Mining industry directors in the firing line

The impact of the Mineral and Petroleum Resources Development Act 28 of 2002 on mining companies' liability insurance

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Introduction

In recent years there has been an increased focus on corporate governance matters worldwide. The duties and responsibilities of directors of companies have come under close scrutiny, with shareholders increasing their demands for greater responsibility and accountability. Media attention and pressure groups have also had their effect. Governmental actions have supported these demands and directors have witnessed sweeping legislative changes imposing more onerous duties and liabilities than formerly imposed upon them at common law and in terms of the Companies Act. At the same time, the power of regulatory bodies has been increased to enforce this legislation and make someone pay to remedy an alleged infringement. Breach of such duties may incur personal or criminal liability, or both.

Environmental protection legislation has become a particularly prevalent feature in this regard, and the number and complexity of statutes concerning the environment have increased over the past few years. Directors of South African companies will be familiar with relevant acts such as the National Environmental Management Act 107 of 1998; Conservation of Agricultural Resources Act 43 of 1983; Hazardous Substances Act 15 of 1973, as well as the National Water Act 36 of 1998. Now the directors of mining companies are faced with the Mineral and Petroleum Resources Development Act 28 of 2002.

Material provisions of the Minerals and Petroleum Resources Development Act 28 of 2002

The relevant provisions of the new act for the purpose of this paper are:

Environmental Management Plans (EMP) under the old act and the new act

Under the Minerals Act 50 of 1991, section 39 required the submission and approval of an EMP prior to the commencement of any prospecting or mining operations. However, the Director: Mineral Development could, on application in writing, exempt a holder of any prospecting permit or mining authorization from complying with this requirement or could grant him an extension of time within which to comply with the provision.

In terms of the new act, an environmental impact assessment and an EMP will be required for a mining right and an EMP will be necessary for a reconnaissance permission, prospecting right and mining right. No provision has been made in the new act to apply for an exemption from these requirements (although the transitional provisions mention this possibility). It therefore appears that the right to prospect or mine will not become effective unless the EMP is approved and operations may not begin unless approval is received from the DME. In this respect, the new act is more onerous than the old act.

An old order mining right will only be converted into a mining right if the applicant has an approved EMP. An EMP approved in terms of the old Minerals Act will remain in force, although the Minister may order an amendment to bring it in line with the new act.

Prospecting and mining rights

Under the old act, a mineral right was a real right, which could be ceded, leased, assigned, etc. to a third party. Under the new act, all mineral rights will vest with the State, and the State will issue prospecting and mining rights to applicants who fulfil certain criteria. The added criteria under the act can be summarized as follows:

- The requirement for a pre-approved EMP, which has been mentioned previously
- The requirement for what the act describes as 'the provision, financially and otherwise, for the prescribed social and labour plan.' The act is silent on what would constitute the 'prescribed social and labour plan.' In the absence of the published regulations, speculation on what may constitute a social plan varies from the supply of clean drinking water in perpetuity, to the provision of anti-retroviral drugs according to the recent example by Anglo American Corporation. Whatever form the social plan finally takes, the requirement for such a plan is certainly more onerous than what is currently contained in the Act.
- Mining operations must begin on the orebody to which the mining right relates within one year from the granting of the mining right by the Minister. This has become known as the 'use it or lose it' clause.

The transitional arrangements for the conversion of old order mineral rights to new order rights provide that old order rights will remain valid for five years, during which time the company must comply with the act.

Section 38(2)

This section states 'Notwithstanding the Companies Act,

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1973 (Act No. 61 of 1973), or the Close Corporations Act, 1984 (Act No. 69 of 1984), the directors of a company or members of a close corporation are jointly and severally liable for any unacceptable negative impact on the environment, including damage, degradation or pollution advertently or *inadvertently* caused by the company or close corporation which they represent or *represented*'

This section of the act is more onerous in comparison to existing law in that:

- Prior to the act coming into force, the potential risk which directors faced under the existing environmental legislation depended on the failure by the director to take reasonable steps that were necessary in the circumstances to prevent the harm. Accordingly, a breach of a duty of care associated with an element of management or control was a necessary precondition for liability. On the face of it, the determination of personal liability of directors for environmental harm is now not dependent on some level of operational control by them or the establishment of a directing mind and will of the corporation. In terms of section 38(2), directors may be held liable for corporate environmental harm, which arose outside of their duty to manage the corporation's business and activities, or which fell beyond their powers to direct its affairs. The act implies liability, notwithstanding the absence of intention, negligence or a duty of care on the part of the directors.
- It is not clear whether such damage, degradation or pollution must have occurred at the time when the person was a director. No clear court interpretation on this point currently exists.

One other area of concern is what constitutes an 'unacceptable negative impact on the environment'. By its very nature, mining must have a negative impact on the environment. The question is 'what is an acceptable negative impact and what is an unacceptable negative impact?'[1] We will consider this question later in this article.

Insurance implications

We now turn to an analysis of the implications that the new act has on existing liability insurance cover.

There are two relevant classes of liability insurance to consider:

General liability

A general liability insurance policy normally provides indemnity for the company and its directors and employees for all sums which the company, directors and employees (the Insured) shall become legally liable to pay in respect of injury or damage occurring during the period of insurance in connection with the business. Injury and damage will be defined within the policy wordings; these definitions can vary from a very narrow interpretation to one that is reasonably wide.

There are normally two very important and relevant cover exclusions to take into account:

- This policy does not cover liability for injury or damage directly or indirectly caused by seepage, pollution or contamination. Sometimes cover is available where such seepage, pollution or contamination is caused by a sudden, unintended and unexpected happening.
- This policy does not cover liability for the cost of removing, nullifying or cleaning-up seeping, polluting or contaminating substances. Again it may be possible to extend the cover for a sudden, unintended and unexpected happening.

The question that then arises is: 'What cover is afforded in terms of a general liability policy to the company and its directors for an unacceptable negative impact on the environment, including damage, degradation or pollution?'

As far as pollution is concerned, it is likely that there will be no cover for the company or its directors in view of the exclusions mentioned above.

As far as damage, degradation or any other negative impact on the environment is concerned, the answer depends on whether the effect on the environment falls within the definition of damage mentioned in the policy. Many effects may not fall within this definition and hence the costs of rectifying these effects would not be covered by the policy.

Directors' and officers' liability

A Directors' and Officers' Liability policy (D&O policy) typically covers a claim first made against a director or officer (the Insured) for any wrongful act committed or alleged to have been committed by them in their capacity as directors or officers of the company.

A typical definition of a wrongful act could be 'any actual or alleged breach of duty, breach of trust, neglect, error, misstatement, misleading statement, omission, and breach of warranty of authority or other act by the directors or officers in their respective capacities as a director or officer of the company, or any matter claimed against them solely because of their status as a director or officer of the company'.

Once again, there will be an exclusion relating to pollution. Under a D&O policy it is normally a total exclusion on the following lines:

The insurer shall not be liable to make any payment for loss in connection with any claim made against the insured arising out of, based upon or attributable to or in any way involving, directly or indirectly, the actual, alleged or threatened discharge, dispersal, release or escape of pollutants; or any direction or request to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants, nuclear material or nuclear waste.

A D&O policy also typically excludes claims for damage to or destruction of any tangible property, including loss of use thereof.

Would then a director have cover under a D&O policy for 'any unacceptable negative impact on the environment, including damage, degradation or pollution' as contemplated by Section 38(2) of the new act?

Considering the definition of wrongful act it may be argued that since the (definition) of wrongful act includes the words 'or any matter claimed against them solely because of

[1]Acknowledgement for this insight to Amanda Stobart, Webber Wentzel Bouwens Attorneys

their status as a director, officer or employee of the company', it is likely to include a claim brought in terms of section 38(2) of the M&PRD Act.

However, if the director is held liable in terms of the act for pollution of the environment, he/she will have no cover in terms of the policy in view of the exclusion relating to pollution.

Where the unacceptable negative impact is not pollution or waste related, insurers may attempt to rely on the exclusion of claims for damage to or destruction of tangible property. It is arguable that the claim is not for damage to or destruction of tangible property, but for the liability arising as a result of the unacceptable negative impact on the environment caused by the company. There is, however, enough doubt to be concerned that insurers could avoid liability.

It is worthwhile noting, that some local insurers have expressly excluded any claim arising out of or relating to the MR&PD Act; the sentiment being that, in the absence of a clear definition of 'unacceptable environmental impact', the insurance industry is unable to quantify the risk that it faces and as such a market for such exposures is unviable.

Likely application of the law

Since it seems unlikely that insurance cover can be used as a 'protection' against the full implications of the new act, consideration should be given to how the act will be applied by the courts.

According to Christo Reeders, a director of Bell, Dewar & Hall attorneys:

- Our common law provides that a director will be criminally liable for unlawful acts committed by a company where a director is in a position to prevent the unlawful act and intentionally fails to do so
- In terms of section 424 of the Companies Act, directors can be held personally liable where, upon the winding-up or judicial management of a company, it appears that any business of the company was carried on recklessly or with intent to defraud creditors, or for any fraudulent purpose
- This liability of directors has been extended by section 34(7) of the National Environmental Management Act, which provides that any person who is or was a director at the time of an environmental offence described in a schedule to the act shall themselves be guilty of the offence if the offence resulted from a failure by the director to take all reasonable steps 'necessary under the circumstances to prevent the commission of the offence'
- The promulgation of section 34(7) of the National Environmental Management Act and section 38(2) of the M&PRD Act indicate a clear intention by Parliament to hold the directors of a company accountable for environmental pollution caused by that company.

Section 38(2)

- The drafting of section 38(2) is imprecise and there remains uncertainty concerning its scope and application.
- It is important from a practical point of view to consider in which circumstances the provisions of section 38(2) are likely to be relied on. In most instances, where a company is legitimately mining, most of the company's environmental impacts will be addressed by the environmental management programme
- The authorities conduct inspections of mines and have the right to order the holder of the right to take measures to address environmental impacts and to comply with their legal obligations. This mechanism, together with ensuring adequate and properly monitored environmental management programmes, is likely to remain the most common tools used by the authorities to ensure compliance with environmental law
- It seems then that section 38(2) would most likely be relied on in the following circumstances:
  - in civil proceedings where it is difficult to establish the usual elements and evidentiary burden required by the common law of delict
  - where mining has taken place in contravention of the ordinary statutory requirements (without the establishment of an EMPR and financial provision for rehabilitation)
  - where the mining right holder has ceased to exist, or has no assets and has made inadequate financial provision for rehabilitation
  - where it is considered that proceeding against directors would deter an unacceptable detrimental impact or where there is public pressure to 'make an example' of the directors.

It is important to note that section 38(2):

- does not establish a criminal offence, but rather makes directors 'liable' for unacceptable negative environmental impacts caused by the company
- fails to make it clear what the consequences of the liability are, although the liability would, presumably, generally entail damages either for loss, or the reduction of value of property, or for costs incurred in remediation
- does not make it clear as to who may rely on the provisions of section 38(2). It could arguably be the State or any other legal person
- does not specify that it is applicable to only companies in the mining sector.

Although it may be arguable that section 38(2) must be limited to the mining sector, it is certainly not limited to only the mining right holder, like many of the other provisions regarding environmental obligations and responsibilities in the M&PRD Act. The sub-section could therefore be used to hold liable parties such as contract miners, toll miners, those responsible for the beneficiation of minerals, or transporters of minerals.

Furthermore, the M&PRD Act does not give any indication of what an 'unacceptable negative impact' may be

- Mining and other commercial endeavour will inevitably have some impact on the environment

- Presumably if the impacts of the mining activities are accurately described in the environmental management programme ('EMP') and the EMP is accepted by the minister, those impacts will not be 'unacceptable'. However, it should be noted that the discretion of the minister to reject an EMP seem limited where the EMP complies with the technical requirements set out in the M&PRD Act.
- A negative impact will presumably be an impact that causes harm, damage or injury to health, property or the environment.

Use of the word 'unacceptable' seems to imply that not all harm, damage or injury to health, property or the environment will give rise to liability and the courts will have to make a judgement as to whether the negative impact is acceptable or not, having regard to the usual impacts associated with that activity, the principles in the National Environmental Management Act and the M&PRD Act and, presumably, the benefits of the activity. This uncertainty will discourage reliance on section 38(2).

Comparison with Australian Law

We have established that South Africa has, in some senses, taken the lead in terms of having some of the most onerous environmental legislation around. However, most of our legislation remains to be tested in courts. We can thus learn from foreign experience. Below, a brief outline of the evolution of Australian law and its application are given.

Evolution of Australian Law

Australian environmental law has also followed a process of evolution. Whereas previously in some jurisdictions the prosecution was required to prove, beyond reasonable doubt, that the offence occurred with the consent, connivance or neglect of the director or manager, this is no longer the case. Proposed amendments to the Western Australian Environmental Protection Act 1986 in particular will see directors and other officers concerned in the management of a body corporate being held personally responsible for proving their innocence if they are charged for an environmental offence committed by the companies in which they hold office.

These proposed amendments will bring the Western Australian legislation into line with environmental laws in other Australian jurisdictions, particularly New South Wales, Victoria and Queensland, that have 'deemed liability' provisions for company directors and officers[2]. Under the concept of 'deemed liability', where an offence is committed by a corporation, the director and (in most jurisdictions) other officers concerned in the management of the corporation are deemed to be liable for the activities of the corporation and may personally be prosecuted for the offence.

[2]The test in South Australia and Tasmania is somewhat different. In these states, the prosecution must prove that the officer of the body corporate 'knowingly promoted or acquiesced' in the contravention of the legislation. This evidentiary burden, borne by the prosecution, is not as severe as under the existing Western Australian legislation but falls well short of the deemed liability provisions in Victoria, New South Wales and Queensland.

These provisions are similar to those contained in our National Environmental Management Act of 1998 and new MR&PD Act.

Application of Australian law

However, in terms of prosecutions under the Australian regime, the number of prosecutions remain relatively few. Firstly, it is within the discretion of the relevant regulatory authority to prosecute a director or officer where a corporation has committed an offence. In exercising this discretion, the prosecuting authorities normally have regard to matters such as the magnitude of the offence and its impacts, and the culpability of the company director or manager. The circumstances in which environmental authorities elect to prosecute individual company directors and managers are usually set out in published prosecution guidelines.

For example, prosecution guidelines issued by the New South Wales Environment Protection Authority (NSW EPA) specify that the decision to prosecute a director or manager will be a question of fact, depending on whether there is evidence linking a director or manager to the corporation's activity that resulted in the offence. The NSW EPA requires more than mere evidence of the scope of the director or officer or their capacity to influence the conduct of the company. In this, the application of Australian law is more advanced than in South Africa.

Secondly there are a number of defences available to directors:

- the defendant had no knowledge of the commission of the offence
- the defendant was not in a position to influence the conduct of the corporation
- the defendant used due diligence to prevent the occurrence of the offence
- the corporation would not be found guilty by reason of it being able to establish a defence to the charge.

As environmental legislation becomes more onerous, the need for a strong defence has become imperative for directors wishing to avoid personal liability.

The statistics bear this poor prosecution record out: according to the EPA, prosecution statistics for 2002, where only three out of the 18 prosecutions brought against Victorian companies were also brought against the director (although there were 11 in 2000!), one of 10 in Queensland and one of four in Western Australia. In New South Wales none of the 102 environmental prosecutions in 2002 were brought against a director of a company, nor were any of the five prosecutions in South Australia.

While this data suggests that prosecution of company directors and managers is comparatively rare, this still represents a significant increase in the number of such prosecutions undertaken before the mid- to late-1990s. Moreover, the risk of personal liability must be weighed against the substantial penalties that may be imposed on a director or other officer following a successful prosecution.

Different penalties apply in each jurisdiction in relation to the conviction of an individual under the 'company officer' provisions of environmental laws. The maximum penalties in Australia are $500 000 and seven years' imprisonment.

The first case of a director being jailed for an environmental offence occurred in Western Australia in 1995. Since then, a number of company directors and managers have been imprisoned for contravening environmental laws in New South Wales and Queensland.

As reported in September 2001, the longest prison term yet imposed in Australia under environmental laws is 18 months for an offence committed in Queensland in June 2001. Fines of up to $25 000 have been imposed under these provisions.

Note that the Australian laws impose criminal liability, which is not the case with s38 (2) of the MR&PD Act.

Civil penalties

Civil penalties may also be imposed in terms of Australian law on directors. Such cases have, too, been rare. However, given the all-encompassing nature of our s38 (2) this remains our primary area of concern in South Africa.

Lessons from Australia

As more stringent laws have come into effect in Australia, the imperative for developing and implementing environmental legal risk management systems has become even greater. As directors face both criminal and civil liability their need to have a solid defence has become a priority. Their need is not only for sound legal procedure to be followed, but also to have evidence of sound environmental risk management and adequate anti-environmental impairment controls in place.

From an Australian industry survival point of view (South Africa take note!), financial institutions are taking a more cautious approach to loans to organizations, such as mining companies, because of the legal liability risk attaching to the loan.

For one, it has been common practice by financial institutions to appoint one of their own to represent their interests on the boards of such companies. In so doing, these individuals, as directors and officers of mining and other effected companies, are exposing themselves to personal liability under current environmental legislation. Hence many are refusing to assume a board position. Financial institutions thus are not getting representation or gleaning an intimate knowledge of the business to which they lend money. Their reaction has been either to refuse funding or make such facilities subject to exceptionally onerous disclosure and reporting requirements.

Another consideration for financial institutions is the negative impact of prosecutions, combined with additional expenditure relating to environmental impairment on the ability of borrowers to service their debts. These, combined with the impact of environmental liabilities on the value of securities (for example, through contaminated land or on shares in the company), are making mining and other such industries a risky prospect for financial institutions.

An environmental audit to assess potential liability from environmental risks is now almost mandatory before financial institutions will accept a security. Best practice in the Australian mining industry indicates that such audits are becoming standard procedure.

In Australia, as in South Africa, most organizations examining their current insurance policies will find that pollution is specifically excluded. This is generally the case both for general liability and for directors' and officers' liability insurance. However, from a broader corporate governance and risk management perspective, the risk of personal liability for company officers and managers should be a consideration, rather than a driver, for developing and implementing sound legal risk and environmental risk management practices.

Conclusions and summary

With the information currently at our disposal, we have summarized the effect of the new Mineral and Petroleum Resources Development Act 28 of 2002 on mining business as follows:

- ➤ A more onerous requirement for the submission of an Environmental Management Plan, for the conversion of mining rights from old to new order, for the development of new projects, and for the ongoing maintenance of the EMP until a closure certificate is issued
- ➤ More onerous requirements with which compliance is required prior to the issue of a mining right e.g. social plan, 'use it or lose it' clause
- ➤ In terms of Section 38(2), a more onerous personal liability for possibly both present and past directors of a company for environmental damage
- ➤ In view of the very limited protection offered by liability insurance policies for claims arising out of damage, degradation or gradual pollution of the environment and the extremely onerous provisions of Section 38(2) of the new Act, we recommend that potential claims against directors should be 'risk managed' as far as possible. To this end we recommend that the following actions be taken:
  - Establish what potential liability exists for damage, degradation or pollution of the environment, which the company may already have caused. This will likely necessitate employing professionals to carry out an environmental audit of your operations
  - Treat those risks identified in the environmental audit by means of a suitable risk financing mechanism
  - Ensure that your company has a comprehensive EMP in place, which is enforced from board level. The EMP should include a system of regular audits, the results of which are reported to the board
  - While difficult to obtain, and expensive, it is possible to purchase liability insurance policies specifically designed to cover environmental pollution. However, we would caution that any exposures identified in the environmental audit would be uninsurable.

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With De Beers, asset management is forever*

Global diamond mining giant De Beers has adopted a formal approach to managing its assets with the implementation of AMiP, the asset management improvement plan developed by asset performance management specialist PRAGMA.

De Beers, headquartered in Johannesburg, has 11 mines in southern Africa involved in open pit, underground, alluvial and undersea diamond mining operations.

In 2000 De Beers realized the need for a more defined approach to asset management. Most of the sites had their own array of asset management initiatives in place and as a result there was minimal standardization across the sites. There was a need to assist the individual sites with a formal understanding of asset management and to provide a standard framework within which to work.

'The most important starting point was to determine the current level of asset management at each site,' says Steve Blake, asset manager at De Beers central headquarters. 'Once that could be established, we needed to know how to develop sustainable and standardized asset management improvement plans for the sites.'

De Beers contracted PRAGMA to conduct an audit to establish an asset management baseline and develop the AMiP for six sites in the group—Namdeb (Namibia), Orapa and Lethlakane (Botswana), Premier (Cullinan), Jwaneng (Botswana), Kimberley and Finsch (Kimberley).

PRAGMA uses an asset management framework consisting of 13 key performance areas or pillars through which an organization can be measured and improved. Best practices have been identified for each pillar, which need to be in place to ensure asset management sustainability. The audit process identifies which practices are in place, to what extent, and how the critical practices should be implemented to improve maturity of the pillar.

PRAGMA's audit process consists of six main activities:

- asset management sensitization workshop
- on-site mapping of best practices in the 13 pillars
- interviews with personnel
- verification through plant walkdowns and photographs
- report and recommendation preparation
- feedback and AMiP planning with site personnel.

The main benefits realized through the asset management initiative adopted by central headquarters and the individual sites have been a group-wide understanding and standardization of asset management principles. Asset managers have been appointed at each site, and regular workshops are held to improve asset management practices using PRAGMA's AMiP methodology and framework as the foundation for reference and improvement.

'The asset management audit at Orapa has played a crucial role in raising the awareness of the importance of proper asset management processes,' says Elias Thotslo, asset manager at Debswana Orapa Mine.

'Now that the baseline has been established,' says Blake, 'we need to move further with group-wide and, in some cases, individual initiatives. The focus for the coming year will be on performance measures, strategy management, work planning and control, and maintenance tactics.'

PRAGMA is the preferred asset management partner to a wide variety of large organizations, including Tiger Brands, Nampak Tissue, Barloworld PPC and Parmalat.

'We are very proud to be associated with a prestigious organization such as De Beers. This strengthens our position as the leading asset management consultancy in southern Africa,' says Alan Tait, business development director of PRAGMA Africa

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