

WILL THE PROPOSED REVISION TO THE B-BBEE CODES OF GOOD PRACTICE LEAD TO INCREASED FRONTING ACTIVITY?

Introduction

The proposed changes to the Broad-Based Black Economic Empowerment (“B-BBEE”) codes now intend to make “ownership” a compulsory priority element.

Around 95% of companies fall into the Exempt Micro-Enterprises (“EME”) category.¹ However, an EME that is 100% owned by black people automatically qualifies as a level 1 contributor and an EME that is more than 50% owned by black people automatically qualifies as a level 2 contributor. EMEs that are black owned will gain a distinct competitive advantage.

Additionally, if the amendments are passed in their current form, failure to comply with the minimum threshold means that the rating (for large enterprises) will drop two levels in status, and Qualifying Small Enterprises (“QSEs”) will drop one level. Rather than face the consequences, some companies may find fronting to be an appealing alternative.

BEE and Fronting

The BBBEE Amendment Bill was introduced in an attempt to improve the implementation of the existing B-BBEE Act. In order to meet the B-BBEE Act’s requirements and receive the benefits thereof, companies were engaging in “fronting”. This entailed misrepresenting the two requirements of the B-BBEE Scorecard, being black ownership and management and control. B-BBEE Act sought to move the focus from direct empowerment to include development of human resources and indirect

¹ SARS 2012

empowerment, which allowed companies to achieve adequate B-BBEE levels without necessarily focusing on ownership and management – areas which could mean reduced shareholder returns or relinquishing control. With the proposed changes, and renewed focus on direct empowerment, the Department of Trade and Industry (“DTI”) may re-introduce some of the challenges faced by the original BEE Act, which B-BBEE Act sought to address.

There are three categories of fronting, namely: window dressing, benefit diversion and opportunistic intermediaries.² Window includes the circumstance in which black people are cases in which black people are appointed or introduced to an enterprise on the basis of tokenism Benefit diversion entails initiatives implemented where the economic benefits received as a result of the B-BBEE Status of an enterprise do not flow to black people in the ratio as specified in the relevant legal documentation. The action of opportunistic intermediaries is to conclude agreements with other enterprises with a view to leveraging the opportunistic intermediary's favourable B-BBEE status in circumstances.³

Companies may engage in fronting to appear compliant with ownership, but may be diverting benefits or operating through opportunistic intermediaries. The latter is difficult to police. The current codes state that organisations may not be awarded points for BEE if they indicate that they intend sub-contracting more than 25% of the contract to an organisation with a lower BEE score than itself. This means that an organisation cannot tender for business based on its B-BBEE score if it does not intend to perform the vast majority of the work. However, in reality, this is almost impossible to monitor and we may see an increase in black owned opportunistic intermediaries as vehicles for fronting.

Currently there are no means in place to prosecute companies in the event of fronting

² http://www.thedti.gov.za/economic_empowerment/fronting.jsp

³ http://www.thedti.gov.za/economic_empowerment/fronting.jsp

and companies receiving contracts on fraudulent grounds. Amendments have such been made to the B-BBEE Act and are currently waiting to be passed by Parliament. The proposed amendments include the setting up of a commission in order to monitor the action of fronting by companies and making such an act up for criminal prosecution.

Conclusion

The focus of B-BBEE is again moving towards direct empowerment. Companies that want to maintain or improve their B-BBEE status, but who do not currently comply with ownership, need to start planning for how they will meet the minimum threshold for this scorecard element.

Tashmir Singh, Schoeman Attorneys (Cape Town)

Tel: 0214255604

Email: enquiries@schoemanlaw.co.za

Website: www.schoemanlaw.co.za

Facebook: <https://www.facebook.com/pages/Schoeman-Attorneys-Cape-Town/125007317531885>