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RULES ON MANDATORY TAKE-OVERS IN THE CONTEXT OF PRIVATE PLACEMENTS BY PUBLIC COMPANIES

1. MANDATORY TAKEOVERS

The Nigerian Securities and Exchange Commission (ñSECò) recently released new rules which took effect from May 2014 and changed, significantly, the investment landscape for public companies in Nigeria. One of the new rules introduced, is an amendment to Rule 445 (1) (a) of the Rules and Regulations of the Securities and Exchange Commission made pursuant to the Investments and Securities Act (ñSEC Rulesò) on mandatory takeover bids (ñMTOò).

Prior to 2007, there were no MTO obligations under Nigeria law. Only voluntary takeover bids were regulated, first by the Companies and Allied Matters Act of 1990 and subsequently by the Investment and Securities Act which was re-enacted in 2007. The ISA introduced the requirement for MTOs in section 131 as follows:

> *"Where a person:*
>
> *(a) acquires shares whether by a series of transactions over a period of time or not, which, when (taken together with shares held or acquired by persons acting in concert with him), carry 30% or more of the voting rights of a company; or*
>
> *(b) together with persons acting in concert with him, holds not less than 30% but not more than 50% of the voting rights of a company and such person or persons acting in concert with him acquires additional shares which increases his percentage of the voting rights,*
>
> *such person must make a take-over bid to the holders of any class of equity share capital in which such person or any person acting in concert with him holds shares."*

Simply put, what section 131 says is that the obligation to make an MTO will arise when:

a) a person or group of persons acquire(s) shares that represent 30% (thirty percent) ï or any other threshold prescribed by the SEC from time to time ï of the voting rights of a public company; or

b) a shareholder, who together with other persons, holds shares representing between 30% and 50% of the voting rights of a public company, acquires additional shares in that company.

Where any of the above thresholds are crossed, such person(s) are required to make an MTO to the other holders of the shares of the same class.

Prior to the recent amendment of Rule 455 of the SEC Rules, investors in Nigerian public companies that acquired voting rights which met the thresholds specified in section 131 of the ISA had to make an MTO ï neither the ISA nor the SEC Rules specified any exemptions to this requirement. This might have been due to the rationale for the introduction of the MTO provisions in the ISA, which was to ensure that no shareholder could gain control of a public company either directly or indirectly, without offering the minority shareholders an opportunity to exit the company at a fair price. The MTO requirement was, therefore, designed to act as a mechanism to protect minority shareholders of public companies.

The Amendment to SEC Rule 445(1)

The recently amended Rule 445 (1) provides:

a) *“No person shall acquire, through a series of transactions or otherwise, more than 30% of the shares of a public quoted Company without making a bid.*

b) *Where an existing shareholder, together with persons acting in concert, holds not less than 30% but not more than 50% of the shares of a company acquires additional shares, such person(s) shall make a takeover bid to the other shareholders of the company.*

c) *A takeover made in violation of sub rules (a) and (b) shall be void.”*

Prior to the amendment of Rule 445 (1) it was possible for an acquirer to purchase more than 30% of the voting rights of a public company through a private contractual sale, and thereafter, comply with the obligation to make an MTO. A possible interpretation of the new Rule 445(1), however, is that only 30% of the shares of a publicly quoted company can be acquired by private arrangements with other shareholders of the company i.e. without making an MTO. Thus, where a person intends to acquire shares that represent more than 30% of the voting rights of a public company from shareholders, it can only acquire shares representing not more than 30% of the voting rights of the company in a private contractual sale; any additional shares that will give the acquirer more than 30% of the voting rights of the company would have to be acquired through an MTO.

Another possible (and potentially problematic!) interpretation of the new Rule 445 (1) (a) is that a shareholder who already holds more than 50% of the shares of the company, will have to make an MTO if it acquires additional shares in the company that represent more than 30% of the voting rights of the company. This is because the new Rule 445 (1) (a) states that *“no person shall acquire, through a series of transactions or otherwise, more than 30% of the shares of a public quoted Company without making a bid”* and this suggests that even existing shareholders of the company, including those that own more than 50% of the company, will be subject to Rule 445(1) (a).

The provisions of section 131(1) (a) and (b) of the ISA, on the other hand, have, since 2007, established that the obligation to make an MTO will arise where either (a) a person acquires more than 30% of the voting rights of a public company or (b) where a person who holds more than 30% but less than 50% of the voting rights of a public company, acquires any additional shares in that company. The ISA provisions do not seek to extend the obligation to make an MTO to shareholders that already hold more than 50% of the company. If Rule 445(1) (a) was in fact intended to extend the obligation to make an MTO to shareholders that already hold more than 50% of the company, it would be imposing an obligation that hitherto was not envisaged under the ISA.

The new Rule 445(1) has not yet been applied or interpreted by the SEC and, therefore, remains unclear.

2. PRIVATE PLACEMENT EXEMPTION

Section 131 of the ISA which imposes the MTO obligation, does not specify any exemptions from this obligation. The new rule 445(1) (d), however, now sets out four exemptions from the requirement to make an MTO. One of these exemptions is where an ailing company undertakes a private placement which results in the strategic investor acquiring more than 30% of the voting rights of the company (the "Private Placement Exemption").

By way of background, Nigerian public companies are required, generally, to issue their securities to the public. It is, however, possible for a public company to issue securities to select investors through a process called a private placement. The prior approval of the SEC is required before a public company can undertake a private placement and one of the conditions on which the SEC's consent will be granted is that the company must be in dire need of fresh funds, and where the investor seeks to acquire more than 30% of the voting rights of the company, the SEC would only approve the private placement where the company is ailing.

In addition, before an ailing company can undertake a private placement, the shareholders of the company must approve the private placement by a special resolution (i.e. a resolution passed by 75% of the shareholders present and voting in person or by proxy at a duly convened and validly constituted general meeting of the company).

Prior to the new Rule 445(1) (d) was that where more than 30% of the shares in an ailing company was acquired by a strategic investor by way of a private placement, the strategic investor would have been required to make an MTO. The new Rule 445(1) (d), however, now exempts such a strategic investor from the requirement to make an MTO.

Justification for the Private Placement Exemption

Where a company is ailing, and a strategic investor agrees to invest the much needed funding that the company requires, the capital required to be injected in order to salvage the company could result in the investor acquiring more than 30% of the company. Again, in some situations, the investor may, as a condition to making the investment, require that it acquire a controlling interest in the company. The possibility, however, that the investor will be required to make an MTO when it acquires an interest that exceeds 30% was an issue that investors were generally concerned about and had to get comfortable with in order to proceed with the investment.

It had previously been argued that when the shareholders of an ailing company passed the special resolution approving a private placement that would result in an investor acquiring more than 30% of their company, they had indirectly approved the takeover of a controlling interest in the company by the investor and as such, this should relieve such an investor from the obligation to make an MTO.

The legality of the Private Placement Exemption

Whilst the Private Placement Exemption has been welcomed by the market, there is some debate regarding the legality of this exemption. This debate is based on the fact that provisions of section 131 of the ISA do not contain any exemptions to the MTO obligation and the introduction of exemptions in Rule 445(1)(d) can, therefore, be regarded as an amendment of the ISA which is an Act of the National Assembly.

By virtue of section 4 of the Constitution of the Federal Republic of Nigeria 1999, the legislative powers of the Federation of Nigeria are vested in the National Assembly. Where in a statute, the legislature delegates power to an agency of the government to make subsidiary instruments, such an agency does not have the powers to add to any provision of the principal statute from which it derives the power to issue the subsidiary instrument. In other words, a subsidiary legislation cannot amend the provisions of a principal Act. Thus, any subsidiary instrument which is inconsistent with any provision of the substantive statute is void *ab initio*. In the Supreme Court case of Osadebe ï v- AG Bendel State (1991) 22 NSCC (part 1) 137 at 184, Justice Nnaemeka-Agu, held that:

> *"A subsidiary legislation which derives its authority from a paramount legislation must, when in conflict with the latter, by construction, be cut down so as not to conflict with it".*

Where however, an Act vests powers in a regulator to amend such provision, the regulator can, based on the provisions of the Act make such amendments without violating the Act. Section 309 of the ISA provides as follows:

> *"If the Minister is of the opinion, after consultation with the [SEC], that it is necessary or expedient so to do in the public interest, he may, by order, published in the Gazette, exempt any person or class of persons buying or selling securities or otherwise dealing with the securities market from the operations of this Act."*

The Minister referred to in Section 309 of the ISA is the Minister of Finance and, from the provisions of this section, the Minister is empowered to exempt an investor in a private placement from the obligations of a MTO. Section 309 does not confer similar powers on the SEC and as such, in making its rules (which have the effect of subsidiary legislation), the SEC must remain within the confines of the principal legislation, i.e. the ISA, and limit the remit of its rules to the matters that are provided for in the ISA.

The legality of the Private Placement Exemption is yet to be adjudicated upon by the Nigerian courts.

CONCLUSION

The SEC has indicated that the review of its rules on MTOs were designed to ensure that potential investors seeking to revitalise ailing public companies through a private placement were not ñscared awayò as a result of the effect of Section 131 of the ISA; particularly where such investors were not interested in taking over the investee companies. As these investors take advantage of the flexibility that the revised MTO rules offer, the manner in which the SEC will clarify the debate over Rule 445(1)(a) remains to be seen.