

UNDERSTANDING THE CONTINUING CONSEQUENCE PRINCIPLE FOR THE RECOGNITION OF BLACK OWNERSHIP AFTER SALE OR LOSS OF SHARES BY BLACK PARTICIPANTS

1. Who are we?

The Broad-Based Black Economic Empowerment Commission (“B-BBEE Commission”) is established as an entity within the administration of the Department of Trade, Industry and Competition (“**the dtic**”). The Commission was established in terms of section 13B of the Broad-Based Black Economic Empowerment Act No. 53 of 2003 as amended by Broad-Based Black Economic Empowerment Act No. 46 of 2013 (“the B-BBEE Act”). Its role includes overseeing the implementation of the B-BBEE Act and acting against fronting practices.

2. The Purpose of the Brochure

2.1 This brochure aims to guide how B-BBEE participants and companies must treat and measure B-BBEE equity instruments following the sale or loss of shares by black participants in the context of the continuing consequence principle.

3. What does the continuing consequence principle entail?

3.1 The ownership element of the Codes of Good Practice (the Codes) seeks to achieve a substantial change in the racial composition of ownership and management structures of existing and new enterprises. This element should be evidenced by an increase in the number of black people owning productive assets coupled with management control over such assets.

- 3.2 In promoting ownership and management of new or existing enterprises by black people, Code Series 100 on Ownership, for practical reasons, permits measured entities to recognise black ownership after the sale or loss of B-BBEE shares. This element is known as the continuing consequence principle.
- 3.3 A measured entity can only benefit from the continued consequence principle, where the ownership transaction fully meets the requirements of the ownership scorecard which is:
- a) Exercisable voting rights. The rights of a shareholder to vote in meetings or in respect of decisions based on the number or percentage of shares held and the rights associated with the class of those shares in the entity;
 - b) Economic interest. The rights of a shareholder to receive dividends and capital gains or growth;
 - c) Net value in the hands of black people as a result of either direct or indirect participation in the measured entity. This aspect includes loan repayments and issuance of dividends to ensure the repayment of any loans obtained by black participants to acquire the shares in the entity.
 - d) In the event that ownership was held through a Broad-Based Ownership Scheme (BBOS) or Employee Share Ownership Programme (ESOP) or a Trust, the ownership must also have been compliant with the rules in Annexes (B) – (D) of Statement 100 respectively.
- 3.4 Therefore, a measured entity cannot benefit from the continuing consequence principle where the ownership transaction was not consistent with the B-BBEE Act from the onset. For example, where one of the three ownership criteria was not met, such as the flow of economic interest to black people prior to loss or sale of shares, the measured entity cannot claim B-BBEE points by applying the continuing consequence principle.

3.5 This continuing consequence principle does not grant full points on the ownership scorecard. The black participation arising from continued recognition of black ownership cannot contribute more than 40% of the score on the ownership scorecard – that is 40% of the 25 points available. Should the measured entity desire to increase its ownership points, it will have to conclude another B-BBEE transaction.

4. What qualification criteria is used for benefiting under the continuing consequence principle?

4.1 Where the continued consequence principle is applied for recognition of B-BBEE points, it is subject to strict criteria in the Codes, which also prevents circumvention and misrepresentation. This means that not every exit by black shareholders will qualify for recognition.

4.2 A measured entity can recognise a portion of black ownership after a black shareholder has exited through the sale or loss of shares provided that:

- a) The black participant held the shares for a minimum period of 3 years;
- b) The sub-minimum of 40% of net value based on the time-based graduation factor must have been met at the time of sale or loss of shares; and
- c) Transformation has taken place within the measured entity using the B-BBEE recognition level from the period of entry of black participants to the exiting period.

4.3 The following additional rules also apply:

- a) A written tripartite agreement between the lender (if applicable), measured entity, and black participant must record the loan or security arrangement, except where the measured entity is the lender; and

b) The maximum period that the measured entity can claim ownership points under this principle, is the period that the black participants held their shares in the entity.

5. How long can an entity continue to benefit from the continued consequence principle as a result of loss/sale shares by the black participant?

5.1 The benefit under the continued consequence principle cannot be perpetual as it will undermine the essence of transferring ownership to black participants. It is instead a transitional arrangement to recognise a legitimate ownership for a period while the parties engage in a new transaction.

5.2 Therefore, B-BBEE ownership recognition by applying the continued consequence principle is allowed for the same number of years that the black shareholder held his/her shares, provided all the requirements mentioned in paragraphs 3.3 and 4.2 above are met. This means that if the black participant(s) held the shares for five (5) years, the measured entity can only claim ownership points for five (5) years.

5.3 This period of recognition is to allow the measured entity to consider implementing another empowerment transaction with other black participants without losing out on ownership points. As stated above, a scheme that was flawed in its structure or implementation can never qualify under this principle

6. How are ownership points using the continued consequence principle calculated?

6.1 The ownership points attributable to the measured entity under the continuing consequence principle will be calculated by multiplying the following elements:

a) The value created in the hands of black participants as a percentage of the total value of their shareholding in the measured entity, at the date of sale or loss of shares;

- b) The B-BBEE status of the measured entity based on the balanced scorecard at the date of measurement; and
- c) The ownership points that were attributable to the measured entity on the date of sale or loss of the shares.

7. Formula for the calculation of the recognition of ownership after the sale or loss of shares by black participants.

7.1 In calculating the ownership points post-sale of shares by a measured entity, the following formula will be used:

$A = B \times C \times D$
<p>Where</p> <p>A is the percentage of rights of ownership that survive the sale or loss of an equity instrument by a black participant in paragraph 3.8 of Code Series 100.</p> <p>B is the percentage of rights of ownership for each of the indicators in the ownership scorecard that were attributable to the black participant immediately before his or her sale or loss of shares.</p> <p>C is the net value percentage provided for in paragraph 3 of Code Series 100 undertaken for the equity instruments sold or lost by the black participant on the date of the sale or loss. The value of the entity is measurable as at the date of sale or loss of shares.</p> <p>D is the most recently determined B-BBEE recognition level of the measured entity (which must be less than one (1) year old) based on its generic scorecard result for all elements other than ownership determined using Statement 000.</p>

7.2 As indicated in the above table, which is also outlined in paragraph 5 of Annexe 100 (E) of Code Series 100, for purposes of calculating ownership points under the continued recognition points, item “**D**” is determined using a balance scorecard excluding the points achieved for the ownership element.

8. How is the continuing consequence principle verified?

8.1 When determining the ownership points applying the continuing consequence principle, the verification agency or professional as prescribed in the verification manual issued by **the dtic**, ought to apply the prescribed verification methodologies and determine that:

- a) Black people had exercisable voting rights;
- b) Economic interest accrued to black people;
- c) There was net value realisation in the hands of black;
- d) In the event that ownership was held through a Broad-Based Ownership Scheme (BBOS) or Employee Share Ownership Programme (ESOP) or a Trust, the ownership must also have been compliant with the rules in Annexes (B) – (D) of Statement 100 respectively
- e) Determine that the black participant held the shares for a minimum period of 3 years;
- f) The sub-minimum of 40% of the net value based on the time-based graduation factor must have been met at the time of sale or loss of shares;
- g) Determine if the transformation has taken place within the measured entity using the B-BBEE recognition level from the period of entry to the exit of the black participants;
- h) If the shares were lost, review the agreement between the measured entity, black participant and a lender to ascertain the record of the loan or security arrangement, unless the measured entity is the lender and to ensure that recognition does not exceed the holding period;
- i) Recalculate continuing benefits and confirming that it is less than 40% of the score on the ownership scorecard; and

- j) For black participants who have lost or sold their shares, obtain proof of acquisition date and the date when the shares were lost or sold.
- 8.2 Therefore, the role of the verification agency or professional is to conduct an independent verification of the claims made by a measured entity in respect of above-mentioned requirements. This role does not include the provision of advice to the measured entity on the interpretation of the B-BBEE Act as that inherently compromises the independence required to conduct a verification. Such action would amount to unprofessional conduct that is contrary to the objectives of the B-BBEE Act.
- 8.3 The verification agency or professional does not serve as an appeal or review platform on the position of the B-BBEE Commission where an assessment or advisory opinion on the application of the continued consequence principle was issued to the measured entity.

9. Emerging Concerns on the Continued Consequence Principle

- 9.1 The B-BBEE Commission during the execution of its mandate has identified the following concerns on the application of the continued consequence principle to recognise B-BBEE ownership points:
- a) The black ownership is flawed from inception. For instance, where a lack of ownership was held through a trust or BBOS, the object of the trust or BBOS deviated from facilitating the transfer of ownership into the hands of black people.
 - b) Black people were not involved in the operations and decision-making processes of the measured entity.
 - c) Recognition of flawed ownership structures by the verification agency or professional.

- d) No net value realisation for the period black participants held the shares in the measured entity.
- e) Recognition of structures that undermined the ownership requirements as per Statement 100.

How to contact us:

B-BBEE Commission
Block E, 2nd Floor
the dtic Campus
77 Meintjies Street
Sunnyside
0002

Postal Address
Private Bag X84
Pretoria
0001

Tel: (+27) 12 394 1535
Email: MRamare@beecommission.gov.za
the dtic customer Contact centre: 0861 843 384
Website: www.bbbeeecommission.co.za