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HEARING ON 09 JUNE 2014

CHAIRPERSON: Good morning everyone. Ms Ramagaga can you talk?

MS RAMAGAGA: Good morning chair and Commissioner
5 Musi. The witness that we will be presenting to the commission today is Mr Jayendra Naidoo and he has taken the stand.

CHAIRPERSON: Can the witness take an oath or an affirmation if he has a problem with the oath?

10 MR NAIDOO: I do.

MS RAMAGAGA: Thank you, Chair. The evidence of Mr Naidoo, as well as, or rather the statement of Mr Naidoo, as well as supporting documents is contained in one file. So, any reference that is going to be made today will be from
15 that one file that has been submitted to the commissioners. May I proceed, Chair? Thank you. Mr Naidoo, you are executive chairman of J and J Group. Is that correct?

MR NAIDOO: Yes, that is correct.

MS RAMAGAGA: And you have attached a short curriculum
20 vitae to the statement and it is marked JN1. Is that correct?

MR NAIDOO: That is correct.

MS RAMAGAGA: And that curriculum vitae appears in page
39 of the file.

MR NAIDOO: That is correct.

25 MS RAMAGAGA: You, you, you have made a statement for use at this commission hearing and the last page is page 38 of the bundle. Do you see that?

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MR NAIDOO: I see that.

MS RAMAGAGA: Now, that statement is dated the 7th day of June 2014 and it has a signature on top of the name, Jayendra Naidoo. Is that your signature?

5 MR NAIDOO: That is my signature.

MS RAMAGAGA: Do you confirm that the contents of the statement are the correct reflection of what you want to deal with before the commission today?

MR NAIDOO: I confirm that.

10 MS RAMAGAGA: Commissioners, before I proceed to lead the witness from his statement, I would like it to the attention of the commission that Mr Naidoo, being the appointed chief negotiator in the SADP exercise or procurement had to report to the ministerial committee.
15 Also, when given the go ahead by the ministerial committee, who would report to cabinet.

Now, in his presentation of evidence, he will rely on memory as well as minutes, where possible. I just want to bring it to your attention that the following sets of
20 minutes and presentations are not available. But, to an extent, possible Mr Naidoo will rely on his memory.

The ministerial committee minutes of the 6th day of April 1999 are not available and also, the presentation of that, to that meeting is not available. The meeting of the
25 31st day of August 1999, we do have the minutes in the bundle. However, the presentation that was made by Mr Naidoo, on behalf of the IONT is not in the bundle.

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The commission has indicated that it has not been able to trace those minutes. The meeting of the 24th day of November 1999 is actually referred to as the last meeting at which the IONT made a presentation. Now, those
5 minutes are not available, as well as, the presentation that was made at the meeting of the 24th day of November, it is not available.

The commission has indicated that it has, it is unable to trace those minutes. May I just take one step
10 back and also indicate that there, according to Mr Naidoo, there was also a meeting that was held on the 14th day of September 1999. That is just on the eve of his presentation to the cabinet.

The minutes of that meeting or briefing that he
15 gave to the ministerial committee, are not available and as well as, any presentation that was made there. But, I would just like to highlight that it may be possible that the presentation could be substantial in the same as the presentation that was made to cabinet the following day.

20 But, as to whether that is so or not, commissioners, it is something that, if possible, may be clarified by Mr Naidoo. The presentation of the 31st day of August 1999 is also referred to in the evidence that Mr Naidoo presented before the date, on the 13th of June and
25 14th of June in 2001.

But, even at that hearing he indicated that he was not in possession of that presentation. But, that

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presentation should be in the custody of his principal, in this case, the institution that had given him mandate.

Having given this background to the commissioners, I will now proceed to lead the evidence, through the statement. May I proceed, Chair? Thank you.

MS RAMAGAGA: Mr Naidoo, you have been requested to come and present evidence before the commission and you have agreed to co-operate, notwithstanding the fact that you were not subpoenaed. Is it correct?

10 MR NAIDOO: That is correct. I was informed that the subpoena would be served. But, it has not been served. So, I am here voluntarily at the request.

MS RAMAGAGA: Alright. Now, in terms of paragraph 3 of your statement, you indicate that you have previously given evidence before the joint investigation task team, which will from time to time be referred to as the JIT and you did present your evidence there. You have, in this statement, incorporated relevant portions of your briefing to the JIT hearings. Is that correct?

20 MR NAIDOO: That is correct.

MS RAMAGAGA: Now, you also indicate that you, you will not just restrict yourself to the evidence that you presented to the, to the JIT. However, you are willing to, from time to time, highlight where ever you are required for more information, provided that you are able to do so.

25 MR NAIDOO: I will answer all the questions to the best of my ability.

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MS RAMAGAGA: Now, turning to page 2 of your statement, you indicate in pages 2 and part of page 3, as to what is it that this statement is going to deal with. Is that correct?

5 MR NAIDOO: That is correct.

MS RAMAGAGA: And in pages 3 to pages 4, you just give a synopsis, or just in a [indistinct] form the chronology of events. Is that correct?

MR NAIDOO: That is correct. These are events dealing
10 with the time from my appointment, as chief negotiator, until my time, my duration of my contract expired.

MS RAMAGAGA: Alright. Thank you. Now, I would like you to turn to page 5 of your statement and briefly, I would like to invite you to give this commission the background,
15 relating to your appointment and as to who you reported to and how that would be done. That appears from page 5, paragraph, under background, it is the sub-paragraphs 1, 2, 3.

MR NAIDOO: I was appointed as the chief negotiator on
20 the defence packages, as we call it, by Deputy President Thabo Mbeki on 9th of December 1998. However, I, I commenced duties on the 20th of November 1998 already, after informal approach by the Minister of Trade and Industry, Alec Irvin. My contract was undertaken by Armscor
25 and I had a budget to employ a personal assistant and to contract a small number of professional support staff. I reported directly to the Deputy President, who subsequently

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became President, during the course of that year, 1999. The ministers committee, which was constituted by cabinet for the purpose of this, consisted of the Minister of Defence, Minister of Finance, Minister of Trade and Industry and with
5 the involvement of the Minister of Public Enterprises. The Minister of Public Enterprises was associated with this, but was, and was present in the ministers committee. But, their department had a lower involvement with the activity of the international office negotiating team, as the body was
10 called. The body, international office negotiating team was comprised of members of those three departments. On the side of the defence, it was represented by Armscor, supported by the Department of Defence and the side of finance, by the Department of Finance and the trade and
15 industry, the Department of Trade and Industry and a representative in this, in this committee. Would you like me to cover all through the contents of paragraph 3?

MS RAMAGAGA: Just before you proceed to the next, the next paragraph. Please switch off. You mention in
20 paragraph 2 of your statement that met with the Deputy President, prior to each meeting of ministers committee, except the meeting of April 1999. Now, are you able to tell the commission, as to why, in respect of this meeting, you did not meet with the Deputy President, prior to that
25 meeting?

MR NAIDOO: I, I cannot recall a specific reason. I would think that he was not present in the, and not available. If I,

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If memory serves me right, he also did not attend that meeting. But, I may be wrong.

MS RAMAGAGA: Thank you. In, in paragraph 3 of your statement, you mention that you also met separately with
5 each of the ministers, who were members, prior to each ministers committee meeting, to brief them on progress and to understand their perspective on the issues. Now, can you indicate to this commission as to whether you would, in your briefing with the line ministers also, present them with a
10 pack that would have been presented at the ministerial or ministerial committee meeting? Or would it just be a sort of informal briefing with each line minister?

MR NAIDOO: There were document packs prepared, in advance of each ministers committee meeting, which would
15 have been circulated to the minister, prior to the meeting so that he would be able to read it and come fully prepared to the meeting. There were very few documents that were presented at the meeting cold. So, I would not have a different document, to present to the minister. The purpose
20 of these meetings was simply to help them become familiar with the contents, with the work that had been undertaken and to get a view from them on what were the key issues. So that in the ministers committee meeting, itself, one would be able to help facilitate a consensus, by dealing with the
25 issues, whatever the issues were that were requiring discussion to be, to be smoothed out, beforehand.

MS RAMAGAGA: Alright. Thank you. Still on paragraph

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3, but in page 6, in the statement, you make mention that, where necessary, you would refer the commission, in particular to the minutes of the ministers committee, of the 20th of January, 6th of April, 26th of May, 31st of August and
5 24th of November. Now, it is correct, Sir, that at the time when you signed the statement, you signed it in anticipation of receipt of also, minutes of the 6th day of April 1999, as well as the minutes of the 24th day of November 1999, which are unfortunately, not available today. Is it correct?

10 MR NAIDOO: That is correct.

MS RAMAGAGA: Commissioners, I would request that then, that statement should read the rest of the minutes, except the 6th of April 1999 and the 24th day of November 1999. Now, the resultant effect would be that, even the
15 number of annexures would change. But, that is something that can be taken care of later. What I would just like to sensitize you to is that you will not find all the annexures, ANNEXURES 2 to 6 in the bundle, because the bundle that we have given you, had left those blank and they will
20 continue to be as such. May I proceed? Thank you. Now, in paragraph 4 of your statement, you also mentioned that you met with heads of departments, or advisors to ministers from time to time. Is that correct?

MR NAIDOO: That is correct.

25 MS RAMAGAGA: Now, in paragraph 6, you also mentioned that you had numerous interactions, even with other interest groups and you mentioned those interest groups. Or rather,

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you just say interest groups of certain institutions. Do you confirm that that was the case, then?

MR NAIDOO: That is correct.

MS RAMAGAGA: Now, in page 7, now of the statement,
5 you are talking about your open communication with the government communications and information system. Is that where you would then give information to the general public from time to time? Or what is the position, what was the purpose of that communication?

10 MR NAIDOO: It was both to inform the senior members of the media, so they would get a good insight into what was a, a issue of some depth and complexity. So, in their work, in their reporting, they would be, they were informed. It was also to directly participate in media briefings, where, where
15 the public, at large were directly informed, through the media briefings.

MS RAMAGAGA: And moving on then, in paragraphs 1 and 2, you give information about your appointment and the public announcement of your appointment, as well as to, as
20 to when your appointment formally came to an end. However, you do mention that you were supposed to render further services from the 3rd of December, up until the financing contracts had been concluded and signed by the Minister of Finance. Is that correct?

25 MR NAIDOO: That is correct.

MS RAMAGAGA: Now, effectively, your, you parted ways with your work as the chief negotiator finally, in or around

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January, or beginning February. Is it fair to say so?

MR NAIDOO: When the finance contracts were signed at the end of January, my association with this project was completely concluded.

5 MS RAMAGAGA: Now, take us through paragraph 3, you, where you deal with your co-function as the chief negotiator.

MR NAIDOO: My co-function was to chair the negotiations with the preferred bidders and to direct and lead the South African negotiating team to the desired outcomes, in respect
10 of an agreed, affordable package. This mandate required consensus internally, within the South African government and between the government and the preferred bidders, as well as, between the government and the, the finance institutions. The government, in this case, was being
15 represented by Deputy President and later President Mbeki and the sub-committee of ministers and their departments.

MS RAMAGAGA: Alright. Thank you. And, and you also mention in the succeeding paragraph that the, your, the appointment was initially envisaged to be for six months, but
20 we now know that you served as such for about a year, or so. Now, shall you then proceed to go to the next topic and that is the establishment, in terms of reference of the negotiating team and affordability team. Now, when, when you present evidence in this line, I just want to bring it to
25 your attention that Mr Andrew Donaldson has already testified before this commission. He has spoken about the establishment of the affordability team. He has also spoken

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about the constitution of the affordability team. So, I will invite you to actually, focus more on the key issues addressed in the terms of reference that you were given as the IONT.

5 MR NAIDOO: The, the first meeting that I was party to, was one convened on the 20th of November 1998, by the Minister of Trade and Industry and that involved representatives from the Department of Defence, Department of Trade and Industry, Finance and myself to discuss the
10 question of establishment of a negotiating team. That led to my contract with the Armscor and involvement as the chief negotiator and a terms of reference document was drawn up. This was finally approved in the first formal meeting of the ministers committee, which was on the 20th of January 1990
15 and the ...[intervene]

MS RAMAGAGA: Is it 1999?

MR NAIDOO: It is 1999.

MS RAMAGAGA: Okay.

MR NAIDOO: Thank you. 20th of January 1999, the
20 negotiating team was required to negotiate an achievable funding arrangement and an affordable package with the preferred suppliers, which will result in final contracting. That is the phrase that was used. Further, it was to negotiate and conclude an affordable set of contracts, which
25 satisfactory combine the technical, industrial participation and financial imperatives of the South African government. That terms of reference is part of the document I have

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[indistinct]. The negotiating team consisted of the, the following representatives, if I can go to that correctly.

MS RAMAGAGA: Yes.

MR NAIDOO: It, I have that actually, on paragraph 5 on
5 page 10. Perhaps I should wait for you to get that.

MS RAMAGAGA: Okay. Alright. Then, maybe let me just take you a step back about the terms of reference. From the minutes, as well as, the minutes of the 20th day of January 1999, as well as, the annexures thereto, there are two
10 documents that are described as terms of reference. I want to believe, at that stage, they were still draft terms of reference and the two documents were then considered, were tabled before the committee and the ministerial committee, then, having considered the two documents, then
15 they indicated that, in principal, they would endorse the document, described as ANNEXURE B. Because there two, there was one marked ANNEXURE A, the other one marked ANNEXURE B, as the terms of reference that you would use, moving forward, subject to some amendments that have been
20 suggested at this meeting. Is that correct, Sir?

MR NAIDOO: Yes. Looking at the minutes of the meeting, held on 20th January, I can confirm that two annexures were presented and after discussion at the meeting, it was decided that the document, contained in ANNEXURE B,
25 would be used as the base document from which further changes would be considered.

MS RAMAGAGA: Now, are, are you able to inform this

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commission as to whether there is any final document that was adopted as the terms of reference for the IONT?

MR NAIDOO: I believe that the meeting of the 20th of January adopted these terms of reference that is in
5 ANNEXURE B, with, with certain changes, which were, were, you know, operationally effective. I am trying to find the document now. I see it is in [indistinct] u.

MS RAMAGAGA: Ja, may I just, may I just help you, Sir. If, if you look at page 41, page 41 of the bundle,
10 commissioners. Page 41 is the second page of the ministerial committee meeting minutes. Now, when, when you talk about possible, will you just switch off there? Ja, when you talk about subject to changes that should be made, are you referring to these issues, issue one, two,
15 three and four, that were raised by the specified ministers, with regard to terms of reference? I am asking you this, because from these minutes, it is indicated that ANNEXURE B would be adopted, subject to the factoring in of these issues, raised by the ministers. Is that what you are looking
20 for?

MR NAIDOO: I believe that is correct.

MS RAMAGAGA: Alright. Thank you then. So, that then became the basis, upon which you were to operate. Now, the specific terms of reference, of your team, have actually,
25 already been quoted into the record by Mr Alec Irvin, at the time when he presented his evidence. Shall you then, proceed to paragraph 4, where you are now talking about the

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specifics that had to be done, or undertaken by the negotiating team? In particular, I would like you to draw your attention to the last line in that paragraph, paragraph 4 which reads:

5 *“The whole negotiation of the NIP terms was conducted by the full negotiating team, rather than separately, by the DTY, while initially, the chief negotiator in the Department of Finance engaged in the finance engaged in the finance negotiations. Subsequently, these were conducted by the*
10 *Department of Finance, assisted by the Department of Defence.”*

Can, can you just shed light on this very last part of this sentence, where you say at a certain point, then the negotiations relating to finance were then done by the
15 Department of Finance, assisted by the Department of Defence. Does that mean that at that time, the negotiating team had taken a step back? Or what is the position? Please explain?

MR NAIDOO: The initial negotiations with the preferred
20 that is and the export [indistinct] agencies and the international banks were conducted by the team and primarily the representative of the Department of Finance, Mr Roland White and myself, leading that. But, the Department of Finance had sufficient capacity. So, as the
25 negotiations moved forward, they were in the context of the negotiating team, they managed that negotiation, without any further input from myself or the members of the

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negotiating team, except at the point, when they reported back and they got feedback. So, we did have to co-ordinate what was being undertaken in each of the different negotiation areas. But, they conducted that negotiation and led that negotiation and the Department of Defence did play a supportive role to them in that.

MS RAMAGAGA: And, thank you. Do you also mention that the technical area was actually left to Armscor and the Department of Defence, provided that they did not exceed the cost approved by the cabinet in November 1998? The evidence that has been presented before the commission also, is to the same effect that the Department of Defence would actually be charged with dealing with issues, the technical areas and, and you, you confirm that. Now, I want you to turn to page 10 of the statement, unless there is anything else that you want to highlight on paragraph 4 in page 9. Is there anything else that you would like to highlight?

MR NAIDOO: No. That is fine. Thank you.

MS RAMAGAGA: Alright. Thanks then. In page 10, paragraph 5, in particular, you are talking about the constitution of the negotiating team. Is that correct?

MR NAIDOO: That is correct.

MS RAMAGAGA: And then, in paragraph 6, you allude to the fact that the negotiating team was also supplemented by government staff of affected or relevant departments. Is that correct?

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MR NAIDOO: That is, that is correct.

MS RAMAGAGA: Now, you, will you just highlight anything important that you would like to talk about in this paragraph, because I see you are talking about the financial modelling and analysis, as well as, the proposed NIP projects.

MR NAIDOO: The financial modelling, which was later on taken over, under the affordability team, which was a subset of the negotiating team, was undertaken primarily by the contract staff, hired by the Department of Finance, a consultant, hired by myself, in my capacity as chief negotiator and in conjunction with the Bureau for Economic Research at the University of Stellenbosch, who had a macro economic model, that was then used to test the assumptions, related to this project. The, the values of the NIP projects and what could be assumed in terms of the impact, with regard to investments, revenue, be it exports, or domestic sales and any other relevant economic factor, that had to be assessed by people who were more closer to the cold face, within the DTI and who had done the work on these projects. So, they, they made input on, on all of that. We did not independently assess the project, except for certain projects, which will be referred to later, were, because of the major impact they had, because of their size, we had some independent consultants, international consultants, evaluate [indistinct] and the steel industry area.

MS RAMAGAGA: Alright. Thank you. That now, leads us to paragraph 7, that is, that deals with the experts that you

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sought, in order to increase, or enhance the capacity of the negotiating team. Will you please take the commission through that?

MR NAIDOO: At the first meeting of the ministers
5 committee on the 20th of January 1999, it was agreed that, due to the size and the importance of this project, that world class advisors should be obtained. Firstly, in legal and as a result of that, a process of engaging a shortlist of legal advisors was undertaken and the firm White & Case was
10 selected. This, this was undertaken primarily by the departments involved, being Department of Defence, supported by the Department of Finance. So, they chose White & Case. It was undertaken under the auspices of the [indistinct] departmental negotiating team that executed that
15 way. Then, in addition, on the Financial side, there was a need for a financial service support team to assist the team in the finance negotiations, in particular with the export curve agencies and the Department of Finance undertook a process, via a shortlist and selected Wilbur, Gillan and
20 Reed, which was a London based investment bank.

MS RAMAGAGA: Alright. Thank you. And in the following paragraph, you are making reference to what happened, after the meeting of the 6th day, ministerial committee meeting of the 6th day of April 1999. Now, before dealing
25 with what happened, after that meeting, are you able to inform the commission about any presentation that you made to this meeting, any resolutions that were made by this

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meeting, except for the formation of the affordability team, as well as, any mandates that were given to you at this meeting of the 6th day of April 1999?

MR NAIDOO: Perhaps, it will be useful to, to revert to
5 page 3 of the statement, to revert to page 3 of the statement, in terms of the chronology of events and using that as a tool, to refresh the memory, I can try and reconstruct what was discussed at the 6th of April 1999 meeting. You will see, on page 3, under chronology of
10 events, item 4, says:

“Commencement of the work program, 20th of January.”

And that would be the work program that emanated from the first ministers committee. So, during the period, from 20th of January to 6th of April, the negotiating team travelled to
15 meet the various bidders in, in Europe, in the UK, in Germany, in Sweden, in Italy, I believe. I am not 100 per cent sure. I cannot, I have no memory of whether we went to Italy, or, or not and, and entered into discussions with them, about their programs about the, about the industrial
20 participation projects they were offering. I looked at their sites. I met with the export credit agencies in these countries. I met with the banks. So, in a short space of time, the team got the first hand view of all of the key players and commenced preliminary negotiations on the
25 defence industrial participation and the technical negotiations. Both those areas, being dealt with by Armscor and the Department of Defence. They had already

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established, established document templates for this and established capability, dealing with this. On the finance side, we were looking at creating different agreement. So, we had to do preparative work on the kind of agreement and the kind of document template that would be applicable to this purpose. So, after the appointment of these advisors, which also took place in this preview, we were reviewing the possible legal contractual documentation that would, would follow. We were also assessing the NIP projects and leaving the NIP system. So, in the meeting on the 6th of April, I, I believe that we would have presented an outline of how the contractual documentation would flow. You will see somewhere in the pack there is a reference to, to that. So, we can deal with that when we get there. We would have presented an overview of the documentation and some initial overview of the key issues, around what is affordability. The meeting of the 6th of April did resolve on the establishment of the affordability committee as a sub-sect. So, I would say that the two big decisions of the 6th of April meeting would be the contractual format, for undertaking these negotiations and the establishment of the affordability team and the work of the affordability team, to develop a more in depth response to understanding the financial implications of this for the Republic.

MS RAMAGAGA: Okay. Thank you. Will you then proceed to take us through paragraph 9 and 10 of the, of your statement. Those still deal with the affordability team, as to

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how it was expected to operate, as well as, as to how it was constituted. Please proceed, Sir.

MR NAIDOO: The financial implications of this being so large, the affordability team was mandated to operate under
5 the strictest confidentiality and with the, a selected number of, of people that the ministers committee felt confident, could operate under this confidentiality and discharge the work required of the affordability team. The brief of the affordability team was to evaluate the overall economic
10 fiscal and financial impact of the procurement on the Republic of South Africa. Part of the work of the affordability team was also to focus on the timing and the need for the different defence equipment types, the economic benefit, to be delivered by the industrial
15 participation offered and the attendant fiscal and financial risks. The affordability team was tasked to prepare alternative scenarios, for consideration by the ministers committee, so as to enable the committee to make the final decision about the scale and nature of the procurement.
20 The team had four members, myself, I chaired it, Roland White from the Department of Finance, Paul Jordaan of the Department of Trade and Industry and Shabir Shaik of the Department of Defence. In staff, it was supported by Dr Stephen Gell, an economist, who was contracted in by
25 myself and Mr Clive Van Heren, who was contracted in by the Department of Finance. At a later stage, IDC had some input and then the Department of, Bureau of Economic

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Research at the University of Stellenbosch, was contacted to assist the affordability team with their economic modelling exercise. Furthermore, there were a consortium of three US consulting firms that specialised in steel market analysis, that were contracted for specific tasks, as well as a Mr K Yamaguchi, who was an analyst attached to Wilbur, Gillan and Reed in London, that were already appointed as the financial advisors to the South African government. He reported on, on the viability of the steel projects, as well.

10 You would like me to, to go on? You know, there was obviously, an overlap between the negotiating team and the affordability team. The negotiating team had now a large number of people that involved Armscor and Department of Defence officials, as well as, the Department of Trade and Industry officials, who were dealing with the DIP, NIP and technical aspects. The affordability team had the senior members of the negotiating team and these resource people, looking more distinctly at the, at the affordability aspects. So, there was a, there was a nexus between the two, which

20 was managed by the individuals who were part of both teams.

MS RAMAGAGA: Alright. Thank you. Now, having taken us through how the affordability team was constituted and how it was supposed to work. Will you then take the commission through the next topic, which is the assessment of the negotiation position, right at the inception? As the negotiating team you had to look, do an analysis and assess

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the negotiation position. Please go ahead.

MR NAIDOO: As a logistical exercise, it was quite a vast undertaking. There were six preferred bidders. So, everything had to be done six times. Each contract would
5 have three separate sub-agreements, which was a contract for the supply of the equipment, for the defence industrial participation and for the known defence in the actual participation. Then associated with each contract, there was a separate finance contract, which had to be negotiated,
10 which involved an international bank.

MS RAMAGAGA: Alright. Thank you. I think, further on, you are just elaborating on the multitude of the work that had to be done and how you went about doing internal discussions, as well as, negotiations, inter-departmental
15 discussions and even discussions with the outsiders or the identified suppliers, now, and even the number of contracts that you would have to, to conclude. Now, in paragraph 5, page 13 of the bundle, you mentioned that the South African team had to seek to reduce the cost of the package and
20 insure that the DIP and NIP commitments were both substantial and solid. Will you just take us through that and, and highlight, where necessary about how you were going to go about dealing these NIP's, DIP's, as well as the cost party?

25 MR NAIDOO: Because the exercise was to reach an affordable outcome, we had to, to balance each of these aspects. The first way of making it more affordable was to

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review the size of the package, of equipment to be purchased, the cost of it and ways to, to downsize that. The package had already put on tender, as a result of the defence review that had been undertaken, which had been approved by parliament. So, our work was not really a price negotiation on that equipment, but a review on the equipment, the timing of the equipment, whether it could be pushed out in any, any way, whether certain packages would be prioritized and others could be de-prioritized, so in that way to, to reduce that. The Department of Defence and Armscor, who inter-phased at a later stage, with input about the cost parameters, also went then and did some [indistinct] of the packages, with the view to, to reducing the overall costs. That was the one set of strategies. With regard to industrial participation, we, we, the work to be done was to, was to evaluate whether the industrial participation was, in fact, realistic and ways in which we could, we could make the industrial participation larger in size than what had been offered, to increase it. Therefore, increase the reciprocal benefit to South Africa and how to make it more tangible where we felt it was, it was at risk in some or other kind of a way. There was a third element, which is not referred in this paragraph. It is probably referred to in, in other paragraphs, is to manage the financial costs, in terms of the funding, costs, the currency risks associated with that, that funding, the payment terms, the due dates in which payments were to be effected and the

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cash flow implications for South Africa, for the government and that.

MS RAMAGAGA: Alright. Now, in pursuance of your mandate, you then went on to consider the changes that
5 should be proposed to improve the national industrial participation system. Will you please take the commission through that? That is the next topic that you are now dealing with, from paragraph 5, page 14, Commissioners.

MR NAIDOO: Okay. There were two systems of industrial
10 participation. One, which was defence related, what is called the DIP system, which had been in operation previously for some time and a mature directorate dealing with it and had a very exact view of the projects to be undertaken and the linkage between the equipment being
15 purchased and the DIP program, was frequently present. So, from an industrial policy point of view, it was, it was easy to understand the linkages with the, our defence industry and the defence equipment being purchased and the DIP projects. The non-defence, or national industrial
20 participation system was one that had been established the previous year and had not been in operation for a long time and was based on a system, which required nine different variables to be reviewed.

MS RAMAGAGA: Ja. Thank you. Evidence has already
25 been presented by the people from Department of Trade and Industry about the nine variables that you are talking about. The evidence that they have been presented is that

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ultimately, through negotiations that was then trimmed down to three, three requirements. Now, will you proceed to then, dealing with the following paragraph, unless there is something important that you would like to highlight in
5 paragraph 2, page 15 of your statement.

MR NAIDOO: Which paragraph would, would you like me to deal with then?

MS RAMAGAGA: You, you were dealing with paragraph 2 on page 15, when I brought it to your attention that you need
10 not deal with the detail herein, relating to the nine listed requirements, with regard to NIP in the DTI. The next paragraph would be paragraph 3, on the same page.

MR NAIDOO: Yes. Paragraph 3 is also dealing with the NIP credits. Would you like me to deal with that?

15 MS RAMAGAGA: In paragraph 3, maybe what I would like you to talk to the commission about, is this reference to the cabinet statement of the 18th day of November 1998, where the indication was that the industrial participation performance was in excess of R100 billion and even though
20 the actual rand value amount committed did not exceed R30 billion for the DIP and NIP combined. Can you just clear that, so that we understand in, as lay persons? The Chair, the Commissioners might not be lay persons. But, for the benefit of the audience, please take us through, through
25 that. Thank you.

MR NAIDOO: My understanding is that, in the selection of the preferred bidders, which was undertaken by the

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government, prior to the announcement of certain suppliers that preferred bidders and prior to the establishment of the negotiating team and my involvement in that, that the bidders had presented, together with the supply terms, proposal with regard to industrial participation. The aggregate value of the projects proposed by the successful preferred bidders was nominally, roughly R100 billion. However, the tender required that the bidders would commit contractually to 50 per cent of the contract price. So, if one aggregate the nominal value of the contracts worth R30 billion, even though they had R100 billion of indicative projects for industrial participation on the table, the binding contractual obligation that they would undertake, would in terms of that tender be half, R15 billion. I think that is, that is the, that is what the understanding I have, so that the actual rand value amount committed, would not exceed, it says here R30 billion. But, I think, if we had not changed the system, with the consent of the bidders, in pursuit of affordability, they would have only been required to commit to a smaller number than what was eventually committed at the end of 1999.

MS RAMAGAGA: Alright. Thank you. Towards the end of that paragraph, on the same page, you state that:

"The negotiation team, the negotiating team concluded that the administrative requirement of such a system, in the context of a program as large as the defence procurement would place a high level of stress on the Department of

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Trade and Industry and was also likely to limitations in respect of transparency and public oversight.”

Now, taking into consideration that you recognise that it may put a lot of stress on the department, did you come up with any, any suggestions on how the department could, could avoid the stress. I am talking about the Department of Trade and Industry in particular. Or is that at, would you like to deal with that later, in our evidence?

MR NAIDOO: I am happy to deal with that now. The, the Department of Trade and Industry and our the assessment of the NIP system, was that it a higher level of risk, due to the design of it, which we proposed certain changes to and due to the institutional capacity available to the Department of Trade and Industry to implement it. So, in these two fronts, if you will see on page 16, paragraph 4, there were certain proposals with regard to the design of this system that was proposed, which I suppose we will come to next. But, from the institutional point of view, what was proposed is that a specialized NIP implementation agency should be set up. We referred it to as a NIP implementing mechanism and in subsequent ministers committee meetings and presentation to cabinet, they would all have been presented there and the contracts referred to the implementation agency as a NIP implementing mechanism, which would allow the DTI to be supplemented by appropriate resources that could be gathered from outside of the department.

MS RAMAGAGA: Yes. Thank you. Now, it is in this

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paragraph that you, paragraph 4, on page 16 that you mentioned that:

“The revised system was based only on investments, exports and sales, on a basis of R1 for one credit and all the multipliers, as envisaged in the existing NIP system were eliminated.”

Now, you, you mentioned that the multipliers were eliminated, was there, in terms of the negotiations that you engaged in and ultimately, the decisions or the agreements that were reached, was, was there a scope for the residual discretion to either add onto the three elements, or, not the three elements in particular? Was there a discretionary residual power to also, include the multipliers in the NIP's and DIP's and I am actually referring to the outcome of the negotiations that you had entered into and the agreements that were signed with the suppliers in the relevant departments?

MR NAIDOO: The, the system, the original NIP system had, I believe, nine different variables, where an investment, which also had a technology dimension, would receive certain credits for the amount, rand value of the investments. Then also, it would receive credits for the rand value applicable to the technology. It would also receive credits for the rand value applicable to other multipliers, such as whether it was enhancing small or medium enterprises. As a result, when you added up all of these credits, a division made from the original rand value

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investment, the number of credits would be a multiple of the amount of money invested. This would then, while it had qualitative dimension that was, of course, relevant in the context of making an affordable contract, the economic effect of the rand was not multiplied in the economy. The economic effect was based on the actual effect it had on our balance of payments. The actual effect it had on the generation of, of economic impact in the South African economy. So, the negotiating team then proposed, after consulting with the defence companies, who are initially extremely reluctant to take such an idea on board. But, due to the strength of the negotiations, the pressure on the, on them as a result of affordability, having the risk that the package may be eliminated, or one of the packages could be eliminated if the South African government felt it was not affordable. So, as a result of that negotiation process, they, they consented to an amendment of the system. This amendment was, was discussed with the ministers committee, who approved it. It was faceted into the affordability model, which was calculated and which led to certain recommendations about the size of the system. But, which took into account, the revisions made by the, the negotiation process, with the consent of the defence companies. Such that we arrived at the contract, which I, of course, do not have a copy of. It has not been released to me. But, certainly, from my recollection and from the documents here, in the pack that had been declassified, I

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can say that we arrived at a contract, where the NIP system used, was the amended system. As a result, the objective of the team and the ministers committee was to have roughly, one rand of investment equal to one rand of expenditure on the procurement. In addition to the rand of investment for one rand of procurement, there was exports and sales counted in, on a rand for rand basis. So, only three factors were used, investments, exports and sales, because they were all concrete numbers and each, each number could be faceted into an economical model. The, the NIP projects were not at a final stage. There was a lot being done on many of these projects, the steel moulds and others that was determining whether these projects were feasible and feasible from a commercial point of view. So, there was a path still to be undertaken in several of the projects, which would not be completed, before the contracts were signed in the end of 1999. So, it was obvious that the NIP implementing mechanism would have the flexibility to work with the suppliers, to substitute certain projects, if they failed their test of feasibility with other projects. However, my understanding is that the contract would, would still be on the basis of counting investments, exports and sales, as the three items to be evaluated for the NIP implementing mechanism. Having said that, it is of course, within the power of the South African government and the cabinet to review, from time to time and I have no information as to how they took the process further, after the contracts were

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signed.

MS RAMAGAGA: Now, now that you have touched on, on the contracts, just relying on memory, are you able to tell this commission as to what provision was made for the amendment of the agreements, in particular? Because you were addressing the NIP, NIP agreement, are you able to tell the commission as to whether, as to how the amendment would have to be effected, whether that could just be done unilaterally, whether there would have to be an agreement, whether that has to be in writing, or whether it can be done orally? What is the position, if you are able to assist the commission with that?

MR NAIDOO: I, I have not been able to review the contracts and it is 14 years ago, since they were signed. So, I am not really able to give a definitive answer. However, I have no recollection of any special procedure to amend that would be different to both parties, having the right to make an amendment by mutual agreement, which would have to be recorded in writing, which is the standard amendment provision for contracts. I do not think in any contract, certainly not one of this nature that any one party could amend it unilaterally. On the South African government side, I think the procedures for amending contracts would be consistent with whatever the government has been doing from before.

MS RAMAGAGA: Alright. Thank you, Sir. Now, you, you have mentioned it in passing that a, this amendment to the

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NIP, within the DTI, the NIP that would be based on three elements, instead of the nine elements, which were actually the policy of the department. My question here would be maybe, to ask as to whether this amendment that you are
5 talking about, reducing the elements from nine to three, is it something that was considered and approved by cabinet, or not? Let me just explain why I am asking this question, it is because there seems to be a concern as to whether, because the nine elements, NIP requirements is something
10 that was policy of the department and it must have been endorsed by cabinet. As to what now, the status of this amendment would, would be. I am not asking you to give an opinion on the status all I am in is whether, this proposal did serve before cabinet and what the outcome was.

15 MR NAIDOO: I made a presentation to cabinet on the 15th of September, I believe it was and I have been given a copy of that presentation, in preparation for this meeting and in this pack. The presentation clearly indicates that the change to the NIP system was disclosed explicitly to the
20 cabinet and reported to them. All the decisions and calculations that were presented in the report to cabinet and in the presentation I made were derived from using the, the amended version of the NIP system. So, I believe that the decisions taken by the cabinet on 15 September and then
25 the contracts approved on the 1st of December, the new system was, was endorsed. Prior to making that submission and the submission to the ministers committee on this, this

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matter of the change to the NIP system was discussed with the DTI and it was with their consent only, that one could engage the suppliers about it. So, I believe the cabinet did support this.

5 MS RAMAGAGA: Okay. Thank you. Will you then proceed to deal with the ...[intervention]

CHAIRPERSON: Mr Jayendra, if you do not mind, can you just repeat your last few statements? We could not quite hear you properly.

10 MR NAIDOO: I was answering the question about the cabinet and the changes that were proposed to include the NIP system and what I was saying is that in the presentation made to the cabinet on the 15th of September and if I have some time I can actually, perhaps I should try and find them,
15 it is ...[intervention]

MS RAMAGAGA: It is pages 52 to 112.

MR NAIDOO: Yes. It is ANNEXURE J and 7, the cabinet briefing on the strategic defence package.

CHAIRPERSON: 52 and, it starts on page 52, ja, the
20 cabinet briefing on the strategic defence package.

MS RAMAGAGA: Have you found it?

MR NAIDOO: Yes.

MS RAMAGAGA: Yes, that is the one.

MR NAIDOO: And on page 63 of, or it is marked as page
25 63 in my file and page 64, you will see the presentation deals with the analysis of what is title known defence industrial participation and the presentation says the NIP

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value was the highest single component of the package. There was a fair amount of external scepticism. It then deals with the analysis of international experience of offset, which shows that:

5 *“Offset tends to succeed, where there are large established world class companies involved. The recipient country has clear industrial strategy. The recipient country has relatively developed industrial base. The recipient country has good governance. Has institutional capacity,*
10 *institutional capacity exists to manage offset.”*

And then on page 64, it continues:

“The original NAP credit system encountered both real and strategic benefits.”

And then it reports:

15 *“Revised system developed, credits only for investments, exports and sales.”*

So, I will just stop there, because it goes on.

MS RAMAGAGA: Yes.

MR NAIDOO: To the next few pages about NIP. I think it
20 deal with the question of whether the cabinet was able to take into account the changes.

MS RAMAGAGA: Alright. Thank you, Sir. Unless there is anything else that the Commissioners would like to ask on that presentation, we will go back to the statement.

25 CHAIRPERSON: I understand what you are saying Mr Jayendra. This is a presentation that was made to the cabinet. In this presentation you included your new

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proposed manner of counting the credits that the offerers should get in your manner, the three elements that [indistinct]. There was a policy of DTI, which once, which police was approved by the minister. Are you saying that
5 the mere fact that you have included this, in this presentation that you made to cabinet, this means that the police created by, by the Department of DTI has been amended? Is that what you are trying to say to us?

MR NAIDOO: No, Sir, the, the presentation was one that
10 was approved by the ministers committee, which met on the 31st of August and then again on the eve of the cabinet meeting. So, it is, it was not a presentation of myself or the negotiating team, but really of the minister's subcommittee.

MS RAMAGAGA: Alright. Thank you. We may go back to
15 your statement, we were at page 16, when, now, will you then proceed to take the commission through to the next topic, which is the legal framework in page 16 of the statement.

MR NAIDOO: The legal framework involved two
20 agreements with the, with regard to each defence equipment package, an umbrella agreement with the supplier, which was signed by the Minister of Trade and Industry and the Minister of Defence and which was an agreement between Armscor and the defence supplier and which had three
25 subsidiary agreements. Unfortunately, there is a block, which is blank, but it should read supply terms. I have, I have seen that in some other documents I have been looking

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at. So, I think, I can say that with confidence. The blank block, on the left hand side is supply terms, the, which probably should say schedule a, I think, DIP agreement and NIP agreement, three agreements. Then there would be, in
5 conjunction with each agreement, between Armscor and a supplier, a loan agreement, between the government, represented by the Minister of Finance and the bank. So, those were the, that was the architecture of the contract.

MS RAMAGAGA: Now, are there any provisions of the
10 umbrella agreement and I am talking about general provisions, without, without referring to a particular supplier. Are there any provisions of the umbrella agreement that stemmed out in your mind and that you think it is necessary for you to highlight to this commission?

15 MR NAIDOO: No. There are none that I can think of highlighting.

MS RAMAGAGA: Alright. Thank you. Then proceed to page 17 of your statement, the finance contracts. Will you take the commission through that heading?

20 MR NAIDOO: The, the offer for supply included an offer for finance from each of the selected preferred bidders, which were supported by the export credit agencies of the countries from which the, the suppliers came from. There were certain terms of the support from the expo credit
25 agencies, which is standard with how these agencies operate worldwide. But, which the finance component of the negotiating team, supported by the ministers committee, who

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were seeking to improve, so that one was able to finance the entire contract, based on export credits, including the, the down payment and to reduce the costs, the margins and the interest rates, associated with these, this, this borrowing. I think that is the, the main story as it is captured up to paragraph 8 on page 18.

MS RAMAGAGA: Alright. Then, shall you then proceed to paragraph 9, about the maximal [indistinct] that was achieved by the contracts, as well as, paragraph 10?

10 MR NAIDOO: As, as I indicated earlier in my evidence, the contract negotiations were undertaken primarily by the Department of Finance, after the initial period. However, we co-ordinated the negotiations around the supply terms and industrial participation very closely with the finance negotiations, so that we could extract the maximum pressure and leverage. So, in certain cases, meetings were cancelled with the negotiations on supply terms, until we got a more favourable offer from the export credit agencies and vica versa, you know. As a result of which, the, the, we developed a best case scenario of what we could achieve and, and the Finance Ministry reports, I think, that we achieved a substantial improvement in the finance terms, particularly to get funding, via the support of the expo credit agencies and so not needing any forex denominated commercial loans.

MS RAMAGAGA: Alright. Thank you. You mentioned earlier on, that one of the strategies that you had to

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implement, or to consider was to, the review of the defence equipment. Now, it, it would appear that your presentation, relating to this review, or consideration served at the meeting of the 26th, the ministerial committee meeting of the 5 26th day of May 1999. Now, will you then take the commission through that review, because in your statement, you also mention as to why the equipment was prioritised in the manner in which it appears on this page, as well as the recommendations that were made by the negotiating team?

10 You may proceed, Sir.

MR NAIDOO: After the April meeting of the ministers committee, in which the affordability team was established, part of the work of the affordability committee was now to conduct a, a review of the requirements of these different 15 defence equipment. I, I conducted that draft for the negotiating team and interviewed several parties. I met with the chief of the air force, the chief of the navy, the chief of the defence force and the Minister of Defence, individually, with each of them to talk about the need for the defence 20 equipment under consideration, the timing of these needs, alternative approaches to meeting these needs and what flexibility, in the context of affordability would be possible. I reported back to the negotiating team and took the views of the members of the negotiating team into consideration, 25 in particular the chief of procurement of the Department of Defence and the chief of Armscor, who had a high degree of familiarity with the requirement. I came to the conclusion,

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after these interviews that the, the light utility helicopters were urgently needed, to replace the existing stock. The leading fighter trainers, were urgently needed by the air force. The advanced light fighter aircraft, the Alpha, were not an immediate requirement and I will come back to that in 5 a moment. The submarines were an urgent requirement. The Corvettes, which were originally frigates, but I am not able to explain the difference between a Corvette and a frigate, they were now calling them Corvettes, they were 10 more than urgently required. They were already long overdue. The maritime helicopters are helicopters that are to be located on the Corvettes, so they were a secondary requirement, to the requirement of the Corvettes itself. So, we put them as a secondary requirement. Going to the 15 Alpha, we had a fleet of, of aircraft, which are known as Cheetah fighter aircraft. We had 50, which included 12 dual passenger Cheetah aircraft and they had had an upgrade, during the, what they call a mid-life upgrade. So, the air force was of the view that they could upgrade them, until 20 2012. We were now in 1999. So, given the time, primarily, we were, we reached a conclusion that these aircraft were not immediately required. So, I think, let me stop there and, and they can tell you the rest of the story of the Alpha, as it unfolds.

25 CHAIRPERSON: You say you want to tell us the story as it unfolds, at the appropriate time?

MR NAIDOO: If you would like me to carry on with the,

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the, with it now, I can, because it goes on to the whole option to cancel, which is in the later pages.

CHAIRPERSON: Ja. Maybe, before you do that, I should ask a question, as to, as to whether, you say the Alpha
5 would be required later. Now, this comment, is it a comment that is informed by the discussion that you had held with the relevant arm of service and other stake holders, in respect of the procurement of the equipment?

MR NAIDOO: Yes. I think it is a purely factual
10 observation, based on the information that the existing fleet of Cheetah aircraft would be able to operate until 2012 and you would then need a new fleet to be in place by that time. So, there was the idea that there would be, in the context of affordability, there was some time. That gave a breathing
15 space to the South African government, to manage its need for the advanced fighter aircraft, whereas the other categories were already due, immediately, or in the case of the Corvettes, overdue. The, the fighter air craft were still to become due. So, there is simply factual information that
20 was presented back to the negotiating team and which were then to take into account in the discussion about what was affordable and what was the risk of the package and how to manage that risk.

MS RAMAGAGA: Alright. Thank you. Will you, will you
25 then take us through those issues around the Alpha and what, what was actually presented at this meeting of the 26th day of May 1999 to the ministerial committee?

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MR NAIDOO: The, the Alpha was also linked to a very substantial proposal for industrial participation, with significant benefits for Denel and the defence industry, through participation in sale of these aircraft, the [indistinct] aircraft worldwide. They would follow from the South African sale and then also, on the non-defence industrial participation, the, the proposal involved significant benefits to, to South Africa. So, there was a, there was an industrial participation benefit to the inclusion of the, the Alpha. So, on the 26th of May, the ministers committee, we, we recommended with the view of considering the parameters of affordability that the Alpha package should be postponed and that the South African government should take an option to acquire the Alpha from the suppliers and should in turn, seek to, to offer the supplier the hand of collaboration for the industrial participation that they wanted to do. So, kind of a difficult offer for them to still invest in the things that they wanted to invest in, but to have the option. With some discussion, this was supported, although most of the ministers committee, I would say, unanimously was, was sceptical about whether they would sign such an option and...[intervention]

MS RAMAGAGA: Just, just a minute. When you say such an option, are you talking about the option to cancel?

25 MR NAIDOO: No.

MS RAMAGAGA: Okay. Then maybe the one that I just [indistinct].

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MR NAIDOO: The original I, an option, an option to the South African government.

MS RAMAGAGA: Yes.

MR NAIDOO: To acquire in its discretion at a future point
5 in time.

MS RAMAGAGA: Alright. Thank you.

MR NAIDOO: The, the discussions that followed the 26th of May meeting, were of a, with the British Aerospace and SAAB, were along the lines that that did not present them
10 with the, something that represented favourable economic outcome, because the bulk of the industrial participation work that would come to Denel, would not then arrive, if the South African government had not made a landmark acquisition. That such an acquisition would have been the
15 first sale of such equipment, outside of Sweden, where it was the standard equipment used by the Swedish air force. So, they would not have that reference site, outside of Sweden, which would be negative and the investment required, at risk for the industrial participation, a non-
20 defence industrial participation and the costs associated that, would not make sense, in the context of an option where the South African government could decide just as easily to say, no, in the future. So, they presented in, in return, a different option. One which would manage the
25 affordability concerns of the South African government, as expressed through the negotiating team, but which would give then the benefit of a reference site and would give

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them the benefit of a transaction, that was a real transaction. So, they came up with the option to cancel and to have three tranches, where there was a tranche, with dual, dual aircraft, two-seater aircraft and then the second 5 tranche with the single-seater Hawk fighter trainers and the third tranche with the Griffin advanced fighters. That allowed for the risks, in the event that there were certain pressures in the South African economy, at the time that those options, those purchases became due, allowed the 10 South African government the opportunity to, to cancel and minimise any, any exposure to financial crisis, if that this came about. So, that was their counter and that was the report that they eventually had to take forward to the affordability, to the, to the 31st of August meeting, for 15 discussion at the ministers committee there.

MS RAMAGAGA: Now, paragraph 7 of your statement, at paragraph 7, at page 22 that is where you are dealing with an alternative that was proposed by BAE, for a full transaction to supply 24 Hawk and 28 Griffin, with that first 20 delivery at a certain period. Then on paragraph 8, you actually elaborate about the tranches that were proposed. Now, do the two paragraphs fall within the terrain of the meeting of the 26th day of May 1999, or is it something that was addressed at the meeting of the 31st day of April, of 25 August 1999?

MR NAIDOO: On the 26th May, we had our first discussion at the ministers committee meeting, which deal with the

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possibility of deferring the, what is called the Alpha package. So, no discussion had taken place with the suppliers, prior to that. The, after the 26th of May meeting, we then proceeded to have these discussions with the
5 supplier. As a result of which, they came back to us with the proposal of an option to cancel and the results of those discussions were then presented as a, as an input to the ministers committee meeting on the 31st of August. Then they had to decide about this proposal from British
10 Aerospace.

MS RAMAGAGA: Alright. Sir, you mentioned that at the meeting of the 26th day of May, you had not actually, started the negotiations, relating to cancellations and what have you. What I would like to get from you, is whether the
15 meeting of the 26th day of May 1999, gave you the mandate to go and negotiate with the identified suppliers, BAE in particular, the terms that you are now talking about, the terms that are based on the right to cancel, in the event the government is not able to, or is not interested in proceeding
20 with acquisition of further equipment.

MR NAIDOO: Thank you. Can I draw your attention to ANNEXURE J and 4, which is on page 45 of the file? If you would turn to the next page, page 46 and if you will take note, at the bottom of that page, which is the minutes, this
25 is the minutes of the subcommittee of cabinet ministers on the strategic defence package meeting 26 May 1999, held at the Tambo House, Church street, Pretoria. So, item 4, at

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the bottom of page 46 says, Gripen recommendation and it says:

*“The chief negotiator recommended to the ministers that the decision to defer the acquirement for an Alpha advanced
5 light fighter aircraft should be considered. This recommendation is based on the fact that the Alpha requirement is for 2005 to 2010. However, the military’s.”*

And then on the next page it continues:

*“Requirement for a fighter aircraft program is still valid.
10 Hence, a combined Hawk and Gripen requirement could be considered as an addendum contract to a Hawk contract. The letter submitted by the Department of Finance to the chief negotiator was tabled and discussed by the ministers. After a brief discussion, the Minister decided to defer the
15 Gripen decision and to mandate the negotiating team to explore the option of accommodating the SANDF long term requirement of 28 Gripens into a consolidated BAE contract.”*

So, after this, after these discussions of the 26th of May, we
20 then engaged with the British Aerospace.

MS RAMAGAGA: Alright. Thank you. Will, will you then, proceed to paragraph 8, of your statement in page 22 of the bundle?

CHAIRPERSON: On page 22?

25 **MS RAMAGAGA:** Maybe then, just, just for smoother reading and following of the, of your evidence, I should invite you then, to commence this paragraph 7, because that

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is where now, you introduce this issue of the option to cancel agreement.

MR NAIDOO: Okay.

MS RAMAGAGA: Alright.

5 MR NAIDOO: I am reading now, from page 22, paragraph 7, which starts:

“As an alternative BAE that is British Aerospace, proposed a full transaction for the supply of 24 Hawk and 28 Gripen, with their first delivery of 12 Hawk aircraft and a dual-seater
10 *Gripen aircraft and then option to the South African government to cancel on the supply of the remaining Hawk aircraft, followed by another option to cancel on the single-seater Gripen aircraft. The option involved a purchase contract for the full amount, with the aircraft to be*
15 *constructed and delivered in three batches. The South African government, however, had the right to cancel tranches two and three, without paying any cash breakage costs. This offer was different from the contract to procure, say 12 Hawk and nine Gripen with a costly option to order*
20 *another 12 or 19 Gripen at a later date. In the latter case, the government would have signed a contract for expenditures for tranche one only. In the former, the government would need to secure finance for all three tranches at the outset, albeit with an escape clause,*
25 *covering the latter two tranches. The concept of an option to cancel was motivated by BAE SAAB on the ground that it will allow the financing terms to be contractually locked in,*

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without prejudice to the South African government's right to decide not to go ahead with the rest of the procurements. Either option could be structured without restricting government's capacity to decide whether or not to acquire

5 *the additional equipment and no costs will payable to the South African government elect to exercise its option to cancel. On the other hand, the structure of an option to cancel, could achieve the purpose of contractually locking in price and loan terms. The choice posed to the ministers*

10 *committee on 31st August 1999 then, in the light of its previous decision was either to fully defer the Alpha package, without taking any options, or to accept the proposed combination package. The latter option was recommended by the ministers committee and accepted by*

15 *the cabinet."*

MS RAMAGAGA: Alright. Is it correct that in terms of the proposed tranche delivery by the supplier, there were different premium allocated to the respecting, I beg your pardon, to the respective tranches, that is, there would be a

20 premium for, loaded for the purchase of the first tranche and then the second tranche it would go down and the finally, the third tranche, being the final tranche the premium was at its lowest? Or would you like to refer, what is the position, Sir?

25 MR NAIDOO: I think, my recollection is, it was a notional premium, not an actual premium in that the overall cost of the equipment did not rise as a result of this tranching. But,

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the allocation of the contract value for the Hawk and the Gripen was such that the cost of the equipment became cheaper later. So, the incentive to cancel would be lower in the South African government. I cannot remember the exact
5 number. But, I think the allocation of costs made it look like there was, it was a higher cost in the first tranche and a lower cost in the, in the third tranche. So, it was a bit of an incentive to the South African government to average its price of equipment down, by taking the tranche two and
10 tranche three offers, instead of cancelling.

MS RAMAGAGA: Alright. Thank you. The, the precise amount, or percentages of the premium were covered by the evidence of Mr Andrew Donaldson and it is already on the record of, of the commission, so you need not really bother
15 to go to the specific amounts as per, as per tranche. Now, you say that first delivery, or the delivery of the first tranche, would involve the dual seater aircrafts, which aircrafts are actually used for training. Is that the case?

MR NAIDOO: In, in tranche one, we were taking the dual-seater Gripen and the Hawk fighter trainer. I am not 100 per cent sure, if the, all of the Hawk aircraft were dual-seater, or single seater. But, the, in respect of the Gripen, it was only the dual-seater Gripen that was included in tranche
20 one.

25 MS RAMAGAGA: Ja. As you indicate that you are not certain as to what the position is thereto, is something that is already in possession of the commission. Because

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evidence has been place before the commission, through the evidence of, of Mr Donaldson, in the form of documents that are before the commission, that that gives precise information on whether they were single-seaters or they
5 were dual-seaters. So, in the circumstances we can then proceed to the next page, page 24. We are done with page, page 23, where you spoke about the options that you gave and the election that the ministerial committee made. Now, let us proceed to page 24, which deals with the costs of the
10 packages. Will you take the commission through that?

MR NAIDOO: On the first review of the costs of the package, which was undertaken by the negotiating team and which the Department of Finance made a, a leaving input on, it became clear that all of the costs were not, had not been
15 taken into account. The costs, which needed to be taken into account, to be added to the contract value included statutory costs, such as freight, insurance and taxes, project management costs to be incurred by the Department of Defence and Armscor, which was not in the budget. The
20 financing costs for deferred payments to suppliers, premiums payable on loans and the escalation costs to cover inflation in the supplier countries in future years, based on multi-year deliveries. So, the costs were then recalculated and the, at the time, if I look at paragraph 3, on page 25,
25 taking into account also, certain adjustments in the package that were made, through the affordability exercise and the decision making process, the cost in 1999 rand was R29.9

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billion, as amounts at the time of the cabinet decision in September. So, that would account for the discrepancy between the November 1998 and the September 1999 number.

5 MS RAMAGAGA: Alright. And, and I notice from the, page 24 where you are listing the other costs that were taken into consideration, when the 1999 announcement was made. There is no provision for, for interest and, and what could be the reason? Is it because there was no certainty as to
10 what the likely, or interest would be, or what is the position? Because if we are talking about transactions that are financed through loan, it is always a given that interest would also play a role in the determination of payments, or is because we are looking at payments, as against costs and
15 not treating costs as, what is the position? Least I trick myself with just continuing to talk and not making [indistinct].

MR NAIDOO: So, if, if one goes back to the structure of the agreement, the agreement between Armscor and the
20 supplier dealt with the supply and the industrial participation of the obligations of the supplier and this price refers to that equipment. Then in conjunction with that agreement, there was a loan agreement to finance the purchase, which was undertaken by the Minister of Finance, with the banks.
25 Interest would be in the loan agreement, not in the contract to purchase.

MS RAMAGAGA: Okay. Alright. Thank you. Now, please

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turn over to page 26 of the bundle and the topic that you will now be addressing is the affordability report.

CHAIRPERSON: Shall we break now?

MS RAMAGAGA: Will you please take the commission
5 through.

CHAIRPERSON: Shall we break for lunch? Ms Ramagaga, I see it is already one o'clock. Maybe, this may be an ideal period to take the lunch break and he can, the witness can start with the affordability report just after lunch.

10 MS RAMAGAGA: As it pleases the Chair. Thank you Commissioners. We then request for the adjournment.

CHAIRPERSON: We will be back at quarter to two. Thank you. All adjourn now.

MS RAMAGAGA: Thank you.

15 **(COMMISSION ADJOURNS)**

(COMMISSION REOPENS)

CHAIRPERSON: Thank you.

MS RAMAGAGA: Can you confirm that you are still
[indistinct] Mr Naidoo?

20 MR NAIDOO: I do.

MS RAMAGAGA: May I proceed Chair? Thank you. At the time when we adjourned Mr Naidoo was about to begin with page 26 of the bundle. However, I would like to request for the indulgence for Mr Naidoo to explain the issue relating to
25 the government policy, in particular the DTI in relation to the NIP's as against the new system that they developed specifically for the SDPP and nothing more. This request

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has been made by the witness during the adjournment and I will request the Commissioners to indulge him and let him then explain further. Thank you, Chair. Mr Naidoo, you may then proceed. The Commissioners are granting you the
5 indulgence then to deal with that specific issue.

MR NAIDOO: Thank you very much. I think I only wanted to add to the information given which is that the Government policy on NIP which was in existence prior to the defence package, which is under consideration here today, did not
10 change and for any other package, it remained the policy of the Government with regard to non-defence or what they called "National Industrial Participation". It was only in respect of this package that, with the approval of the Minister's Committee and the Cabinet, that the terms of the
15 NIP were changed and incorporated into the contract and looking through the minutes of the meeting, not much issue is made about this... these amendments and apart from the presentation which I read into the record, perhaps the other place is in the Affordability Report which is... I know it is
20 being considered shortly, but I thought we would just deal with this matter now, which is on page 143 of the file that I have and if you look at the index of the Affordability Report, on page 155 of the file and 156 of the file, in clauses... on page 156, clause 234 as indicated on the side, which sets
25 out that with the consent of DTI the NT decided to amend the NIP system for the purpose of the defence procurement as the existing system appeared to inflate the benefits in an

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exaggerated manner, the NT decided to scrap all the multipliers used to count only investments, exports and sales for the purpose of awarding NIP credit. This report, the Affordability Report was the document typed for the
5 Minister's Committee meeting on the 31st and although it refers to the NT, the negotiating team decided to amend, of course correctly. The negotiating team is authorised only to make recommendations and the Minister is to decide. So effectively that is the record in that, of the way in which the
10 variation took place for the defence system.

CHAIRPERSON: Now this is a follow up, is there any document referring us to, which indicates that NT actually amended that policy position of DTI?

MR NAIDOO: I do not have the Cabinet decision in the
15 pack for the 15th of September, unfortunately, so I am unable to point to any of the Cabinet decisions on this... from this pack.

MS RAMAGAGA: Thank you, Chair. Mr Naidoo, is it correct that the... this Affordability Report that you have just quoted
20 from, was adopted by Cabinet?

MR NAIDOO: The Affordability Report was the input that pulled together all of the work that was done in the period from the May meeting of the Minister's Committee to the August meeting, including the input from the negotiations,
25 as well as in the input from the economic modelling and it raised certain matters for decision and notably about the size of the package in respect of the aircraft and also things

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like the Maritime Helicopters. So I do not think it is fair to say the Affordability Report was adopted. The Affordability Report was taken note of and the Negotiating Team was mandated to implement all matters that were contained in the Affordability Report, with the decisions that were made in the August meeting and with the decisions that still had to be resolved. There was one matter that still had to be resolved which had to do with certain matters of finance. Where the Minister of Finance had a ... there was a particular follow up to be done with him. So I think that would be my view of what was correct. The way of interpreting how the Affordability Report represented a moment... a milestone in the decision making process.

MS RAMAGAGA: Thank you, Chair. Clearly the witness is unable to really commit on whether this was actually... this particular aspect was adopted by Cabinet or not, but part of what causes him not to be able to commit on that, it is because he is not in possession of the Cabinet decision that came out of the presentation that he made on the 15th and that decision I want to believe is an official document and that can be left maybe to the Commission to check whether it can access that, because an official document if there is, there is... the Commission cannot change it, but it could take the contents into consideration when it executes its mandate finally, especially in the report that it would make. That is just my take on that Chair, and I just want to thank you for the indulgence and request then that I leave

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this point and proceed. Thank you. Now I have to ask for the indulgence again before Mr Naidoo deals with the Affordability Report and I would like to take the Commission back to the minutes of the 26th day of May 1999 and in particular, I beg leave to refer the Commission to page 46 of the bundle. Now what appears on page 46 is part of the progress report that was presented by the chief negotiator before the Ministerial Committee and that is Mr Naidoo before us, in particular I would like to refer you, Mr Naidoo, to an item [indistinct] and for the benefit of the Commission I would seek for an explanation and this request is based on the fact that there are some submissions that are made, particular by Mr Feinstein in this regard to the... this equipment. Now reading from the second line in your presentation this is what was said:

“The Combat Suite has a defined cost and time associated risk with respect to IMS sub-system proposed by the Combat Suite Consortium, namely the single bus proposed by the local RSA company. The approach adopted by the negotiating team is to put full system responsibility with German [indistinct] Consortium. The DOD and the JFC considered the local bus to be of high risk.”

Now there is a concern raised in the submissions by Mr Feinstein, that how could you ... in fact there is a suggestion that when you talk about this local bus, you were referring to the C2 C-Square and the criticism is that how could you at that time, make reference to the... this risk

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while you had not as yet negotiated with the suppliers. Do you have any comment?

MR NAIDOO: Yes.

MS RAMAGAGA: And maybe I should just indicate that
5 clearly by the time you were... you came into... when you assumed your position as the chief negotiator, the evaluations had already been done and the suppliers had been... or preferred suppliers had been identified.

MR NAIDOO: Thank you. This page 46 is the second
10 page of the minutes of the Sub-Committee of Cabinet Ministers on the Strategic Defence Package of 26 May 1999 and the item that you were reading out, is actually under item 3, "Status Report", which reports that I was requested to present the status report and I reported as follows, and
15 the report was then presented as reflected in the minutes on each of the six packages, the Hawks, the Submarines, the Maritime Helicopters, the Corvettes, the Utility Helicopters and the Gripen and the passage that you are dealing with, comes in the section dealing with the Corvettes and the
20 paragraph reads:

*"The Department of Defence to make final recommendations on the Combat Suite. The Combat Suite has a defined cost and time associated risk with respect to IMS subsystem proposed by the Combat Suite Consortium,
25 namely the single bus proposed by the local RSA company. The approach adopted by the negotiating team is to put full system responsibility with the German Frigid Consortium.*

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The DOD and the DSC considers the local bus to be of high risk.”

And the background to this is that the ships, the Combat Suite was slightly different to the rest of the packages in
5 that there was a separate process that had been undertaken by the Department of Defence for the electronic systems and the equipment to be placed on the ship, which the Germans were providing and the integration of the ship and the equipment, called the Combat Suite is, of course, matter of
10 high risk. So in the discussions with regard to financing, if the ship does not work [indistinct] overall including the Combat Suite, it would have some negative ramifications for the finance package. So the negotiating team and this is only one of the many points the negotiating team was taking
15 up in these negotiations, was then seeking to put the full responsibility for the entire ship and the finance package for the entire ship, on the shoulders of the consortium, the German Frigid Consortium, as it was then called. So the call was for them to take the responsibility and the risk
20 associated with integrating that, and I think that is reflected in the first part of this paragraph, that the approach adopted by the negotiating team is put full system responsibility. The second... the sentence following that, is simply a report back from the discussions that have been held with the
25 German Frigid Consortium and you will probably see elsewhere if we cover that, that the German Frigid Consortium was one counter party that we had not initialled

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an agreement, because we still had some matters of disagreement, and they had strong views on several matters and one of their views, was that they could not be asked to take the risk of the thing to be integrated with the ship, 5 blindly. So they considered this to be a matter of high risk, because it was a huge financial obligation on them. So there is nothing here in our comment that had to do with any of the technical aspects or competencies of the solution that was proposed and certainly, the name of the company that 10 you have mentioned now, was never brought to the attention of the negotiating team. It was simply that from a financial point of view the prime contractor was being placed with the responsibility to take over all risk for the package which would allow us to fund it on a slightly better footing and 15 manage the risks of delivery on a better footing.

MS RAMAGAGA: Right. Thank you. Shall we then proceed to page 26 and take the Commission through the Affordability Report evidence. You start off by talking about the two objectives of the Affordability Study, I beg your 20 pardon. Please proceed.

MR NAIDOO: The Affordability Study had two objectives. The first was to assess the macro-economic, fiscal and financial impacts of the expenditure on the procurement and the issue here was whether the procurement would create 25 undue pressure on South Africa's overall economic performance, employment levels, external economic position and that is measured by the current account deficit and the

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balance of payments, and the Government's financial position as measured by fiscal deficit and public debt. So in analysing this question, the impact of different levels of total expenditure was analysed with the corresponding
5 different levels of off-set commitments. Off-set commitments here to industrial participation. The second objective of the Affordability Study was to analyse the risks involved in the procurement and a number of procurement risks were identified which are spelled out below.

10 MS RAMAGAGA: Right. Now you proceed to talk about the Affordability Study and how it is defined, Affordability Study and the methodology adopted in the Affordability Study?

MR NAIDOO: Correct.

MS RAMAGAGA: Now all that information has already been
15 placed before the Commission through the evidence of Mr Andrew Donaldson. Now what I would request you to do is to proceed to page 28 of your statement... page 28 of the bundle and deal with item number 11 where you deal with the risks that were identified and the advice given or
20 recommendations made. Please proceed, sir. Unless there is... maybe before you do that, is there anything in the preceding paragraphs that you would like to highlight?

MR NAIDOO: No, there is nothing to highlight in the preceding paragraphs.

25 MS RAMAGAGA: Okay. Right. Thank you. Then proceed with the paragraph 11.

MR NAIDOO: I think it is fair to say that in any large

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procurement in any corporate or public sector entity in any territory, it is standard to have a risk assessment done of the implications that procurement... on the company undertaking the procurement and that was the manner in which this risk assessment was done which is to say that you look at all the risks without distinguishing which ones are more hypothetical than the next, and you analyse the probability of these risk and the dimension of these risks, and the risk identified here included an increase in domestic interest rates that would come about upon the announcement of the packages. It included the risk of non-performance of the industrial participation commitments. It included the risk that the Rand would depreciate more rapidly than assumed in the costing calculations, and also it assumed the risk of a financial crises from an external source that would be a shock to the economy and how our economy would be placed to deal with such a shock in the context of this procurement, and we gathered up these different risks into two scenarios.

The first was a large high risk scenario which was assuming that a large shock was presumed to occur in the wake of the announcement of the expenditure and in this scenario, the assumption was the financial market would react strongly to the increased public expenditure on the grounds of the increase, would prevent Government meeting its fiscal deficit targets and thus destroying its growing credibility with the bond holders who are holding South

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African Government Bonds, and there is more colour being given to that scenario here.

There was also a corresponding low risk scenario, which assumed a small but positive rise in the interest rate, resulting from little reaction to the announcement, but a small risk in the international risk premium on South African Government Bonds and all of these risk scenarios were consulted with the South African Reserve Bank officials and with [indistinct] Dylan Reed to get their input on it. We could not consult private banks because of the danger of having premature leaks on the financial markets, so this consultation took place purely within all advisors and the Reserve Bank.

Then on the NIP risk there were two risks identified, in addition to the other financials as we talked about now and the one risk was contract risk, and the other one was market risk. Now contract risk refers to the failure of the suppliers to deliver their commitments on the industrial participation. Now it is commonly assumed that defence suppliers often fail to meet their off-set commitments and the affordability team did an investigation about this matter by looking at the literature regarding off-sets in several countries and came up with the conclusion, that the key issues in determining success or failure, is in the capacity of the buyer to monitor the process and to embed the off-set commitments within a clearly defined industrial strategy

So that was... going further on contract risk, another way

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of addressing contract risk was to increase the performance guarantees which the negotiating team generally sought to increase from 5% as per the request for proposal and the tender submissions, to 10%.

5 MS RAMAGAGA: Now on [intervenes]

MR NAIDOO: Sorry.

MS RAMAGAGA: Thank you. On page 30... I think that is where you are now, page 30 of your statement [intervenes]

MR NAIDOO: Yes.

10 MS RAMAGAGA: In particular paragraph 5, you say :

“The contract risk was additionally addressed via the performance guarantees which were improved during the negotiations from an average of below 5% to 10%.”

Now from the evidence that has been presented, it would
15 seem that the permitted... or in terms of the RFI's, request for information invitations that were issued, the required commitment on the NIP's and DIP's was 5%. Now I would like to get some clarity on what you state here, because you are now talking about *“from an average of below 5%”*. Are
20 you suggesting that on aggregate the commitments that were done by the suppliers were about below 5%, or what does that mean?

MR NAIDOO: I think the statement should be corrected actually, because to the best of my knowledge it was 5% that
25 had been submitted, not below 5%. So it was an average of 5%.

MS RAMAGAGA: Okay.

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MR NAIDOO: That we were seeking to raise to a level of 10%.

MS RAMAGAGA: Thank you. Commissioners, I request that the statement so reflect, just by deleting that "*an average of*
5 *below*", that it should read "*negotiations from 9% to 10%*".

MR NAIDOO: 5%.

CHAIRPERSON: 5.

MR NAIDOO: From 5%.

MS RAMAGAGA: Ja, from 5% to 10%. Oh, sorry. May I
10 proceed? Thank you. Now Mr Pillay... Mr Naidoo, I beg
your pardon, I am thinking of Mr Wynand Pillay, I am sorry
about that, sir. Sorry. I think in terms... or rather in terms
of information that is already available before the
Commission, the suppliers were... had indicated a
15 commitment of about 50% of the contract price for the NIP's
and DIP's, is that correct?

MR NAIDOO: That is correct.

MS RAMAGAGA: Now in terms of your negotiations you say
that you were able to bring some improvement in the
20 threshold of the guarantees that would be issued, which
would be moving from 5% to 10%. Now regard being had to
the risks that you have outlined, especially the risk of a
possibility of non-performance, is there any reason why in
your negotiations you agreed to accept the 10% performance
25 guarantees from the bank? Could you not have raised that
guarantee at least to a higher percentage? This question
comes from paragraph 5 on page 30.

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MR NAIDOO: Yes. So the learning from the analysis that was done, is that to mitigate against contract risk one should try and maximise the costs to the supplier which would be then in the case of performance guarantees, and they would lose those guarantees if they did not perform to the industrial participation required. They were contracted by the tender to offer 5%. Our point of leverage was what was affordable and affordability was very much influenced by the quality and the certainty around the delivery of industrial participation, hence the rationale for increasing, by the consent of the bidders, the performance guarantees to a higher level. So we doubled it from 5 to 10, which in our assessment was a 100% increase in the obligation. It is not something that they would have budgeted for, because there was no opportunity for price adjustment from their point of view, to mitigate the costs of such an increased guarantee. It was a substantial penalty. 10% of the contract value would be a very material part of any of their profits, not having detailed insight into their profits, but you know doubling the impact of that.

So the negotiating team and the Minister's Committee were satisfied to shoot for this type of 10% and except in one case, which was the case of the Corvettes, we simply refused and we had no success with them at all in increasing the performance guarantees. But we concluded that their package being the most mature, had the least risk and therefore at the time when we were concluding the

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contracts for the Corvettes, we were satisfied to leave that at 5, because we had achieved all of the points that were material from the Government point of view about what was affordable, and so we did not want to take that point further, 5 if they were so doggedly against it and we were satisfied with the quality of their offer in general. But in all the rest, we were successful in increasing the performance guarantee to 10%, which I am given to understand, is much higher than the performance bond that is applicable in such contracts 10 generally, and so we took it as a sign of great achievement and making the affordability and the quality of the industrial participation, of a higher standard.

MS RAMAGAGA: Thank you. Then take the Commission through paragraph 6 on page 30. Actually pages 30 and 31, 15 to 32.

MR NAIDOO: Ja.

MS RAMAGAGA: You need not necessarily read through the [intervenes]

MR NAIDOO: Okay.

20 MS RAMAGAGA: The statement, but just make the highlights where there is still a need to bring information to the Commission.

MR NAIDOO: The other risk associated with NIP 25 commitments, related to the potential of projects to fail once investments have been made. That even if the investments were made as planned, they would not deliver the goods, because they were a failure and so we undertook

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investigations of the project similar with these independent consultants. As I have mentioned the US consultant firm specialising in steel and the analyst employed by [indistinct] Dylan Read and their conclusions about this study were
5 summarised in the report and in one of the three proposals, they were extremely positive about the commercial viability of it. In the second one they were positive and in the third one, they were pessimistic. they reported back to the Minister's Committee.

10 So for the purpose of quantifying what industrial participation would potentially come through and the implication of that for the South African economy and therefore how affordable this package was, we assumed certain non-delivery which the economic model is, I think, of
15 the Department of Finance, would be the better position to talk about, but on the low risk scenario we assumed that between 65 to 80% would be delivered and in the high risk scenario, we assumed that two-thirds would not be delivered, in order to do that modelling exercise.

20 MS RAMAGAGA: And in the following paragraph you mentioned that:

"The modelling exercise also explicitly included assessment of the impact of more repeat depreciation of the Rand."

25 Now shall we then proceed to deal with the next topic on page 32 and that appears under clause 12: *"Main conclusions of the modelling exercise"*. Please take the

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Commission through that... those paragraphs of the statement.

MR NAIDOO: I am unfortunately missing a page 33. Thank you. I think it would be most useful if I take you on
5 page 33, clause 2, which looks at the broad conclusion and the broad conclusion was taking all the inputs into account that now are derived from these assumptions and the exercise as already been undertaken by the negotiating team, was that the impact of the procurement would be more
10 or less neutral over the eight year period, even at the highest expenditure level, if the high risk scenarios were avoided in relation to both interest rate and NIP commitments and those were the two critical things that were things to watch out for.

15 If both these things took place, either the interest rate or the NIP commitments failed, then the modelling exercise predicted that the macro-economic costs would become significant.

MS RAMAGAGA: Right. Thank you. Will you then proceed
20 to page 34, clause 13, the outcomes of NIP. Now the first paragraph which talks about the improvement that you made, it is already on record that you managed to move the threshold from 5% to 10%, that making it 100% of improvement and then in the second paragraph, you are now
25 talking about the... how the negotiations were sequenced. Now I will request you to actually deal with this table that appears under clause 2, page 34. That is part of clause 2,

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page 34, but the table appears on page 35 of the bundle. Please take the Commission through that.

MR NAIDOO: I would like to just go back to page 34, section 13 and the first paragraph, paragraph 1, just to give
5 some clarity to what this means. The contractual commitments were for 50% of the contract value and while the performance guarantees were doubled, that is not what these commitments are referring to. It is the commitment to deliver x-amount of investments, sales and exports that I am
10 referring to here about the NIP commitments, not the performance guarantee, and the contract now with the consent of the suppliers, the preferred bidders, the contract now committed them to the full amount to be delivered. Not the 50% of contract value.

15 So in committing them to that different number, the commitment that they have made on industrial participation, improved by over 100% because their proposals were in that range.

MS RAMAGAGA: Thank you.

20 MR NAIDOO: And the flexible, okay... no, that is fine.

MS RAMAGAGA: Thank you for that clarification, but you can go on. Ja.

MR NAIDOO: Okay. Should I now go on to the table?

MS RAMAGAGA: Are you done with this portion?

25 MR NAIDOO: I think so.

MS RAMAGAGA: Ja, okay. Then proceed then to deal with the table. Thanks.

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MR NAIDOO: The table records the commitments which are the commitments I believed were inserted into the contract, the final negotiations and you will see in each of these six packages, the amount of x-investment and the amount of gross exports and local sales. Exports and sales are the performance that would come from the investments. So it is a different number, but all of these numbers are now Rand numbers that the preferred bidders were committing to, and the total for DIP is in the fourth column. That amounts to a total for the six packages, 15,3 billion and for the NIP package, the investment alone, is 24,928 billion which is substantial numbers, as you will see for exports and local sales.

So numerically it is comparable with the number that the Cabinet saw in November 1998. However, the number that is reflected as at November 1998, is the aggregate number of the proposals, but it is not the committed number. The committed number was 50%, whereas the total including alpha as you see above that, which is the total of the table, it is the committed, contractually committed number.

MS RAMAGAGA: Right. Thank you. And paragraphs 3, 4, 5.

MR NAIDOO: I have dealt with paragraphs 3, 4, 5 in my explanation of the table. It is just summarising that the overall DIP outcome was valued at 15,3 billion and it is highlighting what was the performance guarantees, as I have explained and then it mentions that all the contracts referred to the NIP implementing system, as the

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implementing [indistinct]

MS RAMAGAGA: Right. Thank you. Please then turn over to page 37, which deals with the “*Outcomes: Loan Packages*” and just take the Commission through the “*Negotiations*”
5 *Outcomes*” and the current financing arrangements.

MR NAIDOO: This summarises the conclusions with regard to the loan packages. Firstly, the need for commercial loans was completely eliminated and export credit agency finance could be used for all of the imported
10 content including down payments in respect of the imports, which was a change, a positive change. The non UK Export Credit agencies to different degrees, managed the more attractive option that had been offered by the UK Export Credit Agency. The loans included options to select
15 different currencies and with the exception of the German Export Credit Agency, also a range of interest rate options which managed the interest rate risk, and the premium for the ECA were to be financed from the loans itself for all packages, with a reduction in bank margin and fees, and I
20 think the finance team were extremely pleased with these outcomes and were of the view that they were largely unprecedented especially for defence spending.

MS RAMAGAGA: Right. Then you have already informed the Commission that you participated in the GID Public Hearings
25 which were held in or around 2001 and you have in fact issues relating to the IONT, are captured in the report in chapter 8 of the report. You have had opportunity to go

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through that report. Do you confirm that the contents of that chapter of the report, is a reflection of the IONT's contribution in the public hearings? The copy of the GID Report, chapter 8 in particular is annexed to the statement, and it is marked JM11. It appears from page 210 of the bundle, Commissioners.

MR NAIDOO: I have read the report and I am satisfied that that report is a fair reflection.

MS RAMAGAGA: Now in conclusion, looking back at from the time when you took your office as the chief negotiator and executed your mandate as the team, up to conclusion, what can you say about the achievements and challenges, if any, about your task as the negotiating team?

MR NAIDOO: That is quite an open ended question.

MS RAMAGAGA: Just conclude, sir, thanks.

MR NAIDOO: Yes. In my conclusion in my statement I make the following comment which I think is my conclusion, is that during 1999 from the period commencing after the Government selected the preferred bidders, up to the final signing of the contracts, which was the period of my association with this project, I believe the negotiation process was conducted with great intensity and professionalism by the departments and the officials participating, with the result being a consensus between the Government Departments and Ministers that an improvement outcome had been secured and one which was affordable for the South African Government to enter into and, I believe

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today, years later my conclusion is still the same.

MS RAMAGAGA: Right. Thank you, Mr Naidoo. Chair, that concludes the evidence of the witness.

CHAIRPERSON: Any other question on which you wish to
5 cross examine Mr Naidoo?

ADV DE VOS: Chair, the Lawyers for Human Rights would like the opportunity to cross examine Mr Naidoo on behalf of our clients Stephanie Steyn, Mr Holden and Mr van Vuuren.

CHAIRPERSON: Any other person who might be
10 interested to cross examine?

MS KONGWA: Chairperson, on behalf of the DTI, we just have one question of clarity. We have one question of clarity to pose to Mr Naidoo from the DTI.

CHAIRPERSON: The DTI. Anna, we will come to you.
15 The DTI has only one. [indistinct] Okay, maybe then we give you a chance of asking that one question before we allow cross examination.

MS KONGWA: Honourable Chairperson, my name is Caroline Kongwa. I am an admitted attorney with the
20 [indistinct] Regional Division. I am also the head of the Law Services. The state attorney was not able to represent us today, hence I will be posing the question to the witness and thank you for the indulgence. Mr Naidoo, in your evidence in chief it was presented to you the notion of the
25 amendments of the NIP system. You then went on to indicate that you arrived at the NIP system, or the amendments that you arrived at regarding the NIP system

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amounted to basically for every Rand or Dollar investment made, it had to equate to a Rand on the procurement spent. I just needed clarity. What do you mean by that? Because it is our understanding and the evidence led so far that with regard to specifically NIP, the intention was for a Rand... for every Rand spent on investment [indistinct] of the successful bidder, would be awarded one credit.

MR NAIDOO: Thank you for that question. I am glad to clarify that. The negotiating team had the ... had a number of targets with regard to finance, with regard to the NIP's, with regard to price, so when I talk about the match between the procurement costs and investments costs, it was a target to aim for, that they should be at least the same amount of investment as we were spending in procurement. The obligations of the contractor are as documented in that table, which was the specific number, I think just short of 25 billion rands which is what was contracted in aggregate. So there was no contractual correlation between the procurement and the investment. It was simply the target and what was eventually agreed upon, was as reflected in the table.

MS KONGWA: Thank you Commissioners. I have no further questions.

CHAIRPERSON: Thank you, Ma'am. Advocate de Vos?

ADV DE VOS: Thank you, Chair. Thank you, Chair. Mr Naidoo, do I understand your evidence correctly that if one looks at the chronology of events, that one can safely

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assume that after each date, especially starting with the second Minister's Committee meeting of the 6th of April, item 10, the steps set out in the following numbers, for instance "establishing of affordability team and commencement of work" were steps taken because of decisions made at the committee meeting. Did I understand you correctly?

MR NAIDOO: That is correct.

ADV DE VOS: Then as far as the fourth Minister's Committee meeting is concerned of the 31st of August 1999, you have already indicated that the affordability report was placed before the committee at that time, is that correct?

MR NAIDOO: That is correct.

ADV DE VOS: Do you know whether the report to Cabinet and the final decision that was taken on the 15th of September, whether during that meeting the affordability report was also placed before the Cabinet?

MR NAIDOO: The presentation to Cabinet was in the form of a power point presentation, which I think is an annexure here. On page 52. It is annexure JN7.

ADV DE VOS: This is the presentation you referred to earlier in which the question of changing the NIP requirements for this specific SDP contract, were presented to Cabinet, is that correct?

MR NAIDOO: Sorry, could you please repeat that?

ADV DE VOS: You mention in paragraph 3 and 4 on, I think it is your page 16 of your report, where you discuss the NIP system under item 5, "changes proposed to improve

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national industrial participation system". You mentioned that there were proposed amendments to the NIP system, especially in paragraph 4 :

5 *"For the purpose of the defence procurement to avoid exaggeration of benefits, for the defence procurement revised system was agreed based only on investments, exports and sales and on a basis of one Rand for one credit and all the multipliers as envisaged in the existing NIP system were eliminated."*

10 Now maybe I will rephrase the question. Who were the parties that agreed that the existing NIP system using multipliers, should not be used for purposes of this particular negotiations?

MR NAIDOO: We undertook a review of all aspects
15 relevant to the procurement beginning from the January meeting. In April the Minister's Committee established the affordability team. Although I do not have the April minutes, I would ... I believe that it was in that meeting that the proposal to change the NIP system for the purposes of
20 defence procurement, were proposed and agreed upon. Prior to proposing that, the negotiating team first considered the matter. I would have then discussed this with the appropriate people in the DTI, including the Minister, and then we would have proposed that to the Minister's
25 Committee. All the subsequent documents including the affordability document and the negotiations themselves, could not have commenced unless there had been approval

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at the Minister's Committee level for such a significant change of a system and it would have required a strong consensus on our side to be able to present such a big departure from the contract, and from the initial terms to these...to these defence suppliers. It was then incorporated in the affordability report and in the presentation that went through to the Cabinet, and it was made to the Cabinet. The system as I indicated in my earlier evidence in chief, that the point was highlighted in the presentation.

10 ADV DE VOS: And after that presentation to the Cabinet and the final decision that was made, the final contract negotiations took place, is that correct?

MR NAIDOO: That is correct.

ADV DE VOS: And those final contract negotiations must have been in terms of instructions from Cabinet?

MR NAIDOO: That is correct.

ADV DE VOS: You say then in paragraph 5 on the same page of your statement:

20 *"Negotiations with the preferred bidders, the NT targeted a minimum of one to one ratio between NIP plus DIP investments and the contract equipment purchase price with exports and sales additional. In all cases these amounts were assessed over a period of seven years."*

Am I correct in stating that in the end you were successful to negotiate a one to one ratio, with only the three components as mentioned in paragraph 4 of your summary, were incorporated in the contracts?

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MR NAIDOO: Yes, this touches on the question that was asked by the representative of the DTI and this target was achieved and exceeded, because if you take the combination of the NIP investments, plus DIP investments, it is much
5 more than the contracts are.

ADV DE VOS: And just to make sure that I understand you correctly, so the risk that was identified by the negotiating team and explained in your summary, was contained because of the fact that you were able to use the amended NIP
10 system and that you negotiated and incorporated into the contracts?

MR NAIDOO: The purpose was to mitigate those risks and that is why those particular measures were taken up.

ADV DE VOS: Can I then take you to section 9 of your
15 summary, which is the costs of the packages.

MR NAIDOO: Page?

ADV DE VOS: That should be page 23, I think. I think it is 23. It is item 9, "*Costs of packages*" and it starts with paragraph 1. I think it is page 23/24.

20 MR NAIDOO: Okay.

ADV DE VOS: Do you have that?

MR NAIDOO: Yes.

ADV DE VOS: Now [intervenes]

CHAIRPERSON: Which page is that?

25 ADV DE VOS: 24, Commissioner. 24.

CHAIRPERSON: Thank you.

ADV DE VOS: You explain under item 1 that not all real

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costs were taken into account when the costing was done, and then you list certain items that were not taken into account, is that correct?

MR NAIDOO: That is correct. That is our assessment of
5 what information we had at the point when the international office negotiating team was established. We reviewed the costing and then identified the items that should be added to it, to get to the full and correct price.

ADV DE VOS: And after you added the items that is
10 mentioned here from item 1 to 5, you arrived at what you call "*the cash price*", is that correct?

MR NAIDOO: Correct.

ADV DE VOS: The cash price, however, does not include
15 interest that was paid, or must be paid by the Republic of South Africa, is that right?

MR NAIDOO: Correct.

ADV DE VOS: Do you have any idea what the real price
would have been, if that was added on to it?

MR NAIDOO: That will be a subject of the loan
20 agreements and I think the best person to answer that would be from the Department of Finance.

ADV DE VOS: So where you refer to "*the real price*" we do
not have any numbers, but we know that the cash price referred to was 29.9 million, is that correct?

25 MR NAIDOO: That was how it was calculated at that time, yes.

ADV DE VOS: You also mentioned, Mr Naidoo, that when

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you were negotiating the contracts, you had to do and I think you also say that it was a core part of your function, make sure of the affordability of the contracts?

MR NAIDOO: Correct.

5 ADV DE VOS: Now it has already been canvassed before according to my instruction, that there were concerns about the costs of certain of the packages, in particular regarding the Combat Suite System for the Corvettes and the combined costs of the LIFT and Alpha. As part of the reduction in
10 costs, I was instructed that certain functionalities and features of the equipment purchased, was removed. Am I correct?

MR NAIDOO: Could you just take me to where you are reading out from?

15 ADV DE VOS: I am reading from a note I made from instructions I received from my clients. They indicate that because you had to negotiate, to put it bluntly, cheaper prices for the product that was ordered, and I think you also mentioned in your evidence that some of the specs had to
20 change. Now I am putting to you that the specs that was changed, was actually the fact that certain functionalities and features of equipment purchased was removed, is that correct?

MR NAIDOO: I am aware of many things that were done
25 to change the costs of the package. The Corvettes as a whole were given a price parameter. The manner in which the Department of Defence and ARMSCOR achieved that, it

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is not known to me. The Hawk and Gripen, I think we have dealt with quite exhaustively today, how we mitigated that cost. We dropped the Maritime Helicopters from the contract round and that then meant that we had just the light
5 utility helicopters that went through relatively unscathed and I do not know if I am missing out any package.

ADV DE VOS: Well, maybe I [intervenes]

MR NAIDOO: Yes, then of course and the submarines were also, the last package. So the manner in which the
10 Department respect in order to meet their functionality requirements, but at a different price point, it is not something that I am in a position to give you any substantial detail on.

ADV DE VOS: I just want to refer you to the Joint
15 Investigation Report and Commissioners, if you turn to the bundle that was handed in this morning, it is right at the end of the file, and it will be page 1 of our bundle and I am sure that the witness also has a copy of that. It is paragraph 4.7.9 of chapter 4 of the Joint Investigation Report. I am
20 just reading it to you and I am going to ask your comment on this. Can I proceed, Mr Commissioner?

*“During the negotiation phase the packages were reviewed in order to stay within the amounts approved by Cabinet. This resulted in some essential functionalities of
25 the aircraft in the LIFT and Alpha package not being included in the contracts. Funding will have to be found outside the Cabinet approved package funding for these*

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functionalities.”

Now first of all, obviously it is concerning that essential functionalities were removed from the LIFT and Alpha packages. Were the Minister's Committee informed of the
5 removal of these essential functions and were you aware thereof?

MR NAIDOO: As I have indicated the packages were affected to some amount of respecping to reduce the price. But I am not aware of any essential functionalities that were
10 removed and here I underline the word 'essential'. It is...there has been no report that I am aware of that occurred during the time of the negotiation process, to indicate that an essential functionality was removed, which would then have to be financed and incorporated later.
15 Apart from the Maritime Helicopters, which was well understood that they were a secondary requirement, they would have to be inserted on to the ships at a later stage, and that would perhaps be a core functionality, but I am not aware of any other essential functionality that would damage
20 the usefulness of the equipment for the purposes that they were required.

ADV DE VOS: So you do not agree with the finding of the Joint Investigation Report?

MR NAIDOO: I am not in a position to give any further
25 comment on this. They obviously did a much more detailed investigation than any investigation that I had done. But for the purpose of the negotiation I can say that we were not

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aware of any essential functionalities that were omitted. They may have drawn on more information to reach that conclusion. I cannot comment further on that.

ADV DE VOS: Do you have any knowledge of funding that
5 had to be found outside of the Cabinet approved package to lease these functionalities so that the systems could operate properly?

MR NAIDOO: To the best of my knowledge the systems operated properly, with the conclusion of these contracts
10 and there were no other missing pieces left for later. So I am not aware at all of any further funding requirements outside of the budget of the department concerned.

ADV DE VOS: Now Mr Naidoo, my instructions are, I nearly said that I am going to put it to you, but since I am
15 not Barry Roux, I think I will refrain from doing that, my clients believe that there were certain extra costs involved and that the additional costs were not included in the SDP contracts, but flowed from them and were looking at the opportunity of finding information and obviously looking at
20 you as the chief negotiator, information as to what these costs are.

CHAIRPERSON: I am sorry, Advocate De Vos, I am not quite sure what is the basis of your clients' belief. Can you share that with us so that you know when the witness answers and
25 then we can all understand properly exactly where were they coming from? Because up to now I do not seem to be, the Commission does not seem to be having any evidence of

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such a belief.

ADV DE VOS: Mr Chairman, the question or the line of questioning that was being put to the witness, has to do with the report of the Joint Investigation, or the Joint
5 Investigation Report. Where it was reported that essential functionalities of the aircraft, that is the Hawks and the Gripen, were not included in the contracts and that those had to be leased and that caused additional costs to the Department of Defence and we are just trying to establish
10 what the amount of those additional costs are. I understand from this witness that he is perhaps not in a position to give us this evidence, but I note...I am just making sure of that fact.

CHAIRPERSON: Ja, then to respond again to what you have
15 said to me, we have not heard such evidence. The Chief of the Air Force was here, he never gave us such evidence, so I am not quite sure where your clients' belief comes from, that essential parts of some of those aircraft were removed. We were never told that. The evidence that we have is that
20 those aircraft are in such a good condition that the Air Force believes that they were the best weapons, the best aircraft that the world can offer. So the evidence that we have does not really support what you are trying to put to this witness. I am not quite sure whether that question is a fair question.
25 The question that you put to him, it must be based on the evidence that we have. That evidence that you are trying to refer to, I do not know where it comes from. But in any

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event the witness is here. If he wants to answer that question, he can answer that question, unless Advocate Moerane you wanted to add something to what I have said?

ADV MOERANE: No, Chair. My comments would be
5 precisely what the Chair has said. There does not seem to be a basis for making that submission or asking that question. It appears my learned friend is basing the question entirely on the words that appear in paragraph 4.7.9 and with no other basis than that.

10 ADV DE VOS: Mr Chair, may I just ask that [intervenes]

CHAIRPERSON: Just hold on. Let us find out from the witness who might be in a position to answer that question. [indistinct]

MR NAIDOO: Chair, I have no knowledge or insight into
15 this question of essential functionalities that were not included and I have no knowledge or insight on the funding of such missing essential functionalities. So I would think that the person who wrote this down in the report, would be in a better position to say what they meant by this and what
20 the factual basis of this statement is. But it is...I have no facts...no evidence to comment on this.

ADV DE VOS: Thank you, Mr Naidoo. Can I ask you to turn to the affordability report and more specifically Appendix B, that you will also find as part of the
25 documentation provided for by the Lawyers for Human Rights. It is the last bundle and it is page 7 thereof, if I have it. Can I ask you to turn to page 8 and the summary of

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[indistinct] outputs from the DER model, do you have that in front of you?

MR NAIDOO: Yes, I do.

ADV DE VOS: You mention in your statement that
5 [intervenes]

CHAIRPERSON: Sorry, Advocate de Vos, if you can just read the page that you are reading it from, and also the proposition that you want to make, because we cannot see from these pages that we have.

10 ADV DE VOS: Mr Chair, I have not made any proposition, I am just trying to get the witness to the right page.

CHAIRPERSON: No, no, I understand. I am saying... this is what I am going to ask you to do, because we cannot see...I mean these are all the copies that we have in front of
15 us. We simply cannot see. That is why I am asking you to read it out.

ADV DE VOS: Mr Chair, are you referring to the quality of the copies? I have got exactly the same copy, but I will ask the witness to see if he can read what it says. It is dealing
20 with the discussion on the effect that the transaction may have on the GDP, is that correct?

MR NAIDOO: That is correct.

ADV DE VOS: Perhaps Mr Naidoo, you can explain to the Commission exactly what these figures present, or represent
25 and what to make of them.

MR NAIDOO: So apart from the fact that they are incredibly small and difficult to read even with my glasses

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on, I can say that on the left hand side you will see that there is 12 lines in each box which represents the 12 scenarios that were used by the modellers. I have not looked at this since July of 1999 until this morning, so you will forgive me if you know my memory is not very good on this point, but there are 12 scenarios and they range from four high scenarios to four middle scenarios, to four low scenarios. Each scenario had a different setting of risk on those risks that we were discussing earlier, and then they run through different years. From year 1999 up to 2008 and each scenario ...the numbers there are an output from the model that tells you what happens in each scenario as an outcome of the formulas that are tying together those particular risks. So I cannot tell you what each scenario says in precise detail and you would have to then look at the assumptions that are embodied in each of those 12 scenarios, to really understand what the implications are.

But if you look at the baseline scenario on the first section, it says "no packages" and then it gives you the GDP growth from 1999 to 2008 and it is a number in each of them. I cannot actually see those numbers very clearly, because they are very small, but I think the first one is 683 and the last one in 2008 is 951 and that will represent billions in 1999 Rand. The base model then predicting that this is the GDP of South Africa in real terms based on all our assumptions at that stage of what was the base line growth rate of the South African economy.

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And then the high scenario would... has a reference to full NIP. In other words that everything that was expected came through. Full did not mean 100%. It would mean ...I would guess now somewhere between 65 to 80% as our
5 optimistic, our [indistinct] high road scenario envisaged and it had a impact which, if you can follow the numbers, more or less no impact as a result of the defence procurement relative to the GDP growth, originally before the procurement took place.

10 And then you will look at the last line in that section where it says "low scenario, adverse, INT". I think adverse interest rates, I am guessing and adverse NIP's and it would start from the same number in 1999, and then it goes on down, but it is slightly less than the top number which was
15 951, it becomes 935 in 2008 in real terms. So that would indicate a range of difference between the high scenario and the low scenario on that block.

Now each block represents a different kind of story. So it is ...and I cannot see clearly what each of these boxes are
20 and there were actually pages... and I see you do have some pages here, but pages and pages of this and it probably is a good exercise, one would have to get the modeller, the economic modeller with the document that has the assumptions, in order to really understand what each
25 scenario in this list is saying. I do not have that information off hand.

ADV DE VOS: Thank you, Mr Naidoo. All I wanted you to

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look at was the fact that in each particular scenario, even the best case scenario, the country's GDP would have been lower if the SDP was not pursued, even if only marginally, but the fact of the matter is in all the scenarios that are set
5 out. the GDP would have been in a better position had the SDP not been pursued, according to this particular model.

MR NAIDOO: According to all scenarios, the procurement of imported goods such as defence for a non-economic purpose, which is defence, would have a negative effect. I
10 think that is the nature of procurement of this nature.

ADV DE VOS: Thank you. I also would like you to look at the employment scenario which you will find on the third page and it is once again, we start from the top box. If one looks just at the figures in 2008 to make it easier for you, if
15 you could explain to the Commission. Once again we have a base line scenario where there is no packages and we assume then that the employment... the job creation is naught, based on no packages, is that correct?

MR NAIDOO: Could you please repeat that statement?

20 ADV DE VOS: If one has a look at the deviation from the base line in the employment box, the second entry on the third page.

MR NAIDOO: Okay.

ADV DE VOS: And you look at the record figures from
25 2008 for the high scenario results as well as the average column to the far right, you will see it starts off with "*base line scenario no packages*", then "*high scenario base*

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interest rates, full NIP's minus 12, 8 minus 7" do you see that? Perhaps you can start there and explain to the Commission what that means.

MR NAIDOO: Okay, if you take the high scenario base
5 interest rate full NIP's which is the first line in that second
box which I think is the one you are referring to, it shows
that in year 1, which is 1999, there is no deviation. In year
2, it is a positive of 9. Year 3 a positive of 14. Year 4 a
positive of 12. The following year I think is a positive of 8
10 and then a positive of 2 and then in the remaining four years
it becomes negative, minus 5, minus 9, minus 12 and minus
12 and each line has a different story.

In the low scenario right at the bottom of that, which is
now based on an adverse interest rate, an adverse NIP's it
15 is positive of 1 in year 2000 and then becoming a negative,
minus 4, minus 14 up to minus 117. I cannot tell you exactly
what these numbers mean. Is it 9,000 jobs or is it 9 as
opposed to a factor of something. I am not 100% sure what
that means. Is it a percentage of employment, but each
20 scenario represents a different impact. An explanation for
why the earlier years are positive and the later years are
negative, is simply the way the financial model works. It
does not take into account any other inputs apart from the
procurement itself and the IP, the industrial participation
25 effects on that. So in the early years you will find in some
cases the employment effects are positive.

But, once again, I would have to say to the Commission

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that you know the best person to get if you want to really understand this properly, it is not myself, but it is someone who is... one of the economists that have been working on this model.

5 ADV DE VOS: Thank you. Thank you, Mr Naidoo. I just want to make the following statement to you, that if one assumes that the figure that is given there, let us say minus 270 against high scenario, adverse rates, adverse NIP's under the year 2008 represents 270,000 fewer jobs, that
10 would be created with the let us call it the SDP, then the following statement in my submission, is a correct one and I want your comment. Maybe it is a little bit unfair, you have not seen these figures in a long time, but if one looks at the figures, it seems to me that in all scenarios, excluding the
15 best scenario, the country's level of employment would have been lower than if the SDP was not pursued. Do you agree with me?

MR NAIDOO: The employment impact of an investment programme like the defence procurement programme, is
20 always inclined towards the negative, because you have a cost that is being incurred, which impacts negatively on the economy and hence the entire purpose of the affordability report to try and mitigate that to the point where it was as neutral as possible. In the table you are reading out, I think
25 it is correct to say that we were mindful of the fact that there was a negative employment effect built into the procurement, and hence every effort had to be made to

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mitigate against this effect. In actual fact what has happened, I am unable to say, because now we have got 15 years of data to the extent that there are other things, that are also alive in the economy which affects this, we would
5 have to take that into account, but it is probably a useful exercise to get an analysis now with the benefit of hindsight. But certainly the model was giving us a great deal of insight as a result of which we did our best to build in all these mitigation measures.

10 ADV DE VOS: Mr Naidoo, I have been instructed that there was a public statement by the State at the time that the SDP would create 65,000 jobs. Do you have any idea where that figure came from?

MR NAIDOO: That figure arose in the period leading up
15 to the consideration of the defence purchasers, the procurement and was in the public domain when I became associated with the programme. 65,000 jobs was including both direct and indirect jobs and the number of direct jobs involved in that, was a much smaller number. It is a ratio of
20 four to one, and when we looked at the employment figures, we did not conclude on any employment figure to be associated with this programme, because the nature of the projects were still under feasibility. Many of them were capital intensive, so they were not generating as many jobs
25 as labour intensive programmes and so the ...all the communications from 1999 and beyond, did not put out another number and the 65,000 remained as the number in

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the public domain. Suffice it to say that when you have an investment programme of R24 billion and on the ratio of four indirect jobs to one direct job, you are only looking for about 20,000 direct jobs. It seemed very reasonable that 5 20,000 jobs could be generated from this scale of expenditure. So the team did not make any pronouncements on the number of the jobs. The basis on which these jobs were calculated, I think they were based on schedules. Were the number of people to be employed in all these 10 enterprises to be created, when they were submitted, were submitted by the suppliers, who said this particular factory will employ 10, that one will employ 30 and they counted that up and got a number of direct jobs and then using the multiplier between direct and indirect, which is consistent 15 for the economy, came up to 65,000. But I personally did not review that and none of the economists that we had contracted, you know were focussed at looking at that figure. We left that figure aside.

ADV DE VOS: Thank you, Mr Naidoo. Can I ask you to 20 turn to item 8 of your report. It is on your typed page... it is probably page 20. It says "*review of the defence equipment*".

MR NAIDOO: Okay. I have got it.

ADV DE VOS: It is page 20 of your typed page number. 25 You discussed the question of the need and the priority ranking of the defence equipment and more specifically the Alpha which was not required immediately. You then go on

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to explain why there was a recommendation by the negotiation team to defer the Gripen procurement. Is that correct?

MR NAIDOO: Correct.

5 ADV DE VOS: Eventually after or during that meeting, you were instructed to renegotiate the terms and you came back with an offer that you received as I understand your evidence, from DAE, they proposed a certain particular transaction and you placed this transaction and the details
10 thereof, which you describe the details of in your evidence, to the Minister's Committee on the 31st of August, is that correct>

MR NAIDOO: Correct.

ADV DE VOS: You then summarise their choice in
15 paragraph 10 of the [indistinct] in your evidence:

"In light of its previous decision the Committee was either to fully defer the Alpha package without taking any options, or to accept the proposed combination package."

Now at that particular Committee meeting the affordability
20 report was also on the table, is that right?

MR NAIDOO: Correct.

ADV DE VOS: What was the recommendation in the affordability report, if any pertaining to the second option mentioned in paragraph 10?

25 MR NAIDOO: The affordability report presented at that meeting of the Minister's Committee on the 31st of August, was a report, although it was entitled "*affordability report*",

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it was the report... the combined report of the negotiating team and the affordability team, both chaired by myself. So all of the calculations of the economic model, all of the results of the negotiations were collated into this report. So
5 the Ministers then had all of the information that we had extracted, available to make the decision. The affordability report did not say this is the best option and that is the best option. It was the information presented that said, these are the facts as we have it, and this is the decision that you
10 have to make and that was the decision that they made, which was to take the combination package with the tranches and risks mitigated in that way, rather than cancelling the package entirely.

ADV DE VOS: Thank you. I understand that the, well let
15 us call it the combination package was made attractive by the option to cancel the second and third tranches, is that correct?

MR NAIDOO: Well, I would not use the word 'attractive'.
But I think the point was that the South African Government
20 would be better off having the flexibility to deal with its ...with any economic shock if such a shock occurred if it had an option to cancel without any costs. The objective from the Ministry of Finance side and the negotiating team was to
25 give more space for the management of the economy to the Government, and hence to have the opportunity to downsize the size of a package, if a situation arose. That was you know, that was what was behind this approach.

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ADV DE VOS: Can you turn to page 147 and 148 of your bundle, which is the part of the affordability report particularly dealing with the financial implications of this combination offer particularly paragraph 1.3.3 to 1.3.8.

5 MR NAIDOO: I have it.

ADV DE VOS: Now according to this report:

“The financial implications of the tranches required close examination. It first points out that the costs of the aircraft in tranche 1 are 34% higher than the average unit costs of the whole Gripen respectively. Because the DAE have front loaded their non-recurrent expenditure for the full contract of tranche 1 price.”

10

You also gave evidence to that effect, correct?

MR NAIDOO: Correct.

15 ADV DE VOS: It then goes on to say that:

“The implications for the Government is that the option to cancel involves a large implicit cost. Exercising the cancellation option would effectively mean that the Government would pay a premium for the aircraft, tranche 1, of 34 to 35%. This equates to a total of 1.736 million. If Government accepts the combination package, it would be financially perverse for it to cancel tranches 2 and 3 later.”

20

Does this not merely mean that there was not option to cancel in practical terms, if you consider what was said in this report?

25

MR NAIDOO: No, it does not mean that. What it is basically describing is that the... there were certain fixed

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costs with the two categories of equipment, the Hawk and the Gripen which were fixed costs and so the initial supply of aircraft was then at a higher cost than the later supply of aircraft, because the fixed costs was taken into the first
5 batch. Now since the objective of the South African Government was not to try and get a discount on the price, we were trying to reduce the costs in general, but in this exercise it was trying to get the space in the event of a shock from some external factor, economic shock, a global
10 financial crises or something of that nature, we would then have the opportunity to step back from tranche 2 and tranche 3. So the cost of doing that would of course mean that you have now equipment from tranche 1 that is much more expensive than if you had taken the whole package,
15 but you have bought the flexibility as the Government to deal with some other shock if you need to deal with that shock.

So as a co-author of the affordability report, what we were trying to describe to the Ministers is to have a full
20 appreciation of the nuances of the situation. That it does mean that you are ... is not an option where you can exercise this in your free discretion. It is an option to be exercised if the economy was in distress. But it would be best if you wanted to acquire the equipment and there was
25 no financial distress from some external source to continue with tranche 2 and tranche 3, and that was a fair outcome which satisfied both the needs of the South African

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Government as well as the commercial needs of the supplier.

ADV DE VOS: Mr Naidoo, there are... there are two additional points which made the supposed flexibility of the whole package really not so flexible, and that is also pointed out in your report and I continue to read on to the next paragraph. Firstly:

“The contract quotes for the Hawk alone as 50 million while the contract price for the proposed [indistinct]tranche 1, is R65,65 million. Secondly, the purchase of some dual seater Gripen up front implies an almost irrevocable commitment to completing the acquisition of the full Gripen package. Exercising the option to cancel the single seater Gripen in 2004 will imply a major waste of resources as the only purpose of acquiring the dual seater Gripen is to train pilots to fly the single seater Gripen.”

Now I just want to point out to you that you are talking about flexibility today, but when you drafted the affordability report you mentioned to the then Cabinet, that:

“We are looking at an almost irrevocable commitment.”

What is your comment on that?

MR NAIDOO: I think that is a correct reading. We are talking about an almost irrevocable commitment, subject to the right of the South African Government to withdraw from tranche 2 and tranche 3, if there was a desperate need as a result of some external shock. Remember this was an exercise where we were trying to mitigate the risks. So your interpretation is correct. The objective here was simply to

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mitigate the risk and not to avoid making a commitment to the purchase.

ADV DE VOS: Thank you. Then, Mr Naidoo, the last issue I would like to take up with you is that, you have already
5 stated that the function of the negotiating team and the affordability team especially was to show all the possible scenarios as far as the SDP is concerned, but in spite of that the opportunity cost assessment was not done. You referred to that in your evidence in chief. Why was that?

10 MR NAIDOO: Can you please help me to find where I have referred to the opportunity costs?

ADV DE VOS: It is item 10 of your report dealing... or your evidence dealing with the affordability report. It is probably page 25 or 26. 26 and it is paragraph 3, where you
15 say:

*“The affordability study defined affordability in terms of the capacity of the economy to absorb the overall costs of the exercise as well as the possible increase in cost levels which might occur if the associated risks were experienced.
20 Affordability was not defined in terms of the concept of opportunity costs, that is the positive alternative users of the funds on meeting other policy objectives.”*

MR NAIDOO: Yes. It was not our brief to define affordability from an opportunity cost point of view. Our
25 mandate was to look at affordability under the question, the economy’s ability to absorb this procurement.

ADV DE VOS: But during the discussions at the Ministers’

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Committee of Ministers' level that you were present at, was this concept and the question of the opportunity costs, not discussed and not considered?

MR NAIDOO: It was discussed and the definition of
5 affordability was as set out.

ADV DE VOS: The discussion that you refer to was it based on any costing, any report? Any information as to what the opportunity costs could have been?

MR NAIDOO: This was an exercise dealing with the
10 affordability of defence procurement. So I can only assume that the idea of saying what if we had used this money instead of defence procurement, would have been a different exercise. But it was a procurement programme initiated and supported by the two departments, in principle the
15 Department of Defence and the DTI. So it was intended to consider this defence procurement and whether it was affordable, or not hence the discussion of an alternative to defence spending, was not within the scope.

ADV DE VOS: But I understood from previous evidence
20 that the impact that it would have on the economy, a positive impact, the growth of jobs, etcetera, etcetera, was one of the main reasons why the SDP was concluded. Now surely from a... surely the opportunity costs should have been considered in detail to make a proper ...come to a proper
25 conclusion as to what would be the best route to be and how the money would be spent best?

MR NAIDOO: It was really about defence procurement

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and how to mitigate the impact of defence procurement and convert it to a positive opportunity, which I think is where the whole NIP system derives its source from, to create offsets as a mechanism for stimulating jobs and economic investment. If you were investing in something else like infrastructure, a power station for example, there is no doubt that it would have been an investment which would have showed a stronger positive return on all fronts, than a defence investments which by its nature is non-economic. However, then there would have been no defence equipment. So I think that was the... that was very much the decision that the Government has to make. For the purpose of the exercise that I was undertaking, we were quite clear that it was a defence procurement that we were seeking to manage the risks of and to turn it into a positive opportunity where that was possible.

ADV DE VOS: Thank you, Mr Naidoo. Thank you, Chair. That is the questions for us.

CHAIRPERSON: Any re-examination?

20 MR SELEKA: Commissioners, no re-examination.

MR BROWNE: Thank you, Mr Commissioner. Terry Crawford Browne, I have one question for Mr Naidoo. Mr Naidoo, the affordability study that went to the Cabinet in August 1999 comprised 57 pages plus annexures and totalling 224 pages. The GID report in chapters 8 and 9, commends both the IONT and the financial working groups for their professionalism and remarks about the voluminous

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quantity of their reports and analyses. Could you estimate just how many thousand pages of reports and analyses were distilled down into that 57 pages that went to the Cabinet in August [indistinct] was it 8,000, 10,000? Roughly how many
5 thousand pages of reports were distilled into that report [indistinct]

MR NAIDOO: I would have to look at the report to be exact, but what went to the Ministers' Committee in August is referred to and I have seen it here which has jogged my
10 memory over the last few days, is referred to as 'the blue file' and it was a very ...and what went to the Ministers' Committee in August 1999 was... is referred to in many of these documents as "the blue file' and it was quite a thick file of documents, with the affordability report, the 57
15 pages. I take it is 57 pages, but I am no longer familiar with the number of pages it was, and all the annexures. The annexures including the economic model, including the reports of the analysts [intervenes]

CHAIRPERSON: Mr Naidoo, if you do not mind, can you
20 move [indistinct] you must face us so that we can hear what you are saying. When you are facing that way, you are facing the person who put the question and we simply cannot hear you. You must face in our direction.

MR NAIDOO: My apologies. It is a habit which I
25 apologise for. So I think the question was how many pages were distilled down to those 57, and what I was saying is that we had a file of documents. The first part of the

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document was the affordability report and then there were several annexures to that report. So it represented quite a thick file. The question says approximately 200 and some odd pages, I do not really know, but in terms of distilling it down, I think there were mostly original reports, there were, there was no substantial editing of the annexures. So to the extent that we got a report from the steel analyst we inserted that. The 57 pages was the interpretation of all of this which was put together and that interpretation was done by the affordability team as a whole, with different inputs from different people, but primarily written by the two appointed contracted economists, Mr van Heerden and Mr Gaulb with Mr White and myself acting as co-editors.

MR BROWNE: Mr Naidoo, may I ask if 8 to 10,000 pages of reports will be a reasonable estimate of what the authors of the GID report considered to be voluminous? Would 8 to 10,000, just an estimate, would that be what had been distilled into the affordability study and its... the 57 pages and the annexures, 204 pages?

MR NAIDOO: I cannot comment on that.

CHAIRPERSON: Was that your last question?

MR BROWNE: I will leave it at that, sir. Thank you.

CHAIRPERSON: Any other question? Thank you. There is no other question. Thanks a lot you are excused. Thanks a lot for giving evidence before this Commission.

MR NAIDOO: Thank you.

CHAIRPERSON: I think we are going to adjourn until

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tomorrow morning. If recall the last arrangements made were that tomorrow we will start at eight am and then we are going to start with Mr Ronny Kasrils and then from there Mr Lakota. So we will adjourn and Ms Ramagaga, I am sure you
5 will share with your colleagues who were supposed to be leading Mr Ronny Kasrils and Mr Lakota tomorrow morning, just remind them that we said we will start at eight o'clock.

MS RAMAGAGA: Yes, Chair, I will do so.

CHAIRPERSON: Thank you. We will adjourn until
10 tomorrow morning.

(COMMISSION ADJOURNS)

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