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Mr. Hennie van Vuuren

Open Secrets

By email

hvanvuuren@opensecrets.org.za

Dear Hennie

I am writing on behalf of McKinsey about both the "*The Enablers*" report and the related Financial Mail article published on Thursday 6 February 2020. I had hoped to first have this conversation by telephone, but we were unable to reach you and your office invited me to email you.

McKinsey appreciates your valuable contribution to understanding these events and your right to hold and express critical opinions of McKinsey. These are extremely consequential matters, and as you will have seen from the July 2018 speech by Mr. Kevin Sneader (the global managing partner of McKinsey) at the Gordon Institute of Business Science and other public statements, McKinsey has not shied away from acknowledging serious mistakes and explaining the steps we have taken to address them.

McKinsey has been engaging and cooperating with The Judicial Commission of Inquiry into Allegations of State Capture ("the Commission"), as the Firm has with numerous other inquiries.

Requests for Corrections

Because of the imperative to render an accurate account of what transpired, I wanted to call to your attention several demonstrable factual errors in the report that if not corrected will detract from the report's overall force and clarity. We were never approached by the report's researchers before publication of the report and the article published in the Financial Mail (FM), so this correspondence is unfortunately the only opportunity we have available to engage on these points and correct the record.

In many instances, these errors were made because the original media coverage and other sources upon which the report relies are inaccurate or incomplete, as has since been made clear by other more authoritative information that has come to light. Unfortunately, some of these errors are quite serious and material to the report. As your report has been submitted as evidence to the Commission, and used as a source for wider public understanding, if left uncorrected it will misinform both the Commission and the public. We therefore request that you make corrections to your report and that these updates be reflected in all further copies that are distributed; including that the copy on your website be updated, and that these updates be reflected in any other submissions you make.

A second area of specific concern is where your analysis of the report, as published by the FM on 6 February 2020, in some instances contradicts what is (more accurately) reflected in the report – thus creating a new error in the published media and public understanding. We presume this is simply the sort of editing error that occurs when reducing a large volume of complex material. We have spoken to the editor of the Financial Mail. While he is, under the press code, responsible for the accuracy of what he publishes, he asked us to first reach out to you as the author of the report on which the article was based. Once you have made the necessary corrections to the report this will allow the associated changes to also be made to the FM article.

To assist this process, we will highlight the errors thematically and focus on those that are most serious and readily corrected. (There are other aspects of the report with which we do not agree and our failure to deal with them is not to be taken as an acceptance of their correctness).

McKinsey's work at Eskom

Over the period 2005 to 2017, McKinsey's support to Eskom totalled several hundreds of thousands of hours, covering a wide range of projects. Through this work, McKinsey offered capabilities and resources that were extremely critical to Eskom's efforts to confront its challenges.

The report's description of McKinsey's work at Eskom includes significant errors and omissions that leave the reader with an inaccurate understanding of what transpired.

Many of the most glaring are reflected in the following two paragraphs on page 77:

> "McKinsey chose Trillian to be its B-BBEEE partner, just as it had partnered with Regiments Capital for their work at Transnet. In 2016, Eric Wood, a director of Regiment Capital, had a falling out with fellow directors Litha Nyhonya and Niven Pillay. They had objected to Wood's attempts to sell a 50% stake of Regiments Capital to the Guptas and disputed the terms of his move to Trillian. Wood subsequently became a director of Trillian on 29 February 2016. Salim Essa, who, as shown above, has been widely described as a front-man for the Gupta enterprise, was a the [sic] majority (60%) shareholder of Trillian at the time that Eskom contracted with McKinsey and Eskom's decision to pay Trillian.
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> The agreement envisaged McKinsey paying Trillian 30% of its R1 billion a year contract with Eskom.[17] However, although a contract between McKinsey and Trillian had been prepared and then edited, it was never actually signed, and no contract was concluded. Despite this, on 9 February 2016, McKinsey partner Vikas Sagar sent a letter to Eskom indicating that McKinsey had sub-contracted Trillian, and authorising Eskom to pay Trillian directly.[18] This resulted in Eskom paying Trillian R565 million, in the absence of any contract, and with Eskom later admitting that Trillian had done no work for them.[19] The lack of a contract rendered these payments unlawful."

There are several clear inaccuracies that are important to correct in the above and other places in which these same assertions are made.

- <u>To begin with, it is demonstrably false to claim that the 9 February 2016 letter "resulted in" Eskom paying Trillian R565 million.</u> This letter was never relied upon by Eskom to make any payments to Trillian – a fact that Eskom has now confirmed multiple times including in court filings and recognized in a judicial opinion by the High Court on 18 June 2019 (Case No. 22877/2018). That letter related to a different and much smaller project, had clear preconditions to payment that were never met, and any payments by Eskom to Trillian were made by Eskom long <u>after</u> McKinsey informed Eskom in writing that Trillian had failed

McKinsey's due diligence and McKinsey would not partner with Trillian. This matter has all been well ventilated in court, in Parliament, and in the media. That the report's omission of such critical points, among others, renders the discussion of this subject highly misleading.[1]

- The passage also carries the false implication that McKinsey was aware of Trillian's ties to Mr. Essa when it considered Trillian as a potential B-BBEEE partner at Eskom. In fact, McKinsey was unaware at the time of Mr. Essa's ties to Trillian, repeatedly sought to ascertain information about Trillian's ownership interests in the course of the diligence process (only to be frustrated by Trillian's evasion and lack of responsiveness), and decided not to partner with Trillian because such information was not forthcoming. The report should make clear that McKinsey did not receive the information it was seeking about Trillian's ownership and informed Eskom in writing in March 2016 (in documents that are part of the High Court's proceedings) that McKinsey terminated its potential relationship with Trillian because McKinsey "does not know enough about Trillian, its ownership and governance to be comfortable about going ahead on a programme of this scale" and "is uncomfortable about Trillian's transparency on conflict issues".

- The passage similarly leaves the inaccurate impression that McKinsey was aware of a reported effort by Mr Eric Wood to secure investment from the Guptas in Regiments and that the failure of such an effort is what precipitated his departure to Trillian. The reality is that such internal dynamics and disagreements within Regiments (if true) only became public years later, were not known to McKinsey at the time, and were contrary to what McKinsey understood to be the reasons for Trillian's spin off. What McKinsey understood at the time was that Trillian would have consulting as its core business, whereas Regiments, at times, treated the consulting business as less of a priority than its financial advisory business. The report should make clear that Mr Eric Wood's alleged dealings with the Guptas were not publicly available information and were hidden from McKinsey at the time.

Many of these errors also appear in the diagram titled "Sandton: State Capture Mile" on page 47 of the report where it is stated that:

> "McKinsey not only entered into an unlawful contract with Eskom, but also advised Eskom to pay Trillian R565 million, in the absence of any final contract, and with Eskom later admitting that Trillian had done no work for them"

In these and other references to the "unlawful contract" with Eskom, the report appears to conflate the proposition that Eskom failed to follow applicable procurement requirements in connection with the Turnaround Programme with the proposition that the contract with McKinsey was procured by corruption or other unlawful influence.

- In October 2017, Eskom's legal counsel acknowledged that McKinsey had been misled by Eskom regarding National Treasury approvals in connection with the Turnaround Programme. In particular, Eskom had committed under the contract to seek National Treasury approval given the "at risk" nature of the agreement and had represented to

[1] McKinsey has repeatedly expressed regrets for not having been more responsive to Advocate Geoff Budlender SC when he initially inquired about these matters and causing confusion. But the information that has come to light since Advocate Budlender's report makes clear that the 9 February 2016 letter did not result in the payments to Trillian.

McKinsey in February 2016 that it had obtained such approvals from the National Treasury (a representation that is reflected in the Steering Committee minutes for the meeting).

- It later emerged and became clear that Eskom did not obtain such approvals. Despite having been misled, McKinsey stated publicly in October 2017 that it was committing to voluntarily return the fees earned by it under the Turnaround Programme under a transparent court process and noted that it did not wish to profit from a contract entered into without proper authority.

- McKinsey voluntarily returned the full amounts it received under the Turnaround Programme, with interest, to Eskom in 2018. The settlement agreement that effectuated this provides that the return of the funds was made "[w]ithout any admission of liability or wrongdoing by McKinsey". In doing so, McKinsey has repeatedly emphasized that it returned the fees, not because it engaged in any misconduct but despite being misled, McKinsey had no intention of benefitting from a contract that was invalid due to Eskom failing to obtain appropriate approvals and follow proper procurement procedures.

McKinsey's work with Regiments at Transnet

McKinsey worked at Transnet from 2005 to 2016. During this time, McKinsey performed extensive work and served four different Transnet CEOs and over 30 senior executives. McKinsey's work at Transnet sought to assist Transnet in its efforts to overcome longstanding, serious challenges it faced, including those that had major implications for the broader South African economy.

McKinsey first explored working with Regiments at Transnet in 2012. As Dr David Fine described in his statement to Parliament, McKinsey did not introduce Regiments to Transnet. Rather, Regiments was already a registered supplier for Transnet and had been suggested to McKinsey by Transnet as a possible B-BBEE partner to consider based on Transnet's positive impressions of work Regiments had performed for Transnet's Treasury department.

The report contends on page 60 that:

> "Fine confirmed that although McKinsey became suspicious of the relationship between Regiments Capital and the Gupta family in 2014 (two years after partnering), they did not cease working with them until February 2016."

While Dr David Fine's statement to Parliament is cited as the source for this allegation, the categorization is categorically wrong. The submission to Parliament explained that in July 2014, allegations were published in the Mail & Guardian about alleged improper conduct by Mr Niven Pillay of Regiments who had been McKinsey's main contact up until that point. These reports related to allegations concerning Mr Pillay's involvement with Mr Brian Hlongwa, who was then a Member of the Executive Committee for Health in the Gauteng Government, but there was <u>no suggestion whatsoever</u> of any "Gupta family" involvement. In response to the Mail & Guardian allegations, McKinsey had Regiments confirm that Mr. Pillay would be separated from all McKinsey projects and that Regiments was in compliance with various anti-bribery and anti-corruption legislation.

McKinsey continued the relationship only after receiving confirmation from Regiments on 28 August 2014 that: (1) "the allegations in the press are baseless,"[2] (2) Regiments had policies for "the

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[2] To McKinsey's knowledge, those media allegations have never been confirmed in any proceeding or inquiry.

promotion of honest and ethical behavior" and a "corporate governance framework specifically address[ing] issues such as bribery, corruption, conflict of interest and disclosure of interest"; and (3) Mr. Pillay "step down from the Executive Committee of the Consortium" and Eric Wood would "assume the lead role on the part of Regiments."

The FM article alleges:

> "McKinsey bent over backwards to help Regiments and Gupta-linked company Trillian to extract millions from Eskom and Transnet"

We strongly disagree with the statement that McKinsey knowingly aided either Regiments or Trillian in engaging in any acts of corruption to secure business from state-owned entities. As discussed above, the report's contention that McKinsey suspected links between Regiments and the Gupta family is based on a mischaracterization of the facts. As for Trillian, as recounted above, McKinsey never partnered with Trillian at Eskom because of questions that arose during McKinsey's diligence process—and the report's assertion that McKinsey authorised the payment to Trillian is unfounded and rests on a clear mischaracterization of the 9 February 2016 letter despite findings by the High Court that detail the facts.

The 1064 locos transaction

The 1064 Locomotives project occurred in phases. McKinsey principally contributed to "Phase I", which involved the development of the business case. As Dr David Fine has described in his prior Parliamentary testimony, it was ultimately agreed between Transnet and McKinsey that Regiments should assume responsibility for Phase II. McKinsey withdrew from advising Transnet on the procurement of new locomotives on 4 February 2014, before the 1064 Locomotives tender was awarded, and played no role in determining the locomotive process, selecting the winning suppliers, or working on the transaction advisory service.

The report indirectly attributes to McKinsey actions that were actually taken by Regiments on the Transnet 1064 locomotive tender. The FM article expressly states:

> "McKinsey partnered with Regiments Capital, part-owned by Essa, to rewrite the business case and justify a R16bn escalation in cost."

This is entirely inaccurate.

In the first place, McKinsey to this day does not know whether Mr. Essa at any point had any ownership interest in Regiments Capital—and it is unclear what the source is for this claim in the report. Moreover, the report fails to acknowledge the information presented to the Commission that show that the business case modifications discussed occurred <u>after</u> McKinsey had withdrawn from the project in early February 2014.

The business case McKinsey worked on estimated total cost (ETC) of R38.16 billion. Transnet executives and officials have testified to this fact at the Commission. Various forensic investigative reports also confirm this fact including The National Treasury report which states:

> "5.9.12.34. According to Pillay, a comprehensive research was conducted by McKinsey in arriving at the ETC of R38.6 billion for the supply of 1064 locomotives. Pillay indicated that after validation of the business case by McKinsey, the company arrived at the same contract amount of R38.6 billion and the same number of locomotives required (1064).

> 5.9.12.35. We conducted an analysis of the escalation of ETC from R38.6 billion to R54.6 billion and determined that the increase of ETC was overstated by R9.2 billion. A detailed calculation on the increase in ETC is discussed below. <u>We determined that McKinsey had already withdrawn their services to Transnet relating to the 1064 locomotives advisory services when Transnet increased the ETC from R38.6 billion to R54.5 billion</u>.
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> . . . .
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> 5.9.12.38. We determined that Regiments were part of the team that assisted Transnet in the calculation of the increased ETC of R54.5 billion. Regiments did so knowing that the costs were already included in the ETC of R38.6 billion."

In addition, Werksmans' report for Transnet recognises that the costs associated with the financial advisory work related to the procurement of the 1064 locomotives escalated significantly after McKinsey withdrew from the project. This is also explained in your full report, which reflects that Regiments rewrote the business plan and that McKinsey had already withdrawn from the process. But this is completely contradicted by the FM article – which claims the opposite.

At Pg. 47 of your report you note:

> "Regiments contributed to rewriting the business case at the last minute to facilitate the escalation of the price."

And at Pg. 59 you note:

> "the Fundudzi report has confirmed that Regiments assisted Transnet in rewriting the business case to justify a R16 billion escalation in cost."
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> "McKinsey was tasked with validating the 'business case' for the 1064 locomotive contract in 2013. They did so, and confirmed that the total estimated cost was R38.6 billion, inclusive of all costs (with the single exception of borrowing costs). Asked by Fundudzi investigators, McKinsey insisted that Regiments were part of the consortium of consultants that had undertaken these calculations, and thus were "adamant that Regiments were aware that the ETC of R38.6 billion included all the related costs and excluded only the contingencies. However, as discussed above, the business case was deliberately altered at the last minute to misrepresent the R38 billion as excluding "the potential effects from forex hedging, forex escalation and other price escalations." This was approved by Transnet's board, providing the space for Molefe and Singh to present an adjusted contract cost of R54.5 billion to the board in May 2014."
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> "The Fundudzi investigation concluded that not only was Regiments crucial in calculating the increased costs, but that it "did so knowing that the costs were already included in the ETC of R38.6 billion."

We would ask that you amend the media article to bring this important set of facts in line with your report. We should also for the record state that McKinsey was at that time entirely unaware of an asserted ownership in Regiments by Mr. Essa. Such an ownership interest was certainly never disclosed to McKinsey (and indeed is still not known to McKinsey).

McKinsey's work globally

On McKinsey's global work the report states that:

> "Following the murder of Washington Post journalist Jamal Khashoggi in the Saudi Arabian consulate in Turkey, The New York Times revealed that McKinsey had provided the Saudi government with the names and details of dissidents, who were subsequently targeted by the government."

The FM article mirrors this claim.

This is not accurate. We have repeatedly said that this internal document was a basic social media analysis of publicly available information. It did not reveal anything new nor were we ever commissioned by the Saudi Government to produce such a report.

Your source, *The New York Times*, later issued a correction to its reporting clarifying that the document in question "was prepared for [McKinsey] internal use, not for the Saudi government."

Conclusion

We have identified several verifiable errors and the authoritative sources that confirm our claims in this letter. We therefore ask you to confirm that you will make the necessary factual corrections to both the report and the FM article and in any of your subsequent media engagements and analyses. We would welcome the opportunity to engage with you further to ensure the facts are accurate.

We look forward to hearing from you.

Regards,

Kerry Naidoo
On behalf of McKinsey & Company

cc: Rob Rose

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