

TRANSFER OF FUNDS AND IMPLEMENTING AGENTS UNDER THE NEW DRAFT PUBLIC PROCUREMENT BILL

Helen Venter

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ABSTRACT

Section 14 of the draft Public Procurement Bill, 2020 provides that public corporations and private enterprises who receive transfer payments to implement projects on behalf of government should be bound by the procurement regime of the Bill. This paper measures the provision against the test for legality, if it should be passed, as-is, into law. The conclusion reached is that the section poses more questions than providing legal certainty, which was one of the objectives of the Bill.

Should it be the intention of the drafters of the Bill that public corporations and private enterprises who receive unrequited transfer payments from government should be bound by the procurement regime of those government institutions, it should properly indicate to:

- whom the provision applies;
- what the management, contracting and reporting requirements are, aligned to the current provisions in the PFMA and MFMA; and
- what arrangements apply to these organisations in terms of the procurement regime, bid committee systems, thresholds, dispute management, review mechanisms and enforcement.

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TRANSFER OF FUNDS AND IMPLEMENTING AGENTS UNDER THE NEW DRAFT PUBLIC PROCUREMENT BILL

Helen Venter*

Baccalaureus Legum (LL. B) Baccalaureus Iuris (B.Iur.)

Advocate of the Supreme Court of South Africa.

Affiliate member of CIGFARO [Chartered Institution of Government Finance, Audit and Risk Officers].

1 Introduction

Large corporates are public sector tenderers rendering construction and related services as implementing agent/turnkey contractors on behalf of government. Section 14 of the draft Public Procurement Bill, 2020¹ poses a significant impact on its future sustainability if the section is retained, as is, when the Bill is promulgated into law.

It is author's view that the Bill is fraught with constitutional and legality challenges (*especially from an administrative-law perspective*) and as the basis of the law is flawed, it requires a redraft in totality. However, for purposes of this contribution, the author will only focus on the interpretation and impact of section 14 of the Bill, which provides as follows:

"14. If an institution transfers funds to a person or organisation other than an organ of state to implement a project on behalf of the institution, any procurement arising from the project must be in accordance with this Act."

The purpose of this contribution is thus to offer a few remarks related to the Bill, and more specifically the impact of section 14, if the Bill, as is, is passed into law. In the discussion below, distinct aspects of this section are individually discussed.

* This paper is written based on own opinions and interpretations. Special recognition is given to Vos AJ in his brilliant judgement of *MEC for Economic Opportunities, Western Cape v AGSA* (19259/2018) [2020] ZAWCHC 50 (8 June 2020), where he very aptly describes the complexity around transfer payments.

¹ Hereafter referred to as "the Bill".

2 DISCUSSION

2.1 *Transfer of funds*

Section 14 is triggered when an institution *transfers funds*. The question arises what “transfer of funds” means, its current application in government and the impact on institutions receiving “transfer payments” from government.

2.1.1 *Current application in government*

Transfer payments are unrequited funds that are transferred to other institutions, businesses and individuals.²

The qualification criteria for transfer payments is that it is an **unrequited payment** made by the government unit. A payment is **unrequited** provided that the government unit **does not receive anything of similar value directly in return for the transfer** to the other party.³

Since the inception of the Public Finance Management Act 1 of 1999 (“PFMA”) and the Local Government: Municipal Finance Management Act 56 of 2003 (“MFMA”), transfer payments were made in terms of section 38(1)(j) of the PFMA and section 67 of the MFMA to persons or organisations.

Service delivery and transfer payment agreements are entered into with these persons or organisations within a regulated environment and reported on separately in the relevant government institution’s financial statements.

The contracting with these persons or organisations occurs outside of the procurement regime of government and they do not tender for services⁴ or apply government procurement prescripts.

² National Treasury 2009: 19.

³ National Treasury 2009: 66.

⁴ Examples of current transfers are social security benefits paid to households, fines, penalties, compulsory fees and subsidies. Examples of capital transfers are a payment that is conditional on the recipient unit using the funds to acquire capital assets.

In its classification circular of 28 May 2018,⁵ the National Treasury made a clear distinction between the management and classification of expenditure classified as “transfers” vis-à-vis “goods, services and capital assets”.

“Transfers” to public corporations and private enterprises are *only* allowed in the case of subsidies on products, transfers to acquire capital assets or cover large operating deficits. Where government use public corporations or private enterprises as service providers or agents, expenditure to them is classified as goods and services.

It is evident from the classification circular referenced above,⁶ that the National Treasury is of the view that where government uses another agent (within or outside government) for acquisition of goods and services or capital assets, such expenditure may not be classified as a “transfer” but “goods and services”, thereby confirming that the principle of “transfer of funds” does not fall within the same environment as “goods and services”.

In the event that the Bill is passed into law, without clarification on the definition of “transfer of funds” and the potential augmentation of the PFMA and MFMA provisions with regards to “transfers”, it may result in a situation of legal uncertainty with regards to the management, contracting and reporting of “transfer of funds” in government institutions.

2 1 2 Impact on institutions receiving ‘transfer payments’ from government

If the intention of the drafters of the Bill were to refer to public corporations and private enterprises who receive transfers and subsidies from government as classified by the National Treasury as “transfer payments”, the implications have to also be clearly considered.

The classification circular⁷ from National Treasury indicates that transfer of funds offer beneficiaries the discretion to spend the funds received on any goods and/or services according to their individual needs.

⁵ National Treasury 2018: para 12.

⁶ National Treasury 2018: para 6.2.

⁷ National Treasury 2018: para 7.2.

In the past, these beneficiaries were not forced to apply government procurement prescripts, mostly because of the fact that they operate within normal private sector commercial principles. It is unclear what the impact of this provision will be to those beneficiaries.

2 2 To a person or organisation other than an organ of state

This part of the section raises the question as to whom section 14 applies.⁸

Section 14 provides for the transfer of funds to a “person” or “organisation” other than an organ of state, but fails to define “persons” and “organisations”.

Of interest though, is that the Bill defines a “bidder” to be any “person” or entity who tenders for a bid.

Some may argue that it could be deduced that a “person” defined as a “bidder” will also mean a “person” as contemplated in section 14 of the Bill to whom funds are transferred. Extrapolating this argument, it may follow that section 14 of the Bill purports to apply to “bidders” to whom a government organisation “transfer funds”.

In the event that section 14 applies to bidders, it would result in an absurd situation that all service providers and suppliers to government will have to procure goods and services within the provisions of this Act. This could surely not have been the intention of the legislator and will most definitely not pass the test of “legality”.⁹

2 3 Implement a project on behalf of the institution

When does a person or organisation “implement a project on behalf of government” and how does this phrase align with “transfer of funds” as used in the same section?

⁸ Also refer to ‘implementing agents’ discussion in section 2 3 2 below.

⁹In administrative-law context, and for purposes of this contribution, the requirement of s 1(c) of the Constitution of the Republic of South Africa, 1996 is the principle on which my comments are anchored. This founding provision ensures that, as a constitutional democracy, the state holds the Constitution as the supreme law and upholds the rule of law by inter alia complying with the Constitution. It also needs to ensure that the exercise of public power by the Executive and other functionaries should not be arbitrary. Decisions must be rationally related to the purpose for which the power was given, otherwise they are in effect arbitrary and inconsistent with this requirement.

2 3 1 Alignment with 'transfer of funds' in the same section

Funds are only transferred by government to persons or organisations on an “unrequited” basis, meaning that the government unit does not receive anything of similar value directly in return for the transfer.

If a person or organisation “implement a project on behalf of government”, it is argued that the government unit does receive services and could the “transfer of funds” not be seen as being unrequited.

Mindful of the discussion of “transfer of funds” above, it is argued that the portion of the wording “implements a project on behalf of government” in section 14, is directly in contradiction with “transfer of funds on an unrequited basis in government”.

2 3 2 Potential impact on “implementing agents”

In normal practice, when government employs a person or organisation to implement a project on its behalf, that arrangement is regarded as an “implementing agent”.

An example would be that The Housing Process Guideline, 2009, issued by the National Department of Human Settlements, established the practice of municipalities appointing implementing agents, for housing projects. In this instance, the implementing agent, will, on behalf of these municipalities, deliver on a turnkey contract basis, general, construction and infrastructure goods and related professional, engineering and construction services.

It is therefore argued that section 14 of the Bill, in its current form, means that these “implementing agents” will have to adhere to the provisions of this section when it is appointed to deliver on housing projects, as it will “implement a project on behalf of government”.

The questions immediately evident would then be:

- If each government institution has its own SCM system, must those “implementing agents” develop separate SCM systems aligned to each of those institutions?

- What are the minimum management, contracting and reporting requirements?
- What arrangements will apply to the “implementing agent” with regards to the procurement regime, bid committee systems, thresholds, dispute management, review mechanisms and enforcement?
- How will these “implementing agents” be able to ensure a sustainable and competitive business concept, whilst accepting all these onerous administrative requirements and risks?

2 4 Any procurement arising from the project must be in accordance with this Act

It is noted that the drafters of the Bill uses peremptory language in this section, namely that where funds are transferred to a person or organisation, the latter MUST procure goods and services within the procurement regime of this Act and is not allowed any form of discretion or exemption to any of the onerous provisions of the Act.

The impact on such person or organisation would be that it will have to develop its SCM system inclusive of a bid-committee system aligned to a governmental bureaucratic system and it appears that they will also be bound by the same dispute resolution and review mechanisms prescribed for government. The reporting and enforcement requirements, however, remain an open question.

It is author’s view that this provision is open to legality challenges, in terms of the Competition Act 89 of 1998, which applies to the State,¹⁰ based on the following reasoning.

Government abuses its dominant position by promoting uncompetitive commercial practices, which is prohibited in terms of section 6 of the Competition Act. The argument is put forward as section 14 of the Bill forces a person or organisation to act, to an appreciable extent, independently of its competitors, customers or suppliers as they have to apply the rules, thresholds, preferences and supplier databases of

¹⁰ Competition Act, section 81: “This Act binds the State”.

Government. This practice is contrary to their or their competitors' normal way of doing business.

As a person or organisation must now procure within a highly regulated and convoluted system, it may negatively affect its efficiencies or "competitive edge" and thereby actively impedes or prevents them from entering into, or expanding within, a market. The effect hereof falls within the classification of an "exclusionary act"¹¹ as per the definitions of the Competition Act.

The practice foreseen by this provision may also be classified as collusion as it allows government and its "agents" to enter into an arrangement designed to achieve an improper purpose, which may be regarded as improperly influencing the actions of another party or designed to result in bids at artificial prices that are not competitive.

3 CONCLUSION

In conclusion, it is author's view that section 14 of Bill will not pass muster on the test of legality and poses more questions than providing legal certainty, which was one of the objectives of the Bill.

If it is the intention of the drafters of the Bill that public corporations and private enterprises who receive unrequited transfer payments from government should be bound by the procurement regime of those government institutions, it should properly indicate to:

- whom the provision apply;
- what the management, contracting and reporting requirements are, aligned to the current provisions in the PFMA and MFMA; and
- what arrangements apply to these organisations in terms of the procurement regime, bid committee systems, thresholds, dispute management, review mechanisms and enforcement.

¹¹ Competition Act, section 1(x).

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