LEGAL BRIEF

Too broadly defined, not clear enough yet

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THERE has been a flurry of news articles in recent weeks concerning an apparent challenge to the status quo in the B-BBEE landscape, especially in relation to ownership through trusts.

In a nutshell, the fledgling B-BBEE Commission has indicated that more than half of the existing structures of trust ownership might amount to "fronting".

The B-BBEE Commission is concerned with combating fronting practices which are now criminalised. Individuals may face fines and/or up to 10 years in jail. Companies can face fines of up to 10% of their annual turnover.

Community, employee and charitable trusts have been widely used in empowerment structures.

Recent reports indicate that they have generated approximately R50 billion in value for B-BBEE beneficiaries.

Trust structures have been favoured because they have benefited poor and unskilled black people who ordinarily would not have had an opportunity to participate in a shareholding or interest in a company.

They meet the stated objective of the B-BBEE Act, which is to "increase the broad-based and effective participation of black people in the South African economy".

But trusts are now being criticised because they are passive in the sense that specific black individuals do not drive transformation in the company.

Passive involvement often also applies to minority shareholders, irrespective of race, who may not determine the activities of the company without the majority shareholders' approval.

The other criticism is that black people who are beneficiaries of the trust do not own the shares in their personal names but rather the shares are held by the trustees on behalf of the beneficiaries.

However, this is a feature of all trusts under South African trust law.

The B-BBEE Codes contain rules which must apply to trust structures. These rules are designed to prevent fronting.

There are caps on management fees, half of management of the scheme must be independent with no direct or indirect benefit in the scheme and there are a variety of transparency requirements.

The criticisms raised by the commission go beyond the requirements set out in the codes. More certainty is required as to exactly what is meant.

The mining industry seems to be exempt from these challenges. Under the Mining Charter, mines are obliged to allocate equity to mine communities and usually, the only way of achieving this is through a trust.

It is clear that the commission will be looking more closely at trust structures that have been established. Whilst it has accepted that the trust model can be used to facilitate broad-based ownership at the end of the day, it would seem that the commission will now be looking to see whether there is active participation and true ownership.

Existing structures will be analysed by the commission to see whether this has been achieved.

Objectively, what this means is unclear. While President Cyril Ramaphosa tries to woo investors to sink capital into the economy, the rules for investment need to be clarified and historic structures, compliant with the codes, not placed in question.

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