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BEE fronting indicators - watch out for these “red flags” written by Gideon Gerber

BEE Fronting practices have been criminalised in terms of the B-BBEE Amendment Act.

In a previous blog titled *“3 Most important things you should know about BEE fronting practices”* we dealt with the question “What is fronting?” and provided a brief history of BEE fronting, as well as the fact that fronting within a BEE context has been criminalised in terms of section 13O(1)(d) of the BEE Amendment Act, 46 of 2013.

In this series of blogs on fronting, we will look at so-called fronting indicators, criminal offences and *penalties related to fronting offences* and the requirements for criminal conviction of a fronting offence.

Background to fronting indicators

Since the inception of B-BBEE in 2004, fronting has been identified as an inherent and material risk to the successful implementation of B-BBEE. Earlier inferences to interpret or identify fronting used the “spirit of the B-BBEE Act or the B-BBEE Codes” as a benchmark. After the enactment of the B-BBEE Amendment Act of 2013 (the Amendment Act), this was replaced by the “objectives of the Act”, with a fronting practice presently defined in section 1 of the Amendment Act as ‘activities that undermine the objectives of the B-BBEE Act of 2003’ instead of as being ‘against the spirit of the law’. Early drafts of the B-BBEE Codes in 2005 had contained a statement on fronting.

The B-BBEE Codes are central to the rules to standardise implementation of B-BBEE for the industry and, peculiarly, do not refer to fronting but rather to circumvention activities, setting requirements for certain transactions which are deemed to be anti-fronting provisions, although not specifically indicated as such.

- Fronting has evolved since 2004 and several legislative documents contain direct or indirect anti-circumvention or anti-fronting provisions, all of which played a role in the culmination of fronting as a criminal offence in terms of section 13O of the Amendment Act and implemented in October 2014. This criminalisation of a previously "hard to prove" practice as per the Minister of Trade and Industry means that a business convicted of a fronting practice could face severe sanction.

These fronting provisions across the spectrum of several statements and government notices need to be examined in order to understand the origin and traditional application, as well as the political and social rationale for the present vague and wide formulation of a fronting practice as a criminal offence and the constitutional challenges to which the existing statutory formulation may be subject.

Important statements and guidelines on fronting practices

As alluded to above, the very first drafts of the B-BBEE Codes in 2005 contained a statement on *fronting practices.* This statement is supported by guidelines published in 2009 under the heading "Guidelines on Complex Structures and Transactions and Fronting" and referred to as the guidelines on fronting. The statement and guidelines were the first attempts to regulate fronting practices in South Africa.

- **The statement (hereinafter referred to as the 2005 Statement) defined fronting to mean–**

"*any practices or initiatives which are in contravention of or against the spirit of any law, provision, rule, procedure, process, system, policy, practice, directive, order or any other term or condition pertaining to black economic empowerment under the Codes".*

- **The guidelines (hereinafter referred to as the 2009 Guidelines) contain a simpler definition:**

"Fronting means a deliberate circumvention or attempted circumvention of the B-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. Verification agencies, and/or procurement officers and relevant decision-makers may come across fronting indicators through their interactions with measured entities."

It is notable that the definition in the 2005 Statement is **very broad** compared to the definition in the 2009 Guidelines. The 2005 Statement in essence defines fronting practice as a contravention of any law, procedure or other provisions relating to B-BBEE. The 2009 Guidelines, on the other hand, **are narrower** as they require the intention to circumvent the B-BBEE Act of 2003 and the B-BBEE Codes by using the word "deliberate". This narrower approach of requiring a **deliberate** action or attempt to circumvent the B-BBEE Act of 2003 and the B-BBEE Codes would for many years up to 2013, with the amendments to the B-BBEE Act, form the basis for the understanding and application of a fronting practice.

The 2005 Statement further makes provision for any reasonable interpretation which is consistent with the objectives of the B-BBEE Act of 2003 and indicates that "substance must always take precedence over legal form".

What are the fronting activities?

The 2005 Statement also introduced and illustrated **three fronting activities** or practices that would become well-known terms in the industry, namely "window dressing" or "tokenism", "benefit diversion" and "opportunistic intermediaries". The fronting risk indicators (below) and three fronting activities are also contained in the 2009 Guidelines.

- “Window dressing” is illustrated in the 2005 Statement and 2009 Guidelines (collectively referred to as the “Guidelines”) as an action of tokenism where black people are appointed or introduced in positions within an enterprise but restricted, prevented or inhibited from substantially participating in the core activities or areas they are supposed or expected to participate given the nature of the positions of the black person in that enterprise.
- “Benefit diversion”, according to the Guidelines, refers to initiatives implemented where the economic benefits received as a result of the B-BBEE status of an enterprise do not flow to black people in the same ratio as provided for in the relevant legal documentation.
- The term “opportunistic intermediaries” is illustrated by the Guidelines as the agreement between an enterprise and another entity with a favourable B-BBEE status where the enterprise obtains a favourable B-BBEE status leveraging the B-BBEE position of the B-BBEE entity in circumstances where the agreement between the two entities was not concluded at arm’s length and the provisions of the agreement place significant or material limitations on the B-BBEE entity with regard to its suppliers, clients or customers, and where the operations of the B-BBEE entity are unlikely or unsustainable given the resources of that B-BBEE entity.

What are the fronting indicators?

The 2005 Statement goes further and lists **six fronting risk indicators** that might be indicative of the presence of a fronting practice. These fronting risk indicators are of significance as they have been used in developing certain anti-circumvention provisions in the B-BBEE Codes and some of these indicators have also been incorporated into the formulation of the definition of a “fronting practice” in the Amendment Act.

These fronting risk indicators in the 2005 Statement were further extended and simplified to **11 fronting indicators** in the 2009 Guidelines published to serve as an interpretive guide to enlighten the public at large. These fronting risk indicators which appear in the 2009 Guidelines are, despite the new formulation of a fronting practice in the B-BBEE Amendment Act of 2013, utilised by the authorities to inform and educate the public about fronting activities and to encourage the public to report intentional misrepresentation and fronting practices.

The fronting risk indicators in the Guidelines can be summarised as follows:

- Black people serving as shareholders, executives or management are unaware or uncertain about their roles within an enterprise or the black persons serving in the different roles and responsibilities are paid significant less than other people serving in similar roles in the enterprise;
- Black people at top management level are not actively involved in the strategic decision-making of an enterprise;
- An enterprise does not perform core functions, cannot operate independently and only performs peripheral functions;
- An enterprise buys goods or services or obtained a loan at a non-market-related rate from a related person or entity;
- An enterprise shares premises and infrastructure with a related person or other entities without a B-BBEE status where the cost of such premises and infrastructure is not market related;
- An enterprise in general displays evidence of circumvention or attempted circumvention.

Conclusion

Despite the enactment of the Amendment Act providing for a fronting offence and defining the term *"fronting practice",* the fronting indicators contained in the 2005 Statement and 2009 Guidelines still play an important role in detecting and indicating the presence of possible fronting activities. Although the prevalence of these indicators is not conclusive in determining a fronting practice, they serve as grounds for suspicion that may trigger further investigation by verification agents, procurement officers and the *B-BBEE Commission*.

SERR Synergy assists businesses to implement viable B-BBEE initiatives and ensure alignment of initiatives with the legal requirements of the B-BBEE Codes and to avoid any possible risks associated with fronting or any other unethical business practices that may cause possible reputational damage to an enterprise. Make sure you don't miss the next blog on B-BBEE fronting criminal offences and penalties.

About the author: Gideon Gerber is a director of SERR Synergy (Pty) Ltd, an admitted High Court attorney with the qualifications B.Juris (Unisa), B.Proc (Unisa) and LLM (Pret.) with a Master's dissertation titled: *An Appraisal of the Offence of "fronting" in the context of Broad-Based Black Economic Empowerment (B-BBEE) in South Africa.* He has more than 30 years' experience in Business Structuring & Compliance, Training, Skills Development and Business Compliance in South Africa, the UK and Namibia. He is a regular speaker at various B-BBEE seminars and also writes articles for the Business Day and Landbouweekblad that concerns BEE Matters. He also published an article titled *Criminal liability requirements of the new Broad-Based Black Economic Empowerment (B-BBEE) statutory offence* in the Journal of Contemporary Roman-Duthch Law (THRHR) August 2018. *(Easy Download here)*

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