

Making sense of B-BBEE Codes And Fronting Practices



Important guidelines on the interpretation and application of the new “fronting practice” definition.

What is “fronting practice” in the B-BBEE context?

Before 2013, fronting was dealt with as a common law offence of fraud. With the B-BBEE Amendment Act of 2013, which only came into effect on 24 October 2014, a “*fronting practice*” is criminalised under section 13 0(1)(d) which provides for an offence in the event that “any person knowingly engages in a fronting practice”. The definition is very broad, vague and ambiguous and is drafted in such a way that it may be interpreted inconsistently with certain provisions of B-BBEE Codes. It should be borne in mind that the B-BBEE Codes and Sector Charters issued in terms of section 9 of the B-BBEE Act have as primary function the interpretation of B-BBEE to give effect to the objectives of the Act.

The terms, “the Act”, “B-BBEE” and “B-BBEE initiative” are defined in section 1 of the B-BBEE Act of 2003. One of the dilemmas created by the new “fronting practice” definition is its wide interpretation that could lead to “casting the net too wide” unintentionally including bona-fide *B-BBEE initiatives* provided for by the B-BBEE Codes such as enterprise and supplier development. This is a matter to be discussed at a later stage.

Case: PRASA v Swifambo (Pty) Ltd

In a highly publicised case relating to accusations of state capture (Passenger Rail Agency of South Africa (PRASA) v Swifambo (Pty) Ltd), the High Court recently (July 2017) issued some guidelines on the interpretation and application of the new “fronting practice” definition. The aspects covered by the Court are all too comprehensive to deal with here, but a few important points relating to fronting should be noted.

In this case, PRASA applied to the Court to have a decision by the previous PRASA board reviewed and set aside in terms of the Promotion of Administrative Justice Act (PAJA). The decision relates to the irregular, fraudulent and corrupt award to and conclusion of an agreement with Swifambo, a South African B-BBEE company, for the supply of locomotives. In terms of a supply contract, Swifambo would buy all the locomotives from Vossloh, a foreign owned entity based in Spain.

Irregularities in terms of awarding a tender

Apart from various irregularities in terms of the awarding of the tender and the fact that the Public Protector investigated 40 complaints of maladministration against PRASA, coupled with deliberate attempts by certain staff members of PRASA to remove hard copies from the premises and delete electronic information to obstruct investigations by the Public Protector, the Auditor-General and a specially appointed forensic team, *the Court found the following in respect of the fronting activities:*

- Vossloh, as a multinational entity, could have applied under the Department of trade and Industry’s Equity Equivalent Investment Programme (EEIP) to be *exempted from the B-BBEE ownership component* by contributing a substantial monetary amount to EEIP initiatives promoting the empowerment objectives.
- Instead, Vossloh made use of Swifambo, a shelf-company with no resources and technical capabilities, as a front to bid for the tender.

- Swifambo had nothing to offer Vossloh apart from its B-BBEE status and Swifambo was compelled in terms of the agreement between them to keep its B-BBEE status intact for the duration of the agreement.
- Vossloh had full control over Swifambo as it could, amongst others, appoint the management committee of Swifambo's.
- It is not a requirement under the "Fronting practice" definition that any misrepresentation should have taken place, as is the requirement in the event of fraud.
- It is not a requirement that a fronting arrangement should lead to the exploitation of a specific black individual because the harm would be caused to black people in general as intended beneficiaries of the B-BBEE programme and in that sense it would undermine the objectives of the Act.
- The fact that Swifambo would benefit financially is not deemed to be substantial or substantive empowerment because, for instance, no skills would have been transferred.
- It was an easy way out for Vossloh to use Swifambo instead of making a monetary contribution to the EEIP, which "undermined the implementation of the provisions of the Act" as provided for in the general formulation of a fronting practice. The fact that Swifambo had virtually no operational capacity, staff or other resources makes their business operations improbable. This falls squarely within the ambit of an agreement provided for in paragraph (d)(ii) of the "fronting practice" definition of the Act.
- The fact that individuals in an organisation "conspire or collude" would be seen as "engaging" in a fronting practice.
- The Court also applied paragraph (d)(i) relating to an agreement that would restrict clients, customers and suppliers, as envisage in the definition of a fronting practice, differently from what is provided for in the B-BBEE Codes. It is contended that this different application by the Court can be attributed to the broad and ambiguous formulation of a fronting practice as pointed out earlier.

Disclosure of subcontracting in tenders

Companies should bear in mind that in terms of government's *Procurement Regulations relating to tenders awarded by organs of state*, the main contractor is compelled to disclose any subcontracting of more than 25% to an entity with a B-BBEE status lower than that of the bidding enterprise, unless the subcontractor is an exempt micro enterprise (EME) with the capability and ability to execute the subcontract (Reg. 12(3)). Failure to disclose such a subcontractor may lead to the cancellation of the tender awarded, and if the tender is awarded to another entity, the non-disclosing entity may be penalised with 10% of the tender value (Reg. 14).

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