B-BBEE: A brief summary of recent changes

1. INTRODUCTION

Equality is generally defined as "*the state of being equal, especially in status, rights and/or opportunities*". According to the Constitution of the Republic of South Africa Act, 2006 ("**Constitution**"), equality "*includes the full and equal enjoyment of all rights and freedoms*". In order to promote the achievement of equality, section 9 of the Constitution empowers the legislature to take legislative and other measures designed to protect or advance persons, or categories of persons, disadvantaged by unfair discrimination. Black economic empowerment is one of the means to promote the achievement of equality through advancement of persons or categories of persons disadvantaged by unfair discrimination. The South African government has developed a multi-facet approach to address the this issue, culminating in the enactment of the Broad-Based Black Economic Empowerment Act, 2003 ("**B-BBEE Act**"), which came into effect on 21 April 2004. The B-BBEE Act will significantly be amended by the Broad-Based Black Economic Amendment Act, 2013 which was gazetted on 27 January 2014 and will come into operation on a date fixed by the President ("**Amendment Act**"). The purpose of the B-BBEE Act is to facilitate effective participation in the economy by Black People (i.e. generally Africans, Coloureds and Indians).

The B-BBEE Act is an enabling Act that creates a framework to guide public institutions in promoting broad-based black economic empowerment ("**B-BBEE**"). The precise forms of inducement to promote empowerment are not in the provisions of the B-BBEE Act itself but are contained in the codes of practice and sectoral transformation charters, developed in line with the framework set out in the B-BBEE Act. The latest revised version of these codes of good practice was gazetted on 11 October 2013 ("**Revised Codes**") and will replace the current codes of good practice ("**Old Codes**") within a year (i.e. from October 2014). This means that between 11 October 2013 and 10 October 2014, compliance with the Revised Codes (i.e. being measured under the Revised Code) is optional, and from 11 October 2014 onwards, measurement under the Revised Code will be compulsory. Although the Codes and the B-BBEE Act do not impose obligations on firms to comply with B-BBEE targets, a firm's B-BBEE rating can create certain negative perceptions about the firm, make it difficult for a firm to obtain necessary licences or permits from the State and is an important factor affecting a firm's ability to successfully conduct business (e.g. tendering for government contracts, meeting customers/clients' B-BBEE requirements, etc).

The purpose of this article is to briefly discuss some of the changes brought by the Revised Code and the Amendment Act. It is important to mention at this stage that all entities falling within the scope of a particular section 9(1) sector code are measured or verified under that sector code and not under the generic codes discussed herein under. This means that these entities will not be affected by the Revised Codes, for now. However, this does not mean that entities measured under the sector codes will have it easy as the sector codes will soon be amended to align them with the Revised Codes.

2. FOR HOW LONG WILL THE CODES BE IN PLACE?

The Old Codes contained a provision to the effect that the Old Codes would be revised after a period of 5 years. This obviously created the impression that, depending on progress being made in transforming the economic ownership in South Africa, the Old Codes was a temporary measure which could be relaxed/scrapped in five years. The Revised Codes however do not contain such a provision and merely state that they shall remain in effect until amended, substituted or repealed and that the Minister may review them at any time. It therefore appears that B-BBEE is still far away from a "sunset" clause and the various sectoral codes should be next on the DTI's agenda to bring them in line with the Revised Codes.

3. CHANGES TO THE CLASSIFICATION OF COMPANIES

The threshold for exempted micro-enterprises ("**EME**") has, under the Revised Codes, been increased from a maximum of R5 million to a maximum of R10 million. This means that entities that previously did not qualify as EMEs because they had a turnover of more than R5 milion but not more than R10 million will now qualify and enjoy the benefits afforded to EMEs under the Revised Codes. An EME is deemed to have a B-BBEE status level of "Level Four Contributor" and, to qualify for this status, is only required to obtain a sworn affidavit on an annual basis confirming its turnover and level of black ownership. In terms of the deeming provisions contained in the Revised Codes, EMEs which are more than 51% black-owned automatically qualify for a “Level Two BEE Contributor” status and those that are 100% black owned automatically qualify for elevation to a “Level One BEE Contributor” status.

The threshold for qualifying small enterprises (“**QSE**”) has, under the Revised Codes, been increased from between R5 million and R35 million to between R10 million and R50 million. This means that entities that previously did not qualify as QSEs because they had a turnover of R35 million or more but not more than R50 million will now qualify and enjoy the benefits afforded to QSEs under the Revised Codes. A QSE must comply with all the elements of B-BBEE for purposes of measurement, however, in terms of the deeming provisions contained in the Revised Codes, a QSE which is 100% black owned qualifies for a “Level One BEE Contributor” status and a QSE which is at least 51% black owned qualifies for “Level Two B-BBEE recognition level”. Like EMEs, to qualify for this status, QSEs are only required to obtain a sworn affidavit on an annual basis confirming its turnover and level of black ownership.

4. CHANGES TO THE B-BBEE ELEMENTS

Under the Old Codes, B-BBEE ratings were measured on the following 7 (seven) elements:

- ownership;
- management control;
- employment equity;
- skills development;
- preferential procurement;
- enterprise development; and
- socio-economic empowerment.

Under the Revised Codes, the elements of enterprise development and preferential procurement have been merged, and so have the elements of management control and employment equity, resulting in the reduction of the 7 (seven) elements to the following 5 (five) elements:

Element	Weighting	Code series reference
Ownership	25 points	100
Management Control	15 points (actual scorecard out of 19 points, i.e. 4 bonus points to be gained)	200
Skills Development	20 points (actual scorecard out of 25 points, i.e. 5 bonus points to be gained)	300
Enterprise and Supplier Development	40 points (actual scorecard out of 44 points, i.e. 4 bonus points to be gained)	400
Socio-Economic Development	5 points	500

<u>Ownership</u>

- ✓ Transformation at ownership level is generally regarded as "real transformations". The ownership element measures effective (direct/indirect) ownership of entities by Black People.
- ✓ An entity is required to achieve a minimum of 40% of "net value" points. If this threshold is not achieved, the measured entity still gets the ownership score achieved but the overall scorecard level will be discounted by one

level. The points under "net value" have increased from seven points to eight points and the one point for "ownership fulfilment" has been dropped/consolidated with "net value" points. The points for voting rights have also been increased.

- ✓ New entrants are included in the main points and the threshold for qualifying as a new entrant increases from R20 million to R50 million.
- ✓ A measured entity that applies the Modified Flow-Through Principle cannot also benefit from the Exclusion Principle, and vice versa. The modified flow-through principle applies to any B-BBEE owned or controlled company in the ownership of the measured entity. Where in the chain of ownership, black people have a flow-through level of participation of at least 51%, then only once in that chain may such black participation be treated as if it were 100%. According to the exclusion principle, ownership held by organs of state or public entities must be excluded when determining ownership in a measured entity.
- ✓ The requirements for employee ownership schemes remain the same but the requirements for broad-based ownership schemes have increased.

<u>Management control</u>

- ✓ The employment equity scorecard has now been incorporated into the management control scorecard and the overall weighting reduced from 25% to 15%.
- ✓ The concept of the adjusted recognition for gender has been deleted from the management control scorecard and in its place is a simple carve out with specific targets and weights for black females.
- ✓ Measurement of management (excluding the board of directors and executive management) is based on the overall demographic representation of black people as defined in the Regulations of the Employment Equity Act as amended from time to time, i.e. Africans, Coloureds and Indians.
- ✓ There is no threshold or subminimum requirement per occupational level.
- ✓ Bonus point for independent directors has been removed.

- ✓ The measurement of voting rights of board members have now been broken down into black board members (2 points for 50% of all voting rights), black female board members (1 point for 25% of all voting rights), black executive board members (2 points for 50% of all executive board members) and black female executive board members (1 point), black senior management (2 points), black female senior management (1 point for 25% of all executive board members).
- ✓ The compliance target for senior management is now 60% black and 30% black female and for middle management it is 75% black and for junior management it is 88% black. The compliance target for black disabled employees remains 2%.

Skills development

- ✓ There has been an increase in the target spend from 3% to 6% of payroll.
- ✓ As with the management scorecard, more emphasis is placed on demographics, for measurement purposes.
- ✓ There is no longer an adjusted recognition for gender.
- ✓ The minimum threshold of 40% applies as this is one of the priority elements.
- ✓ There are 5 bonus points if 100% of black people on learnerships are absorbed as employees by the measured entity or an entity in the same industry.
- ✓ A number of other elements on the skills development scorecard as well as a number of the key measurement principles have been amended.

Enterprise and supplier development

- ✓ As mentioned above, enterprise and supplier development is a combination of the two elements previously called preferential procurement and enterprise development. The reasoning behind the merger is to facilitate access of small emerging black enterprises into the value chains of the formal business sector.

- ✓ There is now an increased focus on spend with black owned and black woman suppliers.
- ✓ A concept of an "Empowering Supplier" has been introduced, which serves as a category of persons who contribute to procurement score. The reasoning for the introduction of this concept is to prevent shallow intermediaries who are there merely because of their empowerment credentials and to increase the localisation of the value chain.
- ✓ Measured enterprises are now required to spend 2% of their net profit after tax annually on supplier development and a further 1% of the net profit after tax on enterprise development and sector specific programmes. These two categories together make up the 15 points that was previously attainable under Enterprise Development.
- ✓ The minimum threshold requirement for Enterprise and Supplier Development to be met, so as to ensure that the discounting of BEE level status does not apply, is that the measured entity must achieve a minimum of 40% on three of the specific sub-categories on this scorecard.

<u>Socio-economic development</u>

- ✓ A minimum annual spend of 1% of the net profit after tax is required in order to obtain up to five weighting points.
- ✓ The full value of socio-economic development contributions are recognised if at least 75% of the value directly flows to black people i.e. Africans, Coloureds and Indians.

5. THE INTRODUCTION OF PRIORITY ELEMENTS

The Revised Codes have identified 3 (three) priority elements and have introduced sub-minimum targets for these elements. The three elements are ownership, skills development and enterprise and supplier development and the sub-minimum targets are as follows:

- ➢ 40% of the "net value" targets for the ownership element. "Net value" measures the "debt-free" portion of the B-BBEE ownership of a firm;

- 40% of the total weighting points for the skills development element; and
- 40% of the three subcategories of the enterprise and supplier development elements (namely, preferential procurement, supplier development and enterprise development).

Non-compliance with these threshold requirements will result in an entity's B-BBEE status level being discounted. The draft B-BBEE Codes had provided that non-compliance with the threshold requirements would result in a measured enterprise's BEE Contributor Status Level being dropped by two levels, whereas now this has been amended to one level. The compliance of the threshold requirements of the abovementioned priority elements apply to a "Medium/Large Enterprise", whereas a QSE is required to comply with only the minimum threshold requirements for Ownership as a compulsory element and either of Skills Development Element or the Enterprise and Supplier Development elements, in order to avoid the one level drop penalty.

The introduction of the priority elements, sub-minimums and the discounting principle may have the unintended consequence of discouraging funding of B-BBEE transactions, which often involve financing (i.e. no "debt-free" ownership as required under the target for ownership element) to the B-BBEE shareholder which will be repaid out of dividend flows. BEE deals that are heavily burdened with debt may find the discounting of one BEE Contributor Status level applying to them. Developing and implementing an equity equivalent programme, an option open to multinationals, may be the best course of action for such organisations to take in the face of these more stringent B-BBEE compliance requirements. An equity equivalent programme, which will need to be submitted to the Department of Trade and Industry (DTI) for approval, can include enterprise creation or investments in social advancement initiatives. In essence, multinationals are measured against the value of operations in South Africa. Contributions to equity equivalent programmes are set at 25% of the value of South African operations, or at 4% of the total revenue from a multinational's operations in South Africa over the period of continued measurement.

6. CHANGES TO THE NUMBER OF B-BBEE POINTS REQUIRED TO ACHIEVE EACH B-BBEE LEVEL

Under the Revised Codes, more points are required to be recognised as a certain level of BEE Contributor than was the case under the Old Codes. For example, a Level Two Contributor required between 85 and 100 points, now the points required are between 95 and 100. This means that a firm that previously had 85 points and recognised as a Level Two Contributor will, under the Revised Codes and absent any B-BBEE changes within the firm, be recognised as a Level Four Contributor. The new B-BBEE recognition level table is as follows:

B-BBEE Status	Qualification	B-BBEE recognition level
Level One	100 points or more	135%
Level Two	95 points or more but less than 100 points	125%
Level Three	90 points or more but less than 95 points	110%
Level Four	80 points or more but less than 90 points	100%
Level Five	75 points or more but less than 80 points	80%
Level Six	70 points or more but less than 75 points	60%
Level Seven	55 points or more but less than 70 points	50%
Level Eight	40 points or more but less than 55 points	10%

Non-Compliant	Less than 40 points	0%

7. CHANGES TO BE BROUGHT BY THE AMENDMENT BILL

President Jacob Zuma signed the Amendment Act into law early this year (2014). The Amendment Act will streamline the monitoring and evaluation of empowerment and “significantly” enhance the objectives of the B-BBEE Act. Some of the changes to be brought by the Amendment Bill include the following:

- Establishment of a B-BBEE Commission which may investigate complaints relating to B-BBEE, B-BBEE transactions and “fronting practices” and may apply to court to restrain a breach of the B-BBEE and/or a “fronting practice”. The Amendment Bill defines fronting in extraordinarily broad terms to encompass any ‘transaction' or ‘conduct' that ‘directly or indirectly undermines or frustrates the achievement of the objectives' of the B-BBEE Act. The commission will be given the task of acting independently, without fear or favour. It will also strengthen and foster collaboration between the public and private sector to promote and safeguard the objectives of B-BBEE. Over and above this, the commission will ensure that B-BBEE activities in the country are aligned. The Bill also provides for the regulation of the verification industry by the Independent Regulatory Board of Auditors.

- Introduction of penalties and various criminal offences for noncompliance and circumvention, misrepresenting or providing false information regarding a firm’s B-BBEE status or engaging in a “fronting practice”. A contravention may result in a fine and/or up to 10 years’ imprisonment for the individuals and the firm may be fined up to 10% of its annual turnover and be banned from contracting with government and public entities for 10 years.

- Introduction of a statutory right for government and public entities to cancel any contract or “authorisation” awarded on the strength of false information in B-BBEE status

- Imposing an absolute obligation on government and public entities to take the Revised Codes into account in their procurement policies and in issuing licences (previously they were only required to do so “as far as reasonably possible”).

Michael Gwala