South Africa

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

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1. INTRODUCTION/LEGISLATIVE FRAMEWORK

The M&A legislative framework in South Africa comprises both statute and common law. In private M&A deals, where much is regulated by agreement between the parties, the uncodified common law of contract plays a particularly significant role. As discussed in greater detail below, the three primary means of implementing a private M&A transaction – a sale of business, a sale of shares and a merger – are primarily achieved through contract. Statutory law, which plays a more central role in public deals, is more peripheral in the context of private deals, although still important.

1.1 Corporate law

From a statutory perspective, one of the key pieces of legislation is the South African Companies Act, 2008, as amended, which commenced in 2011 (the Companies Act). Amongst other things, the Companies Act prescribes (1) shareholder approval for the disposal by a target of a greater part or all of its assets or business, (2) appraisal rights for dissenting minority shareholders to mergers and sales of business (if all or a majority of the business is sold) and (3) provides for a statutory merger procedure where two corporate entities amalgamate into one. A draft of the Companies Amendment Bill, 2021 (Companies Amendment Bill), being the first major amendment to the Companies Act, was published on 1 October 2021. The amendments proposed by the current draft are not expected to materially impact private M&A transactions but may result in some technical and procedural clarifications.

South African M&A is also governed by the Takeover Regulations, which are contained within the body of the Companies Act. Although the Takeover Regulations apply primarily to public transactions, they also apply to private transactions where there has been a transfer of 10 per cent or more of the shares in the private company (other than between related parties) within the last 24 months. However, one of the amendments under the Companies Amendment Bill proposes to replace this trigger. If enacted, private companies will instead be caught by the Takeover Regulations if that company (1) has 10 or more shareholders with a direct or indirect shareholding in the company; and (2) meets or exceeds the financial threshold of annual turnover or asset value, to be determined by the Minister of Trade, Industry and Competition in general or in relation to specific industries. The Takeover Regulations apply to so-called ‘affected transactions’, which include, amongst others, those which involve a disposal of the whole or substantially the whole of the business of the company or a merger. An affected transaction may not be implemented by a regulated company unless the Takeover Regulation Panel (the Panel) has issued a compliance certificate, or granted an exemption, in respect of the transaction.

The Listings Requirements of JSE Ltd will also apply if either the seller and/or the purchaser are listed on the Johannesburg Stock Exchange, which is the main licensed exchange in South Africa for the listing of equity and debt securities (the JSE). If the purchaser and/or seller are listed on the JSE, shareholder approvals and/or announcements may be required for acquisitions or disposals above a certain size.

1.2 Competition law

The South African Competition Act, 1998, (the Competition Act) also forms an important part of the South African M&A legislative framework. For those transactions which constitute notifiable mergers under the Competition Act, approval of the South African competition authorities is required before the transaction can be implemented. A notifiable merger is one where there is change of control (either legal or de facto control) over a South African company or business and the thresholds (of assets and turnover) set out in the act for mandatory notification are met.

From a threshold perspective, there are two categories of notifiable mergers: intermediate mergers and large mergers – the latter generally involving a more extended approval process, with the approval of South Africa's higher competition body, the Competition Tribunal. Mergers which fall below the prescribed thresholds for an intermediate merger are considered to be small mergers and are not notifiable, although the South African competition authorities retain the ability to call upon the parties to a small merger to notify the merger if they believe it may substantially prevent or lessen competition or cannot be justified on public interest grounds.

In recent years, amendments to the Competition Act have expanded the public interest factors applicable to merger assessments by introducing a new ground requiring the South African competition authorities to also consider the effect that a merger will have on the promotion of a greater spread of ownership, in particular to increase the levels of ownership in firms by historically disadvantaged persons and workers in the market. In 2021, for the first time since the Competition Act came into force, a proposed acquisition was prohibited by the Competition Commission solely on public interest grounds. However, following discussions with the merging parties and the Minister of Trade, Industry and Competition, the Competition Commission changed its view and accepted a conditional approval of the merger which was approved by the Competition Tribunal. However, this is likely to remain an important consideration for M&A transactions in South Africa going forward.

1.3 Exchange (currency) controls

Another consideration that needs to be taken into account in M&A transactions in South Africa is the system of exchange (currency) controls which South Africa has had in place for many years aimed at regulating the flow of capital in and out of the country. These controls (which are set out in the South African Exchange Control Regulations, 1961) have often played a significant role in the manner in which M&A transactions in South Africa, particularly cross-border transactions, are structured. Amongst other things, approval is required for a South African corporate to acquire a shareholding in an offshore entity, for the sale of South African shares or assets to an offshore entity, or for the use by foreign companies of their shares as acquisition capital for the acquisition of South African entities. These exchange (currency) controls have been gradually relaxed in recent years. For example, with effect from 1 January 2021, the restriction on so-called 'loop structures', where a South African resident has an interest in a foreign structure and that foreign structure directly or indirectly owns assets in South Africa and the Common Monetary Area, has been lifted, subject to supervision measures.

1.4 Empowerment and industry specific laws

One unique consideration in the South African context is the regulatory framework aimed at black economic empowerment (BEE), ie, ensuring the economic empowerment of previously disadvantaged black South Africans. From an M&A perspective, one of the key elements of the government's BEE policies has been the targets established in respect of black equity ownership, and most of the major companies in South Africa have concluded transactions in terms of which they have disposed of a significant equity stake (generally up to 25 per cent or 30 per cent, depending on the industry) to black shareholders. It is generally a key commercial imperative for a company to have this significant equity stake held by black shareholders, and in certain cases (such as for the holders of mining or telecommunications licences), it is a legal requirement. The acquirer of the shares in or business of the target will often need to consider how the business's BEE requirements will be met post-transaction.

In particular industries, there is also industry-specific legislation which will have an impact on the transaction – for example, in terms of the South African Mineral and Petroleum Resources Development Act, 2002, a change of control of the holder of a mining right requires the approval of the Department of Mineral Resources.

2. TYPES OF TRANSACTION STRUCTURES ADOPTED IN PRIVATE M&A TRANSACTIONS

2.1 Key structures and agreements

In terms of structuring a private M&A transaction in South Africa, there are three primary options available to the parties – a sale of the shares in the target company from the vendor shareholders to the acquirer, a sale of the target company's business (or a portion thereof) to the acquirer, or a merger.

Historically, a sale of shares was the preferred route for implementing a private M&A acquisition, given that it is usually cheaper, simpler and quicker than a purchase of a business. A sale of shares avoids the logistical issues inherent in transferring each individual asset and liability of a business and allows for the business to continue largely unaffected. In particular, it often avoids the need to procure governmental and/or third-party consents which may be required to transfer things like licences, intellectual property or contracts. One area where potential formalities usually arise is if there are any change of control provisions in any of the company's contracts, or if a change of control of the holder of a licence requires government approval.

A sale of shares also does not necessitate a transfer of employees, as the employees will simply continue their employment with the target company. Although in terms of the South African Labour Relations Act, 1995, the employees of a business which is sold as a going concern will automatically be transferred as a matter of law to the purchaser, the purchaser will need to ensure that it employs the employees on terms and conditions which are no less favourable than those on which the employees were employed by the seller. If, for example, an employee has certain medical aid and pension fund benefits with the seller, they would be entitled to similar or greater benefits from the purchaser.

Since the Companies Act came into effect, and the introduction into South Africa of the statutory merger provisions which provide for one entity to merge into another or for two or more entities to amalgamate into a new separate entity, the market has seen a slow increase in the number of transactions making use of this statutory procedure. The merger procedure provided for in the Companies Act is, on the face of it, relatively straightforward and flexible. The merger procedure has an advantage over the sale of business in that it provides for the automatic transfer of property and obligations of the merging parties, as well as the dissolution by operation of law of non-surviving entities, without the additional costs, formalities and time to transfer the business and need to go through formal liquidation proceedings.

Logistical considerations aside, however, there may be specific benefits for a purchaser in implementing a sale of business. The key advantage of a sale of business is that the purchaser is able to cherry-pick the assets it requires, and only assume known and quantified liabilities. A sale of business also only requires the approval of the shareholders of the selling entity, unlike the merger which requires approval from all merging entities shareholders.

Ultimately, the most appropriate structure for the transaction will depend on the facts of the particular transaction.

For a sale of shares, the main acquisition agreement is a share purchase agreement (SPA) in terms of which the vendor shareholders agree to transfer their shareholding in the target company to the acquirer. For a sale of business, the main acquisition agreement is a sale of business agreement (or sale of assets agreement where only a portion of the assets is being acquired) in terms of which the acquirer agrees to purchase the target company's business as a going concern (or specific assets it wishes to acquire) and assume the liabilities of the target company that it wishes to assume. For a merger, the parties are required by the Companies Act to enter into a merger agreement setting out the terms and means of effecting the merger or amalgamation.

The content of the acquisition agreement varies greatly from matter to matter, depending on the particular transaction. Generally speaking, a sale of business or sale of assets agreement is likely to be a more complex document than an SPA or merger agreement, as the assets and liabilities that are being transferred need to be carefully defined, and the mechanisms of transferring the business or assets needs to be set out. A SPA and a merger agreement, however, will often have a more comprehensive set of warranties, given that the purchaser of the shares in the company is generally at greater risk than an acquirer of the business, who can pick and choose the liabilities that it would like to assume. Whether the transaction is structured as a sale of shares, a merger or a sale of business (or assets), most acquisition agreements will have a number of standard provisions, including clauses dealing with the consideration and manner of payment, conditions precedent to the transaction, pre-transaction and post-transaction covenants, warranties and representations and dispute resolution. These are dealt with in greater detail below.

2.2 Ancillary documents

In addition to the main acquisition agreements, the parties will often enter into heads of agreement setting out indicative terms of the transaction prior to concluding a definitive transaction agreement; an exclusivity agreement pursuant to which the seller agrees not to solicit a competing offer from a third party in respect of the target shares or the target business; a nondisclosure agreement in respect of information relating to the proposed transaction and confidential information to which the parties become privy; and a disclosure letter in terms of which the seller makes certain disclosures against which the warranties and representations in the SPA or the sale of business (or assets) agreement are qualified.

At closing, the parties will also sign certain documents to transfer or register title to the sale shares or assets. These will differ depending on the nature of the assets being transferred (eg, for a transfer of shares, transfer forms will need to be signed and new share certificates issued).

2.3 Tax considerations

Tax considerations generally play a key role in deciding which structure may be appropriate for a transaction. A sale of business, for example, may result in a potential extra level of taxation for the vendors, given that taxes may be required to be paid, both when the assets are sold and when the proceeds are distributed to shareholders. On the other hand, the acquirer may prefer an acquisition of the business, as it will generally be able to avoid any unforeseen contingent or other tax liabilities which the target may have incurred.

Transfer taxes, in the form of securities transfer tax (STT), are payable in respect of a disposal of shares. For shares in an unlisted South African company, STT is payable by the target company at a rate of 0.25 per cent of either the sale consideration or the market value of the shares (if the sale consideration given is less than the market value of the shares) but may be recovered by the target company from the buyer. Certain exemptions from STT may also be available.

A person disposing of shares in a company, a business or assets may be subject to capital gains tax (CGT) or income tax (depending on whether the person held the relevant asset as a capital asset or a revenue asset). Generally speaking, companies pay CGT at a rate of 21.6 per cent. Conversely, companies pay income tax at a rate of 27 per cent.

Value added tax is levied (at a rate of either 15 per cent or zero) on the supply of goods and services by registered vendors. Certain supplies are exempt from VAT. Generally, a sale of shares will be an exempt supply for VAT purposes. The sale of a business as a going concern may qualify for a zero rating (provided that all of the requirements are met). The party liable to account for VAT will depend on the nature of the supply, the parties to the transaction and where the supply is treated as taking place for VAT purposes.

3. PRE-AGREEMENT DOCUMENTATION

It is not uncommon for parties to enter into heads of agreement prior to concluding a definitive acquisition agreement, particularly in complex negotiations, as a means of determining whether or not the parties are agreed on principal commercial points. Usually, heads of agreement will be short, high-level documents and non-binding. Parties tend to avoid legally binding heads of agreement, as they may take as long to negotiate as the definitive acquisition agreement and may end up being of equal length and complexity. Furthermore, an agreement can be void for uncertainty if major terms are left unagreed. To have a legally binding heads of agreement, it is not only necessary to draft and agree upon the principal terms, such as the assets being sold, the consideration, conditions and other major terms, but it is also necessary to negotiate the detailed wording of the warranties and indemnities, the limitations on the liability of the seller or the directors and what disclosure will form an exception to the warranties. In many cases, lawyers will favour not having heads of agreement at all, given that they often take the parties little further and given that the net result may be merely to delay the preparation and negotiation of the definitive acquisition agreement.

The purchaser will often request exclusivity from the target company, either as a binding provision in an otherwise non-binding letter of intent or in the form of a stand-alone agreement. The typical exclusivity arrangement will block the target company from (1) soliciting offers for the subject business, (2) sharing information and (3) engaging in discussions with other potential buyers, except to the extent required in terms of applicable law and/or their fiduciary duties. A purchaser will generally not want to incur the significant time and expense associated with due diligence and transaction negotiations without exclusivity, and will want to avoid serving as a 'stalking horse' for other bidders. However, target companies typically strongly resist granting exclusivity.

It is also fairly common for the parties to enter into a non-disclosure agreement in terms of which each party undertakes not to disclose information relating to the proposed transaction and not to disclose any confidential information received as part of the due diligence process or in negotiating the transaction agreements. Such agreements would usually continue to bind the parties even after the transaction has been completed or terminated.

4. DILIGENCE STAGE

A purchaser will generally conduct due diligence of the company or business which it is looking to purchase, to ascertain, as far as it is possible, the nature and value of the assets and liabilities to be acquired, and confirm possible risks to which the company or business may be exposed. In some cases, such as where the purchaser is a competitor of the business or the seller is anxious for a quick sale and there are a number of interested parties, the seller may deny the purchaser any meaningful due diligence, but otherwise the purchaser will typically be afforded the opportunity to conduct at least a high-level legal and financial due diligence. While the exact scope tends to vary depending on the specific requirements of the purchaser, in South Africa, purchasers tend to opt for a limited scope 'red flags only' due diligence that seeks to: confirm title to the shares or assets that are to be acquired; identify any change of control provisions or assignment restrictions in material contracts that may be triggered by the proposed transaction; and identify any material undisclosed risks and liabilities.

The purchaser will generally look to have the key findings of the due diligence addressed in the SPA or other main acquisition agreement. Typically, material third-party and government consents and other issues requiring actions to be taken are included as conditions precedent, while other risks are typically mitigated by specific warranties and indemnities. The extent of the due diligence which the purchaser is afforded is likely to impact on the extent of the warranties which are given by the seller. Where the purchaser conducts a comprehensive due diligence, the seller is likely to be less willing to give wide-ranging warranties. Where, however, the purchaser has not been afforded the opportunity to conduct any meaningful due diligence, the purchaser is likely to demand a full set of warranties and/or indemnities.

5. MAIN TRANSACTION AGREEMENT

As discussed above, the main transaction agreement for a sale of shares is an SPA; for a sale of business (or assets) is a sale of business agreement (or sale of assets agreement); and for a merger is a merger agreement.

5.1 Formalities

There are generally no formalities for executing transaction agreements in South Africa. In most instances, a signature by a duly authorised signatory is sufficient and agreements need not be signed in the presence of a commissioner of oaths or be executed as a deed. The parties may agree any stricter standards for signature should they wish, such as having all signatures witnessed or requiring every page of an agreement to be initialled by the signatories for evidentiary purposes.

In terms of the Electronic Communications and Transactions Act, 2002, digital signatures are generally enforceable, although certain agreements may not be concluded electronically.

5.2 Consideration

Although the consideration for an acquisition normally consists of, or largely includes, cash, it is not uncommon for the consideration to be, or to include as an alternative, shares of the purchaser – or indeed other forms of property. The merger provisions in the Companies Act provide for a consideration where shares in the merging companies are converted into shares in the merged entity, but also potentially allows for the shareholders of one or more of the merging entities being paid in cash or receiving shares in an entity other than the merged entity (such as, for example, the holding company of the merged entity) as consideration.

The price will normally either be a fixed price, an amount determined with reference to the net asset value of the target (as shown by accounts prepared as at the closing of the transaction), or a figure calculated with reference to the profits of the company, either historical or future.

If a fixed price is agreed with no provision for adjustment by reference to closing date or other accounts, the consideration can be simply stated. It is increasingly common for purchases to be made by reference to the net assets or profits shown by closing date accounts or, at least, for any fixed consideration to be subject to adjustment by reference to them. This provides a purchaser with far greater protection in knowing exactly what it is paying for. Provision is often made for an inventory-taking clause, which regulates how inventory of the business will be accounted for, and how things such as obsolete and damaged inventory will be treated. A price adjustment mechanism is particularly useful in a sale of business where variable assets such as inventory or book debts are being acquired. Amongst other things, it protects the purchaser against the seller managing the assets to be handed over at closing to its advantage. An example would be a scenario where the purchaser is taking over the book debts of the company but is not acquiring the cash and cash equivalents (given that it makes little sense to pay cash in return for cash). This creates an obvious incentive for the seller to accelerate its debtors' book to increase the cash balance upon closing, to the prejudice of the purchaser and the value of the assets which it pays for. A price adjustment mechanism will help protect the purchaser in this regard, by ensuring that it only pays for what it receives.

The consideration is normally settled in full at closing or, where closing accounts are to be made up, shortly after they are made up, together with interest from the date of closing on any under or overpayment at an agreed rate. Provision can also be made for the consideration to be determined by subsequent events, either realisation on an agreed basis of specific assets or future profitability. Provisions relating the consideration to future profitability ('earn-outs') are most common when there are certain key personnel who are vital for the success of the business. In such cases, if all the key people were to leave, the goodwill would be lost and the target's value much reduced. If the key people are also sellers and they know that all or a large part of the consideration for the sale is related to future profitability, they will be more inclined to stay and work to obtain profitability. Although the principle of an earn-out is simple, the detailed provisions are generally not and are often the subject of extensive negotiation. The sellers will usually require some sort of undertaking from the purchaser that if their consideration is related to future profitability, then the purchaser will not do anything which might adversely affect that profitability. Sellers will generally have to accept the risk of changes from outside events, but they will want to restrict internal change and retain substantial management control. The purchaser will therefore typically be constrained in the way that it can deal with the target and its business until the earn-out has expired.

Holdback arrangements, where a portion of the purchase price is held back as security for any claims that the purchaser may have under the agreement, are not uncommon in South African acquisition agreements. Typically, to the extent that the seller agrees to such an arrangement, it will require that the held back amount is kept in escrow by an independent third party (often a firm of attorneys). The agreement will specify the procedure which must be followed before any amount can be released from the escrow account to either of the parties. Generally, such a clause will provide for a retention period which will mirror the length of the warranty period (as discussed below) and will require that the purchaser not only made a claim against the seller, but (to the extent that the seller has not accepted the validity of such claim) have initiated legal proceedings against the seller prior to the end of the retention period. In such a case, the agreement will typically provide for the money to remain in escrow until the legal proceedings have been settled, although the seller may ask for a provision to be made for that portion of the retention amount that is not in dispute to be released from the escrow account.

5.3 Representations and warranties

Much of the negotiation of the acquisition agreement will centre around the representations and warranties. It has become generally accepted that extensive protection is given to purchasers in acquisition agreements, particularly so in the case of a sale of shares where the purchaser is potentially at greater risk.

There are many warranties that are standard to almost any type of acquisition. This would include, amongst other things, warranties regarding the corporate organisation and structure of the company, the books and records of the company, the assets and liabilities of the company, employees and employee benefits, tax, litigation, intellectual property, material contracts, licences and permits, and compliance with all applicable laws. There are also warranties which will be specific to the type of company or business being acquired. For example, if the company being acquired is a mining business, the purchaser would expect specific environmental and regulatory compliance warranties; if the business involves manufacturing, product liability warranties are generally asked for. A warranty that is often seen in South African acquisition agreements is one relating to the BEE status of the target company. As noted above, BEE has become an important legal and commercial imperative for companies conducting business in South Africa, and a purchaser will want some comfort that the company or business being acquired has an adequate BEE rating, or, in cases where a certain percentage of black ownership was required in order for the company to obtain the licences necessary for conducting its business (such as in the mining and telecommunication industries), that these criteria were met. As the level of BEE ownership is also something that is taken into account in determining the BEE rating, an acquirer will also often need to have a plan in place to ensure that there is adequate replacement BEE shareholding, particularly if a certain level of BEE ownership is required for the target company to maintain its key licences and the BEE shareholding has been reduced or eliminated as a result of the transaction.

In cases where the purchaser has been allowed to conduct due diligence of the target, sellers will typically seek to argue that the level of warranty protection to which the purchaser should be entitled should be reduced accordingly. Many sellers will start from the position that warranty claims should be excluded where they relate to matters which have been or ought to have been uncovered in the due diligence process. Broadly speaking, there will be an inverse relationship between the extent of the due diligence which the purchaser has been allowed to conduct and the level of warranty cover which that purchaser can expect in the acquisition agreement. Whether that inverse relationship is actually reflected in the final document is dependent upon the characteristics of the transaction and the relevant bargaining strengths of the two parties.

5.4 Interim period undertakings

As noted above, competition approval is often required for a transaction, and may lead to a significant delay between signature and closing. The purchaser will therefore often seek to place limitations on the seller’s (in the case of a sale of business) or the target company’s (in the case of a sale of shares or merger) ability to do anything which may impact on the value of the business, by seeking undertakings from the seller and/or target company that they will not do certain things during the interim period without the purchaser’s approval. This will include entering into major transactions, incurring large liabilities, hiring or firing of employees and/or distributing profits of the business to shareholders. Given that this may have a significant impact on the seller and/or target company's ability to conduct its business, the seller will often resist giving a too comprehensive set of undertakings in this regard, particularly if there are a number of other conditions precedent, and if there is no guarantee that the transaction will go through.

To the extent that the seller and/or target company agree to such restrictions, they will generally seek to limit their ambit by requiring that it only apply to transactions outside the ordinary course of business, or to matters over a certain specified amount. Care needs to be taken in the case of transactions requiring competition approval that, in giving such undertakings, the purchaser does not implicitly acquire negative control over the business, as this may be considered by the South African competition authorities to be acquisition of de facto control prior to the necessary approvals being obtained. The purchaser may therefore need to ask for less comprehensive undertakings from the seller or target company than it would otherwise normally want. The purchaser may protect itself in other ways, by asking for an adjustment of the purchase price post-closing if the seller and/or target company's actions during the interim period have significantly impacted the value of the business, or asking for warranties as at the closing date that certain actions have not been taken during the interim period, which will then allow the purchaser to claim damages and/or terminate the agreement if such warranties have been breached. The purchaser may also ask for one of its representatives to be able to attend board meetings of the target as an observer during the interim period, although the seller may well resist this, particularly if the purchaser is a competitor.

5.5 Insolvency-related notices (sale of business only)

Another key clause that is often the subject of negotiation in sale of business agreements relates to the provisions of section 34 of the South African Insolvency Act, 1936, in terms of which any company that seeks to sell its business, or a portion thereof, must publish a notice of the intended disposal in the South African Government Gazette and four daily newspapers at least 30 days and not more than 60 days before the intended disposal. This requirement is aimed at alerting all creditors of the company to an intended disposal of the company's business or part thereof. Upon publication of the notice, any creditor may demand immediate payment of any liquidated claim which it may have against the company, even if such claim would only become due and payable at some future date. If the notice is not published as prescribed by the section, then for a six-month period following the disposition, such disposition will be void as against the company's creditors, and, in the event that the company is liquidated during that period, as against the company's liquidator. Thus, the creditors of the company may, in respect of any liquidated debt owed to them by the company, claim against the business or assets of the company which has been disposed of to the purchaser. Likewise, if applicable, the liquidator of the company may choose to ignore the transfer of the business and treat any disposed assets as forming part of the company's estate.

It is therefore in the purchaser's interest that such notices are published prior to closing, and the purchaser may seek the requisite undertaking from the seller in this regard. Given the potential disruption that this is likely to cause to the seller's business and the significant impact that this may have on the seller's cashflow, the seller generally resists giving such undertakings, and will instead ask that the parties agree to waive giving such required notices, in return for the seller indemnifying the purchaser for any claims that may be made against it. Provided that the seller is a reputable organisation which is unlikely to have significant unpaid debtors, and which has the wherewithal to make good on its indemnity, the purchaser will often agree to this, particularly in light of the impact that the publication of such notices may have on the timing of the transaction and the cashflows of the business. To the extent that the seller is selling all or most of its business, however, the purchaser will generally require an indemnity to be given by a parent or sister company of the seller who will be able to make good on such indemnity. To the extent that the purchaser agrees to acquire all of the liabilities of the seller as part of the acquisition of the business, such an indemnity may not be necessary, and the parties may just agree to waive the publication of the notices.

5.6 Non-compete and restraint of trade undertakings

It is common that a purchaser may request from a seller a non-compete undertaking of some sort. Generally, the willingness of the purchaser to acquire the business or target company may depend on the seller giving certain undertakings, such as not to use a similar name in a competing business, perhaps not to compete at all for a particular period, not to solicit any of the employees for a particular period or merely to continue certain trading arrangements. Any provisions of such nature which may restrict the seller’s future trading ability need to be considered, however, in the light of the relevant South African law, and in particular South African common law.

Under South African common law, covenants in restraint of trade are only enforceable to the extent that they are reasonably necessary for the protection of the party's legitimate interests. On the sale of the company or business, the purchaser has a legitimate interest in ensuring that the seller does not derogate from its sale by seeking to retain some of the goodwill which the purchaser would expect to go with the company or business. What is reasonable, however, varies from case to case, and will depend completely on the facts of the particular transaction. The type of restraint that is required will be relevant. An undertaking not to compete under a similar trading name, for example, is likely to pass muster but an undertaking not to compete at all will, in all likelihood, have to be limited to the business as carried on at closing (and not areas into which it subsequently develops). Other important considerations are the duration and the geographical extent of the restraint. Typically, a restraint will be for a period of one to three years after closing; anything more than five years is likely to be problematic. From a geographical perspective, the starting point will be to limit the restraint to the area in which the business is conducted as at the closing date, although a purchaser may be able to justify a restraint that extends to areas where the business is likely to expand in the near future.

5.7 Arbitration

Arbitration is the favoured method of dispute resolution in South African acquisition agreements. Generally, litigating in the South African courts can be an expensive and lengthy process, and South Africa has a well-developed arbitration infrastructure and legislative framework (both in terms of international and domestic arbitrations), which offer a number of advantages, including the relative speed of the arbitration process and an international arbitration framework that is globally accepted and will be familiar to foreign parties and legal counsel.

If the parties agree to a specific set of arbitration rules to govern the arbitration, they should take into account whether the rules require the arbitration to be administered by a specific body and the resulting administration fees. The parties should also consider that a mechanism exists (either in the agreement or in the arbitration rules themselves) to appoint an arbitrator where the parties do not agree on one and whether the relevant process would result in an appropriate arbitrator being appointed. The parties may wish to specify that someone with relevant industry experience and knowledge decides any dispute.

In some cases, it may be appropriate to agree to more than one arbitrator. This would be in cases where the outcome is of major consequence to the parties and the contribution of more than one mind is appropriate. It would also be appropriate to do so in instances where the arbitration agreement concluded between the parties and/or the applicable arbitration rules do not cater for an appeal mechanism. When using more than one arbitrator, it is important to agree on an odd number to prevent a deadlock between arbitrators.

If the buyer or seller is an offshore entity, they may often request that arbitration or dispute resolution is held in a neutral venue, to ensure the independence of the process. The South African party will generally resist this. Due to the relative weakness of the South African currency, arbitration or dispute resolution in an offshore jurisdiction will be prohibitively expensive for them. In these circumstances, the South African party may be willing to consider applying alternative substantive governing laws or procedural laws to the proceeding in exchange for an agreement that the venue of the arbitration will be South Africa. Of course, with the numerous changes to the conduct of proceedings that have unfolded as a result of the Covid-19 pandemic, it is also possible for parties to agree to have portions of a matter, or indeed the entire matter, heard virtually. Many arbitral institutions have amended their rules to this effect. What is decided will generally depend on the bargaining strength of the parties involved.

To the extent that the parties do not elect to go the arbitration route, they will typically seek to agree to submit any dispute between them to the jurisdiction of a particular court or forum. They will also typically agree on the governing law that will apply to the agreement.

6. TYPICAL CONDITIONS TO CLOSING/RELEVANT REGULATORY REGIME

The conditions of closing to which the acquisition agreement is subject vary from deal to deal. One of the most common conditions is approval from the South African competition authorities. As noted above, a merger which meets the prescribed thresholds must be notified to the South African Competition Commission, and the transaction cannot be implemented until such approval is obtained. Competition approval may take up to 60 business days (in the case of an intermediate merger) and four months (in the case of a large merger), so it is often one of the key factors affecting the timing of a transaction. It also generally means that there may be a long period between the signature date and the closing date, which results in extensive negotiation around issues such as how the business should be managed during the interim period and the extent to which the seller should be liable for a breach of warranties at the closing date as a result of events arising during the interim period.

If a cross-border transaction is involved, approval of the Financial Surveillance Department of the South African Reserve Bank may also be required: this may need to be a condition precedent to the agreement. Approval may, amongst other things, be required in advance if a South African entity is seeking to acquire an offshore entity or if an offshore entity is looking to purchase South African assets (such as intellectual property). Approval is also required if warranties are given by a South African entity to an offshore entity before such warranties can be enforced. Strictly speaking, such approval is only required when the purchaser is looking to enforce the seller's warranties, but a purchaser will generally want to get such approval upfront to have certainty that the warranties can be enforced. If an offshore entity acquires shares in a South African company, such shares will need to be endorsed 'non-resident' by the South African exchange (currency) control authorities. This does not need to be a condition precedent to the transaction; it is a straightforward process and may be done post-closing. If it is not done, it does not affect the validity of the transaction, but until such endorsement is obtained, no dividends can be paid out in respect of such shares nor can the purchaser repatriate any funds received for the shares should it subsequently sell the shares to a South African purchaser.

In particular industries, where a licence is required to operate the business, the approval of the relevant authorities will generally be required for the transfer of the licence (in the case of a sale of business) or a change of control of the licensee (in the case of a sale of shares or merger). In case of such a requirement, the approval will need to be a condition precedent to the agreement. Industries where such approvals are likely to be required in South Africa include the mining, telecommunications and banking industries.

In terms of the Companies Act, any sale by a company of all or the greater part of its business or a merger requires a special resolution of the shareholders of the company (being 75 per cent of the disinterested shareholders voting at the meeting called to consider the resolution). This therefore needs to be a condition precedent to any sale of a business which involves all or a majority of the business being transferred or in case of a merger. The Companies Act unfortunately does not define what is meant by 'the greater part' of the company's business (although it does set out the mechanism and prescribed manner in which to fairly value the disposal of a company that is governed by the Takeover Regulations). In situations where not all the business is being sold, consideration needs to be given to whether this constitutes a 'greater part' of the business in order to determine whether such approval will be obtained. Often, in situations when it is not completely clear, the parties may in any event make the obtaining of such a resolution a condition precedent in order to be on the safe side in this respect.

A merger or a sale of all or a greater part of a business will trigger appraisal rights for shareholders who vote against the transaction. Dissenting shareholders who vote against any of the aforementioned transactions may also apply for a court review of a transaction, and if more than 15 per cent of shareholders vote against, an automatic court review is required (unless the company decides to treat the resolution as a nullity). It may be made a condition precedent to the transaction that no court review process is initiated or required.

A condition precedent that is often required by the purchaser in sale of business agreements is that approval is obtained for the assignment of certain contracts from the seller to the purchaser. Even where such contracts do not have a strict prohibition on assignment without the consent of the counterparty, a delegation of the seller's obligations under such contract will, as a matter of South African common law, require the consent of the other party. The purchaser will therefore generally want certainty that such consents will be obtained – although, for matters of practicality, this will usually be confined to those contracts which are particularly material to the business. One of the major advantages of implementing a transaction by way of a merger is that assets and liabilities are assumed by the surviving entity by operation of law; therefore, that there is no need to obtain approval for the assignment of contracts, except in limited circumstances where the contract expressly contemplates and restricts a statutory assignment. In the case of a sale of shares, where consent of a counterparty to a material contract is required if there is a change of control of the entity in which the business is housed, the purchaser will want to make it a condition precedent to the transaction that such consent is obtained.

7. CLOSING ACTIONS

A closing meeting is typically held (either in person or, increasingly, virtually) after it has been confirmed that all of the conditions precedent have been satisfied and that closing can proceed.

At the closing meeting, the seller would typically deliver documents of title (share certificates and share transfer forms in the case of a sale of shares) and other ancillary documents required at closing to the purchaser. In the case of a sale of business or assets, the seller would provide the purchaser with access to the premises from where the business being acquired is operated or where assets are located or otherwise facilitate access as appropriate in the circumstances.

Payment of the consideration (or agreed portion) is usually only effected by the purchaser once it is satisfied that it can take ownership and control of the target company or business from the date of closing. Generally, the closing meeting is concluded and the transaction is regarded as being implemented when the purchaser provides evidence to the seller of such payment being made, although the seller will sometimes require the funds to be credited in its bank account – particularly in the case of cross-border payments when a wire transfer could take a few days to be completed.

8. POST-CLOSING

It is not unusual for the parties to agree to post-closing undertakings that are not considered to be sufficiently material to hold up the transaction as conditions precedent or can otherwise only be effected post-closing. For example, it is not uncommon for the purchaser to undertake to release the seller or its affiliates from any guarantees or similar arrangements it has made to third parties in respect of the target company or business being sold.

Another post-closing undertaking which is typically included in a sale of business agreement is an obligation on the seller to give the purchaser reasonable access to its books and records as the purchaser may require for the purposes of its tax affairs or for the continued operation and management of the business.

As noted above, as a matter of South African common law, except in the case of a merger in respect of which contracts are assigned by operation of law, even where there is no express prohibition on the assignment of a contract, the delegation of the seller's obligations under a contract will require the consent of the counterparty. Although in respect of material contracts that need to be assigned as part of a sale of business and where the obtaining of such consent will therefore often be made a condition precedent to the agreement, this requirement is not necessarily practical for all contracts to which the company is a party. Accordingly, it is usual in a sale of business agreement to include a clause regulating the manner in which those contracts where consent has not been obtained will be dealt with. Typically, the clause will provide that, to the extent possible, the purchaser will perform all the seller's obligations under the contracts as if it were a subcontractor to the seller, and the seller will exercise all its contractual rights for the benefit of the purchaser and will pay to the purchaser all amounts paid to it. It will also provide that to the extent this is not possible, the purchaser and the seller must cooperate to find the best manner to achieve their objective.

Specific regulatory requirements will be dependent on the nature of the target business: eg to the extent the target company holds certain regulatory licences, it may be required to make post-closing notifications to the relevant regulatory authorities.

As discussed above, STT is payable in respect of a disposal of shares. Arrangements are usually made for the target company to settle this amount directly with the South African Revenue Service within the prescribed time period post-closing, although the purchaser is then required to repay this amount to the target company unless otherwise agreed.

Where an offshore entity acquires shares in a South African company, such shares will need to be endorsed 'non-resident' by the South African exchange (currency) control authorities. This is typically done post-closing by the South African company's local commercial bank if such bank is an authorised dealer acting under delegated authority of the South African Reserve Bank.

While share transfers are not currently registered in South Africa, any amendment or replacement of the constitutional document of a South African company (known as its memorandum of incorporation) would need to be filed and registered with the South African Companies and Intellectual Property Commission (CIPC) to take effect. Other changes in the company's details that are registered with CIPC, such as its directors, are also required to be filed with the CIPC within 10 business days of the change taking effect.