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Obtaining the Required Approvals for Equity Transactions in Nigeria

1. Introduction

Businesses aim to raise capital from institutions and individuals as investment, with the intention of making profit for the business and investors. These investments may be structured as equity (such as share acquisition), quasi-equity (such as convertible loan notes) or debt investments (such as simple lending) which provide the investors with differing features depending on the circumstances. An equity investment is the purchase of ownership in a company or business which imbues the investor with the right to the businesses' profits and assets. Where such a transaction culminates in the transfer of shares that exceeds stipulated parameters, it is a merger or an acquisition. As such, a reference to 'merger' in this article is reference to such equity transactions that would lead to regulated business combinations.

Equity is the value of shares issued by a corporate entity such as a limited liability company, indicating ownership in the business itself and the profit deriving thereof. Equity investment is attractive as it provides the investor with an ownership stake in the business, basis to partake in the decision-making process of the business, potentially higher returns on the investment derived from the dividends declared, and comparably higher liquidity and ease of sale of interests in investment. These investments may be undertaken in private or unlisted companies (private equity) or in listed public companies through venture capital, buyouts, and corporate restructurings.

Share acquisitions potentially affect the position of the existing shareholders of the company and other third parties adversely. As such, the law requires certain approvals be obtained prior to the consummation of transactions effecting the share acquisition. These approvals are broadly divided into internal approvals (which include shareholder approvals and third-party approvals) and regulatory approvals, with the aim of ensuring that the transaction meets the stipulated standards and requirements.

2. Internal Approvals

2.1. Shareholder Approvals

One of the most prominent concerns for equity investors is the risk of future share dilution. In a bid to protect shareholders, Nigerian law recognises the rights of shareholders and provides for mandatory requirements in any process that might lead to share dilution including the allotment of shares by the company. As a result, shareholders have the right to approve any equity investment transaction that can have a significant impact on the company's ownership structure or financial health.

Shareholder approvals serve as a form of check-and-balance in corporate governance to encourage accountability. They are required for the sale of a considerable portion of a company's assets, winding up of a going concern or the alteration of the share capital of companies (by consolidation, reduction, or increase). By obtaining approval from shareholders, companies demonstrate their commitment to transparency and accountability, and ensure that major business decisions are subject to scrutiny and oversight by the company's owners. Overall, shareholder approvals provide an important safeguard for the interests of the company and its shareholders in equity investment transactions.

Although the nature and limitations to the power of a company to allot its shares is usually provided in the Articles of Association (Articles) of the company; certain internal authorisations are required such as the approvals of the board of directors and the shareholders/members of the company. Under Nigerian law, private limited liability companies typically can only issue shares through a resolution passed by the members of the company while the directors of a public limited liability company are usually empowered by the members to allot shares of the company in accordance with the Articles and the extant law. The resolution for allotting the shares specifies the persons to whom shares are being allotted and the number of shares being allotted to such persons.

However, following changes introduced by the Companies and Allied Matters Act, 2020 (CAMA), the consent of existing shareholders is now required for allotments by all private and public companies. By moving away from the concept of authorised share capital to minimum share capital, the law now requires that prior to the allotment of shares by a company, its share capital must be increased to such a quantity to cover the number of shares to be allotted. Moreso, the Companies Regulations issued by the Corporate Affairs Commission requires companies to fully issue its shares. Hence, a resolution must be passed by the company to increase its share capital at any time shares are to be allotted. This has created a requirement for the approval of shareholders of a company before shares may be allotted.

This development has statutorily recognised the right of first refusal of existing shareholders which prior to the enactment of CAMA 2020 was primarily safeguarded under provisions protecting shareholders from share dilution in investment agreements and shareholder agreements. This rationale is reinforced by the provisions of CAMA that newly issued shares shall not be allotted unless such shares have been first offered to existing shareholders of the company.

Section 142 of the CAMA provides for the pre-emptive right of shareholders by requiring that newly issued shares be offered to all existing shareholders prior to being allotted to third parties. CAMA requires that the offer be made through a notice offering the newly issued shares to the shareholders as nearly as possible in proportion to their shareholding. As such, CAMA made this offer a condition precedent for the allotment of shares to a third party by any company.

The Business Facilitation Act (BFA) 2022 which was recently signed into law by the President has made consequential amendments to the above provisions. Firstly, the BFA [1] amended section 127 of CAMA by providing that resolutions approving the allotment of shares may be passed by the members in a general meeting or, where permitted by the articles of association of the company, the board of directors. Secondly, it also amended section 142 by providing that the exercise of right of first refusal is mandatory only for private companies [2].

As such, a right of first refusal is now applicable only to private companies and such companies can now alter their constitutional documents to provide that their board of directors may allot new shares in the company. However, the members of all companies must in a general meeting, approve the increase of the share capital of the company as provided by section 127 of CAMA. This continues to serve as a means of ensuring that existing shareholders are, at the least, informed of, and approve of the issuance of new shares.

2.1. Third Party Approvals

Companies may enter into agreements that affect their ability to issue new shares. This may include agreements with lenders, previous investors or financial institutions indicating that the company may not issue new shares except with the prior approval or consent of such other party. Comparable to the negative pledge provisions utilised in debt (securities) transactions, these provisions aim to ensure that the interests/benefits of the lender/investor/financial institution is not eroded by the issuance of such new shares.

For example, where Company A has borrowed money from Bank B, Bank B may require that Mr C and Mr D as the only shareholders of Company A create a charge over their shares in Company A in favour of Bank B to secure Company A's obligations to repay the borrowed sum on the agreed repayment date. To guarantee the effectiveness of the created security, Bank B may require Company A to covenant that it will not, during the existence of the loan, issue new shares (which will by default, be free from all encumbrances by the bank) without its prior consent.

Where they are required, failure to obtain such third-party approvals could result in a breach of the contract between the target (investee) company and the third party or render the equity investment inchoate or invalid.

2. Regulatory Approvals

In addition to internal approvals, equity investments require approval by some regulatory authorities. Regulatory approvals refer to the process by which government agencies review, assess, and activities to ensure that they meet certain standards. The requirement for regulatory approval is a creation of statutes and are usually mandatory in nature. Regulatory approval is required for a wide range of industries, including pharmaceuticals, medical devices, food and beverages, and financial services. However, some of these regulatory approvals are only required for equity investment transactions that exceed certain limits or would lead to a change in control or a merger.

Some of the major regulators that require prior notification or required to approve equity transactions are:

3.1.Corporate Affairs Commission

The Corporate Affairs Commission (CAC) was established by the Companies and Allied Matters Act (CAMA) and is charged with receiving filings regarding all entities registered under CAMA as private limited liability companies, public limited liability companies, companies limited by guarantee, business names and incorporated trustees. It plays an integral role in the operation of corporate entities in Nigeria as these entities are required to notify the CAC of any changes in its operation including changes in its share capital.

[1] in Paragraph 3, Part 1 of its Schedule
[2] paragraph 4, Part 1 of the Schedule to the BFA

Where a company has increased its share capital and allotted new shares, it must notify CAC of such increase (within one month)[3] and allotment (within fifteen days)[4]. Failure to notify the CAC of such changes makes the company or any officer of the company liable for penalty and costs of or incidental to the application[5] upon conviction.

3.2. Federal Competition and Consumer Protection Commission

The FCCPC is empowered[6] to approve equity transactions wherein, amongst other things, one or more undertakings directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another undertaking (notifiable merger). Although the FCCPC's approval is required only for such equity transactions that exceed the prescribed limit, failure to notify the FCCPC of such transactions before completion could render them void and the involved undertakings will be liable to pay fine[8].

3.3. Security and Exchange Commissions

Established by the Investment and Securities Act, the Securities and Exchange Commission (SEC) is charged with the regulation of public companies in Nigeria and the equity capital market, by extension. This includes the registration of shares to be issued by public companies and approval of equity transactions by or involving public companies and the businesses, assets and subsidiaries of such public companies that would lead to a merger or an acquisition. SEC's approval to these transactions is in the form of a confirmation of a 'No-Objection' to the transaction, after SEC is satisfied that all shareholders are fairly, equitably and similarly treated and given sufficient information regarding the transaction[9].

3.4. Nigerian Exchange Limited

The Nigerian Exchange Limited (NGX) is a self-regulatory entity that provides the platform for the trading of equity in Nigeria. The NGX must be notified of all major equity investments in quoted companies. In a bid to ensure the integrity and robustness of the Nigerian equity capital market, listed companies are required to notify NGX of any conflict-of-interest issues between directors and the investor or merging companies.

3.5. Federal Inland Revenue Service

The Federal Inland Revenue Service (FIRS) is charged with collecting all federal taxes and administering national tax laws in Nigeria. Generally, companies income tax, capital gains tax and stamp duties are payable at the completion of equity transactions. It is thus mandatory for companies seeking to engage in equity transactions that would lead to a merger, take-over, transfer or restructuring of its trade or business to obtain the direction of the FIRS and clear any due and payable capital gains tax before undertaking such transactions.[10] Failure to comply with this requirement makes the involved entities liable for fine in addition to the tax liability to be settled as result of such equity transactions.

3 Section 126 of CAMA
4 Section 154 of CAMA and Section 6 of Part 1 of the Schedule to the Business Facilitation Act 2022
5 Section 744 and 154(2) of CAMA
6 Section 93 of the FCCPA
7 Section 1 of the Notice of Threshold for Merger NNotification
8 Section 96(7) of the FCCPA
9 Section 121 of the Investment and Securities Act
10 Section 29(12) of the Companies Income Tax Act

3.6. Central Bank of Nigeria

The Central Bank of Nigeria regulates major equity transactions involving banks and financial institutions under the power endowed on it by the Banks and Other Financial Institutions Act 2020 (BOFIA) and the Central Bank of Nigeria (CBN) Act 2007. The FCCPA provided that financial institutions licensed by the CBN shall be exempt from the regulatory oversight of the FCCPC, hence the relevant provisions of the FCCPA applies as if the CBN is the FCCPC for such transactions[11].

3.7. National Insurance Commission

The National Insurance Commission Act[12] mandates insurance companies in Nigeria to obtain the approval of the National Insurance Commissions (NAICOM) prior to amalgamating with, transferring its business (or any part thereof) to or acquiring business (or any part thereof) from any other person involved in insurance business through any equity acquisition.

3.8. National Health Insurance Authority

The National Health Insurance Authority (Authority) is charged to regulate and supervise the various health insurance schemes in the country. The NHIA Act mandates that all health insurance schemes must obtain the approval of the Authority before transferring its activities through an equity transaction unless it has the prior written approval of the Authority. The Operational Guidelines issued by the National Health Insurance Scheme (which has now been rechristened the Authority)[13] provides that no Health Maintenance Organisation (HMO) shall engage in any equity transaction that would cause it to merge with, transfer to or receive from any other HMO, its business, or lives without the approval of the Authority in writing.

3.9. National Electricity Regulatory Commission

The Nigerian Electricity Regulatory Commission (NERC) is empowered to approve equity transactions that would lead to a merger or an acquisition of a company operating in the Nigerian power sector[14]. NERC may issue a cease order or levy a fine where it determines that a proposed transaction constitutes or may lead to an abuse of power in the electricity industry[15].

3.10. National Communications Commission

The Nigerian Communications Act 2003 endowed the Nigerian Communications Commission (NCC) with the power to regulate the Nigerian communications industry. The NCC requires appropriate notification of proposed equity transaction that would lead to a merger or an acquisition of more than 10% of the shares in licensed entities in line with its Competition Practices Regulations 2007. Failure to comply with the notification procedures to obtain the approval of the NCC for the notifiable transactions attracts sanctions or other punishments by the NCC as stipulated under the NCC's Enforcement Process Regulations 2005.

3.11. Nigerian Upstream Petroleum Regulatory Commission and the Nigerian Midstream and Downstream Regulatory Authority

The Petroleum Industry Act 2021 (PIA) provides that any equity transaction that would lead to a merger or an acquisition or an exchange of shares by persons holding a petroleum mining license or an oil mining lease or a production sharing or service contractor shall not be completed without the consent of the Minister of Petroleum.

3.12. The Federal High Court

The Constitution of the Federal Republic of Nigeria granted the Federal High Court (FHC) the exclusive jurisdiction to handle all matters arising from the operation of CAMA or regulating the operation of companies incorporated under CAMA.

11 Section 64 of the Banks and Other Financial Institution Act (BOFIA) 2022
12 Section 30
13 which was last revised in 2012
14 Section 82(5) of the Electric Power Sector Reform Act 2005 (EPSRA)
15 Section 82(7) of EPSRA

CAMA and other laws prescribe for some forms of equity transactions that require the approval of the Federal High Court. These include an amalgamation with, transfer to or acquiring of any insurer carrying on life insurance business or employee compensation insurance business[16]. The power of the FHC extends beyond approving equity transaction as it also has the power to set aside equity transactions upon application by a minority shareholder of the target company.[17]

Regulatory approval is essential for ensuring that shareholders and the public are protected from transactions that may otherwise harm their interests. Where a regulator does not approve an equity transaction as required by law, such transaction is inchoate and of no effect in law as regulatory approvals where provided by law are mandatory condition precedents to the completion of such transactions.

4. Conclusion

Despite the difference in their foundations, the existence and applicability of internal and external approvals are acknowledged by law and protected by Nigerian courts. Approvals to equity investments exist to mitigate risks associated with such transactions as they provide objective assessment of the transaction and aim to protect the interest of all parties involved. They provide a level of transparency and accountability which can assist in building trust between the parties.

Failure to obtain required regulatory approvals for equity transactions makes such transactions inchoate and sometimes attracts punitive consequences such as the imposition of fines. However, identifying the necessary approvals requires an in-depth understanding of the Nigerian legal system whereas the process for obtaining the approvals differ depending on the relevant industry and can be lengthy and complex. Companies seeking regulatory approval need to collaborate with experienced legal and financial advisers to carefully navigate the process and work closely with government agencies to ensure that all necessary requirements are met.

Under Nigerian law, while shareholder and regulatory approvals are creations of statute, requirement for third-party approvals are typically contractual obligations created by binding agreements between the parties involved. Hence, the existence of the requirement for such third-party approvals must be discovered upon disclosure by the target (investee) company or by diligent investigation of the proposed investor.

As such, there is need to undertake an extensive due diligence exercise on a target company where a substantial investment is intended to be made. This is to ensure that the investor is poised to receive the full legal title and interest in the equity sought to be purchased. The due diligence exercise will typically reveal whether a shareholder approval is required to consummate the transaction, whether the company is bound by subsisting agreements restricting its rights to offer new shares to the proposed investor and whether the company is in good standing with its primary regulators and able to receive the regulator's approval where such is required to complete the transaction.

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[16] Section 30(b) of the Insurance Act

[17] Section 354 of CAMA