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Without Prejudice

The recent Amendments to the Broad-based Economic Empowerment Act 53 of 2003 (the Act/the Amended Act) followed by the publishing of the strongly debated BEE Regulations on 6 June 2016, has signalled government's strong stance against empowerment circumvention and has ushered in a new Black Economic Empowerment Commission (Commission) that is geared up to enforce compliance and combat practices that undermine the Act.

The history of Black Economic Empowerment

Prior to 1994, South Africa was based on a system of racial exclusion, known as apartheid, which excluded black people from the main stream economy, political arena and social life. Post 1994, the democratically elected government adopted a policy of Black Economic Empowerment (BEE) in order to address the social and economic imbalances caused by apartheid.

While BEE has been government policy since 1994 it was not defined, neither was there a legislative strategy in implementing it. In 1998 a commission was established with the mandate of defining and setting the parameters of BEE and the commission released a strategy for Broad-based Black Economic Empowerment (B-BBEE) in 2003, which defined B-BBEE as:

"an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country's economy, as well as significant decreases in income inequalities."

The strategy report paved the way for the enactment of the Act and section 9 of the Act empowers the Minister of Trade and Industry (Minister) to issue codes of good practice on BEE. This may include guidelines for stakeholders in relevant sectors to draw up BEE or Empowerment Charters, and matters necessary to achieve the objects of the Act.

The codes of good practice published by the Minister are binding on every organ of state and public entity. This means that BEE it is not binding on private entities, however; it is economically binding where such entities engage in procurement in the public sector.

The definition of fronting and certain indicators thereof

A "fronting practice" has only now been defined as per the Amendment Act as "a transaction, arrangement or other conduct that directly or indirectly undermines or frustrates the achievement of the objectives of this Act or the implementation of any of the provisions of this Act, including but not limited to practices in connection with a B-BBEE initiative:

- "(a) In terms of which Black persons who are appointed to an enterprise are discouraged or inhibited from substantially participating in the core activities of that enterprise;
- (b) in terms of which the economic benefits received as a result of the broad-based black economic empowerment status of an enterprise do not flow to Black people in the ratio specified in the relevant legal documentation;
- (c) involving the conclusion of a legal relationship with a Black person for the purpose of that enterprise achieving a certain level of broad-based Black economic empowerment compliance without granting that Black person the economic benefits that would reasonably be expected to be associated with the status or position held by that Black person; or
- (d) involving the conclusion of an agreement with another enterprise in order to achieve or enhance broad-based Black Economic Empowerment status in circumstances in which –
 - (i) there are significant limitations, whether implicit or explicit, on the identity of suppliers, service providers, clients or customers;
 - (ii) the maintenance of business operations is reasonably considered to be improbable, having regard to the resources available;
 - (iii) the terms and conditions were not negotiated at arm's length and on a fair and reasonable basis."

The impact of fronting on Black Economic Empowerment

Fronting practices are an all too common occurrence in South Africa and have adversely effected economic transformation. This is because, as stated by the Minister, fronting circumvents empowerment by taking away rightfully deserved opportunities from companies that comply with the B-BBEE scorecards, in favour of fronting companies that exploit transformative ideals and manipulate B-BBEE scorecards.

In terms of a statistical analysis, an article published in the *Cape Times*, dated 30 March 2016, has stated that the National Empowerment Fund estimates that equity holding by black persons, on the Johannesburg Stock Exchange, to be 3% while the 2015 Commission of Employment Equity report showed that white persons represented about 70% and 60% of top and senior management respectively, with black persons representing only 13, 6% and 21% respectively.

These figures are alarming but, what is more alarming, is that of the 33 complaints received by the Commission since it started operating in April 2016 up until 1 June 2016, 22 of these related purely to fronting practices, as pointed out by the Commission's Zodwa Ntuli.

The Commission's role in fronting practices

The Act together with its Regulations, aim to create effective ways of dealing with fronting practices.

A key function of the Commission is to curb fronting, including misrepresentation and other practices that undermine the objectives of the Act. In carrying out its functions, the Commission must maintain a register of major B-BBEE transactions (these are transactions that are of a certain financial threshold yet to be determined by the Minister); receive and analyse reports on compliance from entities as listed in the Act, receive complaints relating to B-BBEE; make findings on fronting practices and conduct investigations either on its own initiative or in response to a complaint.

The Commission must follow due process for conducting an investigation, as stipulated in the Act. However; it is also empowered to utilise a wide range of mechanisms in doing so. These include the issuing of a summons; holding formal hearings; and instituting court proceedings to restrain any breach of the Act, including any fronting practice.

In terms of section 13J of the Act, where the Commission finds that a matter may involve a criminal offence, it must refer the matter to the National Prosecuting Agency (NPA) or a competent branch of the South African Police Service. It may also refer a matter to the South African Revenue Service or any regulatory authority, if justifiable reason exists.

Penalties and consequences

Simply put, fronting may be regarded as fraud. This means that criminal liability may ensue if a party is found to be guilty. According to the Act, individuals that had actual knowledge or who were in a position where they ought to have had actual knowledge of a fronting practice can face criminal sanctions, which include a fine and/or up to 10 years' imprisonment. Companies can face an administrative penalty of up to 10% of annual turnover.

Further, section 13P of the Act prohibits any person or company that has been convicted of an offence in terms of the Act from doing business with organs of state for up to 10 years. In this regard, a court has discretion to limit this prohibition to only the persons involved in the fronting practice instead of the company concerned.

Possible implementation challenges

So what does the aforementioned mean for individuals, particularly directors and managers, and what are the possible issues that may arise with the implementation thereof?

The Commission has not set out how it intends to protect trade secrets and confidential company documents. It is also unclear how the Commission will conduct their investigations especially in respect of searches and seizures.

Another key issue not dealt with by the Act or the Regulations relates to how the Commission would deal with a situation where a complainant is also a "frontee" (that is, the token black person) in the matter. One must bear in mind that the Commission has a legal obligation to report

fronting practices involving suspected criminal activity to the NPA and as such, the complainant would be inadvertently placed in a vulnerable position, in which they may be held criminally liable for fraud as well.

Accordingly it remains to be seen whether the Commission may borrow from the Competition Commission by adopting a leniency policy. One could even go so far as to say that it may be prudent for the Commission to adopt a Memorandum of Understanding between itself and the NPA to facilitate not only leniency, but also immunity from prosecution, as a tool to better achieve its objectives.

The Companies Act does overlap with the Act. In this regard, and to the extent that it too provides for criminal liability with the exact penalties as prescribed by the Act. However; it does not sufficiently address fronting practices, hence the need for further amplification of the Amendment Act and Regulations.

Companies and individuals may find that the floodgates regarding civil damages and class actions may be opened wide, in that possible claimants could range from the bona fide BEE company that lost a tender to a fronting company, to the employees that lost jobs as a consequence, and even the "innocent" company that entered into the relevant agreement based on a company's BEE scorecard that were subsequently found to be based on fraud.

In this regard, section 13P of the Act creates a statutory right to cancel a contract while still affording the right to institute a damages claim.

The legislative enactments leave individuals and especially directors, most vulnerable to criminal and personal consequences. With specific regard to directors, section 76 of the Companies Act 71 of 2008 (Companies Act) sets out that a director has a fiduciary duty to act in the best interests of the company and for a proper purpose. A director who exposes the company to possible fraudulent activity is certainly not abiding by this duty, while an innocent director (a director that has not been a party to a fronting transaction) fits the criteria of a person who would be in a position where he ought to have had actual knowledge of the fronting practice, by virtue of his fiduciary duty to the company.

Further, in certain instances, directors can be jointly and severally liable and therefore adversely affected by another director's conduct. In addition to this, section 214 of the Companies Act read together with section 77 sets out that a director can be held liable for any loss, damages or costs sustained by the company, if such a director acted for a fraudulent purpose or been a party to an act or omission by the company despite knowing that the act or omission was calculated for a fraudulent purpose.

Conclusion

The Commission and implementation of the Act are still in their infancy and the implementation is yet to be tested and refined over time. At the time of publication, more than 100 complaints have already been submitted to the Commission. While we can merely speculate on possible

implications and the manner in which the Commission will chose to deal with fulfilling its mandate, one thing remains certain: the Amendment Act has teeth and its watchdog, the Commission, is certainly equipped to bite.

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