

THE DETERMINATION OF BLACK OWNERSHIP IN COMPANIES FOR THE PURPOSE OF BLACK ECONOMIC EMPOWERMENT (PART 1)

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SUMMARY

In Part I of this two-part article the primary statutes regulating black economic empowerment are considered. The Preferential Procurement Policy Framework Act 5 of 2000 with its regulations determines the parameters within which organs of state may give preferential treatment to historically disadvantaged suppliers when making procurement decisions. The Broad-Based Black Economic Empowerment Act 53 of 2003 creates a legislative and bureaucratic framework for the realisation of black economic empowerment, that includes codes of good practice that seek to introduce an empowerment agenda to a variety of administrative decisions, including state procurement. This overlap in application leads to conflicts between the duties placed on the state by the two Acts, and it is submitted that the Procurement Act and its regulations require amendment that will have to coincide with the coming into effect of the codes of good practice under the BEE Act. Part II of the article will analyse the recognition of black ownership in companies arising from the sale of equity instruments.

1 INTRODUCTION

At the time of writing, 11 years had passed since the beginning of a democratic dispensation in South Africa. Whilst the apartheid system and its predecessors were characterised by segregation and unequal access to resources, the post-apartheid system is based on integration and equality. The goal of a society which treats each human being equally on the basis of

equal worth and freedom cannot, however, be achieved by insisting on identical treatment in all circumstances before that goal is achieved.¹ According to Ackermann J:

“Past unfair discrimination frequently has ongoing negative consequences, the continuation of which is not halted immediately when the initial causes thereof are eliminated, and unless remedied, may continue for a substantial time and even indefinitely.”²

It is this concept of “remedial” or “restitutionary” equality that forms the basis, in post-1994 South Africa, of statutory intervention into areas of life suffering the enduring consequences of past discriminatory legislation.

The subject matter of past segregationist legislation extended to most areas of life, and access to, and participation in, the economy was no exception. Many policies of racial discrimination predated the unification of South Africa, but in the early part of the twentieth century these policies received an added impetus to aid the developmental needs of urbanising white people after the South African War.³ National economic policy was shaped to encourage economic opportunity for white people,⁴ by implication at the expense of black people. Thus race-preferring social and economic policies became inextricably intertwined with the legislative programme of South Africa in the twentieth century. Examples of such economic empowerment policies include:

- The Customs Tariffs Act of 1925, in terms of which importation rebates were withheld from manufacturing firms which could not prove to the Board of Trade and Industries that they employed an adequate number of white workers;⁵
- The Apprenticeship Act of 1922, which changed the age requirements for admission to trades in a way that advantaged white applicants over coloured applicants;⁶
- The Group Areas Act of 1966, which, *inter alia*, caused the removal of coloured fisher people from their residences at the coast to houses on the Cape Flats,⁷ closed off the central business districts of most towns to Indian-owned businesses,⁸ and generally prohibited trade by a person in an area that had been set aside for a race group other than

¹ *President of the Republic of South Africa v Hugo* 1997 4 SA 1 (CC) par 41.

² *National Coalition for Gay and Lesbian Equality v Minister of Justice* 1999 1 SA 6 (CC) par 60-61.

³ Davenport and Saunders *South Africa: A Modern History* 5ed (2000) 624.

⁴ *Ibid.*

⁵ *Ibid.*

⁶ Davenport and Saunders 625-626.

⁷ Davenport and Saunders 439.

⁸ Davenport and Saunders 626.

his/her own,⁹ thus denying access for black traders to the most lucrative markets.

- The 1963 Regulations that limited African trading in “locations” to “daily essential domestic necessities” and prohibited African trading partnerships in white areas;¹⁰ and
- The Mines and Works Amendment Act of 1926 that reserved the granting of certificates of competence in skilled trades to white and coloured people, thus effectively excluding Indian and black people from these trades.¹¹

It is against this historical backdrop that one must understand the sanction by the Constitution¹² and the Constitutional Court¹³ of legislative measures to remedy the ongoing consequences of past discrimination. This article deals with measures that are designed to address the economic empowerment of black people in terms of business ownership.

Part I considers the context and operation of the pivotal Acts of black economic empowerment (BEE) regulation, namely the Broad-Based Black Economic Empowerment Act 53 of 2003 (“the BEE Act”) and the Preferential Procurement Policy Framework Act 5 of 2000 (“the Procurement Act”). The Procurement Act with its regulations determines the parameters within which organs of state may give preferential treatment to historically disadvantaged suppliers when making procurement decisions. The BEE Act creates a legislative and bureaucratic framework for the realisation of black economic empowerment that includes codes of good practice that seek to introduce an empowerment agenda to a variety of administrative decisions, including state procurement. This overlap in application leads to conflicts between the duties placed on the state by the two Acts, and it will be argued that the Procurement Act and its regulations require amendment that will have to coincide with the coming into effect of the codes of good practice under the BEE Act.

Part II analyses Statement 100 of BEE Code 100,¹⁴ a policy instrument which provides a detailed set of rules for the determination of the levels of black ownership in a business by virtue of the sale of equity instruments. This has by far been the most controversial aspect of BEE to date. Code 100 aspires to champion very particular types of black ownership structuring, including rewards and penalties for the ways in which share acquisitions are financed and held. As will be argued in Part II, the intention behind Code 100 is to encourage businesses to achieve the desired level of black ownership as quickly as possible, and to ensure that black shareholders enjoy all the

⁹ Kahn and Forsyth (eds) *Reader's Digest Family Guide to the Law in South Africa* 1ed (1982) 487.

¹⁰ Davenport and Saunders 627.

¹¹ Davenport and Saunders 636-637.

¹² S 9(2) of the Constitution of the Republic of South Africa, 1996 (hereinafter “the Constitution”).

¹³ *Inter alia* in *National Coalition for Gay and Lesbian Equality v Minister of Justice supra*.

¹⁴ Any reference to Code 100 means that it is taken from Statement 100 of that code, unless otherwise indicated.

rights and benefits of ownership in as unrestricted a fashion as possible. Such provisions are no doubt a counter-measure to opportunistic businesses that would be content to create the appearance of black ownership without creating the true substance of it. As laudable as these provisions are, the risk does exist that the baby will be thrown out with the bathwater. Many of the ownership structures and restrictions that are frowned upon by the codes of good practice are fairly common in business, *inter alia*, as a means to finance share acquisitions or to optimally arrange equity holdings for estate planning and other purposes.

BEE law is an emerging field and at the time of writing this article all the policy instruments had not yet come into effect. This article deals with the law as it stood on 30 November 2005. At this time the Acts of Parliament discussed in paragraph 2 had commenced, but the codes of good practice that are to be issued in terms of section 9 of the BEE Act were at different stages of completion and none had taken effect. Parts of Code 000, providing the framework for the measurement of broad-based BEE, Code 100, dealing with the measurement of ownership, and Code 200, dealing with the measurement of management control, had passed through a comment and revision process that took almost 11 months and resulted in drafts released for public comment in December 2004, June 2005, and a final draft released in November 2005 for information purposes prior to gazetting.¹⁵ This final draft was released to the public after cabinet approved it for gazetting under section 9 of the BEE Act, but it must be noted that such gazetting had not yet taken place at the time of writing.

On 20 December 2005 additional components of Codes 000¹⁶ and 100¹⁷ were released for comment along with the first drafts for public comment of Codes 300 to 700 and 1000.¹⁸ These documents fall outside the scope of this article.

Remarks attributed to the Department of Trade and Industry suggest that it is unlikely that any of the codes will take effect before April 2006.¹⁹ It is unclear whether this gazetting will cover only the parts of Codes 000, 100 and 200 that have been approved by cabinet, or whether other documents will also be included.

¹⁵ The evolution of key concepts through the various revisions of the codes will be highlighted in the discussion that follows in Part II.

¹⁶ Namely Statements 001 and 002, dealing with fronting practices and other misrepresentations of BEE status, and specific verification issues relating to complex structures.

¹⁷ Namely Statements 102 to 105, dealing, respectively, with the recognition of ownership contributions from investments by BEE targeted "warehousing funds", multinational companies, public entities and organs of state, and companies limited by guarantee and Section 21 Companies.

¹⁸ Codes 300 to 700 deal with employment equity (Code 300); skills development (Code 400); preferential procurement (Code 500); enterprise development (Code 600); and a so-called residual element (Code 700). Code 1000 and onwards deal with BEE measurement for so-called "qualifying small enterprises" and "exempted micro-enterprises".

¹⁹ Khuzwayo "Busa Disappointed with Gazetting Delay" 2005-11-02 *The Star* 1.

2 THE REGULATORY FRAMEWORK OF BLACK ECONOMIC EMPOWERMENT

The BEE Act was promulgated in furtherance of section 9 of the Constitution. Section 9(2) of the Constitution provides, *inter alia*, that legislative measures may be taken in order to protect or advance persons or categories of persons who were disadvantaged by past policies. As its name suggests, the BEE Act focuses on the achievement of the economic equality of black people as a category of persons who were disadvantaged.

The BEE Act, together with the Procurement Act, have been described as the “cornerstone acts” of government’s programme of using its own purchasing decisions to encourage the economic empowerment of black people.²⁰ The use of the state’s buying power is achieved through government agencies rewarding businesses that make a contribution towards economic transformation with purchase orders.²¹ The framework created by the BEE Act provides a relatively objective measurement system through which government will be able to assess a business entity’s contribution towards economic transformation relative to that of other entities. A complication is that the Procurement Act, which predates the BEE Act and has not been repealed or amended since the BEE Act came into effect, already provides rules according to which organs of state must exercise their procurement power for empowerment purposes. This creates significant potential for statutory contradictions between the frameworks created by these Acts of Parliament.

The BEE Act is, ironically, a latecomer to the scene of empowerment legislation. Apart from the Procurement Act, a number of other Acts have also been passed to achieve the broad objective of making the economy more accessible to black people (often by inclusion in a broader beneficiary class such as “historically disadvantage individuals”). The Competition Act 89 of 1998 (“the Competition Act”) allowed a relaxation of the prohibition of anti-competitive practices if these practices increased the ability of small black-owned and controlled businesses to become competitive.²² It also allowed, on public interest grounds, otherwise anti-competitive mergers to proceed if the merger increased the ability of small black-owned and controlled businesses to become competitive.²³ The Employment Equity Act 55 of 1998 (“the EEA”) furthermore provided for the prohibition of unfair discrimination in the workplace²⁴ as well as the introduction of affirmative action in employment.²⁵ The Skills Development Act 97 of 1997 (“the SDA”) established an institutional and financial framework to achieve, *inter alia*, the improvement of the employment prospects of persons previously disadvantaged by unfair discrimination and to redress those disadvantages

²⁰ Scholtz *BEE Service* (2005) par 1.2.

²¹ *Ibid.*

²² S 10(3)(b)(ii) of the Competition Act.

²³ S 12A(1) of the Competition Act read with s 12A(1)(a)(ii) and s 12A(3)(c) of the same Act.

²⁴ Chapter 2 of the EEA.

²⁵ Chapter 3 of the EEA.

through training and education.²⁶ Although a comprehensive analysis of the regulatory context is beyond the scope of this work, it is nonetheless necessary to reflect on the interconnection between the Procurement Act and the BEE Act as it answers the critical question of how the score that is the output of the ownership assessment (the subject of Part II of this article), is to be used by the state.

2 1 The Broad-based Black Economic Empowerment Act 53 of 2003

2 1 1 Purpose

According to the long title of the BEE Act, its purpose revolves around three themes: (a) the establishment of a legislative framework for the promotion of black economic empowerment; (b) the empowerment of the Minister of Trade and Industry to issue codes of good practice and to publish transformation charters; and (c) the establishment of a Black Economic Empowerment Advisory Council. The preamble to the Act further expands on this purpose by, *inter alia*, indicating that the Act is passed in order “to promote the achievement of the constitutional right to equality, increase broad-based and effective participation of black people in the economy and promote a higher growth rate, increased employment and more equitable income distribution”.

Black people are defined as “a generic term which means Africans, Coloureds and Indians”.²⁷ The Cabinet-approved draft of the codes of good practice further narrows this definition to include only natural persons who fit the aforementioned racial profile and who are also South African citizens by birth or descent, or who acquired citizenship by naturalisation *before* the commencement date of the Constitution of the Republic of South Africa, 1993 Act 200 of 1993 (“the interim Constitution”).²⁸ A further inclusion is made for otherwise qualifying persons who only became citizens by naturalisation *after* the commencement of the interim Constitution, but who would have been able to become naturalised citizens, if it were not for the fact that they were barred from doing so by the apartheid system.²⁹

2 1 2 Objectives

The objectives of the BEE Act are closely related to the definition of “broad-based black economic empowerment” (“broad-based BEE”).³⁰ Broad-based BEE is defined as “the economic empowerment of all black people including

²⁶ S 2(2)(a) of the SDA read with s 2(1)(e) of the same Act.

²⁷ S 1 of the BEE Act.

²⁸ Department of Trade and Industry *Code 000: Framework for the Measurement of Broad-Based Black Economic Empowerment – Statement 000* Final draft approved by cabinet for gazetting (2005) 000-2-000-3.

²⁹ *Ibid.*

³⁰ S 2 of the BEE Act.

women, workers, youth, people with disabilities and people living in rural areas, through *diverse but integrated socio-economic strategies ...*" (emphasis added).³¹ Guidelines for the focus of these strategies are provided, highlighting the following areas:³²

- (a) The increase of black management, ownership and control of enterprises and productive assets;
- (b) The facilitation of the ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective schemes;
- (c) Human resources and skills development;
- (d) The achievement of an equitable representation across occupational categories and levels in the labour force;
- (e) Preferential procurement; and
- (f) Investment in black-owned and managed businesses.

The objectives of the BEE Act can be summarised as the facilitation of the above notion of broad-based BEE.³³

2 1 3 Strategy for broad-based black economic empowerment

Section 11 of the BEE Act provides for the issuing, by the Minister of Trade and Industry, of a strategy for broad-based BEE. In March 2003 the Department of Trade and Industry (DTI) published such a strategy, but the document has not subsequently been issued in terms of the BEE Act, as would be required for it to have any status under that Act.³⁴ The strategy set out the DTI's BEE strategy in broad terms and provided, for the first time, a standard generic scorecard, albeit without any targets.³⁵ It is submitted that the breadth of topics now covered in detail by the codes of good practice will make the codes, rather than the strategy, the pre-eminent source of BEE policy.

2 1 4 Codes of good practice

Whilst the framework created by the BEE Act will provide government with a method of BEE assessment, the Act itself does not provide the criteria that government procurement officials will have to take into account.³⁶ The codes of good practice, instruments with the status of delegated legislation and

³¹ S 1 of the BEE Act.

³² *Ibid.*

³³ S 2 of the BEE Act.

³⁴ Benjamin, Raditapole and Taylor *Black Economic Empowerment: Commentary, Legislation & Charters* (2005) 1-4.

³⁵ Department of Trade and Industry *Strategy for Broad-Based Black Economic Empowerment* (2003) 23.

³⁶ Scholtz par 1.2.

issued in terms of section 9 of the BEE Act, fulfil this function.³⁷ The codes of good practice cover, amongst other things:³⁸

- The further interpretation and definition of broad-based BEE.
- Indicators by which to measure broad-based BEE.
- The weighting to be attached to the above indicators.
- Qualification criteria for preferential procurement.

A code of good practice may also specify targets consistent with the BEE Act and set periods within which these targets must be met.³⁹

Organs of state and public entities must, as far as is reasonably possible, apply the codes of good practice when issuing licenses, concessions or other authorisations, when developing and implementing preferential procurement policy, when determining criteria for the sale of state-owned enterprises, and when developing criteria for public-private partnerships.⁴⁰ This effectively compels organs of state and public entities to apply the codes of good practice, unless it is not reasonably possible to do so.⁴¹

2 1 5 Transformation charters

The BEE Act allows the Minister of Trade and Industry to publish and promote a transformation charter for a particular sector of the economy, provided the charter has been developed by major stakeholders in that sector, and it advances the objectives of the BEE Act.⁴² These charters serve two primary purposes:⁴³

- (a) They involve stakeholders in the sector in the setting of BEE goals consistent with the objectives of the Act, as well as the articulation of methods to attain these goals; and
- (b) They give the stakeholders in the sector a limited opportunity to negotiate a variation of the generic BEE indicators and weightings in order to accommodate the unique circumstances of their sector.

In a pre-emptive attempt to shape the empowerment agenda for their sectors, certain industries had signed empowerment charters even before the BEE Act commenced, setting empowerment objectives and targets for the signatories.⁴⁴ A discussion of the content of individual charters falls

³⁷ Scholtz par 2.1.

³⁸ S 9(1) of the BEE Act.

³⁹ S 9(3) of the BEE Act.

⁴⁰ S 10 of the BEE Act.

⁴¹ Benjamin *et al* 1-7.

⁴² S 12 of the BEE Act.

⁴³ Scholtz par 2.2.

⁴⁴ Charters that have emerged to date include the Mining Charter, Financial Services Charter, Tourism Charter, Agricultural Charter (AgriBEE), Information and Communication Technology (ICT) Charter and the Health Charter. No charters other than the Mining Charter have been gazetted and most charters have only been published in draft format.

outside the scope of this work, but it should be noted that the final draft of Statement 010 of Code 000, which provides guidelines for the development and gazetting of transformation charters, makes it clear that charters that do not use substantially the same approach as that of the codes of good practice have little chance of being recognised as more than evidence of the commitment to BEE of the signatories.⁴⁵ The implication is that charters that depart materially from the methodology of the codes of good practice, will not be applied when the state deals with the signatories.⁴⁶ This development creates serious doubt whether charters still have a separate role to play in the empowerment framework.

2 2 Preferential Procurement Policy Framework Act 5 of 2000

In terms of section 217 of the Constitution an organ of state must make use of a fair, equitable, transparent, competitive and cost-effective system when it contracts for goods or services.⁴⁷ This does not prevent an organ of state from implementing a procurement policy that provides for categories of preference in the allocation of contracts and the protection or advancement of persons (or categories of persons) disadvantaged by unfair discrimination.⁴⁸ Such a procurement preference policy must, however, be implemented within a framework prescribed by national legislation.⁴⁹ The Procurement Act was promulgated in order to give effect to this Constitutional mandate.⁵⁰

The framework set out by the Procurement Act (read with the Preferential Procurement Regulations)⁵¹ requires that contracts be awarded by rating competing tenders on a preference point system consisting of 100 points. For contracts to the value of R30 000 up to (and including) R500 000, 80 points are awarded on the basis of favourable pricing.⁵² The remaining 20 points are awarded on the basis of whether the tenderer is a Historically Disadvantaged Individual (HDI), and/or is subcontracting with an HDI, and/or is achieving one of a list of specified goals related to the Reconstruction and Development Programme (RDP).⁵³ An identical points system is used for contracts with a value above R500 000, except that the pricing points are awarded out of 90 and the HDI preference points out of 10.⁵⁴ It is

⁴⁵ Department of Trade and Industry *Code 000: Framework for the Measurement of Broad-Based Black Economic Empowerment – Statement 010* Final draft approved by Cabinet for gazetting (2005) 010-6–010-7.

⁴⁶ *Ibid.*

⁴⁷ S 217(1) of the Constitution.

⁴⁸ S 217(2) of the Constitution.

⁴⁹ S 217(3) of the Constitution.

⁵⁰ Preamble to the Procurement Act.

⁵¹ GN R725 in GG 22549 of 2001-08-10.

⁵² Reg 3(1) of the Preferential Procurement Regulations.

⁵³ Reg 3(2) of the Preferential Procurement Regulations.

⁵⁴ Reg 4 of the Preferential Procurement Regulations.

furthermore allowable for the conditions of a tender to set a hurdle to further adjudication based on the functionality of the tender.⁵⁵

Where an organ of state has decided that a particular specific goal will form part of the allocation of preference points it must clearly set out in the invitation to tender what the specific goal is.⁵⁶ Such a goal must furthermore be measurable, quantifiable and monitored for compliance.⁵⁷ Apart from these requirements there is no formula for the calculation of the preference points as there is for the price points. The contract must ultimately be awarded to the tenderer with the highest score on the applicable point system unless objective criteria, in addition to those related to HDI status and specific goals, justify the award of the tender to a tenderer other than the one scoring the highest points.⁵⁸

In the context of this legislated benefit to HDIs it becomes necessary to briefly reflect on the definition of this class. The Procurement Act makes reference to “persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of race, gender or disability”⁵⁹ whilst the Preferential Procurement Regulations define a Historically Disadvantaged Individual as:⁶⁰

“A South African Citizen –

- (1) who, due to the apartheid policy that had been in place, had no franchise in national elections prior to the introduction of the Constitution of the Republic of South Africa, 1983 (Act 110 of 1983) or the Constitution of the Republic of South Africa, 1993 (Act 200 of 1993) (‘the interim Constitution’); and/or
- (2) who is a female; and/or
- (3) who has a disability:

Provided that a person who obtained South African citizenship on or after the coming into effect of the interim Constitution is deemed not to be an HDI.”

The implications of this definition, when read with the preference point system of the Preferential Procurement Regulations and contrasted with the provisions of the BEE Act and its codes of good practice, is discussed below in the section dealing with the convergence and divergence between Preferential Procurement and BEE policies.

⁵⁵ Reg 8(5) of the Preferential Procurement Regulations.

⁵⁶ S 2(1)(e) of the Procurement Act.

⁵⁷ S 2(2) of the Procurement Act.

⁵⁸ S 2(1)(f) of the Procurement Act; Reg 3(4) and 4(4) of the Preferential Procurement Regulations; and for an application of these principles see the case discussion on 20 *infra*.

⁵⁹ S 1(d)(i) of the Procurement Act.

⁶⁰ Reg 1 of the Preferential Procurement Regulations.

2 3 Convergence and divergence between preferential procurement and BEE policies

Preferential procurement policy (as embodied in the Procurement Act and its regulations) and BEE policy (as constituted by the BEE Act and its codes of good practice) have a common purpose of giving preferential treatment in government decision-making to parties that deliver on certain transformational expectations. This common purpose is also the source of the conflict in application between these systems.

In the first instance, the two approaches have different beneficiaries in mind. The Procurement Act advances HDIs and the BEE Act black people. When the definitions of these beneficiary classes are compared⁶¹ one finds certain incongruities, most blatant of which is the fact that the definition of HDI allows for the advancement of people who are not black (a white female, or a white male who is disabled, for example) whilst the BEE Act does not. It is, however, also possible for a black person, as defined in the BEE Act, to not qualify as an HDI in terms of the Procurement Act. An example would be a black person who became a citizen by naturalisation after the commencement of the interim Constitution, because the apartheid system barred him/her from doing so before that date. Another example is a black person who was born after the commencement of the interim Constitution. This could have practical relevance where a company is owned by a trust that has such a black person as its beneficiary. Subject to certain rules, Code 100 allows for the recognition of the economic interest that flows from the company *via* the trust to the black beneficiary as an element of black ownership in the company, regardless of whether the trustee is black.⁶²

Further conflicts arise from the fact that both Acts seek to prescribe empowerment considerations that organs of state should take into account when procuring goods or services from suppliers, each Act proposing its own system with which to quantify the preference that should be given. The Procurement Act allows empowerment considerations a 10% or 20% influence on the outcome of the procurement decision⁶³ whilst the BEE Act requires organs of state to, as far as is reasonably possible, apply the codes of good practice (which contain the BEE scorecard) when developing and implementing a preferential procurement policy.⁶⁴ Price plays no role in determining a tenderer's score on the BEE scorecard and the codes of good practice contain no guidelines on how the BEE score should be applied when preferring one tendering party over another.⁶⁵

⁶¹ See par 2 1 1 above for the definition of black people and par 2 2 above for the definition of HDIs.

⁶² See Part II of this article for a discussion of the rules governing such recognition.

⁶³ S 2(1)(b)(i)-(ii) of the Procurement Act.

⁶⁴ S 10 of the BEE Act.

⁶⁵ Department of Trade and Industry *Draft Codes of Good Practice on Broad-Based Black Economic Empowerment* 1st Draft (2004) 18; Department of Trade and Industry *Draft Amended Codes of Good Practice on Broad-Based Black Economic Empowerment* 2nd Draft (2005) 000-11; These references contain one-page summaries of the cumulative BEE

For the purpose of statutory interpretation a common-law presumption exists that statute law does not alter the existing law (including existing statutes) more than is necessary.⁶⁶ An application of this principle to the situation under discussion would be that the BEE Act does not modify the Procurement Act more than would be necessary. As far as possible these Acts must therefore be read together in a way that reconciles them.⁶⁷ One way to do this would be to dovetail the scoring systems by converting the BEE score of a business into a score out of 10 or 20 (depending on the value of the tender) for it to make up the preferential component of the Procurement Act's points system.⁶⁸ This approach is, however, potentially contrary to the purpose of both of the Acts in question. The preference points under the Procurement Act are meant to advantage HDIs, which may include white women and white disabled men. The points can therefore not be generated exclusively by way of a system such as that of the BEE framework that specifically excludes all people who are not black. The dovetailing approach may also be seen to obstruct the objectives of the BEE Act, as the BEE score would be greatly reduced in significance when it is converted to an influence of only 10% or 20%. Furthermore, even where an HDI supplier does achieve the highest score on the Procurement Act's system, an organ of state may still select another tenderer where "objective criteria" justify such an award.⁶⁹ This has the potential to sideline the BEE score, further reducing the impact of the BEE Act.

It is submitted that there is an urgent need for the legislature to harmonise the provisions of the Procurement Act and its regulations with that of the BEE Act and its codes of good practice. If the BEE codes of good practice are issued without the amendment of the Procurement Act and its regulations, organs of state could find that they have to apply potentially conflicting rules when awarding tenders. As will be discussed later, the awarding of state tenders are considered to be administrative action. As such, a procurement decision that only takes account of the BEE codes of good practice could be susceptible to judicial review on some of the grounds listed in the Promotion of Administrative Justice Act 3 of 2000 ("PAJA"), such as:

scorecard, reflecting all elements to be taken into account – the final draft of Code 000 does not contain such a summary, but it can be expected to be published in gazetted form later.

⁶⁶ Du Plessis *Re-Interpretation of Statutes* (2002) 177-178. See further Du Plessis 72-77 for a detailed discussion on the circumstances in which later statutes repeal or amend earlier statutes.

⁶⁷ *Wendywood Development (Pty) Ltd v Rieger* 1971 3 SA 28 (A).

⁶⁸ Reg 3(2) and 4(2) of the Preferential Procurement Regulations. There is no detailed formula in the Procurement Act to calculate the HDI related points.

⁶⁹ An alternative approach would be to use the BEE score generated by way of the BEE system as the "objective criteria" that justify selecting a BEE compliant tenderer that scores low on the Procurement Act's system over a BEE *non*-compliant tenderer who scores high on the procurement system. It is suggested that such an approach would make a mockery of the procurement system. Tender awarders would simply be overruling the procurement system with the BEE system whenever the "right" name is not produced by the procurement formula. Using the BEE score as "objective criteria" therefore seems to be contrary to the purpose of the Procurement Act. Case law also suggests that the objective criteria cannot be an aspect that is already accommodated in the preference point system (see par 2 2 above).

- The action was taken for a reason not authorised by the empowering provision (the competing Procurement Act being the empowering provision for the preferential procurement policies of organs of state);⁷⁰
- The action was taken because irrelevant considerations were taken into account or relevant considerations were not considered (as has been suggested above, the scoring system of the BEE codes of good practice is incompatible with and thus not relevant to the points system of the Procurement Act);⁷¹ or
- The action is not rationally connected to the purpose of the empowering provision (the Procurement Act's purpose of also advancing white women and white disabled men would be defeated by applying a system using the BEE beneficiary class which excludes these parties).⁷²

Conversely, a procurement policy of an organ of state that only follows the Procurement Act and does not, as far as is reasonably possible, apply codes of good practice issued in terms of the BEE Act, will fall foul of section 10 of the BEE Act and hence be unlawful, and as such susceptible to review.⁷³

A draft revision of the Preferential Procurement Regulations (“the Draft Procurement Regulations”) was issued for public comment on 4 October 2004, and provides some insight into the type of changes government foresees as necessary to align the preferential procurement and BEE policies.⁷⁴ The features of the Draft Procurement Regulations include:

- Replacing the reference to HDIs with a reference to black people, using the same definition as found in the BEE Act;⁷⁵
- The Treasury will prescribe which BEE scorecard has to be applied;⁷⁶
- A maximum of 20 points (or 10 points, depending in the value of the contract) may be awarded to a bidder for achieving Government's procurement related socio-economic objectives;⁷⁷
- The BEE score must be converted to 20/10 points (by multiplying the BEE score, as a percentage, by 20/10);⁷⁸
- If the BEE percentage is less than a “prescribed minimum”, no points on the preference system will be allowed for it;⁷⁹

⁷⁰ S 6(2)(e)(i) of PAJA.

⁷¹ S 6(2)(e)(iii) of PAJA.

⁷² S 6(2)(f)(ii)(bb) of PAJA.

⁷³ S 6(2)(f)(i) and S 6(2)(i) of PAJA.

⁷⁴ Draft Preferential Procurement Regulations, 2004 in GG 26863 of 2004-10-04.

⁷⁵ Reg 1(c) of the Draft Procurement Regulations; In light of the fact that government has seen fit to elaborate on the definition of the BEE Act by way of the codes of good practice, it is submitted that a revised Preferential Procurement Regulation would need to make use of this latter definition.

⁷⁶ Reg 3(2) of the Draft Procurement Regulations.

⁷⁷ Reg 3(3) of the Draft Procurement Regulations.

⁷⁸ *Ibid.*

⁷⁹ Reg 3(3) and 4(3) of the Draft Procurement Regulations; and the annexures to the draft regulations indicate this minimum as 40%.

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- The balance of 80/90 points is calculated on the basis of price according to the same formula used in the current Preferential Procurement Regulations;⁸⁰
 - The BEE points out of 20/10 are added to the price points out of 80/90 to give each tenderer a score out of 100;⁸¹
 - Only the bid with the highest number of points may be selected.⁸²

It is relevant to note that, notwithstanding possible changes to the regulations as reflected above, section 2(1)(f) of the Procurement Act still allows that a tender may be awarded to a tenderer other than the one scoring the highest points if objective criteria, in addition to those related to specific goals, justify such an award.

Although the period for public comment for these draft regulations closed on 25 October 2004, it has not yet been gazetted. It should be clear from the above list that it is necessary for the BEE framework to be in operation before the Preferential Procurement Regulations can be replaced by something resembling the draft. Part of the problem is that all the codes of good practice, dealing with all seven elements of the BEE scorecard, would have to be in effect and to date these documents have been issued and debated piecemeal. Only certain parts of some of the codes have been approved for gazetting by cabinet, but these parts do not alone provide a sufficient basis for the calculation of a full BEE score.

It is submitted that, in order to change the regulations in the way reflected in the draft, it would also be necessary to amend the Procurement Act, as it currently provides for “contracting with persons, or categories of persons, historically disadvantaged by unfair discrimination on the basis of *race, gender or disability*” (emphasis added) as part of the preference system.⁸³ It is submitted that such wording opens an opportunity for unsuccessful tenderers to argue that regulations that only accommodate one of these groups are *ultra vires*. In light of the further development of the concept of BEE in the codes of good practice, it is also submitted that the Draft Procurement Regulations cannot be gazetted without changes to the current text, which may necessitate a further public comment period.⁸⁴

⁸⁰ Reg 3(1) and 4(1) of the Draft Procurement Regulations.

⁸¹ Reg 3(4) and 4(4) of the Draft Procurement Regulations.

⁸² Reg 3(5) and 4(5) of the Draft Procurement Regulations.

⁸³ S 1(d)(i) of the Procurement Act.

⁸⁴ Public comment for draft regulations is required in s 5(2) of the Procurement Act. An example of such a necessary change is that the current annexures of the draft contain the generic scorecard found in the Strategy for Broad-Based Black Economic Empowerment (the only generic scorecard available at the time of drafting) – the scorecard has been considerably altered by the emerging codes of good practice.

2 4 Potential remedies in black economic empowerment

The range of decision-making activities in which organs of state will directly apply the BEE Act and codes of good practice, fall within the definition of administrative action in PAJA.⁸⁵

“[A]ny decision taken, or any failure to take a decision, by –

(a) an organ of state, when-

- (i) exercising a power in terms of the Constitution or a provincial constitution; or
- (ii) exercising a public power or performing a public function in terms of any legislation; or

(b) a natural or juristic person, other than an organ of state, when exercising a public power or performing a public function in terms of an empowering provision ...”

The courts have confirmed that the awarding of state tenders⁸⁶ and the calling for and adjudication of tenders⁸⁷ fall under administrative action. Benjamin *et al* suggest that the same holds true for the following BEE-relevant decisions made by public officials:⁸⁸

- The awarding of licenses;
- The imposition of conditions or restrictions;
- Granting of consent, permission, approval or direction; and
- Giving of a certificate.

Insofar as the above actions are administrative actions they must comply with the requirements of administrative law and are subject to judicial review. At its most fundamental level this means that the actions must be lawful, reasonable and procedurally fair.⁸⁹ Where PAJA is concerned, it is required, *inter alia*, that an administrative decision has to be rationally connected to its purpose, failing which it can be taken on judicial review.⁹⁰ Where black economic empowerment is part of an action’s purpose (as it would be in the case of state procurement) the outcome of the underlying decision would have to reflect this purpose.⁹¹ The degree to which this purpose must be

⁸⁵ S 1 of PAJA.

⁸⁶ *Umfolozi Transport (Edms) Bpk v Minister van Vervoer* [1997] 2 All SA 548 (SCA).

⁸⁷ *Transnet Ltd v Goodman Brothers (Pty) Ltd* 2001 1 SA 853 (SCA).

⁸⁸ Benjamin *et al* 1-31; and Cox (“BEE Codes: The Legislative Challenge” 2005-06-24 *Mail & Guardian*) points out that a complication is that many of the actions listed in s 10 of the BEE Act are regulated in some detail by statutes enacted specifically for that purpose (such as the Telecommunications Act 103 of 1996) and that such statutes may already impose empowerment obligations. This creates the potential for conflicting provisions and could mean that the codes of good practice can only be applied in these instances after (and to the extent that) conflicting provisions of the existing legislation have been amended.

⁸⁹ S 33(1) of the Constitution, 1996.

⁹⁰ S 6(2)(f)(ii)(aa) of PAJA.

⁹¹ Benjamin *et al* 1-32.

reflected will depend on the policy guiding the decision-maker.⁹² A policy giving specific targets would have to be complied with fairly strictly, whilst a policy that only states a broad requirement for empowerment to take place without stating the pace or process will leave the administrator in question with a wider discretion.⁹³ The opportunity exists for tendering parties and license applicants to take a decision on review on the basis that it does not adequately reflect its empowerment purpose.⁹⁴

The recent unreported case of *Phumulela Office Automation v Nelson Mandela Metropolitan Municipality*⁹⁵ is a good illustration of the strictness with which the courts will hold administrators to an empowering provision such as the Procurement Act, regardless of a respondent's protestations of broader moral and constitutional mandates.

In this matter the applicant had unsuccessfully tendered for the supply of paper to the Nelson Mandela Metropolitan Municipality (first respondent).⁹⁶ The tender notices stated, *inter alia*, that the contract had been "ring-fenced" for the benefit of HDIs. The successful party (second respondent) tendered an amount of R29,84 per ream of paper and was 100% HDI owned, whilst the applicant tendered R24,15 per ream and was 66% HDI owned. The contract was awarded to the second respondent primarily on the basis that it was "ring-fenced" for HDIs.⁹⁷ The applicant approached the court for a judicial review of the first respondent's decision to award the contract to the second respondent, *inter alia*, on the basis that the first respondent applied a preference that was not in compliance with the Procurement Act and hence acted unlawfully and unconstitutionally.⁹⁸ The first respondent's argument included the assertion that its procurement policy makes provision for the reservation of some contracts for the benefit of HDIs for the purpose of achieving the constitutional imperative of addressing the imbalances of the past, promoting equality and advancing BEE.⁹⁹

The court held that the first respondent was wrong to award the contract to a party that did not score the highest on the point system found in the Preferential Procurement Regulations. In terms of such a point system the effect of the tenderers' equity ownership status should have meant only that the second respondent, being 100% HDI-owned, would receive 10/10 for specific goals, and the applicant, being merely 66% HDI-owned, would receive fewer points on a *pro rata* basis.¹⁰⁰ There is no basis in the Constitution or the Procurement Act for the imposition of a requirement that a corporation must be 100% owned by HDIs to be considered for a tender.¹⁰¹

⁹² *Ibid.*

⁹³ *Ibid.*

⁹⁴ *Ibid.*

⁹⁵ SECD 2005-11-22 Case no 2596/05.

⁹⁶ The facts appear from par 2-13 of the judgment.

⁹⁷ *Phumulela Office Automation v Nelson Mandela Metropolitan Municipality supra* par 12.

⁹⁸ *Applicant's Heads of Argument* par 20.

⁹⁹ *Respondent's Heads of Argument* par 13.

¹⁰⁰ *Phumulela Office Automation v Nelson Mandela Metropolitan Municipality supra* par 31.

¹⁰¹ *Phumulela Office Automation v Nelson Mandela Metropolitan Municipality supra* par 32.

The court held that the ring-fencing requirement could not be justified as objective criteria, as allowed for in section 2(1)(f) of the Procurement Act, that justify the award of the tender to a tenderer other than the one scoring the highest points. Such objective criteria must be criteria other than those mentioned in sections 2(1)(d) and (e), namely contracting with HDIs and implementing RDP programmes.¹⁰² *In casu*, the HDI component already received consideration as specific goals in sections 2(1)(d) and (e) and therefore could not be regarded as additional objective criteria which justify the award to another tenderer.¹⁰³ The court found that the awarding of the contract to the second respondent was a contravention of the Procurement Act and set aside the tender award with costs.¹⁰⁴

The efficacy of black economic empowerment is threatened by the lack of consistency between its two primary instruments, the Procurement Act and the BEE Act. There are no provisions in either Act that allow a court to do anything but apply the law as it stands at the time that a dispute arises. Whilst the BEE codes of good practice are not gazetted, it remains possible to apply the existing Preferential Procurement Regulations without complications. However, as soon as the codes are issued, interpretational difficulties are likely to arise unless the Preferential Procurement Regulations are replaced with a text that is consistent with the provisions of the codes of good practice. It is submitted that the prudent course would be to gazette these documents together.

3 CONCLUSION

It has been argued that the efficacy of black economic empowerment is critically dependent on whether the regulatory context within which it is introduced allows the codes of good practice to be applied. In essence, the quandary is that many areas in which the codes are to be applied according to the BEE Act are already regulated by existing legislation. Such legislation often provides its own empowerment mechanisms.

Due to the fact that the decisions in which the codes must be applied typically qualify as administrative action, the rules of administrative law (and specifically the remedy of judicial review) will continue to compel public officials to apply the law as it stands. The BEE Act itself will only become compelling once all the codes of good practice are in effect. Even then the risk of conflict with existing rules remains unless the necessary legislative alignment takes place.

Part II of this article will focus on the content of Statement 100 of Code 100, dealing with its attempts to regulate the recognition of black ownership in companies arising from the sale of equity instruments.

¹⁰² *Phumulela Office Automation v Nelson Mandela Metropolitan Municipality supra* par 28.

¹⁰³ *Ibid.*

¹⁰⁴ *Phumulela Office Automation v Nelson Mandela Metropolitan Municipality supra* par 38. Although not expressly stated in the judgment it is submitted that the BEE Act played no direct role in the above judgment due to the fact that the codes of good practice were not yet gazetted. Without these codes the act has little effect.