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SUBMISSION ON DRAFT PREFERENTIAL PROCUREMENT REGULATIONS, 2009

Introduction

The AIDS Law Project (ALP), a not-for-profit organisation that seeks to use and develop the law to defend and advance constitutionally protected rights, has a direct interest in the draft Preferential Procurement Regulations ("the draft regulations") published for public comment on 14 August 2009.[1] In large part, this arises out of our work on access to medicines – an integral part of the right to have access to health care services – and the manner in which the state procures antiretroviral (ARV) medicines.

Amongst others, we have made the following contributions towards the state procurement of ARV medicines:

- As a result of a complaint lodged with the Competition Commission by the ALP on behalf of the Treatment Action Campaign (TAC) and others in September 2002, a number of pharmaceutical companies were able to submit bids in 2004 for the supply of generic zidovudine, lamivudine and nevirapine products to the public sector.[2]
- As a result of our intervention on behalf of the TAC in March 2004, the Department of Health agreed to permit provinces to procure interim supplies of ARV medicines pending the finalisation of the 2004/2005 tender – absent this intervention, tens of thousands of people with HIV/AIDS would have died waiting for treatment over the 15 months that it took to adjudicate bids and award tender contracts.[3]
- In anticipation of the 2008 ARV tender, the ALP prepared a memorandum for the Presidency in September 2007 that highlighted the lessons learnt from the previous ARV tender and their implications for the upcoming tender.[4] This

[1] General Notice No. 1103, Government Gazette No. 32489 (14 August 2009)
[2] See TAC Newsletter, "Competition Commission Settlement Agreements Secure Access to Affordable Life-Saving Antiretroviral Medicines", available at http://www.tac.org.za/newsletter/2003/ns10_12_2003.htm.
[3] See TAC Electronic Newsletter, "MinMEC Agrees to Interim Procurement of Antiretroviral Medicines", available at http://www.tac.org.za/newsletter/2004/ns25_03_2004.htm.
[4] This memorandum is available upon request.

was followed up in March 2008 by a further memorandum that identified a number of concerns relating to the 2008 tender specifications.[5]

- As a result of a complaint lodged with the Competition Commission by the ALP on behalf of the TAC in November 2007, five pharmaceutical companies – including two local generics producers – were able to submit bids in 2008 for the supply of efavirenz to the public sector.[6] The 2008 tender price for efavirenz is approximately half of that paid for the ARV medicine under the previous tender.
- In July 2009, the Competition Commission requested the TAC to provide input on Aspen Pharmacare's proposed acquisition of GlaxoSmithKline South Africa's pharmaceutical division. The TAC's submissions, which were drafted in consultation with the ALP, appear to have resulted directly in the condition attached to the approved merger – that a number of companies be licensed to bring generic abacavir products to market. This will go a long way towards ensuring that there is competitive bidding in respect of such medicines in the 2010 ARV tender.[7]

Our particular interest in the development and finalisation of the draft regulations is twofold: first, to bring to government's attention the extent to which the draft regulations – if promulgated in their current form – have the potential to undermine the right to have access to health care services; and second, to make proposals regarding how best to address concerns relating to broad-based black economic empowerment (B-BBBEE) and local production in the procurement of medicines by the state.

Detailed submissions

In these submissions, we consider the following aspects of the draft regulations in some detail:

- Explanatory memorandum:
  - Limited purpose of the draft regulations (paragraph 1);
  - Effect of the draft regulations (paragraph 2(ii));
- Application of the draft regulations to all organs of state regardless of circumstances (draft regulation 2 read with draft regulation 9(1));

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[5] The memorandum is available at http://www.tac.org.za/community/files/ALPMemorandumOn2008ARVTender.pdf.

[6] See TAC Press Release, "TAC complaint increases access to efavirenz: MSD finally agrees to grant licenses on reasonable terms", available at http://www.tac.org.za/community/node/2329.

[7] See TAC Press release, "Competition Commission places condition on GSK and Aspen merger – GSK must license abacavir to generic manufacturers", available at http://www.tac.org.za/community/node/2744.

- Circumstances in which organs of state may apply the 80/20 preference point system for price quotations with a value of less than R30 000 (draft regulation 4(1));
- Bids also evaluated on functionality (draft regulation 8(4));
- Award of contracts to bids not scoring the highest number of points (draft regulation 9(1));
- Limiting certain tender processes to local manufacturers (draft regulation 11(1)); and
- Tiebreaker mechanisms in the event of equality of points (draft regulation 11(12)).

Explanatory memorandum

The long title of the Preferential Procurement Policy Framework Act 5 of 2000 ("the Act") describes the Act as giving "effect to section 217(3) of the Constitution by providing a framework for the implementation of the procurement policy contemplated in section 217(2) of the Constitution". When read together with section 2(1) of the Act, which also speaks to "implementing the programmes of the Reconstruction and Development Programme", section 217(2) of the Constitution make it plain that this procurement policy is to include – but not be limited to – "the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination."[8]

Further, section 217(1) of the Constitution speaks about a procurement system "which is fair, transparent, competitive and cost-effective." Thus the provisions in subsections (2) and (3) can and should be understood to complement – and not detract from – the requirements of subsection (1). In addition, section 217 is to be read together with – amongst other provisions – section 27 of the Constitution, which guarantees everyone a right to have access to health care services and imposes positive obligations on the state in respect of the right's progressive realisation.

Put differently, the Constitution and the Act contemplate a procurement system that seeks to achieve a careful balance of interests. However, if implemented in their current form, the draft regulations will run the risk of upsetting the fine balance required by the Constitution. Insofar as they apply to the procurement of medicines, they will also run the risk of unconstitutionality, potentially limiting access to health care services in a manner not contemplated or permitted by the Constitution.

This is because the draft regulations –

[8] Section 217(2)(b) of the Constitution

- Are designed simply to ensure that preferential procurement procedures "are aligned with the aims of the Broad-Based Black Economic Empowerment Act, 2003 and associated Codes of Good Practice"; and
- "[R]eplace the awarding of bids on the basis of HDI status and the promotion of RDP goals with the BEE rating of a bidder".[9]

Consider the pharmaceutical sector as an example. The two main local generics producers – Adcock Ingram and Aspen Pharmacare – are level 6 B-BBEE contributors. In terms of the draft regulations, each would receive three preference points in any bid worth over R1 million. In any such bid process where one of the companies were to score 90 points for price, a small level 1 B-BBEE contributor that imports fully-formulated medicines would simply have to score 83 points on price.[10] In essence, this means the state would be paying a price for a fully imported medicine that is ±7.8% more expensive than the cheapest locally manufactured product. This does not square with section 217 of the Constitution, particularly in cases where the 7.8% premium is to be paid out of a limited health budget, thereby limiting access to health care services.

In our view, a preferential procurement framework should not provide space for this to happen. In the pharmaceutical manufacturing industry, for example, which has particularly high barriers to entry, it should create incentives for existing companies to transform. The incentive to be offered should be the award of all or part of a contract, not the ability to extract high prices. In this way, the objectives of B-BBEE legislation are advanced whilst at the same time ensuring that the procurement system "is fair, transparent, competitive and cost-effective."

Application of the draft regulations to all organs of state

Given the inflexible nature of the proposed preferential procurement system, draft regulation 2 – which requires that all organs of state comply fully with the regulations, unless directed otherwise by the Minister of Finance – may lead to the types of undesirable consequences outlined above. This could be avoided if sufficient flexibility were built into the regulations in a manner consistent with the rule of law. If this were to be done, it would require the following two amendments to the draft regulations:

- A requirement that the Minister of Finance may only exercise the power in draft regulation 2(2) in consultation with the Minister to whom the relevant organ of state reports; and

[9] Paragraphs 1 and 2(ii) of the explanatory memorandum respectively.

[10] This is because draft regulation 11(12)(a) makes it plain that where scores are equal, the firm with the higher B-BBEE score will be awarded the bid.

- An amendment to draft regulation 9(1) that provides guidance on what constitutes "reasonable and justifiable grounds" for awarding a contract to a bidder that did not score the highest number of points.[11]

Together, the amendments would go some way towards allowing for a generic preferential procurement system to be tailored to the peculiarities of a specific sector or industry.

Circumstances in which the 80/20 preference point system may be applied for price quotations with a value of less than R30 000

Draft regulation 4(1) permits the application of the 80/20 preference point system in respect of price quotations valued at less than R30 000 "if and when appropriate". It does not, however, provide any guidance on when it may be appropriate to do so. In the result, the draft regulation may be sufficiently vague and uncertain as to violate the rule of law.

Bids also evaluated on functionality

Draft regulation 8 permits – but does not require – that bids also be evaluated on functionality, defined as "the measurement according to predetermined norms of a service or commodity designed to be practical and useful, working or operating, taking into account among others quality, reliability, viability and durability of a service". In particular, draft regulation 8(4) requires that "[b]ids that have achieved the minimum qualification score for functionality must be evaluated further in terms of the preference point systems prescribed in [draft] Regulations 4 and 5."

In certain sectors, such as pharmaceuticals, such an approach would not compromise the quality of goods procured. This is because all medicines have to satisfy certain standards relating to quality, safety and efficacy. However, where services are to be procured, such an approach may result in a violation of section 217 of the Constitution. Consider the following example. Purely on the basis of price, a non-compliant B-BBEE company that achieves the minimum score for functionality may edge out a compliant B-BBEE company that provides more expensive but better, cost-effective services.

Award of contracts to bids not scoring the highest number of points

Section 2(1)(f) of the Act requires that contracts are "awarded to the tenderer who scores the highest points, unless objective criteria in addition to those contemplated in paragraphs *(d)* and *(e)* justify the award to another tenderer". Paragraph (*d*) refers to "contracting with persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender or disability" and "implementing the

[11] This issue is addressed in detail below.

programmes of the Reconstruction and Development Programme", whereas paragraph (*e*) refers to "any specific goal for which a point may be awarded, [which] must be clearly specified in the invitation to submit a tender".

Yet draft regulation 9(1) simply permits a contract to be awarded to a bidder that did not score the highest number of points "on reasonable and justifiable grounds", without saying anything more. In our view, this provision is not contemplated by the Act and is therefore in breach of the constitutional principle of legality. At a minimum, it should require that the relevant invitation to submit a bid expressly detail additional factors on the basis of which a contract may be awarded and the extent to which such factors will be considered. In addition, the provision should provide some degree of guidance regarding the types of factors that may be considered.

Limiting certain tender processes to local manufacturers

In the sole reference in the draft regulations to local production, draft regulation 11(1) seeks to make provision for the awards of bids to local manufacturers in certain limited circumstances. In so doing, the provision runs the risk of running foul of the rule of law. This is because the Act, which is designed to give effect to section 217(2) of the Constitution, does not contemplate such a protectionist system, which in addition to being unfair may in fact result in insulating local industries from fair competition.

Section 217(1) of the Constitution makes it plain that the procurement system must be "fair, equitable, transparent, competitive and cost-effective". Section 217(2) allows for such a system also to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination, as well as to provide for "categories of preference in the allocation of contracts".[12] A preference – not an exclusive set-aside – is thus permissible. Anything else would run the risk of violating section 217(1)'s guarantee of fairness.

Tiebreaker mechanisms in the event of equality of points

This submission has already drawn attention to draft regulation 11(12), which details which bid should succeed in the event that two or more bids score equal points. In our view, draft regulations 11(12)(a) and (c) are problematic for the following reasons:[13]

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[12] The wording of section 217(2) – "[s]ubsection (1) does not prevent" – makes it plain that subsection (2) is not an exception to subsection (1), but instead that the two provisions are to be read together.

[13] Draft regulation 11(12)(b) is problematic to the extent that it effectively incorporates draft regulation 11(12)(a).

- By using preference point scores for B-BBEE as a tie-breaker, draft regulation 11(12)(a) effectively allocates greater value to B-BBEE status than permitted by the Act;
- There is no reference whatsoever to local production, which may in fact serve as a better tie-breaker; and
- The drawing of lots appears to preclude the splitting of tenders, which is both commonplace and necessary in a public health context.

In our view, draft regulation 11(12) should be amended to address these concerns.

Recommendations

In addition to the recommendations that we have already made in respect of the specific draft regulations considered, the ALP recommends that the following proposals be considered seriously:

- The Act, which brought the 90/10 and 80/20 systems into force, requires reconsideration if the preferential procurement system is to ensure that section 217(2) of the Constitution is implemented in a manner that does not detract from – but rather forms an integral part of – section 217(1);
- Unless and until this happens, the draft regulations should be amended to ensure a better split of the preference points between local production and B-BBEE, with the former being based on the percentage of local manufacturing content;[14] and
- If and when the allocation of preference points results in the procurement of more expensive essential services and/or products, separate funds for this effective subsidy should be provided in addition to the budgets allocated for such services and/or products.[15]

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[ENDS]

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[14] The 2008 ARV tender was based on this principle. However, it did not award preference points for anything below 30% local content. This is not appropriate in the generics industry, where most domestic products are formulated locally using imported active ingredients (which often account for up to 70-80% of value). In our view, it would have been more appropriate to award a third of local production preference points for value up to 30%, half of the points for local content of between 30% and 40%, two-thirds of the points for local content of between 40% and 50%, and the full point allocation for local content of at least 50%.

[15] For example, a local procurement subsidy in the field of medicines should be paid out of a trade and industry budget for industrial development and not cut into a health budget for pharmaceutical products.