May 26, 2021

Broad-Based Collective Ownership Programmes - comment on Explanatory Memorandum published

The Minister of Trade, Industry and Competition (“the Minister”) has published the long-awaited and long-overdue guidelines on broad-based ownership programmes in respect of Broad-Based Black Economic Empowerment (B-BBEE) in the form of an Explanatory Memorandum in Government Gazette No. 44591 dated 18 May 2021

(see “Broad BEE trusts are genuine” – Patel, Business Day, 8 February 2021, and “BEE pioneers applaud Patel’s confirmation of status” in Business Day, 9 February 2021).

In the initial phases of B-BBEE, the use of so-called “charity trusts” (for philanthropic or altruistic purposes) and charitable non-profit companies (NPCs) with economic upliftment objectives, such as the provision of education, housing, etc., as ownership structures, especially by bigger corporates, mines and multinational entities, was very popular.

The B-BBEE Codes make specifically provision for the use of Broad-Based Ownership Schemes (B-BOS) and Employee Share Ownership Programmes (ESOPs). These collective programmes are generally housed in legal structures such as trusts and non-profit companies (NPCs) and, to a lesser extent, associations and foundations. They were always recognised as viable B-BBEE ownership structures, and were in fact actively promoted by government as “poster boys” for the broad-based ideals of the B-BBEE and transformation programme.

However, with the establishment of the B-BBEE Commission in 2016, the Commission adopted a different point of view, namely that these charity-type of collective structures may be used for socio-economic development, *skills development* and corporate social investment purposes but not for the recognition of B-BBEE ownership. The Commission, for instance, insisted, amongst others, that–

- the purpose and objectives of these collective programmes must be clearly stated in their governing documents (e.g. trust deed), namely that they were established to fulfil a B-BBEE ownership role;
- minors could not be beneficiaries of such programmes or family trusts;
- the trust deed or other governing document cannot merely state a class of beneficiary, but must specifically delineate the names of each individual black beneficiary, and the portion of their entitlement;
- the beneficiaries should each have an individual right similar to direct shareholders in a company, such as economic interest entitlements and voting rights;
- beneficiaries may not be selected each year from the defined group or pool of beneficiaries to receive benefits;
- fiduciaries such as trustees do not have any discretion with regard to changing the participants (beneficiaries) and their portion of entitlement.

From the above, it is clear that the Commission attempted to apply the rules of direct shareholding to beneficiaries / participants of collective programmes. The Commission even refers to participants of collective programmes, such as beneficiaries in a trust, as "indirect shareholders", which is legally misdirected. The Commission also contended that the beneficiaries should mandate the fiduciaries. This is, of course, highly objectionable and against the grain of well-established fiduciary common law principles which dictate that a fiduciary may not allow its powers and duties to be abdicated and should at all times exercise an independent judgement. An attempt to apply direct shareholding principles and rules to the beneficiaries of collective programmes is to force a square object into a round hole (see "BEE pioneers fight for their legitimacy, Commission regards early trusts as fronts, appeals to Ebrahim Patel for clarity falls flat" (*Business Day*, 24 November 2020).

Section 13G of the B-BBEE Act and submission of a B-BBEE-compliance report

Section 13G of the B-BBEE Act 53 of 2003, as amended (by Act 46 of 2013), read with Regulation 12 of the B-BBEE Regulation 2016, requires all spheres of government, public entities, organs of state, public (listed) companies and all Sectoral Education and Training Authorities (Setas) to submit a B-BBEE-compliance report annually to the B-BBEE Commission. Section 13F(1)(f) of the Act, read with Regulation 18, further requires parties who enter into a "major broad-based black economic empowerment transaction", to submit the transaction to the Commission for registration within 15 days after conclusion thereof. The Minister set the threshold for major broad-based economic empowerment transactions at a value above R25 million.

The Commission raised several concerns during the statutory reporting of such transactions, leading to various disputes and an impasse (stand-off) between various big corporates, multinational enterprises and the B-BBEE Commission. Several media statements issued by the Commission and media reports on iterations by the Commission created the unfortunate narrative and perception that collective ownership programmes and B-BBEE trusts constitute fronting and are unlawful (see "Fronting still a problem, says BEE regulator" – *Business Day*, 10 October 2017; "More than half of trusts are non-compliant" – *Business Day*, 27 October 2017; "Broad-based trusts not black ownership" – *Business Day*, 24 April 2019; and "BEE targets keep shifting" – *Business Day*, 24 April 2019).

The requirements adopted and enforced by the B-BBEE Commission were not congruous with the Codes. The Explanatory Memorandum in essence rebuts the B-BBEE Commission's idiosyncratic and contentious interpretations, requirements and conjectures, and reaffirms the traditional and conventional use of broad-based programmes such as charity and employee ownership programmes.

What are the rights of beneficiaries and fiduciaries in broad-based collective ownership programmes?

The Explanatory Memorandum also clarifies the rights of beneficiaries and fiduciaries in such programmes, and explicitly provides that–

- collective programmes established with charity and economic upliftment objectives, such as education for black youth, may be recognised for B-BBEE ownership purposes although such programmes were not specifically established to fulfil an ownership role;
- minors may be participants / beneficiaries;
- the trust deed or other governing document of a collective programme can state either the class of beneficiaries or the names of the beneficiaries, as provided for by the B-BBEE Codes;
- the beneficiaries do not have individual voting rights. Instead, voting rights are attributed to the beneficiaries as a group, as exercised by the fiduciaries of the programme on behalf of beneficiaries as a collective (e.g. trustees of the trust);
- depending on the powers conferred by the governing document(s), the fiduciaries will have the power to select beneficiaries from time to time for benefits from the defined group;
- the individual beneficiaries do not have a right or entitlement to economic interest in the measured entity in which the programme holds shares or equity;
- the provisions in the B-BBEE Codes in respect of the restrictions imposed on the discretion of fiduciaries in terms of who the beneficiaries are and their right to entitlement, should not be interpreted parochially, but rather broadly in the context of the trust deed and governing documents.

In conclusion

The Explanatory Memorandum is a positive development for businesses, as well as the objectives of B-BBEE, and will definitely reignite a surge in the use of these types of trusts. Unfortunately, the respective Masters of the High Court in whose jurisdiction all trusts are registered, are presently in disarray and the registration process of trusts takes a long time to be finalised. A more viable option is the registration of non-profit companies (NPCs) in terms of the Companies Act 71 of 2008 with the Companies and Intellectual Property Commissioner (CIPC), which can be done online and can fulfil the same purpose as trusts. The B-BBEE Codes explicitly allow for NPCs to be used to house broad-based collective programmes such as charity programmes with economic upliftment objectives for black people, or to house employee share or equity ownership programmes to benefit black employees. Both trusts and NPCs can be structured to benefit all staff (black and white). In such instances where a collective programme benefits black and white staff, only the black percentage will be recognised in terms of the Flow-Through Principle in the B-BBEE Codes.

SERR Synergy assists businesses to implement viable B-BBEE initiatives and ensure alignment of initiatives with the legal requirements of the B-BBEE Codes.

About the author: *Gideon Gerber* is a director of SERR Synergy (Pty) Ltd. He is an admitted attorney to the High Court and holds the qualifications B.Juris (Unisa), B.Proc (Unisa) and LLM (Pret.), with a Master's dissertation titled: *An Appraisal of the Offence of "BEE fronting" in the context of Broad-Based Black Economic Empowerment (B-BBEE) in South Africa*. He is a registered doctorate candidate (LLD) with the University of Pretoria, with the following research topic: *Assessing the Beneficiaries of the Broad-Based Black Economic Empowerment (B-BBEE) Programme within the Normative Framework of International Law and the Constitution*. He is also a regular speaker at various B-BBEE seminars and writes articles for *Business Day* and *Landbouweekblad* on B-BBEE matters. He has also published the following legal academic articles: "*Criminal liability requirements of the new Broad-Based Black Economic Empowerment (B-BBEE) statutory offence"* in the Journal of Contemporary Roman-Dutch Law (THRHR) August 2018, and "*Interpretation of 'fronting practice' in terms of the Broad-Based Black Economic Empowerment Act 53 of 2003 – Passenger Rail Agency of South Africa V Swifambo (Pty) Ltd" (THRHR) 2019*.