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# Safeguarding M&A transactions: Exploring environmental issues

**By Suhara Mohd Sidik**

Rapid industrialisation and economic growth over the past two decades have transformed Malaysia from a predominantly agricultural country to an industrialised one. This transformation has indirectly allowed M&A activities to blossom and caused continuous global expansion and emergence of new markets. This rise in M&A contributes to, amongst other, corporations' improved financial conditions, continued pressure on corporate governance and the emergence of hedge funds.

The key to detecting environmental issues in an M&A transaction is a detailed assessment of the liabilities inherent in the assets to be sold. To manage possible risks, deal makers should decide how to allocate the risk of environmental liabilities that are already apparent or that are apt to be revealed by due diligence. These risks will be a cost to the transaction if they are not treated properly. Ordinarily adopted methods to safeguard transactions against risks would include an indemnity agreement, an insurance policy of the pollution-legal-liability or the cost-cap type, a guaranteed fixed-price remediation contract and a performance-based contract with an environmental consulting company. The party may also choose to initially determine the party responsible for any required site cleanup and the time for executing such act.

Another way to safeguard the M&A transaction is by using a 'material adverse change clause'. Under this clause, a buyer may exit the deal or renegotiate its terms if an unforeseen material adverse business or economic change affecting the target company occurs between executing the acquisition agreement and closing the transaction. Such material adverse change clause also provides the seller with a means of qualifying certain representations and warranties so that immaterial breaches could be ignored, at least for the purpose of closing. Note however that any prior knowledge obtained through a due diligence exercise may preclude the 'unforeseen' element of the breach.

The problem with this clause is that it is difficult to set the benchmark of when an actual adverse change hits 'material' level. As such, material adverse change clause provisions are usually heavily negotiated before the parties embark on M&A transactions. The buyers in the negotiation will seek broad material adverse change clauses for maximum flexibility to exit the transaction while the sellers would prefer narrow material adverse change clauses to ensure that the transaction closes at the agreed-upon price. In negotiating this clause, understanding how courts view these material adverse change clauses and the recent trends in their drafting is essential as the operation of these clauses does not guarantee a dispute-free transaction.

One of the challenges that has to be faced by the deal makers after deals are closed is the management of environmental issues. Sellers can be challenged about how to manage things over time, as issues can remain unsolved for decades. Some companies, like Shell, take a sage step by choosing to have a dedicated group of people to manage post-sale issues including post-closing environmental liabilities. This is a very wise step to take as there is potential risk of post-transaction litigation. To illustrate, a single M&A transaction may spawn different actions such as claims by shareholders for alleged misrepresentations, competitors for possible antitrust liability, federal agencies for regulatory violations, shareholders for derivative actions and environmental cleanup claims for successor liability. On top of all of this, the failure of the transaction itself may give rise to litigation between the parties.

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