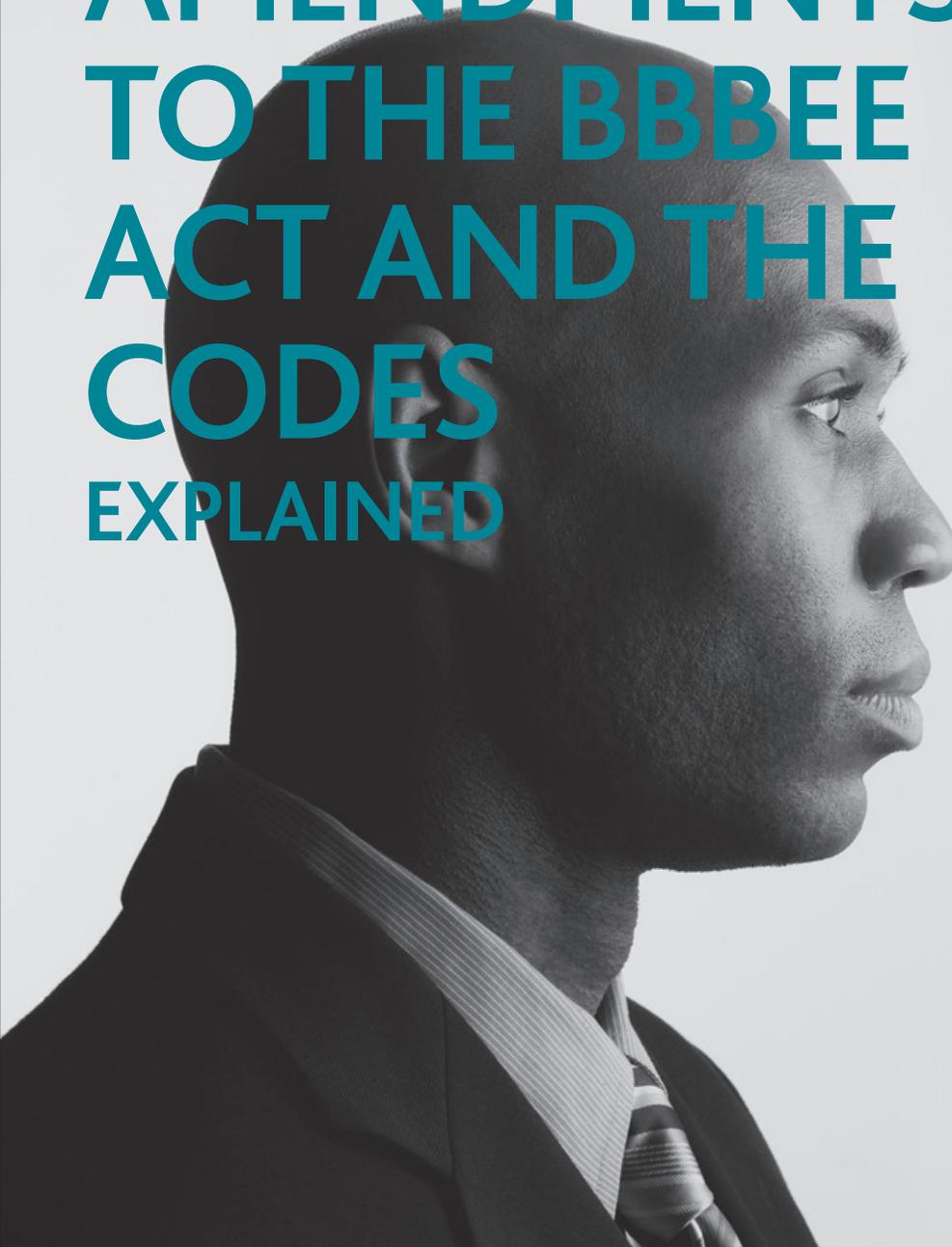


AMENDMENTS TO THE BBBEE ACT AND THE CODES EXPLAINED



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BACKGROUND TO THE GUIDE

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The Broad-Based Black Economic Empowerment Act 53 of 2003 ("**BBBEE Act**") provides the legislative framework for Broad-Based Black Economic Empowerment in South Africa ("**BBBEE**"). The Codes of Good Practice may be issued under the BBBEE Act and such Codes may be sector specific or "generic" (i.e. of general application). The current "generic" Codes of Good Practice on Black Economic Empowerment were published on 9 February 2007 ("**Codes**").

The primary purpose of the BBBEE Act and the Codes is to address the legacy of racist apartheid policies and enhance the economic participation of Black people in the South African economy.

Significant changes to the existing "generic" Codes were published in the Government Gazette on 11 October 2013 and will take effect from 1 May 2015. The amendments to the BBBEE Act came into effect on 24 October 2014.

The purpose of this Werksmans guide is to provide you with a basic understanding of the changes to the BBBEE framework and the significance of the changes for your business.

INTRODUCTION TO THE AMENDMENTS

INTRODUCTION

The amendments to the BBBEE Act and the Codes fundamentally change the current BBBEE framework and are a powerful expression of the Government's intention to promote and implement BBBEE.

Government policy has to date been based on the "voluntarist" principle that the manner in which a firm applies BBBEE is to be decided by the individual firm having regard to its own business needs and that the BBBEE framework simply provides a methodology for measuring the BBBEE rating of the firm.

Unlike the current framework, the new BBBEE framework introduces penalties in certain circumstances. This is an important departure from previous Government policy.

Although the BBBEE Act and Codes do not impose legal obligations on firms to comply with BBBEE targets, a firm's BBBEE status is an important factor affecting its ability to successfully tender for Government and public entity tenders and (in certain sectors like mining and gaming) to obtain licences. Private sector clients also increasingly require their suppliers to have a minimum BBBEE rating in order to boost their own BBBEE ratings.

BBBEE is accordingly an important factor to be taken into account by any firm conducting business in South Africa.

AMENDMENTS TO THE BBBEE ACT

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The amendments to the BBBEE Act came into force on 24 October 2014 and indicate the more actively interventionist and prescriptive approach by Government to the implementation of BBBEE. Several new measures are introduced including to:

- > establish a BBBEE Commission to play an oversight and advocacy role with regard to BBBEE and investigate complaints relating to BBBEE, BBBEE transactions and “fronting practices” (which is very widely defined – see the glossary at the end of this booklet). The BBBEE Commission will have important powers including subpoena powers and the right to apply to Court to restrain a breach of the BBBEE Act and/or a “fronting practice”;
- > introduce various criminal offences for misrepresenting or providing false information regarding a firm’s BBBEE status or engaging in a “fronting practice”. A contravention may result in a fine and/or up to 10 years’ imprisonment for individuals and the firm may be fined up to 10% of its annual turnover and be banned from contracting with Government and public entities for 10 years;
- > introduce a statutory right for Government and public entities to cancel any contract or “authorisation” awarded due to false information on BBBEE status;
- > impose an absolute obligation on Government and public entities to apply the Codes in their procurement policies and in issuing licences and authorisations (previously they were only obliged to do so “as far as reasonably possible”);
- > impose an obligation on South African listed entities to provide a report to the BBBEE Commission on their compliance with BBBEE.

THE REVISED SCORES IN THE CODES

REVISED BBBEE POINTS

The amendments to the “generic” Codes (which come into effect from 1 May 2015) significantly change the manner in which a firm’s BBBEE status (or level) will be calculated, as the number of BBBEE points required to achieve a particular BBBEE level has been increased.

The changes are set out (and compared with the current position) in the following table.

BBBEE Level	Amended Codes	Current Codes
1	≥ 100 points	≥ 100
2	≥ 95 but < 100 points	≥ 85 but < 100
3	≥ 90 but < 95 points	≥ 75 but < 85
4	≥ 80 but < 90 points	≥ 65 but < 75
5	≥ 75 but < 80 points	≥ 55 but < 65
6	≥ 70 but < 75 points	≥ 45 but < 55
7	≥ 55 but < 70 points	≥ 40 but < 45
8	≥ 40 but < 55 points	≥ 30 but < 40
NON-COMPLIANT	< 40 points	< 30

These far-reaching changes will materially affect a firm’s existing BBBEE rating and may potentially result in an automatic downgrade of its BBBEE status from 1 May 2015. For example a firm with 65 points would have an “old” BBBEE level 4 rating but a “new” BBBEE level 7 rating.

This holds major implications for business especially for firms whose customers require a minimum BBBEE status from suppliers, for firms with contractual or other obligations to maintain a minimum BBBEE status for ownership fulfillment and for firms with Government licences, permits or other authorisations requiring a minimum BBBEE status.

Firms will have to review their current BBBEE strategy to assess the impact of these changes and take steps to try and maintain their existing BBBEE ratings.

**SEVEN
BBBEE
ELEMENTS
IN THE
EXISTING
CODES
REDUCED
TO FIVE**

REVISED BBBEE ELEMENTS

Under the current "generic" Codes, the following seven elements are taken into account when calculating a firm's BBBEE rating:

1. OWNERSHIP
2. MANAGEMENT CONTROL
3. EMPLOYMENT EQUITY
4. SKILLS DEVELOPMENT
5. PREFERENTIAL PROCUREMENT
6. ENTERPRISE DEVELOPMENT
7. SOCIO-ECONOMIC DEVELOPMENT.

The amendments to the "generic" Codes reduce the number of elements to five by fusing the enterprise development/preferential procurement and management control/employment equity elements.

NEW WEIGHTINGS FOR MEASURING BBBEE STATUS

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The weighting for each of the five new elements are set out (and compared with the current position) in the following table:

Element	Weighting Points (Amended Codes)	Weighting Points (Current Codes)
OWNERSHIP	25	20 plus 3 bonus points
MANAGEMENT CONTROL	15 plus 4 bonus points	Management control -10 plus one bonus point Employment equity - 15 plus three bonus points
SKILLS DEVELOPMENT	20 plus five bonus points	Skills development – 15
NEW ENTERPRISE AND SUPPLIER DEVELOPMENT	40 plus four bonus points	Preferential procurement – 20 Enterprise development - 15
SOCIO-ECONOMIC DEVELOPMENT	5	5
TOTAL	118	107

The total number of available points has increased from 107 to 118. This may, depending on each firm’s circumstances, assist in minimising any adverse effects as a result of the revised scores mentioned above.

FREQUENTLY ASKED QUESTIONS

1. HOW DO THE AMENDMENTS AFFECT SMALL, MEDIUM-SIZED AND START-UP ENTERPRISES?

Under the current Codes, Exempted Micro-Enterprises (EMEs) are deemed to have a Level 4 BBBEE status and start-up enterprises (in the first year from formation or incorporation) are measured as EMEs. This is not changing but the threshold for qualifying as an EME has been increased from R5 million (or less) to R10 million (or less) of the total annual income. This is a positive development which will assist small firms which would otherwise not have benefited from the deemed Level 4 status.

The threshold for being a Qualifying Small Enterprise (QSE) has been increased to having total annual income of between R10 million and R50 million (currently between R5 million to R35 million). The amendments also provide that the BBBEE status of QSEs will be measured by reference to all five BBBEE elements (under the current Codes, QSEs may choose to be measured by reference to any four of the existing seven elements) and are subject to the automatic downgrade in BBBEE status if the minimum requirements referred to below are not met (see below).

Important changes are that EMEs and QSEs that are 100% black-owned will be deemed to have a Level 1 BBBEE status and EMEs and QSEs that are 51% black-owned will be deemed to have a Level 2 BBBEE status. This is a significant advantage over other EMEs and QSEs especially given the increase in the number of BBBEE points required to achieve a particular BBBEE level (as mentioned above). QSEs that are not 51% or more black owned will be subject to a more onerous regime than under the current Codes.

EMEs and QSEs will no longer need a certificate from a BBBEE verification agent to confirm their BBBEE status. All that is required is an affidavit certifying its total annual income and level of black ownership. This will save costs for all EMEs and QSEs.

2. WHAT ARE THE CONSEQUENCES IF TARGETS ARE NOT MET?

Generally speaking if targets in the Codes are not met, the firm will not score the maximum number of available BBBEE points. However under the new Codes, ownership, skills development and enterprise and supplier development are identified as “priority elements” and firms are expected to comply with the following minimum requirements:

- > 40% of the “net value” targets for the ownership element. “Net value” measures the “debt free” portion of the BBBEE ownership of a firm;
- > 40% of the total weighting points for the skills development element;
- > 40% for each of the three subcategories of the enterprise and supplier development element (being preferential procurement, supplier development and enterprise development).

A “Large Enterprise” (which is not defined, but presumably is a firm other than an EME or QSE with a total annual income greater than R50 million) is obliged to comply with all the priority elements. If a “Large Enterprise” fails to comply with all three of the minimum requirements as set out above, its BBBEE status will automatically be downgraded by one level. In other words, if its score would otherwise have been Level 4, it will automatically be downgraded to Level 5.

The downgrade indicates a departure from previous Government policy towards a more punitive BBBEE framework. The automatic nature of the downgrade applies regardless of the reasons for the failure to comply ie there is no exception or defence.

3. WILL THE DOWNGRADE FOR FAILING TO MEET THE MINIMUM REQUIREMENTS ALSO APPLY TO NON-COMPLIANT EMES AND QSEs?

A QSE is required to comply with ownership as a compulsory element and either one of the skills development or enterprise and supplier development elements. The downgrade also applies to QSEs which do not comply with the minimum requirement for BBBEE “net value” as well as those for either the skills development element or the enterprise and supplier development element. The downgrade does not apply to EMes.

4. HOW WILL A DOWNGRADE FOR FAILING TO MEET THE MINIMUM REQUIREMENTS AFFECT EXISTING AND NEW BBBEE TRANSACTIONS?

The risk of a downgrade has serious implications for BBBEE ownership transactions which often involve providing financing to the BBBEE shareholder which will be repaid out of dividend flows (which depend on the company’s profits and ultimately factors which are generally beyond the company’s control, such as the state of the national and global economy). Mechanisms will have to be provided to deal with the possible failure to meet the minimum “net value” ownership targets. Existing BBBEE transactions will have to be reviewed to assess the likelihood and effect of a downgrade. Ironically, BBBEE shareholders may be prejudiced by being required to fund transactions (in whole or in part) using their own resources.

The downgrade may accordingly have an unintended “chilling effect” on funding for BBBEE transactions and make BBBEE transactions more complicated and costly.

5. WILL FOREIGN MULTINATIONALS BE IMPACTED BY THE DOWNGRADE?

Foreign multinationals will be subject to the downgrade if they don’t comply with the minimum requirements. The risk of a downgrade may result in foreign multinationals considering the little used “equity equivalent programme” available under the existing Codes. This allows a foreign multinational to earn BBBEE ownership points without actually having a BBBEE shareholder or partner.

6. WILL ALL FIRMS HAVE TO REVIEW THEIR CURRENT BBBEE STRATEGIES?

The amendments to the Codes make several significant changes to the current methodology for calculating a firm’s BBBEE status and all firms should review their current BBBEE strategies to assess the impact of the changes to the Codes on their BBBEE rating and business going forward.

7. DO THE AMENDMENTS TO THE CODES PROVIDE AN INCENTIVE FOR FIRMS TO CONSIDER BROAD-BASED OPTIONS?

The current Codes provide for one BBBEE ownership point (and a 2.5% compliance target to earn that point) for an economic interest in a firm held by “black-designated groups” (which include black unemployed, black youth, black disabled people, black rural residents and black military veterans) and/or black participants in employee share ownership programmes and broad-based black ownership schemes (an additional “bonus point” may be earned if a firm has such black economic interest and meets the compliance target of 10%).

The amendments to the Codes scrap the bonus point but increase the number of available points for such black economic interest to 3 with a 3% target. This provides an incentive for firms to consider these “broad-based” options.

8. ARE FIRMS INCENTIVISED TO CONSIDER INCLUDING NEW ENTRANTS IN THEIR BBBEE TRANSACTIONS?

Under the amendments to the Codes, two BBBEE ownership points (with a 2% compliance target) have been allocated for an economic interest of “new entrants” in the firm. Under the current Codes, two “bonus” points for new entrants have a 10% compliance target, i.e. it is currently more difficult to earn these two points. The definition of “Black New Entrant” has also been widened in the amendments to cover black persons who have not held equity in another firm with a total value of R50 million (R20 million under the current Codes). These changes widen the pool of “new entrants” and provide an incentive for firms to consider including new entrants (i.e. small and medium-sized black firms) in their BBBEE ownership transactions.

9. WHAT IMPACT WILL THE AMENDMENTS HAVE ON BBBEE SKILLS DEVELOPMENT?

The amendments to the Codes increase the number of factors to be considered under the skills development element. Under the current Codes, only three factors are taken into account for the skills development element whereas five factors are taken into account under the new Codes. The new factors provide points for training unemployed black persons and the number of black people “absorbed” at the end of learnership programmes. The number of points and the compliance target for skills development expenditure have increased from 6 to 8 and from 3% to 6% respectively.

10. WILL PREFERENTIAL PROCUREMENT BECOME MORE DIFFICULT?

The amendments to the Codes introduce the concept of an “Empowering Supplier” for the preferential procurement subcategory of the enterprise and supplier development element. The requirements for qualifying as such a supplier are unduly complicated and include being a “BBBEE compliant entity” and a “good citizen”, complying with “all regulatory requirements” and meeting at least three (or for QSEs, one) of certain local procurement, job creation, raw material transformation/beneficiation and skills transfer requirements.

No preferential procurement points will be obtained if a supplier does not comply with these requirements. This is a major change from the position under the current Codes (which focus only on “BBBEE related” issues).

The amendments to the Codes assume that “Empowering Suppliers” are generally available in every sector of the economy but in practice this may not be the case so earning procurement points may become more difficult under the new Codes. Ironically, these changes will prejudice black-owned and controlled firms that do not comply with all the requirements for “Empowering Suppliers” as there will be no incentive (from a BBBEE rating perspective) for a firm to prefer such black-owned and controlled firms over others.

The process of verifying whether a supplier is an “Empowering Supplier” will also involve extra administration, management time and costs. Of greatest concern is that a firm’s BBBEE status will be automatically downgraded (as mentioned above) if it fails to meet the minimum 40% target for preferential procurement (even if the firm has made genuine efforts to comply).

11. HOW DO THE AMENDMENTS AFFECT SECTOR CODES?

The BBBEE Act allows any sector of the economy to have its own BBBEE code. The current Codes provide that a sector code has equal status with any other code. This has led to confusion as to whether a firm's BBBEE status should be measured under the sector code or the "generic" Codes. The amendments to the Codes (as well as the recent amendments to the BBBEE Act) resolve this by providing that the BBBEE status of a firm in the relevant sector may only be measured in accordance with the sector code for that sector (if any).

12. WHAT IS THE STATUS OF THE EXISTING SECTOR CODES?

The existing sector codes remain applicable and their status vis-à-vis the "generic" Codes has been clarified (see 11 above). An interesting question arises as to the position if the existing sector codes are not aligned to the new "generic codes" by 1 May 2015. The Government has indicated that the existing sector codes must be aligned but the 1 May 2015 deadline is looming and to date no amended sector codes have been issued under the BBBEE Act. As the Act provides for a 60-day period for public commentary on replacements or amendments to codes, it is clear that the sector codes will not be aligned by 1 May 2015. The existing sector codes are likely to be less onerous than the amended "generic" Codes and this will make it easier for firms in the sectors to score higher BBBEE ratings than firms covered by the "generic" Codes. This will lead to the undesirable situation of a dual rating system which prejudices firms covered by the "generic" Codes. The only way of avoiding this is for the Government to extend the 1 May 2015 deadline, something which it has to date publicly stated it will not do.

13. WHEN WILL THE AMENDMENTS COME INTO EFFECT?

The amendments to the "generic" Codes of Good Practice are due to take effect from 1 May 2015. It is important that firms review and reassess their BBBEE strategies to mitigate (and preferably avoid) any adverse effects resulting from the changes.

The amendments to the BBBEE Act came into effect on 24 October 2014.

14. ARE ENTITIES REQUIRED TO OBTAIN NEW BEE CERTIFICATES UNDER THE NEW CODES BY 1 MAY 2015?

A firm which obtained a BEE certificate under the current Codes before 1 May 2015, is not obliged to get a new BEE certificate under the amended Codes before the expiry date of that BEE certificate. However the firm must be careful that it does not unwittingly contravene the new criminal offences in the BBBEE Act (namely fronting practices and misrepresenting BBBEE status) by relying on such certificate after 1 May 2015. It must be made clear to third parties that the certificate was obtained using the previous and not the amended "generic" Codes. Firms may well decide to avoid this risk by getting new certificates under the amended Codes.

GLOSSARY OF TERMS

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BROAD-BASED BLACK ECONOMIC EMPOWERMENT (BBBEE)

The economic empowerment of all black people including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies that include, but are not limited to:

- (a) increasing the number of black people that manage, own and control enterprises and productive assets;
- (b) facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises;
- (c) human resource and skills development;
- (d) achieving equitable representation in all occupational categories and levels in the workforce;
- (e) preferential procurement; and
- (f) investment in enterprises that are owned or managed by black people

BBBEE STATUS

Means the BEE status of an enterprise as measured under the Codes or applicable sector code

BLACK PEOPLE

Natural persons who are African, Coloured or Indian (as well as certain Chinese) who are:

- (a) citizens of the Republic of South Africa by birth or descent; or
- (b) citizens of South Africa by naturalisation before 27 April 1994 or on or after 27 April 1994 and would have been entitled to acquire citizenship by naturalisation before that date.

FRONTING PRACTICE

A transaction, arrangement or other act or conduct that directly or indirectly undermines or frustrates the achievement of the objectives of the BBEE Act or the implementation of any of the provisions of the BBEE Act including but not limited to practices in connection with a B-BBEE initiative:

- (a) 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;
- (b) in terms of which the economic benefits received as a result of the broad- based black economic empowerment status of an enterprise do not flow back to black people in the ratio specified in the relevant legal documentation;
- (c) involving the conclusion of a legal relationship with a black person for the purpose of that enterprise achieving a certain level of broad- based black economic empowerment 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;
- (d) involving the conclusion of an agreement with another enterprise in order to achieve or enhance broad- based black economic empowerment status in circumstances in which –
 - i) there are significant limitations, whether implicit or explicit, on the identity of suppliers, service providers, clients or customers;
 - ii) the maintenance of business operations is reasonably considered to be improbable, having regard to the resources available;
 - iii) the terms and conditions were not negotiated at arm's length and on a fair and reasonable basis

CONTACT DETAILS

For more information, contact one of the following Werksmans directors:



PIETER STEYN

Direct line: +27 (0)11 535 8296

Fax: +27 (0)11 535 8696

Switchboard: +27 (0)11 535 8000

Email: psteyn@werksmans.com



NOZIPHO BHENGU

Direct line: +27 (0)11 535 8166

Fax: +27 (0)11 535 8766

Switchboard: +27 (0)11 535 8000

Email: nbhengu@werksmans.com



SANDILE JULY

Direct line: +27 (0)11 535 8163

Fax: +27 (0)11 535 8663

Switchboard: +27(0)11 535 8000

Email: sjuly@werksmans.com



SEROSHAN PADYACHY

Direct line: +27 (0)11 535 8284

Fax: +27 (0)11 535 8584

Switchboard: +27 (0)11 535 8000

Email: spadayachy@werksmans.com

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