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# Recent high court case clarifies fronting practices

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## INTRODUCTION

In the recent High Court case involving the Passenger Rail Agency of South Africa (PRASA) and Swifambo Rail Agency Proprietary Limited, Judge Francis set out certain useful guidelines on the "fronting practice" definition in the Broad-Based Black Economic Empowerment Act (B-BBEE Act) namely "a transaction, arrangement or other act or conduct that directly or indirectly undermines or frustrates the achievement of the objectives of this Act or the implementation of any of the provisions of this Act including but not limited to practices in connection with a B BBEE initiative:

- 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;
- 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 to black people in the ratio specified in the relevant legal documentation;
- 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; or
- 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 there are significant limitations, whether implicit or explicit, on the identity of suppliers, service providers, clients or customers or the maintenance of business operations is reasonably considered to be improbable having regard to the resources available or the terms and conditions were not negotiated at arm's length and on a fair and reasonable basis".

## THE B-BBEE ACT

The above wording is very wide and may have the unintentional effect of including bona fide B BBEE initiatives in the definition. The criminalisation of fronting practices in terms of the B BBEE Act adds to the seriousness of this issue for both existing and future B BBEE initiatives. In terms of the B BBEE Act a firm may be fined up to 10% of its annual turnover and individuals may be subject to a fine and/or imprisonment for up to ten years. In addition, the individual or firm may not contract any business with any organ of State or public entity for a period of ten years and will be entered into the register of tender defaulters maintained by the National Treasury.

The PRASA/Swifambo case related to the award of a tender to Swifambo by PRASA for the supply of locomotives to PRASA. The locomotives would be sourced by Swifambo from Vossloh, a company based in Spain. The Court decided to review and set aside PRASA's decision to award the contract to Swifambo.

The Court found that the arrangement between Swifambo and Vossloh constituted to a fronting practice on the basis that:

- Swifambo was merely a "token participant" which had received monetary compensation in exchange for the use of its B BBEE rating by Vossloh;
- Vossloh maintained completed control of the operations of the business (including the appointment of members of the steering committee) and Swifambo's role was limited to minor administrative activities. There was no transfer of skills to Swifambo;

- Vossloh had chosen not to take advantage of the “equity equivalent” programme whereby multinational firms may earn B BBEE ownership points by contributing to an approved programme instead of having a B BBEE shareholder. Vossloh had instead used Swifambo as a vehicle to tender for the locomotive contract even though Swifambo had no resources or technical capabilities, operational capacity, staff or other resources and its business operations were accordingly improbable. It was effectively a shelf company;
- the true nature of the relationship between Swifambo and Vossloh was that Swifambo was a front for Vossloh and had effectively subcontracted 100% of the work required under the PRASA contract to Vossloh.

The Court also found that the definition of fronting practice does not require a misrepresentation to the relevant State body of the true nature of the arrangement between the fronting parties. This is important as before 2013, fronting practices were covered by the common law criminal offence of fraud which requires a misrepresentation in order for a person to be convicted. The Court’s finding makes it easier for a fronting practice as defined in the B BBEE Act to be prosecuted.

The Court also found that a fronting practice did not require the exploitation of a black person. The fact that there was a financial benefit to Swifambo from the arrangement was accordingly not a defence. The relationship between Swifambo and Vossloh however amounted to the exploitation of the intended beneficiaries of the B BBEE Act, namely black people.

The case highlights the importance of ensuring that State and Parastatal tenders are structured in a way which complies with the B BBEE requirements of the tender and does not amount to a fronting practice. The Preferential Procurement Regulations under the Preferential Procurement Policy Framework Act provides guidance on the tender process including with regard to subcontracting arrangements. In terms of the Regulations, a successful tenderer may not subcontract more than 25% of the value of the contract to a firm which does not have an equal or higher B BBEE status level unless the subcontract is to an exempt micro enterprise (a firm with less than R10 million annual revenue) which has the ability and able to execute the subcontract. The successful tenderer also requires the approval of the relevant organ of State for any subcontracting arrangement entered into after the award of a tender.

## CONCLUSION

The B BBEE Commission is currently investigating various firms for possible fronting practices. Given the serious consequences of fronting practices, it is vital that businesses carefully review their existing and future B BBEE initiatives including B BBEE ownership structures to ensure compliance with the B-BBEE Act.

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