THE DETERMINATION OF BLACK
OWNERSHIP IN COMPANIES FOR
THE PURPOSE OF BLACK
ECONOMIC EMPOWERMENT
(PART 2)

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SUMMARY

This is the second part of a two-part article dealing with the determination of black ownership in companies for the purpose of black economic empowerment. The BEE codes of good practice define and measure ownership in terms analogous to the principal rights flowing from membership of a company, namely voting rights at a meeting of members and economic interest in the company. Economic interest includes, but is not limited to, a shareholder’s entitlement to receive dividends. Targets are set for the degree to which black people generally, as well as certain sub-groups of black people specifically, are entitled to the ownership elements in companies. Safeguards are built in to discourage fronting practices. The degree of detail with which the codes attempt to prescribe the nature of black ownership in companies has the potential to lead to confusion and unintended consequences that may be contrary to empowerment objectives.

1 INTRODUCTION

The recognition of black ownership in companies that arises from the sale of equity instruments is analysed in this second part of a two-part article on ascertaining the level of black ownership in companies for the purpose of meeting Black Economic Empowerment (“BEE”) policy expectations. Part 1 of the article considered the legislative context within which BEE operates.¹

¹ Marais and Coetzee “The Determination of Black Ownership in Companies for the Purpose of Black Economic Empowerment (Part 1) 2006 Obiter 111.
In this part we analyse the content of Statement 100 of BEE Code 100, commenting in the first instance on how the code defines the type of ownership that it promotes. The discussion moves on to cover an examination of the intricacies of the ownership scorecard, including illustrations of some of its calculations. Attention is given to the rewards in the scorecard for removing restrictions from black shareholders’ rights, as well as the penalties incurred when economic benefits are delayed. As part of this discussion the dilemma of financing BEE equity acquisitions is addressed. Whilst vendor financing is prohibited by section 38 of the Companies Act 61 of 1973 (hereinafter “the Companies Act”), Code 100 actively penalises the use of third-party financing that places restrictions on a black shareholder’s rights. It appears that in this regard Code 100 does not fully take into account the economic realities that parties to a prospective BEE deal have to face. The discussion concludes with a reflection on specific ownership schemes that are singled out for recognition by the code. The rules regarding the use of trusts as a conduit for economic benefits to reach black people are of particular interest. Discretionary trusts are almost completely disqualified and it is required that black beneficiaries be entitled to appoint trustees. The latter is an unusual arrangement in trust law and creates complications for existing black shareholding trusts that were not set up in this way.

Although the ownership measurement guidelines apply regardless of the type of business entity, the discussion here deals exclusively with the application of the guidelines to companies. As such the terminology used is that of companies and reference is only made to the provisions of the Companies Act.

This article deals with the law as it stood on 30 November 2005. By that time Statement 100 had been revised several times before finally being approved by cabinet for gazetting in terms of section 9 of the Broad-Based Black Economic Empowerment Act 53 of 2003 (“the BEE Act”). The said gazetting had, however, not yet taken place.

2 DEFINING AND MEASURING OWNERSHIP IN THE CONTEXT OF BLACK ECONOMIC EMPOWERMENT

Code 100 is the primary source of law regarding the determination of the levels of black ownership in companies. As discussed in Part 1 codes of good practice issued by the Minister of Trade and Industry in terms of section 9 of the BEE Act may extend the interpretation and definition of broad-based BEE and may provide indicators to measure the level of broad-based BEE in an entity. The codes may also determine the weighting associated with each of the indicators and set targets for the indicators.

2 Any reference to Code 100 means that it is taken from Statement 100 of that code, unless otherwise indicated; refer to Marais and Coetzee 2006 Obiter 111 for a discussion of the status and effect of the BEE codes of good practice of which Code 100 forms part.

3 S 9(1)(c)-S9(1)(e).

4 S 9(1)(d).
consistent with the objectives of the Act.\(^5\) It is in terms of this mandate that Code 100 establishes an ownership scorecard that outlines the mechanism for determining the level of black ownership in a business.

### 2.1 Defining ownership for the purpose of black economic empowerment

Before analysing the content and operation of the ownership scorecard, it is necessary to consider the meaning of a number of concepts that have been created and specifically defined for use in the scorecard.

#### 2.1.1 Components of ownership

There has been a notable evolution in the Department of Trade and Industry’s conceptualisation of the measure of ownership it wishes companies to transfer to black people. The *Strategy for Broad-Based Black Economic Empowerment*\(^6\) originally identified the focus of the direct economic empowerment of black people as the “ownership of enterprises and assets through shares and other instruments that provide the holder thereof with voting rights and economic benefits, such as dividends or interest payments.”\(^7\) The first draft of the codes of good practice elaborated on this principle by introducing the interrelated concepts of equity, equity interest, voting rights and economic interest.\(^8\) The indicators of the presence of black ownership fell primarily under the headings of entitlement to voting rights and economic interest.\(^9\) This remains the essence of ownership assessment for BEE purposes in the final draft of the codes of good practice. There has, however, been a significant development in thought regarding the impact on a company’s score where restrictions are placed on the ownership rights of black shareholders, or where debt remains outstanding on a black person’s acquisition of shares.

The indicators of black ownership emphasised in the codes of good practice represent an attempt to find metrics that indicate the effective degree to which black shareholders in a company are entitled to the principal rights flowing from membership of a company, namely:\(^10\)

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\(^5\) S 9(3)(a).

\(^6\) See Marais and Coetzee 2006 *Obiter* 111 for a discussion of the context and status of this document.

\(^7\) Department of Trade and Industry *Strategy for Broad-Based Black Economic Empowerment* 21.

\(^8\) Department of Trade and Industry *Codes of Good Practice on Broad-Based Black Economic Empowerment* 1st Draft (2004) 101-105; these concepts are discussed in some detail from par 2 1 1 1, 2 1 1 2 and 2 1 1 3 below.

\(^9\) Department of Trade and Industry *Codes of Good Practice* 1st Draft 106.

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- The right to attend and vote at meetings of members;
- The right to participate in dividends; and
- The right to participate in the surplus assets of the company in the event of winding up.

It is of particular importance for the purpose of BEE ownership measurement, firstly, to identify the actual entity of which the black ownership level is being determined, and, secondly, to identify the person or entity that effectively holds the shares. The first entity is termed the “measured enterprise”, being the enterprise that is being subjected to a measurement of its BEE compliance status.\(^ \text{11} \) In the context of complex holding structures it is not always as simple as it may seem to identify the measured enterprise. The second investigation leads to the identification of shareholding parties that may be either natural or juristic persons, as well as entities such as trusts that hold shares for the benefit of other parties. The focus of Code 100 is specifically on “participants” in the measured entity. These are natural persons who are entitled to an economic interest in the measured enterprise and who enjoy exercisable voting rights in that enterprise.\(^ \text{12} \) A further provision is made for the inclusion of “deemed participants” in the definition.\(^ \text{13} \) This comprises “a natural person who is entitled to receive a distribution or benefit from a broad-based ownership scheme.”\(^ \text{14} \)

It is therefore clear that companies will not, in principle, receive unequivocal recognition for arrangements where their shares are held by juristic persons, even if the majority of shares in such holding entities are owned by black people. An analysis must be done in order to identify each black participant (being, first and foremost, a natural person) in the

\(^ {11} \) Department of Trade and Industry Code 100: Measurement of the Ownership Element of Broad-Based Black Economic Empowerment Final draft approved by cabinet for gazetting (2005) 100-105.

\(^ {12} \) Ibid.

\(^ {13} \) Ibid. The exact phraseology of the definition of participants is problematic. The three elements, namely entitlement to economic interest, enjoyment of exercisable voting rights and inclusion of deemed participants are separated by the word “and”, suggesting that all three characteristics must be present in order for a natural person to be considered a participant. It is, however, clear from the use of the word “deemed” in the term “deemed participant” as well as the definition provided for the latter term that it covers natural persons who would not otherwise fit within the definition of participants, but who are by exception to be treated as participants. It would therefore be nonsensical to require that, in order to be a participant, a person must also be a deemed participant. It is submitted that a more correct construction of the definition of participant would be that it means “a natural person who is: (a) entitled to an economic interest in a measured enterprise; and (b) enjoying an exercisable voting right in a measured enterprise; alternatively, it means a deemed participant”. It is to be hoped that the drafters of the codes of good practice will remedy the current contradiction in this very fundamental definition before the gazetting of Code 100. Several other critical definitions, such as “black new entrants”, “economic interest” and “voting right”, rely on this definition for meaning. In its current form it will no doubt lead to interpretational difficulties.

\(^ {14} \) Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-104; Such a scheme is a collective ownership scheme that is set up in order to facilitate the participation of specified natural persons in the benefits flowing from the ownership by the scheme (or by its fiduciaries) of an equity interest in an enterprise (Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-103).
ownership chain. Such an approach is consistent with the definition of black people in the codes of good practice which excludes juristic persons. The recognition of shares held in a trust for the benefit of black people are determined according to a separate set of rules.

The ownership scorecard contained in the final draft of the codes of good practice is shown below in order to provide context to the analysis of the ownership concepts that are introduced in the codes of good practice.

<table>
<thead>
<tr>
<th>Category</th>
<th>Ownership Criteria</th>
<th>Weighting</th>
<th>Compliance Points</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.1 Voting rights:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.1.1 Exercisable voting rights in the enterprise in the hands of black people</td>
<td>3</td>
<td>25% + 1 vote</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.1.2 Exercisable voting rights in the enterprise in the hands of black women</td>
<td>2</td>
<td>10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.2 Economic interest:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.2.1 Economic interest in the enterprise to which black people are entitled</td>
<td>4</td>
<td>25%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.2.2 Economic interest in the enterprise to which black women are entitled</td>
<td>2</td>
<td>10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.2.3 Economic interest in the enterprise to which the following natural persons are entitled:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.2.3.1 black designated groups</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.2.3.2 black deemed participants in distribution schemes or employee schemes; or</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.2.3.3 black participants in co-operatives</td>
<td>1</td>
<td>2.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.3 Realisation points:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.3.1 Ownership fulfilment</td>
<td>1</td>
<td>Refer to paragraph 17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.3.2 Net equity interest</td>
<td>7</td>
<td>Refer to paragraph 17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.4 Bonus points:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.4.1 Involvement in the ownership of the enterprise of:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.4.1.1 black new entrants;</td>
<td>3</td>
<td>Refer to paragraph 18</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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15 For a fuller discussion of this approach see the analysis of the flow-through principle, the modified flow-through principle and the control principle in par 2242 and 2243 below.
16 See Marais and Coetzee 2006 Obiter 111.
17 The recognition of shareholding through trusts is dealt with in par 242 below.
18 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-107.
19 The scorecard is copied verbatim from Code 100. Paragraph references are to paragraphs in the code itself and the numbering on the left is the original numbering used in the text of the code.
<table>
<thead>
<tr>
<th>Category</th>
<th>Ownership Criteria</th>
<th>Weighting</th>
<th>Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.4.1.2</td>
<td>black deemed participants of broad-based ownership schemes; or</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>5.4.1.3</td>
<td>black Participants in co-operatives</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

### 2.1.1.1 Equity interest and equity

Equity interest was defined in the first draft of the codes of good practice as the portion of equity which an individual member has as a claim against the enterprise or against the other members of the enterprise, expressed as a percentage of the total equity in the enterprise. Equity for this purpose is “the capital invested in [the] enterprise in respect of which the members have a claim against the enterprise or against the other members of that enterprise by reason of holding an equity interest”. The analogy is that equity interest includes the concept of shares in a company limited by shareholding, whilst equity relates to the notion of issued share capital in a company limited by shareholding. Preference shares, or other similar instruments that represent debt, were specifically excluded from the definition of equity interest.

The second draft of the codes of good practice did not contain a separate reference to equity, and used a modified definition of equity interest, describing it as a “collective term referring to the entitlement of a participant to receive economic interest and to exercise voting rights in an enterprise”. An instrument that is created as a means to facilitate the repayment by a participant or an enterprise of a debt was specifically excluded from the definition of an equity interest. This diminished definition is further emaciated in the final version of the codes of good practice. An equity interest now simply means “the entitlement of a participant to receive an economic interest and to exercise a voting right in an enterprise”, reducing it to a mere collective term for voting right and economic interest entitlement. The important parts of the definition of equity interest, linking it to ownership in the form of shareholding, have now been taken up in the definitions of voting rights and economic interest.

### 2.1.1.2 Voting rights and exercisable voting rights

A voting right in a company with a share capital is the right to exercise a vote at a general meeting of shareholders. The voting right must furthermore

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20 Department of Trade and Industry *Codes of Good Practice* 1st Draft 103.
24 Department of Trade and Industry *Draft Amended Codes of Good Practice* 2nd Draft 100-104.
26 Department of Trade and Industry *Code 100* Final draft approved by cabinet for gazetting 100-105.
attach to an instrument owned or held by or on behalf of a participant. The reference to a participant found in the definition of a voting right gives it a certain circular quality, due to the fact that the enjoyment of a voting right is itself a requirement to be a participant. It does, however, clarify that not all entitlements to vote at a general meeting of shareholders will constitute voting rights. It is submitted that in a case, for instance, where the articles of the company provide, in accordance with section 195(4)(a) of the Companies Act, for the chairman of a general meeting of shareholders to have a casting vote, such “voting right” would not meet the requirements of the voting right definition in Code 100 and would thus not be taken into account for the purpose of the ownership scorecard.

Voting rights denote the level of control a participant exercises over the affairs of a company and are calculated by dividing the number of votes the participant is entitled to at a meeting of shareholders, by the total number of votes available to all shareholders at such a meeting, expressed as a percentage.

The ownership criteria for voting rights, as used in the ownership scorecard, refer specifically to exercisable voting rights. These are a participant’s voting rights that are not subject to any limitation. The concept of a limitation on voting rights is not clarified in the final draft of Code 100, unlike the approach that was followed in the earlier two drafts. In the first draft of the code the concept “unrestricted voting rights” was used rather than exercisable voting rights, the contemplated restriction being a consequence of the terms of the equity interest acquisition or the financing of the acquisition. The voting rights would be considered “restricted” if the aforementioned terms had the effect that the equity interest or its attached voting rights were:

- Pledged, ceded, or in a similar way encumbered in favour of another person; or
- Subjected to a mechanism intended to reserve the benefit of the equity interest or of the voting right for a person other than the member;
- Subjected to a mechanism designed to withhold, defer or restrict the member’s exercise of his/her voting right;
- Subjected to a restriction of the member’s ability to elect a number of directors reasonably proportional to the equity interest held by the member; or

27 Ibid.
28 See the discussion of participants in par 21.1 above.
29 Department of Trade and Industry Codes of Good Practice 1st Draft 104-105. Although these statements derive from the first draft of Code 100, and are not contained in the final draft, it is submitted that the point remains valid.
30 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-105.
31 Department of Trade and Industry Codes of Good Practice 1st Draft 108.
32 Ibid.
Subjected to an option, exercisable by and at the instance of another person, in terms of which the member can be forced to relinquish his/her equity interest or any part of his/her voting rights.

The list appeared to be a *numerus clausus* and voting rights that were restricted in any of the above ways would not have been taken into account when calculating the number of voting rights that accrue to black people, except where the restriction was arranged in such a way as to gradually release voting rights from its effect, in which case the released rights could be added to black-held rights as they were released.  

The second draft of the codes did not continue with the approach of using a separate list of possible restrictions on voting rights, but broadened the scope of the prohibition by acknowledging only "exercisable voting rights" in the hands of black people, as is the case in the final draft. Unlike the final draft, however, it provided two specific examples of the kind of limitations on voting rights that would disqualify such rights from being considered "exercisable". The first is an instance where the participant is not entitled to exercise his/her voting rights because of a condition of the financing arrangement under which he/she acquired the equity interest to which the voting rights attach, or, alternatively, because of an agreement amongst the participants in the measured enterprise. The second example of a limitation on voting rights is a situation where the participant is prevented from appointing directors or other analogous owner-appointed management in proportion to his/her entitlement to voting rights.

It is apparent that the evolution of the concept of restrictions or limitations on voting rights has moved away from closed lists and specific examples to a much broader prohibition (as contained in the final draft) that leaves it open to interpretation which arrangements would fall foul of the prohibition. A significant consequence of this development is that there is no longer a link between the restriction or limitation on the voting right and the terms of the equity interest acquisition or financing. This changes the earlier position that restrictions or limitations that were unrelated to such acquisition or financing did not disqualify the voting right from black ownership recognition.

In contrast with directors, who may not constrain their vote by prior arrangement, there is nothing in company law that prevents shareholders from concluding agreements that bind their votes. In light of the above discussion it is apparent that companies should carefully examine such

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33 Ibid.
34 Department of Trade and Industry Draft Amended Codes of Good Practice 2nd Draft 100-104 to 100-105.
35 From the wording of the definition it would appear that these examples were not meant to be a *numerus clausus* of conditions that excluded exercisable voting rights, but rather were provided "for the avoidance of doubt" that these particular practices precluded the rights in question from being exercisable voting rights (Department of Trade and Industry Draft Amended Codes of Good Practice 2nd Draft 100-104 to 100-105).
36 Department of Trade and Industry Draft Amended Codes of Good Practice 2nd Draft 100-104 to 100-105.
37 Ibid.
38 Department of Trade and Industry Draft Amended Codes of Good Practice 2nd Draft 100-105.
39 Cilliers et al 107; and Pretorius et al 148-150.
agreements for the impact it might have on black ownership levels. Voting rights affected by this type of agreement may well fall foul of the very broad prohibition on limitations that is now contained in Code 100. Should this be the case, such voting rights held by black people will not be counted towards the relevant element of the company’s black ownership achievements.

2 1 1 3 Economic interest

Economic interest constitutes a participant’s return on his/her ownership in a measured enterprise.\textsuperscript{40} Economic interest would therefore include the entitlement to dividends, but is not restricted to this type of receipt. Other economic rights flowing from ownership, such as the right to participate in the surplus assets of the company in the event of winding up, would also fall within the definition.\textsuperscript{41}

Certain entitlements to a return that accrues to a participant may be considered to be economic interest even if it does not have the nature of a return on ownership.\textsuperscript{42} For this to occur, the following elements should be present:\textsuperscript{43}

- There must be an entitlement to receive a payment or part payment on the participant’s claim\textsuperscript{44} from a measured enterprise; and
- This payment must be:
  - Not at arms-length;
  - Not market-related;
  - \textit{Mala fide};
  - Without a commercial rationale; or
  - Intended to circumvent the provisions of Statement 100 of Code 100 or the objectives of the BEE Act.

This means that certain payments made to shareholders that are not related to their shareholding and are made for an ulterior purpose, such as circumventing the code of good practice, will also be included in economic interest. An example of such a payment would be a situation where a measured enterprise does not pay dividends to a white shareholder, but rather channels the money to him/her by way of making a payment for “consulting services” rendered to the measured enterprise at a rate that is substantially higher than the market rate for such services. This type of

\textsuperscript{40} Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-104.
\textsuperscript{41} Such an entitlement was specifically included in the definition of economic interest in the first draft of Code 100 (see Department of Trade and Industry \textit{Codes of Good Practice} 1st Draft 102).
\textsuperscript{42} Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-104.
\textsuperscript{43} Ibid.
\textsuperscript{44} Defined as “any claim to payment that a participant enjoys in relation to a measured enterprise, including claims enjoyed through one or more other enterprises” (Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-105).
payment is not in the nature of a receipt on ownership in the enterprise and would therefore not have been considered as an economic interest according to the first part of the definition. By paying the money to a white shareholder in this way the measured enterprise would increase the economic interest paid to black shareholders as a percentage of all economic interest by artificially reducing the amount of economic interest paid to white shareholders. To counteract this manner of mischief, the rider to the definition of economic interest specifically includes this type of payment in economic interest.

The drafters of the codes of good practice have taken into account that measured enterprises may have placed restrictions on the economic interest of black shareholders that has the effect of frustrating the realisation of the empowerment potential represented by the economic interest. According to the first draft of the codes, examples of such restrictions include situations where, by virtue of the equity acquisition or financing arrangement, the economic interest or its associated equity interest is:

- Pledged, ceded, or in a similar way encumbered in favour of another person; or
- Subjected to a mechanism intended to reserve the benefit of the equity interest or of the economic interest for a person other than the member;
- Subjected to a mechanism designed to withhold, defer or restrict the member’s receipt of his/her economic interest; or
- Subjected to an option, exercisable by and at the instance of another person, in terms of which the member can be forced to relinquish his/her equity interest or any part of his/her economic interest.

The first draft furthermore extended the scope of restricted economic interest to include situations where the acquisition of the equity interest was wholly or partially financed by means of a loan to the acquirer, or where the terms of the acquisition included a deferral of the obligation to make payment of the acquisition price (or part thereof) to a date later than the date of acquisition.

The practical consequence of the differentiation between restricted and unrestricted economic interest was that the first draft scorecard penalised restrictions to the extent that 8 of the 15 points allocated to economic interest could only be achieved to the extent that the target level of black shareholding was unrestricted. In the final draft of Code 100 the concept of restrictions on economic interest makes way for a mechanism in the ownership scorecard that encourages companies to work progressively at reducing conditions similar to those found in the list of restrictions in the first draft. The detail of this mechanism is considered below as part of the discussion of the ownership scorecard.

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45 Department of Trade and Industry Codes of Good Practice 1st Draft 110.
46 Department of Trade and Industry Codes of Good Practice 1st Draft 110-111.
47 Department of Trade and Industry Codes of Good Practice 1st Draft 106.
48 See par 2.2 below.
2.2 Measuring ownership for the purpose of black economic empowerment

2.2.1 The scorecard methodology

The scorecards contained in the codes of good practice are the materialisation of the authority these documents have to create the indicators that measure broad-based black economic empowerment. The overall BEE scorecard comprises 100 points distributed across a number of empowerment indicators or criteria. The points are not distributed evenly – areas that are considered to be more significant criteria of empowerment are allocated more points in order to increase the impact of compliance in these areas. The points associated with a criterion are referred to as the weighting points. Each weighted criterion has a compliance target. An enterprise's actual compliance in terms of the criterion is compared to the compliance target for that criterion by expressing the actual compliance as a percentage of the compliance target. The outcome of this calculation is multiplied by the indicator weighting to produce a score for the indicator. The criteria scores are then aggregated to produce an overall BEE score out of 100.

Ownership comprises 20 of the 100 points on the overall scorecard. These points are further divided across criteria for voting rights, economic interest and realisation points (which is essentially a further economic interest criterion). An additional three points are allocated to a bonus category making it theoretically possible to score in excess of 20 points for the ownership element.

2.2.2 The measurement of black ownership in terms of the scorecard

2.2.2.1 The measurement of voting rights

The target is for 25% of exercisable voting rights in the measured enterprise, plus one vote, to be in the hands of black people and 10% to be held by black women. These indicators account for respectively three and two of

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49 S 9 of the BEE Act.
50 The description that follows in the rest of this paragraph is loosely based on the scorecard application guidelines found in the various drafts of the codes of good practice, as well as on an interpretation of the black ownership formulae contained in these documents. The relevant references are as follows: Department of Trade and Industry Codes of Good Practice 1st Draft 19, 106, 107 and 109; Department of Trade and Industry Draft Amended Codes of Good Practice 2nd Draft 100-115 to 100-116; Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-118 to 100-119.
51 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-107 to 100-108; The ownership scorecard appears on 506 and 507 above.
52 Ibid.
53 Ibid.
54 For an exposition of the definition of black people refer to Marais and Coetzee 2006 Obiter 116.
55 Surprisingly, the term "black women" is not defined in the final draft of Code 100, nor in the more general Code 000 which provides the definition of black people. The simultaneously
the 20 ownership weighting points, meaning that in total the voting rights indicators comprise 25% of the ownership scorecard.

The first mention of a specific black ownership target came in the report of the BEE Commission,\(^5\) which suggested that black equity participation in every part of the economy should be increased to “at least 25% including individuals and collective enterprises”.\(^6\) The report further suggested that at least 25% of the shares of companies listed on the Johannesburg Stock Exchange (JSE) should be held by black people.\(^7\) Equity participation is defined for the purpose of the report as ownership measured in terms of economic interest.\(^8\) The Commission expresses a general preference for economic interest (rather than control) as an indicator of the deracialisation of business ownership.\(^9\) Economic interest ownership is viewed as an unambiguous indicator reflecting a situation where the BEE company has paid for its full portion of an equity stake.\(^10\) The preference for economic interest considerations over control considerations (represented by the voting right indicators) is also reflected in the drafts of the codes of good practice where 75% of the ownership score has consistently related to economic interest.\(^11\)

There are no statements in the BEE policy documents to explain how exactly the targets for exercisable voting rights and economic interest were arrived at. As far as exercisable voting rights are concerned it is most likely that the goal of 25% of the voting rights, plus one vote, is directly related to the requirements in the Companies Act that special majorities are needed for released final draft of Code 200, dealing with the measurement of the management and control element of BEE, does not contain the same oversight and defines black women simply as “black people who are women” (Department of Trade and Industry Code 200: Management of the Management and Control Element of Broad-Based Black Economic Empowerment Final draft approved by cabinet for gazetting (2005) 200-201). This is also the definition that was used in the second draft of Code 100 (Department of Trade and Industry Draft Amended Codes of Good Practice 2nd Draft 100-102).

The BEE Commission was established in May 1998 as a direct consequence of a resolution taken at the National Conference of the Black Management Forum (BMF) in 1997. The resolution suggested that an intervention was needed to remedy the fact that empowerment was proceeding without a common definition or benchmark to serve as minimum requirement. The contention was furthermore that black people had not been sufficiently involved in defining BEE and that the programme as it had evolved fell short of the aspirations of black people. The BEE Commission operated under the auspices of the Black Business Council (BBC) and had as objectives, \textit{inter alia}, the gaining of insight into BEE progress through empirical research, the drawing of conclusions regarding the obstacles to meaningful participation by black people in the economy, and the development of benchmarks and guidelines to monitor the implementation of a National BEE Strategy (Black Economic Empowerment Commission \textit{Black Economic Empowerment Commission Report} (2001) 1). The BEE Commission Report, submitted to government in March 2001, is closely associated with the move from narrow-based to broad-based empowerment, and was an important stimulus to the thinking that shaped the BEE Act and its associated policy instruments (Benjamin, Raditapole and Taylor \textit{Black Economic Empowerment: Commentary, Legislation \\& Charters} (2005) 1-3).

\(^5\) The BEE Commission Report 8.
\(^6\) Ibid.
\(^7\) Ibid.
\(^8\) Ibid.
\(^9\) BEE Commission Report 34.
\(^10\) Ibid.
\(^11\) Department of Trade and Industry \textit{Codes of Good Practice} 1st Draft 106; Department of Trade and Industry \textit{Draft Amended Codes of Good Practice} 2nd Draft 100-109; Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-107.
certain decisions at meetings of members, most notably for the passing of special resolutions. Requirements for special resolutions include that the resolution must:

(a) Be taken at a general meeting where members holding in the aggregate not less than 25% of the total votes of all the members entitled to vote at the meeting, are present in person or by proxy;

(b) Be passed by at least 75% of the number of members who are eligible to vote and who are represented in person or by proxy at the meeting (if the vote is taken by way of show of hands), or at least 75% of the votes to which the members present in person or by proxy are entitled (if the vote is taken by way of a poll).

If the quorum mentioned in (a) above is not achieved, another meeting can be convened where the members who are present in person or by proxy and are entitled to vote may deal with the business for which the original meeting was convened and a resolution passed by at least 75% of these members shall be deemed to be a special resolution even if less than 25% of the total votes are represented at the adjourned meeting.

By putting forward a target for black involvement of one vote more than 25% of the available voting rights, the codes of good practice seem to set an objective that accepts black people as minority shareholders, but requires that they have significant control from within that minority shareholding. This would theoretically be achieved where black shareholders control more than 25% of the exercisable voting rights. If these shareholders were to act in concert (which assumes, perhaps unrealistically, that a common purpose is to be expected amongst black shareholders) and ensure that all black shareholders are represented in person or by proxy when a meeting is called where a special resolution will be tabled, they will ensure that the meeting must go ahead and that it cannot be adjourned to a later meeting where the less stringent quorum requirements will apply. The black shareholders alone will then hold enough votes at the meeting to ensure that all the other shareholders present cannot together muster the 75% required to pass the special resolution. Theoretically this encourages majority shareholders to include black shareholders in major decisions (or at least enough of them to tip the voting scales at a members’ meeting).

It is indeed the purpose of the requirements in section 199 to protect minorities (so long as they can marshal support equivalent to 25.1% of the

---

63 S 199 of the Companies Act.
64 The other requirements relate to the giving of proper notice of the meeting (s 199(1)).
65 S 199(1)(a) of the Companies Act. In the case of a company limited by guarantee, at least 25% of the members entitled to vote at the meeting must be present in person or by proxy (s 199(1)(b)).
66 S 199(1) of the Companies Act.
67 And the relevant notice requirements have been met (cf s 192(2) of the Companies Act).
68 S 199(2)(b) of the Companies Act.
69 By virtue of controlling more than 10% of the Voting Rights in the company, the black shareholders will also be able to demand that voting at the meeting takes place by way of a poll (s 198(1)(b)(ii)).
70 Such a scenario is naturally only valid where the enterprise has met the full ownership target.
total shareholding in the company) by giving them “negative control” of the company through the ability to prevent certain critical business decisions.\textsuperscript{71} Such decisions include:\textsuperscript{72}

- Conversion of a company into another type of business entity.\textsuperscript{73}
- Alteration of memorandum regarding the objects and powers of the company.\textsuperscript{74}
- Alteration of articles.\textsuperscript{75}
- Alteration of share capital and shares.\textsuperscript{76}
- Authorisation for payment of interest out of capital.\textsuperscript{77}
- Acquisition of own shares.\textsuperscript{78}
- Authorisation of share option scheme for directors.\textsuperscript{79}
- Approval of a loan to a director.\textsuperscript{80}
- Resolution to voluntarily wind up the company.\textsuperscript{81}

The protective effect of the ownership scorecard’s exercisable voting rights target must not, however, be overstated. The most obvious complication is that there is not a sufficiently compelling reason for a measured entity to achieve the full target as it receives a percentage of the relevant weighting points equal to the percentage of the target it meets.\textsuperscript{82} In a company with a total of 100 shares and one vote per share, the company would meet the target for the first voting rights criterion if 26 votes are, without limitation, in the hands of black people. The black shareholders would have negative control of the company, as described above, and the company would receive all three of the weighting points related to the first criterion. If, however, the company only sold 24 shares to black people, it would meet 92.3\% of the target and hence receive 2.77 weighting points. The black shareholders would not have negative control and if the company ensured that at least ten of the votes held by black people were in the hands of black women, it would collect two more points giving it 4.77 or 95.4\% of the five points available for voting rights.

Even if the full voting rights target is met, the position of the black minority shareholders is not as robust as it might seem. In the first instance, if the black shareholders hold 25\% of the votes plus one, and no more, it would be


\textsuperscript{72} References in parenthesis are sections from the Companies Act 61 of 1973. This list is a selection from decisions requiring special resolutions highlighted in Cilliers \textit{et al} 108 fn 84.

\textsuperscript{73} S 22-25.

\textsuperscript{74} S 55.

\textsuperscript{75} S 62(1).

\textsuperscript{76} S 75.

\textsuperscript{77} S 79.

\textsuperscript{78} S 85.

\textsuperscript{79} S 223.

\textsuperscript{80} S 226(2)(a).

\textsuperscript{81} S 349.

\textsuperscript{82} The basic scorecard methodology is explained in par 2 2 1 above.
necessary for almost all of the black shareholders to be present at a meeting where a special resolution is being tabled to, in fact, have the negative control referred to above.

Table 5 below illustrates a company with 100 votes that has met its voting rights target. The white shareholders wish to pass a special resolution, but find that they do not have sufficient votes amongst themselves to do so. If all votes are represented at the meeting they need 75 votes, but only have 74. They would therefore only be able to pass the resolution if they can persuade at least one black shareholder to support the resolution. However, if all the white shareholders attend the meeting and some of the black shareholders do not, the dynamic changes dramatically. As shown, the white shareholders could pass the special resolution by controlling 75% or more of the votes at the meeting, even if they do not control 75% of the votes in the company. The more likely situation is that some black and some white shareholders would miss the meeting, but the principle remains valid that, depending on the balance of the absenteeism, the special resolution could be passed.

Table 5. Impact of non-attendance of black shareholders

<table>
<thead>
<tr>
<th>Black votes at meeting</th>
<th>White votes at meeting</th>
<th>Total votes at meeting</th>
<th>% White votes at meeting</th>
<th>Votes required for resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>26</td>
<td>74</td>
<td>100</td>
<td>74.0%</td>
<td>75</td>
</tr>
<tr>
<td>25</td>
<td>74</td>
<td>99</td>
<td>74.7%</td>
<td>75</td>
</tr>
<tr>
<td>24</td>
<td>74</td>
<td>98</td>
<td>75.5%</td>
<td>74</td>
</tr>
<tr>
<td>23</td>
<td>74</td>
<td>97</td>
<td>76.3%</td>
<td>73</td>
</tr>
<tr>
<td>22</td>
<td>74</td>
<td>96</td>
<td>77.1%</td>
<td>72</td>
</tr>
<tr>
<td>21</td>
<td>74</td>
<td>95</td>
<td>77.9%</td>
<td>72</td>
</tr>
<tr>
<td>20</td>
<td>74</td>
<td>94</td>
<td>78.7%</td>
<td>71</td>
</tr>
<tr>
<td>19</td>
<td>74</td>
<td>93</td>
<td>79.6%</td>
<td>70</td>
</tr>
<tr>
<td>18</td>
<td>74</td>
<td>92</td>
<td>80.4%</td>
<td>69</td>
</tr>
<tr>
<td>17</td>
<td>74</td>
<td>91</td>
<td>81.3%</td>
<td>69</td>
</tr>
</tbody>
</table>

Furthermore, for the negative control to exist in a situation where the target has been met, but not exceeded, all of the black shareholders would have to make common cause and vote the same way. It is submitted that this is an unrealistic assumption verging on the somewhat absurd suggestion that people of the same race will always view the merit of a business decision in the same way.

222 The measurement of economic interest

Mention has been made of the fact that Code 100 separates economic interest that is free from restriction or debt from economic interest that is subject to such encumbrances. In terms of the scorecard in the final draft of the code the weighting points previously allotted to the level of unrestricted entitlement of black people to receive their economic interest in an
enterprise is awarded as “realisation points” in terms of a set of formulae. This approach is explained below as part of the discussion of unrestricted economic interest.\(^{83}\)

### 2.2.2.1 Economic interest regardless of restrictions

There are three levels of criteria, namely economic interest in the enterprise to which (a) black people,\(^{84}\) (b) black women,\(^{85}\) and (c) specific groups of natural persons are entitled. Because all the members who qualify under the definition of black women will also qualify as black people, a company will effectively get double recognition (once under indicator (a) and once under indicator (b)) for its black female members.\(^{86}\) The same holds true for economic interest holders who are members of the specific groups listed in the third part of the criterion, namely black designated groups, black deemed participants in distribution schemes or employee schemes, and black participants in co-operatives. This makes it clear that, over and above seeking to extend ownership of enterprises to black people generally, BEE policy drives at ensuring that certain sub-groups of black people are specifically included. This must be viewed as part of the drive to broaden the base of empowerment.

The target for economic interest accruing to black people is 25%.\(^{87}\) There is no suggestion as to how this figure was arrived at, but it is submitted that it is in pursuit of the ideal that black shareholders should possess all of the principal benefits of their shares.\(^{88}\) Therefore, if the target for voting rights is 25% plus one vote, it is not surprising that the target for economic interest is the rounded down figure of 25%. The targets for economic interest held by black women and specific groups of natural persons are, respectively, 10% and 2.5%. In the absence of any indication to the contrary, it appears that these figures have been arrived at fairly arbitrarily.

### 2.2.2.2 Unrestricted economic interest

Restrictions on economic interest were quite dramatically discouraged in the first draft of the codes of good practice. Whilst seven of the 15 points allotted to economic interest could be gained regardless of restrictions, a further eight points (53% of the total economic interest points and 40% of the total ownership scorecard) could only be achieved to the extent that the same target of 25% of total economic interest accrued to black people without any restrictions.\(^{89}\) This had the problematic consequence that several BEE ownership deals that had been concluded before the belated release of the

\(^{83}\) See further in par 2.2.2.2 below.
\(^{84}\) For an exposition of the definition of “black people” refer to Marais and Coetzee 2006 *Obiter* 116.
\(^{85}\) Refer to fn 55 above for an overview of the meaning of “black women”.
\(^{86}\) Scholtz par 3.8.
\(^{87}\) Department of Trade and Industry *Code 100* Final draft approved by cabinet for gazetting 100-107.
\(^{88}\) See the discussion in par 2.1.1 above relating to the components of ownership.
\(^{89}\) Department of Trade and Industry *Codes of Good Practice* 1st Draft 106.
first draft of the ownership code, fell foul of the strict requirements of what would constitute unrestricted economic interest, _inter alia_, due to the fact that options and other deferred-interest schemes had been used.\(^{90}\) Perhaps even more controversial was the fact that debt-financed equity, by virtue of which BEE parties did not receive economic interest until the debt was repaid, was considered to be restricted and hence ineligible for the eight points in question.\(^{91}\) This potentially disqualified companies who had used such a mechanism from 40% of the ownership scorecard and drew sharp criticism from business bodies such as Business Unity South Africa (BUSQA).\(^{92}\)

The later drafts of the codes of good practice benefited from the approximately 350 written submissions that the Department of Trade and Industry received by way of public comment on the first draft.\(^{93}\) Amongst the most noticeable changes related to how the restriction of economic interest was to be dealt with, the new approach being to give companies the opportunity to receive the full set of points up front with the risk of losing them progressively if restrictions and debt were not reduced according to a prescribed programme.\(^{94}\) The amended ownership scorecard did away with a single criterion for unrestricted economic interest and allocated the underlying eight points to the realisation of “ownership fulfilment” (one point) and “net equity interest” (seven points).\(^{95}\) This approach, first adopted in the 2\(^{nd}\) draft of Code 100, is also followed (with some modifications) in the final draft.\(^{96}\)

Ownership fulfilment occurs when a black participant who holds an economic interest is released from all third party legal or commercial rights that withhold, defer or restrict the enjoyment of the participant’s rights.\(^{97}\) If the participant was never subjected to such third party rights ownership fulfilment will also be achieved for that participant.\(^{98}\) A third party right will only obstruct ownership fulfilment if it was created mainly as a method of securing for a lender the repayment of a loan extended to the participant in order for him/her to acquire the instrument to which the affected economic interest is attached.\(^{99}\)

Net equity interest is somewhat unsatisfactorily defined as “the result of the formula in paragraph 17.1.”\(^{100}\) The relevant paragraph, in fact, provides

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\(^{90}\) Mahabane “Here’s the BEE Hymn Book” 2005-01-14 Financial Mail 39.
\(^{91}\) Ibid.
\(^{94}\) Department of Trade and Industry _Code 100_ Final draft approved by cabinet for gazetting 100-120; Khuzwayo “State Backs Down on BEE Codes” 2005-06-26 Sunday Independent – Business Report 1.
\(^{95}\) Department of Trade and Industry _Code 100_ Final draft approved by cabinet for gazetting 100-107.
\(^{96}\) Department of Trade and Industry _Code 100_ Final draft approved by cabinet for gazetting 100-119 to 100-122.
\(^{97}\) Department of Trade and Industry _Code 100_ Final draft approved by cabinet for gazetting 100-121.
\(^{98}\) Ibid.
\(^{99}\) Ibid.
\(^{100}\) Department of Trade and Industry _Code 100_ Final draft approved by cabinet for gazetting 100-105.
two formulae. Formula A and Formula B, along with the instruction that the result of the lower of the two must be used as the score for net equity interest.\textsuperscript{101} It is, in fact, Formula A that captures the essence of net equity interest, whilst Formula B is a safeguard against the first formula’s potential for rewarding companies for underperformance – an unintended consequence of allowing the gradual achievement of the ten-year target.\textsuperscript{102}

\textbf{2 2 2 2 2 1 Calculation of the ownership fulfilment points}

It is a precondition for the awarding of the single point under ownership fulfilment that the company must already hold (and then retain) all seven points for net equity interest.\textsuperscript{103} The measured entity must furthermore ensure that the requirements of ownership fulfilment have been met for every black participant in the entity.\textsuperscript{104} As has been mentioned, for the third party rights to fall within the ambit of this provision they must have been created for the purpose of securing the repayment of an equity financing debt.\textsuperscript{105}

\textbf{2 2 2 2 2 2 Calculation of the net equity interest points}

Formula A of the net equity interest calculation determines the degree to which the measured enterprise is in compliance with the target for the value of equity held by black participants, after third party rights or claims related to the financing of the acquisition of the instrument have been deducted, as a percentage of the current value of the measured enterprise. A mechanism called “the graduation factor” is built into the formula to allow the enterprise to achieve the target progressively over a period of ten years.\textsuperscript{106}

\textsuperscript{101} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-119.

\textsuperscript{102} The practical implications of both Formula A and Formula B are clarified by way of an example in par 2 2 2 2 2 2 below.

\textsuperscript{103} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-121.

\textsuperscript{104} Department of Trade and Industry Draft Amended Codes of Good Practice 2nd Draft 100-116. The final draft, unlike the second draft, does not spell out this provision. It is submitted that the logic of the scorecard dictates that the principle remains valid.

\textsuperscript{105} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-121.

\textsuperscript{106} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-119 to 100-120.
A is the score that the measured enterprise will receive for net equity interest. B is the deemed current value of instruments held by black participants and is arrived at by subtracting the value of all third party rights or claims related to financing the equity acquisition (E) from the value of the instruments to which the economic interest of black participants attach (D). The answer is then divided by the current value of the measured enterprise (F). This calculation of B may be expressed as a formula in the following way:

\[ B = \frac{D - E}{F} \]

The element of 25% that is contained in Formula A is, in fact, the target for the portion of economic interest without third party rights or claims that is to be held by black people within ten years. It is the multiplication of this target by C, the periodically escalating graduation factor, that reduces the target for the years preceding the tenth year. The effect of the graduation factor is illustrated in the table below.

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Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-119.

Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-120.

Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-121.
Table 6. Impact of the graduation factor on Net Equity Interest

<table>
<thead>
<tr>
<th>Year</th>
<th>Graduation Factor</th>
<th>Effective target for Economic Interest free of 3rd party rights or claims</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>10%</td>
<td>2.5%</td>
</tr>
<tr>
<td>2</td>
<td>20%</td>
<td>5%</td>
</tr>
<tr>
<td>3-4</td>
<td>40%</td>
<td>10%</td>
</tr>
<tr>
<td>5-6</td>
<td>60%</td>
<td>15%</td>
</tr>
<tr>
<td>7-8</td>
<td>80%</td>
<td>20%</td>
</tr>
<tr>
<td>9-10</td>
<td>100%</td>
<td>25%</td>
</tr>
</tbody>
</table>

The multiplication of the long-term target of 25% by the percentage of the graduation factor effectively allows the measured enterprise to reach full compliance incrementally.\(^{111}\) For the first year after a gazetted date, companies only have to achieve 10% of the 25% compliance target. In other words, the effective target for this period is reduced to 2.5%. For the second year companies have to achieve 20% of the target (an effective target of 5%) and so on until the beginning of the ninth year, at which time the enterprise must achieve 100% of the 25% target.\(^{112}\)

With the effective target determined, the percentage of compliance that has been achieved by the measured enterprise can now be calculated by dividing its actual level of black-held economic interest free of third party rights or claims by the effective target for that period. As per the normal methodology of the scorecard,\(^{113}\) this percentage is multiplied by the applicable weighting points (seven in this case) to determine the score that the measured enterprise achieves for this criterion. In light of this, it is suggested that Formula A could be more meaningfully expressed in the following way:

Diagram 3. Formula A: Suggested alternative expression

\[
A = \left( \frac{B}{25\% \times C} \right) \times 7
\]

\(^{110}\) Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-120.

\(^{111}\) Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-120.

\(^{112}\) Ibid.

\(^{113}\) As discussed in par 2.2 above.
A notation such as the one above achieves the same outcome, but better reflects the convention of the scorecard methodology, making it easier to understand for those who have to interpret and apply the codes of good practice.

The result of Formula A must be compared with the result of Formula B, and the lower of the two values constitutes the net equity interest points of the enterprise. Formula B functions as a reality check, comparing the result of Formula A with its graduation factor to the measured enterprise’s degree of compliance with the primary economic interest indicator, namely “economic interest in the enterprise to which black people are entitled” as contained in paragraph 5.2.1 of the ownership scorecard.

**Diagram 4. Formula B: Net equity interest**

\[
A = \frac{B}{C} \times \frac{1}{7}
\]

Here A is the result of Formula B, which will be compared to the result of Formula A. B is the percentage of economic interest to which black participants are entitled and C is the target specified in respect of the ownership criteria in paragraph 5.2.1 of the ownership scorecard, namely “economic interest in the enterprise to which black people are entitled”. The operation of Formula A and the impact of its comparison with Formula B are best illustrated by way of an example.

A hypothetical Company X with a share capital value of R1,000,000 sells shares to the value of R250,000 in Year 1 to black people. The first day of Year 1 also happens to be the gazetted date referred to in the graduation factor provisions of Formula A. The new black shareholders pay R20,000 in cash towards the acquisition of their shares and finance the balance of the acquisition (R230,000) through a third party, using the shares as security for the loan. In Year 2 the black shareholders manage to pay off R10,000 of the debt, reducing the outstanding third party claim to R220,000 and in Year 3 they pay off a further R20,000, reducing the claim to R200,000. The results of the various calculations are shown below.

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114 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-119.
115 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-120.
116 See par 2 2 2 above.
117 For the sake of the illustration the issue of paying interest on the financing is disregarded.
Table 7. Illustration of the operation of net equity interest Formula A

<table>
<thead>
<tr>
<th>Formula A</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of the equity instruments held by black participants (D)</td>
<td>R 250,000</td>
<td>R 250,000</td>
<td>R 250,000</td>
</tr>
<tr>
<td>Value of finance securing 3rd party rights/claims (E)</td>
<td>R 230,000</td>
<td>R 220,000</td>
<td>R 200,000</td>
</tr>
<tr>
<td>Value of the enterprise (F)</td>
<td>R 1,000,000</td>
<td>R 1,000,000</td>
<td>R 1,000,000</td>
</tr>
<tr>
<td>Deemed current value (B)</td>
<td>2%</td>
<td>3%</td>
<td>5%</td>
</tr>
<tr>
<td>Graduation factor (C)</td>
<td>10%</td>
<td>20%</td>
<td>40%</td>
</tr>
<tr>
<td>Effective target for economic interest free of 3rd party rights or claims (25% x C)</td>
<td>2.5%</td>
<td>5%</td>
<td>10%</td>
</tr>
<tr>
<td>Net equity interest (A)</td>
<td>5.6</td>
<td>4.2</td>
<td>3.5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Formula B</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>% Black economic interest (regardless of 3rd party rights) (B)</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Target for black economic interest (C)</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Net equity interest (A)</td>
<td>7</td>
<td>7</td>
<td>7</td>
</tr>
</tbody>
</table>

Company X will have net equity Interest scores of 5.6, 4.2 and 3.5 in Year 1, 2 and 3 respectively, these values being the lower of the results of Formula A and Formula B in the given periods. The company immediately reached its full target for Economic Interest in the hands of black people (as provided for in paragraph 5.2.1 of the ownership paragraph), but due to the third party claim that is the consequence of the black shareholders financing a portion of the acquisition, these black shareholders cannot be said to hold the full value of their economic interest in the company. By virtue of the graduation factor, Company X has some breathing space to gain points whilst its black shareholders release themselves of the burdens associated with the terms of their financing agreements, but it should be clear that the formula penalises situations where the debt is not paid off consistently and significantly over the ten-year graduation period. Because the result of Formula B is higher than that of Formula A, it is the latter that is used as the company’s net equity interest score.

In order to illustrate a situation where the result of Formula B will be used as the net equity interest score of a measured enterprise, the example used above is adjusted slightly. In a similar situation where the prospective black shareholders have the same amounts of cash available to them to pay for shares, the share acquisitions may be structured in such a way that they buy shares as and when the money is available to them. The black shareholders therefore acquire shares to the value of R20,000 in Year 1, a further R10,000 in Year 2 and another R20,000 in Year 3. No outside financing is used and hence there are no finance-securing third party rights or claims. The results of the various calculations are shown below.
Table 8. Illustration of the implications of Formula B
for the Net Equity Interest score

<table>
<thead>
<tr>
<th>Formula A</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of the equity instruments held by black participants (D)</td>
<td>R 20,000</td>
<td>R 30,000</td>
<td>R 50,000</td>
</tr>
<tr>
<td>Value of finance securing 3rd party rights/claims (E)</td>
<td>R 0</td>
<td>R 0</td>
<td>R 0</td>
</tr>
<tr>
<td>Value of the enterprise (F)</td>
<td>R 1,000,000</td>
<td>R 1,000,000</td>
<td>R 1,000,000</td>
</tr>
<tr>
<td>Deemed current value (B)</td>
<td>2%</td>
<td>3%</td>
<td>5%</td>
</tr>
<tr>
<td>Graduation factor (C)</td>
<td>10%</td>
<td>20%</td>
<td>40%</td>
</tr>
<tr>
<td>Effective target for economic interest free of 3rd party rights or claims (25% x C)</td>
<td>2.5%</td>
<td>5%</td>
<td>10%</td>
</tr>
<tr>
<td>Net equity interest (A)</td>
<td>5.6</td>
<td>4.2</td>
<td>3.5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Formula B</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>% Black economic interest (regardless of 3rd party rights) (B)</td>
<td>2%</td>
<td>3%</td>
<td>5%</td>
</tr>
<tr>
<td>Target for black economic interest (C)</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Net equity interest (A)</td>
<td>0.56</td>
<td>0.84</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Because the deemed current value is the same in the two examples, the two sets of results for Formula A are also identical. In the case of example 2 this would potentially reward Company X for transforming much less of its shareholding than the fundamental requirement contained in paragraph 5.2.1 of the scorecard. After selling only 2% of its shares to black people Company X would collect 5.6 of the eight net equity interest points for achieving 80% of the graduated target, and 0.32 of the four points allocated to economic interest in the hands of black people for achieving 2% compared to a target of 25%. This aggregates to 5.92 of the 12 points associated with these two criteria – a significant number of points when it is considered how poorly Company X is performing against the principal economic interest target of 25%. In fact, under such a dispensation, a company would score all seven of the net equity interest points by transferring to black shareholders economic interest that only equals the level of the graduation factor rather than the principal target of 25% (as long as there are no finance-securing third party rights or claims against the black-held shares). The four points associated with paragraph 5.2.1 of the ownership scorecard would be lost, but the reward of seven net equity interest points combined with the retention of economic interest for the incumbent shareholders might make this an attractive option for companies that are unenthusiastic about empowerment. This unintended opportunity to evade the purpose of Code 100 as far as economic interest is concerned would be progressively lost as the graduation factor escalates towards 100%.

It is, however, through the use of Formula B that the potentially counterproductive consequences of the graduation factor are neutralised. In the second example Company X had Formula B results of 0.56, 0.84 and 1.4 in the three years under consideration. This is the consequence of the low percentages of overall black-held economic interest during these years, these percentages being multiplied by the seven weighting points to provide
a sanity check against which the outcome of Formula A could be measured. By virtue of the fact that the lower of Formula A and Formula B constitutes Company X's net equity interest, it will be in the company's interest to achieve the primary 25% economic interest target as soon as possible, even if the acquisition of some of these shares has to be financed and consequently burdened with third party rights. It will then be in the company's interest to ensure that black shareholders receive sufficient economic benefits from their shareholding so that they may remove these third party rights in accordance with the schedule contained in the operation of the graduation factor.\textsuperscript{118}

2.2.3 Bonus points for the inclusion of particular categories of black people in the ownership of an enterprise

A measured enterprise may receive up to three bonus points for the degree to which it has included black new entrants,\textsuperscript{119} black deemed participants of broad-based ownership schemes\textsuperscript{120} or black participants in co-operatives in its ownership.\textsuperscript{121} The three bonus points are calculated on the basis of the following formula:

\begin{equation}
\text{Diagram 5. Measurement of bonus points}
\end{equation}

\[ A = \frac{B}{15\%} \times \frac{C}{25} \times 3 \]

A is the bonus score for the measured enterprise.\textsuperscript{122} B is the percentage of economic interest to which black new entrants and/or black deemed participants of broad-based ownership schemes are entitled,\textsuperscript{123} and C is the percentage of economic interest to which black people are entitled.\textsuperscript{124}

\textsuperscript{118} The issue of financing the acquisition of shares by black people is dealt with in par 2 3 below.

\textsuperscript{119} Defined as "a black participant or participants who: [1] hold a voting right and economic interest in a measured enterprise; and [2] prior to acquiring an equity interest in a measured enterprise, have not concluded similar transactions in respect of any other enterprise which have, in aggregate, a cumulative value of R20,000,000.00 measured in accordance with an acceptable valuation standard" (Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-103).

\textsuperscript{120} See fn 13 above for a discussion of the requirements that have to be met before a black person will be considered to be a deemed participant of a broad-based ownership scheme.

\textsuperscript{121} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-108.

\textsuperscript{122} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-122.

\textsuperscript{123} It is significant that the ownership scorecard provides for the bonus provision to cover economic interest in the hands of one or more of three groups, including black participants in co-operatives, whilst the formula according to which the score is calculated only recognises two groups, excluding black participants in co-operatives. This appears to be a drafting error.

\textsuperscript{124} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-122.
essence this means that the target for the inclusion of these groups of black people is 15% of the measured enterprise’s economic interest. The level of compliance with this target is multiplied by the percentage compliance with the principal economic interest target for black people (being 25%). The percentage that results from this calculation is multiplied by the three bonus points to provide the number of points to which the measured enterprise is entitled. There is no reward for over-performance in either of the categories represented by B or C in the formula.

2.2.4 Key measurement principles

Over and above the specific guidelines for measurement found in the parts of Code 100 that deal with the individual ownership criteria, a number of so-called “key measurement principles” have been created that are applied to specified calculations.

2.2.4.1 The flow-through principle

As is apparent from the definition of a participant, recognition for black participation in the ownership of an enterprise focuses on natural persons. It is, however, fairly typical for juristic persons or trusts to be interposed between a company and its natural person shareholders. In such a case, the flow-through principle determines the methodology according to which the level of ownership of the natural persons must be determined. The prescribed approach is illustrated below:

Diagram 6. The Flow-Through Principle

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125 Found in par 5.2.1 of the ownership scorecard (Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-107).
126 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-122.
127 See fn 13 above for a discussion of this definition.
128 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-109.
129 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-110.
The percentage of the black natural person’s economic interest or voting rights held in the interposed entities is multiplied by the percentage economic interest or voting rights of each of these entities.\footnote{130} The net effect is that the black holding in the measured company is diluted by the holdings of non-black shareholders along the ownership chain.

2.2.4.2 The modified flow-through principle

The flow-through principle is supplemented by a modified flow-through principle. According to the latter, when a measured enterprise’s chain of ownership contains one or more black majority-owned companies (its black entitlement to economic interest exceeds 50%) the measured enterprise may, when calculating economic interest using the flow-through principle, treat one of these black majority-owned companies as if it were 100% owned by black people.\footnote{131} The modified flow-through principle is illustrated below:

\textbf{Diagram 7. The modified flow-through principle}\footnote{132}

\begin{center}
\begin{tikzpicture}
  \node (black) [circle, draw] {Black Person} ;
  \node (trust) [rectangle, draw, below of=black] {Trust} ;
  \node (coa) [rectangle, draw, below of=trust] {Co A} ;
  \node (cob) [rectangle, draw, right of=coa] {Co B} ;
  \node (nonblack) [rectangle, draw, right of=coa] {Non-Black Persons} ;
  \node (nonblack2) [rectangle, draw, right of=cob] {Non-Black Persons} ;
  \node (measured) [rectangle, draw, below of=nonblack2] {Measured Company} ;

  \draw[->] (black) -- (trust) node [midway, above] {90\%};
  \draw[->] (trust) -- (coa) node [midway, above] {90\%};
  \draw[->] (coa) -- (nonblack) node [midway, above] {90\%};
  \draw[->] (coa) -- (nonblack2) node [midway, above] {90\%};
  \draw[->] (nonblack2) -- (measured) node [midway, above] {90\%};
  \draw[->] (coa) -- (measured) node [midway, above] {65\%};
  \draw[->] (coa) -- (measured) node [midway, above] {10\%};
  \draw[->] (coa) -- (measured) node [midway, above] {35\%};
  \draw[->] (coa) -- (measured) node [midway, above] {10\%};
  \draw[->] (coa) -- (measured) node [midway, above] {26\%};
  \draw[->] (measured) -- (measured) node [midway, above] {90\%};
  \draw[->] (measured) -- (measured) node [midway, above] {90\%};
  \draw[->] (measured) -- (measured) node [midway, above] {100\%};
  \draw[->] (measured) -- (measured) node [midway, above] {21.1\%};
\end{tikzpicture}
\end{center}

2.2.4.3 The control principle

The new control principle is analogous to the modified flow-through principle (referred to above), but applies exclusively to the calculation of voting rights. For the purpose of the control principle the concept of black majority-controlled companies (black entitlement to voting rights exceeds 50%) is used rather than black majority-owned companies.

The principle is closely related to the modified flow-through principle, but where the latter relates specifically to economic interest, the control principle relates to exercisable voting rights.\footnote{133} Where an ownership chain exists as described above, the measured enterprise may treat each black majority-
controlled company in the chain as if it is 100% black-owned for the purpose of calculations involving the flow-through principle. A black majority controlled company is:

"[A] company having shareholding in which black Participants are entitled to Exercisable Voting Rights in excess of 50% of the total entitlement to Exercisable Voting Rights in that Enterprise measured using the Flow-Through Principle and specifically excludes the Measured Enterprise."\(^{135}\)

The application of the control principle may be illustrated as follows:

Diagram 8. The control principle\(^{136}\)

2.2.4.4 The exclusion principle

Where an organ of state or public entity has invested capital in a measured enterprise the enterprise may exclude from ownership calculations the economic interest and voting rights associated with shares held by an organ of state and the part of the economic interest attributable to an organ of state where the shares are held by a public entity.\(^{137}\) The flow-through principle must be applied in order to determine the level of economic interest or voting rights that are to be excluded.\(^{138}\) The exclusion principle is illustrated below:

\(^{134}\) Ibid.
\(^{135}\) Ibid.
\(^{136}\) Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-113.
\(^{137}\) Ibid.
\(^{138}\) Ibid.
Diagram 9. The exclusion principle

The calculation of black ownership is that of the flow-through principle, using the actual level of black ownership in the chain (ie without the conversions allowed by the modified flow-through principle and the control principle). The result is then adjusted by reducing the denominator of 100% by the degree of ownership that can be attributed to organs of state.

2.3 Financing the share acquisitions of black prospective share holders

The discussion regarding finance-securing third party rights above forms part of a bigger debate concerning the potential and preferred sources of financing for empowerment deals. In such deals the lack of access to funding experienced by black prospective investors is often one of the biggest challenges that needs to be overcome. The potential sources for empowerment financing may be broadly classed under the headings of third party financing and vendor financing.

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139 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-114.
140 See par 2 2 4 1 above.
141 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-114.
142 Ibid.
143 Par 2 2 2 2 above.
23.1 Third party financing

In the case of third party financing, the black prospective shareholder approaches a party, such as a bank, that is not otherwise party to the acquisition of shares in the target company, and requests funds on credit to allow him/her to pay for the shares. Repayment is usually funded out of dividends received by the black shareholder on the shares it now holds in the target company or through the growth in value of its shares (funds could be realised by selling some shares at a profit).\textsuperscript{146} The black shareholder will often use the shares in the target company as security in relation to the third party for the repayment of the loan and, by implication, the third party will have the right in the event of default to take over the shares or dispose of some or all of them.\textsuperscript{147}

Making use of third party financing for BEE deals presents several problems. Mongalo has identified some of these complications as follows:\textsuperscript{148}

- Shorter loan periods are often demanded

Due to the perceived risks involved in financing empowerment transactions, financiers such as banks often favour shorter loan periods. As a consequence repayment obligations are more onerous, taking the form of either high periodic repayments, or a large capital lump sum repayment at the end of the repayment period with lower repayments during the period. The problem in the first case is that periodic payments are usually funded out of the dividends the shareholder receives during the period. Such income is at best unpredictable. In the second case, a black shareholder might find that when the lump sum repayment is demanded at the end of the period the only assets it has at its disposal are the shares in the target company, necessitating the sale of some of these shares. Such a disposal reduces the black shareholder’s control over the company and reduces the target company’s BEE ownership score. This situation is aggravated if the shares have lost value during the repayment period.

- Limited benefits flow to the black shareholders

Shorter loan periods and larger repayment obligations may lead to a situation where all of the dividend income received by a black shareholder is diverted to repaying his/her financing commitments. For some time the direct financial benefit for the black shareholder may be very limited.

\textsuperscript{146} Mongalo \textit{Black Economic Empowerment & Section 38 of the Companies Act} 4.

\textsuperscript{147} Ibid.

\textsuperscript{148} The discussion of the complications that flow from third party financing is sourced from Mongalo \textit{Black Economic Empowerment & Section 38 of the Companies Act} 3-7, unless otherwise indicated.
• The nature of the security given may have undesirable side-effects

Using the shares acquired by the black shareholder as security for the repayment of the borrowed funds could lead, *inter alia*, to the following problems: (1) the third party may want to exercise control over the votes attached to the shares, thus diminishing the target company’s score for voting rights; (2) because the value of the security depends on the success of the target company, the third party will want to oversee the activities of the target company as far as possible, to the extent of demanding board representation – in this way control of the company may shift to the third party rather than the black shareholder; (3) the veto rights and negative control flowing from the minority shareholding of a black shareholder will flow to the third party, thus obstructing the empowerment purpose of the voting rights targets contained in the ownership scorecard;149 and (4) in the event of the black shareholder defaulting on his/her repayment, the third party may take over the shares from the black shareholder, leading to the failure of the BEE deal.

• The costs are higher than usual

Third party financing is aimed at generating profit for the third party. As such there are costs to be borne by the shareholder making use of the service, typically in the form of interest rates and other additional charges such as “arrangement fees”. Because of the risks inherent to the transaction the finance charges in BEE deals are often high. As a consequence it is often easier to see the benefit of the transaction for to the financier rather than for the black shareholder.

• Financing may be unavailable

It may be possible that some BEE deals simply cannot obtain third party financing. Possible reasons for this include that the shares of the target company may not be attractive to financiers as security, or the prospective BEE partners may have no proven track record in business.

• There may be a negative effect on the target company’s net equity interest points150

Any claims or rights that third parties may have against the black shareholder as a consequence of the financing of the shareholder’s acquisition of the shares will be considered to reduce the value of the shares in the hands of the black shareholder and may therefore diminish the target company’s net equity interest score.151

149 In this regard see also the discussion of the implications of the target for black shareholding on par 2 1 above.
150 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-119 to 100-122.
151 *Ibid*; and see also the analysis of the net equity interest formulae in par 2 2 2 2 2 2 above.
2.3.2 Vendor financing

In the BEE context, vendor financing occurs where the target company itself finances the acquisition of its shares. As Mongalo points out, this approach does not involve the same obstacles as those encountered when third party financing is used.\textsuperscript{152} The financier has an intrinsic interest in the success of the deal rather than a profit-motive and hence the terms of the transaction are likely to be more flexible and less onerous for the black shareholder. This decreases the chances of the shareholder defaulting on the loan and increases the benefits that flow to him/her as a result of the transaction. Vendor financing would also provide a solution to situations where the BEE deal does not easily attract third party financing (for instance, where the BEE partner has no proven track record).

The problem with vendor financing is that, in principle, it is a contravention of section 38 of the Companies Act. Section 38(1) determines that:

“No company shall give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares of the company, or where the company is a subsidiary company, of its holding company.”

This precludes most situations in which vendor financing might be used as a viable alternative to third party financing. There are, however, examples of companies that have set up financing structures to legally skirt the provisions of section 38, making it possible to use vendor financing in BEE deals in a roundabout way.\textsuperscript{153} Mongalo describes such an arrangement that involves the creation of a special purpose vehicle (SPV).\textsuperscript{154} All the ordinary shares of the SPV are held by the target company, making it a subsidiary of that company.\textsuperscript{155} The SPV then proceeds to issue preference shares to the target company. The SPV uses the funds raised through the preference share subscriptions to buy shares in the target company. The target company next sells all the ordinary shares it holds in the SPV to a black person and also acts as the financier of the sale. The black person then wholly owns the SPV, which owns shares in the target company. The SPV retains its funding commitments to the target company by way of dividend and redemption obligations in respect of the preference shares issued by it to the target company. Whether such a scheme falls inside or outside of the broad ambit of section 38’s prohibition of indirect financial assistance remains to be seen.

It has been suggested that section 38 needs to be changed in order to remove its inhibiting effect on the viable financing of BEE deals.\textsuperscript{156} One school of thought is that, in the short term, the current section needs to be amended in order to allow an exemption of BEE transactions from the

\textsuperscript{152} Mongalo \textit{Black Economic Empowerment & Section 38 of the Companies Act} 3-7.
\textsuperscript{153} Mongalo \textit{Black Economic Empowerment & Section 38 of the Companies Act} 9-10.
\textsuperscript{154} Ibid.
\textsuperscript{155} This example is based on the description of such a structure in Mongalo \textit{Black Economic Empowerment & Section 38 of the Companies Act} 9-10.
\textsuperscript{156} Mongalo \textit{Black Economic Empowerment & Section 38 of the Companies Act} 2.
vendor financing prohibition, whilst another view is that the section will benefit most from a broader reform that goes beyond the considerations of BEE transactioning.\textsuperscript{157} According to the latter view, the section should allow vendor financing generally whilst still protecting the interests of minority shareholders and creditors.\textsuperscript{158} This could be achieved by making the decision to extend vendor financing subject to the requirements that:\textsuperscript{159}

(a) A solvency and liquidity test has been satisfied;

(b) The approval of a particular majority of shareholders has been obtained; and

(c) A full disclosure of the arrangement is made in the financial statement of the company.

2.4 Specific ownership schemes

2.4.1 Broad-based ownership schemes

A broad-based ownership scheme is

“[A] collective ownership scheme constituted with the view to facilitating the participation of specified natural persons in the benefits flowing from the ownership by that scheme or by its fiduciaries of an Equity Interest in an Enterprise.”\textsuperscript{160}

Code 100 highlights the following types of broad-based ownership schemes:

- Distribution scheme

A broad-based ownership scheme in which more than 50 natural persons are meant to receive distributions payable from the economic interest received by the scheme or its fiduciaries.\textsuperscript{161}

- Benefit scheme

A broad-based ownership scheme in which more than 50 natural persons are meant to benefit from an economic interest received by the scheme or its fiduciaries; and the economic benefits paid from the economic interest received are not distributed, but rather used for the benefit of the scheme’s deemed participants.\textsuperscript{162}

\textsuperscript{157} Ibid.
\textsuperscript{158} Mongalo Black Economic Empowerment & Section 38 of the Companies Act 11.
\textsuperscript{159} Ibid.
\textsuperscript{160} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-103.
\textsuperscript{161} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-104.
\textsuperscript{162} Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-102.
Employee scheme

A broad-based ownership scheme relating to more than 90% of the employees of an enterprise, or 90% of the employees in a particular occupational category in the enterprise. An employee scheme can have the qualities of either a distribution scheme, a benefit scheme, or a combination of the two.\textsuperscript{163}

Before the beneficiaries of these schemes will be considered to be “deemed participants of broad-based ownership schemes”,\textsuperscript{164} as is required for the measured enterprise to receive bonus point recognition for shares held by such a scheme,\textsuperscript{165} a number of onerous requirements have to be met.\textsuperscript{166} These include that:

1. The scheme or its fiduciaries must not be allowed a discretion as to the identity of deemed participants or the proportion in which they will benefit from the scheme.\textsuperscript{167}

2. All deemed participants must be permitted to take part in the appointment of the fiduciaries of the scheme.\textsuperscript{168}

3. The scheme must be structured in such a way that it is required that all accumulated economic interest be paid to the intended deemed participants at the earlier of a date specified in the statutory documents of the scheme, or the termination or winding up of the scheme.\textsuperscript{169}

\textsuperscript{163} Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-104.

\textsuperscript{164} As referred to in the ownership scorecard (Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-108). A deemed participant is defined as “a natural person who is entitled to receive a distribution or benefit from a broad-based ownership scheme” (Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-104).

\textsuperscript{165} The method by which these bonus points are calculated is discussed in par 223 above.

\textsuperscript{166} Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-114 to 100-116.

\textsuperscript{167} Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-114; and the constitution of the scheme must provide a mechanism whereby these parties are identified, either by specifying their names, or by determining that members of a specified class of natural persons (such as employees of an enterprise) are included (Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-115).

\textsuperscript{168} Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-114.

\textsuperscript{169} Department of Trade and Industry \textit{Code 100} Final draft approved by cabinet for gazetting 100-115 to 100-116; and it is worth noting that the implication of this provision is that schemes that have been set up in a way that allows accumulated economic interest to revert back to the measured enterprise in certain situations, will be disqualified from recognition on the measured enterprise’s scorecard (Cliffe Dekker Inc \textit{The Way to BEE 2006} (2005) 26-27).
It is possible for the entitlement of black people to economic interest and voting rights in a measured enterprise to be held through the trustees of a trust. If the trust qualifies as a broad-based ownership scheme, its equity holding in the enterprise must be measured in accordance with the rules for such schemes contained in Code 100. Where the trust is not such a broad-based ownership scheme it must comply with the following rules in order to qualify as a vehicle through which ownership benefits can flow to black people:

1. The distribution or benefit entitlement of a black beneficiary of the trust must vest. If the entitlement does not vest, the requirement will be considered to have been met if the trust deed is structured in such a way that the trustee is not allowed a discretion regarding the identity of the black beneficiaries or the proportions in which such beneficiaries share in the economic interest received by the trustee.

2. The identity of the black beneficiaries “may be expressed either by reference to [a] the person's name; or [b] the person’s membership in a specified class of natural persons”.

3. The ratio according to which black beneficiaries share in the economic interest flowing from a trust may be expressed either as fixed percentages, or as the outcome of a formula in terms of which the ratio is determined.

4. The trust deed must be structured in such a way that it is required that all accumulated economic interest be paid to the beneficiaries of the trust at the earlier of a date specified in the trust deed, or the termination or winding up of the trust.

5. All the black beneficiaries must be “entitled and able to participate in the appointment of the trustees to the full extent permissible by law” (emphasis added). Family trusts are exempted from this provision.

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170 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-116.
171 Ibid.
172 Ibid.
173 Ibid.
174 Ibid; and the use here of the word “may” is potentially confusing. It is submitted that the identity of the black beneficiaries must be expressed in one of the listed ways, as is implied by the use of peremptory language in the sentence that introduces this provision as one of the list of requirements for the recognition of the use of trusts: “the following requirements must be complied with in order for the participation by black people of such trusts to be recognised…” (emphasis added).
175 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-116 to 100-117; and the comment in fn 174 above regarding the use of the word “may” also applies to this provision.
176 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-116 to 100-117.
177 Department of Trade and Industry Code 100 Final draft approved by cabinet for gazetting 100-117.
The last requirement is problematic in that it is not clear what is meant by the phrase “to the full extent permissible by law”. The original trustee is usually appointed by the founder of the trust, particularly in the case of an inter vivos trust created by contract, where the trustee is an indispensable party to the contract. As far as subsequent or replacement trustees are concerned, it is possible that the founder may, in the trust deed, bestow on beneficiaries the power to appoint trustees. This kind of arrangement is, however, the exception rather than the rule. It is more common for beneficiaries to participate indirectly in the appointment of trustees in a situation where the court has to appoint a trustee and consults the beneficiaries during the process. Section 7(1) of the Trust Property Control Act 57 of 1988 also obliges the Master of the High Court to consult with interested parties before he/she carries out his/her statutory duty to appoint a trustee. Beneficiaries will undoubtedly be considered such interested parties and thus be conferred with by the Master when he/she is faced with a duty to appoint a trustee.

It remains unclear which of the above possibilities reflect the intended meaning of the requirement that black beneficiaries must participate in the appointment of the trustees. It seems most logical that it refers to the situation where beneficiaries are empowered by the trust deed to appoint trustees. As mentioned, this is not a common practice and one wonders how many existing trusts that already hold shares in companies have such provisions in their trust deeds. Where these provisions do not exist, the economic interest and voting rights held by these trusts will potentially be disqualified from recognition in the ownership scorecards of measured enterprises. If a trust deed does not allow for its amendment and the beneficiaries have already accepted the benefits stipulated in their favour, inserting a provision empowering beneficiaries to appoint trustees may require the contractual consent of the founder, trustee(s) and the beneficiaries.

178 Ibid.
179 The 2nd draft of the codes contained the further surprising requirement that black beneficiaries had to participate in the decision-making processes required for the administration of the trust “as actively as may be permissible by law” (Department of Trade and Industry Draft Amended Codes of Good Practice 2nd Draft 100-113). This requirement has not survived into the final draft of the document.
181 Cameron et al 176; Du Toit 30.
182 Cameron et al 189; Du Toit 58; and Schaumberg v Stark 1956 4 SA 462 (A) 466G-H.
183 Du Toit 58.
184 Cameron et al 190 and 201-207; and Du Toit 58.
185 Cameron et al 191-199; and Du Toit 58-59.
186 Du Toit 59; and Cameron et al 195.
187 Cameron et al 493; and Du Toit 48-49.
3 CONCLUSION

Whilst the need for a programme such as BEE is evident, the efficacy of the initiative is threatened by a number of factors. Amongst these is a concern central to the discussion in Part 1 of this article, namely that the Acts that drive empowerment have apparently developed without coordination. The consequence has been a divergence of rules, beneficiaries and scoring systems that has the potential to leave companies at a loss when attempting to develop strategies that lead to compliance with their statutory duties. An example of such divergence is the difference in operation between the Preferential Procurement Policy Framework Act 5 of 2000 and the BEE Act, which has the potential to lead to confusion regarding which tenderor is to be preferred over another during the public procurement process. It was suggested in Part 1 that the revision of regulations under the Procurement Act should be expedited in order to streamline the empowering provisions of preferential procurement with the BEE codes of good practice before the latter are brought into effect.

A further threat to the efficacy of the BEE programme is the fact that Code 100 has developed into layers of complex rules that seek to control the minutiae of black ownership. The relevant part of the ownership code has a seemingly simple objective: black shareholders must effectively hold 25% plus one vote of the voting rights, and 25% of the economic interest. The complications arise, however, when ownership rights and benefits become restricted, or complex structures are used for shareholding. In some cases these restrictions and structures are used for empowerment avoidance, but in other cases they simply occur as part of the normal cut and thrust of business. Code 100 arguably tries to cover too many of the potential loopholes and as a consequence becomes cumbersome, overly complex, and in some cases, convoluted. One can only hope that the many fears of the drafters will turn out to be unfounded and that the codes, through amendment or relaxed application, will become more simplified and less of a micro-measurement system.

Meanwhile it is concerning that Code 100 in its current form has the potential to penalise both companies and their black shareholders who have concluded ownership deals before the conclusion of the protracted revision process that preceded the release of the final draft of Code 100. Such parties would have acted reasonably in making use of otherwise acceptable practices such as placing shares in trust or making use of third-party financing that requires the black shareholder to use his/her newly acquired shares as security.

The use of third-party finance presents specific problems of its own. In light of the fact that vendor financing is prohibited in terms of the Companies Act, it would have been logical for prospective black shareholders to use third party financiers. As was indicated, such institutions are likely to require that the shares in question be used as security for the acquisition. These arrangements now stand to incur penalties under the net equity interest provisions of the scorecard, which may inhibit the ability of newly
empowered firms to compete for public tenders. Where black shareholders are paying off third-party finance out of dividends, the net equity interest penalty might well prove to be counter-productive as finance repayments become compromised when company profits suffer due to an inability to access expected government business.

It is unlikely that Statement 100 of Code 100 will be further adapted before it becomes effective. It therefore remains to be seen what the effect will be of the fact that the codes are likely to be applied retrospectively, potentially reducing the impact of some ownership deals that have already been concluded.