1995 the provincial government of Gauteng invited tenders for office D accommodation to house various government departments. The appellant obtained an option to purchase a building and tendered to provide office space in it to the provincial government. When its tender was not accepted the appellant instituted a claim for damages in a Provincial Division against the first and second respondents, the State Tender Board and the provincial government. The claim was pleaded on two alternative bases: (1) that the respondents had breached the E appellant's *right to a fair, public and competitive system of tendering as required by s 187(2) of the Constitution of the Republic of South Africa Act 200 of 1993 in that the provincial government, an interested party, had influenced the Tender Board in its decision to award the tender and that the latter had as a result awarded the tender to someone else; and (2) that respondents' above-mentioned conduct F constituted an infringement of the appellant's fundamental right to administrative justice enshrined in s 24(a), (b) and (c) of the Constitution, thus entitling it to damages for its lost profit. It appeared that the appellant had been aware of the facts on which it subsequently based its allegations of impropriety some nine days before the tender was awarded and that the provincial government's written recommendations to the Tender Board, which formed G the centrepiece of the subsequent complaint, had been made available to the appellant at that stage. The Court a quo held that both claims were untenable, but granted leave to appeal to the Supreme Court of Appeal.*

Section 187 of the interim Constitution provides that '(1) (t)he procurement of goods and services for any level of government shall be regulated by an Act of Parliament and provincial laws, which shall make H provision for the appointment of independent and impartial tender boards to deal with such procurements. (2) The tendering system referred to in ss (1) shall be fair, public and competitive, and tender boards shall on request give reasons for their decisions to interested parties. (3) No organ of State and no member of any organ of State or any other person shall improperly interfere with the decisions I and operations of the tender boards. (4) All decisions of any tender board shall be recorded.' Section 24 of the interim Constitution provides that '(e)very person shall have the right to (a) lawful administrative action where any of his or her rights or interests is affected or threatened; (b) procedurally fair administrative action where any of his or her rights or legitimate expectations is affected or threatened … and J
2001 (3) SA p1250

(d) administrative action which is justifiable in relation to the reasons given for it where any of his or her rights is affected or A threatened'.
Held, as to the appellant's contention that s 187 entitled it to claim for damages for loss of profits, that the overriding import of s 187 was to impose legislative duties on the national and provincial legislatures and to prescribe a minimum content for that legislation. Although s 187 evidently required the adoption of new, post-constitutional legislation, until such time as this was done, the B State Tender Board Act 86 of 1968 remained in force and had to be applied in conformity with s 187. This, however, offered scant comfort to the appellant because none of the provisions of the 1968 Act justified the conclusion that a tenderer's lost profits could be recovered for breach of its provisions. (Paragraphs [17], [20] and [21] at 1259C - D and 1259I - 1260E.)

Held, further, that the provisions of s 187 itself were also incapable of founding such entitlement. The content ss (1) C specified for the envisaged national and provincial laws did not assist in establishing a legal foundation for the appellant's claim. SubSection (2), while setting out the minimum desiderata for the system to be created, i.e. that it should be 'fair, public and competitive', left the legislative framework and its detail to the said legislatures. Provided the minimum desiderata were met, the D legislatures were free to limit an aggrieved claimant to a particular remedy such as interdict, review, or out-of-pocket losses caused by actual expenses arising from the breach complained of. SubSection (3), which prohibited improper interference with the decisions and operations of tender boards, was similarly subject to the legislative power to define the recourse occasioned by its breach, so that it could E not without more be concluded that its purpose was to ground a direct action for damages for lost profit. (Paragraphs [21] - [27] at 1260E - 1262C/D, paraphrased.)
Held, further, that this conclusion was underscored by the fact that the appellant's claim contained no prayer or averments regarding out-of-pocket expenses occasioned by the breaches relied on, but relied on lost profit from the tender it averred it would have been awarded had those breaches not occurred. In so doing the appellant F sought to evoke a

delictual remedy from the interstices of the Constitution while aspiring to recover through it a loss measured in contractual terms. While it was not impossible that a statutory provision might accord such a recompense for its breach, it was quite inappropriate for this to occur by judicial interpretation of a provision whose primary injunction was for legislative action to occur in that very area. Nor could it be contended that it would be just and G reasonable, or assertive of the fundamental values of the Constitution, to award an unsuccessful tenderer, who was able to prove malfeasance in the award, its lost profit. Due to its contentious nature the award of such an entitlement was a matter for decision by the national and provincial legislatures, not for judicial inference. (Paragraphs [28] - [30] at 1262C/D - 1263B/C, paraphrased.) H
Held, accordingly, that the appellant's first claim was rightly set aside by the Court a quo. (Paragraph [31] at 1263F/G - G.)

Held, further, as to the appellant's contention that an award for lost profits constituted 'appropriate relief', as intended in s 7(4)(a) of the interim Constitution, for the breach of the administrative justice provisions contained in s 24 thereof, that what constituted 'appropriate relief' depended on the circumstances I of each case. That the appellant had been aware of the facts on which it subsequently based its allegations of impropriety for some time before the tender was awarded had acute consequences for its ability to prove that an award of lost profit would constitute 'appropriate relief'. An interdict would not only have anticipated the dispute but also eliminated the source of loss invoked by the appellant. The fact that interdictory relief J2001 (3) SA p1251 was available at an early stage was relevant to the assessment of the appellant's claims that the award of lost A profit would vindicate the purposes of the Constitution and inhibit maladministration of public bodies, particularly in the light of the amplitude of the claim, which derived from a breach of fair process but sought to recover the equivalent of a successful outcome. Moreover, the impact on the exchequer of awarding damages over and above common-law entitlement in a country where resources were scarce raised serious B policy considerations which pointed away from the constitutional right to damages asserted by the appellant. (Paragraphs [38] - [42] at 1265G - 1267D, paraphrased.)

Held, further, that although it was not necessary to decide that a lost profit may never be claimed as constitutional damages, the lost profit claimed by the appellant was, in the circumstances of the C case, including the availability of alternative remedies, not an appropriate constitutional remedy. It followed that the second claim was also correctly set aside by the Court a quo. (Paragraph [42] at 1267D - E/F.) Appeal dismissed.
The decision in the Transvaal Provincial Division in Olitzki Property Holdings v State Tender Board and Another confirmed. D

EASTERN CAPE PROVINCIAL GOVERNMENT AND OTHERS v CONTRACTPROPS 25 (PTY) LTD 2001 (4) SA 142 (SCA)

Section 4(1) of the Provincial Tender Board Act 2 of 1994 (Eastern Cape) (the Act), provides inter alia that the tender board established in terms of the Act 'shall have the sole power to procure supplies and services for the province, and, subject to the provisions of any other Act of the provincial legislature, to arrange B the hiring or letting of anything or the acquisition or granting of any right for or on behalf of the province, and to dispose of movable provincial property, and may for that purpose - (a) on behalf of the province conclude an agreement, which shall be in writing, with a person within or outside the Republic for the furnishing of supplies and services to the province or for the hiring or letting of anything or the acquisition or granting of any right for or on behalf of the C province or for the disposal of movable provincial property; (b) with a view to concluding an agreement referred to in para (a), in any manner it may deem fit, invite offers and determine the manner in which and the conditions subject to which such offers shall be made; … .'. D

These and other provisions of the Act show how important a role the tender board is intended to play in ensuring good governance in the field of procurement policies and procedures and the priority accorded to fair dealing and equitable relationships among parties to provincial contracts. It is difficult to see any room for the co-existence of a power residing in other entities or persons within the provincial administration to do, without any reference whatsoever to the tender board, that which s 4(1)(a) and (b) empowers the E tender board to do. That the tender board 'acts on behalf of the province' in arranging to hire premises or in concluding a lease cannot derogate from the fact that s 4(1) disables the province from acting autonomously in this regard. (Paragraph [7] at 147F/G - H/I.) The mischief which the Act seeks to prevent is plain enough. It is to eliminate patronage or worse in the awarding of contracts, to provide members of the public with opportunities to tender to fulfil provincial F needs, and to ensure the fair, impartial and

Annexure E: Case law example of organised labour involvement in municipal services provision decisions

SOUTH AFRICAN MUNICIPAL WORKERS UNION v CITY OF CAPE TOWN AND OTHERS 2004 (1) SA 548 (SCA)

There is no language anywhere in the Local Government: Municipal Systems Act 32 of 2000 which expressly requires one to confine the ordinary meaning of the wide expression 'municipal services' where it appears in the Act to municipal services which are charged for or which G are notionally capable of being charged for and which have identifiable users. It cannot be accepted that throughout the whole of the Act any reference to municipal services must be taken to be confined to services which are chargeable to individual users. (Paragraph [8] read with para [6] at 550C/D - D, 549E - E/F and 550I - I/J.) H

As to the question whether a municipality is obliged to assess or take into account the views of organised labour before making a decision to establish a municipal police service: While the provisions (ss 16 - 21) in the Local Government: Municipal Systems Act which foster participation by the community as a whole in decision-making processes are cast in relatively wide and general terms, the provisions of s 78 are not. They are applicable only '(w)hen a municipality has in terms of s 77 to decide on a mechanism to provide a municipal service I . . . or to review any existing mechanism . . .'. They are not applicable to the anterior decision to provide a municipal service or even to extend an existing service. While the making of such decisions is subject to the general provisions of the Act that promote community participation, it is not subject to the specific provisions of s 78. J
2004 (1) SA p549

It is implicit in the plain language of s 77 of the Act (which provides that a 'municipality must review and decide on the A appropriate mechanism to provide a municipal service when - (a) … .; (b) a new municipal service is to be provided; (c) an existing municipal service is to be significantly upgraded, extended or improved; . . .') and, more specifically, in the tenses employed that it is not concerned with the anterior decision to provide a new municipal service or to significantly upgrade, extend or improve an B existing municipal service or to review an existing delivering mechanism. It is concerned with the question of how these things are to be done and not with the question of whether they should be done. It is, no doubt, conceivable that a consideration of 'how' may lead in a particular case to a revisiting of the question of 'whether' but that would be fortuitous and not the purpose for which ss 77 and 78 were enacted. That purpose is to compel a municipality, in the stated C circumstances, when considering 'how', to consider first how it could be done through an appropriate internal mechanism. Only after that has been done may the provision of the service through an external mechanism be considered. It is in considering these questions that s 78(1)(a)(v) and (3)(b)(v) oblige the municipality to assess or take into account 'the views of organised labour'. If s 77 is not plain enough, s 78 is. The opening words of D the provision also postulate that a decision has already been made to provide a municipal service or to review an existing mechanism. The provisions of ss 77 and 78 do not have to be complied with before a decision to provide a new service (in casu a municipal police service) or significantly upgrade, extend or improve an existing service is reached. (Paragraphs [11], [13] - [14] and [26] at 551E/F - G, 551J - 552D and 555G - H.) E
The decision in the Cape Provincial Division in South African Municipal Workers Union v City of Cape Town and Others confirmed, but for different reasons.

The following uncertainties and ambiguities in some aspects of the legislative framework do create risks for councils and MSP service providers.

- *The* scope *and extent of provincial intervention in municipal affairs are not sufficiently defined (see Provincial roles with respect to municipalities).*
- *The apparent prohibition under the Local Government Transition Act on a council's authority to* delegate *tariff-setting methodologies and tariff collection severely limits the full application of lease and concession type MSPs (see Municipal tariff-setting and collection).*
- *The rationale for the present municipal reporting requirements and consultation with the provincial* premiers *on certain types of MSPs is not clear nor fully justified (see Reporting to, and consultation with, national and provincial government).*
- *The parameters of procedural fairness in council decision making are not clearly defined (see Municipal* council *decision-making).*
- *The* scope *of a council's authority to pledge or incur financial obligations in structuring MSPs is unclear (see Limitations on financial powers of municipalities).*
- *The* Water *Services Act requires supporting regulations that provide councils with the appropriate flexibility to select MSP service providers, to specify the duration of contracts and other contractual provisions, public disclosure and the definition of basic services (see Water and sanitation services).*
- *There is* no *clear legislative authority to permit councils to form multi-jurisdictional service areas (see Multi-jurisdictional MSPs).*
- *Existing* procurement *legislation does not address adequately the specific requirements MSP procurement (see Municipal procurement).*
- *The scope and extent of consultative processes with labour by municipal councils with respect to MSPs are presently unclear (see Labour law: Overview, Institutional structure of municipal labour relations and Labour Relations Act).*
- *The present approaches to handling transferred membership and lump-sum payouts for municipal employees affected by an MSP are not optimal from the perspective of public policy, affected* employees *and municipal employers (see Municipal pension and provident funds).*
- *The* extent *to which MSP service providers are likely to be bound by the South African Local Government Bargaining Council, or other forums, is unclear (see Collective bargaining council).*
- *Unless* provided *for under other appropriate legislation, the Competition Act may apply to "dominant" or "monopoly" MSP service providers (see Competition Act).*
- *The tendency of the Companies Act to favour liquidation rather than reorganisation creates a risk that* municipal *services may be suspended if an MSP service provider encounters financial difficulties (see Insolvency laws).*
- There is no clear strategy for engaging NGOs or CBOs in MSP arrangements (see legal and policy issues affecting public-NGO/CBO MSPs).

The constitutional uncertainties with regard to provincial intervention pose risks to councils and MSP service providers that will be difficult to allocate in an MSP service contract, which will increase the cost of MSPs or, in some cases, discourage their use. These risks could be eliminated, or at least minimised by the adoption of national legislation to regulate the provincial and national intervention processes.