
GOVERNMENT NOTICES • GOEWERMENTSKENNISGEWINGS

DEPARTMENT OF TRADE, INDUSTRY AND COMPETITION

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EXPLANATORY MEMORANDUM FOR GAZETTE ON RULES FOR DISCRETIONARY COLLECTIVE ENTERPRISES PUBLISHED IN TERMS OF THE B-BBEE ACT**1 Explanatory memorandum**

- 1.1** The purpose of this Practice Note is to provide clarity on how ownership by entities such as Broad- Based Schemes, Employee Share Ownership Programmes, Trade Unions, Not for Profit Companies, Co-operatives, Trusts (together "Collective Enterprises") should be interpreted under the B-BBEE Codes of Good Practice (the "Codes").
- 1.2** Over the last number of years there has been significant differences of opinion between regulators and major entities in the B-BBEE space on how ownership structures like discretionary Collective Enterprises, which provide for some discretion in respect of the distribution of proceeds to beneficiaries should be considered for ownership purposes under the Codes. These differences of opinion are affecting the decisions of firms in the economy and clarity is required.
- 1.3** Government policy has been to promote broad-based empowerment, which embraces a number of aspects, including facilitating ownership by groupings of designated persons through vehicles such as cooperatives, women's investment vehicles, youth empowerment structures, trade union investment vehicles and community welfare projects. These arrangements differ from the traditional model of share ownership being held directly or indirectly to the name and for the account of individuals from the designated groups.
- 1.4** The Minister of Trade, Industry and Competition (the "Minister") has taken note of these varying interpretations and following legal advice hereby issues this Practice Note in order to clarify interpretation of the current provisions. The effect of the Practice Note will be to clarify that a defined class of black beneficiaries satisfies the ownership provisions under the Codes, and that specific beneficiaries need not be individually identified, provided that the "Collective Enterprises" comply with the provisions in this Practice Note. As a consequence, ESOPs or worker ownership schemes which provide a benefit for a large proportion or all of current and future black workers of the firm, or broad-based schemes which provide a benefit for certain designated groups like black students as recipients of bursaries, can satisfy the ownership provisions under the Codes.
- 1.5** The Practice Note further clarifies that evergreen ESOPs, which provide perpetual benefit to workers of the company, also satisfies the ownership provisions under the Codes. Evergreen ESOPs are an important policy tool for broad-based empowerment and has the added benefit that it can contribute to improved industrial relations in South Africa, in this way helping to make firms and hence empowerment itself more

sustainable. Such structures, coupled with appropriate representation for workers on company boards, further create an important means of broadening the benefits and impact of empowerment.

- 1.6** In addition, the Practice Note provides clarification on inter alia the qualification of minors in the ownership calculations and determination of Collective Enterprises; that distributions can be in cash or kind and that both can be claimed under Economic Interest on the Ownership scorecard; Allowing for discretion to be applied by the Fiduciaries on the value or portion of Economic Interest distributions to beneficiaries or participants of Collective Enterprises provided that it is aligned to the constitution of the scheme; and allowing for Voting Rights to be measured through the Fiduciaries voting on behalf of the beneficiaries or participants.
- 1.7** In the course of the discussion, broader policy questions have arisen on ways to further strengthen broad-based empowerment vehicles like ESOPs, including through measures to encourage participation of worker nominees on company boards and establishing evergreen structures. Challenges with existing schemes (covering their funding mechanisms, fronting practices, inadequate information to intended beneficiaries and governance challenges) will need to be addressed. At the same time, the regulatory environment should also promote the participation of individual entrepreneurs from designated groups and maintain policy momentum to improve the level and quality of representation of black South Africans in the economy. These matters however go beyond the remit of a Practice Note which seeks to guide the Department, the regulator and the market on the approach to be followed in giving effect to current policy and legislation. To address the challenges that fall outside the scope of a Practice Note, the Minister intends to appoint a panel to provide a report on ways to address these areas. The Minister will therefore commence a process to ensure appropriate changes are made to give better effect to the aims of the Act and to close opportunities for exploitation of BEE provisions, so as to ensure that the broad based ownership does not dilute the pressure to transform the economy but in fact strengthens it further.

**PRACTICE NOTE IN TERMS OF B-BBEE ACT, 2003:
RULES FOR DISCRETIONARY COLLECTIVE ENTERPRISES**

I, Mr. Ebrahim Patel, Minister of Trade, Industry and Competition, by virtue of the powers vested in me in terms of section 14 (2) of the Broad-Based Black Economic Empowerment Act, 2003 (B-BBEE Act No. 53 of 2003) as amended by B-BBEE Amendment Act No.46 of 2013 ('the Act'), hereby publish a Practice Note on the Rules for Broad- Based Schemes (BBOS), Employee Share Ownership Programmes (ESOPs), Trade Unions, Not for Profit Companies (NPC), co-operatives and Trusts, juristic persons or other Collective Enterprises for B-BBEE Measurement purposes of recognition and measurement of such schemes as follows:

RULES FOR DISCRETIONARY COLLECTIVE ENTERPRISES

1 Background

- 1.1** This clarification aims to respond to existing interpretative misalignment on how Discretionary Collective Enterprises such as Broad- Based Schemes (BBOS), Employee Share Ownership Programmes (ESOPs), Trade Unions, Investment Holding Companies that are BBOSs, Not for Profit Companies (NPCs) and Trusts amongst other juristic persons should be treated in terms of the Broad Based Black Economic Empowerment legislation. Discretionary in this context and in line with the B-BBEE Codes means that Fiduciaries are able to decide on the disbursement of the fund without deviating from the founding or constitutional documents. In addition, it aims to develop the understanding in the market of the requirements for measuring such structures, taking into consideration the substance over legal form principle. It is important to note that the impact of such structures have benefited many black beneficiaries in terms of economic empowerment and/or access to the economy.
- 1.2** Government advocates and promotes that the implementation of Broad Based Black Economic Empowerment (B-BBEE) legislation should ensure broad participation as well as meaningful participation of black people in the mainstream economy. This will lead to B-BBEE contributing towards addressing the triple challenges of poverty, inequality and unemployment. An ideal B-BBEE ownership transaction should empower black people, black women, black designated groups, black participants in an ESOP, BBOS and Co-operatives. Furthermore, it should empower and be inclusive of entrepreneurs and investors, SMMEs and suppliers, employees, communities as well as other marginalised groups. Furthermore, such ownership transactions must lead to the achievement of the objectives of B-BBEE, as detailed in Paragraph 2 of the Broad-Based Black Economic Empowerment Act 53 of 2003, as amended.
- 1.3** This Practice Note deals with the application of the rules related to the measurement, evidentiary and reporting treatment of discretionary Collective Enterprises and related matters. As such it seeks to clarify and regulate the existing legislation provided for in the Codes of Good Practice on B-BBEE (the Codes) in respect of these matters.

2 General Clarification

- 2.1** The Rules for Broad-Based Ownership Schemes (BBOS), Employee Share Ownership Programmes (ESOP) and for Trusts contained in the Codes issued in terms of section 9 of the Broad-Based Black Economic Empowerment Act, No. 53 of 2003 (the Act) determine that the constitution of the scheme must define the participants and the proportion of their claim to receive distributions. However, in terms of the Codes the use of a 'defined class of natural person' satisfies the requirement for identification. Paragraph 3.1.1 of Statement 100 of the Codes expressly recognise that black people are entitled to participate in measured entities on an indirect basis. This notice is an express recognition of the validity of collective enterprises, amongst others, as valid vehicles for furthering B-BBEE. In particular, the interest of that interposing vehicle (whether a Collective Enterprise or otherwise) in a Measured Entity must in some lawful manner be capable of being attributed to black persons in accordance with paragraph 3.3.1 of Statement 100 of the Codes.
- 2.2** This option to use a 'defined class of natural person' as Participants when structuring a BBOS, ESOP or Trust, as opposed to a written record of names of Participants, was expressly provided for in the Codes in furtherance of the objectives of the Act. The objectives embodied in sections 2(c), (e) and (f) of the Act, which talks to **broad-based** and meaningful ownership in the economy by black people, communities and workers, are often best served through this mechanism of identifying a natural class of persons to benefit from the scheme as opposed to a list of individuals with vested rights against the income and capital of the scheme. The use of a defined class of natural person is also not necessarily limited to BBOS, ESOP and Trusts as other juristic persons such as Non-Profit Companies also utilise it from time to time.
- 2.3** Typically in such schemes the defined class of natural persons would have a vested right against the income and capital of the scheme but the individuals that might form part of that defined class of natural persons do not have a similar vested right. The individuals merely have what is commonly referred to as a 'spes' or hope to participate in income and capital but not a vested right to it. Such schemes could typically provide for a discretion to the fiduciaries of the scheme to from time to time select individuals from the defined class of beneficiaries that would benefit out of distributions of the scheme. Fiduciary discretions sometimes even allow the fiduciaries to determine the proportion of entitlement that a particular beneficiary will receive once he/she is selected out of the 'defined class of natural person'.
- 2.4** Discretions like these, do not contradict the rule that the fiduciaries may have 'no' discretion in relation to defining the Participants and the proportion of their claim to receive distributions. For example, it follows, quite logically, that if the scheme expressly (in writing) provides for a fixed percentage of distributions to vest in the 'defined class of natural person' that it satisfies the rule of identifying the proportion of entitlement of Participants by means of a "*written record of fixed percentages of claim*". As long as the scheme does not provide for a discretion to the fiduciaries to distribute less than that fixed percentage to beneficiaries who are members of the 'defined class of natural person' - the requirement that the fiduciaries may have 'no' discretion in relation to these terms are also met.

- 2.5 Similarly, where a scheme provides for a formula to determine the proportion of claim of a defined class of persons or the entitlement of individuals selected out of that defined class and the fiduciaries are not awarded a discretion to deviate from the formula, the scheme complies with the rule that the fiduciaries 'may have no discretion' on the terms.
- 2.6 Once the fiduciaries exercise their discretion, each beneficiary selected to partake in a particular distribution acquires a vested right to such portion of the particular distribution allocated to them at that point in time. Also, subject to the provisions of the scheme, it is important to understand of this type of mechanism that if an individual at one point in time was selected to partake in a distribution of the scheme, that it not necessarily entitles that individual to partake in future distributions.
- 2.7 These discretionary powers afforded to fiduciaries are critical to ensure meaningful beneficitation of some members of the class of natural persons. As an example, a bursary scheme that is 100% for 'Black Female Students that Matriculate in Gauteng Province' would be such a Collective Enterprise. In this example the defined class of natural person would be '*Black Female Students that Matriculate in Gauteng Province*' and the fixed percentage of proportion of claim of this defined class would be '100%'. Typically, not all black female students that matriculate in Gauteng have a vested right to receive bursaries out of the scheme's limited funds, but only those that are selected by the fiduciaries from year to year. The defined class of natural persons' rights, are however, vested and the fiduciaries are not allowed to award a bursary to any individual that fall outside of the defined class of natural persons by for example awarding a bursary to a black male or white female or black female matriculating outside of Gauteng province. Also, the value of a distribution to a black female student selected may, if such discretion is provided to the fiduciaries, differ from the value of distributions to other black female students that were selected as long as the 'defined class of natural person' do not receive anything less than provided for by means of the fixed percentage (100% in this example).
- 2.8 Other than that, only Black People Participants attract recognition on the ownership scorecard, the Codes places no restrictions on the nature of Participants. Without derogating from the generality of this statement, minors for example, are not restricted from being Participants or beneficiaries in any way whether as part of a defined class of natural persons or individually.
- 2.9 Similarly to dividend distributions out of companies that may be in cash or in kind, distributions out of these types of Collective Enterprises may also be, and more often than not are, in kind. Instead of making cash distributions to beneficiaries these schemes often pay for skills development, education or training on behalf of beneficiaries or facilitate access to funding or fund social or community interventions or developments for the benefit of the participants who are a 'defined class of natural persons'. Discretionary schemes making distributions in kind to members of a defined class of natural persons does not in any way detract from the Economic Interest points claimable by or through these schemes.
- 2.10 Further to this, whether distributions are made or not has no bearing on whether or not Economic Interest may be claimed in terms of the Codes. In terms of the Codes Economic Interest attaches to the **right** to receive dividends or a **similar right** and not

to the distribution itself. The primary factor in determining whether or not dividends are declared, or distributions are made, is solvability and liquidity aspects of the business or Collective Enterprises. Measured entities and discretionary Collective Enterprises may not be penalised for not having made distributions in any particular year. Any earnings that are retained and not distributed in any event vests in the individual or defined class of natural person entitled thereto, and cannot be distributed to any other person other than those individual/s or that defined class of natural persons which had vested rights in such earnings.

- 2.11** The rules in the Codes that require the financial reports of Collective Enterprises to be presented to Participants at an annual general meeting implies that Participants must be invited to the annual general meeting of a Collective Enterprise but does not mean that all will attend or that attendance of all Participants is a requisite for the Collective Enterprise to comply.
- 2.12** Discretionary Collective Enterprises, therefore, allow so called single purpose Collective Enterprises such as educational, developmental and community upliftment type of BBOS or trusts to be recognised in a chain of ownership and the Measured Entity receiving the points commensurate to the black ownership housed in such a single purpose Collective Enterprise.
- 2.13** In respect of ESOPs, it is further clarified that evergreen ESOP structures, which provides perpetual benefit to workers of the company, may also satisfy the ownership provisions of the Codes. The defined class of beneficiaries in such cases may be "workers of the firm" in question. Paragraph 2.4 of Annexure 100C of the Codes lays down requirements for the identification of participants. It permits a scheme which identifies the participants as employees of the company for as long as they remain in its employ. Paragraph 2.5.5 on Annexure 100C says that all accumulated economic interest of the scheme is payable to the participants at the earlier of a specified date or event, or the termination of the scheme. But it does not require such an earlier date or event to be specified at all. Its only purpose is to ensure that the accumulated economic interest of the scheme ultimately goes to its participants and not to anybody else. The scheme's constitution may accordingly say no more than that its accumulated economic interest must be distributed to its participants on termination or winding-up of the scheme.

3 Measurement and Evidentiary Requirements

- 3.1** The terms of a constitution, memorandum of incorporation (MOI) or the trust deed of a discretionary Collective Enterprises, whichever the case may be, need to have a clearly defined objective and may, notwithstanding the Rules for ESOPs, Trusts and BBOSs (e.g. that at least 85% of the value of benefits allocated must accrue to Black People, 50% of the fiduciaries must be independent, 50% of the fiduciaries must be Black people and 25% must be black women), provide for a discretion to the fiduciaries to distribute, in their sole and unfettered discretion, such portions of the scheme's income and capital as they deem fit from time to time to some members of a defined class of natural persons to the exclusion of others.
- 3.2** A discretion to fiduciaries referred to in 3.1 above, exercised within the confines of the defined class of natural persons, in accordance with the terms of the constitution, MOI

or trust deed, will not disqualify the Collective Enterprise from qualifying for recognition as a BBOS, ESOP, Trust or in general from qualifying under the Ownership Scorecard;

3.3 Where such a discretion or a partial discretion exists, the race and gender composition of Rights of Ownership that flow through the Collective Enterprise must be determined with reference to the wording of the constitution, MOI or trust deed and any applicable law having regard to the race and gender of members of the defined class of natural persons and that class's vested proportion of entitlement to income and or assets;

3.3.1 where the wording of the constitution, MOI or trust deed is clear on the racial or gender composition of a defined class of natural persons - the constitution, MOI or trust deed, whichever the case may be, will serve as a written record to those facts it is clear on, thereby satisfying the requirement for identification;

3.3.2 where the determination of race and gender of Participants are not practically determinable from a pure reading of the trust deed, reliance may be placed on an independent competent person's report estimating the rights of ownership that flows through the scheme. Such report may have regard to various factors which could include where appropriate:

3.3.2.1 ad hoc distributions to Participants of income and capital during the Measurement Period;

3.3.2.2 official estimating records such as publicly available municipal records, university or school enrolment records and the South African census reports;

3.3.3 where the determination of race and gender of Participants are indeterminable notwithstanding the mechanisms provided for in paragraphs 3.3.1 and 3.3.2 the Participants must be regarded as non-black.

3.4 Participants in Collective Enterprises with these discretionary terms seldom have the right to vote at general meetings of the scheme. Their rights are represented by the fiduciaries who make decisions for and on their behalf. For this reason, the Voting Rights of such Participants, although exercised by such fiduciaries, will be attributed to the race and gender of the Participants and not that of the fiduciaries. For the avoidance of doubt, where the right of Participants to vote at general meetings of the Collective Enterprise are expressly provided for, the Voting Rights will also be attributed the race and gender of the Participants.

4 Reporting Requirements

Where a measured entity is called upon to report on its B-BBEE compliance to the B-BBEE Commission in terms of section 13(G) of the Act read together with the Regulations and the forms pursuant thereto - it might very well be that a discretionary Collective Enterprises or one or more other juristic vehicles in its chain of ownership are not capable of reporting on the "black people" Participants' in terms of classification, their 'number', their 'province' or 'age' etc. This may be because the 'defined class of natural person' does not distinguish between these categories or the competent person is unable to distinguish between them or because the Codes does

not require verification thereof. In such cases the measured entity will be required to report only on the participation of "black people" but not the other categories, it must do so in line with the information that the Collective Enterprises are able to produce. This could include province, further breakdown of demographic or other relevant information, even though such information might not be verified. A Measured Entity which is unable to produce verified information requested cannot, however, be compelled to do so, and therefore cannot be considered as non-compliant with the requirements of Annexure 100 B-D. It must be noted that unverified information cannot be included in the Ownership scorecard.



EBRAHIM PATEL
MINISTER OF TRADE, INDUSTRY AND COMPETITION
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