

MDA CONSULTING



FIRST AID FOR CONTRACTS



First Edition – January 2014

GENERAL: BEE DEDUCTION : A PENALTY

Introduction

Black Economic Empowerment is entrenched in our legislative system by the Broad-Based Black Economic Empowerment (BBBEE) Act No. 53 of 2003, the stated objective of which, is to:

**BEE DEDUCTION: A
PENALTY
Black Economic
Empowerment (BEE)**

“promote the achievement of the constitutional right to equality, increase broad-based and effective participation of black people in the economy...promote a higher growth rate, increased employment and more equitable income distribution...and establish a national policy on broad-based black economic empowerment so as to promote the economic unity of the nation, protect the common market, and promote equal opportunity and equal access to government services.”

Recent calls by the Black Management Forum, sparked by the tabling of the BEE Amendment ACT, for sanctions enforcing the implementation of BEE provisions has brought to the fore the question of penalties as a sanction for failure to comply with the Act and the Regulations promulgated thereunder.

As the BBBEE Act currently stands, there is no direct penalty for a mere failure to comply with its provisions, as opposed to a misrepresentation of BEE status, such as fronting, which can result in the

imposition of penalties and jail terms.

Enforcement has, rather, been achieved through economic means as various consumers and of particular relevance, the South African Government are not prepared to engage in business dealings with those who are not BEE compliant.

It has, further, become the practice, in the construction industry, to insert a clause in the contract between an Employer and Contractor to the effect that certain additional requirements with respect to BEE must be met, failing

which a deduction will be made from the contract value.

This deduction is dealt with separately from the more conventional penalty relating to the delay to the completion of the works.

What is a Penalty?

The Conventional Penalties Act No. 15 of 1962 governs the imposition of penalties.

In terms of Section 1 of the Conventional Penalties Act:

“(1) A stipulation, hereinafter referred to as a penalty stipulation, whereby it is provided that any person shall, in respect of an act or omission in conflict with a contractual obligation, be liable to pay a sum of money or to deliver or perform anything for the benefit of any other person, hereinafter referred to as a

Disclaimer: The contents of this newsletter does not constitute legal advice. If you have a specific problem please contact MDA on 011 648 9500, at our Durban office on 031 764 0811 or by e-mail on info@mdaconsulting.co.za

creditor, either by way of a penalty or as liquidated damages, shall, subject to the provisions of this Act, be capable of being enforced in any competent court.

- (2) *Any sum of money for the payment of which or anything for the delivery or performance of which a person may so become liable, is in this Act referred to as a penalty.”*

For a provision of a contract to act as a penalty stipulation, therefore, it must require payment of a sum of money or delivery or performance for the benefit of another, as a result of a breach of a contractual provision.¹

Further, under the common law, the term “penalty” means a provision intended to operate in terrorem of the offending party.²

Thus we have a contractual provision, which stipulates that when a further provision of the contract is breached, the offending party will be obliged to pay a sum of money or to deliver or perform something for the benefit of the other party, and which is intended to instil in the offending party a fear of breaching this provision.

Clearly the additional BEE provisions referred to above, and the deduction made in consequence thereof, amount to a penalty stipulation and penalty respectively and are in terms of the Conventional Penalties Act, enforceable.

A further provision which may be found in certain construction contracts is that in addition to the penalty for the failure to comply with the BEE requirements of the Contract, the portion or percentage of the Contract Price which was to be spent in fulfilment of these BEE requirements and was not spent on its intended purpose, will be deducted from the Contract Price.

This too constitutes a stipulation, which is intended to instil in the offending party a fear of breaching the contractual provisions regarding the portion or percentage to be spent on the BEE requirements. But does this constitute a penalty stipulation?

The answer, it is suggested, is yes.

This stipulation, by way of an omission (failure to spend the required portion or percentage of the Contract Price on the BEE requirements) in breach of a contractual provision entitles the Employer to deduct the balance that has not been spent from the Contract price, or in other words, requires the Contractor to re-pay the balance not spent to the Employer.

Reduction of a Penalty

There is, however, a glimmer of hope for a party who breaches such a provision of the contract.

In terms of Section 3 of the Conventional Penalties Act:

“If upon the hearing of a claim for a penalty, it appears to the court that such penalty is out of proportion to the prejudice suffered by the creditor by reason of the act or omission in respect of which the penalty was stipulated, the court may reduce the penalty to such extent as it may consider equitable in the circumstances: Provided that in determining the extent of such prejudice the court shall take into consideration not only the

¹ Plumbago Financial Services (Pty) Ltd t/a Toshiba Rentals v Janap Joseph t/a Project Finance 2008 (3) SA 47 (C)

² Cape Municipality v F Robb & Co Ltd [1966 \(4\) SA 329 \(A\)](#) and Plumbago Financial Services (Pty) Ltd t/a Toshiba Rentals v Janap Joseph t/a Project Finance 2008 (3) SA 47 (C)

Disclaimer: *The contents of this newsletter does not constitute legal advice. If you have a specific problem please contact MDA on 011 648 9500, at our Durban office on 031 764 0811 or by e-mail on info@mdaconsulting.co.za*

creditor's proprietary interest, but every other rightful interest which may be affected by the act or omission in question.”

This Section of the Conventional Penalties Act was considered in *Smit v Bester* 1997 (4) SA 937 (A) where it was held that:

1. The onus is on the debtor to show, on the face of it, that the penalty is disproportionate to the prejudice suffered and to what extent it should be reduced;
2. When the debtor has discharged this onus, the onus shifts to the creditor to refute this; and
3. The court may, on its own, without application by a debtor, exercise its discretion to reduce the amount of a penalty if it appears from the pleadings that it is out of proportion to the prejudice suffered by the creditor.

Further consideration was given to this Section in the case of *Plumbago Financial Services (Pty) Ltd t/a Toshiba Rentals v Janap Joseph t/a Project Finance* 2008 (3) SA 47 (C), where it was stated that:

“[In]... a determination of whether the penalty was out of proportion to the prejudice suffered by the plaintiff...[t]he best method of determining this is to compare what the plaintiff's position would have been had the defendant not defaulted in the contract as opposed to what the plaintiff's position would be should it obtain judgment in the full sum sought.”

It must be borne in mind, however, that this does not apply only to monetary loss as the Conventional Penalties Act requires the court to take into account, not only a creditors proprietary loss, but also every other rightful interest which may be affected.

The weight of the prejudice, which would be given to an Employer's (particularly if this Employer is an organ of State) interest in ensuring compliance with the BBBEE Act, particularly in light of the wrongs this Act is intended to remedy, could very well be hefty.

The generic BEE Scorecard, derived from the Codes of Good Practice on Black Economic Empowerment, takes account of the following:

1. Ownership;
2. Management Control;
3. Employment Equity;
4. Skills Development;
5. Preferential Procurement;
6. Enterprise Development; and
7. Social-Economic Development.

Whether an entity is empowered in terms of the provisions of the BBBEE Act, will depend upon its rating in terms of the above scorecard. Such an entity would have a rightful interest in ensuring that skills, enterprise and socio-economic development schemes, which it is implementing through its Contractors, are successful, as the success of these schemes would in all likelihood have an effect upon its own BEE rating.

Disclaimer: *The contents of this newsletter does not constitute legal advice. If you have a specific problem please contact MDA on 011 648 9500, at our Durban office on 031 764 0811 or by e-mail on info@mdaconsulting.co.za*

Further, the state as an employer has a rightful interest in ensuring compliance with the stated objective of the BBBEE Act.

Whether such weight would be given to a provision that demands compliance in excess of that required by the BBBEE Act is debatable and may perhaps result in a reduction of the penalty.

Conclusion

A BEE deduction, in either form, stipulated in a construction contract meets the requirements of Section 1 of the Conventional Penalties Act and is accordingly, both a penalty stipulation and enforceable.

A Contractor signing a Contract is therefore well advised to carefully scrutinize the BEE provisions thereof to establish whether such a penalty is stipulated and, if so, to ensure that it does not fall foul thereof.

Should it transpire that this penalty is incurred however, there is still the possibility that a court may reduce it.

In drafting such a penalty stipulation, an Employer would therefore be equally well advised to ensure that the penalty which it stipulates for breach of its BEE provisions can be substantiated, and proved to be commensurate with the loss the Employer will suffer as a result of such breach, and further, that the requirements of its BEE requirement provisions are not so far removed from the provisions of the BBBEE Act as to bring into question the weight to be given to its interest in the enforcement thereof.

Author: Michelle Kerr

Disclaimer: *The contents of this newsletter does not constitute legal advice. If you have a specific problem please contact MDA on 011 648 9500, at our Durban office on 031 764 0811 or by e-mail on info@mdaconsulting.co.za*