

Circular 3

28 October 2014

BROAD-BASED BLACK ECONOMIC EMPOWERMENT: FRONTING

The Broad-Based Black Economic Empowerment Act 53 of 2003 (**2003 Act**) together with the generic codes of good practice and the sector codes, provide the legislative framework for Broad-Based Black Economic Empowerment (**BEE**) in South Africa.

The Broad-Based Black Economic Empowerment Amendment Act, 46 of 2013 (the **Amendment Act**) which brings about significant changes to BEE, came into effect on 24 October 2014.

The Amendment Act introduces a number of far-reaching changes to the 2003 Act.

This circular highlights the key changes introduced by the Amendment Act with a specific focus on the criminalisation of fronting practices.

BACKGROUND TO THE AMENDMENT ACT

Since the proclamation of the 2003 Act, many enterprises have resorted to dishonest measures (including fronting practices) in order to boost their BEE score.

Under the 2003 Act “fronting” was not defined. The DTI defined fronting as “*a deliberate circumvention or attempted circumvention of the BBEE Act and the Codes. Fronting commonly involves reliance on data or claims of compliance based on misrepresentations of facts, whether made by the party claiming compliance or by any other person.*”

Fronting was not a criminal offence under the 2003 Act and therefore was prosecuted as fraud.

Complicated fronting practices have been employed by enterprises which have become difficult to identify.

The Amendment Act seeks to address these unintended consequences of BEE by criminalising fronting and establishing a body (the BEE Commission) to oversee and ensure compliance with the 2003 Act (as amended).

FRONTING DEFINED

The Amendment Act introduces a broad definition of “fronting practice” which essentially is a transaction, arrangement or other act that directly or indirectly undermines or frustrates the achievement of the objectives or the implementation of any of the provisions of the **2003 Act, as amended** (hereinafter referred to as “the **BEE Act**”).

Included in the non-exhaustive list of “fronting practices” are the following:

1. where black people who are appointed to an enterprise are discouraged or inhibited from participating substantively in the core business of that enterprise;
2. where benefits received by an enterprise as a result of its BEE status, do not flow to black people in the ratio specified in the relevant legal documentation;
3. the conclusion of a legal relationship with a black person in order to achieve a certain level of BEE compliance without the economic benefits that would reasonably be expected to flow from that status / position being granted to the black person;
4. the conclusion of agreements with other enterprises, in order to achieve BEE status in certain defined circumstances.

KNOWLEDGE REQUIREMENT

The Amendment Act provides that any person who **knowingly** engages in a fronting practice commits an offence.

The definition of “knowingly” includes where the person has actual knowledge of the fronting practice as well as where the person concerned was in a position in which they reasonably ought to have had:

- actual knowledge;
- investigated the matter to the extent where they would have obtained actual knowledge; or
- taken other measures which, if taken, would reasonably be expected to provide the person with actual knowledge,

of the fronting or other misrepresentations regarding the BEE status of the enterprise.

OFFENCES AND PENALTIES

The Amendment Act criminalises fronting and other misrepresentations regarding the BEE status of an enterprise. Any person convicted of an offence in terms of the BEE Act may be liable to a fine or a maximum prison sentence of 10 years, or in the case of a juristic person, a fine of up to 10% of its annual turnover.

Further, any person convicted of an offence in terms of the BEE Act may not for a period of ten years from the date of conviction, contract or transact any business with any organ of state or public entity and will be registered in a register of tender defaulters with the National Treasury.

The Amendment Act not only introduces an offence for fronting, which was not the position previously, but it creates an offence for individuals who do not take proactive steps to ensure that fronting is not taking place in any ventures in which he or she may be involved.

BEE COMMISSION

Section 8 of the Amendment Act establishes a regulator for BEE, to be known as the Broad-Based Black Economic Empowerment Commission (the **Commission**).

The Commission will be tasked with overseeing and promoting compliance with the BEE Act and receiving and investigating complaints regarding BEE, including fronting practices, either at its own initiative or in response to complaints received.

In investigating fronting practices, the Commission is empowered to:

- issue summonses, subpoenas and interrogate witnesses and alleged offenders; and
- institute court proceedings to restrain any breach of the BEE Act, including a fronting practice or to obtain appropriate remedial relief, and if the Commission is of the view that any matter that it has investigated may involve the commission of a criminal offence in terms of the BEE Act or any other law, it must refer the matter to the National Prosecuting Authority or the appropriate division of the South African Police Service.

In addition to the criminal sanctions that may be imposed for fronting practices, significant reputational harm could be suffered by enterprises involved in fronting practices.

Because of the broad definition of “fronting practices” and the potential liability of persons who reasonably ought to have had knowledge or taken steps to determine whether a fronting practice was taking place,

enterprises and their directors and shareholders would do well to examine the enterprise's structure and ways of working to ensure that it is compliant with the Amendment Act.

FURTHER ADVICE

Should you require advice or assistance on any BBBEE related matters, please contact Michael Jackson on 031 – 536 8512, email : mjackson@coxyeats.co.za or Keren Watson on 031 - 536 5818, email : kwatson@coxyeats.co.za or Simon Watson on 031 - 536 8530, email : swatson@coxyeats.co.za or Jason Goodison on 031 - 536 8517, email : jgoodison@coxyeats.co.za or Jenna Padoa on 031 - 536 8529, email : jpadoa@coxyeats.co.za.

