

opinion

to **Kevin Lester**
cc
from Safiyya Patel
date 27 January 2009

RE: OPINION ON VALIDITY OF THE BEE VERIFICATION MANUAL AND INTERPRETIVE GUIDE AND RELATED MATTERS

1. **INTRODUCTION**

1.1. We have been asked to consider and advise on various issues relating to -

1.1.1 the Codes of Good Practice on Black Economic Empowerment issued by the Minister of Trade and Industry ("**the Minister**") in terms of section 9(1) of the Broad-Based Black Economic Empowerment Act, 2003 ("**the BEE Act**") ("**the Codes**");

1.1.2 the interpretive guide dated June 2007 published by the Department of Trade and Industry ("**DTI**") ("**the Interpretive Guide**"); and

1.1.3 the framework for the accreditation and verification by all verification agencies published by the DTI on 18 July 2008 ("**the Verification Manual**").

1.2. In particular we have been asked to consider and advise on various specific questions relating to these documents. For the sake of clarity each of these questions are reiterated below, and the answers to each of them are dealt with, in turn, below each of the questions.

2. **WHAT IS THE LEGAL STATUS OF THE INTERPRETIVE GUIDE, AND CAN THIS DOCUMENT BE RELIED UPON BY VERIFICATION AGENCIES IN INTERPRETING THEIR VERIFICATION OBLIGATIONS IN RESPECT OF BROAD BASED BLACK ECONOMIC EMPOWERMENT?**

2.1. The Interpretive Guide is not legislation. In this regard it is important to note at the outset that the DTI has no legislative powers. In other words, the DTI is not empowered, in terms of the BEE Act nor any other relevant or applicable legislation, to pass legislation. Nor is it empowered in terms of the BEE Act to pass any subordinate legislation relating to the BEE Act.

2.2. The only person vested with powers in terms of the BEE Act to pass subordinate legislation is the Minister. In terms of section 9(1), the Minister is empowered to issue the Codes and in terms of section 14 the Minister may make regulations with respect to the implementation of the BEE Act.

2.3. Therefore, in our view, the Interpretive Guide has no legal status. At best, the Interpretive Guide constitutes an indication by an administrative body, in this case the DTI, of its

understanding of the Codes. The Interpretive Guide may, accordingly not be utilised to read into the BEE Act or the Codes matters that have not been specifically dealt with there. In other words, provisions in the Interpretive Guide which have the effect of re-writing the BEE Act and/or the Codes or are new provisions which never existed in the BEE Act and/or the Codes has no legal status.

3. **WHAT IS THE LEGAL STATUS OF THE VERIFICATION MANUAL, AND CAN THIS DOCUMENT BE RELIED UPON BY VERIFICATION AGENCIES IN INTERPRETING THEIR VERIFICATION OBLIGATIONS IN RESPECT OF BROAD BASED BLACK ECONOMIC EMPOWERMENT?**

3.1. The cover page to the Verification Manual states:

"By the powers vested in me by section 9(1) of the Broad-Based Black Economic Empowerment Act, 2003 (Act No. 53 of 2003) and pursuant to paragraph 10 (under the heading "STATEMENT 000: GENERAL PRINCIPLES AND THE GENERIC SCORECARD") of General Notice No. 112 of 2007 published in Government Gazette No. 29617 of 9 February 2007,

I, Mandisi Maphalwa, Minister of Trade and Industry, hereby-

- (a) Issue the following Verification Manual;*
- (b) Determine that the Verification Manual will come into operation on the date of this publication; and*
- (c) That the use of this document is prescribed as part of the accreditation process and shall be used by all Verification Agencies when performing B-BEE verification". (Our emphasis)*

3.2. Therefore, the Minister is stated to have derived his powers to issue the Verification Manual from section 9(1) of the BEE Act.

3.3. Section 9(1) of the BEE Act states:

"In order to promote the purposes of the [BEE] Act, the Minister may by notice in the Gazette issue codes of good practice on black economic empowerment that may include-

- (a) the further interpretation and definition of broad-based black economic empowerment and the interpretation and definition of different categories of black empowerment entities;*
- (b) qualification criteria for preferential purposes for procurement and other economic activities;*

- (c) *indicators to measure broad-based black economic empowerment;*
- (d) *the weighting to be attached to broad-based black economic empowerment indicators referred to in paragraph (c);*
- (e) *guidelines for stakeholders in the relevant sectors of the economy to draw up transformation charters for their sectors; and*
- (f) *any other matter necessary to achieve the objectives of this Act.”(Our emphasis)*

3.4. Accordingly, the Minister is, in terms of section 9(1), empowered to issue “**codes of good practice**” on the matters listed in paragraphs (a) to (f). The Minister is not vested under this section with the powers to issue any other type of document.

3.5. What falls to be considered, therefore, is whether the Verification Manual constitutes a code of good practice as contemplated in section 9(1) of the BEE Act. In this regard, reference ought to be made to the other known document issued by the Minister under this section, namely the Codes.

3.6. The cover page to the Codes state:

“I, Mandisi Mphalwa, Minister of Trade and Industry, hereby-

- (a) *issue the following Codes of Good Practice under section 9(1) of the Broad-Based Black Economic Empowerment Act, 2003 (Act No. 53 of 2003); and*
- (b) *determine that these Codes will come into operation on the date of this publication.” (Our emphasis).*

3.7. Therefore, in publishing the Codes, the Minister clearly denoted them as Codes of Good Practice under section 9(1) of the BEE Act. On the other hand, there is no reference anywhere in the Verification Manual (and more particularly, the cover page) to the designation of the Verification Manual as codes of good practice. Accordingly, there is no evidence of an intention by the Minister to have published the Verification Manual as codes of good practice.

3.8. On this basis, our view is that the Verification Manual does not constitute a code of good practice as contemplated in section 9(1) of the BEE Act, and, therefore, in issuing the Verification Manual, the Minister acted ultra vires or beyond the powers vested in him in terms of section 9(1) of the BEE Act.

- 3.9. The phrase "ultra vires" is used to describe acts which purport to be done by virtue of a certain authority, but which are really in excess of such authority, or of acts which are otherwise unauthorised. Ultra vires acts or decisions may be set aside by a court on review.¹
- 3.10. The Verification Manual may, therefore, be susceptible to an attack that it be set aside on the basis that the Minister acted ultra vires the powers vested in him in terms of section 9(1) of the BEE Act in issuing the Verification Manual.

Prescribed procedure

- 3.11. If assuming that the Verification Manual constitutes a code of good practice under section 9(1) of the BEE Act, and that, accordingly, the Minister acted within his powers in issuing the Verification Manual (which we do not agree with), then the question which next falls to be considered is whether the Minister followed prescribed procedures, if any, in issuing the Verification Manual.
- 3.12. In the first instance, it is noteworthy that section 33(1) of the Constitution of the Republic of South Africa, 1996 ("**the Constitution**") provides that:

"Everyone has the right to administrative action that is lawful, reasonable and procedurally fair." (Our emphasis).

- 3.13. Pursuant to that provision in the Constitution, section 4(1) of the Promotion of Administrative Justice Act, 2000 ("**PAJA**") states:

"In cases where an administrative action materially and adversely affects the rights of the public, an administrator, in order to give effect to the right to procedurally fair administrative action, must decide whether –

- (a) to hold a public inquiry in terms of subsection (2);*
- (b) to follow a notice and comment procedure in terms of subsection (3);*
- (c) to follow the procedures in both subsections (2) and (3);*
- (d) where the administrator is empowered by any empowering provision to follow a procedure which is fair but different, to follow that procedure; or*
- (e) to follow another appropriate procedure which gives effect to section 3."*

¹ *Van Eck v Etna Stores* 1947 2 SA 984 AD; See also: *S v Van Niekerk* 1975 3 SA 233 (C) (petrol regulations); *S v Concalves* 1975 2 SA 51 (T) (regulations banning pin-tables held invalid).

- 3.14. Accordingly, in issuing the Verification Manual, the Minister was, in terms of his obligations under PAJA, obliged to either:
- 3.14.1 hold a public enquiry;
 - 3.14.2 follow a notice and comment procedure;
 - 3.14.3 if he was empowered by the BEE Act to follow a procedure which was fair but different, to follow that procedure; or
 - 3.14.4 follow another appropriate procedure which gives effect to:
 - 3.14.4.1 adequate notice of the proposed Verification Manual; and
 - 3.14.4.2 a reasonable opportunity to make representations.
- 3.15. The provisions of the BEE Act not only empowers, but obliges, the Minister to follow a prescribed procedure in issuing a code of good practice. Section 9(5) of the BEE Act state that:
- “The Minister must, before issuing, replacing or amending a code of good practice in terms of subsection (1)-*
- (a) publish the draft code of good practice or amendment in the Gazette for public comment; and*
 - (b) grant interested persons a period of at least 60 days to comment on the draft code of good practice or amendment as the case may be.” (Our emphasis).*
- 3.16. Therefore, in terms of this section, the Minister was obliged to do the following before issuing the Verification Manual:
- 3.16.1 publish a draft version of the Verification Manual for public comment; and
 - 3.16.2 grant interested persons a period of at least 60 days to comment on the draft Verification Manual.
- 3.17. The Verification Manual was published in its final form on 18 July 2008. That publication was not preceded by a publication in the *Gazette* of any draft verification manual. Nor was any other type of procedure provided for in section 4(1) of PAJA followed. Accordingly, our view is that if the Verification Manual constitutes a code of good practice under section 9(1) of the BEE Act, the Minister failed to follow the prescribed procedure under section 9(5).
- 3.18. Furthermore (and in any event), if for some reason the Verification Manual is held not to constitute a code of good practice, and the Minister is held not have acted beyond his

capacity in issuing the Verification Manual (which we do not agree with) then our view is that the Minister contravened the provisions of section 33 of the Constitution, and, in particular section 4(1) of PAJA, by failing to follow any other type of procedure provided for in section 4(1) in issuing the Verification Manual.

3.19. In light of the above, we are of the view that the Verification Manual may potentially be set aside on any one of the following grounds, namely that in issuing the Verification Manual:

3.19.1 the Minister acted beyond the powers vested in him in terms of section 9(1) of the BEE Act;

3.19.2 the Minister failed to follow the prescribed procedure under section 9(5) of the BEE Act; and/or

3.19.3 the Minister contravened section 33 of the Constitution, and, in particular section 4(1) of PAJA.

3.20. As such, and until such time as the matters in paragraph 3.19 are clarified, we are of the opinion that, like the Interpretive Guide, the Verification Manual lacks legal status and may not be utilised to read into the BEE Act and the Codes matters which have not been specifically dealt with there.

4. **IF THE STATUS OF EITHER OR BOTH OF THE DOCUMENTS IN 2 AND 3 ABOVE ARE SUCH THAT THEY DO NOT CARRY ANY LEGAL WEIGHT, WHAT ACTIONS ARE AVAILABLE TO VERIFICATION CLIENTS RECEIVING ADVERSE VERIFICATION FINDINGS RESULTING FROM RELIANCE BY THE VERIFICATION AGENCY ON THE DOCUMENTS IN 2 AND 3?**

4.1. On the basis of our conclusion that both the Interpretive Guide and the Verification Manual lacks legal status, our view is that any application of these documents by verification agencies which results in adverse findings for verification clients may potentially be set aside by a court on the basis that such action constitutes a contravention of the BEE Act and the Codes.

4.2. Furthermore, to the extent that any third parties may have placed any reliance on such adverse findings to the detriment of a verification client, the verification client may potentially institute an action against the verification agency for damages suffered by the verification client resulting from the verification agency's non-compliant adverse findings. A typical example is the loss which may be suffered by a verification client as a result of the cancellation of a contract by a customer on the basis of the verification agency's adverse finding.

4.3. Note that the merits of each case would need to be assessed in order to determine the prospects of success of any potential application or action against a verification agency.

5. **DOES THE FACT THAT THE VERIFICATION AGENCY IS SEEKING ACCREDITATION FROM THE ACCREDITATION AUTHORITY (SANAS) REFERRED TO IN PARAGRAPH 10 OF CODE 000 STATEMENT 000 HAVE ANY BEARING ON THE LEGAL STATUS OF THE INTERPRETIVE GUIDE AND THE VERIFICATION MANUAL?**

5.1. No.

5.2. Paragraph 10.3 of code Series 000 Statement 000, states that:

"Accreditation of BEE verification agencies will be conducted by SANAS on behalf of the DTI in terms of the accreditation criteria that will be developed, maintained and enforced by SANAS." (Our emphasis).

5.3. Paragraph 10.4 states:

"Such Accreditation Standards govern the terms and conditions on which the Accreditation Body may grant, refuse to grant, revoke or suspend an accreditation of a Verification Agency."

5.4. Paragraph 10.7 states:

"The DTI together with the relevant industry body will from time to time develop Verification Methodology and other relevant practices that will be used as standards by all verification agencies."

5.5. Therefore, the verification of verification agencies is intended to be conducted by SANAS against predefined accreditation standards and verification methodology which will be utilised as standards.

5.6. As with the Interpretive Guide, the standards may not be construed as legislation, nor subordinate legislation, on the basis that neither the DTI nor SANAS are empowered in terms of the BEE Act to pass any form of legislation regarding the application of the BEE Act. Therefore, the standards may not be utilised to read into the BEE Act and the Codes any matters not specifically dealt with there.

6. **ON A READING OF ALL LEGALLY BINDING DOCUMENTS RELATING TO THE MEASUREMENT OF OWNERSHIP UNDER CODE 100 STATEMENT 100, CAN THE "MODIFIED FLOW-THROUGH PRINCIPLE" AND "THE MANDATED INVESTMENT PRINCIPLE" BE APPLIED CONCURRENTLY IN MEASURING OWNERSHIP RECOGNITION OF A PARTICULAR OWNERSHIP STRUCTURE?**

6.1. The definition and application, of the "Modified Flow-Through Principle" is dealt with in paragraph 3.3 of Code 100 Statement 100 of the Codes. This paragraph states as follows:

"3.3. The Modified Flow-Through Principle:

3.3.1 The Modified Flow-Through Principle applies to any BEE owned or controlled company in the ownership of the Measured Enterprise.

3.3.2 *In calculating Exercisable Voting Rights under paragraph 2.1.1. and Economic Interest under paragraph 2.2.1 the following applies: Where in the chain of ownership, black people have a flow-through level of participation in excess of 50% then only once in that chain may such black participation be treated as if it were 100% black.*

3.3.3 *The Modified Flow-Through Principle may only be applied in the calculation of the indicators in paragraphs 2.1.1 and 2.2.1. In all other instances, the Flow-Through Principle applies."*

6.2. Therefore, in terms of the Codes the rules pertaining to the application of the "Modified Flow-Through Principle" are as follows:

6.2.1 it applies to any BEE owned or controlled entity; and

6.2.2 it may only be applied in the calculation of "Exercisable Voting Rights in the Enterprise in the hands of black people" and "Economic Interest of black people in the enterprise".

6.3. The Codes do not prescribe any other rules or restrictions regarding the application of the "Modified Flow-Through Principle".

6.4. The "Mandated Investment Principle" is dealt with in paragraphs 3.4.4 to 3.4.6 of Code 100, Statement 100, of the Codes. These paragraphs state as follows:

"3.4.4 When determining ownership in a measured entity, rights of ownership of Mandated Investments may be excluded. The maximum percentage of the ownership of any measured entity that may be so excluded is 40%.

3.4.5 *A Measured Entity electing not to exclude Mandated Investments when it is entitled to do so, may either treat all of that ownership as non-black or obtain a competent person's report estimating the extent of black rights of ownership measurable in the Measured Entity and originating from the Mandated Investment.*

3.4.6 *A Measured Entity cannot selectively include or exclude Mandated Investments and an election to exclude one mandated investment is an election to exclude all Mandated Investments and visa versa."*

6.5. Therefore, in terms of the Codes the rules pertaining to the application of the "Mandated Investment Principle" are limited to the following -

6.5.1 an entity may not selectively include or exclude mandated investments;

6.5.2 an election to exclude one mandated investment is an election to exclude all mandated investments;

6.5.3 the maximum percentage of ownership of mandated investments that may be excluded is 40%;

6.5.4 an entity electing not to exclude mandated investments when it is entitled to do so, may either treat all of that ownership as non-black or obtain a competent person's report estimating the extent of black rights of ownership originating from the mandated investments.

6.6 As appears from the above, there is no rule, nor restriction, in the Codes prescribing that the "Modified Flow-Through Principle" may not be used in circumstances where an entity has applied the "Mandated Investments Principle" or that an entity which has applied the "Mandated Investment Principle" may not apply the "Modified Flow-Through Principle". If this was indeed the intention of the legislature, then such a rule should have been specifically included in the Codes.

6.7 Our view, therefore, is that the "Modified Flow-Through Principle" may be applied concurrently with the "Mandated Investment Principle" in measuring the ownership recognition of a particular ownership structure.

7. **ON A READING OF ALL LEGALLY BINDING DOCUMENTS RELATING TO THE MEASUREMENT OF OWNERSHIP UNDER CODE 100 STATEMENT 100, CAN AN OFF-SHORE INVESTOR, MEETING THE DEFINITIONAL REQUIREMENTS OF A "MANDATED INVESTMENT" BE EXCLUDED IN ACCORDANCE WITH PARAGRAPH 3.4.4?**

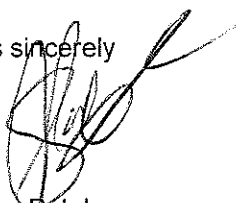
7.1. "Mandated investments" are defined as:

"...any investments made by or through any third party regulated by legislation on behalf of the actual owner of the funds pursuant to a mandate given by the owner to a third party, which mandate is governed by that legislation. Some examples of domestic mandated investments and the portions of those investments subject to the exclusion principle. Are contained in Annexure 100A attached to statement 100"
(Our emphasis).

- 7.2. Therefore, in terms of this definition, to qualify as a mandated investment the investment must comply with the following criteria:
- 7.2.1 it must be made by or through a third party on behalf of the actual owner of the funds;
 - 7.2.2 the third party must be regulated by legislation (note that, in terms of the definition, this may be foreign or local legislation);
 - 7.2.3 it must be pursuant a mandate to the third party from the actual owner; and
 - 7.2.4 the mandate must be governed by legislation (note that, in terms of the definition, this may be foreign or local legislation).
- 7.3. Therefore, the criteria for the qualification of an investment as a mandated investment does not prescribe that the investment must be domestic, nor that the third party, nor that the mandate given to the third party, must be governed by domestic legislation. As appears from the above, there is no restriction pertaining to off-shore or foreign investments.
- 7.4. The definition refers only to "examples" of domestic investments. In our view this reference to "examples" is not sufficient to exclude foreign-based investments from the ambit of the definition of "Mandated Investments". To the contrary, we are of the view that the use of the terminology "examples of domestic investments" without specifically excluding foreign-based investments indicates an intention on the part of the legislature to include foreign-based investments within the ambit of "Mandated Investments".
- 7.5. Therefore, we are of the view that an off-shore investor meeting the definitional requirements of a "Mandated Investment" may be excluded in accordance with paragraph 4 of the Codes.

If you require any further information please do not hesitate to contact me.

Yours sincerely



Safiyya Ratel