GUIDE – BROAD-BASED BLACK ECONOMIC EMPOWERMENT
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Introduction

Broad-based black economic empowerment (B-BBEE) is a central part of the South African government’s economic transformation strategy. The formulation of policy and legislation to achieve B-BBEE has been driven by the Office of the Presidency together with the Department of Trade and Industry (DTI). A multi-faceted approach to B-BBEE has been adopted with a number of components which aim to increase the numbers of black people (being South African citizens who have been racially classified as African, Indian or Coloured) that manage, own and control the country’s economy, and to decrease racially based income inequalities.

In this guide we provide a general overview of B-BBEE in South Africa. We also discuss the measurement of B-BBEE and the principal differences between the Codes of Good Practice published in 2007 (current Codes) under the Broad-Based Black Economic Empowerment Act 53 of 2003 (BEE Act) and the revised Codes of Good Practice (new Codes), which are expected to come into effect on 30 April 2015.

In addition, we provide two special focus pieces – (1) ownership under the current Codes and the new Codes, and (2) enterprise and supplier development under the current Codes and the new Codes. We also provide an overview of a number of pertinent B-BBEE issues such as the measurement of ownership by trusts under the current Codes and the new Codes, financial assistance for B-BBEE with a particular focus on notional funding structures, and the monitoring of B-BBEE compliance particularly in the context of the recent amendments to the BEE Act, such as the introduction of enforcement mechanisms for the combating of “fronting practices”.

Our Firm

Bowmans exists to help our clients overcome legal complexity and unlock opportunity in Africa. Our track record of providing specialist legal services, both domestic and cross-border, in the fields of corporate law, banking and finance law and dispute resolution, spans over a century.

With seven offices in five African countries and over 400 specialised lawyers, we draw on our unique knowledge of the business and socio-political environment to advise clients on a wide range of legal issues.

Everywhere we work, we offer clients a service that uniquely blends expertise in the law, knowledge of the local market and an understanding of their businesses. Our aim is to assist them to achieve their objectives as smoothly and efficiently as possible while minimising the legal and regulatory risks.

Our clients include corporates, multinationals and state-owned enterprises across a range of industry sectors as well as financial institutions and governments.

Our expertise is frequently recognised by independent research organisations. We were ranked first by deal value and second by deal count in Mergermarket’s 2018 Africa league tables for legal advisors. We received awards in five out of six categories at the Dealmakers East Africa Awards for 2018: top legal adviser in M&A for both deal flow and value, top legal adviser in General Corporate Finance for both transaction flow and value, and advised on the Deal of the Year. In the Dealmakers South Africa Awards for 2018, we were placed first for deal flow in the General Corporate Finance category.

We were named South African Law Firm of the Year for 2018 in the Chambers Africa Awards for Excellence. We also received the 2019 awards for Transportation and Infrastructure Team of the Year and TMT Team of the Year at the African Legal Awards hosted by Legal Week and the Corporate Counsel Association of South Africa.
Our Footprint in Africa

We provide integrated legal services throughout Africa from seven offices (Cape Town, Dar es Salaam, Durban, Johannesburg, Kampala, Moka and Nairobi) in five countries (Kenya, Mauritius, South Africa, Tanzania and Uganda).

We work closely with our alliance firm, Aman Assefa & Associates Law Office, in Ethiopia, and our best friends in Nigeria and Mozambique (Udo Udoma & Belo-Osagie and Taciana Peão Lopes & Advogados Associados, respectively). We also have strong relationships with other leading law firms across the rest of Africa.

We are representatives of Lex Mundi, a global association with more than 160 independent law firms in all the major centres across the globe. This association gives us access to the best firms in each jurisdiction represented.
Recent B-BBEE Deals

Bowmans has extensive experience in advising and acting for clients in all areas of B-BBEE. We have been involved in several ground-breaking B-BBEE transactions and have advised major international commercial and industrial corporations, mining houses and banks in many areas of economic activity in the country. Our lawyers are up to date with the most recent developments in B-BBEE and are well-placed to provide comprehensive advice and strategies for lasting and sustainable transformation.

Recent B-BBEE-related M&A deals include advising:

- BP, in relation to its black economic empowerment transaction in terms of which the following two new B-BBEE partners acquired ordinary shares in the used share capital of BP Southern Africa: (i) Kapela Investments acquired 20% plus one share; and (ii) the BP Southern Africa Education Foundation acquired 5% of the total issued shares.

- FLSmidth, in relation to a broad-based black economic empowerment transaction in terms of which a community trust formed for the benefit of HDSA will acquire a 25.1% equity stake in FLSmidth South Africa. PPC, on its ZAR 11 billion empowerment and restructuring deal, which resulted in shares being issued to an employee share trust established for the benefit of all PPC’s South African employees, strategic business partners, and to a broadly-based trust for the benefit of various black women in the regions and areas where PPC operates in South Africa. The transaction resulted in 20.8% percent direct broad-based ownership by the broadly-based entities, translating into an effective 26% B-BBEE ownership of PPC’s operations in South Africa.

- Hulamin, in respect of its B-BBEE ownership transaction including employees, black management and longstanding strategic black partners, the Makana Consortium and the Imbewu Consortium. The estimated deal value was ZAR 103 million based on Hulamin’s market cap of ZAR 2.44 billion on 11 December 2014.

- Northam Platinum, in relation to the establishment of a broad-based consortium of Historically Disadvantaged South Africans (HDSA), which will hold 31.4% of Northam’s issued shares through a combination of a subscription for new ordinary shares and the acquisition of ordinary shares from the Public Investment Corporation. Upon implementation of this ZAR 6.6 billion transaction, Northam’s total effective HDSA ownership level will increase to approximately 35.4%.

- Rothschild (South Africa), in a black empowerment transaction in which the Rothschild South Africa Foundation acquired 25.1% of the shares in Rothschild (South Africa). The Rothschild South Africa Foundation is a trust established to support HDSA in appropriate education programmes relevant to the financial services sector.

- Standard Bank, in relation to its USD 27.3 million sale of 10% of its shares in Standard Bank Namibia to employees of Standard Bank Namibia and a community trust, in compliance with regulatory requirements to increase local participation in the financial sector.
An Overview of B-BBEE in South Africa
INTRODUCTION

The BEE Act is the principal legislation through which B-BBEE is regulated. In terms of section 9 of the BEE Act, the Minister of Trade & Industry (Minister) may issue codes of good practice on B-BBEE. These codes may include, among other things, indicators to measure B-BBEE and the weighting to be attached to those indicators. In terms of the BEE Act, every organ of state and public entity must apply any relevant code of good practice issued in terms of the BEE Act in:

- determining qualification criteria for the issuing of licences, concessions or other authorisations in respect of economic activity in terms of any law;
- developing and implementing a preferential procurement policy;
- determining qualification criteria for the sale of state-owned enterprises;
- developing criteria for entering into partnerships with the private sector; and
- determining criteria for the awarding of incentives, grants and investment schemes in support of B-BBEE.

CURRENT STATUS OF THE CODES

The Minister published the current Codes, which set out the details of the measurement process for B-BBEE, in February 2007. The new Codes, which are expected to replace the current Codes at the end of the transitional period i.e. 30 April 2015, were published on 11 October 2013. Further proposed amendments to the Codes were published by the Minister for public comment in the Government Gazette on 10 October 2014. These proposed amendments are in respect of, amongst others, the Codes for Qualifying Small Enterprises (QSEs), the Code regarding recognition in the sale of assets, equity instruments and other business, and the Code regarding recognition of equity equivalents for multinationals. The deadline for public comments on these proposed amendments was 14 November 2014, although this was subsequently extended to 9 December 2014. The Minister has also published various sector specific codes which detail the manner in which B-BBEE must be measured for businesses operating in particular sectors. Where a sector specific code has been issued, businesses in that sector are required to apply the relevant sector code rather than the general Codes of Good Practice. The general Codes of Good Practice apply only where there is no sector specific code although, in general, the general Codes of Good Practice and the sector-specific codes apply the same broad principles. Sector codes have been published for the tourism, forestry, information communication and technology, chartered accountancy, finance, construction, transport, and agriculture sectors. The DTI has indicated that it intends to align the various sector codes with the new Codes and this process is currently underway. Until the sector codes are amended, they will apply in their current form.

ARE COMPANIES REQUIRED TO ACHIEVE SPECIFIC TARGETS?

Other than in certain state licensing, permitting and authorisation processes, there is no “hard law” requiring that any private entity in South Africa must meet specific B-BBEE targets or must implement a B-BBEE policy. The BEE Act does not provide for offences or penalties relating to B-BBEE performance but rather seeks, through various economic measures, to facilitate a uniform approach to B-BBEE in the South African economy. In other words, the BEE Act, the current Codes and the new Codes do not impose any requirement that a certain level of B-BBEE must be achieved or that a certain percentage of equity in a business must be held by black people and there are no sanctions for non-compliance.

However, in certain sectors, such as mining and telecommunications, minimum equity requirements are or may be imposed in terms of the sector-specific legislation governing those sectors.
From a practical perspective, although there are no absolute requirements in relation to B-BBEE, any company wishing to do business in the South African environment must consider and develop its B-BBEE position as, in addition to the pressures from government, an entity that does not have a good B-BBEE rating, or does not strive to improve its B-BBEE rating, may be hampered in the conduct of its day-to-day business with government, organs of state and private sector customers. Most private sector businesses to which services are rendered or goods are sold will themselves have B-BBEE procurement targets to meet and so the B-BBEE rating of entities from which goods and services are procured will be a factor in determining whom to do business with.

**B-BBEE, GOVERNMENT BODIES AND STATE-OWNED ENTERPRISES**

In terms of the BEE Act, government bodies and state-owned enterprises (SOEs) are required to take private sector parties’ relative B-BBEE levels into account when they procure any goods or services, when they issue any licence or other authorisation, or enter into partnerships with the private sector. As such, businesses that interact with government by, for example, selling to government or that require licences to perform their particular activities (e.g. telecommunications, broadcasting, mining, banking, transportation, etc.) are incentivised to increase their levels of B-BBEE.

The Preferential Procurement Policy Framework Act 5 of 2000 also provides that B-BBEE must be considered by any public sector body in the context of its procurement practices, and details the manner in which B-BBEE must be taken into account by government departments and agencies and SOEs. In this regard, in the tender evaluation process, tenders for contracts with a value of up to ZAR 1 million are scored on the basis that 80% of the available points are for price, and 20% of the available points are for B-BBEE. In tenders for contracts above ZAR 1 million, 90% of the available points are based on price and 10% of the available points are for B-BBEE. The number of points that a bidder will score for B-BBEE depends on its B-BBEE status level. For example, a bidder which has a Level 1 B-BBEE status (see page 10) will score the full 10 or 20 points for B-BBEE as the case may be, depending whether the 90/10 or 80/20 system is applicable. A bidder which has a Level 4 B-BBEE status will score either 5 or 12 points as the case may be.

**B-BBEE AND THE PRIVATE SECTOR**

A private sector company could also have its own B-BBEE requirements. For example, a business may adopt a policy that it will not purchase goods or services from suppliers that do not meet certain minimum B-BBEE requirements. These requirements could go beyond that which is provided for in the Codes of Good Practice. Where customers impose such requirements, a prospective supplier’s B-BBEE measurement is a competitive assessment of its B-BBEE status relative to that of its competitors.
The Measurement of B-BBEE
SCORECARD APPROACH

In assessing B-BBEE, a “scorecard” approach is used whereby the different aspects of B-BBEE are accorded points to arrive at the B-BBEE score of a company. A general scorecard is included in the general Codes of Good Practice, while sector specific scorecards are included in the sector codes that are applicable to particular sectors.

The scorecards detail the various elements and sub-elements of B-BBEE on which enterprises are measured and stipulate targets to be achieved for each element and sub-element. The closer an enterprise is to reaching a particular target, the more points it will achieve for that element of B-BBEE.

B-BBEE RECOGNITION LEVELS

The more points a business achieves in total across each of the individual elements, the higher its B-BBEE status level will be. Each B-BBEE level also translates into a procurement recognition level. Under both the current Codes and the new Codes:

- Level 1 is the highest status level, where a business achieves 100 points or more on the scorecard under the current Codes and the new Codes.
- Level 8 is the lowest status level, where a business achieves between 30 and 40 points on the scorecard under the current Codes and between 40 and 55 points under the new Codes.
- Under the current Codes, less than 30 points is considered to be “non-compliant”. Under the new Codes, less than 40 points is considered to be “non-compliant”.

A business’s B-BBEE score will be determined on the basis of its activities during the previous financial year and its ownership and management structures and staff profile as at the date of measurement. Under both the current Codes and the new Codes, “ownership” of an enterprise by black people is only one element of B-BBEE which is evaluated when assessing the B-BBEE status of an enterprise. Ownership counts for 20 points (and three bonus points) under the current Codes and 25 points under the new Codes.

<table>
<thead>
<tr>
<th>Status recognition level</th>
<th>Points under the current Codes</th>
<th>Points under the new Codes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 1 B-BBEE status</td>
<td>100</td>
<td>100 or more</td>
</tr>
<tr>
<td>Level 2 B-BBEE status</td>
<td>85 - 100</td>
<td>95 - 100</td>
</tr>
<tr>
<td>Level 3 B-BBEE status</td>
<td>75 - 85</td>
<td>90 - 95</td>
</tr>
<tr>
<td>Level 4 B-BBEE status</td>
<td>65 - 75</td>
<td>80 - 90</td>
</tr>
<tr>
<td>Level 5 B-BBEE status</td>
<td>55 - 65</td>
<td>75 - 80</td>
</tr>
<tr>
<td>Level 6 B-BBEE status</td>
<td>45 - 55</td>
<td>70 - 75</td>
</tr>
<tr>
<td>Level 7 B-BBEE status</td>
<td>40 - 45</td>
<td>55 - 70</td>
</tr>
<tr>
<td>Level 8 B-BBEE status</td>
<td>30 - 40</td>
<td>40 - 55</td>
</tr>
<tr>
<td>Non-Compliant</td>
<td>Less than 30</td>
<td>Less than 40</td>
</tr>
</tbody>
</table>
GENERIC SCORECARD

Under the current Codes and the new Codes, the elements of B-BBEE on which an enterprise’s B-BBEE score is measured and their respective weightings (excluding bonus points) are:

<table>
<thead>
<tr>
<th>Seven elements under the current Codes</th>
<th>Points</th>
<th>Five elements under the new Codes</th>
<th>Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>20</td>
<td>Ownership</td>
<td>25</td>
</tr>
<tr>
<td>Management control</td>
<td>10</td>
<td>Management control</td>
<td>15</td>
</tr>
<tr>
<td>Employment equity</td>
<td>15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Skills development</td>
<td>15</td>
<td>Skills development</td>
<td>20</td>
</tr>
<tr>
<td>Preferential procurement</td>
<td>20</td>
<td>Enterprise and supplier development</td>
<td>40</td>
</tr>
<tr>
<td>Enterprise development</td>
<td>15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Socio-economic development</td>
<td>5</td>
<td>Socio-economic development</td>
<td>5</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>100</strong></td>
<td><strong>TOTAL</strong></td>
<td><strong>105</strong></td>
</tr>
</tbody>
</table>

A BRIEF OVERVIEW OF EACH OF THE ELEMENTS OF B-BBEE

• The ownership element relates to the extent to which ownership interests, i.e. voting rights and economic interest, in a measured enterprise are held by black people, and the extent to which such ownership interests are unencumbered by debt. Sub-minimum requirements are imposed under the new Codes in relation to ownership.

• A company can increase its score for management control if it increases the number of black members of its board of directors and, in particular, the number of black women who sit on its board. Under the new Codes, the number of black people who participate in management are also measured under the management control elements. Management is presently measured under employment equity under the current Codes.

• Points are scored on the employment equity element under the current Codes for the number of black employees in management roles who are employed by the organisation. As such, the more black managers that a company has, the higher its B-BBEE score on this element will be. Companies above a certain size also have separate obligations in terms of the Employment Equity Act, 1998 to prepare employment equity plans and to submit returns regarding their progress on employment equity to the Department of Labour. Employment equity is not a separate element under the new Codes but is measured under the management control element.

• Companies can score points on the skills development element for the amount of money that they spend on skills development programmes for their black employees. Employers are required to, by law, pay an amount equal to a prescribed percentage of all their employees’ salaries to the National Skills Fund in terms of the Skills Development Act, 1998 and the Skills Development Levies Act, 1999. Companies can also score points for the number of learnerships that they facilitate.
for black people, black women and black disabled persons, the amount of money that they spend on bursary programmes, and the implementation of mentorship programmes. Sub-minimum requirements are imposed under the new Codes in relation to skills development.

- Points for the preferential procurement element are scored under the current Codes depending on the extent to which companies procure goods and services from black empowered suppliers. As indicated above, the points that a supplier itself scores for B-BBEE translates into a procurement recognition level which is expressed as a percentage e.g. a Level 4 B-BBEE contributor has a recognition level of 100%. This means that the relevant percentage of a company’s expenditure with that supplier is recognised as B-BBEE expenditure. Companies can increase their scores on this element if they procure a greater percentage of goods and services from suppliers with higher B-BBEE ratings and from small businesses. Under the new Codes, preferential procurement is measured under enterprise and supplier development. Points are scored for enterprise development in relation to the contribution (both monetary and non-monetary) that a company makes to developing businesses that are owned by black people. The types of contributions that will be measured include, for example, investing in businesses owned by black people, making loans to businesses owned by black people, providing credit guarantees to businesses owned by black people, providing preferential credit terms to businesses owned by black people, giving discounts, and providing training or mentoring. The targets that apply to enterprise development are set as a percentage of the measured company’s net profit after tax (NPAT). Under the new Codes, enterprise development is measured under enterprise and supplier development. Supplier development is also measured under enterprise and supplier development.

This refers to the enterprise development contributions that a company makes to its black-owned suppliers and, in particular, small black-owned businesses who are its suppliers. Sub-minimum requirements are imposed under the new Codes in relation to the enterprise and supplier development element.

- Points are scored for socio-economic development (SED) on the basis of the corporate social investment (CSI) contributions that a business makes.
EMEs, Start-up Enterprises and QSEs under the Current Codes and the New Codes
Different criteria apply, under both the current Codes and the new Codes, to an Exempted Micro-Enterprise (EME), a Start-up Enterprise and a Qualifying Small Enterprise (QSE).

**EMEs**

Under the current Codes, any enterprise with an annual total revenue of ZAR5 million or less qualifies as an EME. Under the new Codes, the threshold for a company to qualify as an EME has been increased to ZAR10 million. EMEs are deemed to have a Level 4 B-BBEE status (having a B-BBEE procurement recognition of 100%). Under both the current Codes and the new Codes, EMEs are allowed to be measured in terms of the QSE scorecard should they wish to maximise their points and move to the next procurement recognition level.

**QSEs**

Any enterprise with an annual total revenue of between ZAR 5 million and ZAR 35 million qualifies as a QSE under the current Codes. Under the new Codes, the threshold for a company to qualify as a QSE has been increased to ZAR 50 million from ZAR 35 million. Under the current Codes, a QSE must select any four of the seven elements of B-BBEE for the purposes of measurement under the QSE scorecard. Where a QSE does not make a selection, its four best element scores will be used for the purposes of measurement. Under the proposed amendments to the new Codes, which as discussed above have been published for public comment, a QSE will be required to comply with all the applicable elements of B-BBEE for the purposes of measurement under the scorecard.

**START-UP ENTERPRISES**

Under both the current Codes and the new Codes, Start-up Enterprises must be measured as EMEs for the first year following their formation or incorporation. This provision applies regardless of the expected total revenue of the Start-up Enterprise. If, however, they tender on large projects, then they must submit a scorecard. The value of the tender will determine whether they are required to submit a QSE scorecard or a generic Code scorecard.

An important change in the new Codes is that EMEs and QSEs that are 100% black-owned will be deemed to have a Level 1 B-BBEE status and EMEs and QSEs that are 51% black-owned will be deemed to have a Level 2 B-BBEE status. EMEs and QSEs will only need a sworn affidavit, on an annual basis, confirming total annual revenue and level of black ownership. Any misrepresentation in this regard is a criminal offence.
An Overview of the Changes Introduced by the new Codes
**When do the new Codes take effect?**

The new Codes initially provided for a transitional period of 12 months, although this was extended by the Minister for a further six months. As such, it is now anticipated that the new Codes must be applied as from 30 April 2015. While there has been some discussion in the market that the implementation date of the new Codes may be further extended to the end of the year, there has been no official confirmation of such extension (as of the date of preparing this brochure).

This means that when the B-BBEE score of any enterprise is measured before 30 April 2015, the enterprise may elect to be measured on the basis of either the current Codes or the new Codes (where there is no relevant sector code). However, when the B-BBEE score of any enterprise is measured after 30 April 2015, it will be measured on the basis of the new Codes (where there is no relevant sector code). Further, if, for example, an enterprise is issued with its new B-BBEE certificate scored on the basis of the current Codes on 29 April 2015, it will only need to apply the new Codes when it is measured again in 2016.

**Key changes to the Codes**

The new Codes are different from the current Codes in certain key respects. Important features of the new Codes are as follows:

- In terms of the new Codes, B-BBEE will be measured on the basis of five elements as opposed to seven elements. The separate employment equity element under the current Codes has been removed, with some of the elements being included under management control. Preferential procurement and enterprise development, which are separate elements under the current Codes, have been combined.
- The total possible points that may be scored for ownership will increase from 20 points to 25 points under the new Codes. Participation by broad-based structures such as employee ownership schemes and broad-based ownership schemes will be measured under the main scorecard rather than being something for which bonus points can be scored.
- The total possible points that may be scored on the entire scorecard under the new Codes, with bonus points, will increase to 118 points.
- Sub-minimum requirements will be introduced in the context of the ownership, skills development and enterprise and supplier development elements. If the sub-minimum requirements, i.e. 40% of the relevant targets, are not met, a measured enterprise will be deemed to drop, as a penalty, one B-BBEE level. If, for example, a business scores sufficient points to be a Level 3 B-BBEE contributor but fails to meet one of the sub-minimum requirements, it will be deemed to be a Level 4 B-BBEE contributor.
- The number of points on the scorecard that will be required to achieve the various B-BBEE levels has increased. For example, under the current Codes between 75 and 85 points are required to achieve a Level 3 B-BBEE rating. Under the new Codes, between 90 and 95 points will be required to achieve a Level 3 B-BBEE rating.
- As discussed above, the threshold for a company to qualify as a QSE has been increased to ZAR 50 million from ZAR 35 million. Under the current Codes, QSEs are scored on a different basis and are rated on the four elements of B-BBEE on which they score best. Under the proposed amendments to the new Codes, which as discussed above have been published for public comment, a QSE will be required to comply with all the applicable elements of B-BBEE for the purposes of measurement under the scorecard.
• The management control element measures the number of black and female board members, and members of executive management, senior management, middle management and junior management. Fewer points are available under the new Codes in respect of the number of black and black female employees in management roles at the various levels of management compared to the current Codes.

• The targets for senior, middle and junior management and skills development must be broken down in proportion to the racial sub-groups in the category of persons who are classed as “black people”. To calculate the number of black employees in management positions a measured entity must refer to the economically active population (EAP) compliance targets set in the regulations published under the Employment Equity Act, 1998. The EAP includes people from 15 to 64 years of age who are either employed or unemployed and seeking employment. For example, the target for participation by black employees in middle management is 75%. As such, a measured entity must examine how many African males, African females, Coloured males, Coloured females, Indian males and Indian females are employed in middle management positions to determine how close it is to reaching the 75% target.

At present, a company can score a total of 20 points for preferential procurement and a total of 15 points for enterprise development under the current Codes. Under the new Codes, 40 points in total can be scored for supplier and enterprise development. Of these 40 points, 25 points are scored for preferential procurement. This includes: procurement spend based on suppliers’ B-BBEE levels, procurement spend on QSEs, procurement spend on EMEs (being businesses with an annual turnover of less than ZAR 5 million under the current Codes and less than ZAR 10 million under the new Codes), procurement spend on suppliers that are at least 51% black owned and procurement spend on suppliers that are at least 30% owned by black women. Significantly more points (9 points under the new Codes, up from 3 points under the current Codes) are allocated to procurement from suppliers that are 51% owned by black people. Similarly, more points are allocated to procurement from QSEs and EMEs under the new Codes (7 points) compared to the current Codes (3 points). In addition, 10 points are allocated to the new category of “supplier development”. 5 points are also allocated to the annual value of enterprise development contributions to non-supplier beneficiaries. As discussed above, if a measured company does not achieve 40% of the target for each of these elements, it will be penalised and will drop one B-BBEE level.
Special focus: Ownership
Under the Current Codes and the New Codes
The ownership scorecard under the current Codes compared to the ownership scorecard under the new Codes is as follows:

<table>
<thead>
<tr>
<th>Ownership indicator</th>
<th>Target</th>
<th>Weighting points</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current</td>
<td>New</td>
</tr>
<tr>
<td><strong>Voting Rights</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exercisable voting rights in the hands of black people</td>
<td>25% + 1</td>
<td>25% + 1</td>
</tr>
<tr>
<td>Exercisable voting rights in the hands of black women</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Economic interest</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Economic interest of black people in the enterprise</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Economic interest of black women in the enterprise</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Economic interest of the following black natural people in the enterprise:</td>
<td>2.5%</td>
<td>3%</td>
</tr>
<tr>
<td>• Black designated groups;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Black participants in employee ownership schemes;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Black beneficiaries of broad-based ownership schemes; or</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Black participants in co-operatives</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Economic interest of new entrants</td>
<td>N/A</td>
<td>2%</td>
</tr>
<tr>
<td><strong>Realisation points</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ownership fulfilment</td>
<td>1</td>
<td>N/A</td>
</tr>
<tr>
<td>Net value</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td><strong>Bonus points</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Involvement in the ownership of the enterprise of black new entrants</td>
<td>10%</td>
<td>N/A</td>
</tr>
<tr>
<td>Involvement in the ownership of the enterprise of black participants in:</td>
<td>10%</td>
<td>N/A</td>
</tr>
<tr>
<td>• employee ownership schemes;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• broad-based ownership schemes; or</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• co-operatives</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Under both the current Codes and the new Codes, the basis on which points are scored is that if, for example, a company achieves the target for a particular indicator or if it exceeds the target for a particular indicator, it will achieve the full points for that indicator. For example, if 25% of the economic interest in respect of the company is held by black people, it will achieve the full 4 points for that indicator. If only 15% of the economic interest in a company is held by black people, the company would get points in proportion to its achievement of the target ie 5%/ 25% x 4 = 2.4 points.
FLOW-THROUGH PRINCIPLE

Under both the current Codes and the new Codes, ownership is calculated on an effective, flow-through basis. The flow-through principle requires that black ownership can be traced back to a specific black individual. As such, when measuring the rights of ownership of any category of black people in a measured entity, only rights held by natural persons are relevant. If the rights of ownership of black people pass through a juristic person, then the rights of ownership of black people in that juristic person are measurable. This principle applies across every tier of ownership in a multi-tiered chain of ownership until that chain ends with a black person holding rights of ownership. However, for the purpose of calculating the score in respect of voting rights in the hands of black people and the economic interest of black people, one entity in the ownership chain which has more than 50% ownership by black people may be treated as if it is 100% owned by black people. This is referred to as the “modified flowthrough principle”.

NET VALUE

Realisation points are scored in relation to the extent to which the ownership interests held by black people in the company are unencumbered (i.e. debt-free). The net value indicator relates to the extent to which black shareholders have been released from funding obligations in respect of their acquisition of shares and their shareholding becomes unencumbered. The target for the percentage of shares that should be debt-free increases over a 10-year period from when black shareholders are first introduced. As such, for example, in year 1 following a B-BBEE transaction, the target is that 2.5% of the shares in the company that are held by black people should be debt-free, i.e. assuming that an acquisition was fully funded and that no discount was given, 10% of any debt should be paid down by the end of year 1. By year 10, the full 25% target should be debt-free i.e 100% of the debt should be paid down. If only a portion of the acquisition price is funded and/or shares are acquired by black people at a discount, the percentage of the acquisition debt that would need to be paid down in each year following the transaction to meet the target would be adjusted.
Special focus: Enterprise and Supplier Development Under the Current Codes and the New Codes
The new Codes will require companies to fundamentally re-assess how B-BBEE is implemented, particularly in the context of enterprise and supplier development which carries the heaviest points weighting under the new Codes. In essence, the enterprise and supplier development element under the new Codes measures the extent to which entities buy goods and services from “empowering suppliers” (which is discussed in detail below) with strong B-BBEE recognition levels, and also measures the extent to which entities carry out supplier development and enterprise development initiatives intended to assist and accelerate the growth and sustainability of black enterprises.

Under the current Codes, a company can score a total of 20 points for preferential procurement and a total of 15 points for enterprise development. Under the new Codes, 40 points in total can be scored for enterprise and supplier development. Of these 40 points, 25 points are scored for preferential procurement, 10 points are allocated to the new category of “supplier development”, and 5 points are allocated to the annual value of enterprise development contributions to non-supplier beneficiaries. Enterprise and supplier development is also considered to be a priority element under the new Codes, which means that the sub-minimum requirement is 40%, regardless of whether or not a company has made genuine efforts to comply with this element. In other words, a measured entity must achieve a minimum of 40% of the targets for each of the three categories within the enterprise and supplier development element, namely preferential procurement, enterprise development and supplier development. Not meeting these targets will negatively affect a measured entity’s B-BBEE scorecard and will result in a company dropping a B-BBEE level.

**PREFERENTIAL PROCUREMENT**

Points for the preferential procurement element are scored under the current Codes depending on the extent to which companies procure goods and services from black empowered suppliers. Companies can increase their scores on this element if they procure a greater percentage of goods and services from suppliers with higher B-BBEE ratings and from small businesses. Under the new Codes, however, preferential procurement is measured under enterprise and supplier development. The preferential procurement category of enterprise and supplier development includes: procurement spend based on suppliers’ B-BBEE levels, procurement spend on QSEs, procurement spend on EMEs (being businesses with an annual turnover of less than ZAR5 million under the current Codes and less than ZAR10 million under the new Codes), procurement spend on suppliers that are at least 51% black owned, and procurement spend on suppliers that are at least 30% owned by black women. Significantly more points (9 points under the new Codes, up from 3 points under the current Codes) are allocated to procurement from suppliers that are 51% owned by black people. Similarly, more points are allocated to procurement from QSEs and EMEs under the new Codes (7 points) compared to the current Codes (3 points).

Under the new Codes, points for preferential procurement are scored depending on the extent to which companies procure goods and services from “empowering suppliers”. The requirements for qualifying as an empowering supplier include being (1) a “B-BBEE compliant entity”, (2) which is a “good citizen South African entity”, (3) which complies with “all regulatory requirements” of South Africa, and (4) which meets at least three of the following criteria (or one if it is a QSE)
relating to the development of local production, job creation, localisation of business activities and skills transfer to small black businesses whose annual turnover is less than ZAR 50 million:

- at least 25% of cost of sales excluding labour cost and depreciation must be procured from local producers or local suppliers in South Africa;
- 50% of jobs created are for black people;
- at least 25% transformation of raw material or beneficiation which includes local manufacturing, production and/or assembly, and/or packaging; and
- at least spend 12 days per year of productivity deployed in assisting black EMEs and QSEs beneficiaries to increase their operation or financial capacity.

No preferential procurement points will be obtained under the new Codes if a supplier does not comply with these requirements (although EMEs and Start-up Enterprises will automatically qualify as empowering suppliers). The process of verifying whether a supplier is an empowering supplier will likely involve extra administration, management time and costs.

ENTERPRISE AND SUPPLIER DEVELOPMENT

Under the current Codes, points are scored for enterprise development in relation to the contribution (both monetary and non-monetary) that a company makes to developing businesses that are owned by black people. The types of contributions that will be measured include, for example, investing in businesses owned by black people, making loans to businesses owned by black people, providing credit guarantees to businesses owned by black people, providing preferential credit terms to businesses owned by black people, giving discounts, and providing training or mentoring. The targets that apply to enterprise development are set as a percentage of the measured company’s net profit after tax (NPAT). Under the current Codes, it is considered to be relatively easy to score points under this element, and also allows companies to take an arms-length approach to enterprise development.

Under the new Codes, both enterprise development and supplier development are measured, together with preferential procurement, under the enterprise and supplier development element. In terms of the new Codes, 1% of an entity’s net profit after tax should be spent on enterprise development, while 2% of an entity’s net profit after tax should be spent on supplier development. Beneficiaries of supplier development and enterprise development must be EMEs or QSEs which are at least 51% black owned or at least 51% black women owned. Further, while supplier development refers to the enterprise development contributions that a company makes to its black-owned suppliers and, in particular, small black-owned businesses who are its suppliers, enterprise development refers to contributions to non-supplier beneficiaries. Examples of enterprise development and supplier development contributions include, amongst others, investments in beneficiary entities, loans made to beneficiary entities, guarantees given or security provided on behalf of beneficiaries, credit facilities made available to beneficiary entities, etc.
The Measurement of Ownership by Trusts in Terms of the Codes
The current Codes and the new Codes set out certain minimum qualifying criteria for different types of trusts, such as broad-based ownership schemes (BBOS), employee share ownership programmes (ESOPs) and other trusts such as family or business trusts. If these criteria are met, the trust concerned may contribute a maximum of 40% of the total points on the ownership scorecard of the measured entity concerned. If certain additional criteria are met for each type of trust, the trust may then contribute up to 100% of the total points on the measured entity’s ownership scorecard.

The ownership scorecard has been set up in such a way to encourage broad-based BEE ownership and the establishment of an ESOP or BBOS is one way to achieve this.

**BROAD-BASED BLACK OWNERSHIP SCHEMES**

Under the current Codes, a BBOS is a scheme that meets the seven listed requirements. If these requirements are met, the BBOS can contribute up to 40% of the total points available on the ownership scorecard of the measured entity concerned:

- the management fees of the scheme may not exceed 15%;
- the constitution of the scheme must record
- the rules governing any portion of economic interest received and reserved for future distribution or application;
- at least 85% of the value of the benefits allocated by the scheme must accrue to black people;
- at least 50% of the fiduciaries of the scheme must be independent persons having no employment with or direct or indirect beneficial interest in the scheme. The trustees of a trust are its fiduciaries;
- at least 50% of the fiduciaries of the scheme must be black people and at least 25% must be black women;
- the chairperson of the scheme must be independent; and
- on the winding up or termination of the scheme, all accumulated economic interest must be transferred to beneficiaries or an entity with similar objectives.

The new Codes retain the seven basic requirements to qualify as a BBOS, but add the following three additional requirements. If these ten requirements are met, then under the new Codes the BBOS can contribute up to 40% of the total points available under the ownership element:

- the trust deed must be available, on request, to any participant in an official language in which that person is familiar;
- the trustees must present the financial reports of the scheme to participants yearly at an annual general meeting of the trust; and
- the trust deed must define the participants and the proportion of their claim to receive distributions (and the trustees “must have no discretion” in relation to these).

Under both the current Codes and the new Codes, in order to obtain all of the points on the ownership scorecard for ownership through a BBOS, the following additional criteria must also be met:

- the scheme must have a track record of operating as a BBOS; and
- or in the absence of such a track record, there must be demonstrable evidence that the BBOS has full operational capacity to operate as a BBOS. The scheme’s operational capacity must be evidenced by suitably qualified and experienced staff in sufficient number, experienced professional advisors, operating premises and all other necessary requirements for operating a business.

**EMPLOYEE SHARE OWNERSHIP PROGRAMMES**

Under both the current Codes and the new Codes, an ESOP must meet the following minimum qualifying criteria to contribute a maximum of
40% of the total points available on the ownership scorecard of the measured entity concerned:

- the trust deed must define the participants and the proportion of their claim to receive distributions (and the trustees “must have no discretion” in relation to these);
- the participants must take part in appointing at least 50% of the fiduciaries;
- the participants must take part in managing the scheme at a level similar to the management role of shareholders; the trust deed must be available, on request, to any participant in an official language in which that person is familiar;
- the trustees must present the financial reports of the scheme to participants yearly at an annual general meeting of the trust; and
- and on the winding up or termination of the scheme, all accumulated economic interest is payable to the participants at the earlier of the date or event specified in the deed or on termination or winding up of the scheme.

Under both the current Codes and the new Codes, in order to obtain all of the points on the ownership scorecard for ownership through an ESOP, it must be shown that the scheme has a track record of operating or it has full operational capacity for ESOPs. This is demonstrated on the same basis as the operational track record of a BBOS (as discussed above) (plus a bonus point if 10% achieved), and under the new Codes is 3%.

A summary of the points that ownership by BBOS and ESOPs can contribute

<table>
<thead>
<tr>
<th></th>
<th>Current Codes</th>
<th>New Codes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exercisable voting rights</td>
<td>6 points</td>
<td>6 points</td>
</tr>
<tr>
<td>Economic interest</td>
<td>5 points</td>
<td>6 points</td>
</tr>
<tr>
<td>Ownership by BBOS and ESOP</td>
<td>1 point (+ 1 bonus point)</td>
<td>3 points</td>
</tr>
<tr>
<td>Ownership by black new entrants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Value</td>
<td>8 points (including ownership fulfilment)</td>
<td>8 points</td>
</tr>
<tr>
<td>Total points:</td>
<td>Potentially 21 out of 23 (effectively 21 out of 20)</td>
<td>Potentially 23 out of 25</td>
</tr>
</tbody>
</table>

The targeted levels of BBOS and ESOP ownership under the current Codes is 2.5% (plus a bonus point if 10% achieved), and under the new Codes is 3%.
B-BBEE Funding Structures
B-BBEE investors often do not have access to sufficient capital to acquire equity. As such, B-BEE transactions are often structured in such a way to facilitate the purchase of the equity by the B-BBEE investor. It is typical, however, for the B-BBEE investor to pay a portion of the purchase price i.e. “skin in the game” which serves the dual purpose of incentivising the B-BBEE investor and assisting the measured entity in achieving initial net value points.

The choice of a funding structure will depend on a number of factors including, but not limited to: availability and source of funding (e.g. vendor or third party), the amount of funding required, tax implications and potential tax efficiencies, the ability of the B-BBEE investor to pay a portion of the purchase or subscription price, the type and composition of the proposed B-BBEE investor (e.g. a trust, ESOP, BBOS, special purpose vehicle, etc), the key parties’ B-BBEE strategy, the sector in which the measured entity operates, the sector to which the measured entity supplies, and any existing or ongoing contractual commitments regarding B-BBEE rating and/ or ownership.

There are a number of different possible funding arrangements including: a traditional loan structure (vendor or third party), notional vendor finance (NVF structure), or a preference share structure (vendor or third party). The general features of the different funding arrangements are as follows:

<table>
<thead>
<tr>
<th>Preference Share</th>
<th>Traditional Loan</th>
<th>Notional Vendor Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preference share funding</td>
<td>Loan funding (vendor or third party)</td>
<td>Shares acquired for nominal value, separate notional funding provided</td>
</tr>
<tr>
<td>Preference shares issued to funder: funder has preferential right to dividends</td>
<td>Ordinary shares issued to B-BBEE partner</td>
<td>Ordinary shares issued to B-BBEE partner</td>
</tr>
<tr>
<td>B-BBEE partner has voting rights</td>
<td>B-BBEE partner has voting rights</td>
<td>B-BBEE partner has voting rights</td>
</tr>
<tr>
<td>Dividends from the measured entity used to service preference share dividends</td>
<td>Dividends from the measured entity used to service loan</td>
<td>B-BBEE partner waives dividend rights or holds a different class of shares with voting rights and there are no or limited dividend rights until the funding is “repaid”</td>
</tr>
</tbody>
</table>
| Preference shares redeemed after a period (usually between 7 and 10 years) | Encumbrances on B-BBEE partner’s shares fall away if the loan is repaid | Formula applied to determine:  
• how many shares the B-BBEE partner retains and are converted to ordinary shares  
• how many shares are repurchased by the company/ measured entity at the end of the term at nominal value |
Notional vendor finance structures have been used in listed companies’ B-BBEE transactions such as SAB Zenzele, Vodacom Yebo Yethu, Kumba Iron Ore and MTN Zakhele Limited. Notional vendor funding achieves the same economic effect as a traditional loan structure, but without any actual flow of funds, hence the term “notional”:

- In a traditional loan structure, the vendor or third party would advance a loan to a B-BBEE partner to acquire the shares. This loan amount would usually incur interest. The B-BBEE partner would use some or all of the dividends to pay down the loan. If the loan is not repaid, the shares may be sold to settle the outstanding debt, or the loan may be refinanced.

In a notional vendor funding structure, the B-BBEE partner would acquire ordinary shares or shares of a different class for nominal value. The parties, i.e. the vendor and the B-BBEE partner/s, would negotiate and agree on the terms that will apply to the proposed B-BBEE transaction, including a notional vendor funding formula, which effectively replicates a traditional loan structure. In this regard, the notional funding amount would be agreed (e.g. the market value of the shares), that amount would be increased over a notional funding period by a notional interest factor, and the amount would be decreased by the notional value of dividend attributable to the B-BBEE partner’s shares. It should be noted that this is not regarded as a loan, as no funds are actually advanced to the B-BBEE partner or owed by the B-BBEE partner. Further, the B-BBEE partner will either waive any dividend rights (if ordinary shares have been acquired) or will hold a different class of shares with voting rights but with no or limited dividend rights until the funding is “repaid” i.e. the end of a lock-in period.
Monitoring of B-BBEE Compliance and Fronting Practices
B-BBEE audits and B-BBEE ratings

Where a business presents any information in relation to its B-BBEE score, for example in the context of a tender response, this must be supported by a certificate issued by an accredited verification agency. The certificates issued by the verification agencies are valid for twelve months. Accordingly, businesses generally perform a B-BBEE “audit” on an annual basis. A business’s B-BBEE score will be determined on the basis of its activities during the previous financial year and its ownership and management structures and staff profile as at the date of measurement.

Various verification and ratings agencies have been established to measure enterprises’ B-BBE levels. These agencies issue certificates on an annual basis certifying an enterprise’s levels of B-BBEE. As from October 2011, only B-BBEE certificates issued by accredited verification agencies and auditors that have been approved to certify B-BBEE levels, are valid.

Fronting practices

The Codes of Good Practice provide that, when measuring B-BBEE levels, substance applies over legal form. This is an attempt to limit instances of “fronting” by enterprises which make representations that they have adopted particular B-BBEE initiatives in order to score points when, in substance, the initiatives have not been adopted. In terms of amendments to the BEE Act, which came into effect on 24 October 2014, it is now a criminal offence to engage in a “fronting practice” or to make deliberate misrepresentations in relation to an enterprise’s true B-BBEE status. The BEE Act defines a “fronting practice” as “a transaction, arrangement or other act or conduct that directly or indirectly undermines or frustrates the achievement of the objectives of [the BEE Act] or the implementation of any of the provisions of [the BEE Act]”.

In terms of the BEE Act, fronting practices include, but are not limited to, practices in connection with a B-BBEE initiative:

• 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;

• in terms of which the economic benefits received as a result of the B-BBEE status of an enterprise do not flow to black people in the ratio specified in the relevant legal documentation;

• involving the conclusion of a legal relationship with a black person for the purpose of that enterprise achieving a certain level of B-BBEE 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

• involving the conclusion of an agreement with another enterprise in order to achieve or enhance B-BBEE status in circumstances in which (1) there are significant limitations, whether implicit or explicit, on the identity of suppliers, service providers, clients or customers; (2) the maintenance of business operations is reasonably considered to be improbable, having regard to the resources available; or (3) the terms and conditions were not negotiated at arm’s length and on a fair and reasonable basis.

B-BBEE Commission

From 24 October 2014, the BEE Act was also amended to provide for the establishment of a B-BBEE Commission which will be responsible for, amongst other things, investigating alleged “fronting” practices and referring them for prosecution. While the B-BBEE Commission has not yet been established, we understand that the intention is for the B-BBEE Commission to be established by 31 March 2015. In terms of the BEE Act, fines for fronting may be up to 10% of a company’s annual turnover.

B-BBEE Reporting

Finally, in terms of the amendments to the BEE Act, listed companies are now required to report annually on their levels of B-BBEE and B-BBEE transactions above a certain threshold, as determined by the Minister by notice in the Government Gazette, are required to be reported to the B-BBEE Commission. However, this threshold has not yet been prescribed by the Minister.
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