Overview of the Eskom 'capital scrubbing project' awarded to PwC as the principal contractor after a competitive bidding process

In August 2016 PwC was appointed as a "Panel A" member on Eskom's panel of professional services providers under contract number 4600061004 following a competitive bidding process. In September 2016 PwC (and we believe three other professional service providers on "Panel A") received an invitation from Eskom's procurement division to quote on a project to design and implement a programme that would identify and achieve savings on Eskom's five-year capital expenditure ("the capital scrubbing programme").

Initially Eskom sought to achieve a saving of R 30 billion - R 40 billion in capital expenditure over five years. The capital scrubbing would be achieved in three ways:

- identifying capital projects where expenditure could be deferred, cancelled or de-scoped, without compromising on safety and security and Eskom's ability to supply energy to South Africa;
- Increasing Private Sector Participation (PSP) by having the private sector invest in capital projects and reduce Eskom's reliance on borrowed funding; and
- build Eskom's capacity to optimize the way it plans and executes their capital expenditure budget and portfolio, thus reducing the reliance on consultants.

PwC submitted a quote in response to the competitive bidding, with a dual fee structure of fixed fees and risk-based remuneration. In October 2016 Eskom's procurement division advised PwC that given cost pressures and the desire to pay for results, it wished to pursue a risk-based fee arrangement for the capital scrubbing project and asked PwC to submit a revised quote solely on that basis.

Risk based fees would mean that the consultant would only be paid if a saving was identified and approved by Eskom's governance structures.

PwC understands that this requirement for a risk-based fee arrangement was done as a result of Eskom's liquidity pressure, and that the State-Owned Enterprise could only afford to pay consultants for proven savings realised through the capital scrubbing process.

We were also advised that this outcome/risk-based approach was being applied on other initiatives in Eskom to achieve results, and had Treasury approval.

What followed was the award of the project to PwC on a "risk based" fee basis, subject to contract number 4600061004, supplemented by an addendum and task order SM003. The addendum was finalised and concluded in January 2017 and the task order in February 2017, by which time the client had also increased the capital expenditure savings target to R65bn. In April 2017 a revised task order was issued extending the project to July 2019.

The sub-contracting relationship with Nkonki

The panel appointment agreement 4600061004 required PwC to assign a minimum of 15% and a maximum of 25% of work to suppliers on Eskom's Panel B list in terms of a supplier development programme. This requirement was subsequently amended to 40% and was to include members on Eskom's B and C panels.
PwC accordingly entered into the agreement with Eskom as principal contractor and entered into subcontracting agreements with Aurecon and Nkonki. In order to comply with Eskom's supplier

development requirements in relation to Panel A members, we subcontracted a target of 30% of the work to be allocated to Nkonki and 20% to Aurecon as technical partners, with the condition that suitably skilled resources were deployed to the extent of the 30% and the work delivered was of a satisfactory quality.

Given Aurecon's brand and international standing as an engineering and infrastructure advisory company, PwC approached Aurecon to partner with it in rendering management consulting services to Eskom.

Nkonki was already an Eskom panel member (Panel C) and was a rational choice as a subcontractor to PwC based on the fact that they were working on other projects within Eskom and hence had a good understanding of the client context. PwC and Nkonki have also successfully worked together previously in other State-Owned Enterprises.

As is required by our internal governance processes, PwC subjected Aurecon and Nkonki to our standard risk management procedures and joint business relationship procedures prior to submission of our bid and entering into the subcontracting agreements with them. Both Aurecon and Nkonki had met the requirements of PwC's own internal risk and independence assessments.

Project fees

In terms of the original risk-based contract, PwC would have been paid fees on a sliding scale between 5% - 7.5% of savings identified and where such savings had been vetted and approved through Eskom's governance structures.

The fees earned were to be shared between PwC and its subcontractors relative to the supplier development targets and effort expended. The project was contracted for the period January 2017 to July 2019 and not for five years. The five years related to Eskom's five-year capital expenditure budget, so that savings identified during the period January 2017 to July 2019 would result in savings in capital expenses for Eskom over the next five years.

PwC received no risk-based payments at any time. The only payments that were received relate to time and effort expended by the team in the delivery of the agreed work at the Eskom panel rates and in line with Treasury guidelines. Once PwC was paid, it paid its subcontractors' invoices on the basis of time spent on the project.

As a subcontractor, Nkonki has been paid approximately R 17 million, VAT inclusive, to date. Nkonki had a number of members on the engagement team, including subcontracting a portion of their work to EPCM Consultants (for their technical and engineering capabilities). Nkonki and subcontractors have spent time rendering technical assistance during the capital scrubbing process (supported by individual time sheets) covering, amongst others, the following key functional areas:

- identifying cost saving initiatives across the various divisions within Eskom;
- analysis of the capital budget for potential savings;
- site visits to various power stations to meet Eskom officials to establish and verify in relation to identified savings initiatives, the following:
    - risks associated with project execution;
    - risk of postponing/deferring of projects;
    - risk associated with cancellation of projects;
- data collection for the development of the portfolio optimization model;
- Involvement in the development of the formula for the financial modelling;

- Trend analysis on capital portfolio data;
- Providing resources to support the PSP (Private Sector Participation) team; and
- Finalisation of the PSP policies to be adopted by Eskom.

Nkonki/EPCM and Aurecon worked with PwC as integrated teams deployed on the various initiatives during the execution of our scope of work.

PwC and its subcontractors identified approximately R 56 billion in savings that are at the various levels of Eskom's governance approvals for implementation. PwC and its subcontractors also identified a full portfolio for Public Sector Participation and have designed the optimization tools, governance process and policies for implementation by Eskom for its capital expenditure budget and portfolio going forward.

Status of the contract

The agreement between PwC and Eskom has not been cancelled. PwC remains on the Eskom Panel. The project end date (i.e. Task Order SM003) was brought forward to March 2018 and the payment structure reverted to a time and materials basis from a risk-based fee basis.

The project was reverted solely to a time and material basis by agreement between PwC and Eskom, after it came to PwC's attention that notwithstanding Eskom's confirmation to the contrary during the project negotiation phase, Eskom had not obtained Treasury approval for the risk-based agreement.