

**AN APPRAISAL OF THE OFFENCE OF “FRONTING” IN THE
CONTEXT OF BROAD-BASED BLACK ECONOMIC
EMPOWERMENT (B-BBEE) IN SOUTH AFRICA**

by

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ABSTRACT

*“It is not the strongest species that survive,
nor the most intelligent
but the one most receptive to change.”*

- **Charles Darwin**

SUMMARY

The objective of this dissertation is to examine the new statutory offence of “fronting” within the context of broad-based black economic empowerment (B-BBEE) introduced in South African law. The social and political influence that led to a legislative overhaul of the B-BBEE legal framework is considered, coupled with the inability of the authorities to curb fronting practices in the past. The increase in the levels of sophisticated fronting and significant increase in circumvention and fronting practices following the 2013 legislative amendments culminated in the ultimate deterrent known to authorities, being the promulgation of a criminal offence with hefty sanctions.

The origin and DNA of these fronting provisions are investigated to determine their traditional application within the administrative law compared to the new formulation and scope of application as a statutory offence within the criminal law. The criminal liability requirements applicable to the new fronting offence are appraised to determine the criminal legality of the new statutory formulation. Unfortunately, the statutory formulation is unclear, broad and ambiguous and will have to be interpreted by the courts in order to fill the gaps left by the legislature. This will create various constitutional challenges in respect of a person’s right to a fair trial and the separation of powers doctrine entrenched in the Constitution, 1996.

Apart from the vague and ambiguous formulation that might not satisfy the requirements of criminal legality entrenched in the Bill of Rights in the Constitution, 1996, further constitutional challenges are expected in respect of the lowering of the criminal culpability standard by the legislature to prevent offenders from easily escaping prosecution by the new fronting offence.

The practicalities of effectively enforcing the new statutory prohibitions within the ambit of the relevant legal framework and powers assigned to the various enforcement functionaries are analysed to determine whether the legal mechanism of enforcement meets the objectives of the new statutory offence and the B-BBEE Act of 2003 in general.

The question to be probed in this dissertation is whether the new fronting offence is an “overkill” in a desperate attempt to satisfy the broad social and political agenda, rather than pragmatic. Considering all the facts leading up to the adoption of a criminal instrument as a deterring mechanism, this dissertation proves that the present formulation is a “blunt” instrument creating a false sense of security with authorities. This dissertation proposes legal modification and reform of the structure of the fronting offence, as well as a balance in application between various spheres of the law to be effective.

FOREWORD AND ACKNOWLEDGEMENTS

The opportunities in life that come our way if we are fortunate enough can be solely attributed to His grace. The ability and opportunity to gather knowledge for sharing with others will not remotely be possible without the assurance that our Heavenly Father is our guide and inspiration in every endeavour.

The labouring efforts to gather information to be pioneered into the fruits of knowledge for self-fulfilment and the privilege of sharing this with others would not be conceivable without the Divine Power that is far greater than us. To Him all the glory.

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**DECLARATION OF AUTHENTICITY
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Declaration:

1. I understand what plagiarism is and I am aware of the University's policy in this regard.
2. I declare that this dissertation is my own, original work. Where other people's work (either a printed book, Internet source or any other source) was used, it was properly acknowledged and referred to in accordance with the requirements of the Faculty.
3. I did not make use of another person's work and submitted it as my own.

SIGNATURE

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CHAPTER 1

INTRODUCTION

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1.1 BACKGROUND

A “fronting practice” generally refers to those activities or transactions serving as a cover for the secret or illegal activities of a person or group.¹ Other legislation, such as the Income Tax Act,² the Companies Act,³ and the Labour Relations Act,⁴ describe these practices as anti-avoidance, circumvention or non-genuine operations or activities. In the context of B-BBEE, practices of so-called window-dressing or tokenism are referred to as “fronting” or “fronting practices”.⁵

Although circumvention practices are not unique to the B-BBEE environment, the term “fronting” or “fronting practice” is unique to B-BBEE, as it was for the very first time officially incorporated in 2005 as part of the first draft of the then B-BBEE Codes of Good Practice (B-BBEE Codes) containing a detailed statement followed by guidelines in 2009 identifying fronting risks and proposing how these risks should be dealt with by the industry.⁶

In two later civil cases, namely *Viking Pony African Pumps (Pty) Ltd t/a Tricom Africa v Hidro-Tech Systems (Pty) Ltd and Another*⁷ in 2010 and *Peel (Pty) Ltd and Others v Hamon J&C Engineering (Pty)*

¹ Hornby *et al* (1986) 347; and Collins (2011) 312.

² Act 58 of 1962.

³ Act 71 of 2008.

⁴ Act 66 of 1995.

⁵ Codes of Good Practice – Statement 001 - Fronting Practices and other misrepresentation of BEE Status published in *Government Gazette* No. 28351 dated 20 December 2005.

⁶ As above.

⁷ 2011 SA 327 (CC); 2011 (2) BCLR 207 (CC) paras [7] – [9] and [49]; and Warikandwa and Osode *PER/PELJ* (March 2017) 16.

*Ltd and Others*⁸ in 2012, the courts examined, amongst others, the inner working of certain transactions, and found misrepresentation in respect of the substance and operations of transactions in a B-BBEE context as fronting activities.

Before 2013 fronting was, from a criminal justice point of view, dealt with under the common law offence of fraud. Very few cases have been reported in this regard and the overall view (although misplaced) was that this form of misrepresentation could hardly be dealt with as a criminal offence under the common law.⁹ According to Vuyo Jack, a chartered accountant who developed the B-BBEE rating index, uncertainty and a lack of guidance from the authorities contributed largely to the notion that verification agents are prevented under their contractual obligation with clients from reporting matters of B-BBEE fraud.¹⁰

Fronting has over time become increasingly sophisticated and problematic for the authorities to regulate. This was illustrated by this statement by the Minister of Trade and Industry, Rob Davies, in 2010:

“It is not just the obvious one, where you take the factory-floor worker and call him the managing director...It’s now beginning to involve accountants, lawyers and verification agents that are giving people ideas of more sophisticated ways to front...Fronting is becoming analogous to tax avoidance and tax evasion”.¹¹

The Minister and a senior official from the Department of Trade and Industry, Nomode Mesatywa, further illustrated the growing concern about fronting by stating that the department received between 150 to 200 complaints of fronting every year, but had successfully secured a prosecution in only one matter. The Minister and the department have blamed this poor prosecution rate on the fact that fronting is “hard to prove”.¹²

⁸ 2013 (1) All SA 603 (GSJ); 2013 (2) SA 331 (GSJ) paras [13] and [21].

⁹ Rampedi *The Star* (Aug 2012). It was briefly reported that a top medical company was alleged to have appointed a domestic worker, Elizabeth Tsebe, as a 40% shareholder and director without her knowledge. During this period, the company was able to obtain tenders to the value of over R160 million. According to Tsebe, she had been fraudulently presented with documents to be signed effecting the transaction by her employer who claimed that the documents related to the Unemployment Insurance Fund. Due to the lack of punitive measures in making fronting a punishable offence, according to the report, no consequences may be faced for the misrepresentations. Tsebe has, however, instituted claims from the medical company for an amount of R10 million for the compensation she should have received as a director, and the value of any dividends declared which would have accrued to her in her capacity as shareholder in the company.

¹⁰ Jack (2015) 32, 38-44 and 479. The establishment of a company, Empowerdex, of which Jack was a co-founder as developers and compilers of the B-BBEE Codes on instruction and guidance of the Department of Trade and Industry.

¹¹ Mokone *Business Report, The Times* (Nov 2010) 12; and Pressly *Cape Times* (Nov 2010) 12.

¹² As above.

In an address to the B-BBEE Advisory Council in 2011, the President of South Africa emphasised the presence and origin of fronting practices and stated that:

“Fronting and tender abuse is an unintended consequence of an overemphasis on diversity of ownership and senior management in implementing broad based black economic empowerment”.¹³

In order to address this ever-growing trend of misrepresentation, as well as the inability of the authorities to effectively deal with fronting under the common law, the B-BBEE Act of 2003 was amended with the enactment of the Broad-Based Black Economic Empowerment Amendment Act (B-BBEE Amendment Act of 2013),¹⁴ which criminalises “knowingly engaging in a fronting practice” as a statutory offence in terms of section 13O(1)(d).¹⁵ From the outset, legal professionals have described the formulation of this offence as broad, vague and problematic.¹⁶

In order to enforce the new fronting provisions, the B-BBEE Commission was established in May 2016,¹⁷ amongst others, to oversee compliance with the B-BBEE Act of 2003,¹⁸ with vast powers to investigate fronting practices and misrepresentation, summon people and subpoena documents and even to make a determination that a specific initiative is a fronting practice.¹⁹

This dissertation will look at the statutory formulation of a fronting practice as a criminal offence, brought about by the B-BBEE Amendment Act 46 of 2013 (B-BBEE Amendment Act), and the constitutional legality challenges this new statutory offence might face in light of its vague, broad and ambiguous formulation, as well as the powers assigned to the B-BBEE Commission to make a finding as to whether any B-BBEE initiative involves a fronting practice.

¹³ Zuma *IOL* (April 2011) 1.

¹⁴ Act 46 of 2013 published in *Government Gazette* No. 37271 dated 27 January 2014 with commencement date 24 October 2014.

¹⁵ Act 53 of 2003 - for purpose of clarity the O as sub-section refers to the grammatical character and not the numerical zero.

¹⁶ *Legal Brief Today* (Feb 2017) 20. According to Clark, a legal professional, “the definition of fronting practice in the BEE Act is broad and includes any transaction, arrangement or other conduct that undermines the achievement of the objectives of the BEE Act. This definition has not yet been tested by the courts and may be refined over time”; and Jeffery (2014) 186.

¹⁷ Regulations published by means of *Government Gazette* No. 40053 dated 6 June 2016 to regulate the functions of the B-BBEE Commission.

¹⁸ Promulgated by *Government Gazette* No. 25899 Notice no. 17 dated 9 January 2004 with Commencement Date 21 April 2004; and s 13F and J of the B-BBEE Act of 2003.

¹⁹ S 13J (3) of the B-BBEE Act of 2003; and Jeffery (2014) 188.

Very few people can argue about the need to criminalise circumvention practices which could undermine the objectives of the B-BBEE Act of 2003²⁰ and the redress imperative provided for by the Constitution, 1996, such as poverty relief and social justice.

This research will not attempt to answer the question of whether we need fronting laws or to find loopholes in the law, but rather whether the existing fronting practice formulation strikes a balance between rooting out illegal practices and serves as a proper deterrent without undermining the objectives of the B-BBEE Act of 2003 and without creating unintended consequences.²¹

1.2 RESEARCH QUESTIONS

In the light of often complex commercial transactions and ownership structures, the present ambiguous, vague and broad formulation of fronting practice as a criminal offence lacks legal certainty and objectively determinable benchmarks.²² This lack of certainty could lead to absurd or unintended consequences in stifling much-needed incorporation of black people into the main stream of economic activity as an objective of the B-BBEE Act of 2003.²³ The existing wide and vague formulation of a “fronting practice” as such will be legally problematic to apply and become an undermining and frustrating factor of the very objectives it purports to promote. As indicated at the beginning of this dissertation, this research will not attempt to find loopholes in the existing fronting provisions but rather to tighten up the formulation of fronting practice as a criminal offence.

Therefore, pertinent questions to be addressed in the dissertation are the following:

- Will the ambiguous, vague and broad formulation of a fronting practice as a criminal offence pass constitutional muster?
- How should policy makers define existing fronting provisions so as to strike an appropriate balance between being constitutionally consistent and promoting the objectives and purpose of the B-BBEE Act of 2003?

²⁰ Jack (2013) 470.

²¹ Balshaw and Goldberg (2014) 22 and 23 which raise the point that the onerous provisions of the new B-BBEE Codes and lack of consultation with business could lead to businesses not participating in the new approach.

²² Jeffery (2014) 10, 182 and 186 stating that fronting has been defined in “extraordinarily broad terms”; and Warikandwa and Osode *PER/PELJ* (March 2017) 17 state that South Africa adopted a dualist approach with an “elastic” definition of fronting which is “broad” and a “catch-all” definition.

²³ Jack (2013) 7, 15 and 22; and Madi (2016) xxxiv and 41.

1.3 SIGNIFICANCE OF THE STUDY

Several media reports have recently surfaced to illustrate the difficulty business owners experience with complex legal requirements in terms of viable B-BBEE ownership initiatives in the face of possible criminal prosecution in the form of fronting practices.²⁴

The B-BBEE Commission commissioned research in 2016²⁵ as to the national state of transformation and to collect and analyse real time data by economic sectors with the focus on B-BBEE certificates and other proof of compliance issued. The research has indicated that according to statistics provided by the South African Revenue Service (SARS), South Africa has 924 021 economically active businesses in total. Of these, 95% are exempted from B-BBEE requirements. Two per cent, or 11 871 businesses, have to fully comply with the B-BBEE Codes and a further three percent or 34 118 have to comply partially.²⁶ As explained later in this dissertation, a large percentage of those deemed as exempted will however be “forced” to participate in the B-BBEE programme to effectively compete for business with government, state owned entities and big corporations due to the cascading effect of the B-BBEE programme.²⁷

The B-BBEE Commission’s research further found that those professionals who operate within the B-BBEE rating industry have an inadequate understanding of the new B-BBEE Codes and widely different interpretations when measuring similar data sets.²⁸ It is clear that a thorough knowledge of the B-BBEE Codes and related legislation is essential for all B-BBEE professionals and business owners to deal adequately with fronting activities.²⁹ Wider research is required to enlighten and inform all stakeholders about the legal requirements in this regard.

This research therefore aims to:

- provide an objective analysis of the concept of a “fronting practice” as a criminal offence and clarity regarding the interpretation of the relevant terms relating to a fronting practice;
- suggest much-needed changes to the legislative framework and propose properly drafted guidelines and presumptions in line with other legislation to effectively regulate circumvention activities;

²⁴ Gerber *Business Day* (Mar 2016) 23; and Asmal *Mail and Guardian* (Dec 2016) 28; and Jack (2013) 472.

²⁵ B-BBEE Commission National Report (Oct 2016) 1.

²⁶ As above para 2; and Balshaw and Goldberg (2014) 14.

²⁷ See Chapter 2 para 2.4 below.

²⁸ B-BBEE Commission National Report (Oct 2016) para 4.

²⁹ Jack (2013) 470; and Balshaw and Goldberg (2014) 28.

- eliminate a false sense of security on the part of authorities that the application of a fronting practice in its existing form will significantly deter unwanted practices;
- provide legal certainty to encourage B-BBEE initiatives to meet the objectives of the B-BBEE Act of 2003.

1.4 RESEARCH METHODOLOGY

Although a country such as Malaysia operated a similar economic redress programme between 1970 and 1990,³⁰ this programme is no longer in operation. Other countries with corrective economic politics, such as India and South Korea, do not operate within a legal framework similar to that of South Africa and do not have specific criminalised circumvention or fronting provisions. Although considered, a legal comparison with these countries will not provide conclusive answers to the research question relating to this dissertation.³¹

This study instead comprises an analytical study of the mechanisms of B-BBEE and the objectives of the B-BBEE Act of 2003, criminalising certain disguising or circumvention practices by the formulation of a fronting practice. An analytical literature study approach is followed by comparing evidence, opinions and case law and also analyses available internet discussions up to 31 August 2017, to determine the constitutional requirements applicable to a fronting practice as a criminal offence.³²

Constitutional Court and High Court judgements, in setting objective tests for examining and scrutinising circumvention and anti-avoidance practices in general, are compared and applied in respect of the present codification of a fronting practice.

A socio-legal research methodology is applied in understanding the political nature of the B-BBEE legal framework and the need for minimalising unwanted circumvention practices. Utilising the socio-legal methodology, this research considers the effectiveness and intended effect of the research question to assist in law reform proposals to create synergy and a rationale between the statutory formulation of a fronting practice and the goals of the fronting provisions.³³

³⁰ Mokhtar *et al* (JMC) (Mar 2013) Vol. 1 No. 1.

³¹ Morris and Murphy (2011) 37.

³² As above 38 – 40.

³³ As above 34.

1.5 PROPOSED STRUCTURE

The study consists of six chapters. The chapter outline of the study is as follows:

Chapter One – Introduction

This chapter provides an introduction to and insight into the area of circumvention activities within the context of B-BBEE and specifically the necessity from a policy and constitutional point of view to curb fronting practices. Early attempts and difficulties experienced by government to curb fronting practices which culminated into the introduction of a fronting offence in our law are illustrated.

Chapter Two – Historical background, legal framework and application of B-BBEE

This chapter addresses the extent and significance of B-BBEE in the South African constitutional and business environment and how it influences a broad spectrum of businesses and business activities in South Africa. A systematic and chronological exposition of the development and implementation of economic redress policies, with specific emphasis on B-BBEE, is provided. The practical scoring mechanism to determine B-BBEE compliance within the context of the elements and cascading effect of B-BBEE is provided. The role of government in procuring goods and services and in controlling the economy by issuing licences and through other mechanisms are evaluated as the imperative for government's involvement in driving the transformation process. The various statutory bodies, enforcement agencies and mechanisms in enforcement and oversight are examined.

Chapter Three – The evolution and application of fronting outside the criminal statutory framework

The evolution of anti-circumvention rules for B-BBEE is examined, as well as early unsuccessful attempts to manage and regulate fronting practices. Initial endeavours to provide guidelines in relation to the research question are analysed. The historical and legal development of the fronting phenomenon and the interaction of and overlapping with other common law offences such as fraud are appraised. The development of anti-fronting measures, as well as the origins and application of these traditional rules, is investigated. Case law as well as juristic and academic commentary are analysed to establish the knowledge development and contemporary understanding of a fronting practice embedded into the system.

Chapter Four – Statutory fronting provisions and other related offences

The statutory formulation of a fronting offence is examined. This formulation consists of various definitions and concepts contained in the B-BBEE Act of 2003 and some provided for in other legislation. The full spectrum of the definitional elements is analysed to determine the full extent and application of a fronting offence, especially in the light of relevant case law in this regard. Various other statutory provisions directly related to the fronting practice offence are investigated and the entire relationship between the various statutory offences is scrutinised.

Chapter Five – Criminal liability requirements of the statutory fronting practice provisions

All the elements and requirements for criminal liability as substantive law are appraised. Specific emphasis is placed on the criminal liability elements of legality within the constitutional requirements, as well as a study to clearly distinguish between the various elements of criminal liability. These general principles for criminal liability are then applied to the definitional elements of a fronting offence examined in Chapter 4 of this dissertation. The legal position in respect of the prosecution of corporate bodies is examined and appraised.

Chapter Six – Final Conclusion and recommendations

Conclusions are drawn and proposals made regarding possible interventions that could facilitate change to the legal framework to effectively curb circumvention and fronting practices in a more decisive and pragmatic manner to ensure that the objectives of the B-BBEE Act of 2003 are achieved and promoted. Amendments to the B-BBEE Act of 2003 are suggested, in particular to the formulation of a fronting practice in line with the objective benchmarking already applied in other areas of the law. Amendments to the legal application of fronting practices in respect of B-BBEE are suggested to enhance effectiveness in dealing with fronting practices across a spectrum of appropriate legal remedies and to create legal certainty in a criminal environment.

CHAPTER 2

HISTORIC BACKGROUND, LEGAL FRAMEWORK AND APPLICATION OF B-BBEE

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2.1 INTRODUCTION

B-BBEE is part of an overarching policy relating to economic transformation.³⁴ This policy emanated from the provisions³⁵ in the Constitution, 1996 to, amongst others, eradicate poverty, inequality and racial discrimination. Other policy considerations to enhance economic redress within this broader policy framework are employment equity and land reform. Although each of these three policies has its own policy and legal framework, they overlap and are intertwined. Employment equity is for instance one of the sub-elements to be measured under the management and control element³⁶ of the B-BBEE scorecard, while the degree of participation by an entity in respect of land redistribution is measured under the existing Sector Charter for the Agricultural Sector.³⁷

Apart from the economic redress policies, several other economic policies in general were adopted by the African National Congress (ANC) before 1994 and later by government to change the structure of the economy to allow more people to participate.

These general economic policies have a profound influence on transformation and redress policies and are the main drivers for giving effect to the objectives of B-BBEE legislation. The main general economic

³⁴ S 2(a) Objectives of the B-BBEE Act of 2003; and Balshaw and Goldberg (2014) 72.

³⁵ S 9, 24, 26, 27, 28, 195 and 217 of the Constitution, 1996; and Balshaw and Goldberg (2014) 73.

³⁶ Statement 200 of the B-BBEE Codes published in *Government Gazette* No. 36928 dated 11 October 2013 implemented on a transitional period with full implementation on 1 May 2015; and Balshaw and Goldberg (2014) 119; and Jeffery (2014) 201.

³⁷ Sector Code of Good Practice of Forestry, Fishing and Agri Industry promulgated by *Government Gazette* No. 36085 dated 28 December 2012.

policies are: the Reconstruction and Development Programme (RDP) from 1990 to 1994; the Framework for Macro Economic Policy in 1993;³⁸ Growth, Employment and Retribution, a Macro-Economic Strategy (GEAR) in 1996;³⁹ the National Development Plan (NDP) in 2012;⁴⁰ the Industrial Policy Action Plan (IPAP) in 2014;⁴¹ and the Black Industrialist Policy in 2015.⁴²

2.2 BACKGROUND TO B-BBEE LEGISLATION

In order to implement these policies successfully, government had to adopt appropriate legislation in this regard. This did not happen overnight and the first B-BBEE legislation was only enacted 10 years after the dawn of democracy. The first signs of incorporating commercial and economic redress into some statutory form were seen during the early 2000s with policy formulation in the form of a mining and liquid fuels charter for the mining and liquid fuels industries providing for the Minister of Mineral and Resources in terms of the Mineral and Petroleum Resources Development Act (MPRDA)⁴³ to set criteria for awarding licences for mining and exploration purposes.⁴⁴ The Liquid Fuel Charter was the very first step towards a scorecard system to measure compliance as later adopted for measurement by means of the B-BBEE Codes across all industries.⁴⁵ After extensive consultation between government and stakeholders, a more industry-friendly mining charter was promulgated in 2004 in terms of section 100 of the MPRDA.

Concurrently with this process in the mining and liquid fuels industries, a Black Economic Empowerment Commission (BEECom) chaired by the now Deputy President, Cyril Ramaphosa, was established in 1998 and published a report in 2001.⁴⁶ This led to the adoption of the B-BBEE Strategy and the B-BBEE Act of 2003.⁴⁷

³⁸ The Transition to Democracy: a Framework for Macro Economic Policy—Extract for the ANC Macro-Economic Research Group (MERG), December 1993.

³⁹ Growth, Employment and Retribution, a Macro-Economic Strategy (GEAR) Published by the Department of Finance, (1996).

⁴⁰ The National Development Plan (NDP) – The National Planning Commission, 2012 - 2030 (2012).

⁴¹ Industrial Policy Action Plan (IPAP) Economic Sectors and Employment Cluster 2014 – 2017 (2014).

⁴² The DTI: Black Industrialist Policy (2015).

⁴³ Act 28 of 2002; and Jack (2013) 23.

⁴⁴ Jack (2013) 23.

⁴⁵ As above.

⁴⁶ Black Economic Empowerment Commission (BEECom) The BEECom Report (2001); and Jack (2013) 21; and Madi (2016) xxxiii. Some sources suggest the (BEECom) was established in 1997 (Jack) and others in 1998 (Madi). The date of 1998 is more commonly advocated by commentators.

⁴⁷ Promulgated by *Government Gazette* No. 25899 Notice No. 17 dated 9 January 2004 with Commencement Date 21 April 2004; and Department of Trade and Industry (DTI) (2003) in South Africa’s Economic Transformation: “a Strategy for The Broad-Based Black Economic Empowerment”; and Jack (2013) 24 and 25; and Balshaw and Goldberg (2014) 71.

2.3 LEGAL FRAMEWORK AND STATUTORY BODIES

The B-BBEE Act of 2003 allows the Minister of Trade and Industry to issue sub-ordinary or enabling legislation in the form of Codes of Good Practice or B-BBEE Codes,⁴⁸ Sector Codes or Charters, regulatory guidelines and practice notices relating to the effective implementation of B-BBEE.⁴⁹

The present legal framework in respect of B-BBEE and interpretation of B-BBEE legislation can be summarised as follows: the Constitution, 1996; the B-BBEE Act of 2003 and the B-BBEE Amendment Act of 2013;⁵⁰ B-BBEE Codes;⁵¹ the Strategy for Broad-Based Black Economic Empowerment;⁵² Sector Codes or Charters;⁵³ B-BBEE Regulations;⁵⁴ guidelines and practice notes;⁵⁵ and the Verification Manual.⁵⁶

Other legislation influencing the interpretation and implementation of B-BBEE is as follows: the Public Finance Management Act, including Treasury Regulations and Directives;⁵⁷ the Preferential Procurement Policy Framework Act⁵⁸ and Regulations; the National Empowerment Fund Act;⁵⁹ the Companies Act;⁶⁰ the Competition Act;⁶¹ the Employment Equity Act⁶² and the Skills Development Act.⁶³

⁴⁸ S 9 of B-BBEE Act of 2003; and Balshaw and Goldberg (2014) 75.

⁴⁹ S 9 and s 14 of the B-BBEE Act of 2003; and Balshaw and Goldberg (2014) 68, 69, 74 and 75; and Jack (2013) 92 and 93.

⁵⁰ Act 46 of 2013 published in *Government Gazette* No. 37271 dated 27 January 2014.

⁵¹ Issued in terms of s 9 of the B-BBEE Act of 2003.

⁵² Issued in terms of s 11 of the B-BBEE Act of 2003; Department of Trade and Industry (DTI) (2003) “South Africa’s Economic Transformation: A Strategy for Broad-Based Black Economic Empowerment”; and Jack (2013) 24 and 25.

⁵³ Issued for a particular sector of the economy in terms of s 9 and 12 of the B-BBEE Act of 2003; and Jeffery (2014) 192.

⁵⁴ Regulations published by means of *Government Gazette* No. 40053 dated 6 June 2016 to regulate the functions of the B-BBEE Commission.

⁵⁵ Issued in terms of s 14(2) of the B-BBEE Act of 2003 relating to the interpretation and application of the B-BBEE Act of 2003.

⁵⁶ Issued in terms of s 9(1) and s 14(2) of the B-BBEE Act of 2003 published in terms of *Government Gazette* No. 39378 dated 6 November 2015. The only document that is allowed to be used by Verification Agents in measuring an entity in terms of the B-BBEE Codes. This document determines the methodology to be used during the verification process by verification agents. According to Jack (2013) 39 and 40, this methodology is essential to determine the rating or verification standard as a pre-requisite of acceptance by businesses.

⁵⁷ Act 1 of 1999.

⁵⁸ Act 5 of 2000.

⁵⁹ Act 105 of 1998.

⁶⁰ Act 71 of 2008.

⁶¹ Act 89 of 1998.

⁶² Act 55 of 1998.

⁶³ Act 97 of 1998.

The regulators and functionaries overseeing the implementation of the above are the Minister of Trade and Industry, as the political custodian to whom the implementation of the B-BBEE Act of 2003 has been assigned; the Department of Trade and Industry as organ of state and line functionary to regulate and oversee the industry as a whole;⁶⁴ the B-BBEE Commission established in terms of section 13B of the B-BBEE Act of 2003 to act as a watchdog;⁶⁵ and the South African National Accreditation Systems (SANAS) as accredited regulatory body⁶⁶ to accredit verification agencies to issue verification certificates⁶⁷ and confirm the compliance level as outcome of the measurement process in terms of the B-BBEE Codes.⁶⁸

The B-BBEE Act of 2003 also makes provision for an Advisory Council⁶⁹ and determines the functions⁷⁰ of the Council to advise government on issues relating to B-BBEE and various other functions to advise on, review and facilitate B-BBEE policy and strategy.⁷¹ The Council is not a regulatory or oversight body in the context of enforcing implementation of the B-BBEE Act of 2003 or the B-BBEE Codes.

The reference to the B-BBEE Commission established in terms of section 13B of the B-BBEE Act of 2003 is not to be confused with the BEECom established in 1998 under the chairpersonship of the now Deputy President, Cyril Ramaphosa.⁷² The latter was not established in terms of legislation and has no present relevance to the implementation of any B-BBEE legislation or policy. The BEECom had conducted research and compiled a report in 2001 that led to the formulation of the B-BBEE Strategy and enactment of the B-BBEE Act in 2003. The B-BBEE Commission, on the other hand, is a statutory body established in terms of section 13B of the B-BBEE Act of 2003 and assigned to perform a variety of enforcement and administrative actions as provided for by section 13F of the B-BBEE Act of 2003 and B-BBEE Regulations. Future reference to the B-BBEE Commission herein will be to the statutory body as established in terms of section 13B of the B-BBEE Act of 2003.

⁶⁴ Balshaw and Goldberg (2014) 76.

⁶⁵ Regulated by the B-BBEE Regulations with functions in terms of s 13F of the B-BBEE Act of 2003; and Balshaw and Goldberg (2014) 76; and Jeffery (2014) 187.

⁶⁶ The B-BBEE Verification Professional Regulation as defined in s 1 of the B-BBEE Act of 2003 appointed by the Minister of Trade and Industry in terms of The BEE Verification Notice Broad Based Black Economic Empowerment Verification Statement 005 published in *Government Gazette* No. 34612 dated 12 September 2011. On the 4th of March 2016, the Independent Regulatory Board of Auditors (IRBA) informed all B-BBEE approved registered auditors (BAR's) of the IRBA Board's decision to withdraw from the regulation of the B-BBEE verification industry. As from 1 Jan 2017, SANAS is the sole regulatory body to accredit verification agents.

⁶⁷ Balshaw and Goldberg (2014) 76; and Jack (2013) 81.

⁶⁸ Paras 1.2 and 3.1.3 of Statement 000 of the B-BBEE Codes; and Jack (2013) 80.

⁶⁹ S 4 of the B-BBEE Act of 2003.

⁷⁰ S 5 of the B-BBEE Act of 2003.

⁷¹ Balshaw and Goldberg (2014) 74.

⁷² Madi (2016) 49.

Apart from direct economic policies and economic redress policies adopted by government, government has since 1994 also embarked on various other forms of legislation to give effect to the socio-economic rights⁷³ entrenched in the Bill of Rights of the Constitution, 1996 in an attempt to create social justice and bolster inclusive growth, of which the following legislation is most commonly known:⁷⁴ the Labour Relations Act;⁷⁵ the Basic Conditions of Employment Act;⁷⁶ the Employment Equity Act;⁷⁷ the Skills Development Act;⁷⁸ the Skills Development Levies Act;⁷⁹ Extension of Security Tenure Act;⁸⁰ Restriction of Lands Rights Act;⁸¹ and the Promotion of Equality and Prevention of Unfair Discrimination Act.⁸² Some of these include a sanction for non-compliance and play a significant role in supporting the constitutional objectives underpinning the objectives of B-BBEE policies and B-BBEE legislation.

The most significant piece of legislation to directly promote economic redress is the B-BBEE Act introduced in 2003. It orders the Minister of Trade and Industry to develop, amongst others, B-BBEE Codes to standardise a set of measurement rules for all businesses⁸³ to become B-BBEE compliant and to advance the interpretation and definition of B-BBEE for all relevant stakeholders of the economy. These B-BBEE Codes were initially published as broad guidelines in 2005.⁸⁴

More detailed B-BBEE Codes were published in 2007⁸⁵ which were amended in October 2013 by a new set of B-BBEE Codes generally referred to as the Amended or Revised B-BBEE Codes.⁸⁶ During the same period the B-BBEE Act of 2003 was also amended by the B-BBEE Amended Act of 2013.⁸⁷ The

⁷³ S 26-29 of the Constitution, 1996; and Liebenberg (2016) 21 and 22. According to Liebenberg, it was hoped that recognizing the social-economic dimensions of human dignity, freedom and equality would “enrich participatory democracy by enabling persons marginalized by poverty to challenge decisions and omissions which have an impact on social-economic well-being”.

⁷⁴ Para 2.4.3 of the B-BBEE Strategy issued in terms of s 11 of the B-BBEE Act of 2003. Department of Trade and Industry (DTI) (2003) “South Africa’s Economic Transformation: A Strategy for Broad-Based Black Economic Empowerment”.

⁷⁵ Act 66 of 1995.

⁷⁶ Act 75 of 1997.

⁷⁷ Act 55 of 1998.

⁷⁸ Act 97 of 1998.

⁷⁹ Act 9 of 1999.

⁸⁰ Act 62 of 1997.

⁸¹ Act 22 of 1994.

⁸² Act 52 of 2002.

⁸³ S 9 of the B-BBEE Act of 2003; and Madi (2016) xxxiii; and Jack (2013) 66.

⁸⁴ S 9(5) of the B-BBEE Act of 2003; and Codes of Good Practice published in *Government Gazette* No. 28351 dated 20 December 2005.

⁸⁵ Published by *Government Gazette* No. 29617 dated 9 February 2007.

⁸⁶ *Government Gazette* No. 36928 dated 11 October 2013 implemented on a transitional period with full implementation on 1 May 2015 by means of *Government Gazette* No. 38764 dated 5 May 2015.

⁸⁷ Act 46 of 2013 published in *Government Gazette* No. 37271 dated 27 January 2014 which commenced on 24 October 2014.

B-BBEE Act of 2003 and B-BBEE Codes do not provide for any sanctions such as fines and awards to enforce B-BBEE compliance. To become B-BBEE compliant is voluntary⁸⁸ and will be determined by an entity's clients and industry requirements.⁸⁹ With the enactment of the B-BBEE Amendment Act of 2013, provision was made for significant fines and other sanctions for those who choose to participate in the B-BBEE programme but then proceed to misrepresent their B-BBEE status or engage in so-called fronting practices.⁹⁰

2.4 WORKING MECHANISM AND APPLICATION OF B-BBEE

To give effect to the B-BBEE Act as a voluntary system, a mechanism was implemented through the B-BBEE Codes to measure an entity's B-BBEE compliance by assigning points on a scorecard.⁹¹ Some entities are excluded from a scorecard to measure their level of B-BBEE compliance and receive an automatic level based on their annual turnover.⁹²

For B-BBEE purposes, entities or enterprises are divided into three categories according to their annual turnover, namely: Exempted Micro Enterprises (EMEs) - less than R10 million; Qualifying Small Enterprises (QSEs) - between R10 million and R50 million; and Generic Enterprises - more than R50 million.⁹³

For those entities whose compliance must be determined by a scorecard measurement, the following elements of B-BBEE contribution are measured, with the total points scored determining the level of a measured entity's B-BBEE compliance⁹⁴ (B-BBEE scorecard): Ownership 25 points; management & control (including employment equity) 19 points; skills development 20 points; enterprise and supplier development (including preferential procurement) 40 points; and socio-economic development 5 points. The B-BBEE scorecard totals 109 points.⁹⁵

⁸⁸ Jack (2013) 78; and Jeffery (2014) 138, 143 which cite B-BBEE as a social economic and strategic imperative rather than a legal obligation.

⁸⁹ As above; and Balshaw and Goldberg (2014) 39.

⁹⁰ S 13 of the B-BBEE Act of 2003.

⁹¹ Jack (2013) 76.

⁹² Balshaw and Goldberg (2014) 86.

⁹³ Paras 4-6 of Statement 000 of the B-BBEE Codes. Some of these annual turnover thresholds may differ for entities under the Sector Charters.

⁹⁴ Paras 3.2, 7 and 8 of Statement 000 of the B-BBEE Codes.

⁹⁵ Para 8 of Statement 000 of the B-BBEE Codes; and Jeffery (2014) 198 and 199.

The levels of compliance are determined according to the total number of points earned, with level 1 being the highest level if more than 100 points are scored, and level 8 the lowest compliance level for entities scoring between 40 and 50 points on the scorecard. Those with fewer than 40 points are considered to be non-compliant entities.⁹⁶

All EMEs receive a level 4 contributor status based on their annual turnover and do not have to prove compliance by being measured in terms of a scorecard.⁹⁷ Likewise, those entities that are EMEs and QSEs with at least 51% black ownership qualify for an outright level 2 contributor status and those with 100% black ownership in the same categories qualify for an outright level 1 contributor status. These EMEs and QSEs with at least 51% black ownership are by virtue of annual turnover and percentage black ownership excluded from the requirement to be measured on a scorecard to determine their level of compliance.⁹⁸

An entity's participation in B-BBEE is determined by their clients, what their competitors are doing with regard to B-BBEE and what their B-BBEE capabilities are. The dynamics of B-BBEE in the economy are such that all businesses will eventually be involved because an entity's level is determined by their suppliers' status, while their own status is determined by their own suppliers and so forth. This is often referred to as the cascading effect in the supply chain.⁹⁹ The influence of a supplier's B-BBEE status on a measured entity's B-BBEE compliance is measured under the sub-element of preferential procurement and has become the main driver of the B-BBEE process. The pressure put on suppliers by their clients to become B-BBEE compliant and continuously improve their B-BBEE compliancy, as well as the preference given to black-owned entities, will to a large extent determine a business's need and imperative to participate in the B-BBEE programme.¹⁰⁰

The role of government procurement in this regard is important as government procures significant amounts from the private sector annually.¹⁰¹ Section 217 of the Constitution, 1996 provides that government may practice procurement contrary to standard financial principles and procure on a preferential basis where the objective of such procurement practice is to advance people who were

⁹⁶ As above.

⁹⁷ Para 3.2 of Statement 000 of the B-BBEE Codes; and Balshaw and Goldberg (2014) 85.

⁹⁸ Paras 4.3 and 5.3 of Statement 000 of the B-BBEE Codes; and Balshaw and Goldberg (2014) 86.

⁹⁹ Balshaw and Goldberg (2014) 24; and Jeffery (2014) 144 and 165.

¹⁰⁰ Balshaw and Goldberg (2014) 14; and Jack (2013) 26, 298 and 299. According to Jack those procuring directly from government are first-tier suppliers and they must buy from second-tier suppliers that have a high B-BBEE recognition level. This "trickledown effect the business imperative [is] driven to virtually every business operation in SA".

¹⁰¹ Jeffery (2014) 130 and 214 suggests that State-Owned Enterprises (SOEs) accumulatively spend R215 billion to R250 billion a year on buying goods and services from the private sector.

disadvantaged by unfair discrimination.¹⁰² The existing government procurement regulations, which came into effect on 1 April 2017, provide for a percentage of government procurement from black-owned entities and require all prospective suppliers to provide proof of their B-BBEE compliance. These are measures that will ultimately force entities to embark on strategies to increase their B-BBEE compliance and black ownership.¹⁰³

B-BBEE legislation does not force anyone to become B-BBEE compliant and is described as a voluntary system.¹⁰⁴ It can be compared to an individual's decision to obtain a degree once they have finished their formal school career. No one forces an individual to do so, but a tertiary qualification will increase the individual's opportunities for better employment and a better career and remuneration. Apart from the normal competitive elements confronting every business, namely price, quality and service, South Africa has an additional competitive criterion, namely B-BBEE compliance or B-BBEE status.¹⁰⁵

2.5 CONCLUSION

Despite numerous policy formulations and given the history of South Africa, the majority of black people still experience difficulty in finding proper employment in managerial positions or acquiring the necessary skills and expertise to start their own businesses. Millions of black people are excluded from the mainstream of economic activity due to a lack of education, training and the applicable skills to find a job or to progress in a career.¹⁰⁶

Government has considered various policies and legislation to give effect to the socio-economic and redress imperative in the Constitution, 1996 of which the B-BBEE Act of 2003 and enabling legislation such as the B-BBEE Codes and Sector Charters are the most significant. This B-BBEE system involves a voluntary programme for businesses to earn points and a B-BBEE recognition level. The higher the recognition level, the more competitive a business becomes in providing goods and services to government, which drives the process with government's significant procurement (monopolistic) muscle and regulatory leverage to grant licences, concessions and sell assets to the private sector.¹⁰⁷

¹⁰² Jack (2013) 17 and 26.

¹⁰³ Preferential Procurement Regulations, 2017 issued in terms of s 5 of the Preferential Procurement Policy Framework Act 5 of 2000 published in *Government Gazette* No. 40553 dated 20 January 2017 implemented on 1 April 2017.

¹⁰⁴ Ponte *et al DOI* (2007) 933; and Jack (2013) 78.

¹⁰⁵ Kleynhans and Kruger *Acta Commercii* (2014) 1; and Balshaw and Goldberg (2014) 56.

¹⁰⁶ Commission for Employment Equity Annual Report (2016–2017) 42-74; and Madi (2016) 41; and Jack (2013) 22.

¹⁰⁷ Balshaw and Goldberg (2014) 16 describe Government's Procurement Policy as a "process of correcting historical imbalances" by "... redirecting capital to black people through the manifestation of government's significant (monopolistic) procurement budget and regulations".

Businesses that deal with government or state-owned enterprises will, in turn, put pressure on their suppliers to become compliant. This cascading effect eventually involves all businesses. Although the system is deemed to be voluntary and no law requires a business to participate, some commentators have been critical about the indirect enforcement of the system and have branded B-BBEE as not purely “voluntary” as businesses will need to achieve good B-BBEE scores and levels of compliance to remain in business.¹⁰⁸

¹⁰⁸ Jeffery (2014) 130, 143 and 144; and Jack (2013) 298 and 299. Jack emphasises this indirect enforcement principle by stating that “BEE is made a business imperative by virtue of government’s preferential procurement” as well as “the trickledown effect” and downstream operations to other businesses in the supply chain.

CHAPTER 3
THE EVOLUTION AND APPLICATION OF FRONTING OUTSIDE THE CRIMINAL
STATUTORY FRAMEWORK

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3.1 INTRODUCTION

According to the Collins English Dictionary,¹⁰⁹ an entrepreneur is the “owner of a business that attempts to make money by risk and initiative” while, according to the Oxford South African Dictionary, an enterprise is a “project or undertaking” undertaken by “bold resourcefulness”.¹¹⁰ The B-BBEE Codes define an “entrepreneur” as a “person who starts and/or operates a business which includes identifying

¹⁰⁹ Collins (2011) 255.

¹¹⁰ Soanes (2009) 294.

opportunities in the market, taking risks with a view of being rewarded with profits”.¹¹¹

Various commentators have over the years warned against the dangers associated with B-BBEE being a “get rich quick scheme” for certain black people. Those benefiting from B-BBEE are often referred to as “politically connected”, the “usual suspects” and “black elite”.¹¹² Instances often occur where white businesses are easily drawn into the practice of ticking all the B-BBEE boxes by entering into a B-BBEE transaction with a black person where the black person will be only too willing to participate to benefit financially. Some sectors of society refer to these fronting practices as the “renting of black faces” by companies anxious to secure lucrative government tenders.¹¹³

Narrow self-interest is in these circumstances served at the expense of true and real transformation.¹¹⁴ Given what is at stake for white businesses as well as the associated monetary benefits for black participants who are prepared to play along, white businesses often attempt to optimise their advantage from a B-BBEE point a view without wanting to sacrifice too much.¹¹⁵ Lwazi Koyana, a corporate financier, states:

“In such a scenario, the established business simply ticks the right box in terms of BEE compliance, while ensuring that the status quo remains unchallenged. This is little more than a very sophisticated level of tokenism. And many of our people fall into this trap, essentially because participating in such relationship may well be more lucrative than their original areas of expertise and profession”.¹¹⁶

Given the above factors, as well as the risk and resourcefulness nature of entrepreneurs, B-BBEE has all the inherent ingredients for concluding disguised transactions in an attempt to outsmart the system.

As with other policies brought about by law, such as tax obligations, it is a natural tendency for entrepreneurs to attempt to minimise the impact of such policies on the profits of a business and to maximise any possible benefits to be obtained.¹¹⁷ Optimising benefits with as little sacrifice as possible is seen as the ultimate business deal. Entrepreneurs will not deviate from this inclination and within a B-BBEE context, this could constitute fronting or a fronting practice. Although B-BBEE is a voluntary system

¹¹¹ Schedule 1 of the B-BBEE Codes.

¹¹² Madi (2016) xxxiii, 29 and 111 as stated by Lawrence Mavundla, President of NAFSOC, the legendary black business chamber of commerce; and Jeffery (2014) 9, 23, 31, 149, 156 and 158.

¹¹³ Jeffery (2014) 171; and Mokone *Business Report, The Times* (Nov 2010) 12; and Warikandwa and Osode *PER/PELJ* (March 2017) 16 refers to empowerment policies that can be manipulated to enrich the “politically connected”.

¹¹⁴ Madi (2016) 28 and 29.

¹¹⁵ Jack (2013) 471.

¹¹⁶ Madi (2016) 129.

¹¹⁷ Jack (2013) 470–471; and Madi (2016) 129.

and no law compels a business to become compliant, those participating in the system are expected to play fairly.

Since the inception of B-BBEE in 2004, fronting has been identified as an inherent and material risk to the successful implementation of B-BBEE.¹¹⁸ Earlier inferences to interpret or identify fronting used the “spirit of the B-BBEE Act or the B-BBEE Codes” as a benchmark. After 2014 this was replaced by the “objectives of the Act” and fronting is presently referred to as activities that undermine the objectives of the B-BBEE Act of 2003 instead of the spirit thereof. Early drafts of the B-BBEE Codes in 2005 did contain a statement on fronting.¹¹⁹ The B-BBEE Codes are very much central to the rules to standardise implementation of B-BBEE for the industry and peculiarly do not refer to fronting but rather to circumvention activities, setting requirements for certain transactions which are deemed to be anti-fronting provisions, although not specifically indicated as such.

Fronting has evolved since 2004 and several legislative documents contain direct or indirect anti-circumvention or anti-fronting provisions, all of which played a role in the culmination of fronting as a criminal offence in terms of section 13O of the B-BBEE Act of 2003 as amended and implemented in October 2014. This criminalisation of a previous “hard to prove” practice as per the Minister of Trade and Industry means that a business convicted of a fronting practice can face severe sanction.

These fronting provisions across the spectrum of several statements and government notices need to be examined in order to understand the origin and traditional application, as well as the political and social rationale for the present vague and wide formulation of a fronting practice as a criminal offence and the constitutional challenges to which the existing statutory formulation may be subject.

3.2 THE STATEMENTS AND GUIDELINES ON FRONTING PRACTICES

The early drafts of the B-BBEE Codes in 2005 contained a statement on fronting practices.¹²⁰ This statement is supported by guidelines published in 2009 under the heading “Guidelines on Complex Structures and Transactions and Fronting” and are referred to as the guidelines on fronting. The

¹¹⁸ Jack (2013) 470; and Madi (2016) 28-30.

¹¹⁹ Codes of Good Practice – Statement 001 – Fronting Practices and other misrepresentation of BEE Status published in *Government Gazette* No. 28351 dated 20 December 2005.

¹²⁰ Codes of Good Practice – Statement 001 – Fronting Practices and other misrepresentation of BEE Status published in *Government Gazette* No. 28351 dated 20 December 2005. Although published as a draft was followed by the industry in the absence of any other guide up to the publishing of the 2009 Guidelines; and Jack (2013) 470.

statement and guidelines were the first attempts to regulate fronting practices in South Africa. The statement (hereinafter referred to as the 2005 Statement) defined fronting to mean:¹²¹

“any practices or initiatives which are in contravention of or against the spirit of any law, provision, rule, procedure, process, system, policy, practice, directive, order or any other term or condition pertaining to black economic empowerment under the Codes”.

The guidelines (hereinafter referred to as the 2009 Guidelines) contain a simpler definition:

“Fronting means a deliberate circumvention or attempted circumvention of the B-BBEE Act and the Codes. Fronting commonly involves reliance on data or claims of compliance based on misrepresentations of facts, whether made by the party claiming compliance or by any other person. Verification agencies, and/or procurement officers and relevant decision-makers may come across fronting indicators through their interactions with measured entities.”¹²²

It is notable that the definition in the 2005 Statement is very broad compared to the definition in the 2009 Guidelines. The 2005 Statement in essence defines fronting practice as a contravention of any law, procedure or other provisions relating to B-BBEE. The 2009 Guidelines on the other hand are narrower as they require the intention to circumvent the B-BBEE Act of 2003 and the B-BBEE Codes by using the word “deliberate”. This narrower approach of requiring a deliberate action or attempt to circumvent the B-BBEE Act of 2003 and the B-BBEE Codes would for many years up to 2013, with the amendments to the B-BBEE Act, form the basis for the understanding and application of a fronting practice.

The 2005 Statement further makes provision for any reasonable interpretation which is consistent with the objectives of the B-BBEE Act of 2003 and indicates that “substance must always take precedence over legal form”.¹²³

The 2005 Statement provides for the identification of fronting activities by verification agents by means of “fronting risk indicators” that compel verification agents to determine, assess and report such fronting practices. Should a fronting practice be established, it should be reported to the Minister of Trade and Industry if the enterprise involved fails to rectify such a fronting practice within 14 days after the verification agent had advised the enterprise of such practice.¹²⁴

¹²¹ Codes of Good Practice – Statement 001 as above para 19.

¹²² 2009 Guidelines on Complex Structures and Transactions and Fronting (Previously Statement 0002) para 6.

¹²³ 2005-Statement above paras 3 and 5.1.

¹²⁴ 2005-Statement above para 9.

The 2005 Statement also provides for fronting to be classified as a category of “fronting statuses” according to the severity of such practices. This fronting status then determines the action to be taken by the verification agent. The four categories or fronting statuses provided for in the Statement are fraud, excessive fronting risks, high fronting risks and low fronting risks.¹²⁵

For the most severe form of circumvention and for fraud to be established, evidence must exist of a fraudulent misrepresentation of an enterprise’s B-BBEE status. The 2005 Statement provides for an enterprise’s scorecard under such circumstances to be disregarded in total and the practice to be reported to the Minister of Trade and Industry by the verification agent if the practice is not resolved within 14 days by the enterprise concerned.¹²⁶ The 2005 Statement determines that if an enterprise is found guilty of fraud or misrepresentation by a court of law, the enterprise and its directors may be “black-listed”.¹²⁷

For the other fronting status categories the 2005 Statement provides for a formula to determine a “fronting score indicator” based on the number of fronting indicators detected according to the risk indicators classified as a high fronting risk indicator or a moderate fronting risk indicator. In this regard the 2005 Statement further provides a list of six high fronting risk indicators and six moderate fronting risk indicators. According to the 2005 Statement, the detection of any of these fronting risk indicators is considered to be an indication of the presence of a fronting practice.¹²⁸

This fronting score indicator then determines the fronting status according to the four categories referred to above and the action the verification agent is required to take in this regard.¹²⁹

For those fronting status categories that do not constitute fraud but do fall into the categories of excessive fronting risks or a high fronting risk, the 2005 Statement requires a reduction in B-BBEE levels on the B-BBEE scorecard based on a sliding scale, an endorsement to be effected on the enterprise’s B-BBEE scorecard and reporting thereof to the Minister of Trade and Industry. For an enterprise on the lowest scale of the fronting status category of a low fronting risk with a fronting score indicator equal to or below 5, no actions, reporting or other sanctions are required by the Statement.¹³⁰

¹²⁵ 2005-Statement above para 10.

¹²⁶ 2005-Statement above para 10.4.

¹²⁷ 2005-Statement above para 10.5.

¹²⁸ 2005-Statement above paras 1.8 and 7.

¹²⁹ 2005-Statement above para 10.3.

¹³⁰ 2005-Statement above para 10.4.

The 2005 Statement also introduced and illustrated three fronting activities or practices that would become well-known terms in the industry, namely “window dressing” or “tokenism”, “benefit diversion” and “opportunistic intermediaries”.¹³¹ The fronting risk indicators and three fronting activities are also contained in the 2009 Guidelines.

“Window dressing” is illustrated in the 2005 Statement and 2009 Guidelines (collectively referred to as the “Guidelines”) as an action of tokenism where black people are appointed or introduced in positions in an enterprise but restricted, prevented or inhibited from substantially participating in the core activities or areas they are supposed or expected to participate given the nature of the positions of the black person in that enterprise. “Benefit diversion”, according to the Guidelines, refers to initiatives implemented where the economic benefits received as a result of the B-BBEE status of an enterprise do not flow to black people in the same ratio as provided for in the relevant legal documentation. The term “opportunistic intermediaries” is illustrated by the Guidelines as the agreement between an enterprise and another entity with a favourable B-BBEE status where the enterprise obtains a favourable B-BBEE status leveraging the B-BBEE position of the B-BBEE entity in circumstances where the agreement between the two entities was not concluded at arm’s length and where the provisions of the agreement place significant or material limitations on the B-BBEE entity with regard to its suppliers, clients or customers, and the operations of the B-BBEE entity are unlikely or unsustainable given the resources of that B-BBEE entity.¹³²

The 2005 Statement goes further and lists six fronting risk indicators that might be indicative of the presence of a fronting practice.¹³³ These fronting risk indicators are of significance as they have been used in developing certain anti-circumvention provisions in the B-BBEE Codes and some of these indicators have also been incorporated into the formulation of the definition of a “fronting practice” in the B-BBEE Act of 2003. These fronting risk indicators in the 2005 Statement were further extended and simplified to 11 fronting indicators in the 2009 Guidelines published to serve as an interpretive guide to enlighten the public at large. These fronting risk indicators which appear in the 2009 Guidelines are, despite the new formulation of a fronting practice in the B-BBEE Act of 2003, utilised by the authorities to inform and educate the public about fronting activities and to encourage the public to report intentional misrepresentation and fronting practices.¹³⁴

¹³¹ 2005-Statement above para 6; and Jack (2013) 472-474.

¹³² 2005-Statement above para 7; and 2009-Guidelines section B 6.

¹³³ 2005-Statement above para 7.

¹³⁴ The DTI website: https://www.dti.gov.za/economic_empowerment/fronting.jsp. The website states “*Intentional misrepresentation by measured entities may constitute fraudulent practices...*”. Accessed on 7 July 2017.

The fronting risk indicators in the Guidelines can be summarised as follows:

- black people serving as shareholders, executives or management are unaware or uncertain about their roles within an enterprise or the black persons serving in the different roles and responsibilities are paid significant less than other people serving in similar roles in the enterprise;
- black people at top management level are not actively involved in the strategic decision-making of an enterprise;
- an enterprise does not perform core functions, cannot operate independently and only performs peripheral functions;
- an enterprise buys goods or services or obtained a loan at a non-market-related rate from a related person or entity;
- an enterprise shares premises and infrastructure with a related person or other entities without a B-BBEE status where the cost of such premises and infrastructure is not market related;
- an enterprise in general displays evidence of circumvention or attempted circumvention.

3.3 THE B-BBEE CODES AND CIRCUMVENTION PRACTICE

Neither the present B-BBEE Codes nor its predecessor, the 2007 B-BBEE Codes, or any Sector Charters make any reference to the term “fronting” or “fronting practice”. The B-BBEE Codes and Sector Charters use the term “circumvention” or “misrepresentation”. Both terms are synonymous with a fronting practice as illustrated by the provisions of the Guidelines. The B-BBEE Codes under key principles state that any misrepresentation or attempt to misrepresent an entity’s true B-BBEE status will be dealt with in terms of the B-BBEE Act of 2003 and “may” lead to the disqualification of the entire scorecard of the entity involved.¹³⁵

The B-BBEE Codes also provide for initiatives to split, separate or divide an entity to obtain a benefit as an EME, QSE or start-up enterprise to be dealt with in terms of the B-BBEE Act of 2003.¹³⁶

Reference in the B-BBEE Codes under these circumstances to the B-BBEE Act of 2003 is a reference to section 13O of the B-BBEE Act of 2003 which criminalises any misrepresentation of an entity’s B-BBEE status or the provision of false information to a verification agent or organ of state relating to an entity’s B-BBEE status. This is the same section of the B-BBEE Act of 2003 that criminalises a fronting practice in terms of section 13O(1)(d).

¹³⁵ Para 2.4 Statement 000 of the BEE Codes.

¹³⁶ Para 2.5 of Statement 000 of the B-BBEE Codes.

The B-BBEE Codes also contain certain provisions that serve as anti-fronting provisions although not directly alluded to as such by the B-BBEE Codes.¹³⁷ For the use of certain ownership structures such as trusts, broad-based ownership schemes and employee share ownership programmes, the B-BBEE Codes provide for rules and additional criteria to be complied with as a condition for an entity to claim ownership points on the B-BBEE scorecard.

In respect of trusts, for instance, the B-BBEE Codes require, over and above a possible B-BBEE certificate, that an entity should be in possession of a certificate issued by a competent person confirming that the trust was created for a legitimate commercial reason which must be fully disclosed (presumably in the Trust Deed) and that the terms of the Trust Deed do not directly or indirectly seek to circumvent the provisions of the B-BBEE Codes or the B-BBEE Act of 2003.¹³⁸

In respect of broad-based ownership schemes and employee share ownership programmes, the B-BBEE Codes set rules for these structures to qualify for the maximum B-BBEE ownership points. The scheme or programme must provide proof of a track record to operate as a broad-based ownership scheme or an employee share ownership programme or, in the absence of such evidence, the programme or scheme must demonstrate operational capacity with sufficient qualified staff and professionals in sufficient numbers as well as operating premises to operate a business.¹³⁹

Unfortunately, these anti-circumvention rules or criteria are very vague and the purpose and meaning of these criteria are not explained in the B-BBEE Codes. For trusts the B-BBEE Codes require, for instance, that the trust must be set up “for a legitimate commercial reason”. A legitimate commercial reason is not defined in the B-BBEE Codes and it is uncertain what is meant given the application and nature of trusts in our law.¹⁴⁰ The purpose of the additional criteria for broad-based ownership schemes and employee share ownership programmes is not clear from the B-BBEE Codes. It seems the B-BBEE Codes want to

¹³⁷ Jordaan *et al* (2016) 54; and Jack (2013) 169 and 170.

¹³⁸ Para 6 Annexure 100 (D) of Statement 100 of the B-BBEE Codes.

¹³⁹ Paras 2 and 3 of Annexure (B) and (C) of Statement 100 of the B-BBEE Codes.

¹⁴⁰ S 1 of the Trust Property Control Act 51 of 1988 defines a trust as an instrument to bequeath property to be managed by trustees on behalf of beneficiaries; and *Land and Agricultural Bank of South Africa v Parker and others* 2005(2) SA 77 (SCA) para [22] wherein the Court illustrated the use of trusts as “designed essentially to protect the weak and to safeguard the interests of those who are absent or dead” emphasizing the preserving nature of trust(s); and *Welch v Commissioner for the South African Revenue Service* [2004] 2 All SA 58 (6) (SCA) paras [18], [21], [31], [46], [53], [71] and [89] the Court clarified a dispute on donation tax in terms of s 55 of the Income Tax Act 58 of 1962 relating to a *quid pro quo* between the Founder and a trust and it is uncertain if this *quid pro quo* principle is relevant to the “legitimate commercial reason” within the context of B-BBEE. Section 40 (5) of the Companies Act 71 of 2008 provides for the legitimate use of trusts in the event of issuing of shares on credit which further creates doubt in respect of “commercial reason” as a requirement in the B-BBEE Codes.

encourage the use of existing programmes or schemes with a proven track record of operations or sufficient resources to operate independently. Given the nature of employee ownership schemes in general, this is not logical as it is impractical for entities to use existing operating programmes for their own staff, nor will small programmes have sufficient resources of their own to operate independently. Due to the vagueness of the B-BBEE Codes, these criteria are easily circumvented.¹⁴¹

The B-BBEE Codes also contain a statement for so-called qualifying transactions. In terms of this practice, the B-BBEE Codes recognise the sale of operational assets or the sale of a business or an equity instrument in another business to B-BBEE parties as an alternative to earning B-BBEE ownership points as if equity was sold in the measured entity itself. This is a deemed ownership or alternative B-BBEE ownership mechanism.¹⁴² The rationale for such transactions is that they promote the objective of B-BBEE to increase the number of black people who own, manage and control enterprises and productive assets.¹⁴³ According to Jack, it might be more beneficial for black people to own operational assets in order to operate their own businesses than to own a small equity stake in an entity, thus the rationale that the sale of assets be recognised as a form of B-BBEE ownership or notional ownership.¹⁴⁴

For such a transaction to be recognised, the statement sets very specific and strict requirements to serve as anti-fronting provisions. These requirements can be summarised as follows:

- the transaction must create a business opportunity and result in the transfer of specialised skills or productive capacity for black people;
- the asset must be sold to a separate entity that has no unreasonable limitations on its clients and customers and has clients and suppliers other than the measured entity from whom the assets are acquired;
- in the event of creating any out-sourcing relationship between the selling and acquiring parties, the transaction must be concluded at arm's length and on a fair and reasonable basis.¹⁴⁵

¹⁴¹ Jack (2013) 164-168 and 170.

¹⁴² Code Series 100, Statement 102: Recognition of Sale of Assets, Equity Instruments and other Businesses published in *Government Gazette* No. 38766 dated 6 May 2015.

¹⁴³ S 1 of the B-BBEE Act of 2003. As per the definition of "broad-based black economic empowerment".

¹⁴⁴ Jack (2013) 205 and 206.

¹⁴⁵ Statement 102 above para 3.2.

3.4 FRONTING PROVISIONS OF THE VERIFICATION MANUAL

The Verification Manual is published in terms of section 9(1) and 14(2) of the B-BBEE Act of 2003¹⁴⁶ and prescribes guidelines to be used by verification agents in issuing verification certificates. It states that the use of this Verification Manual is prescribed and shall be used by B-BBEE verification professionals when performing B-BBEE verifications. The Verification Manual further emphasises the compulsory nature of the provisions of the Verification Manual by stating that any verification agent who issues a verification certificate without applying the provisions of the manual shall be guilty of unprofessional conduct, which may lead to the loss of its accreditation.¹⁴⁷

The Verification Manual attempts to provide a methodology and determine a standard for verifying entities. In this verification process certain minimum requirements are set to, amongst others, detect fronting practices.

The Verification Manual points out that the most significant risk that verification agencies face in verifying the ownership score is the “overstatement of black beneficial ownership”.¹⁴⁸ This beneficial ownership refers to the three ownership indicators to be measured in terms of the B-BBEE ownership scorecard, namely economic interest, voting rights and net value.

As for the verification of the ownership element in general, verification agents are alerted to the potential fronting risks associated with complex structures and are instructed not to use the sampling of evidence technique in assessing the validity of these company structures but rather to obtain all documentary evidence to get a full understanding of the operations of such a structure.¹⁴⁹ For this purpose, the verification agent must obtain sufficient proof of transfer or issue of equity rights through appropriate legal and statutory documentation and determine the effect of any third party rights that may be attached to the equity instruments held by black participants.¹⁵⁰

¹⁴⁶ Verification Manual Published in *Government Gazette* No. 39378 dated 6 November 2015.

¹⁴⁷ Verification Manual above para 3.

¹⁴⁸ Verification Manual above Appendix 2 para 1.2.

¹⁴⁹ Verification Manual above Appendix 2 para 13.4.

¹⁵⁰ Verification Manual above Appendix 2 para 3.5 and 4.1.

With regard to the ownership indicator of economic interest, the Verification Manual highlights “specific fronting risks” in relation to the abuse of the definition of economic interest¹⁵¹ since it does not accommodate for payments outside distributions directly linked to ownership. The Verification Manual explains that benefits to be denied by black equity holders may be channelled to non-black equity partners in the form of management fees, drawings or profit share agreements.¹⁵² In order to detect any impact on the economic interest of black equity holders, the verification agent should inspect a variety of documents such as the Memorandum of Incorporation (MoI) of the measured entity; shareholder agreements where they exist; audited or reviewed financial statements; share certificates; and security registers and supporting and legal documents relating to any debt incurred in the acquisition of equity such as loan agreements or financing agreements.

Verification agents are also to conduct interviews with fiduciaries of schemes and programmes, such as trustees of trusts holding ownership rights on behalf of black beneficiaries, and inspect all documents to ensure that black beneficiaries are entitled to economic interests proportional to the class of shares held by them.¹⁵³

Different classes of shares are cited by the Verification Manual as a possible fronting risk.¹⁵⁴

With regard to the ownership indicator of voting rights, the Verification Manual highlights “specific fronting risks” in that the black participants are denied meaningful participation in the entity as equity holders and where such rights do exist, the verification agent must determine whether the black participants are fully aware of these rights and whether they can actually exercise these rights.¹⁵⁵

¹⁵¹ Verification Manual above Appendix 2 para 4.3.1.

¹⁵² Verification Manual above Appendix 2 para 4.3.1; and Jack (2013) 473 refers to this practice as “transfer pricing” or “benefit diversion” and includes the practice to sell products between related parties or irregular flow of funds between related parties to dilute benefits to black people.

¹⁵³ Verification Manual above Appendix 2 para 4.3.2. Schedule 1 of the B-BBEE Codes define economic interest to mean “a claim against an Entity representing a return on ownership of the Entity similar in nature to a dividend right, measured using the Flow-Through and, where applicable, the Modified Through Principles” and Entity means “a legal entity or a natural or a juristic person conducting a business, trade or profession in the Republic of South Africa”.

¹⁵⁴ Verification Manual above Appendix 2 paras 6.1 and 6.5.

¹⁵⁵ Verification Manual above Appendix 2 para 4.4.1; and Schedule 1 of the B-BBEE Codes define “Voting Rights as attaching to an Equity Instrument owned by or held for a participant measured using the Flow Through Principle or the Control Principle” and “Exercisable Voting Rights” means “a voting right of a Participant that is not subject to any limit” and “Participant” means “a natural person holding rights of ownership in a Measured Entity” and “Equity Instrument” means “the instrument by which a Participant hold rights of ownership in an Entity”.

For the third B-BBEE ownership indicator of net value,¹⁵⁶ the Verification Manual identifies a “potential fronting risk” in the overstatement of value of equity instruments and cites this as a “common” practice. Verification agents are alerted to the impairment of marketability of equity when assessing the value of equity instruments and warned that different classes of shares could also pose a fronting risk and should be factored into the valuation of equity held by black participants.¹⁵⁷ As for the acquisition debt incurred by black participants in acquiring equity factors that would significantly impact on the net value calculation, the Verification Manual identifies a “potential fronting risk” in the inflated costs of the debt that may result in the face value of the debt being understated. The verification agent should ensure that the value attributed to acquisition debt is fair. For this purpose, the verification agent should examine all necessary documentation and look out for notional debt arrangements,¹⁵⁸ so-called special purpose vehicles, preference shares and other debt equity instruments.¹⁵⁹

In verifying ownership held by juristic persons as provided for by the B-BEE Codes,¹⁶⁰ the Verification Manual identifies “fronting risks inherent to [BEE] [P]articipants” that beneficial ownership is overstated and says the verification agent should ensure that the initiative does ultimately benefit black people as defined in the B-BBEE Codes and does not directly or indirectly undermine or frustrate the achievement of the objectives of the B-BBEE Act of 2003 or the implementation of any of the provisions of the B-BBEE Act.¹⁶¹ This provision is almost similar to the definition of “fronting practice” provided for in section 1 of the B-BBEE Act of 2003 to be examined in more detail in the latter part of this dissertation.

With regard to B-BBEE ownership structures in the form of trusts, employee share ownership programmes and broad-based ownership schemes, the Verification Manual cites a significant fronting risk associated with the awarding of further points for compliance by these structures, with the additional

¹⁵⁶ Schedule 1 of the B-BBEE Codes defines “net value” to mean “the percentage resulting from the formula in Annexure 100(e) of Statement 100”. It is in essence the value of the equity in the hands of black participants less any Acquisition Debt in relation to the total equity value of the measured entity. “Acquisition debt” is defined to mean “the debts of: (a) Black participants incurred in financing their purchase of their equity instruments in the [M]easured [E]ntity; and (b) Juristic persons or trusts found in the chain of ownership between the eventual [B]lack [P]articipants and the [M]easured [E]ntity for the same purpose as those in (a)”.

¹⁵⁷ Verification Manual above Appendix 2 para 6.1.

¹⁵⁸ According to Jack (2013) 383 special purpose vehicles (SPVs) provide a structure that enables financing of potential black equity acquisition without exposing the original shareholder to the risk of such financing.

¹⁵⁹ Verification Manual above Appendix 2 para 5.

¹⁶⁰ Para 3.1.1 of Statement 100 of the B-BBEE Codes provide that “black people might hold their rights of Ownership in a Measured Entity as Direct Participants or a Participants through some form of Entity such as: a Company as defined in the Companies Act of 2008 (as amended); a Close corporation; a Co-operative; a Trust, a Broad-Based Ownership Scheme; an Employee Share Ownership Programme; a partnership or other association of natural persons and any form of juristic person recognised under South African law”.

¹⁶¹ Verification Manual above Appendix 2 para 7.2.

criteria as discussed above under the anti-circumvention provisions in the B-BBEE Codes.¹⁶² To combat this, the verification agent is required to subject the trustees and fiduciaries to a formal interview process to ensure that they understand their fiduciary duties to act in the best interest of the beneficiaries, that they observe the rules applicable to the relevant structure they represent as provided for by the B-BBEE Codes, and that they understand the meaning of a fronting practice in terms of B-BBEE legislation. The verification agent should also establish whether economic benefits are flowing to the beneficiaries and, if not, whether any reasonable and *bona fide* reasons exist for this not to occur.

As an anti-fronting measure, the Verification Manual determines further that where EMEs and QSEs are related enterprises¹⁶³ and where it is found that these enterprises were split into separate business units with the intent of falling under a lesser turnover threshold, these enterprises must be issued with a consolidated B-BBEE scorecard¹⁶⁴ as if they are a group structure. Should they elect to obtain an individual B-BBEE scorecard for each enterprise individually, they will be classified in terms of their combined annual turnover.¹⁶⁵

The methodology determined in the Verification Manual, the fronting risks cited for verification purposes, and the application of fronting measures by verification agents and professionals are of great significance in fully understanding the meaning and application of a fronting practice within the B-BBEE regulatory framework.

3.5 INTERPRETATION PROVISIONS

Section 3(1)(a) and (b) of the B-BBEE Act of 2003 requires that, in interpreting the provisions of the Act, effect must be given to “the objectives” and “purpose” of the Act and the Constitution, 1996 must be complied with. Section 3(2) of the B-BBEE Act of 2003 further provides for a so-called “trumping provision” giving the B-BBEE Act precedence in the event of any provision conflicting with “any other law” in force immediately prior to the date of commencement (24 October 2014) of the B-BBEE Amendment Act of 2013 specifically relating to a matter dealt with in the B-BBEE Act. Some commentators have been critical about the trumping provision and its vague and ambiguous wording and believe that the trumping

¹⁶² Verification Manual above Appendix 2 para 7.4.3.3.

¹⁶³ Schedule 1 of the B-BBEE Codes define a “related enterprise” as “an Entity controlled by a Measured Entity whether directly or indirectly by the natural persons who have direct or indirect control over that Measured Entity or the immediate family of those natural persons”.

¹⁶⁴ The Verification Manual above Appendix 2 para 8.3.1 provides for a consolidated scorecard for more than one entity where all the entities measured will have their elements combined.

¹⁶⁵ Verification Manual above Appendix 2 paras 8.4.9-8.4.11.

clause might lead to further uncertainty, especially the position of Sector Codes, in the future.¹⁶⁶

Section 9(1)(a) of the B-BBEE Act of 2003 provides for the issuing of codes of good practice by the Minister of Trade and Industry on B-BBEE to further the interpretation and definition of B-BBEE and the interpretation and definition of different categories of black empowerment entities. Such codes of good practice may stipulate targets consistent with the objectives of the B-BBEE Act of 2003.

Section 11 of the B-BBEE Act of 2003 provides for a strategy for B-BBEE which must be taken into account in preparing any code of good practice. Such a strategy must provide for an integrated coordinated and uniform approach to B-BBEE and be consistent with the B-BBEE Act of 2003 to advance the objectives of the B-BBEE Act.

Section 14(2) of the B-BBEE Act of 2003 grants the Minister of Trade and Industry the authority to issue guidelines and practice notes relating to the interpretation and application of the B-BBEE Act.

In terms of section 13F(3)(b) of the B-BBEE Act of 2003, the B-BBEE Commission is permitted to issue non-binding opinions on the interpretation of any provision of the B-BBEE Act to the public and may apply to a court of law for a declaratory order on the interpretation and application of the provisions of the B-BBEE Act.

The objectives of the B-BBEE Codes are said to provide for the interpretative principles of B-BBEE.¹⁶⁷ Statement 000 of the B-BBEE Codes stipulates that in interpreting the provisions of the B-BBEE Codes, any reasonable interpretation consistent with “the objectives” of the B-BBEE Act of 2003 and the B-BBEE Strategy must take precedence.¹⁶⁸ In interpreting the B-BBEE Codes, one of the fundamental principles listed is that “substance takes precedence over legal form”.¹⁶⁹ From the above it is clear that interpretation of any provision must be consistent with the objectives and purpose of the B-BBEE Act of 2003 as provided for in section 2. The B-BBEE Codes are primarily issued to interpret and further the objectives of the B-BBEE Act of 2003.

Sector Codes or Charters for a specific sector of the economy may also be published by the Minister of Trade and Industry in terms of section 12 of the B-BBEE Act of 2003.

¹⁶⁶ Jeffery (2014) 192 and 193.

¹⁶⁷ Para 1.1 of Statement 000 of the B-BBEE Codes.

¹⁶⁸ Para 2.2 of Statement 000 of the B-BBEE Codes.

¹⁶⁹ Para 2.1 of Statement 000 of the B-BBEE Codes.

3.6 CASE LAW RELATING TO FRONTING AND CIRCUMVENTION PRACTICES

According to the Minister of Trade and Industry, only one out of 150 to 200 cases reported annually to the Department of Trade and Industry since 2006 has been successfully prosecuted.¹⁷⁰ Two civil cases in the period 2010 to 2013 directly relating to B-BBEE fronting activities have played an important role in the final formulation of a fronting practice as a criminal offence in 2013. Two cases directly related to fronting practices, one in the High Court and the other in the Supreme Court of Appeal, in 2014 and 2017 respectively, did not contribute to the formulation of the statutory offence of fronting, but are of significance in respect of the application of the principles and requirements provided for in the statutory offence. Other Supreme Court of Appeal cases relating to simulated transactions in the tax and commercial environment in 2010 and 2014 are seen as landmark judgements relating to simulated transactions, circumvention and anti-avoidance activities in general. These judgements will be discussed in some detail to illustrate the tests applied by the courts in establishing fronting and circumvention practices, especially in relation to complex structures.

3.6.1 *Viking Pony African Pumps (Pty) Ltd t/a Tricom Africa v Hidro-Tech Systems (Pty) Ltd and Another in 2010*¹⁷¹

In this matter the Constitutional Court had to decide on the obligations of an organ of state in circumstances where it is presented with reasonable allegations or evidence that an enterprise to which a tender was awarded had fraudulently manipulated its B-BBEE status.

Viking Pony Africa Pumps (Pty) Limited as the applicant (referred to as Viking) and Hidro-Tech Systems (Pty) Limited as the respondent (referred to as Hidro-Tech) in this matter are competitors that supply and install mechanical and electrical equipment for water and sewerage treatment works. Both entities tendered for work from, amongst others, the City of Cape Town Metropolitan Municipality (referred to as the City). Hidro-Tech contended that Viking was awarded approximately 80% more tenders than Hidro-Tech and that on at least three occasions Hidro-Tech had tendered at a lower price than Viking but was not awarded the tender.

¹⁷⁰ Mokone *Business Report, The Times* (Nov 2010) 12; and Pressley *Cape Times* (Nov 2010) 12.

¹⁷¹ 2011 (1) SA 327 (CC); 2011 (2) BCLR 207 (CC).

As this created suspicion, Hidro-Tech investigated the reason for Viking's advantage and found that Viking won most of these tenders because of its higher historically disadvantaged individual (HDI) profile. Viking was black owned by virtue of historically disadvantaged individuals (HDIs) holding 70% of the shares, which resulted in Viking always scoring higher preference points and tenders being subsequently awarded to it.¹⁷²

Hidro-Tech then obtained information from two former employees (Mr James and Mr Zandberg) about fronting activities relating to the business of Viking. Mr Zandberg, a white male and a former 10% shareholder in a company called Bunker Hills (a white-owned associated company of Viking) and Mr James, an HDI who owned 35% of Viking's shares, parted ways with Viking and joined the ranks of Hidro-Tech. After starting their employment with Hidro-Tech, Mr James and Mr Zandberg disclosed detailed information regarding the extent of the HDIs' control over Viking and their involvement in management.¹⁷³

Mr Zandberg alleged that while he was employed by Viking his monthly remuneration package was R23 500 plus medical aid, a petrol card and a credit card, whilst Mr James earned only R9 500 per month, plus medical aid and received no credit or petrol card benefits. Mr James earned far less than his non-black counterpart. The said disclosures reinforced Hidro-Tech's suspicion that the HDI or black shareholding within Viking was a front and not genuine or legitimate.

Hidro-Tech alleged that the HDIs employed by Viking were neither remunerated nor allowed to participate in the management of Viking to the degree commensurate with their shareholding and position as directors. Hidro-Tech further believed that the benefits received by Viking from tenders awarded to it as a result of its HDI shareholding were being channelled and diverted to Bunker Hills, and that its white directors were handsomely rewarded compared to those employed by Viking.

Hidro-Tech therefore lodged a complaint with the City. The complaint was that Viking had over the years made fraudulent misrepresentations in its tender documents to the City about its profile of HDIs, for the purpose of securing a preference. A letter was forwarded to the City's Head of Tenders and Contracts: Supply Chain Management Directorate citing the said complaint with reference to the allegation that the remuneration, dividends and benefits received by Viking's HDIs were negligible compared to those of its white shareholders, specifically those of its associated company, Bunker Hills. It was further alleged that Mr James did not exercise control over the company and did not actively participate in its management

¹⁷² *Viking* paras [5] and [6].

¹⁷³ *Viking* para [8].

to the extent proportionate to his shareholding.¹⁷⁴

The City requested an external database management company, Quadrem t/a Tradeworld (Tradeworld), to investigate Hidro-Tech's allegations. Tradeworld conducted an exercise which confirmed that Viking's shareholding as reflected in its tender documents was correct. Hidro-Tech was not satisfied with the outcome of the investigation conducted by Tradeworld and indicated to the City that the investigation was inadequate due to Tradeworld's inability to investigate allegations of this nature, namely fronting. Hidro-Tech also demanded the suspension of the work which Viking was doing for the City and demanded that no further tenders be awarded to Viking.¹⁷⁵

After unsuccessful negotiations and consultation between Hidro-Tech and the City, and after the City being unable to comply with Hidro-Tech's demand, they approached the High Court for relief. The order sought by Hidro-Tech was that the City be directed to act against Viking in accordance with Regulation 15(1) of the PPPFA¹⁷⁶ and the City's Procurement Policy Initiative which provided that:

“an organ of state must, upon detecting that a preference in terms of the Act and these regulations have been obtained on a fraudulent basis, or any specified goals are not attained in the performance of the contract, act against the person awarded the contract”.

The alternative order sought was that in the event of the Court finding that there was a need for further investigation, the City be directed to conduct or cause to be conducted a sufficiently thorough investigation into the complaint, to be concluded within two months of the order being issued, in which event the order must be coupled with an order restraining the City from awarding contracts to Viking pending the finalisation of the investigation.

The High Court found that: the investigation conducted by Tradeworld was inadequate in that it did not address the real issues, being the inner workings of Viking and the actual status of its HDI directors; Hidro-Tech was justified in forming the opinion that the City's response to its complaint was inadequate to safeguard its constitutional rights and legitimate commercial interest; the City was obliged to act against Viking; the content of the letter written on behalf of Hidro-Tech was true and that it was in the public as well as Hidro-Tech's interest; the City's persistent opposition to the relief sought, based on the totality of the evidence before the Court, justified a mandatory order against it; on the probabilities neither Mr James nor another HDI shareholder was actually involved in the management of, or exercised control over Viking

¹⁷⁴ *Viking* para [11].

¹⁷⁵ *Viking* para [12].

¹⁷⁶ The Preferential Procurement Policy Framework Act, Act 5 of 2000.

to the extent commensurate with their respective shareholding at the time of the submission of the tenders by Viking; and Viking was guilty of a fraudulent misrepresentation.¹⁷⁷

Viking appealed to the Supreme Court of Appeal (SCA). The SCA found that the High Court had not erred in granting the relief, and the appeal was dismissed with costs. Viking then approached the Constitutional Court for leave to appeal against the SCA's decision. The Constitutional Court granted Viking leave to appeal.

The main issue considered by the Constitutional Court was the obligations of an organ of state in circumstances where an enterprise which had been awarded a tender is plausibly accused of having been successful only because of the fraudulent representations it made.

In considering the aforesaid issue the Court also analysed the meaning of "detect" and "act against" in Regulation 15.¹⁷⁸ "Detect" was interpreted broadly and the Court held that it means no more than discovering, getting to know, coming to the realisation, being informed, having reason to believe, or entertaining a reasonable suspicion that allegations of a fraudulent misrepresentation by the successful tenderer so as to profit from preference points, are plausible.

The Court indicated that it is not the existence of conclusive evidence of a fraudulent misrepresentation that should trigger responsive action from an organ of state. Having regard to the phrase "act against", the Court held that this is broad enough to include the organ of state launching an appropriate investigation into the alleged fraudulent conduct, effectively creating an obligation on the part of the organ of state that receives complaints about alleged fronting to investigate the conduct and to act accordingly.

The Constitutional Court therefore dismissed the appeal and reinstated the order of the SCA with an order directing the City of Cape Town to investigate the allegations made by Hidro-Tech against Viking and Bunker Hills Pumps (Pty) Ltd, including whether or not the HDIs who held the majority of the shares in Viking were, at the time referred to in the complaint, actively involved in the management of the company and exercised control over the company, commensurate with the degree of their ownership.¹⁷⁹

¹⁷⁷ *Viking* paras [16] and [17].

¹⁷⁸ *Viking* para [30].

¹⁷⁹ *Viking* para [59].

The *Viking* case allowed the Constitutional Court the opportunity to assess the constitutional mandate on the executive arm of government by means of the B-BBEE policies as a direct response to “one of the most vicious and disregarding effects of racial discrimination in South Africa” being the “exclusion of black people from the economy”.¹⁸⁰ The Constitutional Court had correctly reaffirmed the constitutional duty of all spheres of government to properly investigate any allegations of fraud and fronting and to act decisively in all instances of transgression in this regard.

The enactment of the B-BBEE Amendment Act in 2013, which led to the incorporation of fronting as a statutory offence and the creation of a statutory body in the form of the B-BBEE Commission, can directly be attributed to the Constitutional Court’s reaffirmation of government’s constitutional obligation and duty in the *Viking* judgement to investigate all allegations of fronting.¹⁸¹

3.6.2 *Peel and Others v Hamon J & C Engineering (Pty) Ltd and Others in 2012*¹⁸²

In this matter the High Court was required to decide on granting relief to the applicant as shareholders and directors in the first respondent in terms of section 163 of the Companies Act 71 of 2008. Section 163 of the Companies Act provides for a shareholder or a director of a company to apply to a court for relief if any act or omission by the company, or the way in which the company’s business was conducted, had a result that is oppressive or unfairly prejudicial to the applicant or that an act or omission unfairly disregarded the interest of the applicant. The first applicant, J Peel (Jnr), was a director and shareholder of the first respondent, Hamon J & C Engineering (Pty) Ltd. The second applicant, J Peel (Snr), is the father of the first applicant, a retired entrepreneur and former shareholder of the first respondent. The third and fourth applicants are also directors and shareholders of the first respondent.

The first respondent, Hamon J & C Engineering, is a joint venture entity between the applicants (and a former legal entity owned by the applicant, J & C Engineering CC) and the second and third respondents. The third respondent, Hamon & Cie, was the holding entity with the first respondent, Hamon J & C Engineering a subsidiary of the second respondent, and Hamon SA was a subsidiary entity of Hamon & Cie as envisaged in section 3 of the Companies Act. In terms of section 2 of the Companies Act all parties are deemed related to one another.

¹⁸⁰ *Viking* para [1].

¹⁸¹ Warikandwa and Osode *PER/PELJ* (March 2017) 16 and 17.

¹⁸² 2013 (1) ALL 603 GSJ; 2013 (2) SA 331 (GSJ).

The fourth, fifth and sixth respondents (Delvaux, Chauke and van der Boon) were all directors of the first respondent.

During 2009 Hamon SA and Hamon & Cie entered into negotiations with an entity, J & C Engineering CC owned by the applicants with the objective of forming an incorporated joint venture entity, Hamon J & C Engineering (Pty) Ltd.

The joint venture called Hamon J & C Engineering (Pty) Ltd was brought about by concluding a Sale and Transfer Agreement on 1 October 2010 whereby J & C Engineering CC as a Close Corporation was converted into a private company and shares were to be issued by Hamon J & C Engineering (new joint venture company) to the previous members of J & C Engineering CC in exchange for transferring the business interest of J & C Engineering CC to the newly formed Hamon J & C Engineering as the joint venture company.

The relationship between the parties deteriorated over time to a point where the parties were looking to part ways. The issue before the Court was on what basis secession should be effected and which parties should effect payment of certain wasteful expenditure and in what proportion. The main reason why the applicants wished to end the relationship was based on the fraudulent and illegitimate B-BBEE deal concluded by the respondents before the conclusion of the Sale of Transfer Agreement which was only discovered by the applicants at a later stage.¹⁸³ The applicants contended that the fraudulent and fronting conduct of the respondents in relation to the B-BBEE transaction was of such a serious nature that it jeopardised the continuation of any business with the second and third respondents.

The B-BBEE fraudulent transaction, which was the subject matter of the application before the Court, related to a sale of shares in Hamon SA on 29 July 2010 concluded between Hamon & Cie and two black female employees of Hamon SA. In terms of a Sale of Shares Agreement, Hamon & Cie would sell 26% shares in Hamon SA to two black females, Bongwiwe November and Daphne Mangwana, with each holding a 13% share portion in Hamon SA.¹⁸⁴

The total of 26% shareholding was of significance as that was the total percentage ownership required in terms of the B-BBEE scorecard to earn maximum points for B-BBEE ownership.

¹⁸³ *Peel* paras [15] and [16].

¹⁸⁴ *Peel* para [17].

The applicants submitted that the sale of shares was a “sham” and not a genuine transaction and relied on the various grounds to advance their point in this regard. Firstly that the ordinary shares, were transferred to the black shareholders at a total purchase consideration of R1 and the transaction was not concluded on an arm’s length basis. Secondly, in terms of the Sale of Share Agreement, Hamon & Cie reserved the right to repurchase the shares at any time, simply on request, which they also did six months after conclusion of the agreement. Thirdly, that the price of the shares purchased by Hamon & Cie would be calculated proportionate to the net asset value of Hamon SA and the number of shares held by each black shareholder. Given the fact that Hamon SA had a negative net asset value at the date of concluding the sale of share transaction with the black shareholders, it would result in Hamon & Cie reclaiming the shares without transferring any value to the black shareholders. Fourthly, one of the black shareholders, Mangwana, confirmed that her position in Hamon SA subsequent to the transaction did not change. She claimed she was not treated as a shareholder or someone who should participate in the strategic decision-making of the business. She was allegedly paid a shareholder’s allowance, which is an unusual payment.¹⁸⁵

The matter was later reported to the Department of Trade and Industry by one of the aggrieved black female shareholders, Mangwana, who made a declaration under oath stating that the sale of shares was clearly a case of fronting in order to improve Hamon SA’s B-BBEE status and was not a genuine B-BBEE transaction. The department lodged an investigation into these allegations.¹⁸⁶

The applicants further contended that in the South African business environment, any fraud relating to B-BBEE is seen as very serious as it constituted “abusing the most vulnerable members of our community”. The applicants submitted that any tainting of an entity’s B-BBEE credentials could potentially destroy any business prospects of such an entity and that the applicants had been or are exposed to serious risks due to the fronting activities of the respondents.¹⁸⁷

On this basis the applicants sought relief in terms of section 163 of the Companies Act to sever ties so that Hamon J & C was no longer a subsidiary of or related to Hamon SA, and Hamon & Cie and the applicant seeking an order directing the exchange of shares and in effect seeking an order to cancel the joint venture agreement between the parties and that Hamon SA pay compensation to the second applicant and/or Hamon J & C.

¹⁸⁵ *Peel* paras [19.1] – [19.13].

¹⁸⁶ *Peel* para [20].

¹⁸⁷ *Peel* paras [21] and [22].

In relation to the B-BBEE transaction, the respondents submitted that they genuinely believed at the time of entering into the agreement with the black shareholders, that the transaction met the B-BBEE requirements. It was only after receiving legal advice that the respondents realised that the transaction did not comply. This was one of the reasons cited by the respondents why Hamon SA had exercised its repurchase right to undo the transaction.

The respondents further submitted that neither the black shareholders nor the directors or other shareholders in Hamon SA were disadvantaged and therefore the conduct of Hamon SA or Hamon & Cie cannot be seen as jeopardising the business interest of the applicants as provided for in section 163 of the Companies Act. The respondents argued that the transaction with the black shareholders occurred before the incorporation of the joint venture; that the B-BBEE transaction was therefore irrelevant to the applicants and their business interests; and that the B-BBEE issue raised by the applicant and the effect of the share transaction on the applicants were entirely speculative.

The Court found that the Department of Trade and Industry's involvement in investigating the matter would deem the B-BBEE issue more than speculative. The fact that the transaction with the black shareholders was not properly constituted and did not constitute proper B-BBEE empowerment was not disputed by the respondents. With regard to the matter raised by the respondents, namely that the share transaction with the black shareholders was concluded before entering into the joint venture agreement and was therefore irrelevant to the position of the applicants, the Court found that it was very clear that the applicants, as directors and shareholders...

“...are plainly prejudiced. Their interests are being unfairly disregarded by the Hamon respondents. The fact that the BEE issue is not being resolved makes the conduct oppressive towards the applicants.”¹⁸⁸

The Court has subsequently granted the relief sought by the applicants in terms of section 163 of the Companies Act. Some of the relief sought by the applicants had been referred to trial by the Court.

At the time of the *Peel* judgement, the B-BBEE Amendment Act of 2013 was published for public comment in the form of the B-BBEE Amendment Bill of 2011 (the Bill). The Court considered the nature of the share transaction in respect of the definition of B-BBEE as defined in section 1 of the B-BBEE Act of 2003 and the aim of the Bill contained in the preamble to the Bill to enforce B-BBEE compliance and

¹⁸⁸ *Peel* para [59].

provide for offences and penalties.¹⁸⁹ The Court was correct in its assertion that an inappropriate or fronting B-BBEE exercise could prejudice shareholders of a related enterprise, irrespective of when such a transaction took place, and the tainting associated with allegations of fronting would tarnish the reputation of a business.

The further importance of the *Peel* judgement stems from the fact that the Court was prepared to grant relief to shareholders in a related enterprise based on the general perception of dishonesty associated with fronting and the subsequent impact on business reputation involving any allegation of fronting irrespective of whether fronting had been proven or not. However, of concern is the fact that the Court was prepared to attach considerable weight to the mere fact that the Department of Trade and Industry had investigated the fronting allegations and the Court concluded on this basis alone that the allegations were “more than speculation.”¹⁹⁰ This conclusion by the Court seems to assume incorrectly sufficient or at least *prima facie* evidence in all cases under investigation by the Department of Trade and Industry.¹⁹¹

3.6.3 CSARS V NWK in 2010¹⁹²

Although this case does not deal directly with B-BBEE fronting, it is a landmark judgement relating to simulated transactions and transactions aimed at circumvention or subversion of the law.

In this matter, the SCA was approached by the appellant, the Commissioner of South African Revenue Service (SARS), for leave to appeal against an order issued by the Tax Court not to allow assessments and additional tax imposed on the respondent by the Commissioner in terms of the then section 76 of the Income Tax Act 58 of 1962 which gives the Commissioner certain powers in the event of tax avoidance.

The background to the transaction is briefly that the respondent, Noordwes Koöorporasie (NWK), was engaging in the business activities of trading maize. NWK had operated as a co-operative society and, in due course was converted into and at the time of the court hearing was operating as a public company.

¹⁸⁹ *Peel* para [54].

¹⁹⁰ *Peel* para [62.1].

¹⁹¹ S13F(2) of the B-BBEE Act 2003 inserted as an amendment by the B-BBEE Amendment Act of 2013 requiring substantiated evidence for the B-BBEE Commission to justify an official investigation. This is not a requirement in respect of the Department of Trade and Industry.

¹⁹² (27/10) [2010] ZASCA 168.

During 1998, NWK was approached by two representatives from First National Bank (FNB) with a proposal for a structured loan facility. The transaction was approved by the NWK board and entered into during April 1998. The transaction can be summarised as follows: the amount of R96 415 776 would be lent to NWK over a five-year period by an FNB subsidiary, namely Slab, which dealt in financial instruments; the capital amount of the loan would be settled by NWK at the end of the five-year loan period by delivering 109 315 tons of maize; interest would be levied on the capital sum at a rate of 15,41% per annum; interest would be payable on a six-monthly basis; for this purpose, NWK would issue ten promissory notes with a total value of R74 686 861; the promissory notes would then be sold by Slab to FNB for an amount less than their face value in order to discount the notes and to fund the loan; on the due date of the notes, NWK would pay FNB; Slab would sell its right to take delivery of the maize at the end of the five-year period to another division of FNB, namely First Derivatives; this “forward sale” for the sum of R45 815 776 would enable FNB (through Slab) to pay the full loan amount to NWK; First Derivatives would sell its right to take delivery of the same quantity of maize for the sum of R46 415 776 to NWK; the sum of R46 415 776 for the right of delivery sold, would be payable immediately on conclusion of the contract between First Derivatives and NWK although NWK would only deliver the maize after five years. This contract in essence neutralised the risks associated with delivery of the maize in future.

For NWK the transaction would enable it to deduct the interest paid on the capital sum as an operational expense in terms of section 11 of the Income Tax Act in the year it was payable, and on that basis the NWK board approved the transaction.

The effect of the service delivery transactions was that each cession transferred the right in an inter-party method and cancelled the other. The series of transactions resulted in Slab ceasing to be a party to any agreements and the Court noted that Slab’s participation was “ephemeral” (short-lived).¹⁹³ Between 1999 and 2003, NWK had in each year of the assessment for income tax claimed the full value of the promissory notes to the sum of R74 686 861, as interest allowed as a tax deduction in terms of section 11(a) of the Income Tax Act. This interest was paid to FNB by means of the right FNB acquired by buying the promissory notes from Slab, which had been issued to the latter by NWK.

During June 2003 the Commissioner issued NWK with additional assessments in terms of section 79 of the Income Tax Act, disallowing the interest as a deduction in terms of section 11 of the Income Tax Act.

¹⁹³ NWK para [20].

The Commissioner also imposed a 200% penalty and interest in terms of sections 79 and 89 of the Income Tax Act, respectively. The objections raised by NWK in respect of the additional assessments were rejected by the Commissioner, which prompted NWK to appeal against the Commissioner's decision to the Tax Court. The Commissioner based his decision to conduct an additional assessment and impose penalties and interest on NWK on the basis that: the series of agreements concluded between NWK, FNB and Slab did not reflect the real transaction, and Slab as a subsidiary of FNB was added as a party solely for the purpose of reducing or evading NWK's liability for income tax; the loan of R96 415 776 from Slab to NWK was in reality a loan for only R50 million; the transaction was "specifically designed to conceal the fact that in reality, the actual loan amount advanced" to NWK was R50 million;¹⁹⁴ the additional amount was simulated with a series of transactions creating the impression that the parties were trading in maize.

The Tax Court found that NWK had in fact acted and performed in terms of the agreements, and that NWK, represented by Mr Barnard, had genuinely intended to act according to the terms and conditions of the loan agreement. The Commissioner appealed the decision of the Tax Court to the SCA which laid down very important principles in determining the real intention of a contract and whether a transaction is simulated. The Court found that there is nothing wrong with a taxpayer arranging their tax affairs to be tax-effective, but there is something wrong with "dressing-up" or "disguising" a transaction to make it appear to be something it is not, especially in circumstances where such transaction has the purpose of tax evasion or the "avoidance of a peremptory rule of law"¹⁹⁵ (a law one is compelled to obey). The Court will not be deceived by the form of a transaction but will "rend aside the veil in which the transaction is wrapped and examine its true nature and substance",¹⁹⁶ and that the enquiry will in each case be one of fact for which no general rule can be laid down.¹⁹⁷ Even in the absence of dishonesty, the determining factor will be whether the transaction was concluded to "achieve another purpose" than for which it is presented or pretending to be concluded.

The Court emphasised the difference between motive and intention, on the one hand, and the intended effect of the transaction, on the other hand, to determine the genuineness of a transaction. If the purpose of the parties is unlawful, immoral or against public policy, the transaction will have no force or effect even if the intention to cede a right is genuine. The opposite is also true: if the intention to cede is not genuine because the real purpose of the parties is something other than a cession, the transaction will

¹⁹⁴ NWK para [30].

¹⁹⁵ NWK para [42].

¹⁹⁶ NWK para [42].

¹⁹⁷ NWK para [44].

also be without force or effect. The reason for this is that the law disregards simulation. However, if the purpose is legitimate and the intention is genuine, such intention will be given effect to. The test to determine a simulation goes further than the intention of the parties to give effect to a contract according to the terms of that contract. It should require an examination of the “commercial sense” of the transaction, meaning its real “substance” and “purpose”. If the only purpose of the transaction is to achieve an object of tax evasion or a law it is expected to obey, it will be regarded as a simulated transaction.

The Court further found that the fact that parties act according to the provisions of a contract is not proof that the transaction is not simulated. The actual performance or “charade” in doing so is often an attempt to give credence to simulation and should therefore not be the determining factor.

In respect of the *NWK* loan transaction, the Court found that the only explanation for *NWK* entering into a loan agreement for R96 415 776 while it only needed R50 million was to achieve a tax advantage. The contract for the inflated loan amount was “dressed-up” to create an obligation to pay interest and consequently to claim a tax deduction to which *NWK* was not entitled. According to the Court, *NWK* deliberately “disguised the true nature” of the loan for this purpose and did not intend, genuinely, to borrow the sum purported in the loan agreement.¹⁹⁸ The Court finally concluded that the loan as purported in the loan agreement was a transaction designed to disguise the real agreement, being a loan of R50 million, and that the Commissioner’s assessments were correct and that the appeal by the Commissioner in respect of the Tax Court must succeed. The Court found that the penalties and interest imposed by the Commissioner were harsh and out of proportion and ordered an alternative percentage to be imposed.

The judgement in the *NWK* has laid down important principles to be considered in the event of simulated transactions, but also circumvention activities in general, such as B-BBEE fronting practices which are in essence simulated by nature. These principles emanating from the *NWK* case can be summarised as follows: Even in the absence of dishonesty when considering the provisions of an agreement, outward performance by the parties in terms of the agreement and their intention and motive are not the only determining elements, as the intended effect or outcome of the transaction must also be considered. To determine this will require an inquiry into each individual case based on the facts of each matter to be considered for which no single rule can be applied. To determine the intended outcome, the inquiry will have to determine whether the transaction makes any commercial or business sense by looking at the substance of the transaction. If the sole purpose is to circumvent the application of law, the transaction

¹⁹⁸ *NWK* para [87].

would be simulated or disguised to avoid or circumvent.

The judgement in the *NWK* case was initially perceived to have upset the established principles regarding simulated transactions.¹⁹⁹ This is in essence a dishonest transaction as the parties deliberately disguised a transaction in order to conceal the true nature thereof to the outside world. The principle established was that a real intention, definitely ascertainable, differs from a simulated intention. However, a transaction is not necessarily disguised merely because it is devised for the purpose of evading a prohibition in a statute or avoiding liability for tax imposed by a statute. If the parties have an honest intention that the transaction should have effect according to its provisions, it will be interpreted by the court according to its provisions. The only question then for the courts to consider is whether the provisions fall within or outside the prohibition of a statute or tax application.

The *NWK* case arouses concern as it appeared to cast doubt on a long-established principle that parties may genuinely and legitimately arrange their transactions in such a way as to avoid or minimise the impact or imposition of any tax provisions or to remain outside the provision of a statute. The judgement in the *NWK* case implied that even an honest transaction might be regarded as simulated and in *fraudem legis* in the event of a lack of a sound commercial purpose.

3.6.4 *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC and Others in 2014*²⁰⁰

In a unanimous judgement drafted by Wallis JA, the Supreme Court of Appeal clarified the issues of concern caused by the *NWK* judgement and in particular the fact that a lack of commercial purpose may establish a simulated transaction despite the genuine intent of the parties to give effect to the provisions of a transaction.

Roshcon was not a tax case but related to a supplier and floor plan agreement between a truck dealer, a financial institution and a purchaser. The question considered by the Court related to the reservation of ownership by the financial institution based on a pledge as security as per the floor plan agreement until the trucks sold were fully paid for by the purchaser. Based on the judgement in *NWK* case, the appellant in this matter contended that the floor plan providing for the pledge should be regarded as a simulated

¹⁹⁹ In *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* [1992] 1 All SA 398 (A); 1992 (1) SA 867 (A) 402 and 405, the Court held that the test for a simulated transaction is "...really a question of intention..." and "motive and purpose differ from intention" and if "the purpose is legitimate and the intention is genuine, such intention, all other things being equal, will be implemented".

²⁰⁰ [2014] 2 All SA 654 (SCA); [2014] (4) SA 319 (SCA).

transaction as the true nature of the transaction, being a disguised loan agreement. The security provided for the trucks was concealed and disguised as being a pledge, which cannot be established under law without delivery or possession of the trucks pledged.²⁰¹ The Court rejected this argument based on the *NWK* case by the appellant and reaffirmed the well-established principles relating to simulations, and placed the judgement in the *NWK* case in perspective:²⁰²

“Whether a particular transaction is a simulated transaction is therefore a question of its genuineness. If it is genuine the court will give effect of it and, if not, the court will give effect to the underlying transaction that it conceals. And whether it is genuine will depend on a consideration of all the facts and circumstances surrounding the transaction.”²⁰³

Those circumstances include the commercial purpose of the transaction, any unusual features of the transaction, and the manner in which the parties intend to implement it. The presence of unusual features which serve no commercial purpose give rise to a suspicion that the transaction was not a genuine one.²⁰⁴

In income tax cases such as that of *NWK*, explained Wallis JA, parties may seek to take advantage of income tax legislation in order to obtain a reduction in their overall liability for income tax. The various mechanisms for doing this involve taking straightforward commercial transactions and adding complex additional elements solely for the purpose of claiming increased or additional deductions from taxable income or allowances provided for in the legislation. “The feature of those that have been treated as simulated transactions by the courts is that the additional elements add nothing of value to the underlying transaction and are very often self-cancelling”. This was so in the *NWK* case where a range of unrealistic and self-catering features had been included “solely to disguise” the true nature of the loan. The requirement of disguise was therefore met in the *NWK* case and therefore the simulation principle applied in these circumstances.²⁰⁵

The problem the Court faced in the *NWK* case was that despite the apparent futility in doing so, the parties intended to take all the steps provided for in the contractual document, “in other words, to jump through the contractual hoops as a matter of form”.²⁰⁶ It was in this context (i.e. the context of a disguised transaction) that Lewis JA had said that it was not sufficient, when testing for a simulation, to enquire whether there was an intention to give effect to a contract in accordance with its terms. The test had to

²⁰¹ *Roshcon* para [7].

²⁰² *Roshcon* paras [7] and [8].

²⁰³ *Roshcon* para [27].

²⁰⁴ *Roshcon* para [27].

²⁰⁵ *Roshcon* para [33].

²⁰⁶ *Roshcon* para [34].

go further, and required an examination of the commercial sense of the transaction, of its real substance and purpose.

The *Roshcon* judgement is welcomed in light of the uncertainty created by the *NWK* judgement in blurring the lines between motive, intention and intended effect of the transaction. The *Roshcon* judgement emphasised that all the facts must be considered and that a single rule cannot be applied. From the *Roshcon* judgement it is clear that the simulation principle still requires an element of dishonesty, disguise or deception. In the absence thereof, the principle cannot apply. In applying this principle to “genuine” transactions it is therefore not necessary for a court to go further and test whether such transactions have commercial substance and purpose as articulated in the *NWK* case. In *Roshcon* the Court found that there were sound commercial reasons for the parties to structure the agreement in the way they did as financial institutions would be required to establish security in circumstances where they cannot be in possession of the property pledged as security and therefore did not consider the transaction a simulated transaction.²⁰⁷

The Court was correctly and plausibly prepared in *Roshcon* to give effect to an agreement based on the intention of the parties and business rationale of the transaction despite the absence of the technical legal requirements to establish a true pledge in terms of the law.

3.6.5 *Esorfranki Pipelines v Mopani District Municipality* in 2014²⁰⁸

In a judgement delivered on 28 March 2014, the Supreme Court of Appeal had to adjudicate on the administrative lawfulness and legality in the awarding of an irregular and fraudulent tender involving conduct of B-BBEE fronting. This case was decided by applying normal circumvention principles relating to fraud and fronting and by not applying the “fronting practice” definition in the B-BBEE Act of 2003, as the B-BBEE Amendment Act of 2013, which incorporated the “fronting practice” formulation into the B-BBEE Act of 2003, only came into operation later that year.²⁰⁹

²⁰⁷ *Roshcon* para [9].

²⁰⁸ (40/13) [2014] ZASCA 21.

²⁰⁹ B-BBEE Amendment Act 46 of 2013 commenced on 24 October 2014.

In this case the Mopani District Municipality (Mopani Municipality) as the first respondent invited tenders for the construction of concrete reservoirs and a pipeline between the Nandoni Dam and the Nsami water treatment works in the Limpopo province. Due to the drought in 2009 and the insufficient water supply to inhabitants of the area, national government approved the project at a cost of R284 million, with the Mopani Municipality appointed as implementation agents to manage and oversee the project.

Esorfranki Pipelines (Pty) Ltd (Esorfranki) and Cycad Pipelines (Pty) Ltd (Cycad) as first and second appellants bid for the tender with co-bidders, Tlong Re Yeng Trading CC (Tlong Re Yeng) and Base Major Construction (Pty) (Base Construction) as the fourth and fifth respondents, respectively. The ninth respondent was the attorney acting for Mopani Municipality who was cited by Esorfranki for his involvement in giving legal advice to the Mopani Municipality, which led to several interim orders not being implemented and which in the view of Esorfranki should be held accountable in their personal capacity for acting in a way that unnecessarily delayed and frustrated the process. The second, third, sixth, seventh and eighth respondents had an interest in the matter by virtue of being either shareholders or related entities to Tlong Re Yeng or Base Construction.²¹⁰

The tender was awarded to a joint venture²¹¹ consisting of Tlong Re Yeng and Base Construction. Esorfranki and Cycad, as competitive bidders, dissatisfied with the decision by Mopani Municipality then approached the High Court to have the decision to award the tender set aside and to grant appropriate remedies in terms of the Promotion of Administrative Justice Act (PAJA)²¹² insisting that the tender in fact be awarded to them.

The High Court eventually, in giving judgement in the review application, decided that the awarding of the tender was unlawful as the joint venture did not comply with the bid specifications; that the joint venture was guilty of fronting; and that the decision of the Mopani Municipality was based on bias and bad faith. The Court based its decision on the fact that one of the joint venture partners, Tlong Re Yeng,

²¹⁰ *Esorfranki* paras [1] – [3].

²¹¹ S 1 of the Preferential Procurement Regulations, 2001 issued in terms of the Preferential Procurement Policy Framework Act 5 of 2000 in effect at the time of awarding the tender (later replaced by the Preferential Regulations, 2017) defines a “consortium” or “joint venture” as “an association of persons for purpose of combining their expertise, property, capital efforts, skill and knowledge in an activity for the execution of a contract”. An “unincorporated joint venture” is defined in Schedule 1 of the B-BBEE Codes as a “joint venture between two or more [M]easured [E]ntities effected by agreement without incorporation”.

²¹² S 6 and s 8 of PAJA Act 3 of 2000 to have and administrative action reviewed and set aside and for a court to grant and order that is “just and equitable”.

did not meet the minimum contractor grading.²¹³ This was, according to the Court, enough reason to have disqualified the joint venture from the tender process.

The joint venture also failed to provide information relevant to their competence and functionality, as required by the tender specification, and provided false information regarding the business address and being in operations for three years prior to awarding of the tender. Base Construction also provided information in which its sole shareholder, being a foreign-based national, falsely claimed to have obtained South African citizenship by means of birth and as a result of this misrepresentation fraudulently scored points under the equity promotion goals of the tender.

The joint venture also falsely claimed that both partners had individual experience in the construction industry while in fact Tlong Re Yeng had no such experience and was consequently unable to execute its portion of the work in terms of the joint venture. The joint venture also obtained favourable points on the basis that the partners would execute the contract in equal shares, while the Court found that this was not the case.²¹⁴ The Court found support for its finding that Tlong Re Yeng was used as a front based on the fact that it was not in existence and operational prior to the publication of the tender and was only set up after publication of the tender. It had no business address as the address given was a residential house with a few pieces of furniture. It also had no assets, employees or income, and the sole member was an employee at another entity.

The Court declared the tender process illegal and invalid and ordered the Mopani Municipality to independently, at the joint venture's cost, verify that all work up to that point had been done according to the tender specifications. The Court further ordered the joint venture to do all remedial work relating to the tender awarded and that the work be completed by the joint venture as soon as possible in terms of the tender agreement.

Esorfranki and Cycad obtained leave from the High Court to appeal the order granted by the High Court for the joint venture to continue with the work and, in their appeal to the Supreme Court of Appeal, asked that this order be set aside and substituted with an order that the agreement between the Mopani Municipality and the joint venture as respondents be declared *null and void*, that they be declared the successful bidders, that Mopani Municipality enter into an agreement with the appellants for the

²¹³ Regulated by the Construction Industry Development Board according which, amongst others, the duration of existence and technical capability of the contractor are graded. Tender specifications determine a grading according to the requirements of the work to be executed.

²¹⁴ *Esorfranki* para [11].

completion of the outstanding work and that the joint venture and Mopani Municipality pay the costs of the review application.

The SCA agreed with the High Court that the tender process was clearly flawed rendering it reviewable and liable to be set aside. The Court then turned its attention to an appropriate relief that was just and equitable under such circumstances consistent with section 217 of the Constitution and section 8 of PAJA. The Court again emphasised the principle of legality, which requires invalid administrative action to be declared unlawful²¹⁵ and the adverse consequences that flow from an order declaring administrative action, unlawful. The Court pointed out that by declaring the tender process unlawful meant that the decision to award the tender and the contract which was entered into pursuant thereto were both *void ab initio*.²¹⁶

The Court held that an appropriate administrative remedy must strike a balance between: the need for certainty; the public interest; the interests of successful and unsuccessful bidders; other prospective tenderers; interests of innocent partners and the interest of organs of state. The Supreme Court of Appeal examined the dilemma faced by the High Court in setting aside the contract which might have been disruptive to the finalisation of a project in need of being expectantly finalised. The potential contractual issues as foreseen by the High Court that might arise between Mopani Municipality and the joint venture as a result of setting aside the contract will in the view of the Supreme Court of Appeal not be of any consequence in the case of corruption or fraud or where the unsuccessful bidder was compliant in the irregularity.

As the joint venture had obtained the tender in a dishonest way, it cannot complain about suffering prejudice as fraud is conduct which nullifies every contract known to the law. The Supreme Court of Appeal then reaffirmed a well-established principle in our law that no court will allow a person to retain an advantage obtained by fraud, and no judgement of a court, or order of a Minister can be allowed to stay intact if it has been obtained fraudulently, as fraud unravels everything and once proven “vitiates judgements, contracts and all transactions whatsoever”. The Court referred to the Constitutional imperative²¹⁷ that tender processes be free of corruption and fraud and that public money does not end up in the pockets of corrupt officials and business people. With regard to fronting, the Court pointed out that the difficulty with fronting was that the person or entity that is to benefit financially from the awarding

²¹⁵ The Court referred to the judgement in *Bengwenyama Minerals (Pty) Ltd v General Resources (Pty) Ltd* [2011] (4) SA 113 (CC) paras [83] and [84].

²¹⁶ *Esorfranki* para [20].

²¹⁷ S 217 of the Constitution, 1996.

of a tender is not the one to whom the tender is awarded. The entity serving as a front in most instances does not have the required capacity, resources or competence to execute the contract entered into. The Court pointed out that this amounts to the exploitation of such “front” individuals for financial benefit and also constitutes defrauding those who are meant to benefit from B-BBEE legislative measures.²¹⁸

The Supreme Court of Appeal found that in light of the High Court’s finding that the tender was unlawful by virtue of fraud and irregularities and not meeting the administrative justice requirements of PAJA, the High Court had erred in allowing this unlawful contract to continue.²¹⁹

The Court upheld the appeal with costs in respect of the orders of the High Court for the joint venture to continue and finalise the construction work in terms of the contract, and replaced it with an order that the contract be declared void *ab initio* and set aside. The Court further ordered Mopani Municipality to determine the extent of the outstanding work on the project and to prepare and invite tenders to complete the remainder of the project.

The importance of *Esorfranki* from a fronting point of view is that the Court emphasised that fronting is a form of fraud and that no person can legally be allowed to benefit under South African law from the proceeds of any fraudulent activities. The Court considered a variety of factors to determine the genuine business operations of the respondents in respect of their technical capabilities, experiences and business resources and concluded that the respondents did not operate as an appropriate *bona fide* business, irrespective of what they attempted to portray to the outside world. The contention by the respondents that an individual black person or individual was not prejudiced as a result of such disguised activities or fronting practices and that fronting could therefore be justified was correctly rejected by the Court on the basis that fronting is a prejudice to those in general whom the B-BBEE policy and legal framework aims to benefit. This approach to extend prejudice beyond individual prejudice to potential prejudice in terms of government policy, is a similar approach the courts follow in respect of prejudice as an element of the common law offence of fraud as discussed later in this chapter.

²¹⁸ *Esorfranki* para [26].

²¹⁹ *Esorfranki* para [27].

3.6.6 *Passenger Rail Agency of South Africa v Swifambo Rail Agency (Pty) Ltd* in 2017²²⁰

In this High Court case involving tender irregularities, fraud and fronting practices where a multinational entity based abroad used a South African B-BBEE shelf company as a front to obtain a lucrative contract. This is the first High Court judgement where the Court had applied the new fronting practice requirements as formulated in the B-BBEE Act of 2003 brought about by the amendments in 2014.²²¹ As this chapter deals with those cases before enactment of the new fronting provisions into law, the *Swifambo* case is listed here as one of the landmark judgements relating to the research question but will be examined and discussed in the next chapter of this dissertation when the definitional elements of the new fronting practice are appraised.

3.7 FRONTING AND FRAUD

Before 2014, cases of fronting were unsuccessfully dealt with under the common law offence of fraud. To understand the apparent reasons for this and the changes effected in 2014 by promulgating a statutory provision to deal with the matter, the meaning and elements of fraud need to be understood. The common law offence of fraud has not been replaced by the new fronting provision and it is envisaged that fraud will to a certain extent remain part of the criminal enforcement landscape relating to circumvention practices in the context of B-BBEE.

Fronting mainly entails presenting facts in such a way as to disguise a transaction's true nature. Misrepresentation is therefore inherent to fronting and misrepresentation is also an element of the common law offence of fraud. Fraud is defined by Snyman as the "unlawful and intentional making of a misrepresentation which causes actual prejudice or which is potential prejudicial to another".²²² The four elements of the crime are misrepresentation, prejudice or potential prejudice, unlawfulness and intention.

The traditional meaning of fronting probably falls within the common law definition of fraud as defined by Snyman. In the *Viking* and *Peel* cases above, the Courts referred to the misrepresentation of B-BBEE statuses and contracts resulting from this as fraudulent B-BBEE transactions. In 2010 the Minister of

²²⁰ (2015/42219) [2017] ZAGPJHC 177.

²²¹ B-BBEE Act 46 of 2013 with commencement date 24 October 2014.

²²² Snyman (2014) 523; and s 8 of the Cybercrimes and Cybersecurity Bill, 2016 published in Government Gazette No. 40487 of 9 December 2016 introduces a statutory offence "Cyber Fraud" by providing that any person who unlawfully and with the intent to defraud, makes a misrepresentation by means of data or a computer programme, or through the interference with data or a computer programme, is guilty of an offence.

Trade and Industry, Rob Davies, stated that “the fronting we know, and that everybody is aware of, is a form of fraud”.²²³ Later that same year the Minister said “this [fronting] was already against the law and alleged transgressors could be prosecuted for fraud.”²²⁴ Anthea Jeffery from the Institute of Race Relations said in 2011, before the criminalisation of a fronting practice, “there is no explicit legal prohibition of fronting, though it could be considered a form of fraud punishable under common law rules”.²²⁵

Unfortunately, authorities have not been very successful in prosecuting fronting activities under the common law. Up to 2010, the Department of Trade and Industry has been successful in prosecuting only one of the approximately 150 to 200 complaints of fronting received per year. The Minister of Trade and Industry attributed this poor prosecution rate to the difficulty in proving fronting under the common law.²²⁶ The Minister did not elaborate on why it was difficult to prosecute fronting. In order to understand the relationship between fraud and fronting and to be able to identify some difficulties that might be experienced in dealing with fronting as fraud, the requirements for a conviction of fraud need closer examination.

3.7.1 Misrepresentation

According to Snyman, misrepresentation entails the perversion or distortion of the truth, which means a “deception by means of a falsehood”.²²⁷ This will be present if a set of facts are presented which in reality does not exist. According to Burchell, misrepresentation is an “incorrect statement of facts or law made by one person to another”.²²⁸ Misrepresentation could be in an expressed or implied form and even a nod or shake of the head to indicate consent is sufficient.²²⁹

Misrepresentation could be either a positive doing of something or the omission to do something in circumstances where the perpetrator has a legal duty to inform or make certain facts known. Such a legal duty may be imposed by legislation or where a court is of the opinion that the perpetrator should have acted positively and not remained silent to remove any misconception if a misconception had existed in the mind of the party to be jeopardised.²³⁰ An example will be to inform someone advancing a loan to a

²²³ Abridged Version of address by Rob Davies, Minister of Trade and Industry *ANC Media* (September 2010) 20.

²²⁴ Pressly *Cape Times* (Nov 2010) 12.

²²⁵ Jeffery *South African News* (March 2011) 9.

²²⁶ Mokone *Business Report, The Times* (Nov 2010) 12; and Pressly *Cape Times* (Nov 2010) 12.

²²⁷ Snyman (2014) 524.

²²⁸ Burchell (2016) 745.

²²⁹ As above.

²³⁰ As above; and Snyman (2014) 525.

perpetrator that the security on which basis the loan was granted does no longer exists. The perpetrator's intentional omission to disclose this fact constitutes a misrepresentation.²³¹

Fraud can also be committed in relation to a promise about the future. An example given by Snyman is a person issuing a cheque to someone where such a person is not sure or does not believe that enough funds would be available to honour payment of the cheque. According to Snyman, if the person issuing the cheque as payment has no intention at the time of doing so to effect payment, or knows or foresees that payment would in future not materialise, this misrepresents an existing state of affairs, being the state of the perpetrator's mind. The perpetrator will represent falsely to others that the perpetrator has a specific intention to effect payment but in fact does not have such intention and consequently such action will be a misrepresentation.²³²

Burchell points out that "puffery" or exaggerated sales talk will not amount to misrepresentation. Such sales talk is excluded from liability as so-called "puffs" do not have the required fraudulent intent and also because it is an honest expression of opinion. People exaggerating in sales activities do not intend listeners to take such content literally or to act thereon.²³³

3.7.2 Prejudice

The mere telling of a lie is not punishable as fraud, and fraud is only committed if the lie or misrepresentation causes harm or prejudice. Actual prejudice is not required but a potential prejudice is adequate to satisfy this element of the crime of fraud. Potential prejudice involves some kind of risk to cause prejudice. The prejudice must not be too remote or fanciful, but there must be a reasonable possibility that the misrepresentation will result in the prejudice of another. It is not relevant or a requirement that the person to whom a representation is made was actually aware that the misrepresentation was false or that the victim acted upon such misrepresentation.²³⁴

Whether the prejudice is actual or potential, it is not a requirement under fraud that the prejudice be proprietary of nature. Non-proprietary prejudice may exist in instances of reputation, dignity or if some aspect of public administration is affected. The approach of non-proprietary prejudice was confirmed in

²³¹ Kemp *et al* (2017) 435; and *S v Yengeni* (A1079/03) [2005] ZAGPHC 117; 2006 (1) SACR 405 (T) paras [39] and [41] where a Member of Parliament was found by the Court to have a legal duty to speak.

²³² Snyman (2014) 526.

²³³ Burchell (2016) 747.

²³⁴ Kemp *et al* (2017) 436.

the case of *S v Tshopo* and others²³⁵ in circumstances where the appellants failed to disclose their relationship to an entity that bid for a tender with the Department of Education and contended that the department had not suffered any prejudice because payment was made for actual services rendered. The Court held that the non-disclosure was prejudicial to other tenderers, the community at large and frustrated the state's efforts to root out favouritism as was intended by the requirement to declare such interests.

According to Burchell, the question is not whether the perpetrator intended to cause prejudice but objectively viewed whether the misrepresentation had resulted in the prejudice. According to Burchell, the test is whether it is reasonably possible for prejudice to occur.²³⁶ It is not essential that the prejudice affects or poses the risk of prejudicing the person to whom the misrepresentation is directed, but may also prejudice a third party or even the state.²³⁷

The concept of potential prejudice may be subject to criticism in that the meaning of prejudice is too wide and vague and some have described it as being excessively wide. This vagueness was constitutionally challenged under the right to a fair trial²³⁸ entrenched in the Bill of Rights in the case *S v Friedman*.²³⁹ The Court found that "the present definition of fraud is wide but does not make it difficult, much less impossible, to ascertain the type of conduct which falls within it".²⁴⁰

The Court also found that there is "nothing objectionable in the approach which punished fraud, not because of the actual harm which it causes, but because of the possibility of the harm or prejudice inherent in the misrepresentation".²⁴¹ The wide scope of application of prejudice was confirmed in circumstances where the accused said that his wife, with a valid driver's licence, was the driver of a vehicle and not the accused, who did not have a valid driver's licence, in order to defraud the insurance company to obtain an insurance pay-out, although the accused later corrected the misrepresentation with the insurance company. His conduct was still fraudulent and he was found guilty of fraud despite the correction of the initial misrepresentation. The Court found that the initial misrepresentation amounts to a risk or potential prejudice to the insurance company.²⁴²

²³⁵ (29/12) [2012] ZASCA 193 para [26].

²³⁶ Burchell (2016) 751.

²³⁷ *Tshopo* para [26] above; and Burchell (2016) 751.

²³⁸ S 35(3) of the Constitution, 1996.

²³⁹ 1996 1 SACR 181 (W).

²⁴⁰ *Friedman* 24 above.

²⁴¹ *Friedman* 26 above.

²⁴² *S v Mngqibiza* (75/07) [2007] ZASCA 119; [2008] (1) SACR 92 (SCA) paras [5] and [12].

3.7.3 Unlawfulness

According to Burchell, exaggeration during sale activities in ordinary commercial advertising (“puffing”) as indicated above, will not be viewed as unlawful even if the prejudice is public knowledge, for instance where items such as cigarettes and liquor might have a health risk.²⁴³ Snyman points out that compulsion or obeying of orders may be possible grounds for justification. Kemp *et al* are of the view that the usual defences and grounds for justification will be available to an accused and even mention coercion as being a possible defence. It is no defence for an accused to allege that the person prejudiced was aware of the untruthfulness of the representation.²⁴⁴

3.7.4 Intention

The onus is on the state to prove intention by the accused to commit fraud. For intention to be established, the accused must be aware of the fact that the representation made by the accused is false. This will be a form of direct intention. *Dolus Indirectus* would be established as a form of intention where the accused made a false misrepresentation that caused prejudice and/or potential prejudice to another person as an indirect result of the accused’s conduct of which the accused was aware, although this indirect result was not necessarily the accused’s ultimate goal. *Dolus eventualis* may also be sufficient to constitute the offence of fraud in circumstances where the accused makes a representation foreseeing the possibility that it may be false but still proceeds with his actions.²⁴⁵ The accused will also establish *dolus eventualis* where, suspicious of the correctness of his representation, the accused will intentionally refrain from verifying the correctness of his representation for eliminating any doubt or suspicion about the content of the representation.²⁴⁶

The intention must not only be to tell a lie, but must also to cause prejudice. This distinction is referred to as an intention to deceive compared to an intention to defraud. Intention to defraud must exist to constitute fraud.²⁴⁷ Burchell states that the intention must not only be to deceive, but also to cause the person being prejudiced to abstain or be prevented from exercising his legal right as a result of such misrepresentation.²⁴⁸

²⁴³ Burchell (2016) 744.

²⁴⁴ Kemp *et al* (2017) 435.

²⁴⁵ As above.

²⁴⁶ *R v Bougarde* [1954] 2 All SA 27 (C) 32; and *Ex parte Lebowa Development Corporation Ltd* [1989] 3 SA 71 (T) paras [101]-[104].

²⁴⁷ Snyman (2014) 531; and Kemp *et al* (2017) 436.

²⁴⁸ Burchell (2016) 753.

It is also important to take note of the provisions of section 103 of the Criminal Procedure Act 51 of 1977 in respect of any prosecution for an act to defraud. The section provides that under such circumstances it shall be sufficient to allege and to prove that the accused performed the act with the intention to defraud, without having to allege and proving that it was in fact the intention of the accused to defraud any particular person, and that the charge does not have to mention or specify the owner of any property involved or set forth the details of the deceit. According to Kemp *et al*, it is sufficient to allege that a mere generic person has been prejudiced or potentially prejudiced and not to allege prejudice to a specific individual or person.²⁴⁹

3.7.5 Difficulties in prosecuting fronting as fraud

The fact that the authorities find it difficult to successfully prosecute fronting under the common law rules of fraud might be contributed to the strict requirements in respect of intention. The element of prejudice and/or potential prejudice is wide enough to include prejudice to the state or a possible risk of prejudice to the state or other competitors for tenders as ruled by the Court in *S v Tshopo* with regard to fraud.

It is not only intention to deceive that must be established. It must at least be foreseen that prejudice or potential prejudice might occur for intention to be established. The accused must be aware that his representation is false or foresee the possibility, or did not take reasonable steps to ascertain the true nature of the representation.

According to Jeffery, the poor conviction rate is directly related to the fact that fronting is often difficult to distinguish from *bona fide* and legitimate attempts to comply with B-BBEE rules, which are intrinsically ambiguous. Jeffery continues by referring to a statement made by the industry body for verification agents that some verification agencies might unknowingly be assisting clients with fronting as the B-BBEE rules are rife with errors, which makes it difficult to assess and distinguish between legitimate and non-legitimate conduct.²⁵⁰ This lack of intention to commit fronting is echoed by Jack in his statement that many instances of fronting have been witnessed “where the transgressors were genuinely unaware what they were doing”. Jack believes some instances of fronting are “inadvertent fronting”. He is of the opinion that B-BBEE consultants do not have adequate knowledge and the necessary expertise, resulting in fronting structures being set up unintentionally. According to Jack, the onus is always on the measured

²⁴⁹ Kemp *et al* (2017) 435.

²⁵⁰ Jeffery (2014) 172 and reference to a statement made in June 2011 by ABVA (Association of BEE Verification Agencies), the industry body for verification agencies.

entity, and ignorance has never been an acceptable excuse for circumvention.²⁵¹ This last statement may be valid for administrative action against a measured entity but might be criticised in the context of *S v Blom*²⁵² where the court introduced the principle of ignorance of the law to be a defence to exclude intention.

3.8 ACADEMICS, AUTHORS, COMMENTATORS AND THE CONTEMPORARY VIEW

Various academics and authors (commentators) have pointed out the need to incorporate far more knowledge into the B-BBEE environment. Some are of the opinion that the apparent lack of knowledge on the part of B-BBEE consultants, verification professionals and other stakeholders has contributed largely to increased levels in fronting.²⁵³

To increase the levels of knowledge, the B-BBEE Commissioner had been tasked by the B-BBEE Act of 2003 with the functions to promote public awareness on matters relating to B-BBEE. In terms of section 13F(3) of the B-BBEE Act of 2003, the B-BBEE Commission can do so by issuing explanatory notes, non-binding legal opinions or applying to a court of law for a declaratory order on the interpretation or application of the provisions of the Act. The B-BBEE Commission can, in order to increase knowledge and promote public awareness, conduct research to be accessed by the public.²⁵⁴

Apart from seeking advice from experts, businesses will, in the absence of clear directives from the authorities, source knowledge and insights from commentators. Given the very few cases heard by the courts before 2013 to provide guidance and interpretation regarding the application of fronting, accompanied by the lack of directives on fronting issues as well as the vague and wide formulation of existing fronting laws, the public opinion or contemporary view in this regard is largely formed by commentators.²⁵⁵

This public narrative and contemporary view of fronting are important as the knowledge required by a person to be aware that a specific initiative or practice might be unlawful is inherent to the requirements for criminal conviction of such an unlawful practice under the common law and the B-BBEE Act of 2003.

²⁵¹ Jack (2013) 470 and 472.

²⁵² 1997 3 SA 513 (A) 531 paras [A] and [C]; and Chapter 5 para 5.5.3 below.

²⁵³ Jack (2013) 470; and Balshaw and Goldberg (2014) 28.

²⁵⁴ B-BBEE Commission National Report (Oct 2016) 1. This report found that B-BBEE professionals operating within the B-BBEE rating industry have an inadequate understanding of the B-BBEE Codes.

²⁵⁵ Jeffery (2014) 186 and 189.

Information obtained from these sources would shape subjective knowledge and the views of stakeholders and will very much set a benchmark for objective and reasonable criteria to be applied in determining culpability as a requirement for any possible conviction of a fronting practice.

With the vagueness of the present legislation, the lack of case law precedents and the pressure created by procurement systems to implement B-BBEE initiatives, especially ownership,²⁵⁶ business owners and professionals operating in the B-BBEE space will, until such time as clear guidelines emerge, rely heavily on the guidance provided by commentators.²⁵⁷

Due to the wide spectrum of activities that fall within the ambit of a fronting practice, commentators have diverse views on what is considered to be a fronting practice and the degree of severity of such practices.

Lwazi Koyana, a prominent corporate financier, describes fronting as a scenario where established business simply ticks the right boxes in terms of B-BBEE compliance while ensuring that the *status quo* remains unchallenged. He describes this in the light of various established entities that incorporate black partners with no knowledge of that specific industry. According to Koyana, such a black partner will not be able to make any meaningful contribution to that business it is involved in although the established business gets B-BBEE recognition. He goes further to describe such practices as “little more than a very sophisticated level of tokenism” and “a massive misalignment of skills”.²⁵⁸

Khanyisile Kweyana, the Chief Executive Officer of Business Unit South Africa (BUSA),²⁵⁹ refers to high calibre black professionals who should not be on boards of big businesses purely for “decorative purposes” and points out that B-BBEE deals that flounder cannot always be blamed on government or the lack of support or “sinister motives of a white partner”. She says that all deals, including B-BBEE deals, are business deals and that “the laws of economics cannot be suspended because someone has done a [B-B]BEE transaction”. She also points out that black people often rush into a B-BBEE deal which is not economically sound purely to be seen as a serious B-BBEE player,²⁶⁰ and warns against the next generation dismissing B-BBEE as a “scam”.²⁶¹

²⁵⁶ Balshaw and Goldberg (2014) 39 and 56.

²⁵⁷ Balshaw and Goldberg (2014) 55 state that “businesses needs to get well acquainted with the vagaries of government’s populace [B]-[B]BEE requirements”.

²⁵⁸ Madi (2016) 129.

²⁵⁹ Madi (2016) 63. She has also previously occupied the position of Executive Director at Anglo American and still holds various other executive positions in various major South African companies.

²⁶⁰ As above 64.

²⁶¹ As above.

Leon Louw, the Executive Director of the Free Market Foundation,²⁶² has labelled the employment equity and B-BBEE programmes as “fraudulent” in that these programmes inadvertently create a “cosmetic impression” that black people are benefiting. Louw is further of the opinion that these programmes have created a new breed of white people who learned to “make money” off it, while the programmes in fact are designed for growth and wealth in the economy.²⁶³

Phanda Madi, a Professor Emeritus at Rhodes University and one of the founders and co-Commissioner of the 1998 BEE Commission,²⁶⁴ has been very critical about black people who act as “tenderpreneurs”. Madi explains this term as a person who uses their political power and influence to secure government tenders and contracts. He also refers to “polipreneurs” or “political rent seekers” that are politically connected B-BBEE people who work in conjunction with corrupt government officials and then steal business deals submitted by *bona fide* entrepreneurs, altering their business plans and submitting them as their own to win tenders and bids from government. Madi contends that these individuals are only involved in politics “to feather their own nests”, see political service as a means to an end and to cover their wealth obtained “under the honourable cloak of BEE”. He refers to the opinions of others describing B-BBEE as a “swearword” and “dignified bribery”. He describes the abuse of B-BBEE related to government procurement as “cronyism and nepotism, dressed in honourable robes”.²⁶⁵

Bonang Mohale, President of the influential Black Management Forum and Chairman of Shell South Africa, has urged black and white businesses to transcend the barriers that remain a reality for black businesses and says that “paper-coating” over them has cost South Africa dearly in the past 20 years in relation to transformation policies.²⁶⁶

Anthea Jeffery,²⁶⁷ is of the opinion that government’s procurement regulations have encouraged fronting activities by white businesses and illustrates this by citing examples where black bidders with no expertise and technical capabilities will sub-contract government contracts to losing white bidders. The original

²⁶² As above 121. The Free Market Foundation (FMF) was founded in 1975 and operates as a public benefit organisation that promotes the principles of an open society, the rule of law, personal liberty and economic and press freedom.

²⁶³ Madi (2016) 126.

²⁶⁴ Phanda Madi served as Visiting Professor at Rhodes University Business School between 2001 and 2008. He is chairman of an investment holding company, Madi Investments Administrators. He was also the author of a book entitled *Black Economic Empowerment in the New South Africa* published in 1997.

²⁶⁵ Madi (2016) 26-35.

²⁶⁶ Madi (2016) xxi Supplementary Foreword.

²⁶⁷ Doctor Anthea Jeffery holds a doctorate in law from the University of London and is the Head of Special Research at the Institute for Race Relations and author of *Business and Affirmative Action: People’s War; New Light on the struggle for South Africa* and *Chasing the Rainbow: South Africa’s move from Mandela to Zuma*.

black bidder won the tender “simply for lending its name to the process”. She has described fronting as an “exaggeration of BEE credentials”.²⁶⁸

Tony Balshaw and Jonathan Goldberg, in their publication²⁶⁹ dealing specifically with the 2013 amendments to the B-BBEE Codes and the B-BBEE Act of 2013, caution of the dangers brought about by the higher requirements and emphasis on ownership and management and says that businesses will opt for “smoke-and-mirror” solutions which are not commercially viable by “colouring in by numbers” and that “profit opportunistic predators” may abuse the system through well-crafted structures. According to Balshaw and Goldberg, this “veneer” will be quickly stripped away. They further contend that the onerous requirements of ownership will incentivise fronting, window-dressing and “phantom” B-BBEE ownership and management schemes.²⁷⁰

In an attempt to explain fronting, they agree with other commentators that fronting and misrepresentation constitute fraud, and then define fronting as “the deliberate misrepresentation of the true BEE status of an entity, which results in a false or favourable BEE status being conferred or claimed”.²⁷¹

Vuyo Jack,²⁷² describes fronting in a variety of ways. According to him fronting is in essence a circumvention activity that defeats the purpose of the B-BBEE Codes.²⁷³ He, however, provides a more comprehensive definition of fronting namely:

“the practice of making unsubstantial broad-based black BEE claims, where the [B]lack person has no real right to commensurate benefits claimed to have been given by the measured entity. It can further be defined as any action that goes against the spirit of BEE”.²⁷⁴

Jack further explains that fronting has the effect that business carries on as usual for the established company and in some cases black people earn fronting commission for using a black company to obtain

²⁶⁸ Jeffery (2014) 129-132.

²⁶⁹ Balshaw and Goldberg (2014) 11. Balshaw is a chartered accountant and an accredited verification signatory for an accredited verification agency and author of *Thrive! Making Family Business Work*. Goldberg is the CEO of Global Business Solutions and consults on a range of entities on B-BBEE.

²⁷⁰ Balshaw and Goldberg (2014) 23, 24, 38 and 57.

²⁷¹ Balshaw and Goldberg (2014) 227 and 246.

²⁷² Jack (2013) 32-44. Jack is a chartered accountant as well as co-founder and chairman of Empowerdex, South Africa’s best known B-BBEE rating agency that was instrumental in developing a rating index for measuring B-BBEE compliance levels. Jack is also a visiting professor at the School of Management at the University of the Free State. He also served on the Department of Trade and Industry Commission who developed the B-BBEE Codes.

²⁷³ As above 470.

²⁷⁴ As above.

business such as government contracts and channel them to white companies.²⁷⁵

Jack also states that fronting is no different from other policies implemented through legislation in that it is a natural tendency for businesses to attempt to minimise the impact of such laws on the profit margins of companies and consequently entrepreneurs will challenge such boundaries of the law. Some strategies might fall within the ambit of the law and others outside. Those strategies falling outside the boundaries of the law will then be deemed to be fronting.²⁷⁶ Jack cited four types of fronting practices, some of which have been dealt with as part of the 2009 Guidelines.²⁷⁷ These types of fronting include opportunistic intermediaries, transfer pricing or benefit diversion, window-dressing and thin capitalisation. Although some of these types of fronting have been dealt with in the published 2009 Guidelines, Jack uses a more business-like approach in his explanation which is worth noting, as the emphasis and effect, according to his explanation, lie in the business rationale and commercial tendency in the industry which differ from the meaning of the published version as per the 2009 Guidelines.

An opportunistic intermediary, according to Jack, refers to a company or person whose purpose is to fulfil an agency role without real substance or commercial sense. Jack then also provides some indicators that could be indicative of the presence of a fronting practice under such circumstances which will compel a verification agency to investigate the possibility of fronting. These indicators would be present where: the intermediary entered the value chain of supply on an exclusively B-BBEE basis; where the B-BBEE intermediary does not add value to the supply chain; the B-BBEE entity has no sustainable stand-alone operational capacity; the B-BBEE intermediary is reliant on one client or entity in the chain for survival and instances where goods are provided directly to the client without any real need for the agent's involvement. The illustration of opportunistic intermediary in the 2009 Guidelines, in comparison, place emphasis on the leveraging of the intermediary to the benefit of a measured entity, while Jack's explanation also emphasises the intention and commercial sense of such a transaction. He points out that such intermediary entities are opportunistic because they dilute the benefits to the intended beneficiaries and that black people are not actively incorporated into owning and operating entities with substance.²⁷⁸

According to Jack transfer pricing and benefit diversion involve stripping the profits of one company and channelling them to another company. He provides three indicators for the possible presence of such a

²⁷⁵ As above 471.

²⁷⁶ As above.

²⁷⁷ See Chapter 3 para 3.2 above.

²⁷⁸ Jack (2013) 473.

practice, being the exchanging of management fees between two entities or individuals in management positions, which does not make business sense; the sale of products between related entities at non-market-related terms; and irregular or unusual flow of funds between related entities.²⁷⁹

The 2009 Guidelines, on the other hand, refer in this context to benefits that do not flow to black people in the ratio described in the legal documents. Jack's version of benefit diversion is broader and includes practices of stripping of benefits irrespective of the provisions in legal documentation.

Window-dressing is described by Jack as involving black people in "senior positions" with no substance associated with the position. This constitutes a "hollow appointment" where a black person is appointed with no authority, responsibility, budget or subordinates, or the black person is paid less than others in the same position. This practice of window-dressing also occurs where black people with no qualifications, experience or ability are appointed. Jack advocates the principle of not setting black people up for failure, but rather developing them over time and gradually incorporating them into the system.

The 2009 Guidelines are narrower in its illustration and refer to "discouraging or inhibiting" black people from participating in the core activities or in certain stated areas. The 2009 Guidelines have a deliberate tokenism in mind, while Jack's version concentrates on the substance of the position, irrespective of the intention of the fronting party.²⁸⁰

Thin capitalisation, according to Jack, refers to the practice of stripping profits from an empowerment company and diverting them to a non-empowered company by charging excessive interest rates on loans to empowerment companies, black persons or entities acquiring shareholding by means of loans. The 2009 Guidelines do not include these practices but do list the practice of excessive rates charged to empowerment entities as a fronting risk indicator.²⁸¹

Jack also distinguishes between three categories of fronting depending on the appearance of the practice. He describes "extreme fronts" as instances where a white male divorces his wife and marry a black woman solely for the sake of obtaining a B-BBEE benefit. The shareholding in the company owned by the white male then be transferred to the new "black wife" with a hidden second prenuptial agreement stating that all the assets will revert to the husband in the event of divorce. The divorce is set to occur

²⁷⁹ As above.

²⁸⁰ As above 474.

²⁸¹ As above.

whenever the B-BBEE laws are repealed. Such cases of extreme fronting will, according to Jack, equate to window-dressing.²⁸²

Cases of “classic fronts” usually occur when a gardener or domestic worker is appointed as a director or shareholder with limited benefits. Such black people will have no participation and there is no substance to the relationship. Such cases of “parading black faces or black names” to obtain a B-BBEE benefit will also be deemed window-dressing or tokenism.²⁸³

“Sophisticated fronts,” according to Jack, go to “astounding” lengths and include complex transactions with very complex financial derivatives, different classes of shares and second hidden agreements that supersede the publicly presented agreement. These techniques are often devised to undermine the substance of the transaction and circumvent the B-BBEE ownership requirements.²⁸⁴

Jack also points out other forms of fronting such as the creation of empowerment subsidiaries or joint ventures; engineering of B-BBEE deals; offering insignificant procurement opportunities to black companies;²⁸⁵ transactions where the risks taken by the parties do not yield commensurate returns;²⁸⁶ off-loading non-core assets to empowerment companies that can be regarded as token ownerships;²⁸⁷ B-BBEE initiatives without sound economic principles;²⁸⁸ legal form masking the substance of a transaction;²⁸⁹ transactions and strategies based on manipulative interpretations;²⁹⁰ transactions with provisions that reverse black ownership or lock-in clauses linked to the retracting of B-BBEE legislation;²⁹¹ ownerships where risk is not commensurate with ownership;²⁹² unrealistic or unfair hurdle rates as criteria in the event of deferred shares to ordinary shares in complex ownership transactions.²⁹³

The term “fronting” is in general used very loosely and inappropriately. While the term was traditionally used to describe a deliberate or dishonest attempt to gain a B-BBEE advantage, the term had with time evolved and is presently used to describe any unfairness or perceived unfairness of initiatives that are

²⁸² As above 475.

²⁸³ As above.

²⁸⁴ As above 476.

²⁸⁵ As above 2.

²⁸⁶ As above 9.

²⁸⁷ As above 16.

²⁸⁸ As above 67.

²⁸⁹ As above.

²⁹⁰ As above.

²⁹¹ As above 89 and 408.

²⁹² As above 153.

²⁹³ As above 392.

not regarded as “in the spirit of the B-BBEE Codes”. The reference to the “spirit of the B-BBEE Codes” is not necessarily derived from the objectives of the B-BBEE Act of 2003, but from the principle of a “rainbow nation” and “Ubuntu” (to do good to others) as incorporated in early economic policies such as the RDP.

This has led to all transactions and arrangements which, on face-value, seem to be unfair, to be branded as fronting, while the transaction is not necessarily a deliberate or dishonest attempt to disguise or simulate. Examples of such transactions are ownership transactions where the company finances the transaction which is then be paid for by future profits of the company. In such instances the directors are in terms of their fiduciary duties compelled to protect the financial interest of the company and will build protection measures into the transaction, such as call options or pledging of the shares. These measures could dilute benefits and restrict the rights of black shareholders and are perceived to be fronting, although these transactions are also applied to white shareholders in the same position, make commercial sense and are not abnormal in terms of commercial use and application.

One of the principles of the B-BBEE programme is to incentivise existing established entities in assisting those in need of empowerment. For this purpose and to serve legitimate business interests, several transactions involving restrictions could have a legitimate commercial purpose and cannot simply be branded as fronting. The rules developed by the courts in evaluating a simulated transaction to consider the intention, motive, intended effect of the transaction as well as the commercial sense and interest it serves, will have to be built into legislation as factors in determining fronting. Given the principles already adopted by our courts in respect of fronting activities, the common law offence of fraud and simulated transactions, any assessment of fronting will have to involve a balance between the commercial rationale and objectives of B-BBEE. Undermining or frustrating of the objectives of B-BBEE cannot be the only or main criterion, as this will undermine innovation in finding solutions to hurdles such as lack of funding to facilitate substantive B-BBEE initiatives.

3.9 CONCLUSION

Fronting and anti-fronting provisions are contained in an array of B-BBEE policy documents, legislation, sub-ordinary legislation, guidelines, and to a certain extent case law. The meaning and interpretation of fronting are being shaped by the illustration of and explanation given to these practices by academic and legal commentators. The term “fronting” has become synonymous with B-BBEE and the term has been sculptured in a contemporary meaning.

Not all instances of fronting practices are referred to as such within the B-BBEE legal framework, but they are often referred to as circumvention practices or misrepresentation. The more commonly used terms within a fronting context are window-dressing, tokenism or simulated transactions. Fronting is often dealt with by identifying fronting risks or fronting indicators that create a suspicion or presumption that necessitates further investigation into a possible fronting practice.

The way fronting practices were dealt with in the past was very much of an administrative nature in that verification agents would penalise measured entities found to have engaged in a fronting practice and report more serious misrepresentation matters to the Department of Trade and Industry or the Minister of Trade and Industry. The latter could then disregard any or all points given or disregard the B-BBEE status of the measured entity in total. If found guilty of a criminal offence relating to B-BBEE fraud or misrepresentation in the past, such entities and their directors could be black-listed or barred from doing business with government or state-owned entities.

Attempts to deal with circumvention and fronting under the common law as criminal offences were not successful. The real reason for this is unknown as it is merely contended that these cases are hard to prove. Comparing the requirements for a conviction of fraud with the new statutory provisions, those hard-to-prove areas had to do with the *mens rea* element of intention that is required, and an element of dishonesty and deliberate misrepresentation.

Some commentators have expressed the view that convicting offenders for fraud relating to fronting could be problematic given that compliance with the B-BBEE Codes is not compulsory and that the B-BBEE Codes only bind government and agents of the state.²⁹⁴ For private businesses it is a mere rating system brought about by a business or strategic imperative. In light of this, verification agents can only deny points to contravening measured entities, while any fronting detected in the past could not automatically be treated as fraud.²⁹⁵

²⁹⁴ S 10 of the B-BBEE Act of 2003 determines the status of the B-BBEE Codes "...that every organ of state and public entity must apply any relevant code of good practice issued in terms of this act" to issue licences, implementing preferential procurement, determining qualification criteria for sale of government assets, entering into partnerships with the private sector and determining criteria for incentives, grants and investment schemes.

²⁹⁵ Jack (2013) 471 and 479. Jack makes mention of the contractual relationship that exist between the verification agency and the measured entity that compels the verification agency to treat all information received by the verification as confidential. This also restricts the ability of verification agents to report other forms of fraud discovered in the verification process. According to him, the verification agent should report the fraud to the board of the measured entity and resign.

CHAPTER 4

STATUTORY FRONTING PROVISIONS AND OTHER RELATED OFFENCES

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4.1 INTRODUCTION

With the escalating number of fronting cases reported and the increase in levels of sophistication of fronting experienced, especially with regard to complex B-BBEE transactions,²⁹⁶ the government was put

²⁹⁶ Jeffery (2014) 129.

under increased social and political pressure to act against fronting activities as fronting practices are viewed to be destructive to the objectives of B-BBEE.²⁹⁷

The amendments to the B-BBEE Codes in 2013 also brought about a self-assessment mechanism for small entities such as EMEs and certain QSEs in terms of which they are only required to submit an affidavit or a certificate issued by the Companies and Intellectual Property Commission (CIPC) on an annual basis as proof of their percentage black ownership and annual turnover.²⁹⁸ The exclusion of this category of entities from the requirement to obtain a B-BBEE scorecard was apparently intended to assist small businesses to reduce the costs involved in obtaining a B-BBEE certificate.²⁹⁹ Self-regulation has for a long time been deemed by government and commentators in general as measures that will heighten levels of fronting as entities evaluating themselves will not deny themselves points or recognition for transactions, for instance those transactions without substance.³⁰⁰ Some commentators have suggested that the government's deviation from a well-established policy not to allow self-assessment due to the inherent risk of above, and permitting and promoting the use of affidavits as a self-assessment system in terms of the new amendments will open the "floodgates to fronting" and prove to be counter-productive despite the Department of Trade and Industry's determination and drastic measures to stamp this out.³⁰¹

The more onerous provisions of the B-BBEE Codes introduced in 2013³⁰² will also place businesses under increased pressure to resort to fronting practices to ensure compliance, especially the more stringent requirements relating to ownership. It is anticipated that this will lead not only to a dramatic increase in the number of fronting practices but also to higher levels of sophisticated fronting activities.³⁰³ Some commentators are of the view that unrealistic obligations imposed on businesses with the introduction of more onerous B-BBEE requirements "simply encourage fronting". The more onerous B-BBEE requirements are also seen as encouraging a "tick-box" mentality without any substance to transactions.³⁰⁴

In light of the expected rise in fronting activities following the amendment to the B-BBEE Codes, the limited success government had in the past in prosecuting fronting under the common law offence of

²⁹⁷ Jack (2013) 470.

²⁹⁸ Paras 3.2, 4.5 and 5.3.3 of Statement 000 of the B-BBEE Codes.

²⁹⁹ Jeffery (2014) 181; and Practice Guide 02 of 2016 dated 29 August 2016 issued by the B-BBEE Commission in terms of s 13F(3) of the B-BBEE Act of 2003.

³⁰⁰ Jack (2013) 78 and 79.

³⁰¹ Jeffery (2014) 211.

³⁰² Although only fully implemented in May 2015.

³⁰³ Balshaw and Goldberg (2014) 39, 56 and 57.

³⁰⁴ Jeffery (2014) 142 and 185.

fraud, and the apparent inability under the common law to deal effectively with sophisticated levels of fronting (especially in relation to complex ownership structures where intention or dishonesty cannot easily be proven), government introduced an array of criminal offences by means of the B-BBEE Amendment Act of 2013 with severe fines and sanctions in the event of contravention in an attempt to deter fronting practices. A B-BBEE Commission was also created to investigate complaints and oversee the implementation of and compliance with the B-BBEE Act of 2003 and has the authority to find a practice to be a fronting practice.

The extension of the common law crime of fraud to include more “tailor-made” statutory offences relating to misrepresentation and fronting practices is similar to the method employed by the legislature to extend the common law offence of bribery, with a narrow application, to include a wider enforceable statutory offence in terms of the Prevention and Combating of Corrupt Activities Act 12 of 2004.³⁰⁵ Different from the corruption legislation, a fronting practice has not replaced the common law offence.

The formulation of a fronting practice as a criminal offence has raised concerns that it is too vague, broad and ambiguous and might not stand constitutional muster.³⁰⁶

4.2 STATUTORY PROVISIONS ON FRONTING PRACTICES, MISREPRESENTATION AND PROVIDING OF FALSE INFORMATION

In the context of B-BBEE, the criminal conduct of misrepresentation as one of the elements of the common law offence of fraud has been unbundled and multiplied into several separate statutory offences. With the enactment of the B-BBEE Amendment Act in 2013, which became effective on 24 October 2014,³⁰⁷ the B-BBEE Act of 2003 provides for five new statutory offences of which three relate to misrepresentation. Section 13O(1)(a) provides for an offence if a person knowingly misrepresents or attempts to misrepresent the B-BBEE status of an enterprise, while section 13O(1)(b) and (c) renders the disclosure of false information or misrepresentation of information to a verification professional or any organ of state or public entity an offence. The statutory provisions created by section 13O(1)(a)-(c) distinguish between misrepresentation or attempted misrepresentation of a person’s B-BBEE status, on the one hand, and the providing false information in assessing or securing a B-BBEE status to specific institutions such B-BBEE verification professionals, organs of state or public entities, on the other hand.

³⁰⁵ Snyman (2014) 401 and 402. The common law offence was limited to application of government officials only, while the statutory extension includes agents and principles outside the official government sphere.

³⁰⁶ Jeffery (2014) 186.

³⁰⁷ *Government Gazette* Notice 55 in *Government Gazette* No. 37271 dated 24 January 2014.

Section 13O(2) of the B-BBEE Act of 2003 creates a legal duty to report any commission or attempt to commit an offence referred to in section 13O(1)(a)-(d). A legal duty is placed on a B-BBEE verification professional,³⁰⁸ procurement officer or other official of an organ of state or public entity when becoming aware of the commission of such an offence to report the offence to a law enforcement agency.³⁰⁹ Failure to report such offences shall constitute an offence on the part of the B-BBEE verification professional or procurement officer.

The provisions of section 13O(2) of the B-BBEE Act of 2003 place a legal duty only on verification professionals, procurement officers or other officials of organs of state and public entities. These provisions do not apply to persons in positions of procurement outside of the sphere of organs of state or public entities. The duty to report does not refer to reporting to the B-BBEE Commission, but to an appropriate law enforcement agency. The B-BBEE Commission is not deemed a law enforcement agency and is allowed in terms of the B-BBEE Act of 2003 to investigate complaints by complainants or on its own initiative of an administrative nature.³¹⁰ A report by a verification professional or a procurement officer seems to fall outside the ambit of a complaint, as the B-BBEE Act of 2003 assumes they have the required knowledge to recognise offences to be reported directly to law enforcement agencies without the intervention of the B-BBEE Commission. The feasibility of this provision can be questioned on the basis that someone other than the verification professional or procurement officer might approach the B-BBEE Commission in respect of the same transgression, with the result that more than one institution might end up investigating the same matter simultaneously. The legal duty to report in terms of section 13O(2) of the B-BBEE Act of 2003 is a provision to ensure that those who are in a position to detect offences in terms of the Act report such offences. This is similar to the provision in the Prevention and Combating of Corrupt Activities Act,³¹¹ which provides that any person in a position of authority who knows or ought reasonably to have known that an offence provided for in that legislation had been committed, has a duty to report such an offence.

This statutory duty to report also removes the uncertainty that existed in the past in relation to a B-BBEE verification professional's contractual obligation to a client to treat all information secured from the client as confidential. This uncertainty had led to a general low risk approach followed by B-BBEE verification

³⁰⁸ S 1 of the B-BBEE Act of 2003 defines a B-BBEE verification professional as “a person who performs any work in connection with rating the status of enterprises in terms of broad-based black economic empowerment compliance on the authority of, or for a rating agency accredited by, a B-BBEE Verification Professional Regulator”. A B-BBEE Verification Professional Regulator is defined in this para 4.3 below.

³⁰⁹ S 13J(5) of the B-BBEE Act such as the South African Police Service (SAPS) or the Special Investigation Unit (SIU).

³¹⁰ S 13F(d) of the B-BBEE Act of 2003.

³¹¹ S 34 of Act 12 of 2004.

professionals of not reporting possible incidents of irregularities and fronting activities.³¹² With regard to the legal duty to report, B-BBEE verification professionals and procurement officers receive protection in this regard under the Companies Act³¹³ and the Protected Disclosures Act.³¹⁴ The Protected Disclosure Act protects employees against recourse from their employers in the event of reporting, amongst others, a criminal offence committed by their employers. The Companies Act protects employees and a variety of individuals such as auditors, legal advisors and suppliers of goods and services to the company for disclosing any contravention of legislation. Reporting in terms of the Companies Act is subject to a qualified privilege and immunity from any civil, criminal or administrative liability and provides for compensation in the event of any conduct or threat to deter or harm whistle-blowers from exercising their rights in terms of the Companies Act.

4.3 PENALTIES FOR FRONTING PRACTICES, MISREPRESENTATION AND RELATED OFFENCES

Any person convicted of an offence in terms of the B-BBEE Act of 2003, will, for offences provided for under section 13O(1)(a)-(d), be liable to a fine or imprisonment for a period not exceeding 10 years or to both a fine and such imprisonment. If the convicted person is not a natural person, then a fine not exceeding 10% of annual turnover shall apply.³¹⁵

A person who fails to report an offence in terms of section 13O(2) of the B-BBEE Act of 2003 may, on conviction, be liable to a fine or imprisonment for a period not exceeding 12 months.

The B-BBEE Act of 2003 further provides that in determining a fine for offences committed under section 13O(1)(a)-(d), the court must take the value of the transaction derived from the commission of the offence into account. The Act also places an obligation on the court³¹⁶ in which a person is convicted to report the conviction to the B-BBEE Verification Regulator,³¹⁷ if the person convicted is a B-BBEE verification professional, and any other cases to the Advisory Council³¹⁸ or the convicted person's employer.

³¹² Jack (2013) 470.

³¹³ S 159 of Act 71 of 2008.

³¹⁴ S 3 of Act 26 of 2000.

³¹⁵ S 332 of the Criminal Procedure Act 51 of 1977 provides for the prosecution of corporate bodies.

³¹⁶ As above s 13O(4).

³¹⁷ S 1 of the B-BBEE Act of 2003 defines a B-BBEE Verification Regulator as a "body appointed by the Minister for the accreditation of rating agencies or the authorisation of B-BBEE verification professionals".

³¹⁸ The B-BBEE Advisory Council established in terms of s 4 of the B-BBEE Act of 2003 to advise government on B-BBEE.

The B-BBEE Act of 2003 also grants jurisdiction to a magistrate's court to impose any penalty provided for in the Act.³¹⁹ The Act further makes provision for a prohibition on doing business with organs of state or public entities for a period of 10 years following any convictions in terms of the B-BBEE Act of 2003 and provides for National Treasury to keep a register of defaulters for this purpose.³²⁰ A court that convicts any person who is not a natural person may limit the order prohibiting business with an organ of state or public entity to those members, directors or shareholders who had contravened the B-BBEE Act of 2003.³²¹

Section 13A of the B-BBEE Act of 2003 also provides for an organ of state or a public entity to cancel any contract or authorisation granted on account of false information knowingly furnished by or on behalf of an enterprise in respect of its B-BBEE status. The cancellation by an organ of state or a public entity may be done without prejudice to any other remedies available to such organ of state or public entity.

Some commentators have argued that although the above statutory offences do not replace the possibility of prosecution under the common law, it is anticipated that the authorities will rather opt for prosecution under the statutory provisions as it is doubtful whether conviction under the common law will allow for the high penalties provided for in the B-BBEE Act of 2003. Some have also criticised the penalties as "draconian".³²² The severity of penalties would depend on the sentencing jurisdiction of the court in which prosecution is instituted as sentencing for a common law offence by the Regional Court may even result in a higher penalty than what is prescribed by section 13O (3) of the B-BBEE Act of 2013.

While section 13P of the B-BBEE Act of 2003 prohibits an enterprise from doing business with an organ of state or a public entity following a conviction in terms of the Act, it is unlikely that authorities in future will seek any prosecution in terms of the common law. A common law conviction such as fraud or a conviction in terms of any other law will not trigger the prohibition created by this section. However, conviction of an offence in terms of the B-BBEE Act 2003 is not a requirement to cancel a contract or authorisation by an organ of state or public entity in terms of section 13A of the B-BBEE Act of 2003.

³¹⁹ S 13O(6) of the B-BBEE Act of 2003.

³²⁰ S 13P(1) of the B-BBEE Act of 2003.

³²¹ S 13P(2) of the B-BBEE Act of 2003.

³²² Jeffery (2014) 189.

With regard to the cancellation of contracts and prohibition on doing any business with an organ of state (black-listing), the Preferential Procurement Regulations (PPR)³²³ provide that a contract may be cancelled and an enterprise black-listed in the event of providing false information or failing to disclose any subcontracting arrangements involving more than 25% of the value of a contract with an organ of state under certain circumstances. The PPR also provides for a 10% penalty based on the contract value to be levied against a transgressing enterprise if a contract has to be re-published to invite bidders to complete the remainder of the contract.³²⁴ Such actions by an organ of state in terms of the PPR differ from those provided for in the B-BBEE Act of 2003 where a conviction in terms of the Act is required to trigger the prohibition.

The B-BBEE Act of 2003 has a wider application in respect of prohibition on doing business with an organ of state and a public entity than that provided for by the PPR as the B-BBEE Act also makes provision for the black-listing of members, directors and shareholders in addition to the black-listing of the legal entity.

With regard to the cancellation of contracts by organs of state or public entities, the judgement in *Esorfranki*³²⁵ case provides for the review and setting aside of contracts which do not meet the requirements for administrative legality, such as contracts obtained irregularly or through fraud, fronting, dishonesty and collusion.

A court convicting a person of an offence under section 13 of the B-BBEE Act of 2003 is obliged to take the value of the transaction into consideration, as some commentators have argued that a fine based on the turnover of a non-natural person as the sole criterion may lead to misappropriated penalties.³²⁶ Apart from penalties, fines, imprisonment, cancellation of contracts by organs of state and public entities and a 10-year prohibition on doing business with an organ of state or a public entity faced by the offending corporation or its members, directors or shareholders, a director of a company may also be disqualified from serving as a director if convicted under the B-BBEE Act of 2003. Section 69(8) of the Companies Act³²⁷ provides for the disqualification of a person from serving as a director if he or she is convicted of an offence involving fraud, misrepresentation or dishonesty or an offence involving theft, fraud, forgery or perjury and sentenced to imprisonment without the option of a fine or a fine exceeding the prescribed

³²³ The PPR published in terms of s 6 of the Preferential Procurement Policy Framework Act 5 of 2000.

³²⁴ Regulation 14(1)(c)(ii) of the PPR.

³²⁵ *Esorfranki* paras [24]-[26] above; and see Chapter 3 para 3.6.5 above.

³²⁶ Jeffery (2014) 189.

³²⁷ Act 71 of 2008.

amount.³²⁸ A conviction in terms of section 13O(1)(a)-(c) of the B-BBEE Act of 2003 relating to misrepresentation and providing of false information will automatically disqualify a person from serving as a director in terms of the Companies Act. The offence of knowingly engaging in a fronting practice under section 13O(1)(d) of the B-BBEE Codes of 2003 does not necessarily involve dishonesty, as dishonesty or misrepresentation is not a requirement for being convicted of engaging in a fronting practice. Therefore, not all convictions of a fronting offence will disqualify a person from serving as a director in terms of the Companies Act.

As discussed under paragraph 4.1 above, the B-BBEE Codes also allow for an affidavit to be submitted by certain smaller categories of entities to prove their B-BBEE compliance status. Providing false information in an affidavit could lead to prosecution under section 13O(1)(a)-(c) of the B-BBEE Act of 2003 which prohibits the conduct of knowingly providing false information or misrepresenting an entity's B-BBEE status. Such conduct also constitutes an offence in terms of section 9 of the Justice of the Peace and Commissioners of Oath Act³²⁹ which provides that any person who, in an affidavit, affirmation or solemn or attested declaration made before a person competent to administer an oath³³⁰ or affirmation or take the declaration in question, has made a false statement knowing it to be false, commits an offence. Section 9 of the Justice of the Peace and Commissioners of Oath Act also provides for certain penalties in the event of a conviction under the section that applies for a conviction of the offence of perjury.³³¹

Providing false information in an affidavit might lead to prosecution in terms of section 13 O(1)(a)-(c) of the B-BBEE Act of 2003 and section 9 of the Justice of the Peace and Commissioners of Oath Act. Since such an offence involves dishonesty, it will lead to the person being disqualified from serving as a director in terms of the Companies Act.³³² Although the offence criminalised in terms of the B-BBEE Act of 2003 already exists in the form of fraud or other statutory offences but with higher penalties and fines provided for in the B-BBEE Act of 2003, it is expected that prosecuting authorities will formulate the contravention of provisions in terms of the B-BBEE Act of 2003 as the main charge, and charges relating to traditional offences with lower expectant fines and penalties as alternative charges.³³³ The provisions under section 13O of the B-BBEE Act of 2003 do not replace the provisions of the common law or those that exist in

³²⁸ In terms of Regulation 39(4) of the Companies Act Regulations, 2011, the minimum value of a fine is R1 000.

³²⁹ Act 16 of 1963.

³³⁰ S 2 of the Interpretation Act 33 of 1957 provides that where the word "oath" occurs in a statute it includes an affirmation or declaration to speak the truth.

³³¹ Snyman (2014) 332 defines perjury as "the unlawful and intentional making of a false statement in the course of judicial proceedings".

³³² S 69(8)(b)(aa) of the Companies Act 71 of 2008.

³³³ Jeffery (2014) 189.

other statutes, but were created in addition to those provisions to, amongst others, make it easier, in theory at least, to prove, and to provide for heavier fines and penalties.

4.4 THE STATUTORY DEFINITIONAL REQUIREMENTS OF A FRONTING PRACTICE

In terms of the B-BBEE Act of 2003, fronting was criminalised over and above those provisions criminalising misrepresentation and providing false information. Although misrepresentation and providing false information may be dealt with under the common law and overlap with other statutory offences, they could technically also be dealt with as a fronting practice. In the formulation of the offences in section 13O of the B-BBEE Act of 2003, the legislature has distinguished between misrepresentations and providing false information, on the one hand, and a fronting practice on the other. However, the “fronting practice” definition is broad enough to include misrepresentation and providing false information.

With regard to fronting, section 13O(1)(d) of the B-BBEE Act of 2003 provides that a person commits an offence if that person knowingly engages in a fronting practice. On face value it seems like a very simplistic and uncomplicated formulation consisting of only two main elements, namely “knowingly” and “fronting practice”. Both these terms are defined in section 1 of the B-BBEE Act of 2003. However, the definition of “fronting practice” leads to several other definitions and sections, not only in the B-BBEE Act of 2003 as such but also within the wider B-BBEE legal framework such as the B-BBEE Codes which make the formulation of the offence a conglomerate of definitions and clauses, which is not easy to understand. The definition of a “fronting practice” as one element within the formulation is virtually a crime formulation on its own. It can be described as a crime within a crime as it consists of acts and omissions of its own in addition to those provided in the main formulation of the crime.

The definition of a fronting practice consists of two parts. The first is a general part and the second deals with specific practices, initiatives and transactions. This format of formulation to provide for general offences, on the one hand, and specific offences, on the other, is similar to the structure adopted in the formulation of prohibited corrupt activities in terms of the Prevention and Combatting of Corrupt Activities Act although not that thorough.³³⁴

³³⁴ Act 12 of 2004; and Snyman (2014) 403.

A “fronting practice” is defined as follows:

“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...”³³⁵

The second part of the definition includes four specific B-BBEE initiatives and states that these initiatives are included in the general meaning of the offence but are not limited to these four initiatives. These B-BBEE initiatives can be summarised as: (a) an initiative in terms of which black people appointed in an enterprise are discouraged or inhibited from substantially participating in the core activities of the enterprise they are appointed to; (b), a B-BBEE initiative which do not result in the flow of benefits to black people in relation to an enterprise’s B-BBEE status and in the ratio specified in the relevant legal documentation; (c) a B-BBEE initiative involving a legal relationship with a black person in circumstances where an enterprise achieves a certain B-BBEE compliance without granting the black person the economic benefits reasonably expected to be associated with the position held by that black person; (d) a B-BBEE initiative involving a transaction with another enterprise to achieve a B-BBEE status where such an agreement is not negotiated or concluded on an arm’s-length basis and where limitations and restrictions are placed on the identity of suppliers, customers and clients or the enterprise does not have adequate resources to make the maintenance of business operation probable.³³⁶

These specific transactions and B-BBEE initiatives included in the second part of the definition will be examined in paragraph 4.4.2 below.

4.4.1 THE GENERAL PART OF THE FRONTING PRACTICE DEFINITION

As pointed out above, the first part of the definition of a fronting practice consists of four terms defined in the B-BBEE Act of 2003 itself, one term defined in another statute and various terms which are not defined in the Act. The definition of a “fronting practice” also refers to “objectives of this Act” which are comprehensive broad policy statements. The term “this Act” includes various other provisions in the “fronting practice” definition. This combination of definitions and provisions in a single definition leads to a very broad and complex network of inter-related terms and provisions. In order to fully comprehend the interaction of these terms and provisions contained in the definition of a “fronting practice”, an examination and unravelling of these building blocks are required.

³³⁵ S 1 of the B-BBEE Act of 2003.

³³⁶ S 1 paras (a)-(d)(i)-(iii) of the B-BBEE Act of 2003.

4.4.1.1 The term “B-BBEE initiative”

A “B-BBEE initiative” is defined in the B-BBEE Act of 2003 as “any transaction, practice, scheme or other initiative which affects compliance with this Act or any other law promoting broad-based black economic empowerment”. The reference to an “other law” promoting B-BBEE is for instance a reference to the MPRDA,³³⁷ the Public Finance Management Act³³⁸ and the Preferential Procurement Policy Framework Act³³⁹. The term “B-BBEE initiative” is wide enough to include aspects of the Employment Equity Act³⁴⁰ as the latter directly promotes B-BBEE as defined and discussed below.

On a technical point, the wording “affects compliance with this Act” should have read “affects compliance provided for in this Act” as the B-BBEE Act of 2003 provides for the B-BBEE Codes to be issued to determine qualifying criteria and indicators to measure B-BBEE compliance. Therefore, a B-BBEE initiative relates to B-BBEE compliance as provided for in the B-BBEE Codes issued in terms of the B-BBEE Act of 2003.³⁴¹ The wording “effects compliance with this Act” creates the impression that “this Act” and the B-BBEE Codes contain compulsory compliance provisions and, as pointed out above, that B-BBEE compliance is voluntary and not compulsory. B-BBEE compliance does not mean compliance with an Act or provisions but rather a measurement according to “rules provided for by this Act”.³⁴²

4.4.1.2 The term “this Act”

The term “this Act” includes “any code of good practice or regulation made under this Act”. Section 9 of the B-BBEE Act of 2003 provides for the issuing of codes of good practice by the Minister of Trade and Industry. This also include the Sector Charters published in respect of relevant sectors of the economy³⁴³ and the Regulations published in terms of section 14 of the B-BBEE Act of 2003.³⁴⁴ The term “this Act” is

³³⁷ The Minerals and Petroleum Resources Development Act 28 of 2002.

³³⁸ Act 1 of 1999.

³³⁹ Act 5 of 2000.

³⁴⁰ Act 55 of 1998.

³⁴¹ S 9 of the B-BBEE Act of 2003.

³⁴² S 1 of the B-BBEE Act of 2003 creates certain offences but not offences relating to B-BBEE initiatives but rather offences in connection with the functions of the B-BBEE Commission such as hindering/obstruction or improperly influencing the Commission or refuses to attend or produce documents when summonsed by the Commission.

³⁴³ S 10(3) of the B-BBEE Act of 2003 providing that enterprises in a sector in respect of which the Minister of Trade and Industry has issued a sector code of good practice in terms of s 9 of the B-BBEE Act of 2003, may only be measured for compliance according to such a Sector Code. A total of eight Sector Codes or Sector Charters are in operation.

³⁴⁴ Issued in terms of s 14(2) of the B-BBEE Act of 2003 relating to the interpretation and application of the Act.

very wide and includes the provisions of the Act itself, the B-BBEE Codes, Statements issued separately as part of the B-BBEE Codes,³⁴⁵ Sector Charters,³⁴⁶ as well as the Regulations.

4.4.1.3 The term “person” and principle of corporate criminal liability

The term “person” is defined in the Interpretation Act³⁴⁷ which applies to the interpretation of every law as defined in the Interpretation Act as well as the interpretation of any by-laws, rules, regulations or orders made under the authority of any such law.³⁴⁸ “Person” is defined in the Interpretation Act to include any divisional councils, municipal councils, village management boards or similar authority, as well as any company incorporated or registered as such under any law and any body of persons, corporate or unincorporated.³⁴⁹ From this definition it is clear that it includes a natural person as well as non-natural persons such as companies, close corporations, co-operatives, unincorporated associations, clubs and partnerships.

However, it does not make provision for trusts created under notarial deed. In order to avoid the uncertain position of trusts, the Companies Act has specifically included trusts in the definition of a “person”³⁵⁰ and the Competition Act contains a similar provision for trusts in the definition of a “firm” which forms the subject matter of natural and non-natural persons regulated under the Competition Act.³⁵¹ The uncertainty about the criminal liability of trusts emanates from the corporate criminal liability principle provided for in section 332 of the Criminal Procedure Act³⁵² and the matter decided in *S v Peer*.³⁵³

Section 332 of the Criminal Procedure Act provides for the prosecution of corporations for the conduct of their directors or servants and for any act performed by or on the instructions of or with permissions, express or implied, given by a director or servant of that corporate body in the exercise of their powers or in the performance of their duties as director or servant or in furthering or endeavouring to further the

³⁴⁵ Statement 004: Scorecards for Specialized Enterprises; Statement 102: Recognition of the Sale of Assets; Equity Instruments and Other Businesses; Statement 103: The Recognition of Equity Equivalents for Multinationals.

³⁴⁶ Published in *Government Gazette* No. 38766 date 6 May 2015 as guidelines for developing Sector Codes provided for in s 9(1)(e) of the B-BBEE Act of 2003.

³⁴⁷ Act 33 of 1957 as amended. Last amendment by Constitutional Consequential Amendments Act 201 of 1993.

³⁴⁸ S 1 of the Interpretation Act 33 of 1957.

³⁴⁹ S 2 of the Interpretation Act 33 of 1957.

³⁵⁰ S 1 of Act 71 of 2008 defines a “person” to include a “juristic person” and a juristic person includes a foreign company and a trust irrespective of whether it was established within or outside the Republic of South Africa.

³⁵¹ S 1 of the Competition Act 89 of 1998 includes a person, partnership or a trust in the definition of “firm”.

³⁵² Act 51 of 1977.

³⁵³ [1968] 4 SA 186 (N) 187 and 188; and *Snyman* (2014) 246.

interest of that corporate body. In essence, this section provides that the fault (intention or negligence) of any of the directors or servants will be imputed or attributed to the corporate body.³⁵⁴

In the past, under section 332(5) of the Criminal Procedure Act, a director or employee of a corporate body could also be held liable for a crime committed by a corporate body unless the director or employee could prove that they did not take part in the commission of the offence or had prevented such commission of an offence. Under the fair trial and presumption of innocence principle provided for in section 35(3)(h) of the Constitution, 1996, the reverse onus was declared unconstitutional in *S v Coetzee and others*.³⁵⁵

Presently the position is that only the corporate entity can be held liable for crimes committed by its directors or employees. The directors and employees will only be liable if they actively associated themselves with the commission of the crime,³⁵⁶ or would be liable under the common law only if the conduct of such director or servant satisfies the requirements of the common law accomplice liability.³⁵⁷

Section 332(7) of the Criminal Procedure Act determines that in the case of unincorporated associations such as partnerships or clubs, all the members of that association could be liable for the conduct of one member, unless the association is governed and controlled by a committee. Several commentators agree that this presumption is a similar revers onus provision that was declared unconstitutional in *S v Coetzee* above.³⁵⁸ Some have also argued as to the constitutionality of section 332(1) of the Criminal Procedure Act on the basis that the corporate body may not have participated in the crime; the body corporate may lack knowledge of the crime; the body corporate may have taken reasonable steps to prevent the crime; or the body corporate was not able to prevent the commission of the crime.³⁵⁹

In the event of criminal prosecution procedure, section 332(2) of the Criminal Procedure Act provides for the director³⁶⁰ and servant to be cited as a representative or nominee of the corporate body. In the case of *S v Peer* referred to above the Court found that a trust is not a juristic person but merely consists of

³⁵⁴ Kemp *et al* (2017) 244.

³⁵⁵ 1997 (3) SA 527 (CC).

³⁵⁶ Kemp *et al* (2017) 244.

³⁵⁷ Burchell (2016) 468.

³⁵⁸ Snyman (2014) 248; and Kemp *et al* (2017) 244.

³⁵⁹ Kemp *et al* (2017) 245.

³⁶⁰ A “director” is defined in s 332(10) of the Criminal Procedure Act for the purpose of s 332 to mean “in relation to a corporate body a person who controls or governs that corporate body or who is a member of a body or group of persons who controls that corporate body or in the absence of such a body or group, a person who is a member of that corporate body”.

an aggregate of assets and liabilities. The Court regarded the trust as the accused and found that a trustee cannot be charged on behalf of the trust or as a representative of the trust as would be the case with a corporate body. To charge the trustee in a representative capacity was found to be a nullity because the trust is not a legal personality. The view is that a trustee be charged in his personal capacity as owner of the property by virtue of his position as trustee. A trust does not fall within the ambit of a “person” as defined in the Interpretation Act or a corporate body for purpose of section 332 of the Criminal Procedure Act 51 of 1977.

The B-BBEE Act of 2003 differentiates in sanctions between natural and non-natural persons. Apart from the fact that a trust cannot be prosecutable under the B-BBEE Act of 2003, an interesting question arises, namely: if a trustee is prosecuted in his personal capacity, which sanction will apply to such trustee?³⁶¹

The non-inclusion of trusts as “person” in the B-BBEE Act of 2003 could be seen as an oversight by the legislature. It is difficult to imagine any other possibility given the explicit provisions for trusts in other legislation³⁶² operating in the same environment, such as the Companies Act and Competition Act.

4.4.1.4 The terms “undermine”, “frustrate” and “engage”

The terms “undermine” and “frustrate” are not defined and bear their grammatical meaning. According to Collins English Dictionary, “undermine” means to “weaken gradually or insidiously” while “frustrate” means to “hinder or prevent”. The Oxford Advanced Dictionary describes “frustrate” as “prevent from doing or being carried out”.³⁶³ The term “engage” means “to take part in or to participate”.³⁶⁴

The aim of the fronting provisions is to target all the parties participating in fronting. Jack points out that it takes two parties to front and that it cannot be done by a white company alone. According to Jack, black people would participate as the financial reward makes it attractive for them to front.³⁶⁵ The term “engage” is also used to criminalise cartel offences in terms of section 73A of the Competition Act³⁶⁶ where more

³⁶¹ S 130(3) of the B-BBEE Act of 2003 provides for a fine based on turnover in the event that the “convicted person is not a natural person” or under prohibit or so-called “blacklisting” members, directors or shareholders if the “convicted person is not a natural person”.

³⁶² S 1 of the National Credit Act 34 of 2005 includes trusts in definition of a “juristic person” with more than three trustees or where a trustee itself is a “juristic person”.

³⁶³ Hornby *et al* (1986) 348.

³⁶⁴ As above 252 and 285.

³⁶⁵ Jack (2013) 471.

³⁶⁶ S 73A of the Competition Act 89 of 1998 provides for the causing or permitting of a person, partnership or trust (referred to as a “firm”) to engage in prohibited practices in terms of s 4(1)(a) and (b) of the Competition Act which has

than one participant is targeted.³⁶⁷ The fronting provisions aim to have a similar application for anti-collusion practices provided for in the Competition Act as the corrupt giver and corrupt recipient in the Prevention of Combatting of Corrupt Activities Act.³⁶⁸ Fronting is often referred to as “institutional corruption” or “dignified bribery”³⁶⁹ to describe the active and passive roles of parties involved in a fronting offence similar to those in offences such as corruption and bribery.³⁷⁰

4.4.1.5 Objectives of the B-BBEE Act of 2003

The definition of a fronting practice also refers to the “objectives of the Act”. The objectives of the B-BBEE Act of 2003 is contained in section 2 of the Act and need to be examined in conjunction with the definition of “broad-based black economic empowerment” provided for in section 1 of the Act. “Broad-based black economic empowerment” is defined as the viable economic empowerment of all black people³⁷¹ but in particular women, the youth, people with disabilities and people living in rural areas³⁷² through diverse but integrated socio-economic strategies. The definition then lists six strategic areas and states that these strategic areas should not be limited to those provided for in the definition. These strategic areas are: increasing the number of black people who manage, own and control enterprises and productive assets;³⁷³ facilitating ownership and management of enterprises and productive assets by communities, workers, co-operatives and other collective enterprises; human resource and skills development; the achievement of equitable representation in all occupational categories and levels in the workforce;³⁷⁴ and

the effect of substantially preventing or lessening competition or involved in price fixing, dividing markets or collusive tendering.

³⁶⁷ Ensor *Mail & Guardian* (Oct 2016) 24. The B-BBEE Commissioner, Zodwa Ntuli, illustrated the point that all parties participating would be criminally prosecuted for engaging in fronting practices and stated “willing frontees are people who are making themselves available to be fronted for a quick buck...you cannot expect the Commissioner to treat them differently just because of their colour of their skin”.

³⁶⁸ Act 12 of 2004.

³⁶⁹ Jeffery (2014) 199 quoting the Minister of Trade and Industry referring to B-BBEE ownership as a source of “institutional corruption”; and Madi (2016) 30.

³⁷⁰ Snyman (2014) 402.

³⁷¹ In terms of s 1 of the B-BBEE Act of 2003 “black people” is a generic term which means Africans, Coloureds and Indians who are citizens of the Republic of South Africa by birth or who became citizens before 27 April 1994 or who were entitled to acquire citizenship by naturalisation prior to 27 April 1994.

³⁷² This category of black people is also defined in the B-BBEE Codes as “Black Designated Groups”.

³⁷³ Ownership of productive assets is promoted by Statement 102: Recognition of Sale of Assets, Equity Instruments and other Businesses published in *Government Gazette* No. 38766 dated 6 May 2015.

³⁷⁴ The Employment Equity Act 53 of 1998; and Promotion of Equality and Prevention of Unfair Discrimination Act 52 of 2003 seen as separate legislation in support of B-BBEE objectives.

preferential procurement from enterprises³⁷⁵ that are invested in enterprises that are owned³⁷⁶ or managed by black people.³⁷⁷

The objectives of the B-BBEE Act of 2003 are contained in section 2 of the Act and identify eight areas of facilitating B-BBEE as defined above. These areas can be summarised as: promoting economic transformation in order to enable meaningful participation of black people in the economy; achieving a substantial change in the racial composition of ownership and management structures and in the skills occupation of existing and new enterprises; increasing the extent to which black women communities, the workers, co-operatives and collective enterprises own and management existing and new enterprises and increasing these groups' access to economic activities, infrastructure and skills training; promoting investment programmes that will lead to broad-based and meaningful participation by black people in the economy in order to achieve sustainable development and general prosperity; empowering rural and local communities by enabling them to access economic activities, land infrastructure, ownership and skills; promoting access to finance for black small, medium, micro and start-up enterprises, co-operatives and black entrepreneurs in general, including those involved in the informal business sector of the economy; and increasing the effective economic participation of black-owned and black-managed enterprises and enhancing their access to financial and non-financial support.

The objectives of the B-BBEE Act of 2003 are very broad policy statements to facilitate those strategies deemed to be broad based in nature as defined and contained in the B-BBEE strategy issued in terms of section 11 of the Act.

The Preamble to the B-BBEE Act of 2003 is instrumental in understanding the purpose to coincide with the objectives of the B-BBEE Act of 2003 and mentions the promotion of a higher economic growth rate,³⁷⁸ more equitable income distribution, protection of the common market and equal opportunity and equal access to government services. These aims identified in the Preamble are not directly dealt with as objectives in terms of section 2 of the B-BBEE Act of 2003 or as part of the definition of "broad-based black economic empowerment" but the Preamble widens the scope of understanding and interpretation

³⁷⁵ The Preferential Procurement Policy Framework Act 5 of 2008 with its procurement muscle as main driver of B-BBEE; and the Competition Act 89 of 1998 which states as its objective in particular to increase the ownership stakes of historically disadvantaged persons.

³⁷⁶ "B-BBEE owned Company" is defined in Schedule 1 of the B-BBEE Codes as an entity in which black people have 51% of the voting rights and enjoy 51% of the right to economic interest in the entity.

³⁷⁷ The National Empowerment Fund Act 105 of 1992 is specifically enacted to assist black owned enterprises with financial support.

³⁷⁸ Jack (2013) 22 which emphasises that the cornerstone of B-BBEE is growth. The policy promotes growth instead of pure distribution.

of the B-BBEE Act of 2003. This could lead to different interpretations of the objectives of the B-BBEE Act of 2003. The definition of “broad-based black economic empowerment”, combined with the objectives and Preamble of the B-BBEE Act of 2003, is important as it illustrates the broad application of black economic empowerment away from the narrow-based approach characterised by the system before 2003 in which a few black individuals or the so-called political elite were involved in mainly ownership transactions.³⁷⁹

In interpreting the objectives of the B-BBEE Act of 2003, read with the Preamble, the definition of “broad-based black economic empowerment” and the B-BBEE Strategy, the question arises as to whether B-BBEE is a growth or redistribution model, and if it is both, what the degree of interdependence between the two concepts is, and, in the event of a conflict between the two, which one should receive preference?

4.4.1.6 The B-BBEE Codes as “provisions of this Act”

The reference in the definition of a “fronting practice” to the “implementation of any provisions of this Act” by virtue of the definition of the term “this Act” includes the B-BBEE Codes, Sector Codes or Charters and Regulations. In the development of the Sector Codes, the B-BBEE Codes must be used as a benchmark for the calculation of methodologies and targets and the same definitions as in the B-BBEE Codes must be used in Sector Codes. The Sector Codes must fully address all the elements provided for in the B-BBEE Codes.³⁸⁰ The B-BBEE Codes issued in terms of section 9 of the B-BBEE Act of 2003 must promote the objectives of the Act.

The purpose of the B-BBEE Codes and the role they play are set out in section 9 of the B-BBEE Act of 2003 as: to further the interpretation and definition of B-BBEE and the different categories of B-BBEE entities; determine qualification criteria for preferential purposes for procurement and other economic activities; set indicators and weightings to measure B-BBEE; determine guidelines for stakeholders in relevant sectors of the economy to draw up transformation charters and Sector Codes;³⁸¹ specify targets consistent with the objectives of the B-BBEE Act of 2003 and the period within which those targets should be achieved; and any other matter necessary to achieve the objectives of the B-BBEE Act of 2003.

³⁷⁹ Jack (2013) 22; and Madi (2016) xxxiii, 29, 49 and 51.

³⁸⁰ Statement 003: Amended Guidelines for the Developing and Gazetting of Sector Codes published in *Government Gazette* No. 38766 dated 6 May 2015.

³⁸¹ As above.

The status of the B-BBEE Codes is provided for in section 10 of the B-BBEE Act of 2003. In terms of section 10 of the B-BBEE Act of 2003, every organ of state and public entity must apply any codes published under section 9 when: determining qualification criteria for the sale of state-owned enterprises; entering into partnerships with the private sector; issuing licences, concessions or other authorisations in respect of any economic activity; developing and implementing preferential procurement policies; and determining criteria for the awarding of incentives, grants and investment schemes in support of B-BBEE.

The Minister may exempt an organ of state or public entity from a requirement contained in section 10 of the B-BBEE Act of 2003 or a deviation from a specific requirement.³⁸²

The B-BBEE Codes are therefore central to the implementation³⁸³ of B-BBEE, but by law the B-BBEE Codes only bind organs of state and public entities.³⁸⁴ All other entities only voluntarily subject themselves to the B-BBEE Codes to have their level of B-BBEE compliance measured. The B-BBEE Codes determine who are measurable under the Codes, bearing in mind that submitting to such measurement is voluntary in order to be considered for doing business with the state or organs of state. Entities that are measurable under the B-BBEE Codes are: organs of state and public entities; a measured entity³⁸⁵ that undertakes any economic activity with any organ of state and public entity; and any other measured entity that undertakes any economic activity, whether directly or indirectly, with any other measured entity that is subject to measurement by virtue of undertaking any economic activity with an organ of state or a public entity, and where such a measured entity wishes to establish its own B-BBEE compliance.³⁸⁶

Direct or indirect frustration or undermining of the implementation of the B-BBEE Codes is seen as a “fronting practice”. In reading and studying the B-BBEE Codes and Sector Codes, the poor drafting, inconsistencies and incompleteness are apparent. Balshaw has described the B-BBEE Codes as onerous, complex and revealing “apparent oversight and poor drafting”. He points out the “numerous

³⁸² The Department of Mineral Resources has been exempted from applying the requirements contained in s 10 of the B-BBEE Act of 2003 to upstream petroleum, mining and minerals industry administered in terms of the Mineral and Petroleum Resources Development Act 28 of 2002 pending the finalization of their Sector Codes published in *Government Gazette* No. 39350 dated 30 October 2015.

³⁸³ Balshaw and Goldberg (2014) 75 and 77 state with reference to the B-BBEE Codes that the effectiveness of the B-BBEE Act of 2003 “will be determined by the ability of the instruments of implementation to ensure achievement of the objectives of the Act”.

³⁸⁴ Jeffery (2014) 138.

³⁸⁵ A “measured entity” is defined in Schedule 1 of the B-BBEE Codes “as an entity as well as an organ of state or public entity subject to measurement under the Codes”.

³⁸⁶ Para 3.1 Statement 000 of the B-BBEE Codes.

grey areas, errors and ambiguity” in the B-BBEE Codes which were inherited from the 2007 version of the B-BBEE Codes and which “errors and anomalies” were not addressed.³⁸⁷

Jeffery points out that the B-BBEE Codes are supposed to fill the gaps left by the B-BBEE Act of 2003 and address government’s desire that the B-BBEE Codes should have the same legal force as the Act itself. She describes the process lead by the B-BBEE Codes as becoming “increasingly complicated, demanding an intrusive” and describes the rules incorporated into the B-BBEE Codes as “complex and vague”. She also points out that the B-BBEE Codes consist of a “hundred drafting errors and ambiguities”. She further contends that the Verification Manual, which is supposed to be the sole guideline determining the methodology for measurement under the B-BBEE Codes, consists of mathematical formulae and complex B-BBEE terminology and that verification agents have reported “following their own interpretation on the vague rules”.³⁸⁸

The observations of Vuyo Jack regarding the B-BBEE Codes are of significance in that he was involved in developing the rating index system incorporated into the B-BBEE Codes and was co-opted by the Department of Trade and Industry’s commissioned technical team tasked with the development of the B-BBEE Codes.³⁸⁹ According to Jack, the purpose of the B-BBEE Codes is to put “practicalities into effect”. The B-BBEE Codes determine a rating system as the basis of B-BBEE compliance and the B-BBEE Codes are a “legal expression of a numerical rating system”. Therefore, according to Jack, the B-BBEE Codes are drafted in “simple language and easy to read” and terms in capital letters are defined in the statement (although the reading of the B-BBEE codes indicates that various terms in capital letters are not defined, or capital letters are used inconsistently in relation to the same term, or terms in the definitions differ from the text of the B-BBEE Codes). According to Jack, in simplifying the B-BBEE Codes “several areas are not addressed” and the B-BBEE Codes “do not guide users” in all respects. He points out several examples where general aspects are not provided for in the B-BBEE Codes. He for instance comments in respect of the calculation of enterprise development in the B-BBEE Codes that it is a “confusing section as the Codes do not lucidly communicate the requirement”.³⁹⁰

Although Jack’s comments relate to the 2007 version of the B-BBEE Codes, the existing B-BBEE Codes are, besides certain targets and weights, virtually a carbon copy of the previous version and all the aspects alluded to by Jack are *mutatis mutandis* applicable in the existing version of the B-BBEE Codes

³⁸⁷ Balshaw and Goldberg (2014) 12, 14, 28 and 30.

³⁸⁸ Jeffery (2014) 137, 139, 141, 142, 172 and 182.

³⁸⁹ Jack (2013) 32-38.

³⁹⁰ As above 29, 45, 65, 161, 166, 170, 171 and 324.

now incorporated into the definition of a “fronting practice” as a criminal offence. The Mining Charter, which was not published in terms of section 9 of the B-BBEE Act, but operates under the Mineral and Petroleum Resources Development Act 28 of 2002 and which is included in the definition of a “B-BBEE initiative” of a fronting practice, has been the subject of a much-publicised and controversial court application by the Chamber of Mines to have the Charter reviewed and set aside in terms of the Promotion of Administrative Justice Act³⁹¹ on the grounds that it is vague, confusing and irrational.³⁹²

The incorporation of such unclear, vague, broad and ambiguous provisions as those contained in the B-BBEE Codes and Sector Charters in a formulation of a statutory offence might prove to be unconstitutional based on the fact that they do not meet the requirements of criminal legality protected under section 35 of the Constitution, 1996.³⁹³ This aspect will be more fully analysed later in this dissertation.

4.4.2 SPECIFIC TRANSACTIONS INCLUDED AS A FRONTING PRACTICE

As pointed out in paragraph 4.4 above, the “fronting practice” definition consists of two parts. The first part is a general formulation of a fronting practice and the second part includes certain specific initiatives and transactions. The specific transactions, although not limited, are included as B-BBEE initiatives which are considered to fit the general formulation as the result of these transactions are to frustrate or undermine the objectives of the B-BBEE Act of 2003 or the implementation of the Act. Four transactions are identified and included, numbered (a)-(d)(i)-(iii) under the definition of a fronting practice³⁹⁴ and can be summarised as follows:

- (a) 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;
- (b) The economic benefits received as a result of the B-BBEE status of an enterprise do not flow to black people in the ratio provided for or specified in the legal documentation of the transaction;
- (c) The conclusion of a legal relationship with a black person for the purpose of achieving a certain B-BBEE compliance level without granting the relevant black person the economic

³⁹¹ Act 3 of 2000.

³⁹² Mahlakoana *Business Day* (June 2017) 23.

³⁹³ Snyman (2014) 35 and 39.

³⁹⁴ S 1 of the B-BBEE Act of 2003.

benefits that are reasonably expected to be associated with the status or position held by that black person;

- (d) An agreement with another enterprise to achieve or enhance a measured entity's B-BBEE status in circumstances where:
- (i) there are significant limitations, whether implicit or explicit, on the identity of suppliers, service providers, clients or customers of the enterprise (although not clear, it can be assumed that reference to enterprise is a B-BBEE enterprise);³⁹⁵
 - (ii) the maintenance of business operations of an enterprise with whom an agreement is concluded is reasonably considered to be improbable, given the resources available to such an enterprise;³⁹⁶
 - (iii) the terms and conditions of the agreement were not negotiated at arm's length and on a fair and reasonable basis.³⁹⁷

4.4.2.1 Application of specific transactions by the High Court in *PRASA v Swifambo*, 2017³⁹⁸

The High Court has in the much-publicised *Passenger Rail Agency of South Africa v Swifambo Rail Agency (Pty) Ltd* applied the above “fronting practice” definition, and in particular the specific transactions listed under (d)(i) and (ii) of the definition in a case involving an investigation by the Public Protector into an irregular and fraudulent transaction involving tender irregularities and fronting.

This *Swifambo* case relates to an application brought by the Passenger Rail Agency of South Africa (PRASA), as the applicants, to have a decision to award a tender by the previous board of directors of PRASA as well as the agreement concluded with Swifambo Rail Agency (Pty) Ltd, as the respondents, reviewed and set aside. In the alternative the applicants sought a declaratory order to the effect that the contract had lapsed and was of no effect and force as a result of the respondent's (Swifambo's) failure to comply with the suspensive conditions within the prescribed period of the contract.

³⁹⁵ Paras 3.2.2.1 and 3.2.2.2 of Statement 102: Recognition of the Sale of Assets, Equity Instruments and Other Business where these types of transactions with reference to “enterprise” means a B-BBEE enterprise.

³⁹⁶ *Esorfranki* paras [11] and [12] above; and see Chapter 3 para 3.6.5 above.

³⁹⁷ Para 3.2.3 of Statement 102: Recognition of the Sale of Assets, Equity Instruments and Other Business in respect of any operational outsource agreements with a related business in terms of recognition for ownership due to a Qualifying Transaction provided for in this Statement.

³⁹⁸ *Passenger Rail Agency of South Africa v Swifambo Rail Agency (Pty) Ltd* (2015/42219) [2017] ZAGPJHC 177.

The review sought by PRASA related to a tender for the purchase and supply of 88 locomotives to be used by the South African rail network. The applicants brought an application in terms of section 9 of the Promotion of Administrative Justice Act (PAJA)³⁹⁹ to have the time limits for lodging such an application extended.⁴⁰⁰ The Court has from the outset emphasised the fact that the case is of significant public interest.⁴⁰¹ With regard to the application to grant an extension of the time period provided for in section 7 of PAJA to lodge a review application, the Court found that such an application must be lodged without unreasonable delay and not later than 180 days after the person became aware of the action and reasons. The applicants contended that the 180 days provided for by PAJA within which to lodge an application to extend the period to lodge and review applications only commenced as from the date on which the irregularities with regard to the tendering and awarding of the contract were discovered. The Court disagreed with this contention and pointed out with reference to sections 6 and 7 of PAJA that the period started running from the date the decision was made, being the conclusion of the agreement between PRASA and *Swifambo*.⁴⁰² In calculating the time period, the Court found that the application was 793 days late, and due to the length of the delay, good cause must be shown by the applicants for such a delay, and the application must be brought by way of a substantive application irrespective if it is brought in terms of the principle of legality or PAJA.⁴⁰³

The Court found that in considering an extension of the period in terms of PAJA, the Court should have regard to the circumstances of the case, the date the party became aware of the irregularity, the concealment of irregularities by staff members, the prospects of success of the review application, and the relief the applicant ultimately seeks. The Court pointed out that the most important factor to be considered by the Court in granting the extension would be the interest of justice.⁴⁰⁴

The Court found that administrative action that does not satisfy the requirements of section 33 of the Constitution, 1996⁴⁰⁵ or PAJA is unlawful and must be declared invalid. The Court also found that the decision to award the contract to *Swifambo* was unlawful and was consequently declared invalid.⁴⁰⁶ In

³⁹⁹ Act 3 of 2000.

⁴⁰⁰ S 7 of PAJA Act 3 of 2000 allows for judicial review to be instituted not later than 180 days after conclusion of any internal remedies and where no such remedies exist, then when the person concerned was informed of the administration action. In terms of s 9 of PAJA, this time limit may be extended by agreement or by the court or tribunal.

⁴⁰¹ *Swifambo* para [25.7] above.

⁴⁰² *Swifambo* para [29].

⁴⁰³ *Swifambo* para [33].

⁴⁰⁴ *Swifambo* paras [29] and [30].

⁴⁰⁵ S 33 (1) of the Constitution, 1996 determines that everyone has the right to administrative action that is lawful, reasonable and procedural fair.

⁴⁰⁶ *Swifambo* para [82] above.

deciding on an appropriate remedy in terms of section 8 of PAJA and section 172 of the Constitution, 1996, the Court held the view that in doing so, the primary focus of judicial review is to correct and reverse unlawful administrative action. The Court considered the various steps taken by PRASA employees to conceal irregularities in order to allow Swifambo to gain a dishonest advantage over other bidders, which constitutes fraud. The Court defined fraud as “an act or course of deception, an intentional concealment, omission or perversion of truth to gain an unlawful or unfair advantage”.⁴⁰⁷ The irregularities discovered in this case, the Court found, were tantamount to corruption, collusion and fraud.

In respect of having the contract between PRASA and Swifambo set aside, PRASA submitted that Swifambo had made illicit payments to the ruling party and that their trains do not meet the technical specification required and are not fit for purpose. PRASA further contended that the agreement between Swifambo and Vossloh constitutes “fronting”. Vossloh is an overseas company that provided Swifambo with the locomotives to be sold to PRASA. PRASA supports its argument that the agreement between Swifambo and Vossloh is fronting by referring to the definition in the B-BBEE Act of 2003 as the arrangement between them undermines the objectives of the B-BBEE Act of 2003 in that the mere payment of money for the use of a black person’s status is not substantive empowerment and is insufficient in the context of this particular matter. The definition of a “fronting practice” in the B-BBEE Act of 2003, according to PRASA, does not require misleading or exploitation of parties to the arrangement.⁴⁰⁸

Swifambo, in reply, submitted that it was an innocent tenderer and denied any involvement in any fronting. It also contended that no evidence could be provided to directly link Swifambo to any fraud and corruption associated with the awarding of the contract and denied that any illicit payments were made to the ruling party.

The Court found with regard to the accusation of fronting that the agreement between Swifambo and Vossloh amounted to fronting as the relationship meets the broader definition under the B-BBEE Act of 2003 as well as the criteria under paragraph (d)(i) and (ii)⁴⁰⁹ of the Act. The Court pointed out that Swifambo’s role was mainly administrative in nature and that Vossloh had complete control over every aspect of the contract, including the appointment of the members of Swifambo’s steering committee. The Court concluded that there were various clauses in the agreement between Swifambo and Vossloh that

⁴⁰⁷ *Swifambo* para [84].

⁴⁰⁸ *Swifambo* para [91].

⁴⁰⁹ See Chapter 4 para 4.4.2 above.

point to the true nature of the agreement and which constitute fronting and undermine and frustrate substantial empowerment.

The Court referred to an option that exists for foreign-owned companies to achieve B-BBEE ownership recognition issued in terms of section 9 of the B-BBEE Act of 2003. In terms of this programme known as “The Recognition of Equity Equivalents for Multinationals”,⁴¹⁰ multinational companies can comply with B-BBEE by contributing towards programmes involving, amongst others, growth, skills development and socio-economic advancement of black people. The Court found that to allow the arrangement between Swifambo, as a local entity, and Vossloh, as an overseas company, whereby Vossloh provided goods in South Africa, would permit foreign companies to disregard the B-BBEE requirements and so-doing frustrate the implementation of the provisions of the B-BBEE Act of 2003 by evading their obligation to invest a substantial amount into empowerment initiatives.⁴¹¹

Apart from the general provisions of the “fronting practice” definition, the Court also applied the specific transactions under (d) in the fronting practice definition and found in respect of (d)(i)⁴¹² that an inherent limitation exists in the identity of suppliers, service providers or customers as Vossloh was performing all the work in a foreign country and Swifambo had no knowledge of or access to any of Vossloh’s suppliers, service providers, clients or customers.⁴¹³ Swifambo is also obliged in terms of the agreement between them to return all confidential information regarding Vossloh’s business activities, products, services, customers and clients, technical knowledge and secrets to Vossloh after termination of the agreement.

With regard to paragraph (d)(ii)⁴¹⁴ in the “fronting practice” definition, it was common cause that Swifambo is a start-up enterprise with virtually no employees, business or customers, which illustrates that the maintenance of business operations is reasonably considered to be improbable given the extremely limited resources at Swifambo’s disposal.⁴¹⁵ The only reason for Vossloh entering into an agreement with

⁴¹⁰ This programme is known as the Equity Equivalent Investment Programme (EEIP) and the Court referred to the first introduction of the programme published in 2007, but it had been subsequently replaced by a similar programme in 2015 to be aligned with the amended B-BBEE Codes per Statement 103: The Recognition of Equity Equivalents for Multinationals, published in *Government Gazette* No. 38766 dated 6 May 2015. Should a multinational entity require recognition under the programme, they need to apply for exemption from the Minister of Trade and Industry to be exempted from the ownership element if a global practice prohibiting the multinational from doing any equity or sale of business in a regional country and such global practice existed before 2003. The multinational is then required to spend four percent of its annual turnover or twenty five percent of its asset value or a *pro rata* amount based on its South African operations for a period of three to ten years on empowerment initiatives provided for in the programme.

⁴¹¹ *Swifambo* para [102] above.

⁴¹² See Chapter 4 para 4.4.1 above.

⁴¹³ *Swifambo* para [104] above.

⁴¹⁴ See Chapter 4 para 4.4.2 above.

⁴¹⁵ *Swifambo* paras [107] and [128] above.

Swifambo was Swifambo's B-BBEE rating, which Swifambo was obliged in terms of the agreement between the parties to attain throughout the course of the agreement. Apart from Swifambo's B-BBEE status, the Court found it had absolutely nothing else to offer Vossloh.⁴¹⁶

The Court pointed out that the definition of a "fronting practice"⁴¹⁷ in the B-BBEE Act of 2003 does not require an element of misrepresentation as to the true nature of the arrangement and the definition of a "fronting practice" should not be interpreted in a manner that requires misrepresentation of the nature of the agreement. The Court found that: reading a requirement of misrepresentation of the true nature of the agreement into the "fronting" definition will not give effect to the interests of the public; that public tenders should be awarded free from fraud and corruption; and that public money should not end up in the pockets of "corrupt officials and businesses people through *inter alia* fronting practices". The public also has an interest in the attainment of B-BBEE which is retarded by corrupt and fraudulent conduct. The Court found that fronting practices will also exist where organs of state and public entities or individuals within their ranks "conspire or collude" in such conduct.⁴¹⁸ In this regard, the Court referred to the *Esorfranki*⁴¹⁹ case where fronting was found to be fraud committed against those who B-BBEE was meant to benefit and in circumstances where individuals within the ranks of government or organs of state conspired and colluded to award tenders to a front under the disguise of B-BBEE.

The Court in the *Swifambo* case found that a fronting practice is present in circumstances where individuals within the ranks of organs of state or public entities are "complicit" in the arrangement even in the absence of a misrepresentation by such individuals.⁴²⁰

With regard to the legal nature of the relationship between Swifambo and Vossloh, the Court found that the true nature cannot be established, as this was obstructed or obscured in the bid. In the bidding documentation mention was made that a joint venture⁴²¹ was established between Swifambo and Vossloh while in other parts of the bid the documentation indicates that no joint venture agreement was structured. The bidding documentation also provided for Vossloh to be a subcontractor doing 100% of all the work or a supplier to Swifambo or a supply partner.

⁴¹⁶ *Swifambo* para [106].

⁴¹⁷ S 1 of the B-BBEE Act of 2003.

⁴¹⁸ *Swifambo* paras [108] and [109] above.

⁴¹⁹ *Esorfranki* see Chapter 3 para 3.6.5 above.

⁴²⁰ *Swifambo* para [111] above.

⁴²¹ S 1 of the Preferential Procurement Regulations, 2001 in place at the time of the transaction (which has been replaced by the Preferential Procurement Regulations, 2017) defines a "consortium" or "joint venture" as "an association or persons for the purpose of combining the expertise, property, capital, efforts, skill and knowledge in an activity for the extension of a contract".

The Court found that an agreement between Swifambo and Vossloh was only entered into 16 months after PRASA awarded the contract to Swifambo and that a joint venture therefore did not exist at the time of awarding the tender to Swifambo, which is contrary to the requirements of the tender documents.⁴²² With regard to a fronting practice, the Court dismissed Swifambo's submission that no exploitation had taken place of any black person or that an opportunity was gained to the individual prejudice of a black person. The Court found that exploitation and prejudice of an black individual were not required as the relationship between Swifambo and Vossloh amounted to the exploitation of the intended beneficiaries of B-BBEE, being black people, which fits the requirement of the fronting practice being an arrangement that undermines or frustrates the achievement of the objectives of the B-BBEE Act of 2003 or the implementation of the provisions of the said Act.⁴²³ The Court found that the contractual agreement between Swifambo and Vossloh amounted to a fronting practice, which is a criminal offence in terms of the B-BBEE Act of 2003, and that Swifambo's involvement in a fronting act justifies the setting aside of the contract between Swifambo and PRASA.⁴²⁴

The Court considered an appropriate relief in terms of section 172⁴²⁵ of the Constitution, 1996 and found that the harm to be inflicted on Swifambo, which had partially delivered in terms of the contract with PRASA, does not weigh up to the interest of public good. The Court also referred to the interest of the holding entity of Swifambo, being Swifambo Rail Holdings, which the Court found had devised the scheme and whose interest is immaterial in comparison to the prejudice of the public interest. The fact that an amount of R1 billion was still to be paid in terms of the contract between PRASA and Swifambo made the setting aside and prevention of the irregular, corrupt and fraudulent agreement even more important in the public interest.⁴²⁶ The Court deliberated on the effect of corruption on society and the harm it would cause "hardworking and honest people", whistle blowers of corruption as well as the administration of justice.⁴²⁷ The Court ordered that: the time period within which to institute review proceedings in terms of section 7 of PAJA be extended; that the sale and purchase of locomotives agreement between PRASA and Swifambo be reviewed and set aside; and that the decision by PRASA to award the contract to Swifambo and the decision to conclude the agreement with Swifambo also be reviewed and set aside.⁴²⁸

⁴²² *Swifambo* paras [112] and [113] above.

⁴²³ *Swifambo* paras [114] and [115].

⁴²⁴ *Swifambo* para [115].

⁴²⁵ S 172 of the Constitution, 1996 provides that when a court decides a constitutional matter, the court must declare that any law or conduct that is inconsistent with the Constitution, 1996 is invalid to the extent of its inconsistency and the court may make any order that is just and equitable.

⁴²⁶ *Swifambo* para [122] above.

⁴²⁷ *Swifambo* para [130].

⁴²⁸ *Swifambo* para [134].

4.4.2.2 Legal questions emanating from the *Swifambo* judgement

Although this case was decided within the parameters of PAJA and the Constitution, 1996 specifically relating to administrative action (decision to award a tender and conclude an agreement) by a public entity (PRASA), the interpretation and application of the definition of a “fronting practice” in the B-BBEE Act of 2003 by the Court are very much relevant in instances outside the ambit of PAJA.

With regard to the review and setting aside of the agreement between PRASA and Swifambo, it should be borne in mind that an organ of state or a public entity is also permitted to cancel an agreement in terms of section 13A of the B-BBEE Act of 2003 in circumstances where a contract was awarded based on false information knowingly furnished by an enterprise in respect of its B-BBEE status. Knowingly providing false information is a criminal offence in terms of the B-BBEE Act of 2003.⁴²⁹ The authority to cancel agreements by an organ of state or a public entity does not require a conviction under the B-BBEE Act of 2003 or any other law; however, the provisions in terms of section 13P of the B-BBEE Act of 2003 relating to “black-listing” of entities, or its members, directors or shareholders for a period of up to 10 years and preventing them from doing any business with organs of state or public entities, require a conviction in terms of the B-BBEE Act of 2003. The aim of this dissertation is to look at a fronting practice from a criminal law point of view and without dwelling too far into other areas of the law. The authority given by the B-BBEE Act of 2003 to organs of state and public entities to unilaterally cancel agreements and authorisations such as licences and permits awarded by organs of state or public entities without a conviction opens up interesting legal questions in respect of the administrative fairness and constitutional legality to do so.

A further question emanating from this is what remedies an organ of state, public entity or a first tier supplier⁴³⁰ would have in circumstances where false information or a fronting practice is discovered in respect of a second tier supplier where revoking a second tier supplier’s B-BBEE status directly impacts the B-BBEE status of a first tier supplier as an innocent party, and which B-BBEE status led directly to the conclusion of an agreement or awarding of an authorisation to such first tier entity by an organ of state. One is inclined to regard the cancellation of the innocent first tier supplier’s agreement or authorisation as an unfair administrative action. By not cancelling such an agreement and continuing with

⁴²⁹ S 13O(1)(c) of the B-BBEE Act of 2003.

⁴³⁰ Jack (2013) 85 states that “first tier suppliers” refer in a B-BBEE context to those primary suppliers of goods and services to organs of state or public entities and second tier suppliers to those providing goods or services to first tier suppliers in circumstances where the B-BBEE status of a second supplier affects the B-BBEE status of a first tier supplier.

an agreement obtained and awarded on the premise of a “mistake” might be an unfair administrative action towards other bidders⁴³¹ with a genuine or uncompromised B-BBEE status.

The importance of the *Swifambo* judgement from a fronting practice point of view is that the Court referred to the general provisions as “broad provisions” and the specific transactions listed under (a)-(d)(i)-(iii) as “criteria”. The Court followed an approach to apply the general provisions and the specific transactions in the fronting practice definition in unison and tested the specific transactions against the general provisions of the definition.

With regard to the Court’s application of a transaction envisaged in terms of paragraph (d)(i) of the definition of a “fronting practice” on the arrangement between Swifambo and Vossloh, it is submitted that the Court applied this specific provision of the definition incorrectly. The provision provides for a B-BBEE initiative involving the conclusion of an agreement with another enterprise to enhance or achieve a B-BBEE status under circumstances in which significant limitations existed on the identity of suppliers, service providers, clients or customers. This provision is almost a *verbatim* replica of a provision providing for the recognition of ownership points in the event of a sale of assets, equity instruments and other businesses. In terms of this recognition principle allowed by the B-BBEE Codes in terms of an additional statement to the Codes,⁴³² an established business selling assets, equity instruments or another separate business or a division of its business such as those provided for under outsourcing agreements (the seller) to a B-BBEE company may then claim ownership points for such a sale subject to certain conditions.

One of the conditions is that the sale of assets, equity instrument and business must involve a separate identifiable related business⁴³³ which has no unreasonable limitations or conditions with regard to its clients, customers or suppliers other than the seller, where the B-BBEE shareholders or their successive B-BBEE shareholders hold the assets for a minimum period of three years. These provisions or conditions are referred to as “anti-fronting” provisions.⁴³⁴ The Statement also provides for any outsourcing agreement between the seller and the separately identifiable related business to be negotiated at arm’s

⁴³¹ *Swifambo* para [84] above. The Court found that the irregularities in awarding a tender to Swifambo created a financial advantage to Swifambo over other bidders.

⁴³² Statement 102: Recognition of Sale of Assets, Equity Instrument and other Business published in *Government Gazette* No. 38766 dated 6 May 2015. These transactions are also referred to as Qualifying Transaction; and Jack (2013) 205 and 207.

⁴³³ Statement 102 above, a separately identifiable related business is defined as a business that is related to the seller by virtue of being a subsidiary, joint venture, associate, business division, business unit or any other similar related arrangements within the ownership structure of the seller.

⁴³⁴ Jack (2013) 207.

length and on a fair and reasonable basis. The Statement also provides for criteria that disqualify the transaction, for instance any re-purchase agreements in respect of the assets by the seller in future.

The 2009 Guidelines contained a similar provision in respect of opportunistic intermediary entities preventing the undue control of such B-BBEE intermediary entities.⁴³⁵ The Court in the *Swifambo* case applied these criteria literally to Vossloh's clients, suppliers and customers, which differed from the traditional application, origin and purpose of these provisions. The aim of these provisions is to prevent established entities from controlling B-BBEE companies in circumstances where the established entities endeavour to continue manipulating the terms of supplier, client or customer agreements in respect of a business they sold off to B-BBEE companies.

The Court found that Vossloh was controlling Swifambo in all respects, which accordingly the provisions of paragraph (d)(i), would apply to any restrictions or limitations placed by Vossloh on Swifambo's clients, customers or suppliers. The provisions should be applied the other way around in respect of Swifambo's⁴³⁶ clients to demonstrate undue control over Swifambo.

The word "identity" in respect of suppliers, clients or customers in paragraph (d)(i) was not part of the original provisions in the Statement to Qualifying Transactions and it is submitted that the inclusion of the word "identity" and omission of the term "opportunistic intermediary" is an oversight in the drafting of the provisions in the process of incorporating certain provisions from the original Statement and 2009 Guidelines into the B-BBEE Act of 2003. The inclusion of the word "identity" does not make sense as the protection of proprietary information by means of a confidentiality agreement by a supplier to its own clients or members of a joint venture agreement is a standard commercial practice and cannot in any way undermine the objectives of the B-BBEE Act of 2003. The aim of this provision is not to look at the "identity" of suppliers, clients or customers but rather whether the terms of an agreement limit the commercial activities of a B-BBEE enterprise in respect of its suppliers, customers and clients.

Unfortunately, some of the specific transactions included in terms of paragraph (a)-(d) of the "fronting practice" definition are often a "clumsy" combination of the old fronting indicators contained in certain Statements to the B-BBEE Codes, the 2005 Statement and 2009 Guidelines to fronting. Some of the present transactions are repetitions of some of the old fronting indicators, while other anti-fronting provisions in Statements to the B-BBEE Codes have been generalised. In some instances, these

⁴³⁵ See Chapter 3 para 3.2 above.

⁴³⁶ *Swifambo* para [103] above.

combinations, replications and generalisation of old fronting indicators and anti-fronting provisions relating to specific types of transactions have created provisions which lost their traditional meaning and should be regarded as unintended. The circumstances relating to *Swifambo* as discussed in the previous paragraph are a case in point.

These transactions are examined more closely to explain the background or “DNA” of these transactions and intended present application.

4.4.2.3 Transactions under paragraph (a)

The transactions envisaged under paragraph (a) provide for discouraging or inhibiting black people appointed to an enterprise from substantially participating in the core activities of an enterprise. This provision was not cited as a fronting indicator in the 2005 Statement or 2009 Guidelines⁴³⁷ relating to fronting and seems to be a combination of more than one fronting indicator for the following: black people identified by an enterprise as shareholders, executives or management are unaware or uncertain of their role within an enterprise; such black people have roles that differ significantly from those of their non-black peers; or there is no significant indication of active participation or active participation by black people identified as top management at strategic decision-making level. The provisions under paragraph (d)(i) of the “fronting practice” definition do not encapsulate these fronting indicators and are more limited in its application as it requires discouragement and inhibiting of black persons who are appointed from participating in the core activities.

The terms “discouraging” and “inhibiting” are normally associated with shareholder restrictions. However, the existing provisions exclude shareholders as it provides for those “appointed” and only apply to directors and prescribed officers as appointed fiduciaries as shareholders are not appointed. Directors and prescribed officers are in terms of the Companies Act⁴³⁸ those responsible for fulfilling the core activities of a company.⁴³⁹ The omission of shareholders from this paragraph is peculiar as the indicators under the 2005 Statement and 2009 Guidelines specifically made provision for the inclusion of shareholders and the non-participation of shareholders is seen as non-substantive empowerment and a source of sophisticated fronting⁴⁴⁰ which the new fronting practice is aiming to stamp out. Non-participation or exclusion of shareholders in the specific provisions as a fronting practice may, however,

⁴³⁷ See Chapter 3 para 3.2 above.

⁴³⁸ Act 71 of 2008.

⁴³⁹ S 66 of the Companies Act 71 of 2008 determine that directors are responsible for the core functions of the company.

⁴⁴⁰ Jack (2013) 127, 169, 392, 400, 408, 409 and 475.

still fall within the general formulation of the “fronting practice” definition.

In *Viking*⁴⁴¹ this type of fronting, where black people were appointed in executive positions but were not involved in any executive capacity and purely used as tokens, occurred.⁴⁴²

4.4.2.4 Transactions under paragraph (b)

Paragraph (b) of the “fronting practice” definition makes provision for a B-BBEE initiative where economic benefits received as a result of the B-BBEE status of an enterprise do not flow to black people in the ratio specified in the relevant legal documentation. Several fronting practices take place to dilute economic benefits to black people through cleverly disguised schemes with different classes of shares, complex structures and sophisticated equity or financial instruments.⁴⁴³ The actual compliance with legal documentation is often a fronting practice⁴⁴⁴ and subsequently the interpretation provision in the B-BBEE Codes states that “substance takes precedence over legal form”.⁴⁴⁵ In respect of simulated transactions in general, as examined by the Courts in the *NWK* and *Roshcon* cases,⁴⁴⁶ the courts have often indicated that compliance with legal documents is not the test for the genuineness of a transaction and that the “charade” to comply with the provisions of legal documents is generally meant to disguise the true nature of the transaction and give credence to the simulation.⁴⁴⁷

The question can also be asked whether, under circumstances where economic benefits are not flowing to black people in the ratio specified in the legal documentation but at a higher ratio (for whatever reason), the provisions of compliance with legal documentation will still be the determining factor, and whether the emphasis on complying with legal documentation as a fronting practice is not missing the “substance over form” point. The Court has also found in the *Esorfranki*⁴⁴⁸ case that the two parties who entered into a joint venture arrangement did not operate according to the percentages specified in the joint venture agreement.

⁴⁴¹ See Chapter 3 para 3.6.1 above.

⁴⁴² *Viking* para [8] above.

⁴⁴³ Jack (2013) 475.

⁴⁴⁴ Jack (2013) 67 states that “legal form masking the substance of a transaction is unlikely to result in points”.

⁴⁴⁵ Para 2.1 under the Key Principles of the B-BBEE Codes.

⁴⁴⁶ See Chapter 3 paras 3.6.3 and 3.6.4 above.

⁴⁴⁷ *NWK* para [55] above.

⁴⁴⁸ *Esorfranki* para [11] above the Court found that one of the joint venture partners had no business experience and resources and could therefore not manage “its half of the work...contrary to the terms of the joint venture agreement, to manage and execute the contract of the construction of the pipeline in equal shares...” and was used as a front and only established a week before the tender was published.

4.4.2.5 Transactions under paragraph (c)

The provisions under (c) of the “fronting practice” definition are fairly wide and include a variety of arrangements. These arrangements include any legal relationship with a black person for the purpose of achieving a certain level of B-BBEE compliance without granting that black person the economic benefits that are reasonably expected to be associated with the status or position held by the black person.

These provisions include the economic benefits that a black person are expected to get as a result of shareholding or being a director or senior manager in a company. The term “economic benefits” indicates that it is not only restricted to shareholders as the return on ownership is defined in the B-BBEE Codes under “economic interest”.⁴⁴⁹ The aim of this provision is to protect black people from getting an inferior economic benefit compared to non-black counterparts. This provision originated from the 2005 Statement and 2009 Guidelines which indicated as a fronting indicator the circumstances where black people serving in executive or management positions are paid significantly lower than the market norm, unless all executives or management of an enterprise are paid at a similar level.

Such circumstances prevailed in *Peer*⁴⁵⁰ where two black females were offered 26% shares in a company collectively without any significant change in economic benefits.

This paragraph attempts, amongst others, to discourage the practice of enterprises appointing a black person as a director or senior manager but is remunerated at a different rate. The Verification Manual also provides that in the auditing of entities verification agents should assess the overall remuneration packages of black directors and management compared to the equivalent non-black directors and management. The verification agent should also examine the performance evaluations of such directors and managers that might impact any remuneration.⁴⁵¹ The provisions of paragraph (c) do not leave the option open for a legitimate differentiation in remuneration. Section 6 of the Employment Equity Act⁴⁵² prohibits unfair discrimination against any person based on a variety of grounds and provides that it is not unfair discrimination to distinguish, exclude or prefer any person on the basis of an inherent requirement of a specific job.⁴⁵³

⁴⁴⁹ As defined in Schedule 1 of the B-BBEE Codes; see Chapter 3 para 3.4 above.

⁴⁵⁰ See Chapter 3 para 3.6.2 above.

⁴⁵¹ Verification Manual above Appendix 3 para 5.1.9.

⁴⁵² Act 55 of 1998.

⁴⁵³ S 6(1) of the Employment Equity Act 55 of 1998 determine the grounds for unfair discrimination to be race, gender, sex, pregnancy, marital status, family responsibility, ethnic or social origin, colour, sexual orientation, age, disability, religion, HIV status, conscience, belief, political opinion, culture, language and birth.

In terms of section 54 of the Employment Equity Act, the Minister of Labour may issue codes of good practice that are intended to provide employers with information that may assist them in the implementation of the Employment Equity Act. In terms of this authority, the Minister of Labour had issued a Code of Good Practice on Equal Pay / Remuneration for Work of Equal Value.⁴⁵⁴ This Code of Good Practice makes provision for instances where a differentiation in remuneration does not amount to unfair discrimination if the difference is fair and rational and is based on one of the factors listed in the Codes of Good Practice such as: seniority or length of service; individuals' respective qualifications; individuals' respective performance; quantity or quality of work; and circumstances where an employee is demoted or temporarily employed; or a shortage of skills exists in a particular job classification.⁴⁵⁵

Although directors are entitled to remuneration as such in terms of the Companies Act⁴⁵⁶ they are also employees for purposes of the Labour Relations Act⁴⁵⁷ and therefore a differentiation could exist in the remuneration of directors on condition that it is based on fair and rational grounds and does not fall within those grounds prohibited by section 6 of the Employment Equity Act.

Insofar as for the differentiation in economic benefits for shareholders is concerned, Jack pointed out that it could also be justified especially in circumstances where acquisition debt or financing is involved.⁴⁵⁸

4.4.2.6 Transactions under paragraph (d)(i)

These transactions involve the conclusion of an agreement with another enterprise to achieve or enhance the B-BBEE status of an entity in circumstances where there are significant limitations, whether implicit or explicit, on the identity of suppliers, service providers, clients or customers. These provisions had their origins in the so-called Qualifying Transactions where the sale of assets, equity instruments or sale of another separate business could contribute to ownership points.⁴⁵⁹ The policy consideration from a B-BBEE point of view is benefit for black people in that a sale of assets transaction gives black people control over operating assets. The definition of the term "broad-based black economic empowerment" in section 1 of the B-BBEE Act of 2003 specifically provides for "increasing the number of black people that manage, own and control enterprises and productive assets".

⁴⁵⁴ Published in *Government Gazette* No. 388837 dated 1 June 2015.

⁴⁵⁵ S 7 of Code of Good Practice on Equal Pay/Remuneration for Work of Equal Value.

⁴⁵⁶ S 66 (8) and (9) of the Companies Act 71 of 2008 make provision for remuneration to be approved by a special resolution of shareholders.

⁴⁵⁷ S 1 of the Labour Relations Act 66 of 1995; and Jack (2013) 255.

⁴⁵⁸ Jack (2013) 156 and 383.

⁴⁵⁹ See Chapter 4 para 4.4.2.2 above.

Control over operating assets gives black people operational involvement in a business which might be more beneficial to black people than holding a minor equity stake in a business. The B-BBEE Codes provide for the sale of assets to count as ownership points for the seller entity on condition that the assets sold are capable of being operated as a sustainable business without undue reliance on the seller. The B-BBEE Codes provide for such a transaction to adhere to all criteria, namely that the transaction must, amongst others, be sold as a separate entity that has no unreasonable limitations on any suppliers, clients and customers. These requirements formed the basis of the anti-fronting provisions contained in the specific statement for these types of transactions. The transaction must be a sale of real assets of a stand-alone and independent business operation beyond the control and manipulation of the seller entity.⁴⁶⁰

The above criteria were applied differently in the *Swifambo*⁴⁶¹ case, which poses the question as to the wide formulation and unintended consequences in its application.

4.4.2.7 Transactions under paragraph (d)(ii)

The transactions envisaged in paragraph (d)(ii) have been a point of much discussion due to its inherent conflict with other initiatives promoted in terms of the B-BBEE Codes. The provisions of this paragraph were also the subject of the judgement in *Swifambo*⁴⁶² where an agreement was entered into with an enterprise in order to enhance or achieve a B-BBEE status where the maintenance of business operations of such an enterprise is improbable having regard to the resources available to that enterprise.⁴⁶³

These provisions also originated from the 2005 Statement and 2009 Guidelines. This fronting provision relates to cases of classic fronting which is a common occurrence where established companies would bid for work with organs of state or public entities through a smaller B-BBEE entity that does not have any technical capability to do the work, no resources such as staff and operating premises and is often a newly established or so-called “shelf or dormant” company.⁴⁶⁴

⁴⁶⁰ Jack (2013) 206 and 207.

⁴⁶¹ See Chapter 4 para 4.4.2.2 above.

⁴⁶² *Swifambo* paras [107] and [128] above the Court found that *Swifambo* was “a start-up, it has virtually no employees, customers or suppliers”.

⁴⁶³ *Esorfranki* and *Swifambo* above.

⁴⁶⁴ “Shelf Company” is a term used to describe an incorporated entity that has not been operational and whom are set up for future use by established entities or by entities who are involved in the business activity of setting up dormant companies for sale.

The only reason for the established company's interest in and business involvement with the B-BBEE company is to leverage work through the B-BBEE company due to the B-BBEE company's favourable B-BBEE status. This is normally structured through a joint venture entity, an unincorporated joint venture, contractor or sub-contractor agreement, client-supplier agreement or outsourcing agreement. The transactions analysed by the Courts in *Esorfranki* and *Swifambo* are examples of this type of fronting.⁴⁶⁵ These transactions are often referred to as the "renting of black faces", "tenderpreneurs", "self-enriching", "institutional corruption" and "dignified bribery".⁴⁶⁶

Although the intention of the provisions in paragraph (d)(ii) are fairly obvious in those practices of classic fronting where B-BBEE entities are used as fronts for established entities, the formulation is so wide that it could encapsulate legitimate initiatives provided for in the B-BBEE Codes such as supplier and enterprise development initiatives. In terms of supplier and enterprise development initiatives, entities receive points on the B-BBEE scorecard if they spend two percent or three percent (depending on the annual turnover and category of enterprise) of their net profit after tax on monetary or non-monetary contributions "with the objective of contributing to the development, sustainability and financial and operational independence of those beneficiaries".⁴⁶⁷

The B-BBEE Codes further incentivise buying goods and service from such a beneficiary entity under the procurement sub-element by giving additional bonus points to a measured entity.⁴⁶⁸ The B-BBEE Codes make provision for setting up and incubating black-owned entities with the assistance of established entities with the aim of developing beneficiary black entities to become sustainable, especially in circumstances to promote local procurement and procure more goods and services from small entities to foster diversification of the economy.⁴⁶⁹

These beneficiary entities often fall into the category described in paragraph (d)(ii) of the "fronting practice" definition, i.e. they do not have available resources and business operations are improbable. The B-BBEE Codes make provision for the development of plans that should include clear objectives to develop a beneficiary entity with priority intentions and key performance indicators linked to implementation milestones.⁴⁷⁰ Despite the existence of a development plan, the arrangement will still fall

⁴⁶⁵ See Chapter 3 para 3.6.5 above; and Chapter 4 para 4.4.2.1 above.

⁴⁶⁶ Jeffery (2014) 31, 129, 130, 132 and 149; and see Chapter 3 paras 3.1 and 3.8 above.

⁴⁶⁷ Definition of "Supplier Development Contribution" in Schedule 1 of the B-BBEE Codes, and describe Supplier Development Beneficiaries as EMEs or QSEs which are at least 51% black owned.

⁴⁶⁸ Para 3.5.1 of Statement 400 of the B-BBEE Codes.

⁴⁶⁹ Paras 4.1 and 4.2 of Statement 400 of the B-BBEE Codes.

⁴⁷⁰ Paras 4.12 and 6.5.3 of Statement 400 of the B-BBEE Codes.

within the parameters of paragraph (d)(ii). Various commentators have warned about the fine line between a fronting practice and supplier development initiative and some have criticised the Department of Trade and Industry's dishonesty in criminalising viable initiatives.⁴⁷¹

4.4.2.8 Transactions under paragraph (d)(iii)

The "fronting practice" definition makes provision for an agreement with another enterprise to achieve or enhance the B-BBEE status of an entity in circumstances where the terms and conditions were not negotiated at arm's length and on a fair and reasonable basis.

These conditions for a transaction had been flagged as a fronting risk or fronting indicator in the 2005 Statement and 2009 Guidelines.

The fronting risks and indicators pointed to transactions where an enterprise buys goods and services at a rate that is significantly different to the market rate from a related person or shareholder, or the enterprise obtained loans that are not linked to the good faith share purchase or enterprise development initiatives, from a related person at an excessive rate.

The wording as it appears in the current "fronting practice" definition is not only one of the fronting risk indicators as per the 2005 Statement and 2009 Guidelines but is also included as an anti-fronting provision under Statement 102 of the B-BBEE Codes.⁴⁷²

Statement 102 provides that any operational outsourcing agreement entered into by a seller and a separate identifiable related entity must be negotiated at arm's length and on a fair and reasonable basis.

The statement further provides for ownership points to be earned under this initiative, with the existing contract between the parties remaining in effect on market-related terms, subject to market norm service levels.⁴⁷³

⁴⁷¹ Jack (2013) 473 states there "is a very fine line between an opportunistic intermediary and for example enterprise development"; Jeffery (2014) 193 and 194 states that these provisions "give the lie to the DTI's assurance that the maximum penalties laid down...including a 10-year jail term will arise only if engage in misrepresentation or fraud".

⁴⁷² Statement 102: Recognition of Sale of Assets, Equity Instruments and other Businesses published in *Government Gazette* No. 38766 dated 6 May 2015.

⁴⁷³ Paras 3.2.3 and 3.2.5.4 of Statement 102 above.

During the early inception of the B-BBEE policies, several statements were published, followed by the first set of B-BBEE Codes of 2007.⁴⁷⁴ These early statements defined and explained economic interest by also including amounts other than dividends stripped from the company and which would be deemed to be a claim against ownership similar in nature than a dividend right. These payments identified were meant to serve as anti-fronting provisions and provided for payments:

- not made on an arm's-length basis;
- not based on market-related terms;
- made in bad faith;
- made without a commercial reason;
- intended to circumvent the provisions of the relevant statement.

These anti-fronting provisions were not incorporated into the 2007 or later B-BBEE Codes. Instead, the definition of economic interest in the B-BBEE Codes attempted to incorporate the above with very broad terms which do not produce the desired effect or provide protection against fronting practices.⁴⁷⁵

This provision, which originated from the initial fronting risks and indicators in 2005 and 2009, has found its way through the Statement 102 Qualifying Transaction provisions into the definition of a “fronting practice” where it would not only apply in respect of the sale of assets, equity or another business, but had also been generalised to apply to all transactions where an entity wishes to achieve or enhance its B-BBEE status.

The purpose of these provisions is to avert the exploitation of B-BBEE entities at the hands of more established entities under circumstances where B-BBEE entities are not in a favourable negotiation or bargaining position and where such agreements will result in diluting the economic benefits and rights of B-BBEE entities.⁴⁷⁶ In such circumstances the established company uses its monopolistic position or market muscle to bully a B-BBEE entity into an agreement where the established company gains a B-BBEE benefit due to its relationship with the B-BBEE entity without sacrificing much or the benefit obtained does not commensurate⁴⁷⁷ with the risk or *quid pro quo*. Jack correctly points out that “there is

⁴⁷⁴ Code 000 Statement 000 and Statement 100. The General Ownership Scorecard and the Recognition of Ownership Arising from the sale of Equity Instruments released on 1 November 2005.

⁴⁷⁵ Jack (2013) 123 and 124. Economic interest as defined in Schedule 1 of the B-BBEE Codes means “a claim against an entity representing a return on ownership of the entity similar in nature to a dividend right...” is intended to incorporate monies flowing to intermediary entities intended to strip away benefits to the disadvantage of black shareholders as occurred in *Viking* para [9] above.

⁴⁷⁶ Jack (2013) 67.

⁴⁷⁷ As above 9, 67 and 153.

no such thing as a free lunch in business” but all transactions should make business sense and have a commercial rationale.⁴⁷⁸

He points out that black people often do not have the necessary finances to structure transactions and that their dependence on finance often leads to abuse.⁴⁷⁹ Under these circumstances black people could receive assets but no economic benefits for a long time due to the high cost of servicing debt relating to the acquisition of assets or equity.⁴⁸⁰ Jack identified various provisions in agreements which would not be deemed to be at arm’s length and fair, such as unreasonable lock-in periods, unreasonable options for established entities, exit clauses such as call or put options, or arrangements devised to channel or strip profits.⁴⁸¹

The provision in paragraph (d)(iii) is to protect black people in B-BBEE transactions similarly to other laws attempting to protect the vulnerable. Jack raises the interesting point that laws that attempt to protect black people may actually stifle black growth, while over-protection may kill entrepreneurial spirit.⁴⁸²

4.4.3 The role of the B-BBEE Commission with regard to a fronting practice

The B-BBEE Commission is a statutory body established in terms of section 13B of the B-BBEE Act of 2003 and any decision of the B-BBEE Commission will have to adhere to the constitutional principles for lawful, reasonable and fair administrative action.⁴⁸³ The B-BBEE Commission is headed by a Commissioner appointed by the Minister of Trade and Industry and performs the duties and functions set out in the B-BBEE Act of 2003 under strict directives from the Minister of Trade and Industry.⁴⁸⁴

One of the main objectives with the amendments to the B-BBEE legislation in 2013 was to prohibit and stamp out fronting activities. To achieve this objective, the B-BBEE Commission has to play a vital role.⁴⁸⁵ The Commission is assigned functions and powers to receive complaints relating to B-BBEE and to investigate complaints received, either of its own initiative or in response to a complaint received.⁴⁸⁶ Such

⁴⁷⁸ As above 3, 67, 89 and 117.

⁴⁷⁹ As above 117 and 119.

⁴⁸⁰ As above 156.

⁴⁸¹ As above 147, 150, 156, 408 and 411.

⁴⁸² As above 148 and 212.

⁴⁸³ S 33 of the Constitution, 1996; and s 1 and s 3 of the Promotion of Administrative Justice Act 3 of 2000.

⁴⁸⁴ S 13B(2) and (4) of the B-BBEE Act of 2003.

⁴⁸⁵ Jeffery (2014) 186.

⁴⁸⁶ S 13F of the B-BBEE Act of 2003.

complaints must be in the prescribed form and substantiated by evidence justifying an investigation.⁴⁸⁷ Regulations were published in terms of section 14(1)(c) of the B-BBEE Act of 2003 to establish an administrative procedure for reporting of complaints and investigations to be conducted by the Commission.⁴⁸⁸

The format and procedure to be followed in conducting an investigation are to be determined by the B-BBEE Commission based on the circumstances of each case. This may also include a formal hearing.⁴⁸⁹ The B-BBEE Commission has the power to make a finding if any B-BBEE initiative involves a fronting practice.⁴⁹⁰ During such investigation the Commission may subpoena any person to submit any book, document or other object and to appear before the B-BBEE Commission and be questioned.⁴⁹¹

Any person who hinders, obstructs or improperly attempts to influence the B-BBEE Commission, knowingly provides false information or refuses to attend when summoned or to answer any question or produce any document as required in the summons, commits a criminal offence.⁴⁹²

If the B-BBEE Commission is of the view that a matter investigated involves the commission of a criminal offence, the matter must be referred to the National Prosecuting Authority or the South African Police Service.⁴⁹³ The Commission may also refer a matter it had investigated to the South African Revenue Services or any other regulatory authority if the matter involves the jurisdictions or sphere of authority of such institutions.⁴⁹⁴ The B-BBEE Commissioner may publish any finding made as a result of an investigation in such a manner as it may deem appropriate. Such powers of the B-BBEE Commission to publish any findings are suspended pending the outcome of any judicial review proceedings relating to the matter to be published or where a matter has been referred to the National Prosecuting Authority and the latter has declined to prosecute any person, or a person prosecuted has been acquitted, or if convicted, only after all legal remedies relating to a conviction have been exhausted.⁴⁹⁵

⁴⁸⁷ S 13F(2) of the B-BBEE Act of 2003.

⁴⁸⁸ Regulations published by means of *Government Gazette* No. 40053 dated 6 June 2016 to regulate the functions of the B-BBEE Commission.

⁴⁸⁹ S 13J(2) of the B-BBEE Act of 2003.

⁴⁹⁰ S 13J(3) of the B-BBEE Act of 2003.

⁴⁹¹ S 13K of the B-BBEE Act of 2003.

⁴⁹² S 13N(3) of the B-BBEE Act of 2003.

⁴⁹³ S 13J(5) of the B-BBEE Act of 2003.

⁴⁹⁴ S 13J(6) of the B-BBEE Act of 2003.

⁴⁹⁵ S 13J(7) of the B-BBEE Act of 2003.

The B-BBEE Commission may also apply to a court to restrain any conduct in terms of the B-BBEE Codes of 2003, including a fronting practice, or apply for a declaration order on any matter of interpretation or application of the Act.⁴⁹⁶ The B-BBEE Commission may also outsource an investigation to a special investigation unit.⁴⁹⁷

The B-BBEE Commission has no authority to impose any administrative fines or issue compliance notices to any person in respect of non-compliance with the B-BBEE Act of 2003, compared to functions and powers of other similar statutory enforcement bodies such as those created in terms of the Consumer Protection Act⁴⁹⁸ and the Competition Act.⁴⁹⁹ Under this legislation, a Commission has the power to investigate transgressions of legislation, and after conclusion of the investigation the matter is referred to a Tribunal which could impose administrative fines. A matter could also be the subject of appeal to an Appeals Tribunal.

Only in extreme cases of non-compliance or in the event of deliberate conduct or if an element of dishonesty is present, is the transgression criminalised and to be referred to the National Prosecuting Authority for possible criminal prosecution.⁵⁰⁰

The absence of a “B-BBEE Tribunal” to issue compliance notices and impose administrative fines leaves the regulation of the B-BBEE industry to a large extent in the hands of the criminal justice system. Should the B-BBEE Commission find that a B-BBEE initiative constitutes a fronting practice, such practice will only amount to a criminal offence if the state can prove above reasonable doubt that the practice was conducted knowingly and is found as such by a court of law. Should a fronting practice indeed be established by the B-BBEE Commission, but the state is unable to discharge the required onus of proof or the National Prosecuting Authority declines to institute any criminal prosecution, such finding of a fronting practice will constitute an administrative action subject to review in terms of PAJA. In the absence of any administrative powers, the administrative finding will have little effect in dealing effectively with fronting practices. Apart from the authority assigned to B-BBEE Commission to publish such finding, it does not have the authority to do so if no prosecution is instituted or if the person is acquitted.

⁴⁹⁶ S 13J(5) and s 13F(3)(b)(iii) of the B-BBEE Act of 2003.

⁴⁹⁷ S 13F(5) of the B-BBEE Act of 2003.

⁴⁹⁸ S 26 for the establishing of a National Consumer Tribunal in terms of the Consumer Protection Act 68 of 2008.

⁴⁹⁹ Chapter 4 and s 21 of the Competition Act 89 of 1998 for the establishment of the Competition Tribunal.

⁵⁰⁰ S 73A and s 4(1)(b) of the Competition Act 89 of 1998.

The only recourse at the B-BBEE Commissioner's disposal will be to refer the matter to the B-BBEE Verification Profession Regulator⁵⁰¹ to disregard any points or status granted to such an entity. Such an exercise might prove to be futile as all B-BBEE certificates are valid only for a period of 12 months⁵⁰² and by the time the process provided for by the B-BBEE Act of 2003 had been finalised, the B-BBEE certificate may have lapsed and the certificate will be of no force or effect in any event. Such entities can also not have their contracts cancelled by organs of state or public entities in terms of section 13A of the B-BBEE Act of 2003 as such instances are only allowed in circumstances of knowingly providing "false information". The remedy to "black-list" such entities under section 13P of the B-BBEE Act of 2003 will also not be possible in terms of the B-BBEE Act of 2003 as the relevant Act only provides for such action in the event that a person is convicted of an offence in terms of the Act.⁵⁰³

Even if the B-BBEE Commission found a "fronting practice" to have occurred, and criminal prosecution is not instituted or is unsuccessful for whatever reason, such finding of a fronting practice by the B-BBEE Commission will only be of academic purpose.⁵⁰⁴

4.5 CONCLUSION

The purpose of the formulation of a fronting practice is to extend the criminal prohibition beyond that provided for by the common law and to provide for dealing with more sophisticated cases of fronting. Certain elements such as misrepresentation and a degree of dishonesty are not required for a B-BBEE initiative to fall within the definitional elements of a fronting practice.

The formulation of a fronting practice is wide, complex and often unclear. It consists of various terms which are defined in the B-BBEE Act of 2003, but some are to be found outside the provisions of the Act. The fronting practice definition consists of a conglomerate of definitions all intertwined and interrelated.

Some of them are nonsensical, for instance the definition of a "B-BBEE initiative" includes "any transaction practice scheme or other initiative", but despite this provision, the term "transaction" is often

⁵⁰¹ S 1 of the B-BBEE Act of 2003 B-BBEE Verification Profession Regulator means a body appointed by the Minister of Trade and Industry for the accreditation of rating agencies or the authorisation of B-BBEE verification professionals.

⁵⁰² Para 1 of the Verification Manual published in *Government Gazette* No. 39378 dated 6 November 2015 defines a "certificate date as the date on which the certificate was issued and therefore the start of the 12-month validity period of that certificate".

⁵⁰³ In terms of Regulation 15 of the Preferential Procurement Regulations, 2017 prohibiting of doing business with organs of state could also be instituted in the event of providing false information or failure to disclose subcontracting agreements.

⁵⁰⁴ In the event of non-prosecution by the National Prosecuting Authority, s 8 of the Criminal Prosecution Act 51 of 1977 allows for private criminal prosecution under certain circumstances.

used on its own as if it is not a B-BBEE initiative. The definition also refers to or incorporates terms such as “legal relationship” or “arrangement” or “other act”, creating the impression that they could constitute a fronting practice although they are not considered to be a B-BBEE initiative. The term “B-BBEE initiative” as defined is not used consistently. Despite the extent and comprehensiveness of the “fronting practice” definition, the vague, wide and inconsistent use of terms, the definition of “this Act” which includes the B-BBEE Codes which are also widely criticised as vague, poorly drafted and lacking completeness, make the reasonable foreseeability of what constitutes a fronting practice in many instances improbable. Even the High Court in the *Swifambo* case applied some criteria indifferently due to the wide and ambiguous formulation of a fronting practice.

The overemphasis on fronting as a criminal offence and the lack of proper administrative action and penalties by, for instance, a tribunal as is the norm in other regulatory environments creates an imbalanced regulatory mechanism to deal effectively with fronting practices.

The difference between a fronting practice as an administrative transgression and fronting practice as a criminal offence is that, apart from all the other requirements for criminal liability, a fronting practice must have been engaged in “knowingly”. A fronting practice not engaged in knowingly would not meet the requirements for criminal liability and conviction and would consequently be without much value from an enforcement point of view.

CHAPTER 5
CRIMINAL LIABILITY REQUIREMENTS OF THE STATUTORY FRONTING PRACTICE
PROVISIONS

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5.1 INTRODUCTION

The increasing number of fronting cases reported annually to the authorities, coupled with the rise in levels of sophistication and low conviction rates, prompted government to introduce a series of new statutory provisions of which a fronting practice is the most significant. The formulation of the “fronting practice” definition is elaborate and widely defined. The levels of fronting practices and other circumvention activities such as misrepresentation and providing false information are expected to rise sharply in the wake of the new B-BBEE requirements introduced by means of the new B-BBEE Codes and the B-BBEE Amendment Act of 2013. Government also introduced a statutory body in the form of the B-BBEE Commission in an effort to curb fronting practices. In order for the new offences to be effective, especially the “fronting practice” offence which is central to this new range of offences, its formulation and application must meet the requirements for criminal liability.⁵⁰⁵

Apart from the common law and constitutional requirement of legality, the requirements for criminal liability can be divided into four categories, namely: the act or conduct, compliance with the definitional elements of the crime, unlawfulness and culpability.⁵⁰⁶ For the purposes of this dissertation, the requirements of legality and culpability are the most important. The other criminal liability requirements are of lesser importance to this dissertation. However, they are included in this dissertation to the extent that they illustrate the relationship between these various requirements for criminal liability and place the more important requirements into context.

5.2 THE PRINCIPLE OF CRIMINAL LEGALITY

The criminal justice system by nature resorts to arrests, trial and the punishing of offenders. These actions amount to interference with basic rights of life, liberty and property. The nature and manner of this interference with basic rights should not infringe upon the civil and political rights of freedom prevailing within a society according to norms of justice and fairness.⁵⁰⁷ In South Africa, as a constitutional democracy, such interference is subject to the rule of law and the Bill of Rights entrenched in the Constitution of South Africa, 1996.⁵⁰⁸

⁵⁰⁵ Snyman (2014) 29.

⁵⁰⁶ As above 34.

⁵⁰⁷ Burchell (2016) 35.

⁵⁰⁸ The supremacy of the Constitution, 1996 and the rule of law is contained in the founding provisions of the Constitution, 1996.

The principle of legality can be described as a mechanism to ensure that the state, its organs and officials, in making and executing law, do not regard themselves above the law, but subject to it. This protects citizens from arbitrary action and sanctioning by government and ensures that citizens are dealt with within the clear and existing provisions of the law. This principle in criminal law is known as *nullum crimen sine lege* and literally translated means “no crime without a law”.⁵⁰⁹

5.2.1 Criminal legality and the Constitution, 1996

The *nullum crimen sine lege* principle is at the centre of the Rule of Law principle and is in essence nothing else than respect for human dignity.⁵¹⁰ This long-standing common law principle is now enshrined in section 35 of Constitution, 1996 as part of the Bill of Rights ensuring that everyone has the right to a fair trial. The *nullum crimen sine lege* principle originated from the separation of powers doctrine, which is also a constitutional principle under the Constitution, 1996.⁵¹¹ This means that Parliament can create statutory offences to be executed by the executive and state officials subject to the validity of such actions being sanctioned, approved or struck down by the courts.⁵¹² The Rule of Law requires for the exercising of public power to be rationally related to a legitimate government purpose.⁵¹³ According to Burchell, it is a prerequisite for the doctrine of separation of powers to function effectively that the legislature in the formulation of offences should make its intention clear.⁵¹⁴

Apart from the constitutional right to a fair trial and the sanctions of separation of powers, section 8(3)(a) of the Constitution, 1996 further requires a court, in giving effect to a right contained in the Bill of Rights, to develop the common law, where necessary, to the extent that the common law does not give effect to such a right. Section 39(2) of the Constitution, 1996 obliges the courts, in developing the common law or customary law, to “promote the spirit, purpose and objects of the Bill of Rights”. This right given to the courts is, however, not an open-ended authority but only permitted to develop common law offences to give effect to constitutional rights. The principle of separation of powers and the courts’ scope of extending the application of an offence came under the spotlight in the case *Masiya v Director of Public*

⁵⁰⁹ Snyman (2014) 36.

⁵¹⁰ Burchell (2016) 35.

⁵¹¹ Budlender *SAJHR* (2011) 582 states that the courts in terms of the Rule of Law must carry out its constitutional mandate to ensure compliance with the Constitution, 1996 and the law.

⁵¹² Burchell (2016) 45; and *Democratic Alliance v President of the Republic of South Africa and Others* [2012] ZACC 24 demonstrates the evolution of the Rule of Law by striking down an irrational and therefor invalid decision by President Zuma to appoint Mr. Menzi Simelane as National Director of Public Prosecution.

⁵¹³ Price *SALJ* (2013) 649 describes the Rule of Law as a “baseline or “safety net standard of legal validity”.

⁵¹⁴ Burchell (2016) 45.

Prosecutions, Pretoria and Another (Centre for Applied Legal Studies and Another, Amici Curiae).⁵¹⁵ In this case the Constitutional Court was prepared to extend the common law offence of rape beyond its common law definition and application of vaginal penetration of a female to anal penetration of a female person, but was not prepared to extend the definition to anal penetration of male persons.

This judgement evoked contravening views and comment. Snyman is of the opinion that the judgement is disturbing as such extension leads to uncertainty and the judgement relied on emotional considerations. His argument is that such an extension sets a dangerous precedent and leads to the unwanted extension of various other offences by the courts contrary to the principle of legality and a fair trial. According to Snyman, the Constitutional Court overstepped its judicial functions and violated the principle of legality. He argues that the origin of the distinction between vaginal penetration and other forms of penetration is to prevent unwanted pregnancy of females and that vaginal penetration has a rational basis for being treated in a different way.⁵¹⁶

Phelps, on the other hand, argues that the judgement in *Masiya* case does not infringe on the principle of legality as the principle has never completely prohibited any development. It can bring new forms of behaviours within the application and scope of the common law. She also pointed out that the common law might be brought into line with the Constitution, 1996.⁵¹⁷ Phelps's view in this regard should be agreed with as the common law application might often be out of step with the present requirements of a modern society which differ vastly from society's moral convictions millennia ago when the common law principles were established. Snyman also acknowledges this reality that might necessitate much needed development of the common law.⁵¹⁸

The principle of legality is firmly incorporated under the Bill of Rights and anyone has the right to a fair trial as protected under the Constitution, 1996.⁵¹⁹ The Bill of Rights is binding on all spheres of government, namely the legislature, the executive, the judiciary and all organs of state.⁵²⁰ In *Du Plessis v De Klerk*, the Constitutional Court confirmed the application of section 39(3) of the Constitution, 1996 that any provision of the common law, the statutory law or customary law which is inconsistent with the Bill of Rights may be declared null and void by a court.⁵²¹

⁵¹⁵ 2007 (5) SA 30 (CC); 2007 (8) BCLR 827 paras [39] – [45].

⁵¹⁶ Snyman (2014) 46.

⁵¹⁷ Phelps *SALJ* (2008) 649-653.

⁵¹⁸ Snyman (2013) 45; and Chapter 5 para 5.2.2.4 below.

⁵¹⁹ S 35(3)(l) and (n).

⁵²⁰ S 8 of the Constitution, 1996.

⁵²¹ Snyman (2014) 38; and Burchell (2016) 13; and *Du Plessis v De Klerk* (CCT8/95) [1996] ZACC 10; 1996 (3) SA 850 (CC); 1996 (5) BCLR 685 para [189].

5.2.2 The components and rules of legality

The principle of legality in criminal law consists of five components, rules or principles, namely the *ius acceptum* principle; *ius praevium* principle; *ius certum* principle; *ius strictum*-principle; and the *nulla poena sine lege* principle.

5.2.2.1 The *ius acceptum* principle

The *ius acceptum* principle implies that a court may not find an accused guilty of a crime that was not an offence at the time the crime was committed by the accused. This means that a court itself cannot create new crimes. This principle applies to both the common law and statutory law, and is endorsed by section 35(3)(l) of the Constitution, 1996 which states that every accused has the right to a fair trial, which includes the right of an accused not to be convicted for conduct that was not recognised as an offence at the time of committing the alleged offence.⁵²² The only way for new crimes to be created is by Parliament through adopting legislation. For the legislation to comply with the principles of legality in creating new crimes, the best approach, according to Snyman, is to expressly declare that a particular type of conduct constitutes a crime and to specify the boundaries of the punishment applicable to a conviction under such crime.⁵²³

If it is unclear from the wording of the statute whether an offence was created, the court would only accept such intention of the legislation if the wording unambiguously indicates that a crime had in fact been created. Should the creation of a crime not expressly be stated in a statute, the courts should, according to Snyman, in line with the presumption in the interpretation of statutes principle relating to a provision in a statute that is ambiguous, interpret that specific provision in favour of the accused.⁵²⁴

5.2.2.2 The *uis praevium* principle

In terms of the *ius praevium* principle of legality, there can be no conviction or punishment of an accused if the conduct was not previously declared a crime.⁵²⁵ By the time the crime took place, it is a requirement under the *ius praevium* principle that the conduct should already be recognised by law as a crime. This

⁵²² Snyman (2014) 39; and Kemp *et al* (2017) 18.

⁵²³ Snyman (2014) 39.

⁵²⁴ As above 40.

⁵²⁵ As above 41.

principle is also endorsed in the Constitution, 1996,⁵²⁶ meaning that there is a presumption against retroactive or retrospective criminal law⁵²⁷ and provision is made for the right not to be convicted for an act or omission that was not an offence under either national or international law at the time it was committed or omitted. In *NDPP v Carolus*⁵²⁸ the Court distinguished between the meaning “retroactively” and “retrospectively” and emphasised that no statute is to be interpreted as having retrospective operation unless the legislature clearly intended that to be the case and that there is a legal culture leaning against retrospective effect where this will constitute unfairness. Any provision created by a legislative body which creates a crime with retrospective effect is null and void.⁵²⁹

5.2.2.3 The *ius certum* principle

In terms of the *ius certum* principle of legality, crimes must be formulated clearly. Common law and statutory provisions must be defined with reasonable precision and undermine the principle of legality if they are formulated vaguely or unclearly.⁵³⁰ In the event of an unclear, vague or ambiguous provision, citizens do not know or understand exactly what is expected of them. According to Snyman, one of the reasons why a broad and widely formulated criminal provision undermines the principle of legality is the protection of citizens against hidden acts which state authority wishes to proscribe but for tactical reasons not expressly wants to name.⁵³¹

The Constitution, 1996 does not specifically provide for vague and unclear provisions to be disregarded. The constitutionality of such provisions will, according to Snyman, be interpreted under the right to a fair trial in the Constitution, 1996, although the *ius certum* principle is not specifically provided for in the Constitution, 1996. Section 35(3)(a) of the Constitution, 1996 reinforces this principle of legality by emphasising the right of every accused to be informed of a charge with sufficient detail enabling the accused to answer to such charge.

With regard to the right created in section 35(3)(a) of the Constitution, 1996 according to a judgement in *S v Lavhengwa*,⁵³² the charge had to be clear and unambiguous and it can only be the case if the nature of the crime is sufficiently clear and unambiguous to meet the constitutional requirement to inform the

⁵²⁶ S 35 (3)(1) of the Constitution, 1996.

⁵²⁷ Burchell (2016) 36.

⁵²⁸ *NDPP v Carolus* 1992 (2) SACR 607 (SCA) para [31].

⁵²⁹ Snyman (2014) 42.

⁵³⁰ Burchell (2016) 35.

⁵³¹ Snyman (2014) 42.

⁵³² (1996) 2 SACR 453 (W) 483-485, 489 and 494.

accused sufficiently of the charge. It was further held that to comply with the provisions of sufficient clarity one should bear in mind that absolute clarity is not required but that reasonable clarity is sufficient.⁵³³ A court that has to decide whether a particular provision is clear or vague should interpret the legislation on the basis that it is dealing with reasonable and not foolish or capricious people.⁵³⁴ With regard to the right to a fair trial by an accused, the Court in *Legoa*⁵³⁵ confirmed the principle that the accused should be provided with sufficient detail to answer to the charge; however, on appeal the Court was reluctant to lay down a general rule in this regard and considered the matter as one of substance and not form. If legislation is vague and uncertain it cannot be stated that the act or omission constituted a crime prior to the court's interpretation of the provision.⁵³⁶

The Constitutional Court in *Savoi*⁵³⁷ confirmed that although overbreadth of legislation is not a self-standing ground for constitutional invalidity, it becomes of importance in the application of the limitation clause in terms of section 36 of the Constitution, 1996. Although vagueness and overbreadth as indicated in *Savoi* are separate constitutional grounds to declare legislation unconstitutional, the Court's statement regarding relevance in the context of the limitation clause of the Constitution, 1996 will also be applicable in the event of vagueness of legislation.

The Court emphasised in *Savoi* that reasonable certainty of a definition of a crime is required.⁵³⁸ In *S v Friedman*⁵³⁹ the concept of potential prejudice as an element of the common law offence of fraud was constitutionally challenged on the basis that it is excessively wide within the scope of the application of the offence of fraud. The Court held that although the crime was broadly defined, it was not too difficult or impossible to apply and the common law offence of fraud survived the constitutional challenge. The Court in *Friedman*, with reference to certain Canadian Supreme Court judgements put forward the test for vagueness of a provision as "whether the law is so obscure as to be incapable of interpretation with any degree of precision using the ordinary tools" or put differently by the Court to mean "does the law provide an intelligible standard according to which the judiciary must do its work."⁵⁴⁰ The Court in *Friedman* does suggest that the vagueness of the definition of a crime could affect the right to a fair trial endorsed in the Constitution, 1996.

⁵³³ Snyman (2014) 43 with reference to *S v Eneldo Taxi Services (Pty) Ltd* 1996 1 SA 329 (A) 396.

⁵³⁴ Snyman (2014) 43.

⁵³⁵ *S v Legoa* 2003 (1) SACR 13 (SCA) paras [14], [18] and [26].

⁵³⁶ Snyman (2014) 42.

⁵³⁷ *S v Savoi* (2014) (1) SACR 545 (CC) para [31].

⁵³⁸ *Savoi* paras [16]-[28] above.

⁵³⁹ *S v Friedman* 25 and 27 above; and Chapter 3 para 3.7.2 above.

⁵⁴⁰ *Friedman* 25 above.

In *Phillips v DDP*⁵⁴¹ a provision in the liquor legislation prohibiting public nudity on a licensed premises, striptease dancing in this instance, was struck down by the Constitutional Court on the basis that it is too widely formulated in that it applied to bars, hotels, restaurants, clubs and sport grounds, but due to its wide formulation could also be extended to theatres.

Snyman points out that it is not always possible to formulate legal rules in general and in particular criminal provisions so precisely and accurately as to exclude any difference of opinion or interpretation. It is the nature of legal rules that they be formulated in general terms as they apply in general and not to an individual person or cater for a once-off occurrence or event. Language as a form of communication is not perfect in every sense and concepts such as clarity and certainty are relative and a matter of degree. He points out that this is the reason why the principle of legality can never literally be fully complied with in any legal system.⁵⁴²

5.2.2.4 The *ius strictum* principle

The *ius strictum* principle requires that provisions creating crimes be interpreted strictly or narrowly rather than broadly and in favour of the liberty of an individual.⁵⁴³ This method of interpretation of statutes is known as *in favorem libertatis* and requires a strict interpretation of acts of Parliament and subordinate legislation in cases where doubt exists concerning the interpretation of a criminal provision and that an accused be given the benefit of the doubt. This principle, according to Snyman, also applies to common law offences. If there is uncertainty about the scope of a common law offence, the court should not interpret such provisions widely but rather strictly. It is preferable to leave the inclusion of a specific conduct for the legislator to deal with.

Snyman also points out that this does not mean that the courts should slavishly follow the rule of the common law under circumstances where the common law application is out of step with the requirements of a modern society, a society which in many ways differs from the society in which our common law writers lived. Snyman cites the example where the courts were prepared to extend the common law offence of theft beyond the well-established principle that only tangible, movable property can be stolen

⁵⁴¹ *Phillips v Director or Public Prosecutions, Witwatersrand Local Division* 2003 (1) All SA 603 GSJ; 2003(3) SA 345 (4) BCLR (CC) paras [60]-[62].

⁵⁴² Snyman (2014) 43.

⁵⁴³ Burchell (2016) 44.

to theft of an abstract sum of money by means of appropriation or even appropriation of credit.⁵⁴⁴ He argues that the general principle of legality can be undermined if a court is at liberty to interpret the words and concepts in the definition of a crime widely or extend the application by analogue interpretation.⁵⁴⁵ Reference to analogy means partial resemblance between two concepts. In the case *S v Smith*⁵⁴⁶ the accused was charged with having indecent photographic material in his possession in contravention of a statute prohibiting the possession of indecent photographic material. The pictures in the possession of the accused appeared to be photostat reproductions and the Court refused to extend the provisions of the relevant statute to include photostat reproductions.

The Constitution, 1996 contains no specific provision relating to the *ius strictum* principle that legislative provisions creating crimes must be interpreted strictly. Snyman submits that the provision of section 35(3)(a) and (l) relating to a fair trial is wide enough to incorporate this principle.⁵⁴⁷ This notion is supported by the judgement in *S v Von Molendorff*⁵⁴⁸ where the Court stated with regard to common law offences that if there is doubt as to whether particular acts are covered by the definition of a common law crime, the accused ought at least be given the benefit of the doubt.

5.2.2.5 The *nulla poena sine lege* principle

The principle of legality also applies in respect of punishment. The *nulla poena sine lege* principle means that no penalty may be imposed without the existence of a statutory provision or legal rule to that effect at the time of the commission of the crime. This principle stresses that punishment is an integral factor in the concept of crime and distinguishes crime from other forms of wrong behaviour. The punishment requirement can be located in statutory law or common law. In *DPP v Prins*⁵⁴⁹ the Supreme Court of Appeal concluded that the absence of specific penalties for some of the offences provided for under the Sexual Offences Act⁵⁵⁰ did not violate the legality principle, including the *nulla poena sine lege* principle

⁵⁴⁴ Snyman (2014) 45; and *S v Ndebele and Another* 2012 (1) SACR 245 (GSJ) 29 and 33 where the court was required to consider developing the Common Law to encompass energy as a thing capable of theft. The court referred to the underlying principle of *contrectatio* that an incorporeal should be capable of “taking” or be “physical moveable”. The court found that the *contrectatio* is constituted by an appropriation of a characteristic which attaches to a thing and by depriving the owner of that characteristic; and s 13 of the Cybercrimes and Cybersecurity Bill, 2016 where the common law offence of theft is extended to include theft of an incorporeal.

⁵⁴⁵ Snyman (2016) 43.

⁵⁴⁶ 1973 3 SA 945 (0); [1973] 4 All SA 175 (0) 178 and 179.

⁵⁴⁷ Snyman (2014) 43.

⁵⁴⁸ *S v Von Molendorff* 1987 (1) SA 135 (T); [1987] 3 All SA 310 (T) 345 para [6].

⁵⁴⁹ *Director of Public Prosecutions, Western Cape v Prins* 2012 (2) SACR 07 (WCC); [2012] 3 All SA 138 (WCC) paras [55] and [56].

⁵⁵⁰ Act 23 of 1957 as amended by the Criminal Law (Sexual Offences and Related Matters) Amendment Act, 32 of 2007.

aspect of the legality principle. The Supreme Court of Appeal linked the specific reading and interpretation of the Sexual Offences Act with the general provision of section 276 of the Criminal Procedure Act 51 of 1977, which provides for the punishment of common law and statutory offences by the courts. Some commentators have warned against this practice of using the general provisions in the Criminal Procedure Act for sentencing to fill the gaps left by the legislature to determine punishment, especially in the event of statutory offences.⁵⁵¹

The legality principle demands adherence to both aspects, namely *nullen crimen sine lege* and *nulla poena sine lege*.

5.2.3 Summary of criminal legality

Burchell summarises legality as punishment that may only be inflicted for contraventions of clearly defined crimes created by a law that was existing at the time of the contravention.⁵⁵²

Given the judgement in *Msiya*, it is unclear how far the courts will go to develop the common law to bring it in line with the principles of the Constitution, 1996, especially in light of the fact that criminal legality is also entrenched in the Constitution, 1996. With regard to statutory offences, the courts are more reluctant to extend such provisions as that will be the role of the legislature. The courts lack the power to create new crimes and if they do have the power, such power will infringe on the *ius certum* and *ius praevium* principles as judicial law-making would always create uncertainty and be retrospective.

The courts have emphasised the need for offences not to be formulated vaguely or to be defined widely to the extent that an accused will only know which conduct is prohibited once the court has interpreted the provisions. The provision does not have to be exact or precise but requires a reasonable degree of certainty to be understood by reasonable persons. The court did find the element of causing potential prejudice with regard to the common law offence of fraud not too wide and too difficult to apply but in other instances the court struck down statutory provisions that were extended too widely. The court has also emphasised that where doubt exists with regard to the inclusion of a specific conduct within the application of an offence, or the ambiguous formulation of an offence, the accused should be given the benefit of such doubt. The courts were also reluctant to lay down a general rule with regard to the right of an accused to be informed with sufficient detail to answer to criminal charges as the matter is one of substance and not form and each case should be considered on its own merit.

⁵⁵¹ Kemp *et al* (2017) 19.

⁵⁵² Burchell (2016) 35.

5.3 COMPLIANCE WITH THE DEFINITIONAL ELEMENTS

The definitional elements refer to the exact description of the particular requirements determined by law for liability for a specific crime, which also distinguish that crime from the requirement of other crimes. The definitional elements contain the model or formula by which an ordinary person and the courts will be able to know or establish what specific or particular requirements are applicable to a specific crime. The definitional elements should be a fair reflection of what kind of conduct or wrongdoing is prohibited by law. This should also be readily determinable by lay persons. The element of criminal liability requires that the act or conduct of an accused must fulfil the definitional elements.⁵⁵³

The definitional elements not only make reference to the kind of conduct but also require: the circumstances and way that an act must be committed; the characteristics of the person acting; the nature of the object in respect of which the act is to be committed; and often the place where or time when the act is to be performed.⁵⁵⁴

Some crimes also require a causal link between the act and the result or outcome. Snyman points out that this causation requirement forms part of the definitional elements and not, as is often incorrectly assumed, the requirements of the act. All instances of crime require an act but not all require a prohibited result or outcome.⁵⁵⁵ Snyman also cautions against the confusion between the fulfilment of the definitional elements and unlawfulness. He points out that an act which fulfils the definitional elements could be regarded as provisionally unlawful and before unlawfulness can be fully established, it must be clear that no grounds of justification exist to exclude unlawfulness. In creating crimes, it is not possible for a legislature to refer to every possible or conceivable defence. This is left to the courts to determine if an act that does fulfil the definitional elements may be justified. However, for the requirements contained in the definitional elements, the courts have no discretion in how to apply them.

The definitional elements contain the minimum elements to be proved by the prosecution in order to establish a *prima facie* case against an accused in a criminal trial. Should the elements of the definitional elements be established, and no grounds of justification exist, the presence of the definitional elements and unlawfulness is referred to as wrongdoing or *actus reus*. *Actus reus* includes all the elements of the crime with the exclusion of the element of culpability.⁵⁵⁶

⁵⁵³ Snyman (2014) 71.

⁵⁵⁴ As above 72.

⁵⁵⁵ As above 73.

⁵⁵⁶ As above 74.

The *mens rea* element of intention and negligence as part of the element of culpability fulfils a dual role as it also forms part of the definitional elements of the crime. For this reason the definitional requirements consist of objective and subjective requirements. The reason why intention forms part of the definitional elements of the crime is that the conduct must be recognisable within the definitional elements and the conduct cannot be merely neutral of nature. Neutral conduct could be regarded as normal lawful behaviour, but to constitute the specific crime, the intended conduct of the accused must be distinguishable as recognisable prohibited conduct.⁵⁵⁷

This aspect of intention which also plays a role in the definitional elements is illustrated by Snyman in circumstances where a crime not only requires intention to commit an act, but also the intention to achieve some further aim. Under such circumstances one can only determine whether the act is unlawful once it is clear that the accused also wanted to achieve the further aim. Without the existence of such intent the act cannot be recognised as a conduct to be prohibited by law, in other words the definitional elements.

At least part of the intention of the accused has to be established before the inquiry into criminal liability can proceed to determine unlawfulness. This is also the case with, for instance, hostile intent as a requirement for the crime of high treason. It is only the accused's own state of mind, as illustrated by his intention and knowledge (subjective), which is indicative of the peculiar intent required within the definitional elements of the crime.⁵⁵⁸

This will also be the case in the event of crimes where possession is an element. The court found that intention (*animus*) to possess must exist, and the accused must, for instance, in a case of possession of dagga, know and have the subjective knowledge that the article in his possession is dagga.

The subjective knowledge under these circumstances relates to the possession and the definitional elements and not only to culpability.

5.3.1 Causation and materially defined crimes

In the event of materially defined crimes where a certain result is prohibited, irrespective of any conduct, unlike formally defined crimes where a certain conduct is prohibited, the principle of causation is a way in which the definitional elements of certain crimes are fulfilled.⁵⁵⁹

⁵⁵⁷ As above 76.

⁵⁵⁸ As above 77.

⁵⁵⁹ As above 81.

For the purpose of fulfilling the definitional elements of a crime for conduct where a result has been prohibited, it will have to be established that the accused's act consists firstly of a factual cause and secondly a legal cause. For a factual cause to be determined, thinking away from the accused's act would also make the result flowing from the act disappear. This is referred to as the *condition sine qua non* formula.⁵⁶⁰ In order to determine factual cause, all the relevant facts and circumstances are to be considered aided by one's knowledge and experience to determine whether the prohibited result would flow from the conduct of an accused. As many factors or events may qualify as factual causes, the criteria for legal causation are applied to eliminate irrelevant factual causes. The result will be considered to be the legal cause of the accused person's conduct if, in the opinion of the court by virtue of policy considerations, it is reasonable and fair to regard the result as flowing from the conduct of the accused.

In order to determine what is reasonable and fair, the court could apply specific theories of legal causation such as the proximate cause, adequate causation and *novus actus interveniens*. In terms of the proximate cause, the courts will attempt to identify and single out a substantial, direct or efficient cause as the most operative condition.⁵⁶¹

Due to the vagueness of the proximate cause in attempting to single out one dominant cause resulting from the accused's conduct, jurists have based the casual relationship on generalisation of what ordinary people regard as the result emanating from a specific action. According to this theory, human experience is in the normal course of events expected to deliver a certain result. It must be typical for such an act to result in such an outcome. If the result or outcome is not typical to that conduct, but unlikely, unpredictable or controllable, there is no adequate relationship between the act and the result. For example, it can be expected that to strike a match will cause a fire or at least has that potential.⁵⁶² The *novus actus interveniens* expression means that the chain of events between the conduct of the accused and the result had to be broken by another act. Such a new conduct can only break the causal link if it is a completely independent act which is an unsuspected, abnormal or unusual event. The new act or *novus actus* will, according to general human experience, deviate from the normal course of events.⁵⁶³

In *S v Mokgathi*,⁵⁶⁴ the Court stated that it is incorrect to single out one theory to be applied and held that

⁵⁶⁰ As above 81.

⁵⁶¹ As above 84.

⁵⁶² As above 85.

⁵⁶³ *Ex Parte S v Grotjohn* 1970 (2) SA 355 (A) 364 and 365.

⁵⁶⁴ 1990 1 SA 32 (A) paras [39], [40], [41]-[43].

the courts should adopt a flexible attitude. Upon deciding on legal causation the court should be guided by policy considerations, meaning what is reasonable, fair and just. Snyman argues that this flexible approach is too vague and will create uncertainty. His view is that when a court is confronted with a set of facts for which no precedent exist, the court will rely on its intuition in deciding a particular matter, which is not desirable. He suggests that the best criteria to apply is the adequate causation test.⁵⁶⁵

5.3.2 Brief overview of the definitional elements of a crime as element of criminal liability

The definitional elements determine the norms and criteria set for conduct to be prohibited. It is a fair reflection of the circumstances, way, characteristics, place and nature or object that are prohibited and punishable by law. This prohibition must also be reasonably determinable by lay persons. The definitional elements also indicate any results that are prohibited from the accused's actions. There is also a link between the other elements of crime such as unlawfulness, culpability, intention and negligence, and the definitional elements of a crime.

With regard to unlawfulness, provisional unlawfulness is established if no grounds for justification exists. It is impossible for legislation to make provision for all instances of justification, which is left in the discretion of the court to determine. As far as the definitional elements are concerned, the court is obliged to apply them as they appear in the formulation of the offence without having discretion in this regard.⁵⁶⁶ Once the conduct of an accused falls within the definitional elements without any grounds for justification and unlawfulness is established, it is said that the accused's conduct constitutes "wrongdoing" or *actus reus*. According to Snyman, the culpability elements of negligence and intention (*mens rea*) play a dual role in establishing the definitional elements as well as culpability. Snyman further contends that part of intention is to be established as part of the definitional elements before one can proceed to the test of unlawfulness. The conduct of the accused according to Snyman, needs to be recognisable within the definitional element by his subjective state of mind.⁵⁶⁷

Causation in the event of a prohibited result emanating from conduct is a way in which the definitional elements are recognised. The law distinguishes between factual cause and legal cause in the case of a prohibited result. In the event of a factual cause between a conduct and result, the result would disappear if the conduct is eliminated from the equation. Causation is often described as crimes that involve an

⁵⁶⁵ Snyman (2014) 88.

⁵⁶⁶ As above 74.

⁵⁶⁷ Snyman (2014) 74-78.

unlawful consequence as opposed to an unlawful circumstance. There must be causal link between the initial act or omission and the unlimited unlawful consequence. Both factual and legal causation will have to be present to establish liability.⁵⁶⁸

As many factors may qualify as factual causes, the principle of legal causation is applied where policy considerations dictate what is fair, reasonable and just. For the purpose of arriving at what is deemed to be fair, reasonable and just, the court could apply specific theories such as the proximate test, adequate causation and *novus actus interveniens* tests. Snyman is of the view and it makes sense that the adequate causation test is the most suitable to be applied.⁵⁶⁹ This test is based on human experience of what result normally flows from a specific action or what result can reasonably be expected to from a specific conduct. Some commentators suggest that in the absence of a *novus actus interveniens*, the court should consider any additional facts or policy considerations that will convince the court that the consequence was too remote or disconnected from the conduct. It is suggested that any such policy considerations has to be extremely compelling.⁵⁷⁰ For a causal link to be established, the court has to consider what is fair, reasonable and just, as well as what human experience dictates will flow from a particular conduct or could have reasonably been foreseen to be the result.⁵⁷¹

5.4 UNLAWFULNESS AS AN ELEMENT OF CRIMINAL LIABILITY

The fact that an accused's conduct falls within the requirements of the definitional elements of a crime, does not mean that the conduct of the accused is unlawful. For unlawfulness to be established a separate inquiry is conducted although there is a link between the two elements. Conduct which falls within the definitional elements might be a forerunner or provisional indication of unlawfulness and is regarded as *prima facie* proof of unlawfulness. Unlawfulness and culpability as elements of a crime are not always contained in the formulation of a crime and form part of the "invisible" requirements of a crime.⁵⁷²

A court will not convict an accused if the accused's actions are not found to be unlawful in addition to complying with the formulation of definitional elements of the crime irrespective of whether the letter of the law specifically makes provision for any justification of the conduct. Once the conduct of an accused falls within the definitional elements of the crime and is unlawful, the overarching term of wrongdoing is used.⁵⁷³

⁵⁶⁸ Burchell (2016) 52.

⁵⁶⁹ Snyman (2014) 88.

⁵⁷⁰ Kemp *et al* (2017) 89.

⁵⁷¹ Burchell (2016) 52.

⁵⁷² Snyman (2014) 95.

⁵⁷³ As above 96 and 97.

According to Snyman, the test for unlawfulness is the absence of 5.5.2.⁵⁷⁴ Several well-known grounds for justification exist in our law, such as private defence, necessity and acting on the basis of legal authority. The list of grounds for justification is not limited.⁵⁷⁵ Different criteria are referred to in order to determine when an act is unlawful and without justification. The criteria put forward by writers and jurists are: the violation of certain legally protected interests and values; conduct contrary to the good morals (*boni mores*) of society; conduct which violates the community's perception of justice or equity; conduct which varies from public or legal policy; conduct which is contrary to objective reasonableness; conduct which causes more harm than good; or conduct which is not socially adequate.⁵⁷⁶ Although it is impossible to formulate one general viewpoint, Snyman is of the opinion that all these viewpoints are in fact similar but are only expressed in a different way. He suggests that the most acceptable viewpoint and one that comes the closest in encompassing the majority of the views is to consider unlawfulness as "conduct which is contrary to the community's perception of justice or the legal convictions of society".⁵⁷⁷

The principles of human dignity, equality and human rights and freedom contained and advanced by the Constitution, 1996 play an important role in shaping the community's perception of justice and legal convictions. Although an individual's moral convictions often coincide with those of the community, this is not always the case and the test in this regard is the legal convictions of society, not its moral convictions.⁵⁷⁸

Snyman cautions against the misplaced perception that the test for unlawfulness is purely objective and that the intention of the accused's conduct is totally ignored and not be considered at all under unlawfulness but solely under the elements of culpability. Unlawfulness requires an objective test with the inclusion of certain subjective elements. The definitional elements, which consist of objective and subjective considerations, are closely linked to the elements of unlawfulness and the presence of elements constituting wrongdoing or *actus reus*. This symbiosis between the two elements dictates that both an objective and subjective test also apply in respect of the unlawfulness element.

⁵⁷⁴ As above.

⁵⁷⁵ As above.

⁵⁷⁶ As above 98.

⁵⁷⁷ As above.

⁵⁷⁸ As above.

A person relying on a ground for justification must do so being aware of the ground on which he is relying. This conscious or positive conduct requires intention in respect of a defence raised. Even if the presence of a ground for justification is objectively established but the accused was not subjectively aware of this presence and intended to act outside of the justification grounds, the accused's conduct is unlawful.⁵⁷⁹ The accused must be aware of the defence he is relying on and must have intended the said defence to exclude unlawfulness. It requires an objective approach and certain degree of subjectivity. This will, for instance, be the case in certain statutory defined crimes which often require an unlawful state of affairs.

Although our law commonly requires a positive act or an omission, some crimes are formulated as such that a person is guilty of an offence merely for being in a prohibited situation or state of affairs.⁵⁸⁰ Such cases may occur in respect of statutory offences which prohibit, for example, the possession of certain goods such as drugs or stolen goods or occupying the driver's seat of a motor vehicle with the engine running whilst under the influence of alcohol.⁵⁸¹ The conduct in these instances is normally criminalised as it was preceded by or linked to another more serious offence. The unlawfulness then arises out of the prior voluntary act of the accused that led to the unlawful state of affairs or the failure of the accused to timeously terminate the state of affairs. For possession to be established, the accused must satisfy the elements of having physical control (*detentio*) and intention to possess (*animus possidendi*).

Although this intention to possess is a test of the accused's state of mind, it forms an integral part of the *actus reus* or "wrongdoing requirement". This state of mind requirement to determine *actus reus* must not be confused with intention as a requirement of culpability. *Animus possidendi* requires at least that the accused knew of the item in his possession although the accused does not have to have positive knowledge of possession at all times, for instance where the accused at a certain point forgets about the possession. For the purpose of *animus possidendi*, the accused does not have to be aware that the item in his possession is unlawful.⁵⁸² Unless the legislature provided for no-fault liability, then knowledge of an unlawfulness of the state of affairs is required.⁵⁸³ The accused must also not mistakenly believe that a ground for justification exists while objectively it does not. Such a defence then only exists in the accused's mind or imagination but not objectively speaking and does not justify the conduct of the accused.⁵⁸⁴

⁵⁷⁹ As above 100.

⁵⁸⁰ Kemp *et al* (2017) 67-69.

⁵⁸¹ S 65 (1)(b) of the National Road Traffic Act 93 of 1996.

⁵⁸² Kemp *et al* (2017) 67-69.

⁵⁸³ Kemp *et al* (2017) 70.

⁵⁸⁴ Snyman (2014) 101.

It is only when it comes to the question of culpability, which includes either intention or negligence (*mens rea*), that one looks at the talents, weaknesses and insight of the offender as a person. Although an accused's intention to act according to a ground for justification forms part of the test under unlawfulness, the accused's knowledge of unlawfulness forms part of the intention requirement to be established under the culpability element. Unlawfulness, on the one hand, is a test to evaluate the conduct while culpability, on the other hand, is an evaluation of the individual offender.⁵⁸⁵

Apart from defences under unlawfulness, our law also recognises defences to exclude capacity and intention. According to Burchell, South African law does not always draw a clear distinction between the concept of defence and excuse but does recognise the concept that certain defences exclude unlawfulness and others exclude intention and the knowledge of unlawfulness.⁵⁸⁶

The overall onus to prove unlawfulness is on the state. The state is required to disprove any defence or ground for justification introduced by the accused beyond reasonable doubt.⁵⁸⁷

Unlawfulness is either absent or present and no third possibility exists. Unlawfulness does not exist in different grades. It is a matter of black and white with no shades of grey.⁵⁸⁸ However, defences in respect of blameworthiness may, if not sufficient to ensure an acquittal, reduce blameworthiness to such an extent as to justify a lesser sentence or deviation from the minimum prescribed sentence.⁵⁸⁹

5.4.1 Brief overview of unlawfulness as element for criminal liability

Although *prima facie* grounds may be established in the event that an accused person's conduct complies with the definitional elements, wrongdoing or *actus reus* is only established when the accused's conduct is also without any justification. Grounds for justification exclude unlawfulness even if the definition does not specifically make provision for defences to apply. Defences are not only established on the well-known or limited grounds for justification available, but on any ground that is contrary to the moral convictions of society. This is shaped by a variety of factors where the constitutional order plays a major

⁵⁸⁵ As above.

⁵⁸⁶ Burchell (2016) 53.

⁵⁸⁷ Excluding a defence of mental illness or mental defect in relation to criminal capacity provided for by s 78(1)(B) of the Criminal Procedure Act 51 of 1977; and Burchell (2016) 53; and Snyman (2014) 102.

⁵⁸⁸ Snyman (2014) 97.

⁵⁸⁹ Burchell (2016) 53.

rule in the community's perception of justice. An act is unlawful if it is in conflict with the rules and criteria of the legal order in totality and not merely the particular demarcation in the definitional elements.⁵⁹⁰

Unlawfulness requires an objective test with the inclusion of certain subjective elements. The subjective state of mind of an accused is relevant in determining the intention to act in accordance with a specific defence under the unlawfulness element. The subjective state of mind is also important to establish *actus reus* within the definitional elements, which is closely linked to unlawfulness in cases where an unlawful state of affairs is prohibited, for instance offences where possession is required. For the prohibited or unlawful conduct of possession to be established as an unlawful state of affairs, the accused must be subjectively aware of the possession although the accused does not have to be aware of the unlawfulness of the item in his possession. The lack of knowledge of unlawfulness may exclude intention as an element of culpability. This initial state of mind is important to establish whether the conduct falls within the definitional element to *prima facie* establish unlawfulness. The concept of unlawfulness evaluates the act which corresponds with the definitional elements. With unlawfulness, the act is not only viewed from the outside (objectively) to establish whether it is contrary to the legal order, but the intention of the accused (subject)⁵⁹¹ is also considered.

5.5 CULPABILITY AS AN ELEMENT OF CRIMINAL LIABILITY

For the element of culpability to be established, the accused had to have criminal capacity and fault. Criminal capacity is the mental ability a person must have to appreciate the wrongfulness of his conduct and the ability to conduct himself in accordance with such a conviction of wrongfulness. Persons with mental illness or under a certain age can be said to lack blameworthiness or capacity. Criminal capacity is indispensable.

Once it is established that an accused is criminally capable, fault (culpability or blameworthiness) needs to be established in the form of either intention (*dolus*) or negligence (*culpa*).⁵⁹²

⁵⁹⁰ Snyman (2014) 96.

⁵⁹¹ As above 79 and 100.

⁵⁹² As above 148 and 155; and Burchell (2016) 60.

5.5.1 Strict liability

The expression “strict liability” means that the requirement of liability has been dispensed with. This might be the case with certain statutory offences. The statute often does not stipulate whether culpability is required. The courts then interpret the statute to determine whether culpability is required and which form of culpability. In the event of severe punishment, one may conclude that the legislature did not intend to create a strict liability offence.⁵⁹³ Strict liability may also be an unconstitutional component of culpability.⁵⁹⁴

In *S v Coetzee and Others*,⁵⁹⁵ O'Regan J regarded the pre-eminence of fault or *mens rea* as inherent to everyone's right not to be deprived of their freedom and security.⁵⁹⁶ The central role of fault, individual blameworthiness or *mens rea* in any fair process of criminal liability and punishment cannot be doubted. The principle that an act is not criminally liable unless *mens rea* is present, is well established in our law.⁵⁹⁷

Burchell points out that the uncertain areas with regard to fault or *mens rea* are the requirement of how far fault or *mens rea* extends and whether it must be present for all offences. He suggests that strict or no-fault liability for all crimes is unconstitutional. Strict liability infringes on the right contained in the Constitution, 1996.⁵⁹⁸ If legislation is silent on the requirement of the matter, then *mens rea* is required. There is a strong presumption against no-fault requirements. Burchell points out that the exception to this rule might be in respect of administrative offences regulating behaviour in a modern society where it is difficult to prove intention above reasonable doubt. These regulatory offences normally regulate behaviour in respect of the safety of others or welfare offences in a modernised industrial environment.⁵⁹⁹

⁵⁹³ Snyman (2014) 240 and 241; Kemp *et al* (2017) 235.

⁵⁹⁴ Snyman (2014) 238 argues that strict liability offences are incompatible with the right to a fair trial in terms of s 35(3) of the Constitution, 1996 and the right of freedom of security provided for in s 12(1) of the Constitution, 1996.

⁵⁹⁵ (CCT 50/95) [1997] ZACC 2; 1997 (4) BCLR 437; 1997 (3) 527 (CC) paras [40], [43] and [44].

⁵⁹⁶ S 12 of the Constitution, 1996.

⁵⁹⁷ *Minister of Justice and Constitutional Development v Masingili* (2014) (1) SACR 437 (CC) where the Constitutional Court was no prepared to confirm a judgement by the High Court to declare section 1 (1) (b) of the Criminal Procedure Act 51 of 1977 unconstitutional in respect of the lack of intention requirement for aggravating circumstances for the offence of robbery. The Constitutional Court found that intention was established for the offence of robbery and that s 1 (1) (b) of the Criminal Procedure Act with the addition of aggravating circumstances does not create a new offence. The absence of intention in respect of aggravating circumstances may be taken into account for purpose of sentencing.

⁵⁹⁸ *Khohliso v S and Another* [2014] ZACC 33 para [9] where the court found that the provisions of a statute created by the President of the former Republic of Transkei that it would be no defence in prosecution of an offence in terms of a particular statute (Decree 9 (Environmental Conservation) of 1992) that the accused had no knowledge of some fact, created a strict liability offence, and without the element of intent usually required for criminal liability may exclude ignorance of the law as defence and therefor unconstitutional based on the right to a fair trial and particularly the presumption of innocence in terms of s 35 (3) (h) of the Constitution, 1996.

⁵⁹⁹ Burchell (2016) 30; and Snyman (2014) 239.

It is therefore possible to create crimes of strict liability where no culpability is required in the event of less serious offences.⁶⁰⁰ For the purpose of this dissertation the intention and negligence requirement of culpability will be examined.

5.5.2 Intention

For criminal law purposes, intention means that a person committed an act while his will was directed towards the commission of the act or the causing of a result in the knowledge of the existence of the circumstances as per the definitional elements of the crime and in the knowledge of the unlawfulness of his actions. Intention consists of two elements, namely a cognitive and conative element. A cognitive or intellectual element consists of the knowledge of the accused in relation to his act, the circumstances formulated or mentioned in the definitional elements and knowledge of the unlawfulness of his conduct. The cognative or volitional (voluntative) element consists of directing the will towards a specific act or outcome.⁶⁰¹ Three forms of intention are identified, namely direct intention, indirect intention and *dolus eventualis*.

Direct intention refers to a person directing his will towards performing a prohibited act or accomplishing a prohibited outcome or result.

In terms of this form of intention, a person is certain what he wants to achieve or what prohibited act he wants to commit. The commission of the act and causing the result are not a mere possibility or a probable scenario.⁶⁰²

In terms of indirect intention or *dolus indirectus* the prohibited act or result is not the goal of the accused, but in pursuing his goal, the prohibited act or result will by necessity materialise. The classic example of X wanting to shoot Y through a glass panel knowing that the glass panel will break although this is not his goal, and still proceeds, serves to illustrate the nature of indirect intention.⁶⁰³

Dolus eventualis is when the commission of the unlawful act or the causing of the prohibited result is not the main aim of a person, but he subjectively foresees the possibility that in pursuing his main aim, the

⁶⁰⁰ Kemp *et al* (2017) 70; and Burchell (2016) 30.

⁶⁰¹ Snyman (2014) 176.

⁶⁰² As above 177.

⁶⁰³ As above 178.

unlawful act or prohibited result may be caused by his main aim or the unlawful act or prohibited result may be caused by his conduct. He reconciles himself with this possibility and still proceeds with his action. With regard to the person reconciling himself with the prohibited possibility, it can also be said that the person was reckless as to whether the act may be committed.⁶⁰⁴ This form of intention is also referred to as “constructive intention” or “legal intention”. Under this intention, the acting person is not deterred by the possibility he foresees.

The voluntative element consists of the fact that a person directs his will towards an event and proceeds realising that a second result may flow from his actions. The possibility to be foreseen by the accused must not be remote or far-fetched but a real and reasonable possibility.⁶⁰⁵ The fact that an accused reasonably foresees the possibility is not enough for *dolus eventualis* to be established. He must also reconcile himself with this possibility. If he comes to the subjective conclusion that the result will not ensue from his act, *dolus eventualis* is absent. Reconcile means to act whatever the result. His action is reckless in respect of the prohibited outcome of his action and he consciously accepts the risk.⁶⁰⁶

The courts have emphasised that both the requirements for intention, the cognitive and volitional requirements, should be present in determining *dolus eventualis*. Failure to prove that a person reconciled himself with the possibility would not satisfy the requirement for intention as intention does not merely require knowledge or appreciation of the existence of some fact.⁶⁰⁷ As the test for intention is subjective, even if the accused unreasonably does not reconcile himself with the possibility, *dolus eventualis* is excluded. The question is not what he should have accepted the result would be, but rather whether he in actual fact accepted that it would be the result. If he foresaw the result but unreasonably concluded that it would not materialise, then he would be negligent. Under such circumstances one would conclude that he was negligent and should have realised or ought to have realised as an objective test that the result would materialise.⁶⁰⁸

⁶⁰⁴ As above 178; and *Masingili* para [56] above the Constitutional Court found that the accused may be held accountable for his reckless choice even if he did not intend or foresee the exact circumstances that occurred, or method used. The Court found that there is no constitutional requirement under s 12 of the Constitution, 1996 that intent regarding the specific circumstances foreseen by the accused be proved in order to secure a conviction.

⁶⁰⁵ *S v Makgatho* (2013) 2 SACR (SCA) paras [9], [15] and [16].

⁶⁰⁶ *Snyman* (2014) 181.

⁶⁰⁷ *S v Ngubane* 1985 3 SA 677 (A); [1985] 2 All SA 340 (A) 685 para [D].

⁶⁰⁸ *DPP v Pistorius* [2015] ZASCA 204 the Supreme Court of Appeal differed from the trial court in that the appeal court held that the accused had foreseen the possibility of someone behind the toilet door being killed and the appeal court considered the foreseeing of this possibility as sufficient for a conviction for murder based on *dolus eventualis* in the form of *dolus indeterminatus* (general intention) when the accused nevertheless went ahead recklessly. The trial judge excluded foresight of the unlawfulness of the accused’s conduct as the trial judge accepted that the accused might have excluded the deceased from his foresight of death because he might have thought that the deceased was in the bedroom at the time and not in the toilet when he fired the fatal shots.

The difference between *dolus eventualis* and negligence in this sense does not lie in what a person had foreseen but rather the way in which he reconciles himself with this possibility.⁶⁰⁹ A person who is an exceptional good marksman may foresee that he may hit persons in the background to his target, but argues subjectively that due to his exceptional expertise and past successes he will not miss the target. If he proceeds and hits a person in the background, he could not have formed intention, but he will be negligent as his view that he cannot miss was unreasonable in this regard. In the case of a person without any specialised skills and past experience in the same circumstances it will constitute *dolus eventualis* as he foresaw the possibility but nevertheless proceeded irrespective of the result. He never came to the conclusion that he cannot miss as is the case with the marksman.⁶¹⁰

As the test for intention is always subjective, the court will attempt to establish the perpetrator's state of mind at the time of committing the offence. The court may for this purpose take objective factors into consideration, such as the type of weapon that was used, the seriousness of injuries and other objective probabilities.

The knowledge component of intention must also exist in respect of the circumstances as well as the unlawfulness of the act. If a person is unaware of the existence of the circumstances of the definition elements, it is said that there was a "mistake" or "error" on his part. An example of a mistake in the evidence of circumstances is a hunter who shoots a person who he mistook for a wild animal. Intention must extend to every element of the crime, including unlawfulness. Where a consequence crime is involved, intention or at least the foreseeing of the possibility must be extended to the general manner in which the unlawfulness occurs.⁶¹¹ With regard to mistakes in relation to the unlawfulness of an act, several factors need to be taken into consideration. Whether there was a real mistake is based on the facts of each case. The true state of the mistaken person's mind is considered as the test for intention as subjective, and not what a reasonable person would have perceived under the circumstances. In *S v Hanekom*⁶¹² the state in a case of possession of illegal pamphlets argued that the accused ought to have known or foreseen that he had the literature. The Court rejected this argument and acquitted the accused

⁶⁰⁹ *S v Humphreys* 2013 (2) SACR 1 (SCA) paras [18] and [19] the Supreme Court of Appeal differed from the trial court in that the accused, although by a process of inferential reasoning, subjectively foreseen the death of his minibus passengers as a possible consequence of his conduct, it nevertheless had not been established that the accused reconciled himself with the consequences of his conduct which he subjectively foresaw. The Supreme Court of Appeal justified this view by emphasising that there was no evidence that the accused reconciled himself to the possibility of his own death or that of his passengers as he thought this would not happen and he successfully performed the same manoeuvre in virtually the same circumstances previously.

⁶¹⁰ *Snyman* (2014) 184.

⁶¹¹ *Burchell* (2016) 61.

⁶¹² 1979 (2) SA 1130 (C) 1131 referred to by *Kemp et al* (2017) 69.

and held that the accused had to have positive knowledge that he had the pamphlets in question and that what he should have known was consequently irrelevant.

It is often said that the mistake must be *bona fide* or genuine and that the mistake must in actual fact have existed at the moment of committing the act. The mistake must be material and relevant to the definitional elements of the crime.

Knowledge of unlawfulness means firstly that a person must be aware that his conduct is not justified or covered by any grounds for justification. Secondly, knowledge of unlawfulness also means that he must have been aware that his conduct is prohibited by law and constitutes an offence. In this instance, different from knowledge of the existence of circumstances, it is the knowledge of the law, not facts, which is required.⁶¹³ *S v De Blom*⁶¹⁴ introduced the principle that ignorance of the law, even if it is unreasonable, is a defence to exclude intention. An accused does not have to know the number or section of the statute at the time of the prohibited conduct, but it is sufficient if he was aware of the possibility that such a rule may exist and he reconciled himself with that possibility. It is adequate for him to be aware in general terms of the law forbidding his actions.

With regard to crimes for which negligence is required, ignorance as a defence excluding the knowledge of unlawfulness is not a defence as the accused could be said to have failed to exercise the care required from him or that he should have acquainted himself with the relevant provisions.⁶¹⁵

Snyman argues that after *S v De Blom* the legal position changed in respect of obtaining a legal opinion as a defence and that obtaining a legal opinion could be a defence even if such a legal opinion later appears to be wrong. Snyman further argues that it will be grossly unfair to refuse such a defence and treat those who do go to the effort to obtain a legal opinion the same as those that do not. This view is supported by the judgement in *S v Zemura*⁶¹⁶ that advice obtained from a civil servant on the interpretation of a statute may offer an acceptable defence.

Snyman is critical of the *De Blom* judgement to allow all defences of ignorance or mistakes of the law, even those avoidable mistakes, as defences. He submitted that a person is not merely an individual but also a social being who not only has rights but also owes society certain duties. Culpability refers to

⁶¹³ *S v Campher* (155/86) [1986] ZASCA 149; [1987] 4 All SA 87 (AD) paras [7], [18], [20] and [21].

⁶¹⁴ 1977 3 SA 513 (A) 531 paras [A] and [C].

⁶¹⁵ *Kemp et al* (2017) 70; and *Burchell* (2016) 53.

⁶¹⁶ 1974 (1) SA 584 (RA) 592-593.

grounds on which a person may be fairly blamed, and blameworthiness includes a value judgement. An accused, Snyman argues, cannot always be measured against himself but some benchmarking outside the accused is required. He suggests that other factors such as practical and utilitarian considerations should dictate that not all mistakes of law should be accepted as a defence.⁶¹⁷

Although ignorance of the law is still a defence to exclude intention and not negligence, the courts have with regard to specialist activities required a duty on an accused to familiarise himself with the relevant provisions of the law. Snyman suggests some law reform in this area of the law and submits that ignorance as a defence to exclude intention should only be allowed if it is reasonable. If X could or should have known the law, he ought not to be allowed to succeed with a defence of ignorance of the law to exclude intention as such a defence will be unreasonable. He further submits that every person has the duty to familiarise himself with the law, in particular to his specific profession or when embarking on a specialised activity or undertaking which requires specific knowledge of that area of the law.⁶¹⁸

5.5.3 Negligence

Negligence (*culpa*) as a form of fault or *mens rea* means that a person's conduct does not comply with a certain standard of care required by law compared to what the reasonable person would have foreseen in the particular circumstances. As a rule, negligence is a less serious form of culpability than intention.⁶¹⁹ With intention a person is at fault because he knows or foresees that his conduct is prohibited and unlawful but nevertheless proceeds with his conduct. In the case of negligence a person is blameworthy because he did not know and foresee something although, according to standards of law, he should have or ought to have known or taken reasonable steps to be informed.

The test for negligence is, subject to certain exceptions, objective as a person's conduct is measured against that of a reasonable person in the same circumstances.⁶²⁰ The common law recognises only two offences as requiring negligence as a form of culpability.⁶²¹ For all the other common law offences, intention is required.

⁶¹⁷ Snyman (2014) 202.

⁶¹⁸ As above 204.

⁶¹⁹ Snyman (2014) 205.

⁶²⁰ As above.

⁶²¹ Culpable Homicide and Contempt of Court committed by a newspaper editor; and Snyman (2014) 205; and Burchell (2016) 62 and 430.

Various statutory offences exist for which negligence as form of culpability or *mens rea* is required. In order to avoid the harsh effect of strict liability where the requirement of culpability is dispensed with, our courts in the absence of a clear provision excluding fault require that negligence is at least present. This approach avoids the general negative view towards “no fault” offences by accepting some form of fault where circumstances exist to impose a stricter standard of care and attention. It may also be the intention of the legislature not only to punish intentional disobedience, but also those whose non-compliance is due to negligence.⁶²² The question whether the legislature intended negligence to be required as a general rule will depend on the foresight or care which the statute demands in the particular circumstances.⁶²³ Burchell suggests that negligence provides a useful middle course between rigorous strict liability offences, which might be unconstitutional, and intention-based liability offences. Negligence is at least assumed by the courts if a statute is silent about the standard of fault required and in the event that the statute in the slightest way suggests the extension of criminal liability.⁶²⁴

In the absence of a clear provision that negligence is required, the courts interpret such a requirement based on the language of the statute and the object and scope the legislation intends to serve. This is especially the case if the relevant statutory legislation has as its object the creation and imposition of duties of care or circumspection.⁶²⁵ The severity of the penalty may often indicate that the legislature intended negligence rather than intention to be the fault element.⁶²⁶ As a general rule, the more severe the punishment prescribed, the higher form of fault is normally required, for example intention as opposed to negligence.⁶²⁷ Aspects relating to the difficulty of proof may indicate a lower form of fault. In cases where offenders can easily raise a lack of intention as a defence to escape liability, it tends to indicate that the legislature did not intend the state to prove intention but rather negligence in order to avoid frustrating the purpose of the legislation. This might even indicate strict no-fault liability.⁶²⁸

The nature and complexity of the legislation may provide an indication of the standard of fault required. The more complex and diffused the legislation, the less likely it is that negligence is required. As negligence requires the reasonable person test, it also requires that the application of this test be reasonable given the difficulties that may arise or create a basis for criminal liability so artificial and

⁶²² Burchell (2016) 431.

⁶²³ As above.

⁶²⁴ Burchell (2016) 432; and *S v Naidoo* [1974] 2 All SA 545 (N); 1974 (4) SA 574 (N) 570, 572 and 576.

⁶²⁵ Burchell (2016) 432.

⁶²⁶ As above.

⁶²⁷ Kemp *et al* (2017) 235.

⁶²⁸ As above.

unrealistic that it could not have been intended by the legislature.⁶²⁹ On the basis of reasonableness, if the application of no-fault liability or negligence will result in undue hardship to the ordinary person, it will indicate that this was not the intention of the legislature.

It will conversely not be unreasonable to expect a higher standard of care where the legislation is aimed at controlling the conduct of individuals who choose to engage in a particular form of enterprise or a particular course of conduct.⁶³⁰

Snyman points out that negligence has three requirements to be proven: the reasonable person would have foreseen the possibility that the particular circumstance might exist or that his conduct might cause a specific result; the reasonable person would have taken steps to guard against such possibility; and the person's conduct differs from the conduct expected of the reasonable person in the same circumstances. Negligent behaviour suggests a particular way in which a person acted and that his action is blameworthy.

The test for negligence in respect of the definitional elements is objective, namely a person's conduct falls short of what is reasonably expected in law. The negligence test in respect of culpability, according to Snyman, is the consideration of certain subjective factors as a person's personal knowledge and attributes must be taken into account to determine whether he could have been expected to comply with the required standard.⁶³¹ The question of whether a person acted with the reasonable degree of care required is a requirement of the definitional elements of the crime.⁶³² The culpability requirement deals with the question of whether a person can be personally blamed for non-compliance. The test for negligence therefore takes certain subjective factors into consideration and is not purely objective.

The test for negligence requires a full inquiry into the personal knowledge of a person, his background and abilities and measures that against a reasonable person in the same circumstances. Snyman submits that although the test for negligence is mainly objective, the courts leave a door open for subjective factors to be considered.⁶³³ Therefore one should rather refer to a "relative objective" test.⁶³⁴ Circumstances under which a court may consider subjective factors in respect of the reasonable person

⁶²⁹ *S v Ndlovu* [1986] 1 All SA 184 (N); 1986 (1) SA 510 (N) 188 and 189; and Burchell (2016) 433.

⁶³⁰ *S v Naidoo* 574 above; and Kemp *et al* (2017) 235.

⁶³¹ Snyman (2014) 206.

⁶³² As above.

⁶³³ As above 208; and *S v Ngema* (1992) 2 SACR (D) 657 the Court stated that in testing negligence by the standard of the reasonable person of the same background, education level, sex and race of the accused.

⁶³⁴ Snyman (2014) 209.

test are: the reasonable person be placed in the same circumstances that the accused found himself at commission of the offence; if the question relates to the negligence of an expert in a certain field, the test is how a reasonable expert would have acted; the criteria with regard to negligent conduct of children should be compared with a reasonable child, and if a person has more knowledge than the average person, then the conduct be measured against a person with such particular knowledge.⁶³⁵

Negligence can apply to both formally defined crimes, where a specific conduct is prohibited, or to materially defined crimes where the causing or effecting of a prohibited result is required within the definitional elements of a crime.⁶³⁶ The reasonable benchmark in considering negligence refers to an ordinary, normal, average person of ordinary knowledge and intelligence. This is not an underdeveloped person or someone who recklessly takes risks. It is also not a person who runs away from every form of danger or never takes a risk. It is not a person with specialised skills and experience.⁶³⁷

With regard to foreseeability as requirement for negligence, the test is what is reasonably foreseeable and not what probably may have happened.⁶³⁸ Far-fetched and remote possibilities are not taken into account. Negligence must also relate to the other criminal liability requirements such as the conduct, definitional elements and unlawfulness of the conduct. It is not a requirement of negligence in respect of foreseeing a result that the precise way or outcome should be foreseen. The only requirement is that the possibility of the outcome should have been foreseen.⁶³⁹

As far as ignorance and negligence are concerned, if a person embarks on an activity requiring specialised knowledge he will be negligent if he committed a prohibited act or caused a prohibited result and his blameworthiness is not based on his ignorance but on the fact that he embarked on the activity, although he lacked the required knowledge or skill. His action is considered unreasonable and contrary to what a reasonable person under the circumstances would have done.

Actual awareness of unlawfulness of the conduct is not required to establish negligence, but only reasonable foreseeability that the circumstances contained in the definitional elements are present, that the prohibited result may flow from his conduct and reasonable foreseeability that no grounds for

⁶³⁵ *S v Ngema* 657 paras [c]-[d] above the Court in considering the expression “ought reasonably to have known” as provided for in s 1(3) of the Prevention of Organized Crime Act 121 of 1998 stating a reasonable person having both the general knowledge, skills, training and experience that may reasonably expected of a person in his or her position.

⁶³⁶ Snyman (2014) 209.

⁶³⁷ *R v Mbombela* (1933) AD 269 273.

⁶³⁸ *S v Russel* (1967) 3 SA 739 (N) 741.

⁶³⁹ *S v John* (1969) 2 SA 560 (RA) 380.

justification might exist.⁶⁴⁰ If an accused charged with an offence which requires negligence as a form of fault genuinely believes that a ground for justification is present, but it is later determined not to be the case, the genuineness of the accused's belief alone will not be sufficient as a defence. The accused's belief must also be reasonable to succeed as a defence.⁶⁴¹

If a person is mistaken about a material element of the crime, he is mistaken about the applicable law, and negligence will not be established unless it is proven that it is a reasonable mistake.⁶⁴² The accused must also with regard to a mistake which is reasonable have acted reasonably according to and in light of this mistake.⁶⁴³

If a person lacks knowledge of a certain area of the law, it is reasonable for such person to obtain legal advice and to rely on such legal advice as a defence on condition that the advice is not obviously far-fetched and that a reasonable person would also have considered the legal advice to be credible. In *S v Longdistance (Pty) Ltd and Others*⁶⁴⁴ the Court stated in respect of a legal opinion that "legal advice has no magic which justifies the recipient in jettisoning his common sense".⁶⁴⁵

In *S v Claasen*⁶⁴⁶ the court took the requirement of relying on legal advice a step further and held that a person is entitled to rely on legal advice on condition that the advice is not unreliable, for example, where the advice is clearly absurd or irrational or the lawyer providing the legal advice is obviously out of his depth or field of expertise.⁶⁴⁷ Even in the event that legal advice is obtained, negligence could still be established if a reasonable person would not have believed the same legal advice or a reasonable person would have sought further and better advice.⁶⁴⁸

⁶⁴⁰ Snyman (2014) 215.

⁶⁴¹ Burchell (2016) 435.

⁶⁴² *S v De Blom* above 530 paras [A] and [C]; and Burchell (2016) 434.

⁶⁴³ *Kemp et al* (2017) 250 argues that the accused is required to act as a reasonable person would have acted with the same subjective state of mind.

⁶⁴⁴ [1990] 1 All SA 390 (A); 1990 (2) SA 277(A).

⁶⁴⁵ *Longdistance* p 393 and 394 above.

⁶⁴⁶ 1992 (2) SACR 434 T; [1992] 4 All SA 681 (T).

⁶⁴⁷ *S v Claasens* 684 above.

⁶⁴⁸ *Kemp et al* (2017) 254.

It was confirmed in the *De Blom* judgement that where a person operates in a particular sphere of activity or endeavour or a specialist activity of the law, he or she ought to know the law relating to that activity.⁶⁴⁹

In an unreported case, *S v Bailey*,⁶⁵⁰ a medical doctor raised the defence that he was ignorant of a relevant statute. The court found, however, that he had been negligent in failing to acquaint himself with the correct legal position, for example that he did not seek legal advice and that he had fault in the form of negligence.

Burchell points out that negligence-based statutory offences are popular with legislatures as it extends the scope of criminal liability on those who fail to take reasonable care but, on the other hand, negligence provides a broad-based defence of reasonable mistake in law.⁶⁵¹

5.5.4 Brief overview of criminal culpability

Criminal culpability refers to the capacity of a person to distinguish between right and wrong and then to act according to that insight. Those who have the capacity to act according to their insight will only be blamed or be at fault if their state of mind meets the requirements for intention or negligence (*mens rea*). Certain statutory offences might dispense with the culpability element and are referred to as “strict liability” offences. They will normally be limited to administrative offences which regulate health and safety matters in the interest of public welfare. Strict liability offences might be unconstitutional.⁶⁵² If culpability is not specifically excluded in a statute, the courts will as a general rule assume culpability. The language, purpose of the statute, complexity and severity of punishment are all factors which the court will consider to determine what form of culpability is required. The courts will as a general rule at least require negligence as a form of culpability.

Intention as a form of fault, blameworthiness or *mens rea* could be manifested in three forms, namely direct intention, indirect intention and intention foreseeing an act or outcome (*dolus eventualis*). With regard to the foreseeability, what a person foresees must not be far-fetched but real and reasonable. To satisfy the requirement for *dolus eventualis*, he must also reconcile him with what he foresees and act reckless in the sense that he proceeds to act irrespective of the result. If what he foresees is unreasonable or he unreasonably reconciles him with the outcome, it will be said that he acted negligently. The

⁶⁴⁹ *S v De Blom* 573 para [H] above.

⁶⁵⁰ *Kemp et al* (2017) 253 with reference to *S v Bailey* 1981(4) SA 187 N.

⁶⁵¹ *Burchell* (2016) 436.

⁶⁵² *Snyman* (2014) 238.

difference between negligence and intention in this sense of foreseeing does not lie in what is foreseen but rather in the way the person reconciles himself with the foreseeability. A person will not reconcile himself with what is far-fetched. Intention also requires knowledge of the circumstances as well as knowledge of unlawfulness.

Any mistake as to the circumstances or the definitional elements should be a *bona fide* or genuine mistake. Knowledge of unlawfulness, "mistake" or ignorance of the law as defence in our law excludes intention. A person has intention and be at fault if he did at last foresee that a law might exist but will be excused if he is subjectively unaware of the existence of any prohibition of his conduct.

Such a person may, however, still be negligent if he should have known or ought to have known or if a reasonable person in his position would have taken steps to be informed. Obtaining legal advice and acting on such advice will exclude intention even if the advice is later proven to be incorrect. In the case of legal advice that is absurd or obtained from a legal advisor who is out of his depth and under circumstances where a reasonable person would have concluded differently, relying on such legal advice would be contrary to what a reasonable person would have done and be negligent.

Negligence requires a duty of care, which even entails obtaining further and better advice. The fact that ignorance of the law excludes knowledge of unlawfulness as a requirement for intention, and therefore culpability, has been criticised and the suggestion is that the law should only excuse reasonable mistakes and not all mistakes of law. It is expected of people who embark on a certain area of the law or a specialised activity to acquaint themselves with what the law requires of them. If they do not, it will be said that they did not act according to the standard of care the law requires of them and such conduct will be negligent. It is not a requirement that a person must have actual awareness of the law, but if it was reasonable, foreseeable negligence will be established.

Negligence applies to formally and materially defined crimes. Legislatures often require negligence for culpability as a lower standard of proof instead of intention for cases which require a higher duty of care or where the defences available under intention will lead to easily avoiding legal responsibility to frustrate the purpose of specific legislation.

5.6 CRIMINAL LIABILITY OF CORPORATE BODIES

The criminal liability of corporate bodies is an exception to the general or traditional rule in law that only human beings can perform an act which is criminally liable. Corporate bodies are abstract, artificial or notional persons with rights and obligations without having a physical body or mind. In the electronic era we live, we could also refer to corporate bodies as “virtual” persons. The law distinguishes between legal or juristic persons, on the one hand, and natural persons on the other.⁶⁵³

It is often argued that a corporate body cannot think for itself but does so by means of its directors and servants and that they should rather to be punished. Due to the role corporate bodies play in society it is legally viable that corporate bodies should be held liable especially in instances of corporate bodies performing specifically imposed statutory duties or where results of wrongdoing by a corporate body may have severe and extensive human consequences.⁶⁵⁴

The matter of criminal liability for corporate bodies is governed by the provisions of section 332 of the Criminal Procedure Act.⁶⁵⁵ The section makes provision for the liability of the corporate body for the acts of a director or servant of the corporate body, as well as the liability of the director or servant for an act performed by the corporate body. Acts performed by a director or servant or an act performed on the instructions of a director or servant or with expressly or implied permission are imposed on the corporate body. For the corporate body to be liable for such a conduct, a director or servant must not have done so for their own benefit but in exercising their powers and duties and furthering the interests of the corporate body.

Under earlier theories of corporate liability, a corporate body could only be liable for offences committed by their agents or employees. This will be similar to a corporate body being imputed by acts of certain individuals it has a close relationship with, such as employees and agents in terms of the vicarious liability principle. The criminal liability imposed by section 332 of the Criminal Procedure Act has a wider application than that of conventional vicarious liability.⁶⁵⁶ Under vicarious liability the employer or corporate body is held liable for the conduct of its employees and agents. The principle is to prevent

⁶⁵³ Snyman (2014) 245; Burchell (2016) 460.

⁶⁵⁴ Snyman (2014) 245; and Burchell (2016) 458. For instance, certain statutory offences created under the Occupational Health and Safety Act 85 of 1993, and negligence as element of culpability to punish corporates in terms of the Compensation for Occupational Injuries and Diseases Act (COIDA) 130 of 1993.

⁶⁵⁵ Act 51 of 1977.

⁶⁵⁶ Burchell (2016) 46.

employers or corporates from escaping liability by hiding behind the conduct of their employees or agents. In terms of the provisions of section 332 of the Criminal Procedure Act, the corporate body will be imputed with liability not only by the conduct of an employee or agent, but also the conduct of a director himself or a servant or conduct performed on the instruction of a director or servant or with their implied or expressed permission.

The fact that a body corporate which is entitled to all the protection provided for in terms of the Constitution, 1996⁶⁵⁷ can be held liable for the fault of others although itself has no fault could be considered a strict liability or no-fault liability and be deemed unconstitutional.⁶⁵⁸ The presumption created in terms of section 332(5) of the Criminal Procedure Act⁶⁵⁹ which provides for the personal liability of a director or servant for a crime by the corporation was declared unconstitutional. In *S v Coetzee and Others*⁶⁶⁰ the reverse onus of proof in section 332(5) of the Criminal Procedure Act was found to be inconsistent with the presumption of innocence⁶⁶¹ and could not withstand the limitations provided for in the Constitution, 1996.⁶⁶²

Section 332(7) of the Criminal Procedure Act provides for the liability of an association of persons which is not a corporate body, such as clubs, partnerships and unincorporated associations where any member who was a member of the association at the time of committing the offence was liable unless, with a reversed onus created by the section, the member concerned could prove that he could not have prevented the commission of the offence or that the association is managed by a committee governing or controlling the association. This reverse onus created in section 332(7) of the Criminal Procedure Act is expected to be declared unconstitutional on the same basis as that held by the Constitution Court in *S v Coetzee and Others* above in respect of the previous presumption provided for in the Criminal Procedure Act.⁶⁶³

⁶⁵⁷ S 12(1) of the Constitution, 1996 provides for the right to freedom and security and s 8(2) of the Constitution, 1996 provides for the extension of the protection of the Bill of Rights to corporations.

⁶⁵⁸ As discussed under “legality” in this Chapter 5 para 5.2 above no-fault or strict liability may be incompatible with s 35(3) of the Constitution, 1996 providing for the right to a free trial; or on the basis of the wide formulation of s 332 of the Criminal Procedure Act to be “overbreadth” from a criminal legality and *ius certum*-principle; and Burchell (2016) 412 and 461.

⁶⁵⁹ Act 51 of 1977.

⁶⁶⁰ Above paras [43] and [44].

⁶⁶¹ S 35(3)(h) of the Constitution, 1996.

⁶⁶² S 36 of the Constitution, 1996.

⁶⁶³ Snyman (2014) 248.

Burchell suggests a much-needed legal development in respect of corporate liability in line with some other jurisdictions which will be more consistent with our constitutional order. He questions the fairness of holding a corporation liable for the conduct of “one lowly employee”. He points out that the existence of a corporation could be jeopardised by the conduct or negligence of an insignificant or junior employee. He suggests a development that bases corporate liability on “collective or organisational fault” which is flexible and could be determined by a variety of factors such as the policies, procedures and collective decisions made by, for instance, the board of directors of a corporation.⁶⁶⁴

Section 214 of the Companies Act⁶⁶⁵ further provides that a director or any other person in a company could be personally liable for false statements, reckless conduct and the non-compliance of the company of certain provisions.

Directors of a company are protected under the so-called business judgement rule in certain circumstances from delictual claims in *bona fide* exercising of their duties where they rely on the advice of, amongst others, a co-employee. The business judgement rule is an American Common Law mechanism which limits a director’s liability to the company in performing their duties and exercising their duty of care when using their discretion to make business decisions. This mechanism has been codified in the South African Companies Act under sections 76(3)-(4) and 77(2). Directors have a defence in the event of a delictual claim for damages instituted by the company or the shareholders if the directors had acted after taking reasonable diligent steps to become informed about the matter⁶⁶⁶ and relied on information, opinions, professional opinions and opinions of employees or committees under certain circumstances.⁶⁶⁷ Section 75 of the Companies Act may not only provide a delictual defence to directors under the business judgement rule but may also constitute a criminal defence for the company and, by virtue of section 332 of the Criminal Procedure Act and the Constitution, 1996, according to Snyman,⁶⁶⁸ to the individual directors.

⁶⁶⁴ Burchell (2016) 466.

⁶⁶⁵ Act 71 of 2008.

⁶⁶⁶ S 76(4)(a) of the Companies Act 71 of 2008.

⁶⁶⁷ S 76(4)(b) and (5) of the Companies Act.

⁶⁶⁸ Snyman (2014) 247.

5.7 REQUIREMENTS FOR CRIMINAL LIABILITY OF A FRONTING OFFENCE

5.7.1 Legality

The criminal offence of a person who knowingly engages in a fronting practice⁶⁶⁹ consists, apart from the terms “knowingly” and “engages”, largely of the definition of a “fronting practice”.⁶⁷⁰ The “fronting practice” definition then refers to various other definitions⁶⁷¹ and provisions⁶⁷² contained in the B-BBEE Act of 2003. The term “this Act” included in the definition of a “fronting practice” includes not only the provisions of the B-BBEE Act of 2003, but also the provisions of all secondary legislation.⁶⁷³ This constitutes a very complex, elaborate and broad definition of the offence which is in many respects ambiguous and unclear. The vague, broad, ambiguous and unclear nature of the fronting offence, as well as the fact that it includes terms such as “directly” or “indirectly” and “other act” or “conduct” makes the conduct prohibited difficult to conceive or to foresee. The fronting offence formulation and the legalistic difficulties in the formulation were dealt with in detail in Chapter 4 of this dissertation.

Snyman indicates correctly that law is generally formulated in broad terms and due to grammar limitation always has some interpretation aspects.⁶⁷⁴ However, it is a constitutional principle in our law that provisions cannot be drafted in vague, broad, unclear and ambiguous terms as this is inconsistent with the constitutional right to a fair trial and the legality principle of *ius certum*. The crime must exist and be clear at the commission of the offence and not when the court has interpreted the provisions.⁶⁷⁵ The Supreme Court of Appeal⁶⁷⁶ was in a matter of substance reluctant to lay down a general rule. As fronting offences often relate to “substance over form” matters and that is also the interpretation principle provided by the B-BBEE Codes.⁶⁷⁷ The attempt by the legislature to formulate a universally applicable rule under the circumstances could be the legal downfall of the formulation being too broad and wide. In terms of the *ius strictum* rule of the legality principle the courts will interpret such provisions narrowly should any doubt exist as to the possible inclusion of conduct under the definitional element. The courts may even strike an act down for being unclear and formulated too broadly.

⁶⁶⁹ S 13O(1)(d) of the B-BBEE Act of 2003.

⁶⁷⁰ S 1 of the B-BBEE Act of 2003.

⁶⁷¹ Such as “broad-based black economic empowerment”, “B-BBEE initiative”, “this Act” and “black person”.

⁶⁷² Such as the objectives of the B-BBEE Act of 2003 contained in s 2 of the Act.

⁶⁷³ S 2 of the B-BBEE Act of 2003 defines “this Act” “to include any codes of good practice or regulations made under this Act”.

⁶⁷⁴ Snyman (2014) 43.

⁶⁷⁵ Snyman (2014) 43.

⁶⁷⁶ *S v Legoa* para [23] above.

⁶⁷⁷ Para 2.1 Statement 000 of the B-BBEE Codes of 2003.

5.7.2 Act or conduct

In terms of the definitional elements, “engages” in the general formulation and under the “fronting practice” definition, “transaction arrangement or other act or conduct” and “B-BBEE initiative” constitutes the act or conduct as an element of the offence. The definition of the “fronting practice” offence creates a materially defined crime in the sense that the conduct described in the definition is not *per se* prohibited but rather the result flowing from the conduct, namely: the indirect undermining or frustration of the achievement of the objective of the B-BBEE Act of 2003 or the implementation of the provisions of the B-BBEE Act. These results form the protected interest the legislation aims to prohibit. The specific transactions provided for in the second part of the definition under (a)-(d)⁶⁷⁸ must also have the result of compromising the protected interest. Any one of these results or protected interests provided for in the general formulation could apply in the alternative.

The phrase appearing in the “fronting practice” definition, “includes but not limited to”, means that the specific transactions provided for in paragraph (a)-(d) of the fronting practice definition are not the only transactions that are included. A fronting offence could therefore be committed in a variety of ways. The term “indirectly” also refers to the fact that the offence could be committed by an intermediary as well. The term “directly” or “indirectly” does not necessarily indicate a form of intention to commit the offence or to create the prohibited result as is the case with a term such as “in order to”.

The conduct in terms of the definition is completed as soon as the prohibited result is actually achieved and any attempt is seen as an act that “indirectly frustrates” or “undermines”, which makes an attempt to commit a fronting offence unlikely.

The conduct of fronting could be committed by any natural person, corporation or association, and corporations are held liable for the prohibited conduct of directors and servants or individuals acting on their instruction or expressed or implied permission. This application of section 332 of the Criminal Procedure Act 51 of 1977 was endorsed by the judgement in *Swifambo*⁶⁷⁹ where the Court held in respect of tender fraud, corruption and fronting that the conduct of individuals in the organisation who colluded or conspired to commit these offences would impute criminal liability on the organisation.

⁶⁷⁸ See Chapter 4 paras 4.4.2.3 - 4.4.2.7 above.

⁶⁷⁹ *Swifambo* para [110] above.

For the commission of a fronting offence, misrepresentation or dishonesty is not required as in a case of common law fraud. Also, a specific black individual does not have to be disadvantaged in the process as a fronting practice is deemed to disadvantage those in general which the B-BBEE policy aims to benefit and that undermines and frustrates the achievement of the objectives of the B-BBEE Act of 2003.⁶⁸⁰

According to the formulation of a fronting practice, an entity who engages in a fronting practice does not under all circumstances have to benefit from such a practice. The definition “B-BBEE initiative” contained in section 1 of the B-BBEE Act of 2003 and referred to in the “fronting practice” definition provides that an initiative must “affect compliance with this Act or any other law promoting broad-based black empowerment”. One is inclined to think that the word “affects” in the context of an “initiative” is intended to mean that an entity’s B-BBEE status is affected positively, giving the entity a B-BBEE advantage, although the term “affects” could also mean a negative effect on an entity’s B-BBEE status. This will be the literal interpretation that could lead to an unintended meaning.

These specific transactions included under paragraph (a)-(d) in the “fronting practice” definition have all, apart from the one listed under paragraph (a), the requirement that they have to relate to the B-BBEE status, B-BBEE compliance or the achievement or enhancement of the B-BBEE status of those involved in such transactions. These transactions require a B-BBEE benefit from the offending person.

There are also transactions, arrangements or other acts or conducts at the beginning of the “fronting practice” definition that do not form part of the specific transactions listed under paragraph (a)-(d) or the definition of a B-BBEE initiative. These are transactions, arrangements, acts or conducts that do not require a B-BBEE benefit to be achieved or to relate to aspects concerning B-BBEE compliance. These transactions, arrangements, acts or conducts must merely undermine or frustrate the objectives or the implementation of the B-BBEE Act of 2003 in a direct or indirect way.

The formulation of a fronting practice is very broad and could include almost any conceivable act remotely related to B-BBEE. By provisionally cutting out conjuncture, words or phrases, a fronting offence could be committed by “any act that directly or indirectly frustrates or undermines the achievement of the objective or implementation of the provisions of the B-BBEE Act of 2003”. As the term “this Act” referred to in the “fronting practice” definition also includes secondary legislation such as the B-BBEE Codes and Sector Charters, it effectively makes every provision of the B-BBEE Act of 2003, the B-BBEE Codes and

⁶⁸⁰ See *Esorfranki* Chapter 3 para 3.6.5 above; and *Swifambo* Chapter 4 para 4.4.2.1 above.

Sector Charters potential enforcement provisions under “this Act”.

The “fronting practice” definition “casts its net so wide” that it could include those who wish not to participate in the B-BBEE programme by choice. Bearing in mind that the B-BBEE programme of being assessed and obtaining a B-BBEE compliance level or status is a voluntary system, those who do not participate or who influence others not to participate are directly or indirectly undermining or frustrating the achievement of the objectives of the B-BBEE Act of 2003. This wide interpretation could lead to absurd consequences. The Department of Trade and Industry, as custodians of the B-BBEE policy implementation, which is often justifiably criticised for their inefficiency in giving directives, not publishing crucial documents on time, allowing the industry for many years to operate under extremely poorly drafted B-BBEE Codes and so forth,⁶⁸¹ could also be seen to directly undermine and frustrate the achievement of the objectives of the B-BBEE Act of 2003 and subsequently commit a fronting offence.

5.7.3 Definitional elements and unlawfulness

The B-BBEE Commission has the powers to find that a practice is a “fronting practice”.⁶⁸² These powers have little bearing on the criminal liability of an alleged offender. Such a finding by the B-BBEE Commission will at best amount to *prima facie* evidence that a person’s conduct meets the definitional elements of the crime as basis for referring the matter to the National Prosecuting Authority or for investigation by law enforcement agencies.⁶⁸³ The rules that the court apply as well as the standard of proof in criminal proceedings differs vastly from those adopted by the B-BBEE Commission as a statutory body in terms of PAJA.⁶⁸⁴

It is possible for the National Prosecuting Authority and a criminal court to come to a totally different conclusion than the finding of the B-BBEE Commission. Such a finding by the B-BBEE Commission will be of administrative value and does not create any precedent in respect of future criminal prosecutions for a fronting offence.⁶⁸⁵ In each criminal prosecution, the National Prosecuting Authority, in considering possible prosecution, and the criminal court, in hearing the matter, consider and adjudicate each case on its own merits to determine whether the prohibited conduct falls within the definitional elements of the

⁶⁸¹ Jeffery (2014) 172, 182, 205, 211 and 215; and Gerber *Business Day* (March 2016) 23; and Gerber *Business Day* (April 2016) 20.

⁶⁸² S 13J(3) of the B-BBEE Act of 2003.

⁶⁸³ S 13J(5) of the B-BBEE Act of 2003.

⁶⁸⁴ Act 3 of 2000.

⁶⁸⁵ Due to the separation of powers contained in the Chapter 4 of the Constitution, 1996, the courts and executives are not authorised to create law.

offence. Circumstances are possible where the B-BBEE Commission finds that a fronting practice has in fact been committed but is not a fronting offence from a criminal point of view. The fact that a conduct falls within the definition of a “fronting practice” or is found to be the case by the B-BBEE Commission does not fulfil the definitional requirements unless the fronting practice also involves engaging in a practice “knowingly”.

The fact that conduct falls within the definitional elements does not mean it is unlawful. A test for unlawfulness is separate from the definitional elements. Although the B-BBEE Act of 2003 does not make provision for any grounds for justification, it contains “invisible” grounds that exist in respect of all offences, including statutory offences. Conduct that is justifiable according to the general notions and local convictions of society will not be regarded as a violation of a norm.⁶⁸⁶ Various justifications in respect of a fronting practice may exist, especially the rules that were developed by our courts in respect of simulated transactions as to the: intention and purpose of the transactions; the commercial sense and business rationale of a transaction; the normality and general commercial practices relating to the transaction; and the complexity of the transaction.⁶⁸⁷ Other legislation may exist to justify deviation from the transactions listed as specific transactions that are deemed to be fronting practices.⁶⁸⁸

5.7.4 *Mens rea*

The *mens rea* element is established by the definition of “knowing”, “knowingly” or “knows” provided for in section 1 of the B-BBEE Act of 2003. The definition provides as follows:

- “‘knowing’, ‘knowingly’ or ‘knows’, when used with respect to a person, and in relation to a particular matter, means that the person either-
- (a) Had actual knowledge of that matter; or
 - (b) Was in a position in which the person reasonably ought to have-
 - i. had actual knowledge;
 - ii. investigated the matter to an extent that would have provided the person with actual knowledge; or
 - iii. taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter”.

⁶⁸⁶ Snyman (2014) 99.

⁶⁸⁷ *NWK* paras [80], [81] and [91] above.

⁶⁸⁸ S 7 of the Code of Good Practice on Equal Pay/Remuneration for Work of Equal Value issued in terms of s 54 of the Employment Equity Act 55 of 1998.

This definition is an exact copy of the term “knowing”, “knowingly” or “knows” found in the Companies Act.⁶⁸⁹ In the Companies Act it fulfils a role in relation to certain statutory offences⁶⁹⁰ but the role of this definition in the Companies Act is mainly to regulate the conduct of directors and prescribed officers to prevent directors and prescribed officers escaping responsibility when claiming not to be aware of matters they should have prevented or acted against. In the context of the B-BBEE Act of 2003 the term “knowingly” is used almost exclusively to deal with the criminal offences created in the Act.⁶⁹¹

The term has a very strong emphasis of being aware and having knowledge of certain matters. Terms used in statutory offences, such as “maliciously”, “knowingly”, “corruptly” or “fraudulently”, are usually indicators of the fact that intention as a form of *mens rea* is required.⁶⁹² Looking at the term “knowingly” as it appears in the B-BBEE Act of 2003, the initial inclination is that only intention (*dolus*) as a form of *mens rea* is required. The term “knowingly” is traditionally used as synonym for one of the elements of intention as the intentional commission of an offence is often referred to as being committed “wilfully” and “knowingly”.

A similar term in the Prevention of Combating of Corrupt Activities Act (PCCAA)⁶⁹³ referring to having knowledge of a fact and “knowing” is defined as:

“that a person has actual knowledge of the fact, or the court is satisfied that the person believes that there is a reasonable possibility of the existence of that fact, and the person has failed to obtain information to confirm the existence of that fact”.

Looking at the “knowledge of fact” and “knowing” definition in the PCCAA it creates intention in the form of *dolus eventualis* by using terms such as “person believes that there is a reasonable possibility” and “failed to obtain information to confirm existence”. To illustrate the difference between *dolus eventualis* as form of intent and negligence in *Mtshiza*,⁶⁹⁴ Holmes JA, in his minority judgement, formulated the distinction between *dolus eventualis* and negligence as follows:

“The result is that nowadays criminal liability is not regarded as attaching to an act or a consequence unless it was attended by *mens rea* Accordingly, if A assaults B and in consequence B dies, A is not criminally responsible for the death unless-

⁶⁸⁹ S 1 of the Companies Act 71 of 2008.

⁶⁹⁰ S 14 of the Companies Act providing for the liability of a director or prescribed officer who is “knowingly” party to the contravention of s 99 of the Companies Act, s 215(1)(e) who “knowingly” provides false information to Companies Commission, s 29(6)(b) “knowingly” involving certain acts relating to the financial statements of a company.

⁶⁹¹ S 13N(3) and 13O of the B-BBEE Act of 2003.

⁶⁹² Kemp *et al* (2017) 234; and Burchell (2016) 397.

⁶⁹³ S 2(1) Act 12 of 2004.

⁶⁹⁴ 1970(3) SA 747(A); [1970] 4 All SA 12 (A).

- (a) he foresaw the possibility of resultant death, yet persisted in his deed, reckless whether death ensured or not; or
 - (b) he ought to have foreseen the reasonable possibility and resultant death.
- In (a) the *mens rea* is the type of intent known as *dolus eventualis*, and the crime is murder; In (b) the *mens rea* is *culpa*, and the crime is culpable homicide.”⁶⁹⁵

The difference between *dolus eventualis* and negligence was further illustrated in *Ngubane*⁶⁹⁶ where the Court held that “*dolus* postulates foreseeing, but *culpa* does not necessarily postulate not foreseeing. A man may foresee the possibility of harm and yet be negligent in respect of that harm ensuing”. The Court has also held that proof of intention does not necessarily exclude a finding of negligence.⁶⁹⁷

The requirements for negligence are: would a reasonable person in the same circumstances as the accused have foreseen the reasonable possibility of the occurrence of the consequence or the existence of the circumstances and the unlawfulness; would a reasonable person have taken steps to guard against that possibility; and did the accused fail to take steps which the accused ought reasonably have taken to guard against such possibility?⁶⁹⁸ With regard to a duty to guard, a person may take a slight risk on the basis of what is socially practical or the urgent and commendable action the accused is engaged⁶⁹⁹ in or that the prevention measures may have been difficult, inconvenient or costly to the extent that a reasonable person would not have guarded against the possibility of the unlawful event.⁷⁰⁰

The provision in paragraph (a) of the “knowing” definition in respect of the fronting offence... “had actual knowledge of that matter...” clearly indicates the presence of intention. Other terms used in paragraph (b)(i)-(iii) of the “knowingly” definition, such as “reasonably ought to have”, “taken other measures” and “would reasonably be expected” are indicative of the requirement for negligence.

The culpability requirement of *mens rea* for an offence of a fronting practice is therefore either intention or negligence. Negligence is a lower standard of fault than that required for the commission of a corrupt activity in terms of PCCAA. The PCCAA requires reasonable foreseeability by what a person believes, but is reckless towards that foreseeability and reconciles himself with that foreseeability by not obtaining information. In the event of a fronting offence, the term “knowingly” requires a duty of care to obtain information and take reasonable steps to be informed. The obtaining of legal advice could be relied on

⁶⁹⁵ *S Mtshiza* 17 paras [A] - [C] above.

⁶⁹⁶ 1985(3) SA 677(A); [1985] 2 All SA 340 (A).

⁶⁹⁷ *Ngubane* 705 paras [G]-[H] above.

⁶⁹⁸ Burchell (2016) 419.

⁶⁹⁹ *S v Harber and Another* (341/1986) [1988] ZASCA 34; [1988] 4 All SA 496 (AD) para [39] and [53].

⁷⁰⁰ *Khupa v South African Transport Services* [1990] 4 All SA 397 (W); 1990 (2) SA 627 (W) 405.

even if the advice is later proven to be incorrect, on condition that it is not far-fetched and that a reasonable person would also have accepted such advice. Failure to obtain advice in circumstances in which it is difficult, inconvenient or costly to do so may also be an acceptable defence.

5.8 CONCLUSION

The common law principle of legality *nullem crimen sine lege* holds that a person should only be punished according to valid and applicable law. This correlates with the principle of the Rule of Law and the common law principle of criminal legality enshrined in the Bill of Rights (section 35 of the Constitution, 1996) relating to a person's right to a fair trial. Although statutory offences are drafted in general terms and considering grammatical limitations that exist, the legislature is expected to formulate provisions in such a way that it is clear enough for persons to know before the commission of an offence which conduct is prohibited. This corresponds with an accused's constitutional right to be provided with clear and adequate information to answer to any allegations and such information could only be clear to the extent that the provisions in terms of which the accused is expected to answer are formulated in a clear and unambiguous way. The Court, in a constitutional challenge that the common law offence of fraud is too vague and broad with regard to the meaning of potential prejudice, dismissed the challenge that it is too difficult to apply. Some commentators suggest that this will not be the last attempt to challenge this relatively broad requirement of the fraud offence.

Various examples exist where the courts were prepared to strike down provisions as being too wide and ambiguous and where the courts interpreted broad and wide provisions narrowly in favour of the accused. The Court in *Masiya*⁷⁰¹ was prepared to extend the application of the common law offence of rape. In respect of statutory offences, it is expected that the courts will leave such extensions to the legislature in terms of the doctrine of separation of powers.

Although no grounds for justification are provided for in the formulation of an offence and similarly not in the definitional elements of a fronting offence, any justification that coincides with society's perception of justice will be a valid ground to exclude the unlawfulness of the conduct. Such grounds may exist in statutory provisions or case law, justifying practices which might *prima facie* appear to be unlawful. The B-BBEE Commission's authority to find a practice to be a fronting practice will be of administrative value or might establish *prima facie* evidence to refer the matter for criminal investigation or possible

⁷⁰¹ See Chapter 5 para 5.2.1 above.

prosecution. Such findings will also not create an offence or set any precedent in relation to the criminal law as such an authority in terms of the constitutional principle of the separation of powers cannot be assumed by the executive or a statutory body. The National Prosecution Authority, in their consideration to prosecute, and the courts, in hearing a criminal matter, will use the more protective principles of criminal justice instead of the administrative law that the B-BBEE Commission is expected to follow as statutory body.

The terms requiring the conduct of a fronting office to be prohibited are very wide and refer to “directly” and “indirectly” or “other act or conduct”. Some transactions and arrangements fall outside of the definition of a B-BBEE initiative and are not related to the obtaining or achievement of any B-BBEE benefit. The literal interpretation of the wide formulation could lead to absurd consequences and in essence “criminalise” all the provisions of the B-BBEE Act of 2003 and the enabling or sub-ordinary provisions. Even government departments and their staff could technically be prosecuted in terms of the fronting provisions of the B-BBEE Act of 2003 for inefficiency which jeopardises the protected subject matter of the B-BBEE Act of 2003, being the wide policy statements contained in the objectives of the Act. Even a person not choosing to participate in the voluntary B-BBEE programme could, according to the wide formulation, be prosecuted for committing a fronting practice offence as such person will be frustrating or undermining the achievement of the objectives of the B-BBEE Act of 2003.

The *mens rea* requirement for a fronting offence is either intention (*dolus*) or negligence (*culpa*) which is a lower culpability requirement than only intention (*dolus*) or *dolus eventualis* as for instance required for the commission of a corrupt activity in terms of the Prevention and Combating of Corrupt Activities Act.⁷⁰² Setting a minimum *mens rea* requirement of negligence by the legislature instead of intention is popular in modern formulation of offences. Negligence is also interpreted by the courts to be the requirement in the absence of clear statutory provisions regarding the requirement of culpability. This lower form of *mens rea* is normally required when the legislature wants to penalise reckless, careless or negligent behaviour. Cases where offenders could easily escape liability by merely raising a defence to exclude intention could also prompt the legislature to rather require a lower form of fault. In the absence of a specific provision as to the norm of fault required, the more severe the penalty the more the tendency will be that intention is required. The courts may also, in the absence of a clear provision as to the fault requirement, not apply a low norm of fault such as negligence if the application of negligence leads to unreasonableness or undue hardship for the ordinary person in the event of complex legislation.⁷⁰³

⁷⁰² See Chapter 5 para 5.5.2 above.

⁷⁰³ Kemp *et al* (2017) 235.

The legislature, in formulating a fronting offence, has set the bar lower as far as the fault requirement is concerned and this makes prosecution easier than is the case with the common law offence of fraud. Furthermore, no misrepresentation or an element of dishonesty is required to commit a fronting practice, as is the case with fraud, and no prejudice or potential prejudice will have to be proven by the state as committing the offence of fronting is deemed to disadvantage people in general, namely the intended beneficiaries of the B-BBEE legislation.

The legislature places a higher onus and duty of care on persons involved in the B-BBEE programme to take reasonable steps to be informed and obtain the necessary knowledge. Ignorance and lack of knowledge of a fact or the law are only a defence if the obtaining of knowledge is unreasonable.

The term “engages” includes both parties participating or involved in the fronting practice, for instance an established white company and a B-BBEE company colluding or conspiring under circumstances as transpired in the *Swifambo*⁷⁰⁴ case.

The terms “undermining” and “frustrating” are a matter of degree. The question is how far a person needs to go to undermine or frustrate. An entity not achieving all the points on the B-BBEE scorecard could also, to a certain degree, although minimal, be seen to “frustrate” and “undermine”. That degree of frustration and undermining increase as an entity moves lower down the ladder of B-BBEE compliance. The point at which a person’s conduct becomes intolerable and falls within the prohibition of the fronting offence is currently a matter of subjective interpretation and not objectively determinable. This is analogue to an offence of driving under the influence of drugs and alcohol⁷⁰⁵ without any statutory threshold or requirements and to leave that open to law enforcement agencies and the courts to interpret on an *ad hoc* and arbitrary basis.

⁷⁰⁴ See *Swifambo* Chapter 4 para 4.4.2.1 above relating to the arrangement between the respondent and a multinational entity to use a South African shelf entity without resources and business operations as a front to gain access to a lucrative contract by a state-owned entity. See also *Esorfranki* Chapter 3 para 3.6.5 above.

⁷⁰⁵ S 65(1) of the National Road Traffic Act 93 of 1996.

CHAPTER 6
FINAL CONCLUSION AND RECOMMENDATIONS

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6.1 INTRODUCTION

The birth of the new statutory offence of fronting in the context of B-BBEE was long awaited and overdue. The conception started with the commencement of B-BBEE legislation in 2004. Due to the nature of the B-BBEE programme of affecting competitiveness and subsequently profit margins of businesses, disguised practices, circumvention and fronting activities always formed an inherent part of the system similar to tax avoidance. Tax legislation operates within a peremptory environment whilst B-BBEE is a voluntary system.

Despite this difference, the legal framework and social considerations require that those who participate in the B-BBEE programme play fairly according to the rules and that “volunteers” or “participants” should not unfairly maximise B-BBEE benefits without sacrificing too much or obtain B-BBEE benefits at the expense of those B-BBEE aims to benefit. The principle of optimising at the least risk is, after all, within the entrepreneurial spirit. The term “fronting” has therefore become synonymous with B-BBEE, similar to tax avoidance within the tax legislation.

Statements and guidelines issued by the Department of Trade and Industry since 2005 have developed a certain understanding and meaning of fronting. This was further shaped by the views and interpretation of jurists and academics. Apart from the odd fraudulent transaction reported in the media, very little case law exists in relation to fronting activities in a criminal environment. Some civil court judgements have to a certain extent provided insight as to the interpretation of certain types of fronting transactions. These civil court cases dealt with fairly obvious and blatant cases of so-called⁷⁰⁶ classic fronting and the courts, being it criminal or civil in nature, did not have the opportunity to adjudicate on sophisticated instances of fronting activities. Sophisticated fronting refers to cases where: the nature of a transaction is disguised by means of clever legal engineering; a series of transactions that require peeling away the layers of complexity to get to the real substance or working of the transactions;⁷⁰⁷ an integral web of related entities and transactions where the transfer of rights and benefits created an “illicit” flow with a diluted effect to black participants;⁷⁰⁸ and complex equity transactions where equity and debt instruments are used to divert benefits and rights from black participants.⁷⁰⁹

Attempts in the past by B-BBEE policies prescribing a process in which fronting should be dealt with by verification agents and industry role-players can only be described as inefficient and “clumsy”. The ultimate recourse in the event of a fronting practice was reporting to the Department of Trade and Industry, which would under certain extreme circumstances refer the matter for criminal prosecution. Successes in this regard were few and far between and the reported cases of fronting were on the increase. The increase in the number of fronting activities reported, as well as the increase in levels of sophistication where some professionals are involved in advising their clients of clever ways to beat the system, required a different approach from authorities to stem the flow.

The ineffective way of dealing with fronting from a criminal point of view in the past, did not bode well in deterring such practices. The exact reasons for the low levels of success in prosecuting offenders were not revealed except for the public statements of the Minister of Trade and Industry and other officials of the department that it is “hard to prove”.⁷¹⁰ It is uncertain whether this statement by the authorities referred to the inefficiency of the criminal justice system or the inadequacy of the instrument at its disposal to curb incidents of fronting, being the common law offence of fraud.

⁷⁰⁶ See Chapter 3 para 3.8 above for an explanation of “classic fronts” and “sophisticated fronts”.

⁷⁰⁷ See Chapter 3 para 3.6.3 above for a discussion of the *NWK* judgement.

⁷⁰⁸ See Chapter 3 para 3.6.2 above for a discussion of the *Peel* judgement.

⁷⁰⁹ Jack (2013) 476.

⁷¹⁰ See Chapter 1 para 1.1 above.

As B-BBEE is a constitutional imperative and an emotional and politically charged subject, fronting is seen as destructive to the constitutional values and economic emancipation of a large portion of the black population. Reported incidents of fronting have amplified the narrative that businesses in South Africa not only resort to illegal practices to increase profits, but will also not shy away from practices that jeopardise the poorest and most vulnerable black members of society. This social injustice created a collective social resistance to fronting behaviour, with mounting pressure from all corners of society for government to act more dramatically and decisively to speed up transformation and remove any obstacles that undermine the achievement of the objectives of B-BBEE.

In order to expedite transformation efforts, government has embarked on a B-BBEE enforcement and legislative overhaul. On the legislative side, several amendments to the existing B-BBEE Act of 2003 have been effected by the B-BBEE Amendment Act of 2013 which was published in January 2014 and became effective in October 2014. The most significant amendments from a fronting point of view were the introduction of a fronting offence and other offences relating to misrepresentation and providing false information. The 2013 amendments also introduced a statutory body, the B-BBEE Commission, with vast powers to investigate fronting and report any criminal activities to law enforcement agencies and the National Prosecuting Authority. In terms of the new amendments a legal duty was imposed on verification agents and procurement officers of organs of state and public entities to report any offences to law enforcement agencies. Failure by verification agents and procurement officers to perform such a duty also constitutes an offence.⁷¹¹

Severe sanctioning of those convicted under the B-BBEE Act of 2003 was introduced, with fines or imprisonment for a period up to 10 years, or both, or a fine of 10% of a corporate's annual turnover. Organs of state and public entities may also in terms of the amendments unilaterally cancel agreements with entities which misrepresented their B-BBEE status or provide false information in this regard, irrespective of an entity being convicted in terms of the B-BBEE Act of 2003 or not.

Those convicted in terms of the B-BBEE Act of 2003 may also be prohibited or "black-listed" for a period of 10 years from doing business with organs of state and public entities which may include black-listing of members, directors and shareholders of such entities in their personal capacity.⁷¹²

⁷¹¹ See Chapter 4 para 4.3 above.

⁷¹² See Chapter 4 para 4.3 above.

Government has ensured that it has equipped itself with heavy artillery to tackle the war on fronting. This was a reactive step in the light of previous ineffectiveness in this regard, but also a proactive measure to curb the anticipated increase in fronting practices contemplated by the second part of the B-BBEE policy overhaul. On the implementation side, the B-BBEE Codes as implementation mechanism was beefed up significantly in 2013 with the introduction of a revised set of B-BBEE Codes which was fully implemented in May 2015 with higher targets and weights for compliance.⁷¹³ The more onerous B-BBEE Codes, with a stronger emphasis on black ownership, place more pressure on businesses and subsequently increase the levels of circumvention and fronting substantially.

According to the part of the new overhauled policies which excludes smaller entities from being measured according to a scorecard in terms of the amended B-BBEE Codes, they are only required to produce an affidavit to prove compliance.⁷¹⁴ This was done as part of a broader policy framework adopted by government to reduce the costs of enterprises, in particular smaller enterprises, to conduct business in South Africa. The introduction of an affidavit is a self-assessment system that largely goes unchecked, with the threat of criminal sanctioning as deterrent. Several commentators have cautioned that this step will open the “flood-gates of fronting”.

There can be little doubt that the B-BBEE environment and South Africa as a whole were in dire need of stringent fronting and circumvention interventions. Governments in general use legislative mechanisms and tools at their disposal to ensure compliance and to regulate behaviour. That is what governments are there for. This is exactly what government did, amongst others, by criminalising a fronting practice with the necessary enforcement mechanisms, in theory at least, to ensure implementation and fair play. The question to be answered is firstly, and the central question to this dissertation, whether government had succeeded in the final product, which culminated over many years and was galvanised by social pressure, to create an effective but still pragmatic deterring measure in the form of a fronting offence. The second part of the question is whether the final product, in the shape of a fronting practice, meets the requirements of criminal legality and whether it is in all respects consistent with the Constitution, 1996.

⁷¹³ See Chapter 2 para 2.4 above.

⁷¹⁴ See Chapter 4 paras 4.1 and 4.3 above and the allowing of a certificate issued by the Companies and Intellectual Property Commission (CIPC) to prove certain information.

6.2 KEY FINDINGS – APPRAISAL

6.2.1 Legality

Fronting had over time taken on a specific meaning synonymous with an element of intended dishonesty and conduct which is “against the spirit of the B-BBEE Codes”. This contemporary meaning was shaped by a variety of guidelines, statements, documents, public statements and commentary. Associating fronting with dishonesty, misrepresentation, providing of false information and a deceptive state of mind was very much embedded in society in that fronting in the past was referred to as “fraud” and was also dealt with as such from a criminal point of view.

The new fronting offence created by the statutory amendments of 2013 lost those characteristics. The present formulation is wide and includes any act or conduct that directly or indirectly frustrates or undermines the achievement of the objectives or implementation of the B-BBEE Act of 2003. As the term “this Act” also includes enabling legislation such as the B-BBEE Codes, it literally criminalises any provision of the B-BBEE Act of 2003, the B-BBEE Codes and Sector Codes. The formulation of a fronting practice goes even further, senselessly and without logic, to include transactions which are not B-BBEE initiatives.⁷¹⁵ The new “fronting practice” definition is a disconnect from the contemporary understanding of fronting and has created a “catching all” and new technical criminal offence. As fronting involves substance over form, the courts have refrained from attempts to lay down a single rule and had adopted a multi-faceted approach.⁷¹⁶ The fronting offence formulation is an oversimplification of a complex issue.

Some benchmarks provided for in the definition of a “fronting practice” are abstract in nature, such as “objectives of the Act”, “undermines”, “frustrates” and “substantially”. From an administrative point of view, these benchmarks could apply but will require a comprehensive inquiry as the courts have suggested. From a criminal point of view, these terms are unclear and uncertain as the transgressions are a matter of degree.

One of the main benchmarks in terms of the formulation is the “objectives of the Act”. These are very broad policy statements and there is uncertainty about how they should be interpreted, especially in the light of different schools of thought and approaches to the concept of B-BBEE. Some regard B-BBEE as an economic growth model, others as a distribution model and a third school as a combination of the two,

⁷¹⁵ See Chapter 4 paras 4.4.1 and 4.4.2 above.

⁷¹⁶ See Chapter 3 para 3.6.3 for judgement in *NWK* above; and *S v Twala* [2012] ZASCA 46 para [10].

but there is uncertainty regarding the balance and precedence of these approaches.

In the interpretation of the objectives of the B-BBEE Act of 2003, the B-BBEE Codes should be used to “promote the purpose of the Act” and to further the interpretation of B-BBEE.⁷¹⁷ Unfortunately, the B-BBEE Codes are poorly drafted, incomplete and ambiguous and are not of much help in this regard. The approach adopted by the courts is not to create a single rule when considering substance over form issues.

The wide formulation of a “fronting practice” seems to be an attempt to do exactly that and creates the impression of a “trial and error” approach to see how the courts fill the gaps, which parts it will be prepared to apply and which parts may be disregarded. This was evident in the *Swifambo* case above where the Court had applied a specific provision of the “fronting practice” definition contrary to the long-established practice in the industry, due to its wide and ambiguous formulation. The Court has with all due respect interpreted a provision literally and strictly according to the script, but the script contained a word and an exclusion which were incorporated in the fronting practice definition by “mistake rather than design”. This opened the provision up for incorrect interpretation. The question can then be asked: If even the High Court is “stumped” by unclear provisions, where does that leave the ordinary person? With regard to the wide, vague and ambiguous formulation of the fronting offence, one does not have to go much further than the *Swifambo* case to be convinced of the legal uncertainty created by the formulation.⁷¹⁸

In this regard, it is prudent to compare the flimsy fronting offence formulation with the extent of detail provided in the Prevention and Combating of the Corrupt Activities Act 12 of 2004 (PCCAA). The provision in the PCCAA is a statutory offence and a replacement of the common law offence of bribery, similar in nature to the B-BBEE Act of 2003 which extends the scope of application of the common law offence of fraud.

The existing fronting offence provision consists of a one-line formulation with two main definitions directly linked to fronting offence provided for in section 1 of the B-BBEE Act of 2003 and two more definitions emanating from the definition of a “fronting practice”. The “fronting practice” definition consists of two main benchmarks and six types of B-BBEE initiatives and transactions that are regarded as a fronting practice. The wording in the definition of a fronting practice, “including but not limited to” implies that the definition is far from complete and that an inquiry will be needed to provisionally determine whether the

⁷¹⁷ S 9 of the B-BBEE Act of 2003 provides for the B-BBEE Codes in interpreting the Act.

⁷¹⁸ See Chapter 4 para 4.4.2.1 above.

conduct falls within the prohibition of the formulation.

The fronting offence is much more technical, diverse and complex than the PCCAA as the fronting offence deals with abstract and relative concepts such as “substance over form”, the commensuration of risks and benefits, commercial rationale and the arm’s-length nature of transactions. Despite this, the volume and extent of the provisions to give legal clarity and certainty in the PCCAA dwarf those of the fronting offence. The PCCAA provides for a single offence and consists of its own interpretation chapter with 26 definitions, seven chapters, 37 sections and a schedule consisting of 15 pages. In comparing the extent and detail provided for in the PCCAA, it is clear that the formulation of a fronting practice is seriously lacking critical detail and substance and can only be described as a “start” and “work in progress”.

6.2.2 Fronting versus fraud

The new fronting offence does not require a misrepresentation or an element of dishonesty as is required by the common law offence of fraud.⁷¹⁹ The prejudice or potential prejudice with regard to fraud is very wide and equally wide in the event of fronting. With regard to the fronting offence it is not a requirement that an individual black person had not been disadvantaged by the fronting activity as a fronting practice prejudices those in general whom the B-BBEE policy aims to benefit.⁷²⁰ The *mens rea* or fault requirement of intention, at least in the form of *dolus eventualis*, for fraud had been replaced by a lower standard of fault in the form of negligence for a fronting offence. This lower standard of fault makes it easier for the state to prove the offence. The legislature requires a higher duty of care and expects persons embarking on a specialist activity such as B-BBEE to obtain knowledge or to take reasonable steps to be informed. Negligence has been opted for as the preferred fault requirement to exclude the possibility of raising mistake in fact or lack of knowledge of the law as defence as an easy let-off and escape of liability for perpetrators.

In terms of the *Swifambo* judgement,⁷²¹ employees and individuals colluding or conspiring within a corporation to commit offences of circumvention, tender irregularity or fraud, may be committing a fronting offence and the liability of those individuals may be imposed on the corporation. Likewise, if the corporation undertakes fronting practices which constitute an offence, the directors or servants participating in such activities may also be liable.

⁷¹⁹ See Chapter 3 paras 3.7.1 and 3.7.3 above.

⁷²⁰ See Chapter 3 para 3.6.5 above and the discussion of the *Esorfranki* judgement.

⁷²¹ Gerber *Business Day* (Aug 2017) 17; and Chapter 4 para 4.4.2.1 above.

The position of trusts as instruments created under notarial deed is uncertain as the term “person” is not defined in the B-BBEE Act of 2003 and the definition in the Interpretation Act 33 of 1957 does not include such structures. Trusts will also escape the provisions of section 332 of the Criminal Procedure Act 51 of 1977 in respect of the prosecution of corporate bodies.⁷²²

6.2.3 The B-BBEE Commission

Unfortunately, the enforcement and regulation of a fronting offence depend too much on the criminal justice system. Once the National Prosecuting Authority decides not to prosecute or the person charged is acquitted, no further action can be taken. All steps or sanctions to be imposed by the B-BBEE Commission hinge on a criminal conviction.⁷²³

Neither the B-BBEE Commission, nor any other statutory body has the authority in the context of B-BBEE to impose any administrative fines as is the case with, for instance, the Consumer- or Competition Tribunals. The B-BBEE Commission has the powers to investigate and publish a finding. Publication may only occur once all review proceedings relating to the findings are finalised and the court has not set the finding aside or, in the case of criminal prosecution, publication by the B-BBEE Commission may only occur in the event of conviction and only once all appeal remedies relating to the conviction have been exhausted. Unlike other regulatory environments involving economic and commercial activities where statutory bodies go a long way in regulating prohibited conduct and are authorised to act decisively against transgressors with fines similar than those prescribed for criminal convictions (10% of annual turnover), the B-BBEE Commission has no authority to impose fines or issue compliance orders. In other regulatory environments only the most severe cases of transgression are criminalised, allowing the industry with its regulatory bodies to do the bulk of the redress.⁷²⁴

Within the B-BBEE environment, the administrative part has also been “criminalised”. This makes the system too dependent and over-reliant on the efficiency of the criminal justice system, “putting all the fronting eggs in one basket”. Once a fronting offence had been handed over to the criminal justice system and no prosecution is implemented or the person is acquitted, hardly anything will happen to such a perpetrator.⁷²⁵ This, despite the fact that the perpetrator may possibly be guilty of engaging in a fronting

⁷²² Snyman (2014) 246.

⁷²³ See Chapter 4 para 4.4.3 above.

⁷²⁴ See Chapter 4 para 4.4.3 above.

⁷²⁵ S 8 of the Criminal Procedure Act 51 of 1977 provides for private prosecution by certain institutions upon whom the right to prosecute is expressly conferred by law in the event that the National Prosecuting Authority declines to

practice although not so from a criminal point of view due to the absence of fault. The absence of one of the elements of the fronting offence such as fault means that the conduct does not meet the requirements for criminal liability although from an administrative point of view the actions of the perpetrator might tick all the boxes. The way the system is designed currently, such a fronting practice that does not meet all the requirements for criminal liability but does meet the requirement of the definition of a “fronting practice” will go unsanctioned. The B-BBEE Commission has the authority to find that a practice is a “fronting practice” and in all likelihood the perpetrator might forfeit points on the scorecard, but no authority is given to the B-BBEE Commission to act against such a perpetrator.⁷²⁶ Such deductions or forfeiture of points is not directly provided for under such circumstances in the B-BBEE Act of 2003 as the perpetrator may still lodge an application in the High Court to have the finding of the B-BBEE Commission reviewed. This lack of administrative remedies for the B-BBEE Commission and the “all-or-nothing” approach in favour of the criminal justice system’s will seriously hamper enforcement of anti-fronting and anti-circumvention activities.

6.2.4 Research question

With regard to the question of whether the new fronting offence achieves the purpose for which it is tailor-made, i.e. discourage fronting practices and to deal with sophisticated incidents of fronting and circumvention, the answer is partially affirmative but to a large extent negative. The significant fines may be a deterrent, but the wide, vague and unclear formulation may face some constitutional challenges.

Firstly, in terms of section 35(3) of the Constitution, 1996 which provides for the right to a fair trial, the fronting offence will with great difficulty survive a challenge for being consistent with the *ius praeivum*, *ius certum* and *ius strictum* principles of legality.⁷²⁷ Secondly, the lower fault requirement in the form of negligence may be constitutionally challenged on the same basis, namely that it infringes on accused’s right to a fair trial given the complexity of the fronting provisions and the high sanctions imposed by the B-BBEE Act of 2003.

prosecute as a possible recourse for the B-BBEE Commission. In terms of s 7 of the Criminal Procedure Act a private person must be able to prove actual damage as a result of the commission of the alleged offence to establish the necessary *locus standi*. In terms of *National Society for the Prevention of Cruelty to Animals v Minister of Justice and Constitutional Development* 2016 (1) SACR 308 (SCA) para [7] a “private person” referred to in s 7 of the Criminal Procedure Act, excludes a juristic person to institute private prosecution.

⁷²⁶ See Chapter 4 para 4.4.3 above.

⁷²⁷ See Chapter 5 paras 5.2.2.2 - 5.2.2.4 above.

If the legislature had provided for the fault requirement clearly in the legislation, the courts will as a general rule give effect to that requirement. The power of the legislature to create and formulate law is not absolute and is restricted by the confines of the Constitution, 1996.⁷²⁸ The vagueness coupled with the complexity of the legislation may be combined factors to challenge the fairness of the low fault requirement.

The present formulation of section 332 of the Criminal Procedure Act 51 of 1977, which imposes liability of directors and servants of the corporation on a corporation and *vice versa*, may also be challenged on the basis of presumption of innocence in terms of section 35(3)(h) of the Constitution, 1996 as the imposed liability of corporations in terms of section 332 of the Criminal Procedure Act creates a form of “strict” or “no-fault” liability on the part of the corporation. Fault-based liability is an integral part of a just system of criminal liability.⁷²⁹ Although overbreadth of an offence is not a self-standing ground to declare a provision unconstitutional, it becomes a relevant issue in the context of the restrictions of rights provided for in section 36 of the Constitution, 1996.⁷³⁰ In the event of widely formulated provisions, the courts will interpret it narrowly in line with the *ius strictum* principle of legality and the *favorem libertatis* method of interpreting legislation.⁷³¹

Apart from the constitutional inconsistencies of the fronting formulations, the B-BBEE Codes as the major enabling sub-ordinary legislation in interpreting the B-BBEE Act of 2003 and the “fronting practice” definition could also face constitutional challenges in terms of section 33 of the Constitution, 1996 providing for everyone to have the right to administrative action that is lawful, reasonable and procedural fair. This is the basis of a pending High Court case involving the Chamber of Mines and the Minister of Mineral and Resources regarding the vagueness and irrationality of the Mining Charter which fulfils the same purpose as the B-BBEE Codes.⁷³²

The statutory fronting practice formulation will be able to deal with the classic or blatant cases of fronting, but so will the common law offence of fraud. For the specific purpose of dealing with sophisticated cases of fronting, the formulation of the fronting offence is not sophisticated and refined enough to deal with those instances. The formulation is too wide and unclear and drafted in general terms to allow for successful prosecutions of those types of fronting. The use of complex structures and equity instruments

⁷²⁸ *Du Plessis v De Klerk* para [189] above; see Chapter 5 para 5.2.1 above.

⁷²⁹ Burchell (2016) 460 and 461; and Chapter 5 para 5.6 above.

⁷³⁰ *S v Savoi* paras [16] - [28] above.

⁷³¹ Snyman (2014) 43 and 44 above.

⁷³² See Chapter 4 para 4.4.1.6 above.

is part of everyday commercial use and makes commercial sense. In order to bring these structures within the ambit and “casting net” of a criminal offence, clearer formulation and benchmarking are needed.

Furthermore, virtually all complex structures involve professional advisors and with the present vague formulation and unclear rules provided for in the B-BBEE Codes it will not be difficult for advisors to legally justify fronting structures. The corporation will then escape liability despite the lower fault requirement and even if such advice is later proven to be incorrect, because the term “knowingly” defined in section 1 of the B-BBEE Act of 2003 only requires that reasonable steps be taken to obtain the necessary knowledge, which the corporation did. Directors of the corporation can also not be expected to have reasonably foreseen that such advice or opinions were incorrect due to the highly specialised area of the law where the reasonable person could not be expected to have judged the reasonable accuracy of a professional opinion.⁷³³

The involvement of professionals in sophisticated incidents of fronting was raised by the Minister of Trade and Industry⁷³⁴ in the comment on the Bill which preceded the amendments in 2013.

Reliance by corporations on opinions and advice of senior employees or committees which are later proven to be incorrect may, as provided for by section 76 of the Companies Act 71 of 2008 and in terms of the business judgement rule, be a delictual defence for directors against claims by shareholders in the event of a fronting practice but still poses a risk of criminal prosecution of the corporation as the negligence of such internal advisor as a servant acting in the furtherance of the interest of the corporation will still be imposed on the corporation.⁷³⁵

6.3 RECOMMENDATIONS AND STRATEGIES

In this dissertation certain recommendations are made to address those areas central to the research question of this dissertation. The recommendations relate to the legal issues to be considered. The legal issues also operate within a broader government policy framework that involves areas outside the ambit of B-BBEE policies. Some matters may well be within the context of B-BBEE but may be of a policy nature and not a legal nature. Those policy issues which may influence legal modification or amendments will also need consideration before any legal amendments could be considered.

⁷³³ See Chapter 5 para 5.7.4 above.

⁷³⁴ See Chapter 1 para 1.1 above.

⁷³⁵ See Chapter 5 para 5.6 above.

6.3.1 Policy considerations

The Department of Trade and Industry is the government department responsible for regulating aspects of the Companies Act 71 of 2008 and the B-BBEE Act of 2003. With the repeal of the previous Companies Act 61 of 1973, the number of criminal offences was reduced from 124 criminal offences to a handful in the present Companies Act of 2008 as part of the Department of Trade and Industry's drive to decriminalise the company law. In a memorandum issued by the Department of Trade and Industry in 2004⁷³⁶ with the effect of decriminalising company legislation it justified this step by stating that there should be a balance between civil, administrative and criminal sanctions, emphasising that the industry should not be reliant on the criminal law to regulate corporate behaviour.⁷³⁷ The memorandum also refers to the fact that the previous Companies Act too readily imposed criminal penalties when civil or administrative remedies could be more appropriate. The memorandum also emphasised the importance of decriminalising the company law to ensure better redress for a director's conduct and failure to perform duties of a director.⁷³⁸ The introduction of a series of new criminal offences relating to B-BBEE in 2013 therefore goes against the grain of government policy to decriminalise the company law. B-BBEE legislation to a large extent operates in the same environment and is intertwined with and interrelated with trade and commerce.

The decision of government to go against its own policy in criminalising misrepresentation, providing of false information and fronting practices is justified given the constitutional imperative of economic and social redress. The introduction of the new fronting offence, however, is not in balance with other enforcement mechanisms, for instance administrative remedies. The wide scope to be covered by the criminal justice system in dealing with fronting offences and the "all-or-nothing" approach in favour of criminal prosecution and the under-utilising of administrative remedies will prove to be ineffective. The criminal justice system is generally considered to be inefficient. This aspect was comprehensively raised and discussed in Parliament recently.⁷³⁹ Fronting offences will be added to the long list of crimes to be prosecuted within the criminal justice system with a generally low priority status. Fronting offences will be caught up in an over-congested system. The National Prosecuting Authority does not have the technical

⁷³⁶ South African Company Law for the 21st Century: Guidelines for Corporate Law Reform (DTI) 2004.

⁷³⁷ As above 10.

⁷³⁸ As above 7.

⁷³⁹ Ensor *Business Day* (Aug 2017) 2. The chairperson of the Finance Portfolio Committee in Parliament stated that it was "extremely worrying", given the gravity of the crisis, that government did not set up any structures to deal with the lack of action by the prosecuting authorities but left it to Parliament. The NPA was summonsed to appear before Parliament to explain their inaction on the illicit flow of money; and Celliers *Business Day* (July 2017) 28 where the cases finalised by the NPA compared to the number of arrests made have dramatically deteriorated from 335 000 cases out of 1 228 000 arrests in 2006 to 311 000 cases out of 1 638 000 arrests in 2016. The article states that the "NPA lacks competence".

capabilities within the system to successfully prosecute highly specialised cases of sophisticated fronting. The National Prosecuting Authority will also not waste scarce resources on prosecuting fronting cases where a corporation has acted on the advice of professional advisors. Such circumstances would prevail in almost all cases of sophisticated fronting.

Considering that one of the main objects of the new fronting offence was to combat cases of sophisticated fronting, irrespective of the flaws with regard to the formulation of the fronting offence, the involvement of the criminal justice system will prove ineffective and over time the deterring factor provided for by the high fines and imprisonment in the B-BBEE Act of 2003 will also be lost as prosecution would be viewed as highly improbable.

As participating in B-BBEE is a voluntary system it depends on initiatives from businesses. For real empowerment to take place, businesses will have to be encouraged to move away from a “tick-box” exercise approach to real substantive empowerment initiatives. Although the present criminalisation of a fronting practice is indeed needed, the formulation will have a “sledge-hammer” effect of “over-kill” and also destroy some good in the process. Due to the uncertainty created by the existing formulation, various businesses will opt rather to refrain from participating or prefer to maintain a low level of participation to avoid the risk of being exposed to possible criminal prosecution.⁷⁴⁰

Some commentators have also warned that the over-protection of black people could lead to the stifling of benefits to black people.⁷⁴¹ Some countries are very aware of the negative impact of over-criminalising the commercial environment and the “sledge-hammer” effect it could have. Late in 2015, the New Zealand government decided to decriminalise certain over-restrictive provisions in their competition legislation. The New Zealand Minister of Commerce and Consumer Affairs expressed the view that directors of companies should be cautious in their decision-making involving competition. However, an economic loss may occur if directors are forced to be “ultra-cautious” due to fear of imprisonment.⁷⁴²

The factors and policy considerations to be balanced in introducing a criminal offence within the B-BBEE context should address the following: curbing fronting practices and the danger it poses for constitutional

⁷⁴⁰ Balshaw and Goldberg (2014) 23 stating with reference to the B-BBEE Codes and the amendments of 2013 that the “unintended consequence of these Codes could very well be that business decides not to participate in the narrow BEE approach”.

⁷⁴¹ Jack (2013) 148 states “[A]s with many of the hotly contested issues in BEE, the laws trying to protect [B]lack people often end up stifling [B]lack growth”.

⁷⁴² Goldsmith beehive.govt.nz (Dec 2015) 8.

redress; the social justice responsibility of government in protecting black people against unfair and unreasonable transactions; the possible stifling of benefits to black people by being overprotective; discouraging businesses from participating in the B-BBEE programmes; and raising levels of participation and promoting substantive empowerment initiatives.⁷⁴³

Looking at the present formulation of a fronting practice, a balance is not struck between the various considerations as the policy consideration leans too much towards criminalisation. This is aggravated by the wide formulation of a fronting practice, “trying to paint with a too broad fronting brush” and extreme under- utilisation of administrative remedies.⁷⁴⁴ From a policy point of view, the remedies available under administrative action are basically non-existent in the context of B-BBEE, while the powers of the B-BBEE statutory body, the B-BBEE Commission, do not make provision for any administrative remedies. Instead, the gap has been filled by criminal sanctions which created an imbalance in the regulatory environment.

6.3.2 Affidavits

The B-BBEE Codes make provision for smaller entities⁷⁴⁵ to use an affidavit to prove annual turnover and black ownership.⁷⁴⁶ They are not required to prove their level of compliance by means of a scorecard. This exemption emanates from an overall government policy to reduce the costs for small business to do business. This is also contrary to government’s traditional B-BBEE policy⁷⁴⁷ not to allow self-assessment as it increases the risk of fronting.⁷⁴⁸

The policy to reduce costs cannot be faulted, but to allow people to do a self-assessment and thus increase the risks of fronting by providing information unchecked by independent competent persons are contrary to government’s efforts to curb fronting. The information provided by means of affidavits goes unverified and is too dependent on the criminal justice system as deterring measure. The little that is achieved in saving minimal costs for businesses compared to the greater, overwhelming public interest in preventing higher levels of fronting will require a reconsideration of this policy if any significant curbing of fronting practices are to be achieved.

⁷⁴³ See Chapter 4 para 4.4.2.7 above.

⁷⁴⁴ Burchell (2016) 458-460 for a discussion of the various sanctions and redress possibilities available in the event of corporate liability such as civil redress, administrative remedies and criminal-law sanctions.

⁷⁴⁵ See Chapter 2 para 2.4 above for classification and categories.

⁷⁴⁶ Amendments effected by means of *Government Gazette* No. 38765 dated 6 May 2015 also made provision for a certificate issued by the Companies and Intellectual Properties Commission (CIPC) to prove certain information.

⁷⁴⁷ Jeffery (2014) 182.

⁷⁴⁸ Jack (2013) 78 and 79 for a discussion on the self-regulating system and the heightened risks of fronting; and Jeffery (2014) 211.

It should be borne in mind that criminalisation of the provision of false information does not constitute an anti-fronting measure. Fronting is detected by assessing substance and not the letter of the law or the correctness of data. For the purpose of assessing substance, a subjective judgement is required to objectively determine the presence of fronting or circumvention practices. This process requires a degree of professional scepticism. Fronting is prevented when verification agents can conduct site visits and perform substantive assessments of B-BBEE initiatives.⁷⁴⁹

6.3.3 Amending the legal structure

The amendments to be recommended are based on the following:

6.3.3.1 Principles

- To distinguish between different categories of fronting practices;
- to provide for a statutory body to impose administrative remedies. As the B-BBEE Commission is the statutory body for investigating complaints, it should be enabled to impose administrative remedies involving some less serious cases of fronting practice;
- to be able to deal with as many fronting cases as possible outside the criminal justice system;
- to avoid cases being backlogged in the criminalise justice system and cases “falling through the cracks” of the system.

6.3.3.2 Primary implementation considerations

- To appoint an institution or technical committee to review the B-BBEE Codes. This is imperative as the existing system or any future modifications will be of little effect if the central document in interpreting and furthering the objectives of the B-BBEE Act 2003 remains in its poorly drafted state with inconsistencies and lack of proper guidance. Under the existing system, professionals are virtually at liberty to *bona fide* justify fronting practices due to the lack of properly drafted provisions and legal certainty. The legal uncertainty allows for too much manoeuvrability;
- publication of the long-awaited Technical Assistant Guide which is referred to in certain statements to the B-BBEE Codes;⁷⁵⁰

⁷⁴⁹ Jack (2013) 78 and 79.

⁷⁵⁰ Statement 103: The Recognition of Equity Equivalents for Multinationals; see Chapter 4 para 4.4.2.1 above.

- to supplement the fronting formulation comprehensively similarly to the structure and approach followed in the PCCAA, Act 12 of 2004.⁷⁵¹ A separate statement published in terms of section 9 of the B-BBEE Act of 2003 could also be considered to fulfil the role of supplementing the fronting offence.

The primary implementation considerations should, irrespective of the acceptance of the proposals to follow, be in place before any other modifications or reforms are considered. With the formulation of the fronting offence in its present form and the system for enforcement being mainly the criminal justice system, the expectation of any successful criminal prosecution and effective deterring of fronting activities especially sophisticated fronting, will be unrealistic if offenders are allowed to continue escaping prosecution as a result of improper directives and a lack of proper rules and legal certainty.

6.3.3.3 Legal Structure Modification

With reference to the abovementioned principles, to categorise the various levels of fronting depending on the scale, gravity and offender's intent to deceive. This can be done by means of a separate statement issued in terms of section 9 of the B-BBEE Act 2003 similar to the 2005 Statement⁷⁵² which categorised fronting and circumvention activities. Fronting practices could be divided in three categories. The first category could provide for the most severe forms of fronting where an element of dishonesty is present and deliberate attempts to circumvent the system, with significant B-BBEE gains accruing to the perpetrator, are detected. This category will be referred to the National Prosecuting Authority or other law enforcement agencies for possible criminal prosecution.

The second category will be moderate incidents of fronting on a fairly low scale, and although an element of dishonesty may be present, the fronting offence had no significant impact on the achievement of the objectives of the B-BBEE Act of 2003. In such circumstances the B-BBEE Commission could be authorised to impose substantial administrative fines.

The third category could provide for technical cases of fronting where no deliberate or dishonest intent is present, but the fronting activity or B-BBEE initiative nevertheless had created a B-BBEE advantage of which the impact is not serious, and was embarked on after reasonable steps were taken to be informed about the legality of the initiative or a *bona fide* mistake had been made. These are often cases of no-

⁷⁵¹ See Chapter 6 para 6.2.1 above.

⁷⁵² See Chapter 3 para 3.2 above.

fault or technical fronting. In such instances a variety of administrative remedies could be available to the B-BBEE Commission. Apart from fines, the B-BBEE Commission should be able to resort to imposing remedies such as compliance orders, awards to the community that was jeopardised, awards to B-BBEE funds to eradicate poverty, education or social development, and even community service where a corporate use its resources to embark on community upliftment projects as an administrative remedy imposed by the B-BBEE Commission.

6.3.4 Statutory Amendments

The following statutory amendments are recommended:

- The incorporation of a definition of “person” in section 1 of the B-BBEE Act of 2003 similar than the provisions in the Companies Act, Consumer Protection Act and Competition Act to deal with the uncertain position of “trusts”;
- To add a provision to the “fronting offence” in section 1 or 13P of the B-BBEE Act of 2003 to deem a conviction for a fronting practice as an act of dishonesty in order for the section 69(8)(b) of the Companies Act to take effect to disqualify a person from being a director of a company. Presently the Companies Act disqualifies persons to be directors for fraud and lesser offences involving an element of dishonesty;
- To align the provisions of section 13P of the B-BBEE Act of 2003 with the new published Preferential Procurement Regulations of 2017 (regulation 6) for circumstances when a corporation or its members, directors or shareholders are prohibited from doing business with an organ of state or a public entity;
- To amend the definition of “B-BBEE initiative” in section 1 of the B-BBEE Act of 2003 to replace the word “affects” with “enhance” and to amend the term “compliance with this Act” with “compliance provided for in terms of this Act”;
- To amend the “fronting practice” definition to use either the word “B-BBEE initiative” as defined or the terms “transaction” and “arrangement” and not both as a transaction and arrangement are already included in the definition of a “B-BBEE initiative”. The use of the terms “transaction” and “arrangement” creates the impression that transactions and arrangements which are not B-BBEE initiatives are also a fronting practice and prohibited;
- To either delete the term “identity” or include the term “intermediary” in the provisions of paragraph (d)(i) of the “fronting practice” definition which led to the incorrect application of this provision by the High Court in the *Swifambo* judgement.

6.4 FINAL WORD

This dissertation set out to determine whether the new statutory offence of fronting will pass constitutional muster; to appraise the legal mechanism and system put in place to enforce and regulate the new fronting offence; and to determine whether the formulation of the fronting offence strikes a balance between constitutionality and promoting the objectives of the B-BBEE Act of 2003.⁷⁵³ In order for this dissertation to meet its objective of an appraisal of the fronting offence, the offence was objectively analysed from a criminal liability point of view. Such a ring-fenced approach is not of much value if the context within which such an offence operates is disregarded. This dissertation was therefore compelled to look at peripheral statutory provisions that influence the application of a fronting offence, and also the social and political influences that are a direct driver of the process.

The fronting offence is unique as it is directly linked to the objectives of the B-BBEE Act of 2003, which is an inseparable part of the economic and political policies and fluctuations of South Africa. Any sway in economic and political sentiment filter down and influence the way in which the fronting offence can be interpreted. This dissertation did not delve too deeply into these areas but had to consider these factors to the extent that they may impact the context within which the legal application of a fronting offence operates. The challenge faced in compiling this dissertation was to know where the boundaries are insofar as the peripheral statutory provisions, the technical mechanism of B-BBEE as well as the social and political permutations are concerned, and to assume certain basic knowledge on the part of the reader who might not be acquainted with some or all of the concepts relevant to the B-BBEE environment and therefore to provide enough information to enable the reader to “connect the dots”.

⁷⁵³ See Chapter 1 para 1.2 above.

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