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Broad-Based Black Economic Empowerment Commission announces investigations of trusts used in B-BBEE ownership structures

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INTRODUCTION

On 7 August 2017, the B-BBEE Commission announced that it had initiated 17 investigations for possible contraventions of the Broad-Based Black Economic Empowerment Act (B-BBEE Act). Six cases deal with the use of trusts in B-BBEE ownership structures, six deal with B-BBEE verification agencies and two involve Government entities (Eskom and the South African Social Security Agency). The criteria used by the Commission in selecting these 17 cases are not clear but the decision to investigate B-BBEE ownership structures involving trusts is interesting as the use of trusts has been criticised in certain quarters.

The B-BBEE Commission is primarily concerned with combatting fronting practices which are now criminalised. Individuals face fines and/or up to ten years in jail. Companies face fines of up to 10% of their annual turnover and being prohibited from doing business with Government and public entities for ten years. Fronting practices can involve individual black shareholders, their family trusts, black owned and controlled companies as well as employee and broad based trusts.

EMPLOYEE AND BROAD BASED TRUSTS

Employee and broad based trusts involve more legal and practical complexity than individual black ownership structures. One of the criticisms about these trusts is that they are "passive" without specific black individuals who can drive transformation in the company. This is however a generalisation as a minority shareholding in a company by black individuals can also be "passive" and minority shareholders are in any event (irrespective of race) limited in their ability to control or influence the business and other activities of the company without the majority shareholder's approval. Another criticism has been that the black people who are beneficiaries of the trust do not own the shares in their personal names but that the shares are rather held by the trustees on behalf of the beneficiaries. However, this is a feature of all trusts under South African trust law. Furthermore, black individuals may (for estate duty or other purposes) choose to hold shares through family trusts and this is expressly permitted by the Codes of Good Practice (Codes) issued in terms of the B-BBEE Act. The Codes also provide that on termination or winding up of the trust, the trust's assets must be distributed to participants who will then own the assets personally.

The Codes contain detailed requirements for employee and broad based trusts which provide protections against fronting practices. For example, the Codes require that black participants in an employee trust must take part in appointing at least 50% of the trustees and in managing the trust at a level similar to the management role of shareholders in a company. Participants' rights to receive distributions from the trust must be clearly stated and the trustees must have no discretion regarding the distributions so the participants must have vested rights to distributions. Trustees are also obliged to give an annual financial report to participants at an annual general meeting. If the trusts don't comply with the requirements, B-BBEE ownership points cannot be scored.

Furthermore, these trusts can provide financial benefits to more black people than individual ownership structures and can especially benefit poor and unskilled black people who would not otherwise have an opportunity to participate in a shareholding or other interest in a company. The stated objective of the B-BBEE Act is to "increase the broad based and effective participation of black people in the South African economy" and the B-BBEE Act and the Codes makes special mention of black women, black workers, black youth, black people with disabilities, black unemployed, black military veterans and black rural dwellers. Trusts can more effectively channel funds to benefit these designated groups. From a policy perspective it is interesting that the 2013 amendments to the Codes increased the

number of B-BBEE ownership points which may be scored for these trusts from 1 to 3 (out of a total of 25 points) for a 3% shareholding by the trust – a clear incentive to firms to include these trusts in their B-BBEE ownership strategies and indicating a policy focus on broad based empowerment which is in line with the B-BBEE Act. The inclusion of these trusts in a B-BBEE ownership strategy not only allows a firm to score these points but can incentivise employees, promote broad based (as opposed to individual) empowerment and contribute to existing or new corporate social responsibility programmes. The trustees of these trusts may also be less likely than individual black shareholders to sell their shares and exit the company, resulting in the loss of B-BBEE ownership points.

It is important that the trusts are properly implemented and treated as an independent third party shareholder. The company is usually the founder of the trust and appoints up to 50% of the trustees. Under South African trust law all trustees have personal fiduciary duties and are accountable to beneficiaries. If the trustees breach these duties they can incur personal liability. The involvement of the company in the affairs of the trust can cause concerns about the independence of the trusts and trustees and it is important that the relationship between the company and the trust is arm's length. The Codes deal with these concerns by requiring employees to elect 50% of the trustees. For broad based trusts, the Codes require at least 50% of the trustees to be independent and the chairperson of the trustees must be independent. The Codes also require the trusts to have either a track record or "operational capacity" including staff, premises and advisors. From a practical perspective, the trust deed must be a implemented as a "living document" and trustees need to hold trustee meetings, attend board and shareholder meetings and report to participants.

Management time and costs are involved in setting up, administering and maintaining these trusts. For example the trust usually has administration expenses and the independent trustees generally require some remuneration (trustees appointed by the company are usually employees and not separately remunerated) and annual meetings with trust participants must be arranged. Funding issues can arise for the trust if it receives no (or insufficient) dividends from the company. In tough economic times, the company may not be able to do so and the Companies Act prohibits a company from declaring dividends if it fails to pass the solvency and liquidity test in the Act. Employees may become disgruntled if the trust is unable to make distributions to participants due to the lack or insufficiency of dividend income from the company. The failure of the trust to deliver funds to its beneficiaries raises potential concerns about whether the trust is achieving its B-BBEE goals.

CONCLUSION

The establishments of the Commission was an important milestone. It is still relatively early days but the Commission can play a very important role in combatting the scourge of fronting practices as well as providing guidance to companies on their B-BBEE strategies. The issue of practice guides by the Commission is a very welcome development. How the Commission handles its investigations, the quality of its advisory opinions, findings and recommendations and its general accessibility to firms and members of the public will be important indicators of its success going forward.

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