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The Broad-Based Black Economic Empowerment Act 53 of 2003 ("BEE Act") was recently amended to provide for (amongst other things) the criminalisation of fronting practices. The Broad-Based Black Economic Empowerment Commission ("Commission") has also now been established to oversee compliance with the BEE Act and to investigate complaints relating to fronting practices.

In this Alert we provide a brief overview of fronting practices as provided for in the BEE Act.

Background

The BEE Act provides for entities to be rated based on the extent to which they promote Broad-Based Black Economic Empowerment ("BEE"). Failure to promote BEE (and therefore having a poor BEE rating) does not make it unlawful to trade. However, Government and public entities (as well as entities doing business with Government and public entities) take an entity's BEE rating into account when determining (i) who they do business with, (ii) who they issue licences to, and (iii) who they issue concessions to.

Accordingly, it may be strategically important for an entity to have a good BEE rating. Interestingly, a good BEE rating provides a small pricing advantage as well in tender processes.

Fronting Practices.

There is a concern in South Africa that companies are adopting a tick box approach to BEE initiatives and that, despite BEE initiatives appearing to comply with the requirements of the BEE Act, not all BEE initiatives promote the objects and purpose of the BEE Act. One of the objectives of the BEE Act is to facilitate BEE by promoting economic transformation in order to enable meaningful participation of Black people in the economy. Accordingly, the BEE Act was amended to make it an offence to knowingly engage in a fronting practice.

A fronting practice is defined as a transaction, arrangement or other act or conduct that directly or indirectly undermines or frustrates the achievement of the objectives or the implementation of any of the provisions of the BEE Act.

The BEE Act sets out a non-exhaustive list of practices that will be regarded as fronting practices. These are as follows:

- **Window-Dressing** - practices (i) 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, or (ii) involving the conclusion of a legal relationship with a Black person for the purpose of that enterprise achieving a certain level of BEE 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;
Consequences of Engaging in a Fronting Practice

It is an offence to knowingly engage in a fronting practice and any person convicted may be liable to a fine and/or imprisonment for a period not exceeding 10 years. If the convicted person is not a natural person, the fine will not exceed 10 per cent of its annual turnover.

Further, any person that has been convicted of engaging in a fronting practice may not, for a period of 10 years from the date of conviction, contract or transact any business with any organ of state or public entity. If a company is convicted for engaging in a fronting practice, the court may order that only those members, directors or shareholders who engaged in the fronting practice, be prohibited from doing business with organs of state and public entities.

Establishment of the Commission

The amended BEE Act provides for the establishment of the Commission. The Commission is responsible for overseeing and promoting compliance with the BEE Act and may (amongst other things) conduct investigations in respect of fronting practices on its own initiative or after it has received a complaint.

During its investigations, the Commission may issue summonses, subpoenas and interrogate witnesses and alleged offenders. Following its investigation, the Commission may make a finding as to whether any BEE initiative involves a fronting practice and may institute proceedings in court to restrain such a fronting practice or obtain appropriate remedial relief.

The BEE Commission may also refer a matter to the National Prosecuting Authority or South African Police Service for prosecution as a criminal offence.

Conclusion

The introduction of the offence of fronting practices could result in various BEE initiatives that were compliant with the BEE Act prior to its amendment being regarded as fronting practices under the amended BEE Act.

Entities should consider conducting a substantive review of their BEE initiatives and the manner in which these initiatives are being structured and implemented to ensure that they are not engaging in a fronting practice.

Your Key Contacts

- **Benefit Diversion** - practices in terms of which the economic benefits received as a result of the BEE status of an enterprise do not flow to Black people in the ratio specified in the relevant legal documentation; or

- **Opportunistic Intermediaries** - practices involving the conclusion of an agreement with another enterprise in order to achieve or enhance its BEE status in circumstances in which:
  - there are significant limitations, whether implicit or explicit, on the identity of suppliers, service providers, clients or customers;
  - the maintenance of business operations is reasonably considered to be improbable, having regard to the resources available; and
  - the terms and conditions were not negotiated at arm's length and on a fair and reasonable basis.