WHAT IS FRONTING?

Presented by
SIM & BOTSI ATTORNEYS
TOPICS FOR DISCUSSION

- What is Fronting
- The Current State of Affairs
- Combatting Fronting
- The New Act
- A Comparison between the Old and New
- Types of Fronting
- Other Legislation which may find application in the Combatting of Fronting
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THE START

Black Economic Empowerment (B-BBEE) aims to:-

• ensure that the economy is structured and transformed to enable the meaningful participation of the majority of its citizens;
• create capacity within the broader economic landscape at all levels through skills development, employment equity, socio economic development, preferential procurement, enterprise development, especially small and medium enterprises;
• promoting ownership/the entry of black entrepreneurs into the mainstream of economic activity.
THE PRESIDENT ON FRONTING

- In his address at the first national summit on Broad-Based Black Economic Empowerment held in October 2013 President Zuma took time to mention the “fronting” problem experienced within South Africa. He said:

“One of the obstacles has been the practise of “fronting”, which is criminalised in the newly adopted B-BBEE Amendment Bill. Fronting is unforgiveable as it distorts our empowerment picture giving an impression of progress where there is none. It is for this reason that we will work hard to prevent and eradicate this practice.”
WHAT IS FRONTING?

THE CURRENT POSITION

• The Guidelines on Complex Structures and Transactions, and Fronting (being the only document which actually addressed the issue of fronting prior to the gazetting of the much awaited Broad Based Black Economic Empowerment Amendment Bill 2012 (“the Bill”) ) issued by the Department of Trade and Industry (“the DTI”) contains the following definition relating to fronting:

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

• The Guideline then lists the following fronting practices:-

“Window-dressing: This includes cases in which black people are appointed or introduced to an enterprise on the basis of tokenism and may be:
• Discouraged or inhibited from substantially participating in the core activities of an enterprise; and
• Discouraged or inhibited from substantially participating in the stated areas and/or levels of their participation”
Indicators of this form of fronting are:

- The black people identified by an enterprise as its shareholders, executives or management are unaware or uncertain of their role within an enterprise;
- The black people identified by an enterprise as its shareholders, executives or management have roles of responsibility that differ significantly from those of their non-black peers;
- The black people who serve in executive or management positions in an enterprise are paid significantly lower than the market norm, unless all executives or management of an enterprise are paid at a similar level;
- There is no significant indication of active participation by black people identified as top management at strategic decision making level;
- The enterprise displays evidence of circumvention or attempted circumvention;

“Benefit Diversion: This includes initiatives implemented where the economic benefits received as a result of the B-BBEE Status of an enterprise do not flow to black people in the ratio as specified in the relevant legal documentation”

Indicators of this form of fronting are:

- The black people who serve in executive or management positions in an enterprise are paid significantly lower than the market norm, unless all executives or management of an enterprise are paid at a similar level;
- The enterprise displays evidence of circumvention or attempted circumvention;

“Opportunistic Intermediaries: This includes enterprises that have concluded agreements with other enterprises with a view to leveraging the opportunistic intermediary's favourable B-BBEE status in circumstances where the agreement involves:
• Significant limitations or restrictions upon the identity of the opportunistic intermediary's suppliers, service providers, clients or customers;
• The maintenance of their business operations in a context reasonably considered improbable having regard to resources; and
• Terms and conditions that are not negotiated at arms-length on a fair and reasonable basis.”

**Indicators of this form of fronting are:**

• An enterprise only conducts peripheral functions and does not perform the core functions reasonably expected of other, similar, enterprises;
• An enterprise relies on a third-party to conduct most core functions normally conducted by enterprises similar to it;
• An enterprise cannot operate independently without a third-party, because of contractual obligations or the lack of technical or operational competence;
• The enterprise displays evidence of circumvention or attempted circumvention.

The Guideline further contains the following regarding the responsibility and procedure to report fronting:

**Responsibility to Report Fronting:** In order to effectively deal with the scourge of Fronting, verification agencies, and/or procurement officers and relevant decision makers are encouraged to obtain a signed declaration from the clients or entities that they verify or provide business opportunities to, which states that the client or entity understands and accepts that the verification agency, procurement officer or relevant decision maker **may** report Fronting practices to the DTI. Intentional misrepresentation by measured entities may constitute fraudulent practices, public officials and verification agencies are to report such cases to the DTI.
STATUS OF SUCCESS IN COMBATTING FRONTING UNDER THE OLD PROVISIONS

Enquiries made to the Advocacy and Institutional Support B-BEE Unit of the Department of Trade and Industry (the DTI) regarding the number of fronting cases referred to the DTI, and the number of cases in which the DTI intervened, and the nature of settlements reached in respect of fronting related cases, gave rise to the following response:

“...please bear with us as we are inundated with fronting queries. Let me take this opportunity to explain as to how our current process works. Currently the BEE legislation as it stands is silent on fronting and you may have heard of the amended BEE legislation which introduces fronting provision, the Bill is now through to the President of the Republic of SA when it is approved it will be gazetted for implementation. In the interim we conduct preliminary investigation which comprise of meetings with both the Defendant and Complainant and should both parties be willing to resolve amicably we then facilitate the process. In a nutshell, currently the cases are resolved by consultation and medication if both parties are willing to do so...”

Enquiries with the Communications Department of the National Prosecuting Authority regarding the number of fronting matters investigated culminated in a similar response, indicating that there has been no engagement with the DTI regarding fronting prosecutions.
It does appear from media reports that a number of fronting cases have been / are being investigated by the Specialised Commercial Crime Court and a number of investigations have resulted in fines and jail sentences. Some of these cases will be discussed hereunder.
PROCEDURE FOR REPORTING OF FRONTING:
The following diagram depicts the procedure for reporting Fronting practices:

Step 1
Detection of Fronting Risks
Notify the measured entity
Measured entity to submit representations within 14 days

Entity submits representations

No explanation

Step 2
Notify the Fraud hotline or the dti’s B-BBEE unit in writing

Step 3
the dti to consider and initiate an investigation

If entity is found to be engaged in Fronting

the dti may completely disregard/suspend a measured entity’s B-BBEE scorecard until such time that the entity takes corrective action

the dti will keep a database of all companies found to be engaged in fronting once all the necessary processes are completed
• It appears that it was originally intended that fronting would have been self-regulated within the BEE industry. It is also submitted that fronting is tantamount to fraud and as such there was always the risk that entities which fronted could be charged with fraud, as will be seen from the case selection hereinafter.

• Unfortunately (as is evident from the few reported cases on the subject matter and the lack of proper sanctions against “fronters”) the above provisions have simply not been sufficient to address the enormous problems created within the industry, and by implication within the South African economy, relating to fronting and as such, various provisions related to fronting where included in the Bill which is expected to be signed into law shortly.
THE NEW POSITION

- The Bill defines a fronting practice as follows:

“fronting practice’ means a transaction, arrangement or other act or conduct that directly or indirectly undermines or frustrates the achievement of the objectives of this Act or the implementation of any of the provisions of this Act, including but not limited to practices in connection with a B-BBEE initiative—

(a) in terms of which black persons who are appointed to an enterprise are discouraged or inhibited from substantially participating in the core activities of that enterprise;

(b) in terms of which the economic benefits received as a result of the broad-based black economic empowerment status of an enterprise do not flow to black people in the ratio specified in the relevant legal documentation;

(c) involving the conclusion of a legal relationship with a black person for the purpose of that enterprise achieving a certain level of broad-based black economic empowerment compliance without granting that black person the economic benefits that would reasonably be expected to be associated with the status or position held by that black person; or

(d) involving the conclusion of an agreement with another enterprise in order to achieve or enhance broad-based black economic empowerment status in circumstances in which—

(i) there are significant limitations, whether implicit or explicit, on the identity of suppliers, service providers, clients or customers;

(ii) the maintenance of business operations is reasonably considered to be improbable, having regard to the resources available;

(iii) the terms and conditions were not negotiated at arm’s length and on a fair and reasonable basis;
• The Bill has received some criticism (in a recent article by Dr Anthea Jeffrey, head of special projects at the SA Institute for Race Relations it was stated that the Bill defines:

“fronting in so extraordinary broad a way that it could include, for example, the failure to give an inexperienced black manager the same responsibilities as a seasoned white one, or the failure to turn a BEE start-up into a successful small enterprise. This vagueness also opens the way for selective and arbitrary enforcement. This could have great practical impact too, as the Bill’s penalties for fronting include jail terms up to ten years.”)

**Offences and Penalties**

Section 13O which deals with offences and penalties:-

**13O.** (1) A person commits an offence if that person knowingly—
(a) misrepresents or attempts to misrepresent the broad-based black economic empowerment status of an enterprise;
(b) provides false information or misrepresents information to a B-BBEE verification professional in order to secure a particular broad-based black economic empowerment status or any benefit associated with the compliance with this Act;
(c) provides false information or misrepresents information relevant to assessing the broad-based black economic empowerment status of an enterprise to any organ of state or public entity; or
(d) engages in a fronting practice.
(2) A B-BBEE verification professional or any procurement officer or other official of an organ of state or public entity who becomes aware of the commission of, or any attempt to commit, any offence referred to in subsection (1) and fails to report it to an appropriate law enforcement agency, is guilty of an offence.

(3) Any person convicted of an offence in terms of this Act, is liable—
(a) in the case of a contravention of subsection (1), to a fine or to imprisonment for a period not exceeding 10 years or to both a fine and such imprisonment or, if the convicted person is not a natural person, to a fine not exceeding 10 per cent of its annual turnover; or
(b) in the case of a contravention of subsection (2) or section 13N, to a fine or to imprisonment for a period not exceeding 12 months or to both a fine and such imprisonment.

(4) For the purpose of determining a fine to be imposed for an offence in terms of subsection (1), the court must take into account the value of the transaction which was derived from, or sought to be derived from, the commission of the offence.

(5) A court in which any person is convicted of an offence in terms of subsection (3) must report the conviction—
(a) to the B-BBEE Verification Professional Regulator, if that person is a B-BBEE verification professional; and
(b) to in any other case, to the Council and to that person’s employer.

(6) Despite anything to the contrary contained in any other law, a magistrates’ court has jurisdiction to impose any penalty provided for in this Act.”
‘knowing’, ‘knowingly’ or ‘knows’, when used with respect to a person, and in relation to a particular matter, means that the person either—
(a) had actual knowledge of that matter; or
(b) was in a position in which the person reasonably ought to have—
(i) had actual knowledge;
(ii) investigated the matter to an extent that would have provided the person with actual knowledge; or
(iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter;”

• Section 13P which deals with prohibition on business with organs of state:

“Prohibition on business with organs of state following conviction under this Act
13P. (1) Any person convicted of an offence in terms of this Act may not contract or transact any business with any organ of state or public entity and must for that purpose be entered into the register of tender defaulters which the National Treasury may maintain for that purpose.
(2) Where the convicted person is not a natural person, the court may in its discretion restrict the order contemplated in subsection (1) to only those members, directors or shareholders who contravened the provisions of this Act.”

• It is clear that the inclusion of the said provisions and specifically the penalties are aimed at combatting fronting with more force.
• The Bill will also establish the Broad-Based Black Economic Empowerment Commission which will be headed by a Commissioner to be appointed by the Minister. The Commission will have jurisdiction throughout the Republic of South Africa and the Bill specifically provides that each organ of state must assist the Commission in the performance of its functions.
• The functions of the Commission are listed in terms of section 13 F of the Bill, are *inter alia*:

  • “to oversee, supervise and promote adherence with this Act in the interest of the public”;
  • “to receive complaints relating to broad-based black economic empowerment in accordance with the provisions of this Act”;
  • “to investigate, either of its own initiative or in response to complaints received, any matter concerning broad-based black economic empowerment”;
  • “to maintain a registry of major broad-based black economic empowerment transactions, above a threshold determined by the Minister by notice in the Gazette”;
  • “to receive and analyse such reports as may be prescribed concerning broad-based black economic empowerment compliance from organs of state, public entities and private sector enterprises”; and
  • “to exercise such other powers which are not in conflict with this Act as may be conferred on the Commission in writing by the Minister”

  • “The Commission may liaise with any regulatory authority on matters of common interest and, without limiting the generality of the foregoing, may—

    (a) exchange information with and receive information from any such regulatory authority pertaining either to matters of common interest or to a specific complaint or investigation;
    (b) participate in the proceedings of any regulatory authority; an
    (c) advise, or receive advice from, any regulatory authority.”;

  • “Notwithstanding the provisions of any law, but subject to the approval of the Minister, the Commissioner may enter into an agreement with any other person, body of persons or organ of state, including a special investigating unit established under the Special Investigating Units and Special Tribunals Act, 1996 (Act No. 74 of 1996), to perform any of the Commission’s duties and functions under this Act”
Section 13J contains specific provisions relating to investigations by the Commission:

**Investigations by Commission**

13J. (1) Subject to the provisions of this Act, the Commission has the power, on its own initiative or on receipt of a complaint in the prescribed form, to investigate any matter arising from the application of the Act, including any B-BBEE initiative or category of B-BBEE initiatives.

(2) The format and the procedure to be followed in conducting any investigation must be determined by the Commission with due regard to the circumstances of each case, and may include the holding of a formal hearing.

(3) Without limiting the powers of the Commission, the Commission may make a finding as to whether any B-BBEE initiative involves a fronting practice.

(4) The Commission may institute proceedings in a court to restrain any breach of this Act, including any fronting practice, or to obtain appropriate remedial relief.

(5) If the Commission is of the view that any matter it has investigated may involve the commission of a criminal offence in terms of this Act or any other law, it must refer the matter to the National Prosecuting Authority or an appropriate division of the South African Police Service.

(6) The Commission may refer to—

(a) the South African Revenue Services any concerns regarding behaviour or conduct that may be prohibited or regulated in terms of legislation within the jurisdiction of that Service; or
b) any regulatory authority any concerns regarding behaviour or conduct that may be prohibited or regulated in terms of legislation within the jurisdiction of that regulatory authority.

(7) The Commission may publish any finding or recommendation it has made in respect of any investigation which it had conducted in such manner as it may deem fit.”

**HOPE RESTORED**

- The establishment of the Commission will hopefully bring relief against the vast number of fronting instances. It does however appear that the enforcement of penalties still has to be sanctioned by a court of law, albeit it is specifically stated that a magistrate’s court will have the necessary jurisdiction to impose penalties provided for in the Bill.

- However, and although it may prove that certain provisions of the Bill will require clarification through interpretation by our courts, the inclusion of the offences and penalty provisions are most definitely welcomed, specifically with reference to the fact that the combating of fronting has to date proven to be unsatisfactory.

- As is evident from the definition of fronting contained in the Guidelines on Complex Structures and Transactions, and Fronting statement quoted above, as well as the definition of fronting practice contained in the Bill, there is no exhaustive list when it comes to fronting.
## A COMPARISON BETWEEN FRONTING: OLD AND NEW

<table>
<thead>
<tr>
<th>OLD</th>
<th>NEW</th>
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<tbody>
<tr>
<td>- Contained in a Guideline</td>
<td>- Contained in Proposed Legislation</td>
</tr>
<tr>
<td>- Defines “<strong>Fronting</strong>” and lists Fronting Practices separately</td>
<td>- Defines “<strong>Fronting Practices</strong>” as a Combined Definition</td>
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<tr>
<td>- <strong>THE ACT:</strong></td>
<td>- <strong>THE ACT</strong></td>
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<tr>
<td>A deliberate/attempted circumvention of the Act and codes or reliance on data/claims of compliance which are based on misrepresentation of fact.</td>
<td>Transaction, arrangement or other act or conduct that directly or indirectly frustrates the achievement of the objectives of the act or the implementation of the provisions of the act specifically but not limited to BEE initiatives.</td>
</tr>
<tr>
<td>- <strong>BY WHO</strong></td>
<td>- <strong>BY WHO</strong></td>
</tr>
<tr>
<td>The party claiming compliance or any other person</td>
<td>Not specified</td>
</tr>
<tr>
<td>- <strong>THE CRIME:</strong></td>
<td>- <strong>THE CRIME</strong></td>
</tr>
<tr>
<td>Fronting could be prosecuted in terms of fraud under the common law</td>
<td>Fronting will under the proposed legislation be a statutory crime in itself which may be prosecuted.</td>
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<td>- <strong>THE EFFECT</strong></td>
<td>- <strong>THE EFFECT</strong></td>
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<tr>
<td>Narrower definition: fronting is circumvention of the BEE act and misrepresentations made.</td>
<td>Wider definition: More acts could be declared as a fronting practice. Subject to interpretation of the objectives of the Act.</td>
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<td>- <strong>THE CONSEQUENCES</strong></td>
<td>- <strong>THE CONSEQUENCES</strong></td>
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<td>Reporting to the DTI for arbitration/fraud to the SAPS/SIU</td>
<td>Fines/ Imprisonment</td>
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TYPES OF FRONTING

• Over the years and since the gazetting of the Codes of Good Practice in 2007 various different forms/types of fronting have been identified.

• The types vary from very basic fronting in the form of obvious window dressing to very sophisticated fronting. A non-exhaustive list regarding the different types of fronting are:-

  • Ownership/Shareholding fronting which includes transactions in terms of which shares/equity are “sold” to a black partner, where such partner is unaware of his duties or obligations as a shareholder, where such shareholder does not participate as a partner or shareholder within the entity. The said transactions are usually structures in such a manner as to allow the non-black shareholders/partners to merely take back the shareholding at their election.

  • (Although it is expected that this form of fronting takes place on a regular basis, there appears to be very few instances in terms of which the said fronting is reported or investigated and only two reported court cases in which the issue was actually considered by our higher courts).

    o Misstatement of the turnover of an entity in order to qualify as an EME or QSE and avoid compliance with a more onerous scorecard.

    o Misstatement regarding information such as the employee base, contributions paid, skills development performed or preferential procurement expenditure.

    o Forged BEE certificates reflecting the SANAS or IRBA logo.

    o Misstatement of applicable industry under which an entity operates to avoid compliance with an applicable industry norm.
- Utilisation of a certificate of a related entity with a similar name.
- Deliberately splitting an enterprise into smaller enterprises in order to ensure that the said entities will each be able to obtain an EME certificate.
- Tendering for a large contract with a start-up certificate where such enterprise is a mere continuation of a pre-existing enterprise.
OTHER LEGISLATION WHICH MAY FIND APPLICATION IN THE COMBATTING OF FRONTING

- Without being exhaustive, other legislation which may require consideration when investigating fronting are:
  - The Protected Disclosures Act, Act 26 of 2000 (specifically with reference to the protection offered to whistle blowers);
  - The Prevention & Combating of Corrupt Activities Act, Act 12 of 2004 (specifically with reference to the reporting obligation which requires any person who knows, ought reasonably to have known, or suspects that an act of corruption, fraud, theft, extortion etc has been committed where the value exceeds R100 000.00 to report such offence or suspicion to the SA Police Services, failure resulting in a criminal offence);
  - The Companies Act, Act 71 of 2008 (with specific reference to section 43 of the regulations which provides that every state owned company, every listed company and any other company that has in two of the previous 5 years scored more than 500 points with reference to regulation 26(2), must appoint a social and ethics committee which committee must monitor the company’s activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice, which regards to matters relating to inter alia, the Broad-Based Black Economic Empowerment Act);
  - The Preferential Procurement Policy Framework Act, Act 5 of 2000 (with specific reference to regulation 13 which places an obligation on an organ of state, upon detecting that the B-BBEE status level of contribution has been claimed or obtained on a fraudulent basis, to act against the tenderer)
REPORTED CASES
VIKING PONY AFRICA PUMPS (PTY) LIMITED T/A TRICOM AFRICA V HIDRO-TECH SYSTEMS (PTY) LIMITED AND ANOTHER 2011 (1) SA 327 (CC)

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

Viking Pony Africa Pumps (Pty) Limited “Viking” and Hidro-Tech Systems (Pty) Limited are competitors who supply and install mechanical and electrical equipment for water and sewerage treatment works.

Both entities tender for work from, *inter alia*, the City of Cape Town “the City”).

Hidro-Tech contended that Viking was awarded approximately 80% more tenders than Hidro-Tech and that on at least three occasions Hidro-Tech tendered at a lower price than Viking but were not awarded the tender.

Hidro-Tech investigated the reason behind Viking’s competitive edge and found that Viking won most of these tenders because of its higher historically disadvantaged individual profile. Historically disadvantaged individuals (HDI’s) held 70% of Viking’s shares, Viking was always given higher preference points, which resulted in the tenders often being awarded to it.

Hidro-Tech then obtained information by two former employees (Mr James and Mr Zandberg) about fronting concerns within the business of Viking. Mr Zandberg (a white male and former director of Viking who held 10% shareholding in Bunker Hills (a white owned sister company of Viking) and Mr James a historically disadvantaged individual who owned 35% of Viking’s shares parted ways with Viking under unpleasant circumstances and joined the ranks of Hidro-Tech. Subsequent to taking up employment with Hidro Tech Mr James and Mr Zandberg they disclosed detailed information on the extent of the HDI’s control over Viking and their involvement in its management.
Mr Zandberg alleged that while he was employed by Viking his monthly remuneration package was R23 500 plus medical aid, a petrol card and a credit card, whilst Mr James earned only R9 500.00 per month, plus medical aid and received no credit card or petrol card benefits.

The said disclosures reinforced the suspicions by Hidro-Tech that the HDI shareholding within Viking was not legitimate.

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

Hidro-Tech therefore lodged a complaint with the City. The complaint was that Viking had, over the years, make fraudulent misrepresentations in its tender documents to the City about its profile of HDI’s, for the purpose of securing a preference. A letter was forwarded to the City’s Head of Tenders and Contracts: Supply Chain Management Directorate containing the said complaint with reference to the allegation that the remuneration, dividends and benefits given to Viking’s HDI’s were negligible compared to those of its white shareholder, specifically those of its sister company, Bunker Hills.

It also caused another letter setting out the information obtained from Mr James and Mr Zandberg, in terms of which letter it was alleged that Mr James did not exercise control over the company and did not actively participate in its management to the extend proportionate to his shareholding.
The city requested an external database managers Quadrem t/a Tradeworld (“Tradeworld”) to investigate Hidro-Tech’s allegations. Tradeworld conducted an exercise which confirmed that Viking’s shareholding as reflected in its tender documents were correct.

Hidro-Tech was not satisfied with the outcome of the investigation conducted by Tradeworld and indicated to the City that the investigation was inadequate due to Tradeworld’s incapacity to investigate allegations of fronting.

Subsequent to talks between Hidro-Tech’s attorney and a senior City official who stated that the City was unable to take action against Viking at that stage, a further letter was forwarded to the City, referring to the inadequacy of the investigation by Tradeworld and requesting an urgent and proper investigation by the City. Hidro-Tech also demanded the suspension of the work which Viking was doing for the City and demanded that no further tenders be awarded to Viking.

When it did not receive a favourable response from the City it approached the High Court for relief. The order sought by Hidro-Tech was that the City be directed to act against Viking in accordance with Regulation 15(1) of the PPPFA (which provided that “an organ of state must, upon detecting that a preference in terms of the Act and these regulations have been obtained on a fraudulent basis, or any specified goals are not attained in the performance of the contract, act against the person awarded the contract”) and the provisions of the City’s Procurement Policy Initiative. The alternative order sought was that in the event of the court finding that there was a need for further investigation, the City be directed to conduct or cause to be conducted a sufficiently thorough investigation into the complaint, to be concluded within two months of the order, in which event the order must be coupled with an order restraining the City from awarding contracts to Viking pending the finalisation of the investigation.
The High Court found that i) the investigation conducted by Tradeworld was inadequate in that it did not address the real issues, being the inner workings of Viking and the actual status of its HDI directors, ii) Hifro-Tech was justified in forming the opinion that the City’s response to its complaint was inadequate to safeguard its constitutional rights and legitimate commercial interest, iii) the City was obliged to act against Viking, iv) the content of the letter written on behalf of Hidro-Tech was true and it was in the public’s as well as Hidro-Tech’s interest, v) the City’s persistent opposition to the relief sought on the fact of the totality of the evidence before the court, justified a mandatory order against it, iv) on the probabilities neither Mr James nor another HDI shareholders were actually involved in the management of, or exercises control over Viking to the extent commensurate with their respective shareholding at the time of the submission of the tenders by Viking and vii) Viking is guilty of a fraudulent misrepresentation.

Viking appealed to the Supreme Court of Appeal (SCA).

The SCA found that the High Court did not err in granting the relief, and the appeal was dismissed with costs.

Viking then approached the Constitutional Court for leave to appeal against the decision of the SCA.

The Constitutional Court granted the leave to appeal.

The main issue considered by the Constitutional Court was that the obligations of an organ of state are in circumstances where an enterprise which had been awarded a tender is plausibly accused of having been successful only because of the fraudulent representations it made.
In considering the aforesaid issue the Court also analysed the meaning of “detect” and “act against” in Regulation 15.

“Detect” was interpreted broadly and the Court held that it means no more than discovering, getting to know, coming to the realisation, being informed, having reason to believe, entertaining a reasonable suspicion, that allegations, of a fraudulent misrepresentation by the successful tenderer, so as to profit from preference points, are plausible.

The Court indicated it is not the existence of conclusive evidence of a fraudulent misrepresentation that should trigger responsive action from an organ of state.

Having regard to the phrase "act against", the Court held that this is broad enough to include the organ of state launching an appropriate investigation into the alleged fraudulent conduct, effectively creating an obligation on the organ of state that receives complaints about alleged fronting to investigate the conduct and to act accordingly.

The Constitutional Court therefore dismissed the appeal and replaced the order of the SCA with the following order:

“(a) The City of Cape Town is directed to investigate the allegations made by Hidro-Tech Systems (Pty) Ltd against Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa and Bunker Hills Pumps (Pty) Ltd t/a Tricom Systems, including whether or not the historically disadvantaged individuals who held the majority of the shares in Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa, were at the time referred to in the complaint actively involved in the management of the company and exercised control over the company, commensurate with the degree of their ownership.

(b) The order for costs made by the Western Cape High Court, Cape Town, is confirmed.

(c) The appeal is otherwise dismissed with costs.”
The City of Cape Town is ordered to pay the costs of Hidro-Tech Systems (Pty) Ltd and Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa in this Court, including the costs of two counsel.

The order in sub-paragraph 4 is provisional.

The parties and the City of Cape Town are invited to make representations within 10 days of the date of delivery of this judgment on whether the provisional order should be made final.”

It is clear from the above that the judgment should have acted as a warning to organs of state to take action when fronting is suspected and certainly created a tool which could be utilised in the combat against fronting, however it appears that notwithstanding this judgment, very few instances of fronting were/are actually reported, which begs the question as to the actual consideration and attention which same receives during the procurement process by government.
PEEL AND OTHERS V HAMON J & C ENGINEERING (PTY) LTD AND OTHERS 2013 (2) SA 331 (GSJ).

Sim and Botsi Attorneys acted for the applicants in this matter.

The main issue to be decided in the aforesaid matter was whether an act or omission of Hamon SA / Hamon & Cie had the result of being oppressive and unfairly prejudicial to, or unfairly disregarded the interests of, the applicants and/or whether the business of Hamon J&C and/or Hamon SA, was carried out or conducted in a manner that was oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicants and/or whether the powers of a/the director/s or prescribed officer of Hamon SA, and/or Hamon & Cie, were exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicants.

The applicants in the above matter (save for the second applicant) and the Hamon SA were involved in a joint venture, Hamon J & C (the JV) which JV were formed subsequent to initial discussions during 2009. The negotiations between the parties were aimed at exploring how Hamon SA and J&C could form a JV company or otherwise work together for the mutual benefit of both parties.

At that stage J&C which was registered as a close corporation, was active in the business of air pollution control and electrostatic precipitators. It was a family owned business which employed all of the applicants.

Hamon SA, at the time, was active in air pollution control activities and other business activities including cooling systems. The activities undertaken by Hamon & Cie and the other companies in its group included in addition to air pollution control and electrostatic precipitators, fabric filters, gas scrubbers etc. on a worldwide basis. Hamon SA was a subsidiary of the multinational company, Hamon & Cie, which was far larger than J&C and conducted business around the world through its group companies.

The discussions culminated in a Sale and Transfer Agreement effective from 1 October 2010. The existing J&C business was transferred to the JV company and Hamon SA sold the Hamon assets (the right to use the Hamon trade name and trademarks associated therewith as well as all business connections in and outside RSA) to the JV company for a consideration of shares. The applicants’ shares in J&C were transferred to the JV company.
Therefore subsequent to J&C being converted to a company, the first and second applications transferred their shares in J&C to Hamon J&C, Hamon SA transferred the Hamon assets to Hamon J&C, the second applicant sold his shares in Hamon J&C to the Hamon SA and Hamon SA paid the sum of R7 Million to the second applicant. The business of J&C continued to run as it had before except that it was now operating under the Hamon J&C name.

The shareholding in the JV company subsequent to conclusion of the transaction were:-

Hamon SA – 10 500 ordinary shares constituting 60% of the total issued ordinary share capital of the JV Company;

The first, third and fourth applicants – 7 000 ordinary shares constituting 40% of the total issued ordinary shares capital of the JV Company;

Hamon SA, the first applicant, the third applicant and the fourth applicant agreed that their relationship as shareholders in the JV Company was to be governed by the provisions of a shareholders agreement concluded by and between the relevant parties.

The application was founded in terms of 163 of the New Companies Act, and was largely based on the alleged conduct of the Hamon respondents and their directors and prescribed officer prior to the conclusion of the Sale and Transfer Agreement and the Shareholders’ Agreement between the applicants and the respondents, and which conduct was discovered subsequently. The alleged conduct relates primarily to an attempt by the Hamon respondents to improve the Black Economic status of Hamon SA.

The applicants’ contended that the conduct was of such a serious nature that it jeopardised the continuation of any business with Hamon and they indicated that they simply did not want to be associated with the Hamon respondents anymore.
The conduct referred to above related to what the court referred to as “the BEE” issue, which in essence pertained to the appointment of two black females, who were employed by Hamon SA as a cleaning lady and a driver and messenger, respectively, who purchased shares (each in the equivalent of 13% of the issued shares of Hamon SA) (collectively totalling the 26% required shareholding as per the Black Economic Empowerment Codes) from Hamon & Cie.

The sale to the cleaning lady, Ms November, was confirmed in correspondence from Hamon & Cie and the sale to Ms Mangwana was confirmed in a written document titled “Agreement of Sale of Shares in Hamon (South Africa) (Pty) Ltd”.

The applicants alleged that the sale of shares agreements were a shame and relied upon the following grounds:

The shares were sold for R1 in a company which had significant value;

The sale of shares agreement concluded with Mangwana contained a clause in terms of which Hamon & Cie reserved the right to “an option to repurchase the shares at any time, on simple request”;

The above option would be computed with reference to the net asset value of Hamon SA (which was negative at the time of the sale), which meant that Hamon & Cie reserved an option to reclaim the shares without transferring any value;

Mangwana stated, *inter alia*, that she and November were not given an opportunity to read the agreements before signature, that her sale of shares agreement was already signed on behalf of Hamon & Cie and by two witnesses (next to the space where she had to sign) when she signed the document, and that the managing director of Hamon SA told Mangwana and November that they must go out and tell all that they are now “major” shareholders of Hamon SA, and further indicated that they will receive a shareholder’s allowance of R115.00 per week from the week during which the agreements were signed;
The fact that no shareholders agreement were concluded by and between the parties and that it appeared that no attorneys were involved in drafting the agreements, made it highly improbable that the transaction was genuine (when taking into account that a multi-national company disposed of 26% of its shareholding);

Mangwana further indicated that her position in Hamon SA did not change subsequent to the sale of shares agreement being concluded. She did not partake in the decision making within Hamon SA and was not treated as one would expect a shareholder of the company to be;

Mangwana indicated that she was aware of a big deal which was pending between Hamon SA and Eskom at the time that the sale of shares transactions were concluded, which deal was awarded to Hamon SA shortly afterwards;

Not long after the conclusion of the sale of shares transactions, two overseas directors from Hamon & Cie visited the SA office and advised all the staff that the company almost closed down, but was “now with BEE” and was able to pay debts where due;

A mere six months after the conclusion of the sale of shares agreement, the shares were simply taken back from Mangwana and November as the managing director of Hamon SA indicated that “a proper lady” was found;

Mangwana referred the matter to the DTI (the DTI was at the time investigating the matter), and her version put forward under oath clearly indicated that the sale of shares to her was a case of fronting aimed at improving Hamon SA’s B-BBEE status;

The applicants held that the committing of a fraud related to B-BBEE is regarded in a serious light in the SA business environment and that the allegations against Hamon SA in this regard influenced the JV (connected to the Hamon name) in that its business were to be tainted by these allegations which had the potential of destroying the JV business;
The applications also indicated that they could not continue to be associated with Hamon in that serious mistrust arose between the parties; The applicants therefore requested to court to sever their ties with Hamon so that Hamon J&C would no longer be a subsidiary of Hamon SA and Hamon & Cie. The applicants therefore sought an order directing an exchange of shares between the second applicant and Hamons SA as per section 163(2) of the Companies Act, and/or directing the restoration of Hamon SA by the applicants of a part, alternatively, the whole of the consideration that Hamon SA paid for the shares, with conditions as envisaged in sec 163(2)(g) of the Companies Act and/or varying or setting aside the sale of shares transaction between Hamon SA, the second applicant and Hamon J&C and compensating Hamon J&C and/or the second applicant, or any other of the applicants as envisaged in sec 163(2)(h); and that Hamon SA pay compensation to the second applicant and/or Hamon J&C, as envisaged in section 163(2)(j);

Although the respondents denied that they acted fraudulently in relation to B-BBEE, they admitted that the sale of shares agreements were concluded and terminated. The respondents contended that the applicants did not demonstrate that the sale of shares agreements oppressed or unfairly disregarded the interest of the applicants or that it resulted in the business of Hamon SA or Hamon & Cie eing conducted in a manner which was oppressive or unfairly prejudicial to the applicants or unfairly disregarded the interests of the applicants;

The respondent’s stated at the time of the conclusion of the sale of shares agreements they believed that the transfer of the shares to Mangwana and November was in compliance with BEE requirements, however, following on further advice received, they learnt that the
sales did not constitute true empowerment as contemplated in terms of BEE legislation and Hamon & Cie repurchased the shares in question, and alleged that Hamon SA and Hamon & Cie did not receive any economic advantage from the transactions;

The respondents further stated that the applicants were merely attempting to undue a poor commercial deal concluded by them, with no valid reason to do so;

The respondents also denied that they threatened to fire Mangwana if she did not withdrew the charges laid with the DTI (with reference to a statement made under oath by Mangwana to the effect), and further denied that a disciplinary hearing against Mangwana were related to the BEE issue;

It was further contended that the JV was a profitable and commercial success due to the Hamon trade mark and name, and that this was the reason for the applicants to seek an exit from the deal between the applicants and Hamon SA, and that the JV used the Hamon name (at the time with approval) to secure lucrative business deals;

The court considered the relevant provisions of section 163 of the New Companies Act, similar provisions under the Old Companies Act, as well as case law precedents related to the said provisions, even foreign law guidance, and specifically recalled that the applicants’ main contention that they were unaware of the BEE issue, raised it with the respondents when they became aware of same later and that the respondents played the issue down;

The court further considered the provisions of the BEE legislation with reference to the BEE issue raised and specifically quoted section 1 of the B-BBEE Act of 2003 which defines Broad Based Black Economic Empowerment.
The court further referred to the Broad-Based Black Economic Empowerment Amendment Bill 2011, which was the relevant Bill published at the time and specifically the issues related to enforcing compliance with the B-BBEE Act addressed in the said Bill.

The court agreed that the fact that Hamon SA and Hamon & Cie engaged in an inappropriate BEE exercise, and that they did not seek to take appropriate measures to remedy their conduct, and that the said conduct was oppressive to the JV.

It concluded that the sale of shares agreements concluded with November and Mangwana and the fact that Hamon SA did not disclose same to the applicants, meant that the conduct of the Hamon respondents was and is unfairly prejudicial to the applicants, and unfairly disregards or disregarded their interests.

It even indicated that Criminal prosecution was not excluded, with reference to potential risks created for the applicants.

Accordingly the court found that the applicants, as directors and shareholders of the JV being prejudiced, and the fact that the BEE issue was not being resolved made the conduct oppressive
WHY SO FEW CASES RELATED TO FRONTING?

• From both the above cases it appears that fronting issues are capable of being challenged and therefore effectively combatted with reference to existing legislation, in the first case specifically the provisions of the PPPFA and in the second case, the provisions of the Companies Act.
• However if one has regard to the legal costs involved in matters such as these, it is understandable that very few civil matters relating the subject has been seen the light of day.
• As stated above the establishment of the BEE commission and the offences and penalty provisions will hopefully provide the necessary assistance to those affected by fronting, who do not necessarily have deep enough pockets to pursue expensive litigation.

FRONTING IN THE HEADLINES

• As stated above and from media reports collected it does appear that a number of fronting cases have been / are being investigated by the Specialised Commercial Crime Courts. We will briefly discuss some of those which received media attention as well as other matters in which fronting issues were raised. The information relating these matters was extracted from articles published in media.
THE MILLE NET MATTER

- Mille Net used their tea lady to win a government tender of approximately R160 million rand;
- The company “sold” 40% of its shares to Ms Elizabeth Tsebe (“Tsebe”) and appointed her as a director of the company in 2007;
- The appointment was without Tsebe’s knowledge and her remuneration subsequent to the appointment did not increase in accordance with her new role;
- After the tender scandal leaked, the company offered Tsebe R3 million Rand in settlement – Tsebe however rejected the above settlement and demanded instead R10 million rand in unpaid salaries and the value of dividends for her shares;
- It appears that the company is currently in liquidation and it is unknown what the ultimate outcome of the fronting issue was.

THE MVULA TRUST MATTER

- Mvula Trust was awarded a R1 billion tender in 2011 to manage the distribution of millions of rands through a communities based job creation project;
- The rules of the tender made it clear that only non-profit organisations (“NPOs”) could qualify for the tender award;
- Subsequent to having been awarded the tender and contrary to the tender agreement, Mvula trust sub-contracted a significant part of the awarded contract to a third party entity named Ubuntu Sima;
• The Mvula Trust Chairperson and Deputy Minister of Water and Environmental Affairs, Rejoice Mabudafhasi, was implicated in the tender irregularities, as there appeared to have been a collaborative relationship between her and one of the directors of Ubuntu Sima, Gabsie Mathenjwa, who was also a trustee of Mvula Trust.

THE BOSASA MATTER

• The DTI was asked to investigate allegations that white IT and engineering staff at Bosasa were paid off the books in order to have the company maintain a high B-BBEE rating level;
• The salaries of the white IT and engineering staff who were doing full time work for Sondolo, a subsidiary of Bosasa Group, were allegedly listed as employees and paid by a shelf company, Consilium Business Consultants;
• According to reports under investigation, Consilium Business Consultants has 37 full-time employees, yet has no offices or branding;
• The allegations of fronting were denied by the Bosasa spokesman who confirmed Consilium Business Consultants to be “a specialist service provider to the Bosasa Group”;
THE ADVERTISING MULTINATIONALS

- Advertising multinational, McCann Worldgroup SA was accused by its empowerment partner, Africa Advertising Communications (ACC) that it, ACC, was not allowed to take active part in the business;
- This accusation was also raised to the DTI by the empowerment partner of another advertising multinational, Young and Rubicam;
- Although the complaints were laid, no actual charges of fronting were forthcoming;
- Empowerdex MD, Lerato Ratsoma, who was quoted in an article related to the matter emphasised that there is a difference between actual fronting and the repercussions of badly drafted shareholders’ or partnership agreements. According to her, many empowerment players have not verified their shareholder agreements and are then surprised when they realise that they do not have the rights they expected.

RAJKAPOOR “TEDDY” LAKRAJ

- Rajkapoor “Teddy” Lakraj was charged with 148 counts of fraud and corruption and appeared in the Durban Commercial Crime Unit during March 2012;
- The aforementioned charges included using his domestic worker and her daughter as fronts to obtain certain tender contracts from the Department of Public Works;
- Lakraj secured 3000 contracts valued at approximately R87 million rand from the DPW over several years by reflecting his domestic worker and her daughter as the controlling shareholders of two of his companies, Quantum Leap Investments 24 (Pty) Limited t/a Teddy’s Construction and Dreamteam Trading CC t/a Siyasiza Builders;
- R79 million rand of Lakraj was restrained by the Asset Forfeiture Unit pending the duration of his trial, with the curator having been ordered to release certain funds to Lakraj for living expenses and legal fees.
ROUX SHABANGU

- Businessman Roux Shabangu was accused of receiving a R6 million helicopter and R4 million as kickbacks for assisting a white owned company to obtain a lease agreement from the Department of Public Works (“DPW”);
- Shabangu and his then business partner, Japie van Niekerk, entered into an agreement in terms of which the Vermeulen Street Building was leased to the DPW for 9 years and seven months in 2009. Shortly thereafter Shabangu and Van Niekerk parted ways, and, according to Shabangu, notified the DPW of the parting;
- In court papers filed by the DPW, it is however alleged that Shabangu led the DPW to believe that the building in question belonged to him, when it in actual fact belonged to his ex-business partner, van Niekerk;
- A special Investigating report stated that the DPW transferred monthly payments of R729 000.00 to Shabangu’s company, Majestic Silver;
- The DPW alleges that the monthly payments were transferred to HKML, a 100 percent white-owned company;
- Shabangu vehemently denied the allegations, and was quoted as saying:

   “Fronting for whites? Don’t make me laugh. I am no man’s puppet.”

DU PLOOY

- Du Plooy a Cape Town businessman who owned four close corporations was fined R30 000.00 for cover quoting (a process in which quotations are submitted by different entities controlled by the same person/s) to install cabling at municipal premises in Cape Town.
TOLPLAN

- Tolplan one of SANRAL’s subcontractors was accused by Lennox Matshaya a shareholder of Tolplan of window dressing to win the deal for implantation of the controversial tolls;
- He was subsequently fired by Tolplan and it appears that it applied to court to gag Matahaya from speaking to the press.

MARNOLDA

- A certain Mr Joubert who owns a Thabazimi-based construction company enlisted a certain Magaladi, an office cleaner as a director and 80% shareholder of his company;
- The company was awarded a R15.09 million tender by the Development Bank of SA;
- Magaladi had no idea about the tender or her 80% shareholding in the company, although it was alleged by Jouberts attorney that an agreement was concluded by Joubert and Magaladi (an agreement drafted in English although Magaladi is not able to speak the language);
- As was stated in a newspaper article published on the matter, it would not be in Magaldi’s interest to be an 80% shareholder whilst not understanding the context and extent of being a shareholder and it would be in her interest to grow her profile first.
CONCLUSION

• Having regard to the fact that fronting is used to enrich a powerful few, and the it impacts directly on government and the major public companies, the biggest spenders in the country, directly, and therefore also the taxpayer at large, the provisions in the Bill related to fronting are welcomed.

• As stated above and as is the case with any new legislation, certain provisions will have to be interpreted by the courts, in order to ensure effectiveness of the legislation;

• The effectiveness of bodies such as the Competition Commission which operates with similar powers as is envisaged for the BEE Commission, has certainly proved to be successful and one can only hope that the same will be said about the Bill and the Commission in time.
THANK YOU