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CORPORATE & COMMERCIAL ALERT

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WHY THE ENVIRONMENT MATTERS TO YOUR DEAL

Recent publication by the International Panel on Climate Change of its Special Report *"Global Warming of 1.5˚C"* has again brought environmental protection to the forefront of sustainable development discourse. With South Africa being a party to the United Nations Convention on Climate Change and Paris Agreement, concerns of the international community and pressure from fellow state parties incentivises the Department of Environmental Affairs' enforcement division, the green scorpions, to further sharpen their sting.

DIRECTOR OVERBOARDING – CONFLICTS OF INTEREST IN TERMS OF SECTION 75 OF THE COMPANIES ACT, 2008

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Within the M&A arena, increased activity on the part of enforcement officials impacts on the materiality of environmental risks to a proposed deal. These risks include:

- fines of up to R10 million;
- demolition orders;
- stop orders;
- administrative enforcement proceedings, including directives and compliance notices;
- cost recovery proceedings where government authorities undertake remedial measures at their own cost (Authority Recovery Proceedings); and
- significant CAPEX required to: (i) address remediation of pollution or environmental degradation; and/or (ii) upgrade facilities or infrastructure which do not comply with environmental law.

Local non-profit organisations have also recently become particularly vigilant and often institute enforcement proceedings in the public interest where a business is polluting, causing environmental degradation or otherwise not complying with environmental laws.

Companies looking to acquire businesses, assets or shares in companies that impact on the environment are therefore reminded of the importance of including the below environmental considerations within the scope of a due diligence.

Legality of operations

In taking over a business or a company, it would be essential for any purchaser that the acquired business or company continues to operate lawfully during and after closing of the transaction. During the due diligence process, this requires vetting of all material environmental permits, licences and authorisations (Environmental Consents), as well as the empowering statutes to identify any restrictive conditions.

With reference to a sale of business or asset transaction, any restriction on the transfer of Environmental Consents to another holder would have to be identified. Depending on materiality of the Consent, a restriction on transfer could result in a new business owner having to make application for a new Environmental Consent to be issued in its name.

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WHY THE ENVIRONMENT MATTERS TO YOUR DEAL

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The duty of care would fall on a new owner of a business or site in the case of a sale of business or assets.

For a sale of shares, any prohibition on change of control would have similar implications. Often Environmental Consents however contain ambiguous conditions that restrict "change of ownership" of a company or business. Whether such a condition includes a sale of shares would have to be determined from the context and nature of the deal. For example, where an acquirer obtains 100% shareholding in an operating company, from a purposive interpretation it is arguable that the ownership of the business has changed.

Often the situation also arises where all requisite Environmental Consents are not in place, as they have either never been applied for or have expired, or the target company holds the incorrect view that they are not required.

Any application for a new Environmental Consent can become highly problematic in terms of deal timelines as certain Consent application processes are legally required to run for up to 300 days and can have CAPEX implications insofar as an array of environmental specialists have to be appointed and public participation processes undertaken.

Pollution Related Risks

The National Environmental Management Act, No 107 of 1998 (NEMA) creates an overarching duty to take reasonable measures to prevent, minimise and rectify significant pollution and environmental degradation (Pollution Measures). A similar duty of care is catered for in the National Water Act, No 36 of 1998, specifically in relation to the pollution of ground and surface water resources.

The ambit of application of the duty of care is particularly wide, and includes:

(i) a landowner;

(ii) a person in control of land; or

(iii) a person who has the right to use the land on/in which:

   a. an activity or process is or was performed or undertaken; or

   b. any other situation exists, which causes, has caused or is likely to cause significant pollution or environmental degradation.

For a sale of shares, the operating company in which shares are acquired would remain liable for taking Pollution Measures to minimise and rectify pollution previously caused by its operations. This liability can potentially extend to shareholders insofar as:

a) they benefitted from the company not having spent CAPEX on remediating the pollution resulting in the purchase price of the shares being lower; or

b) they are deemed to be in control of the company (which would include factors such as majority shareholding; employees of a shareholder being on the company's board of directors; or the degree of involvement of the shareholder in the environmental management of the company).

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The environmental authorities generally pursue the party who caused the pollution under the "polluter pays" principle.

Failure to comply with the duty of care can *inter alia* result in an entity facing fines of R10 million or liability for the costs of remediation of pollution or environmental degradation if Authority Recovery Proceedings are instituted. The environmental authorities generally pursue the party who caused the pollution under the "polluter pays" principle. It is however possible under NEMA that the environmental authorities can pursue a new owner of a business and, although not yet considered by South African courts, a shareholder in the circumstances discussed above.

To properly manage this risk, audits, correspondence with government officials, directives and compliances notices are imperative to consider during a due diligence. If a due diligence is not conducted and environmental pollution or degradation exists, it is arguable that the purchaser has not complied with the duty of care, thereby increasing the risks noted.

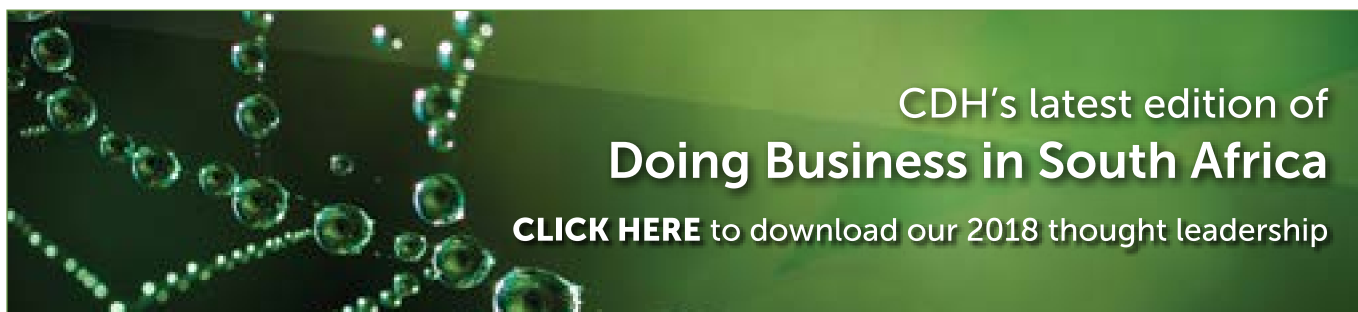
Where there is uncertainty regarding the extent of the pollution, it is often recommended that a baseline environmental study be undertaken to enable parties to "draw a line in the sand" in terms of allocation of liability. Failure to do so can result in a purchaser becoming liable for pollution caused prior to it obtaining shares in the relevant company or acquiring the business or asset(s) in question.

Conclusion

All the above considerations can be properly dealt with and managed in terms of the transaction agreements by the inclusion of, for example, warranties, indemnities, conditions precedent and undertakings by the purchaser and seller . It is often also possible to consult with competent authorities to, where necessary and relevant, agree to an interim arrangement that caters for the company changing ownership.

The importance however is that the risks are timeously identified, particularly with enforcement officials becoming more alert in respect of companies that run operations of a high-polluting nature.

Alecia Pienaar and Sandra Gore



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DIRECTOR OVERBOARDING – CONFLICTS OF INTEREST IN TERMS OF SECTION 75 OF THE COMPANIES ACT, 2008

The practical problem with s75(5) lies in the inclusion of "related persons" .

It seems the frustrations with the Companies Act, 2008 sometimes manifest themselves through overly cautious and broad definitions which cast the net wide enough to include almost anyone (and their second cousin, twice removed). One of these definitions makes a number of appearances in the Act, but for today, we will focus on the infamous "related persons" featured in s75 of the Act, which deals with director's personal financial interests.

The Companies Act clumsily tries to assist by providing that a board decision where the financial interest disclosure has been made in compliance with s75.

Section 75(5) of the Companies Act, 2008 stipulates that if a director has a personal financial interest, or knows that a related person has a financial interest, in any matter to be considered by the board of the company, that director must:

- firstly, disclose the interest to the board; and
- secondly, recuse himself and not take any further part in the consideration of that matter.

The practical problem with s75(5) lies in the inclusion of "related persons" which by itself makes the application of the section far-reaching, but which is further widened by s75(1)(b) which effectively captures any company of which the director or a related person of that director is also a director.

Consider a high-profile individual who serves on several boards. In any material transaction or agreement between two companies where she serves on both boards, she is required to comply with s75 (for each board) even if she does not have any personal financial interest in the matter. This seems like fairly sensible corporate governance.

However, let us consider another common example where s75 causes difficulties - intra-group transactions. You will appreciate that the likelihood of members of a board having common directorships in another company within a group is relatively high. So, in any transaction or agreement between two companies in the same group, the common directors have to disclose their interests and recuse themselves from the meeting, resulting in a dwindling number of directors capable of voting on the resolution. If you have no directors left to deal with the matter after the disclosures and recusals (you could easily have two boards with the exact same directors within a group), a quorum might nevertheless be met, but without anyone left in the boardroom to pass the resolution.

The Companies Act clumsily tries to assist by providing that a board decision will be valid where (i) the financial interest disclosure has been made in compliance with s75, even when no recusal has taken place (the emphasis is on the disclosure); or (ii) where no financial interest disclosure has been made, if the problematic resolution is ratified by an

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Failure to comply with s75 could potentially lead to the invalidity of the board resolution, and possibly even the entire transaction.

ordinary resolution of the shareholders of the company or declared valid by a court. It may be that the best approach is for the directors to make the disclosures and then pass the resolution anyway, with the shareholders ratifying the decision thereafter.

This matters because failure to comply with s75 could potentially lead to the invalidity of the board resolution, and possibly even the entire transaction. Whilst s75 does allow for the shareholders of the company to ratify the decisions made or for an application to be made to court to validate the resolution, either option could be quite an expensive and time consuming ordeal (particularly in the context of a listed company).

The provisions of s75 may lead companies to make more strategic selections in the appointment of directors in order to avoid having directors with technical conflicts in what are otherwise day-to-day transactions. As if finding suitable board candidates wasn't already a sizeable task, imagine going through the difficulty of identifying experienced, appropriately qualified, diverse, non-conflicted board candidates that comply with your BEE requirements, and then adding the criteria of not having any potential technical conflicts, and you and your board of (potentially conflicted) directors may find yourself back at square one.

David Pinnock and Jessica Du Preez

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2017
2nd by M&A Deal Value.
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2nd by BEE Deal Flow and Deal Value.

2016
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1st by General Corporate Finance Deal Flow.
2nd by M&A Deal Value.
3rd by General Corporate Finance Deal Value.

2015
1st by M&A Deal Flow.
1st by General Corporate Finance Deal Flow.

2014
1st by M&A Deal Flow.
1st by M&A Deal Value.
1st by General Corporate Finance Deal Flow.

2013
1st by M&A Deal Flow.
1st by M&A Deal Value.
1st by Unlisted Deals - Deal Flow.

2012
1st by M&A Deal Flow.
1st by General Corporate Finance Deal Flow.
1st by General Corporate Finance Deal Value.
1st by Unlisted Deals - Deal Flow.

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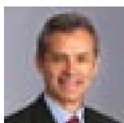

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