



WEBBER WENTZEL BOWENS

BLACK ECONOMIC EMPOWERMENT IN SOUTH AFRICA
STATEMENT 103 : THE MULTINATIONALS CODE
RELYING ON EQUITY EQUIVALENTS? DON'T HOLD YOUR BREATH

At a glance: BEE in South Africa and the Multinationals Code

*The ease with which multinationals are able to implement the South African government's **black economic empowerment** ("BEE") policy will influence BEE's success or otherwise. **Statement 103**, the Multinationals Code of the government's **BEE Codes of Good Practice**, which are still in draft form, was introduced to provide specific treatment for multinationals in relation to BEE ownership and make BEE compliance easier.*

An important practical matter dealt with in Statement 103 is ensuring that BEE is measured only in relation to operations in South Africa, so that multinationals are not penalised because black South Africans are not involved in their activities elsewhere in the world.

*Another issue of considerable importance is a framework for multinationals to earn "**Equity Equivalents**", as an alternative to taking on a BEE equity partner. The concept of Equity Equivalents has already appeared in different guises in the **Financial Sector Charter**, **draft ICT Charter** and the **Mining Charter**. Other matters dealt with in Statement 103 are the treatment of the sale, to black investors, of offshore equity interests, businesses or assets.*

Statement 103 applies to (a) multinationals headquartered outside South Africa, (b) those headquartered in South Africa and (c) those who were previously headquartered in South Africa but have now moved these headquarters to another jurisdiction. Equity Equivalents are, however, only available to multinationals that do not and have never had their head offices in South Africa, ie those in group (a).

*Statement 103 modifies **Code 100**, the BEE ownership code, in respect of multinationals. While the (complex) black ownership rules in Code 100 also apply to multinationals, they are modified by Statement 103 in some cases. For example, where Equity Equivalents are available, under Statement 103 these will count as BEE ownership under Code 100.*

In order to be eligible for Equity Equivalents, a multinational must (a) own and control the entire equity in its South Africa affiliate (b) be subject to a "Global Policy", ie a globally and uniformly applied restriction against selling equity or assets in its foreign affiliates, either imposed by the multinational itself, by a regulator or by law and (c) show that it would suffer substantial commercial harm if it were to implement a BEE transaction.

*Equity Equivalents can be developed either by (a) a government department or provincial or local government or (b) a particular industry and incorporated into a **Sector Code** for that industry which has been gazetted as a Code of Good Practice (which means that organs of state and public bodies must apply the Sector Code when determining the BEE status of companies subject to it). In both cases, Equity Equivalents must be approved by the Minister of Trade and Industry. It will therefore be some time before any approved Equity Equivalents are in force. Until then, multinationals will be judged solely on their BEE equity ownership scores.*



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BEE and multinationals

Barclays Bank's recent acquisition of a controlling interest in Absa Bank and Vodafone's recent acquisition of an additional stake in Vodacom are encouraging indications of the confidence that leading international companies have in the South African economy.

These two UK multinationals are investing in South Africa at a time when policies to transform the economy are being vigorously implemented, so that South Africa's economy better reflects its diverse population. While transformation and diversity are the ends of black economic empowerment ("**BEE**"), the BEE Act¹ and the Codes² are the means.

The way in which the South African government applies and multinationals respond to BEE may determine whether South Africa achieves its goal of diversity and transformation, as well as maintaining a respectable economic growth rate.

Statement 103

On 20 December 2005, the South African Department of Trade and Industry ("**the DTI**") released Statement 103 of Code 100, dealing with the recognition of BEE ownership contributions made by multinational companies ("**Statement 103**"). Statement 103 was released with the second phase of the draft Codes.

Statement 103 establishes key measurement principles for measuring black ownership in the South African operations of multinationals, recognises contributions by multinationals to increasing black ownership through the sale of offshore equity interests, businesses and assets and, probably most importantly, provides for a framework for multinationals to earn "Equity Equivalents" that will count towards their

¹ The Broad-Based Black Economic Empowerment Act, 2003 ("**the BEE Act**")

² The draft Codes of Good Practice issued under section 9(3) of the BEE Act. The first phase was issued on 1 November 2005 and the second phase on 20 December 2005.

BEE ownership score, in lieu of selling equity or parts of their business to black South African investors.

The story so far

Separate treatment for multinational companies in relation to equity ownership first emerged in the **Financial Sector Charter**, which was voluntarily developed and signed by representatives of the South African financial sector on 17 October 2003. The Financial Sector Charter provided for three separate relaxations of its equity ownership targets. Two of these were available only to foreign owned financial institutions. First, under the **global policy exemption**, the South African operations of *foreign owned financial institutions* could apply for complete exemption from compliance with the targets under the ownership and control (as well as human resource development) provisions of the charter, if they had in place or were subject to, a global policy against local equity participation³. Companies subject to global policies would thus be scored only the remaining portions of the scorecard. Second, *foreign banking groups with South African branches* were given a wider range of transaction options for which they would receive credits on the ownership portion of their score card; the Charter thus allowed branches of foreign banks to meet the Charter's ownership requirements by participating in certain types of transactions, such as BEE, housing and infrastructure transactions, rather than selling equity. Third, all *financial institutions with fewer than 50 staff members and less than R10 million of "designated investments"* were completely exempted from the Financial Sector Charter.

In the negotiations on the development of the **ICT Charter** (currently in its fifth draft), US IT multinationals, through the American Chamber of Commerce in South Africa, argued that they faced significant barriers to local equity participation (such as the need to protect their IP and the need for integrated internationally managed operations) and that multinational IT companies should accordingly be exempted from equity ownership participation, or at least allowed it to meet this requirement through equity equivalents. As a result, the current draft of the ICT Charter contains a provision allowing ICT companies to apply for a "**Certificate of Approval**" if they believe that they would "suffer inherent commercial harm to their business due to, amongst others legal, technological or policy barriers, which are incompatible with the sale of equity". Unlike the Financial Sector Charter's complete exemption from equity sales, ICT companies that are granted a Certificate of Approval are still required to substitute equity sales

³ A global policy is defined in the Financial Sector Charter as a "globally and uniformly applied restriction, regulation, or directive imposed on a foreign owned financial institution by the parent company or on any financial institution by a regulator which governs that financial institution".

with "approved replacement offerings" by partnering with black businesses in *inter alia* research and development, expansion of manufacturing or assembly plants, new investments or assisting black South African companies to invest in global markets.

The October 2002 **Mining Charter** was the first empowerment instrument that provided for **offsets against equity ownership**, although these are not limited to foreign mining companies. Under the Mining Charter, companies that advance government's policy of increasing the domestic processing of South African minerals are promised lower BEE ownership targets. The Mining Charter provides that "mining companies will be able to offset the value of the level of beneficiation achieved by the company against its HDSA ownership commitments". The Mining Charter envisages that, for example, a diamond mining company will be allowed to sell less than the standard target of 26% of its assets or equity to black investors if it establishes a diamond cutting works which processes a significant portion of the mine's production. Since 2002 however, the Department of Minerals and Energy ("**the DME**") has failed to indicate how companies can take advantage of this provision, despite announcing in 2003 that a "beneficiation offset table" to calculate offsets would "soon" be published. This is a complex task and it appears that talks on the issue between the Chamber of Mine and the DME have proceeded very slowly. Worryingly, the DME has recently downplayed the possibility of earning beneficiation offsets, urging mining companies to meet the equity targets without relying on beneficiation credits. Companies that have significant investments in facilities that process their mining production, such as the dimension stone (granite and sandstone) industry, have been disappointed by the DME's inaction.

To whom does Statement 103 apply?

Statement 103 distinguishes between "Multinational Businesses" and "South African Multinationals". A Multinational Business is a business headquartered in a jurisdiction other than South Africa, which owns or controls a "Local [ie South African] Multinational Enterprise", while a South African Multinational is either:

- a business headquartered in South Africa with "Multinational Affiliates" (in other words, businesses owned or controlled by the South African Multinational in countries other than South Africa); or
- a business which was previously headquartered in South Africa and has moved these headquarters to another jurisdiction, but has retained a South African affiliate.

The primary reason for this distinction appears to be that Equity Equivalents will not be available to South African Multinationals (as defined), even if their headquarters are located outside South Africa.

Locating Statement 103 within the broader BEE framework

Statement 103 is effectively an add-on to Code 100, the Code on BEE ownership (released with phase 1 on 1 November 2005). While Code 100 will also be used to measure BEE ownership in Multinational Businesses and South African Multinationals under Statement 103, their BEE ownership scores will be adjusted to take account of any Equity Equivalents for which they qualify, or any offshore interests sold to black investors.

Under Code 100, ownership comprises 23 points of the total BEE score out of 100, divided into the following indicators:

Points	Ownership criteria	General target
<i>Voting rights</i>		
3 points	for voting rights exercisable by black persons	25% + 1 vote
2 points	for voting rights exercisable by black women	10%
<i>Economic interest</i>		
4 points	for the economic interest to which black persons are entitled	25%
2 points	for the economic interest to which black women are entitled	10%
1 point	for the economic interest to which black designated groups (such as youth and the aged) are entitled	2.5%
<i>Ownership fulfilment</i>		
7 points	for the net asset value held by black people – that is, the true value of what they own after accounting for the extent to which shares are encumbered in favour of a lender	Progressive targets for net asset value are set out in Code 100
1 point	can be earned only when all seven points for net asset value have been earned and the black investors are completely released from all obligations that defer or restrict the enjoyment of ownership rights	
<i>Bonus points</i>		
3 bonus points	for involvement, in a BEE transaction, of new black entrants, co-operatives and black participants in broad-based ownership schemes	

If a company reaches the target for, for example, economic interest held by black persons, it receives the maximum four points. Falling short of the target earns the company points that are proportionate to how close it was to the target. The general targets are set out in Code 100, but specific industry scorecards may (to an extent)

depart from these suggested targets. The points on each indicator are determined by applying the (rather complex) financial formulae found in Code 100.

Key measurement principles

Statement 103, sensibly, ring-fences the South African operations of multinationals for the purpose of measuring their BEE ownership scores. The focal point for measuring BEE ownership in multinationals is thus their "Local Multinational Enterprise" (ie Multinational Affiliates in any other part of the world are excluded from the calculation). The Local Multinational Enterprise is the South African-based enterprise of a Multinational Business or of a South African Multinational.⁴ A few examples may help to illustrate what is meant by a Local Multinational Enterprise.

Example one: A US PC distributor based in California registers an external company in South Africa and establishes a Johannesburg office from which to supply and service the South African market. Its South African branch will be the Local Multinational Enterprise.

Example two: A South African financial services company incorporates separate companies in London and Amsterdam, to provide financial services in these markets. Eventually, its London office outgrows its South African head office and it takes a decision to move its head office to London, but retains its South African operations. Its South African operations will constitute its Local Multinational Enterprise.

Both the PC distributor and the financial services company might need a BEE rating to be eligible to win tenders to provide services to South African organs of state⁵ and public bodies⁶. In order to determine their BEE ownership score, only the value of their Local Multinational Enterprise (ie their South African operations) would be used, and their operations elsewhere in the world would be excluded entirely from the calculation.

⁴ The definition of Local Multinational Enterprise specifically includes external companies (branches)

⁵ Organs of state include: national or provincial departments, municipalities, Parliament, provincial legislatures and Constitutional institutions such as the Commission for Gender Equality, the Commission for the Promotion and Protection of the Rights of Cultural, Religious and Linguistic Communities, the Financial and Fiscal Commission, the Human Rights Commission, the Independent Communications Authority of South Africa, the Independent Electoral Commission, the Municipal Demarcation Board, the Pan South African Language Board and the Public Protector

⁶ Public bodies include: the Air Traffic and Navigation Services Company, the Airports Company of South Africa Limited, Alexkor Limited, Armscor, the Central Energy Fund, DENEL, the Development Bank of Southern Africa, ESKOM, the Independent Development Trust, the IDC, the Land and Agricultural Bank of South Africa, the SABC, the SA Forestry Company Limited, the SA Nuclear Energy

Who qualifies for Equity Equivalents?

Three requirements must be met before a Multinational Business will qualify for Equity Equivalents:

- the Multinational Business must own and control the entire equity in the Local Multinational Enterprise;
- the Multinational Business must be subject to a Global Policy,⁷ *and*
- the Multinational Business must show it would suffer substantial commercial harm if it were to implement transactions designed to give effect to the provisions of Statement 100 (ie if it were to sell equity or otherwise transfer ownership in its Local Multinational Enterprise to black South African investors).

As the definition of Multinational Businesses specifically excludes South African Multinationals, South African Multinationals accordingly *cannot* qualify for Equity Equivalents. Statement 103 has also limited the scope of the Equity Equivalents by adopting, as requirements, variations of both the "Global Policy" requirement in the Financial Sector Charter and the "commercial harm" requirement in the draft ICT Charter. In other words, both tests must be satisfied for the Multinational Business to be eligible for Equity Equivalents.

What are Equity Equivalents?

Statement 103 recognises two possible ways of earning Equity Equivalents:

- a public programme or scheme of any government department or provincial or local government in South Africa which has been approved by the Minister of Trade and Industry ("**the Minister**");
- alternatives to equity ownership provided for in a "Sector Code" gazetted under section 9 of the BEE Act. Sector Codes gazetted under section 9 are industry transformation charters developed by and for a specific industry that, once gazetted, acquire the same status as the other Codes of Good Practice (ie they must be applied by organs of state and public bodies in any BEE-related decisions

Corporation, the Post Office, Telkom SA Limited, the Trans-Caledon Tunnel Authority, Transnet Limited as well as any subsidiary or entity under the ownership control of these public entities

⁷ "Global Policy" is defined in Statement 103 as a "globally and uniformly applied restriction upon the alienation of equity or in the sale of businesses of the Multinational Affiliates of a Multinational Business imposed by that Multinational Business or by a regulator which has lawful jurisdiction over that Multinational Business or by any law of application to the Multinational Business. Where the Global Policy is imposed by a regulator or by a law, such Global Policy must substantially have been in existence prior to the date of promulgation of the [BEE] Act"

eg in developing criteria for licensing; developing procurement policies; the sale of state-owned enterprises etc).

Equity Equivalents example: For example, if the final ICT Charter, gazetted as a Sector Code under section 9, provides for a scheme of Equity Equivalents as alternatives to black ownership, a government department evaluating our hypothetical US PC distributor's ownership score *must* give it credit for any Equity Equivalents it earns on the gazetted ICT Charter Scorecard. For example, if the company does not sell equity, but instead establishes a training facility in partnership with a black IT training institution, for which it earns the equivalent of 10 points out of 20 for ownership on the ICT Scorecard, these points must be taken into account by organs of state and public bodies that evaluate the company's BEE status. The company may therefore score better on the ownership element than a competitor which has sold equity to a black South African shareholder.⁸

Where to from here?

Statement 103 does not itself create any Equity Equivalents, so the debate around earning and scoring Equity Equivalents is only beginning. It is thus likely to prolong the lengthy process of bedding down BEE rankings as a standard feature of government procurement and licensing in South Africa. This debate will take place on at least four levels:

- in government (at national, provincial and local level) in developing programmes and devising scoring systems for Equity Equivalents;
- in the bodies overseeing the existing transformation charters, especially the Financial Sector Charter Council. The industry representatives on the Council will obviously be keen to see the Charter's existing equity equivalents incorporated in some way into the Codes;
- in the development of industry transformation charters for other industries that intend to have their charters gazetted as Sector Codes under section 9 of the BEE Act; and
- in the Ministry of Trade and Industry, as the Minister is required to vet the government Equity Equivalent programmes, and to evaluate Sector Charters that incorporate Equity Equivalents, in order to determine whether they meet the

⁸ It seems likely, however, that the scoring mechanisms adopted will be weighted in favour of companies that sell equity.

requirements to published in the Government Gazette as Sector Codes under section 9 of the BEE Act.

The *ad hoc* nature of Equity Equivalents is, to an extent, inevitable, as each industry has its own challenges that provide opportunities for devising Equity Equivalents. For the financial sector, financing small businesses, agriculture, infrastructure and BEE transactions are social challenges used as the basis for equity equivalents, while in the mining industry, increasing the domestic processing of South Africa's natural resources has long been high on the government's agenda and is thus a logical equity equivalent incentive.

Conclusion

It is telling, however, that in the mining industry and the financial sector, where the concept of equity equivalents has long been agreed in principle, there has been little progress and less consensus on how to incorporate measurable social upliftment initiatives into a BEE scoring system. While Equity Equivalents are intended to be a concession to multinationals, in fact they may simply compound the uncertainty around BEE that many foreign investors find unsettling. On the other hand, a well considered system of Equity Equivalents may provide an opening for government and business to work together on programmes to address South Africa's stark income inequality. In the long run, this may create a more successful legacy for BEE than waves of complex empowerment transactions, the costs of which frequently outweigh their benefits to South Africa's underemployed and impoverished majority. If government is serious about Equity Equivalents, then why not extend them to everyone?

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