REGULATION OF THE MARKET FOR CORPORATE CONTROL IN NIGERIA

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Abstract

The multiplicity of both economic and social effects of the problems associated with the shareholder model of corporate governance led to the adoption of internal and external control mechanisms of corporate control. The assumption has been that an effective check on the activities of corporate managers could result in improved efficiency and effectiveness of management and, ultimately, to the maximization of profits for the shareholders. Consequently, internal mechanisms were adopted, tried but overtime found incapable of keeping the management in track with the overall expectations of the shareholders. The inadequacy of internal control mechanisms necessitated the exploration of other management control options external to the corporation, giving rise to stock markets and the market for corporate control (MCC). An effective MCC, findings would show, has the capacity to sanction bad management with a takeover threat. A survey on the Nigerian company law however showed that there are certain factors that weaken the effectiveness MCC. For instance, there are definitional issues surrounding the regulation of mergers and takeovers, the two most frequently used mechanisms for the acquisition of control rights. Also, the market for control rights is usually subjected to a somewhat hermetic anti-competition check during merger reviews. The noticeable loophole in the provisions allocating acceptance decision to shareholders during a hostile takeover is another factor affecting the active working of Nigeria's MCC. In effect, there is substantial management interference during a takeover bid, a situation in the Nigerian law which renders the discipline that usually comes with a takeover threat of little or no effect. The study thus, among other

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things, argued that there is need to incorporate a "no frustration" rule in the Investment and Securities Act and its Regulations during an imminent takeover. The aim of this paper is therefore to evaluate the regulation of the Market for Corporate Control in Nigeria. The specific objectives are to ascertain the nature of the market for corporate control; to identify the legal framework regulating the Market for Corporate Control in Nigeria; to ascertain the effectiveness the extant framework is in the regulation of Market for Corporate Control in Nigeria and to explore options for improving the effectiveness of the existing legal framework for the overall development of Nigeria's MCC. In achieving the objectives set out in the study, the authors adopted the doctrinal methodology with analytical approach, using primary and secondary sources of data, and thereafter made recommendations for relevant law and administrative reforms that echo international expectations.

Keyword: *Market for Corporate Control, Mergers, Takeovers, Corporate Law, Securities, Nigeria*

Introduction

Separation of ownership from control in the structure of companies is an attribute of the modern corporation[1] which has left the management of companies in the effective control of persons other than the shareholders, giving rise to a two-pronged effect. On the one hand, a company's management and control are now in the hands of officers who do not necessarily have to be members of the company, but who do possess the requisite skills needed for the running of the corporation. On the other hand, we now have members of a company who are passive and sometimes detached from the management and control of the company, the conceivable implication of which is that, with the officers of the company now having a run of the house, there is now a tendency for them to pursue interests which may be different from, or even at variance with, those of the shareholders. [2] What this means is that, interests of the shareholders are now often subverted mostly in favour of those of the management, which may in the long run, especially where the shareholder primacy holds sway,

1 John Kay, 'The Stakeholder Company' in Gavin Kelly and Others (eds), *Stakeholder Capitalism* (United Kingdom: MacMillian Press 1997) 125-140.

2 Henry Manne, 'Mergers and the Market for Corporate Control' (1965) 73 *Journal of Political Economy* 110.

lead to managerial inefficiency and ineffectiveness, sub-optimization of profits for the shareholders and, ultimately, corporate failure.[3] The multiplicity of both economic and social effects of the problems associated with shareholder model of corporate governance has thus led to the adoption of internal and external mechanisms to control the actions of the management, the assumptions being that an effective check on the activities of corporate managers could result in improved efficiency and effectiveness of management and ultimately to the maximization of profits for shareholders. But then, internal mechanisms with their shortfalls seems to have proven to be incapable of beating management into alignment with the ultimate interests of the shareholders (that is, profit maximization). This inadequacy of internal control of the corporation has necessitated the shopping for and adoption of other management control options external to the corporation, giving rise to external control mechanisms such as stock markets and the market for corporate control (MCC). On its part, the market for corporate control, as developed by Henry Manne, stipulates that the share price of a company acts as a kind of judgment on its management.[4] Consequently, a low share price renders a firm vulnerable to takeover by other firms who believe they can with their management profile run the failing corporation more profitably.[5] Thus, a well-developed MCC, the argument goes, has the capacity to sanction bad management with a take-over threat.[6]

There are however contrary views to the effect that the MCC, however well developed, does not have the capacity to produce this effect on the corporate managers, as being variously canvassed.[7] Be that as it may, this paper aligns with the alternate view, and finds that a well-developed MCC has the capacity to solve to an acceptable extent the problem created by principal-agent theory of corporate governance. In the main, it will be seen that Nigeria, like most other developing economies, does not have an active MCC and this, among other factors, may have accounted for the brazen rate of corporate failure in the country.[8] The paper examines in

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3 See Eyo Eyo, 'Corporate Failure: Causes and Effects' (October 2013). <www.researchgate.net/publication/315644633> accessed 20 October 2023.

4 ……

5 Henry Manne (n 2).

6 Ibid.

7 See for instance Simon Deakin and Ajit Singh, 'The Stock Market, the Market for Corporate Control and the Theory of the Firm: Legal and Economic Perspectives and Implications for Public Policy'(June 2008) <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.167.5918&rep=rep1&type=pdf> accessed 20 October 2022.

8 In 2015, for instance, the Corporate Affairs Commission issued a final notice for the striking-off of names of 38,717 dormant companies for failing to file Annual Returns

relevant details the regulation of the market for corporate control and makes a case for the adoption of approaches that will increase the vibrancy of this market, especially as it touches on the market for the acquisition of control rights in Nigeria.

The paper is divided into three Parts. In addition to the introduction, part 1 looks at at the overview of the Market for Corporate Control in Nigeria. Part 2 examines the law regulating the market and the mechanisms for internal and external control. Part 3 highlights the challenges affecting the development of MCC in Nigeria and concludes with recommendations for law and administrative reforms.

Control Mechanisms in the Management of Corporations

Resolving the tension created by the relationship between the managers and shareholders has been the core concern of corporate governance.[9] In this context, the term corporate governance in its technical meaning relates to the system "through which those involved in the company's management are held accountable for their performance, with the aim of ensuring that that they adhere to the company's objectives."[10] In other words, from the shareholder perspective, corporate governance has been concerned with trying to re-align the interests of the managers with those of the shareholders and to impose disciplines on managers which compel them to act in the shareholders' interest, rather than their own interests. Consequently, mechanisms both internal and external to the corporation have been adopted as tools to keep the activities of corporate executives in proper check. Internal control mechanisms include executive remuneration (such as employee share options), introduction of independent non-executive directors in the Board and use of external auditors. Daoud Jerab noted that,

> Good corporate governance requires institutions and established work mechanisms to ensure achieving results that meet goals and needs with an ideal use of available resources, including natural resources and the protection of the environment. Internal corporate governance controls

as and when due, which is a symptom of failing corporations. For the list of the affected dormant companies, see http://new.cac.gov.ng/home/wp-content/uploads/2015/12/LIST-OF-COMPANIES-SCHEDULED-FOR-DE-LISTING-AS-AT-2ND-OF-AUGUST-2012.pdf> last accessed 10 October 2020.

9 Ibid.

10 John Parkinson 'Company Law and Stakeholder Governance', in Gavin Kelly and Others (eds), *Stakeholder Capitalism* (United Kingdom: MacMillian Press 1997) 143-154.

> include: Ownership Concentration, Monitoring by the board of directors, internal control procedures and internal auditors, management remuneration. In addition to Organization culture, Strategic Planning & Budgeting, Organizational structure, and balance of power which some researcher classifies them as management control system elements.[11]

External mechanisms on the other hand include disciplines that come through the stock market and the market for corporate control.

Overview of the Market for Corporate Control

The market for corporate control is built on the notion that threat of takeover remains a source of pressure on the management in keeping with their duty of profit maximization. In effect, if a company is being operated below its true potential, its shareholders, in protest of poor returns on investment, will be forced to dispose of their shares in the company.[12] Divesting in the company in significant numbers will, by the law of demand and supply, force the price of the shares to fall remarkably. The fall in the price of the company's shares will then trigger the attention of observers in the market. According to Parkinson,

> Observers of the market will conclude that the company's shares are trading at a discount because of the inadequacies of its current managers. This acts as a signal to one or more vital management teams who will respond by mounting a bid to buy the company's shares from their existing owners with a view to unlocking the profitability that the current management is failing to extract. Having obtained control of the company the successful bidder will replace the board with its own appointees and make the necessary changes to improve efficiency.[13]

Thus, in the active market for corporate control, 'control of productive assets is transferred to those who can most efficiently manage them', and the threat of such takeover acts as 'a powerful discipline over directors, since in order to keep their jobs, they must keep their share prices high, and this means that they are obliged to run the company at maximum efficiency.[14]

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11 See Daoud Jerab, 'The Effect of Internal Corporate Governance Mechanisms on Corporate Performance' <http://ssrn.com/abstract=1846628> Accessed 20 April 2021.

12 See generally John Parkinson (n 10) 144-147.

13 John Parkinson, ibid, 145.

14 Ibid.

In the market for corporate control, the primary motivation for launching a bid for takeover, or for acquiring control right in a company, lies in the need to harness the potentials of a corporation by providing a more efficient management in the company. The threat of takeover or the actual takeover that may occur constitutes a discipline on the management, one considered to be at least powerful enough to be regarded as an alternative of, or complement to, the discipline from the internal mechanisms of control.[15] Over all, the argument is settled, at least in theory, that the internal control mechanisms are inadequate to resolve the tension created by the shareholder model of corporate governance. The emphasis is now turned on making the external control mechanisms work so as to produce the required effect as a corporate governance mechanism.

Part II

Laws Regulating the Market for Corporate Control in Nigeria

As noted in the preceding chapter, the market for corporate control (MCC) is the market for the acquisition of control rights through mergers and takeovers, especially.[16] In Nigeria, the MCC is regulated in part by the Federal Competition and Consumer Protection Ac, 2018 (FCCPA), and in part by the Investment and Securities Act, 2007 (ISA) and regulations made thereto. While the FCCPA principally regulates rights acquisition through mergers, the ISA regulates takeovers, even though, as we shall see later in the chapter, there is the possibility of regulatory overlap due to definitional issues arising from the meaning of mergers under the FCCPA.[17] The Companies and Allied Matters Act, 2020 (CAMA) is the principal legislation regulating companies in Nigeria and provides the structure of corporate governance in the jurisdiction. Other laws that touch on the regulation of the MCC in Nigeria include the Financial Council of Nigeria Codes of Corporate Governance, albeit the Codes only regulate internal control mechanisms, they bear on the market for corporate control in that they provide a level of control and foundation upon which an aspect of the Nigeria's MCC is built.

Internal and External Control Mechanisms for Management Control in Nigeria

Corporate governance, as we noted in chapter two, has primarily been

15 John Parkinson (n 10).

16 Proxy fights is another mechanism for control rights but that option is least utilized in Nigeria.

17 As provided in section 92 FCCPA.

concerned with trying to realign the interests of managers with those of shareholders, and to impose discipline on managers so as to compel the managers to act in the interest of the shareholders rather than in their own interest. Internal and external mechanisms have been proposed and subsequently adopted as options for tackling the agency problem. The external disciplines would normally come through the stock market and the market for corporate control. Internal mechanisms are control internal to the corporations, and they include executive remuneration packages such as share options, the greater use of independent non-executive directors to ensure that managers do not act dishonestly and controls imposed under the codes on corporate governance, which equally touch on the regulation of composition of directors, as examined below.

Internal Mechanisms for Corporate Control

a. Employee Share Incentives

Managers, however high their remuneration can be, may still be inclined to treat the business of the corporation with indifference as regards profit maximization for the shareholders. This is a natural consequence of separation of ownership from control, resulting in ineffective supervision by the shareholders. Thus, it is usual to have managers who treat business of the company with laissez-fair especially where their remuneration is guaranteed -whether there is profit or not left for the shareholders.[18] It was then necessary to introduce incentives that link performance with pay. That is to say, the higher your performance, the higher your pay. This philosophy is premised on the assumption that if employee remuneration packages is structured in such a way as to link pay with work, it will boost the motivation of executives to perform better.[19] Thus, it is common to see the shareholders approve higher pay or bonus packages and allowances for the employees for higher profits. However, this form of short-term incentive was found not to be effective. PwC's latest research, 'Making executive pay work: The psychology of incentives' took the views of 1,106 senior executives in 43 countries, within a wide range of senior roles, companies and industries and the results reveal 'a number of common behavioural traits, which show clearly that executives don't necessarily think in the way that many incentive schemes assume.'[20] It was also found

[18] See section 431 CAMA.

[19] N Ogbuanya *Essentials of Corporate Law Practice in Nigeria*, (2nd edn, Lagos: Novena Publishers Limited 2014)332.

[20] Bernard Attard 'Employee Share Options - an Introductory Guide' < https://www.pwc.com/mt/en/publications/share-options.html> accessed 03 January 2024.

that such incentives cost the company a lot more than was necessary.[21] That research from Pwc revealed fundamentally that '[L]ong-term incentive-based pay for employees has gained prominence over past two decades, largely driven by desire to align interests of management and shareholders on the assumption that executives will perform better if they are heavily incentivized in this manner.'[22]

Share incentive schemes are one of such long-term incentive plans that are being used by companies 'to attract and retain talent, and to ensure sustained performance over the long-term.'[23] Share option is thus intended to induce the executives into higher performance by making them co-owners of the corporation, the assumption being that when the executives begin to see the corporation as also belonging to them, it will be easier to have them promote the interests of the shareholders part of which they now are.

The Nigerian company law recognizes the possibility of share incentive in many respects. In this context, section 22(3) of CAMA, while prohibiting a private company from having more than 50 members, provides that employees who become members of the company during and after their contract with the company are not counted for the purpose of determining the legal membership minimum of private companies. This provision thus recognizes the possibility of employees becoming members of the corporation through share acquisition.

In the same vein, section 277 of CAMA provides for share qualification of directors. According to the section, the shareholding qualification for directors may be fixed by the articles of association of the company. Where the articles of the company require a director to hold a specific share qualification, the director is mandated to do so within two months of appointment.[24] Effectively, this provision is intended to give the director a stake in the company he is to manage in a bid to converge his interest with that of the other shareholders who employed him. As Abdulateef pointed out:

> An Employee Stock Option Plan (ESOP) is a benefit plan for employees which make them owners of stocks in the company. ESOPs have several features which make them unique compared to other employee benefit plans. The employees can then be regarded as beneficial owners of the company and thus indirectly entitled to participate in the

21 Ibid.
22 Ibid.
23 Ibid.
24 Section 251 CAMA.

> wealth created by their efforts. However, the profits are not distributed to the employees immediately but are retained in the company on the assumptions that the employer will be able to grow the profit fasters than if they were disbursed to the employee. There is a further assumption that the employees will realise that they are the owners, at least in part, of the company, and this should reinforce their commitment to the growth of the company, and thereby their own wealth creation. ESOPs have thus become a very potent mechanism for hiring, retaining and rewarding a talented workforce.[25]

Employee share options may come by way of employee stock option plans (where the employee allows the employer to withhold a portion of his or her monthly income, to acquire shares of the company at a discount. Such acquisition of shares may happen each month. Alternatively, the portion of the salary deducted may be accumulated to enable the acquisition of the share at a future date) or by stock appreciation rights or plans, (where the employees are awarded stock equivalents at a certain pre-determined value and after a certain minimum stipulated period, the employees are allowed to such rights), among others.[26]

Rule 449 of the Securities and Exchange Rules and Regulations 2013 (SEC Rules) provides for Management buy-out, another important aspect of share incentive. By that provision, a management team is permitted under the law to buy out the controlling shares of the company or its subsidiaries, with or without third-party financing. The implication of this provision is that the management assumes a dual position of principals and agents, and it serves as a powerful incentive that allows the management to take actions that will ultimately serve both the management and shareholders which they now majorly constitute. Ogbuanya has explained that, 'Management buy- out favours proponents of director's share qualification requirement and Employee share ownership scheme to the effect that ownership of substantial interest in a company makes management stakeholders in the affairs of the company'[27] which they manage, 'making them to adopt dexterous management skills to salvage the company out of distress coast

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25 Abdulateef Olatunji Abdulrazaq, 'Taxation of Employees Stock Options in Nigeria', <https://www.linkedin.com/pulse/taxation-employees-stock-options-nigeria-abdulrazaq> accessed on 02 February 2024.

26 Ibid.

27 Ogbuanya (n 19) 612.

and reposition it for profitable returns on investment.'[28]

b. Internal Control Mechanisms under the Codes of Corporate Governance

Codes of Corporate Governance provide guides for best corporate governance practices, guiding 'companies in establishing a framework of processes and attitudes that increases their value, builds their reputation and ensures their long term prosperity.'[29] In recognizing the need for Codes of Corporate Governance in Nigeria, relevant authorities in Nigeria have made efforts towards enacting corporate codes in line with OECD Principles of corporate governance. In 2011, the Securities and Exchange Commission (SEC) issued Code of Corporate Governance which repealed the 2003 Code on Best Practice Corporate Governance.[30] The scope of 2011 Code however is limited to public companies. Thus in a bid to having a Code with general application, the Financial Reporting Council of Nigeria, in line with sections 11 and 51 of the Financial Reporting Council of Nigeria Act, which confer upon the Council the powers to ensure good corporate governance practices in the public and private sectors of the Nigerian economy, came up with the Code of Corporate Governance 2018 (2018 Code).[31] The 2018 Code highlights key principles that seek to institutionalize corporate governance best practices in Nigerian companies.[32] Thus, according to the Council,

> The Code is also to promote public awareness of essential corporate values and ethical practices that will enhance the integrity of the business environment. By institutionalising high corporate governance standards, the Code will rebuild public trust and confidence in the Nigerian economy, thus facilitating increased trade and investment. Companies with effective boards and competent management that act with integrity and that are engaged with shareholders and other stakeholders are better placed to achieve their business goals and contribute positively to society. In such well managed organisations, the interests of the Board and management are

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28 Ibid.

29 KPMG '2018 Nigerian Code of Corporate Governance' <https://home.kpmg/ng/en/home/insights/2019/01/2018-Nigerian-Code-of-Corporate-Governance.html> accessed 02 February 2020.

30 Ogbuanya (n 19) 336.

31 There have been other Codes before this version, which were either suspended or rendered inoperative.

32 Ibid.

> aligned with those of the shareholders and other stakeholders.[33]

Principle 6 provides for Non-Executive Directors (NEDs), recognizing that 'Non-Executive Directors bring to bear their knowledge, expertise and independent judgment on issues of strategy and performance on the Board.' Principle 6.1 thus recommends that NEDs should be chosen on the basis of their wide experience, knowledge and personal qualities and are expected to bring these qualities to bear on the Company's business and affairs; should constructively contribute to the development of the Company's strategy[34] and should not be involved in the day-to-day operations of the Company, which should be the primary responsibility of the MD/CEO and the management team.[35] NEDs should have unfettered access to the EDs, Company Secretary and the Internal Auditor, while access to other senior management should be through the MD/CEO.[36] To facilitate the effective discharge of their duties, NEDs should be provided, in a timely manner, with reasonable support as well as quality and comprehensive information relating to the management of the Company and on all Board matters.[37]

Principle 7 provides for Independent Non-Executive Directors, who are expected to bring a high degree of objectivity to the Board for sustaining stakeholder trust and confidence.[38] An Independent Non-Executive Director (INED) should represent a strong independent voice on the Board, be independent in character and judgment and accordingly be free from such relationships or circumstances with the Company, its management, or substantial shareholders as may, or appear to, impair his ability to make independent judgment.[39]

An INED is a NED who does not possess a shareholding in the Company the value of which is material to the holder such as will impair his independence or in excess of 0.01% of the paid up capital of the Company; is not a representative of a shareholder that has the ability to control or significantly influence Management; is not, or has not been an employee of the Company or group within the last five years; is not a close family member of any of the Company's advisers, Directors, senior employees, consultants, auditors, creditors, suppliers, customers or substantial

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33 See the Preamble to the National Code of Corporate Governance 2018.
34 Principle 6.2, ibid.
35 Principle 6.3, ibid.
36 Principle 6.4, ibid.
37 Principle 6.5, ibid.
38 Principle 7, ibid.
39 Principle 7.1, ibid.

shareholders; does not have, and has not had within the last five years, a material business relationship with the Company either directly, or as a partner, shareholder, Director or senior employee of a body that has, or has had, such a relationship with the Company; has not served at directorate level or above at the Company's regulator within the last three years; does not render any professional, consultancy or other advisory services to the Company or the group, other than in the capacity of a Director; does not receive, and has not received additional remuneration from the Company apart from a Director's fee and allowances; does not participate in the Company's share option or a performance-related pay scheme, and is not a member of the Company's pension scheme; and has not served on the Board for more than nine years from the date of his first election.[40] Essentially, the role non-executive directors and Non-Executive directors is to provide a creative contribution to the board by providing independent oversight and constructive challenge to the executive directors who undertake the day to day activities of the company.[41]

Principle 11 of the Code introduces specific mechanism for internal control by requiring the Board to delegate some of its functions, duties and responsibilities to well-structured committees, without abdicating its responsibilities so as to ensure efficiency and effectiveness. For instance, the audit committee is expected to ensure the development of a comprehensive internal control framework and obtain annual assurance and report annually in the audited financials on the design and operating effectiveness of the company's internal controls over financial reporting.[42] Thus the Code buttresses the importance of an effective internal control system and requires the audit committee to ensure the development of a comprehensive internal control framework that promotes effectiveness and efficiency of operations; ensure reliability and integrity of financial reporting, safeguards assets and ensures compliance with applicable laws and regulations.[43]

Another key principle of the 2018 Code is Principle 19. Principle 19 provides for an effective whistle-blowing framework for reporting any illegal or unethical behaviour, minimizes the Company's exposure and prevents recurrence. Accordingly, the Board is expected to establish a

40 See generally Principle 7.2.

41 Inspiring Business, 'What is the role of the Non-Executive Director?' <https://www.iod.com/services/information-and-advice/resources-and-factsheets/details/What-is-the-role-of-the-NonExecutive-Director> accessed 20 January 2020.

42 KPMG (n 28).

43 Ibid.

whistle-blowing framework to encourage stakeholders to bring unethical conduct and violations of laws and regulations to the attention of an internal and external authority so that action can be taken to verify the allegation and apply appropriate sanctions or take remedial action to correct any harm done. This framework should be known to employees and external stakeholders.[44] The Board should also ensure the existence of a whistle-blowing mechanism that is reliable, accessible and guarantees the anonymity of the whistle-blower, and all disclosures resulting from whistleblowing are treated in a confidential manner. The identity of the whistle-blower should be kept confidential. The Board is to accord priority to the effectiveness of the whistleblowing mechanism and continually affirm publicly, its support for and commitment to the Company's whistle-blower protection mechanism.[45]

The team responsible for managing disclosures obtained through the whistle-blowing mechanism should: review reported cases and bring them to the notice of the committee responsible for audit and provide the committee responsible for audit with a summary of reported cases, cases investigated, the process of investigation and the results of the investigations.[46]

A whistle-blower can disclose any information related to a violation or suspected violation of any laws, internal policies, etc., connected with the business of the Company, its employees or stakeholders,[47] and the Board should ensure that no whistle-blower is subject to any detriment on the grounds that he has made a disclosure. Where a whistle-blower has been subjected to any detriment, he may present a complaint to the Board and/or regulators. A whistle-blower who has suffered any detriment by reason of disclosure may be entitled to compensation and/or reinstatement as appropriate.[48]

Principle 20 provides for External Auditors, who are appointed to provide an independent opinion on the true and fair view of the financial statements of the Company to give assurance to stakeholders on the reliability of the financial statements. The Principle also has recommended practices to preserve independence of the auditors[49] and

44 Principle 19.21, Nigerian Code of Corporate Governance 2018.
45 Principle 19.3, ibid.
46 Principle 19.4, ibid.
47 Principle 19.5, ibid.
48 Principle 19.6, ibid.
49 See Principles 20.4 and 20.5, ibid.

ensure quality audit outcomes.[50] Accordingly, where external auditors discover or acquire information during an audit that leads them to believe that the company or anyone associated with it has committed an indictable offence under any law, they should report this to the regulator, whether or not such matter is or will be included in the management letter issued to the committee responsible for audit and/or the Board.[51]

The internal corporate control mechanisms have not yielded the expected outcome in beating the management into alignment with the overall interest of the shareholders.[52] This conclusion is underscored in large part by corporate failure witnessed in some economies known to have favoured the shareholder model. This ineffectiveness of the internal control systems has been attributed to the expansion and attendant complexities of the modern corporation following the nineteenth century industrial revolution.[53] According to Jensen, '[e]vents of the last two decades indicate that corporate internal control systems have failed to deal effectively with these changes, especially excess capacity and the requirement for exit.'[54]

Jansen, among other things, identified "board culture" as one of the factors responsible for this ineffectiveness of internal control systems. According to the author,

> The great emphasis on politeness and courtesy at the expense of truth and frankness in boardrooms is both a symptom and cause of failure in the control system. CEOs have the same insecurities and defense mechanisms as other human beings; few will accept, much less seek, the monitoring and criticism of an active and attentive board… The result is a continuing cycle of ineffectiveness: by rewarding consent and discouraging conflicts, CEOs have the power to control the board, which in turn ultimately reduces the CEO's and the company's performance.[55]

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50 Principle 20.6, ibid.
51 Principle 20.8, ibid.
52 See Michael C Jensen 'The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems.' *Journal of Finance* (1993) < https://onlinelibrary.wiley.com/doi/full/10.1111/j.1540-6261.1993.tb04022.x> accessed 10 January 2020.
53 Ibid.
54 Ibid.
55 Ibid.

With the Board characterized in this manner, it is often difficult to subject the CEO and the entire management team to effective supervision by the Board.

Jensen also sees information asymmetry as another factor responsible for the collapse of internal control measures. In his words, serious information problems limit the effectiveness of board members in the typical large corporation. For example, the CEO almost always determines the agenda and the information given to the board. This limitation on information severely hinders the ability of even highly talented board members to contribute effectively to the monitoring and evaluation of the CEO and the company's strategy.[56]

Share incentives have also proven to wield little influence on the will of the executives, and this problem spawned from the fact that 'neither managers nor nonmanager board members typically own substantial fractions of their firm's equity'[57] a 1991 finding for instance showed that '[w]hile the average CEO of the 1,000 largest firms (measured by market value of equity) held 2.7 percent of his or her firm's equity, the median holding is only 0.2 percent, and 75 percent of CEOs own less than 1.2 percent.'[58] This accounts for the continued failure of corporations in spite of the disciplines from share options,[59] and it is this ineffectiveness of the internal control mechanisms as examined above that has led to the current emphasis placed on the external control disciplines.

External Control Mechanisms in Nigeria

External control mechanisms are the systems of control external to the firm, effected through the acquisition of control rights.[60] Acquisition of right control is generously permitted under the Nigerian through the mechanisms of proxy fights, direct purchase of shares (or takeovers) and the mergers, as examined hereunder.

Proxy Fights

Proxy votes are permissible in most jurisdiction as a way of encouraging shareholders to exercise their voting rights by proxy and have a say over decision-making in general meetings of a company. This provision

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56 Ibid.

57 Ibid.

58 Ibid.

59 Ibid. General Motors, IBM and Eastman Kodak are few examples Jensen highlighted that have experienced corporate failure despite the internal control mechanisms in place in the US.

60 Henry Manne, (n 2) 112, 114.

in effect enables a minority of shareholders to publicly obtain some delegated proxy rights from others and be able to influence decisions and sometimes policies in the firm. When decisions affecting major shakeups in a corporation are received in a notice of a meeting, especially in a largely held shareholding, shareholders who perhaps are divided over the performance rating of the management will begin a fight for proxy votes. The fight is to gain control right and vote along the line of preferred policies. If successful in the contention, shareholders who for instance favour the removal of the board or management can through the gained accumulated proxy votes effect that decision. Even if unsuccessful, the acquisition in no little way constitutes a threat on the management and may force them to sit up and refocus on shareholders' satisfaction. It can thus be seen that the acquisition of proxy voting rights 'does not merely provide small shareholders with an opportunity to voice their opinions',[61] but, more importantly, 'forms a source of external pressure on management and major shareholders'.[62]

The challenge in utilizing this mechanism for right control has been on the cost implications. Expenses associated with proxy right 'have always included direct expenses of mailings, advertising, telephone calls and visits to large shareholders.'[63] Shareholder-education is also a factor with huge cost effect. This is largely because, since giving a proxy means, technically, voting of the shareholder who is delegating his powers, the company or the person seeking to acquire the proxy will have to include information about all aspects of the company's affairs, including fact that the shareholder has a right to appoint a proxy or two.[64] This responsibility has equally increased the cost of soliciting proxies.[65]

It is important to however note that a contestant in a proxy fight can recover expenses incurred during the contest. This however depends on the purpose for which the proxy is sought. Accordingly, a contestant will recover from the company's treasury if the contest is "found to be one of policy rather than a purely personal power contest.[66] In *Resenfeld v Fairchild Engine and Airplane Corp*.[67] the old board of directors and the new board spent over $120,000 each in soliciting proxies for a

61 Ibid.
62 Ibid.
63 Manne (n 62).
64 See section 254 of CAMA.
65 Henry Manne (n 2), 115
66 Ibid.
67 (1955) 309 NY 168,129 NE 2d 291.

shareholder vote for new directors. After the new board won the contest, they authorized the company, Fairchild, to reimburse the old board for most of their expenses. Plaintiff filed a shareholder's derivative action against the company and its directors. The court held that a company's directors may spend the corporation's money "for soliciting a proxy in a bona fide policy contest provided that the amount is reasonable."[68]

Some jurisdictions, like the US, have relaxed the restrictions on shareholders gaining proxy voting rights.[69] The relaxation has however not affected the cost positively, and this makes the option of proxy vote in a control right less appetizing. According to Leonard Machtinger, although shareholders are encouraged to press their views before the corporate electorate, a major obstacle preventing them from challenging management in a proxy contest in the US is the high cost of such a challenge. He noted that while the 1954 New York Central Railroad proxy fight cost both sides a total of $2,159,000, the 1955 Montgomery Ward battle management spent $766,000. In a 1964 proxy solicitation one faction spent $365,000, and in the M-G-M proxy fight, management's known and estimated expenses amounted to $125,000 and the insurgents were $175,000.[70]

In Nigeria, the right to appoint a proxy is protected under the CAMA. In section 254, it is provided that any member of a company entitled to attend and vote at a meeting of the company is entitled to appoint another person as his proxy to attend and vote instead of him, and a proxy appointed to attend and vote instead of a member has the same right as the member to speak at the meeting.[71] The burden of educating the shareholder on his right to appoint a proxy is borne by the company, which is required to make a statement in every notice calling a meeting that a member entitled to attend and vote is entitled to appoint a proxy or, where that is allowed, two or more proxies, to attend and vote instead of him, and that a proxy need not be a member.[72] It appears that it does not really matter whether or not the

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68 See Case Briefs, "Rosenfeld v Fairchild Engine & Airplane Corporation", https://www.casebriefs.com/blog/law/corporations/corporations-keyed-to-klein/problems-of-control/rosenfeld-v-fairchild-engine-airplane-corporation/> accessed 16 March 2021.

69 See also OECD, 'The theory of the market for corporate control and the current state of the market for corporate control in China' <https://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/31601011.pdf> last accessed 20 January 2020, 7.

70 See generally Leonard Machtinger, 'Proxy Fight Expenditure of Insurgent Shareholders', *Case Western Reserve Law Review* vol 19, 2, 213-4.

71 Section 254(1) CAMA. See also Regulations 58 and 59 of Company Regulations 2021 on the Content and Delivery of Proxy Notices.

72 Section 254(2) CAMA.

shareholder is enlightened on this proxy contest to be entitled to such notice. That implies that there is no selective circulation of information relating to proxy, and failure to comply with this provision on right of proxy incurs a penalty on the part of the director or officer involved in the omission or complicity.[73]

Direct Purchase of Shares

In large part because of the high cost associated with proxy fights, the use of a proxy contest to gain control of a corporation is now being replaced by an offer to shareholders to purchase their shares usually at a price above the market. "Such an offer is likely to be much simpler and involve less disclosure and less expense than a proxy contest for control,"[74] and in the event that the offeror is unsuccessful, a large percentage of the funds expended in purchasing the shares can usually be recovered in subsequent sales by the person making the offer.[75]

Direct acquisition of shares can be achieved principally in three ways, the most obvious being an outright purchase of shares on the open market of the requisite percentage of shares needed to gain control. The acquirer may also approach the shareholders personally and make an offer to purchase their shares. Lastly, he may make a bid for tenders, which requires target shareholders to sell their shares to him at a premium. There are a few economic and legal issues associated with direct purchase. Economically, there is the problem of who owns the premium associated with sale of controlling shares. On this Berle contends that control is a corporate asset, implying that any premium accruing to a shareholder for a sale of control belongs to the rest of the shareholders.[76] This argument, if allowed to stand, is capable of eroding the lustre that inheres in direct acquisition of shares for control rights, the reason being that, quite apart a desire to support a replacement for a non-performing management, the incentive for a shareholder to readily release his shares to another lies in the premium associated with the sale of his block of shares. It appears however that the court in *Perlman v Feldmann*[77] has modulated this postulation by Berle, to the effect that if the controlling shareholder serves as a director of the company, he must in the sale protect the interest of the other shareholders to

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73 Section 254(4) CAMA.

74 Cohen, 'A Note on Takeover Bids and Corporate Purchases of Stock,' *22 Bus. Law* 149 (1966), cited in Leonard Machtinger (n 70).

75 Ibid.

76 Henry Manne (n 2) 116.

77 (1955) 219 F.2d 173.

whom he stands as fiduciary, otherwise he is bound to account for the premium. In the *Perlman case,* Plaintiffs and Defendants were shareholders in Newport Steel, a company which provided steel sheets to regional customers. Due to the Korean War, steel was at a premium and it turned Newport Steel into a more profitable venture. Newport began updating their facilities, but a third party, Wilport Company, bought Defendants' shares in an effort to secure more steel output. The over-the-counter price for the shares was $12 and the book value was $17.03, but Wilport paid $20 per share to Defendants. Plaintiffs sued to receive the same premium for their shares, and the trial court denied their claims. The trial court ruled that the premium was an inherent benefit of having a controlling ownership, and alternatively, the burden was on Plaintiffs to prove the lesser value of the stock. The court held that the Plaintiffs are entitled to a share of the premium paid to Defendant shareholders, pointing out that Feldmann being the president and dominant shareholder, owes a fiduciary duty to minority shareholders not to let a personal interest override the interests of all the shareholders.[78]

Under the Nigerian law, however, once a bid is tendered for acquisition of controlling shares, all shareholders of the same class of an offeree company shall be treated similarly by an offeror,[79] and during the course of an offer or when an offer is in contemplation, neither an offeror nor the offeree company nor any of the representatives and advisers of the offeror or offeree shall furnish information to some shareholders which is not made available to all shareholders.[80] This provision prohibiting asymmetry of information in respect of the bid is helpful, to a large extent, in dealing with the issue of premium during a takeover bid. This is basically because all the shareholders by that provision will have equal bargaining power and will not be left in the dark in respect of any aspect of the transaction.

Another problem associated with direct purchase as a means of gaining control is the legal requirements usually associated with such acquisitions. Under the Nigerian Law, for instance, a shareholder or any person with significant control over a company is required to disclose to the company the particulars and extent of such control.[81] The company is required to within one month of receiving such information notify the Commission.[82]

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78 See generally Case Briefs, 'Perlman v Feldmann', <https://www.casebriefs.com/blog/law/corporations/corporations-keyed-to-klein/problems-of-control/perlman-v-feldmann/> last retrieved 16 March 2021.

79 See section 131(2) of the Investment and Securities Act, (ISA) 2007.

80 Section 131(3) ISA 2007.

81 Section 119(1) CAMA.

82 Section 119(2) CAMA.

Significant control is however defined under the CAMA to mean a person (a) directly or indirectly holding at least 5% of the shares or interest in a company or limited liability partnership; (b) directly or indirectly holding at least 5% of the voting rights in a company or limited liability partnership; (c) directly or indirectly holding the right to appoint or remove a majority of the directors or partners in a company or limited liability partnership; (d) otherwise having the right to exercise or actually exercising significant influence or control over a company or limited liability partnership; or (e) having the right to exercise, or actually exercising significant influence or control over the activities of a trust or firm whether or not it is a legal entity, but would itself satisfy any of the first four conditions if it were an individual.[83] For a public company, a person who either by himself or by his nominee holds shares in the company which entitle him to exercise at least 5% of the unrestricted voting rights at any general meeting of the company is regarded as a substantial shareholder and is required to make a disclosure.[84] It is not clear the purpose of this regulation under the CAMA, but the tenor of the various provisions of persons with significant control suggests that the Commission would without more want to be aware of intentions of a shareholder during an acquisition of shares of both private and public companies. The position is however different under the Investment and Securities Act (ISA). Under the ISA, where any person acquires shares, whether by a series of transactions over a period of time or not, which carry 30 per cent or more (or any lower or higher threshold as may be prescribed by the Commission from time to time) of the voting rights of a company, or together with persons acting in concert with him, holds not less than 30% but not more than 50 per cent (or a lower or higher threshold as may be prescribed by the Commission from time to time) of the voting rights and such person or any person acting in concert with him, acquires additional shares which increase his percentage of the voting rights, such person shall make a take-over offer to the holder of any class of equity share capital in which such person or any person acting in concert with him holds shares.[85]

Takeover under the ISA means "the acquisition by one company of sufficient shares in another company to give the acquiring company control over that other company."[86] By this definition, it appears that it is only corporate bodies that can make an offer for take-over. This direct implication

[83] Section 868(1) CAMA.
[84] See section 120 CAMA.
[85] Section 131(1) ISA.
[86] Section 117 ISA.

is not consistent with other provisions of the ISA relating to take-over, as is evident in other relevant sections.[87] All the same, there is already a gap in the threshold for the requirement of control in a company. Under the CAMA 2020, control is attained once a person acquires 5% of the voting right, whereas under the ISA, 30% is required to gain control. The ISA provides a better picture on the intention of regulators on shares acquisition for control right, for under the ISA, once the threshold is attained, the offeror is mandated to make a take-over offer to every holder of any class of equity share equity share capital where he holds shares.[88] Thus the essence of disclosure under the provision of the ISA could be to notify the company and as such the Commission on attainment of the threshold or of an intention to gain control.

Making an offer for a take-over requires a take-over bid to be made by the offeror to the shareholders contemplated under the ISA,[89] and this is not made as a matter of course, as the Commission must give authority to proceed. Where an application is made for a takeover bid to proceed, the grant of authority is dependent on the effect of the takeover bid on the Nigerian economy and on any policy of the Federal Government with respect to manpower and development, particularly.[90] When read together with the provisions of the Federal Competition and Consumer Protection Act on competition, it would appear that this provision will still be subjected to the same regulatory requirement as obtainable during mergers, that is to say, the Commission, while considering the effect of the takeover bid on the economy of Nigeria, would necessarily have to consider whether such a takeover bid would lessen competition on that line of business. Competition check is implicated because even if a takeover bid does not necessarily lead to a merger, competition could be lessened through corporate communication especially where the bid is in respect of a horizontal acquisition. Invariably, horizontal acquisition of shares results to horizontal shareholdings, which exits when "a common set of investors own significant shares in corporations that are horizontal competitors in a product market." [91] Economic models, as highlighted by Einer Elhauge, show that "substantial horizontal shareholdings are likely to anti-competitively raise prices when the owned businesses compete in a

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87 See sections 131-151. In section 137, there is a specific provision for a corporation making a take-over bid, further suggesting that the general provisions on the point relate to both companies and individuals seeking to gain control in a company.

88 See section 131 ISA.

89 Those of the same class where the offeror holds shares.

90 Section 134(6) of ISA.

91 Einer Elhauge 'Horizontal Shareholding' (2016) 5 *Harvard Law Review*, (129) 1265.

concentrated market",[92] and this consequently triggers the anticompetitive regulatory measures of the FCCPA with their sweeping effects. What that means is that, once it is perceived that a take-over bid if successful would lessen competition in a relevant market, it appears that authority to proceed with the bid would be denied, thus defeating the aspiration of the offeror to gain control of the firm.

Mergers

A merger is the third mechanism for taking over control of a corporation. Typically, a merger involves the mutual decision of at least two companies to combine and become one entity[93] and may result in change of control rights.[94] A point to readily note is that, even though a merger involves the mutual agreement of the merging entities, there is always an initiating entity with usually a stronger financial power. A corporation intending to acquire control in another firm should typically be a prospering one with a trusted management. Logically, what this translates to is that, at least in principle, the management and success of the merged corporation becomes a high possibility, given that the same officers will be entrusted with the restructured company. This proposition will be valid under certain circumstances. Firstly, the two companies before the merger are, but need not be, in the same line of business, that is, horizontal mergers. This way, employing its expertise on the merged company for enhanced profit wouldn't be a tough transition on the acquiring company's management. Secondly, the management of the target company, perceived, at least in principle, as being responsible for the misfortunes of the company will be dispensed with after the merger. This is why in every of such mergers, the management of the target company will normally employ some tactics aimed at frustrating the merger talks.[95] As a response to this possibility,

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92 Ibid.

93 See Investopedia,' Merger vs Takeover: What's the difference?' <https://www.investopedia.com/ask/answers/05/mergervstakeover.asp> accessed 20 May 2020.

94 See section 92 of the FCCPA.

95 For instance, the target management may employ poison pills as a defence. The term refers to a defence strategy used by a target firm to prevent or discourage a potential hostile takeover by an acquiring company. Potential targets use this tactic in order to make them look less attractive to the potential acquirer. A company targeted for an unwanted takeover may use a poison pill to make its shares unfavourable to the acquiring firm or individual. Poison pills also significantly raise the cost of acquisitions and create big disincentives to deter such attempts completely. See Investopedia,<https://www.investopedia.com/terms/p/poisonpill.asp#:~:text=A%20poison

some jurisdictions will normally put a check on some of these tactics perceived as frustrating tactics by the management of the target company. Thirdly, there may not be need to recruit untested new members in the management, since the management of the acquiring company has been adjudged capable and worthy to pilot the company's affairs to an appreciable prosperity.

Another important point to note about the choice of merger is that, the medium of exchange used in the acquisition of control will usually be shares of the acquiring company rather than cash, and so the transaction normally minimizes the cost of purchase of shares or proxy rights in direct purchase mechanism and proxy fights.[96] The share for share denomination in the merger also comes with incentives for the shareholders of the target company. One is that, as against outright disposition, share transfer during mergers in most jurisdictions enjoys tax exemption. In Nigeria, section 32 of the Capital Gains Tax Act provides for exemption of tax on gain arising from mergers and acquisitions. According to the section, a person shall not be chargeable to tax in respect of any gains arising from the acquisition of the shares of a company either taken over, or absorbed or merged by another company as a result of which the acquired company loses its identity as a limited company, *provided that no cash payment is made in respect of the shares acquired.*[97] In both proxy fight and other forms of acquisitions, payment is made mostly by way of cash, and once that happens, any premium is subject to taxation under the Capital Gains rule. In mergers, as already noted, the consideration is shares of usually a higher worth. Thus, a shareholder with 50 units of shares in company B, a target company, may be richer after the merger since the new shares are usually higher in value, even though sometimes the quantity of the shares held in the old company may be reduced.[98] But most shareholders wouldn't really mind if they received lesser shares in number

%20pill%20is%20a,of% 20a%20new% 2C%20hostile%20party> last accessed 20 May 2020.

96 Henry Manne (n 62).

97 Emphasis supplied. See also section 104 of the Stamp Duties Act on relief from capital and transfer duty in case of reconstructions or amalgamation of companies.

98 In the Access Bank/Diamond Bank merger scheme, for instance, the Diamond Bank shareholders received N3.13 per share, comprising of N1.00 per share in cash and the allotment of two (2) new Access Bank ordinary shares for every seven (7) Diamond Bank ordinary shares held at the date of implementation. See Zainab Babalola, 'Diamond and Access Bank Merger - Changing Financial Landscape in Nigeria', https://www.mondaq.com/nigeria/commoditiesderivativesstock-exchanges/853530/diamond-and-access-bank-merger--changing-financial-landscape accessed 10 May 2021.

than they held in the old company provided that there is a prospect of higher returns on investment in the long run upon vesting the management of the new entity in some other persons.

Mergers also offer a comparative advantage to shareholders of the failing, target company who may be at the verge of losing their investment during a bankruptcy proceeding against the company. Thus, if the merger is not exploited as an alternative to bankruptcy, the assets of the company will be distributed to secured creditors first and where there are no residues, equity shareholders go emptyhanded. This loss of investment to the shareholders will be effectively avoided with mergers.[99] The comparative advantages offered by mergers, as highlighted above, among others, informed the conclusion of Manne that mergers remain the 'most efficient of the three devices for corporate takeovers, especially as they are of considerable importance for the protection of individual non-controlling shareholders and are desirable from a general welfare-economics point of view.'[100] Sadly, as further noted by Manne, many mergers would not occur due to the strict regulations of antitrust laws.[101]

Part III

Challenges Affecting the Development of the Market for Corporate Control in Nigeria

a. Definitional Issues and Supervisory Overlap in the Regulation of Control Rights Acquisition

Mergers and takeovers are the most prominent options for the acquisition of right control, as noted in the preceding chapters. In Nigeria, the two mechanisms are principally regulated by the Federal Competition and Consumer Protection Commission (FCCPC) and the Securities and Exchange Commission (SEC), with surrounding uncertainties occasioned by the definitional scope of mergers as provided under section 92 of the Federal Competition and Consumer Protection Act (FCCPA).[102]

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99 Henery Manne (n 62).

100 Henry Manne (n 62) 119.

101 Henry Manne ibid.

102 We noted earlier that the FCCPA has defined mergers in terms of acquisition of control right thereby subjecting every form of acquisition of control right to the regulation of the supervision of FCCPC. Takeover on the other hand, which is a mechanism for control right acquisition, is regulated by the SEC. The challenge posed by the definition offered under the FCCPA is that of delineating the contours in terms of the scope of regulations of the two transactions by the two agencies, especially

Under the Act, a merger occurs when one or two undertakings directly or indirectly acquire or establish control over the whole or part of the business of another undertaking, and can be achieved through amalgamation or acquisition of shares. In other words, under the Act, a merger could occur by amalgamation or by acquisition, either of which is regulated by the FCCPC. However, under the ISA, takeover means the acquisition of the shares of a company by another company of such an amount as to give the acquiring company control over the target company. Takeover is regulated by the SEC.[103]

By implication, there seems to be an overlap in the meaning of mergers and takeovers as provided by the two pieces of legislation. Under the FCCPA, it is a merger when there is an acquisition of right control through the purchase of shares in a company by another company. Under the ISA, it is a takeover when there is acquisition of shares such as is sufficient to give the acquiring company control over the target company. Under the FCCPA, however, the threshold for control through the purchase of shares is at least 51 percent.[104] Thus, when a company acquires over 50 percent of shares or voting rights in another company, a merger occurs and will fall under the regulatory purview of the FCCPA. Under the ISA, as well, when there is a purchase of shares which carries a voting right of 30% or more, the transaction is deemed to be takeover and regulated by the SEC.[105]

When it is takeover, the regulation is captured under sections 131 to 151 of ISA, and subjected to some regulatory rigors supervised by the SEC. Specifically, the procedure is that, upon the attainment of the threshold of 30 percent or more as prescribed by the Act,[106] the company acquiring such units of shares is required to make a takeover offer to the shareholders to acquire their shares. The offer is to be made by a bid and requires authority of the SEC to proceed. The authority to proceed is granted by the SEC upon a consideration of the likely effect of the takeover on the Nigerian economy or any policy of the Federal Government touching on manpower and development.[107] Approval to proceed will be denied if the takeover will have adverse effect on the two indices. However, it appears that even though s. 134(6) ISA has not mentioned competition implication of the

with the overlap of the transactions that can constitute a takeover and a merger under the FCCPA and ISA. See section 92 FCCPA and section 131 of the ISA.

103 See section 117 ISA.

104 See section 92(2)(a) FCCPA.

105 Under section 445 of the Securities and Exchange Rules and Regulations 2013 (SEC Consolidated Rules), the acquisition is restricted to only quoted companies.

106 See section 131 ISA.

107 See section 134(6) ISA.

takeover as a consideration for granting authorities to proceed the combined effects of section 134(6) ISA and section 164 FCCPA, suggest that the SEC will also be required to consider the competition implication of the takeover transaction. Section 164 FCCPA provides that the provisions of any other enactment, including the Investment and Securities Act, regulations or subsidiary laws in force relating to or connected with the subject matter of the ISA shall be read with such modifications as are necessary to bring them in conformity with the provisions of the FCCPA, the underlining effect being that the provision of section 134 ISA will now be read to include the competition effect of the proposed takeover. Otherwise, it appears that the FCCPC may still subject that transaction to its review by virtue of the provisions of sections 17(e) and 18(c) of the FCCPC empowering the Commission to investigate such transactions and compel compliance where necessary.

When the acquisition is a merger, especially a large merger, however, the transaction is subjected to approval by the FCCPC under the considerations examined in the preceding chapter. The challenge posed by this definitional interception is that a company purchasing shares in a target company for the sole purpose of acquiring right control can be subjected to merger review and may be denied the benefits of that transaction if the transaction does not meet up with the criteria drawn up under the FCCPA, such criteria including subjecting the transaction to a rigid competition test. Going by the definition of mergers as offered under FCCPA, therefore, it is now difficult to know when a particular transaction becomes a merger to be subject to supervision by the FCCPC, and when it is a takeover to be supervised by the SEC.

The Regulation however makes an attempt at resolving this challenge by providing in Reg 9 that a party undertaking a transaction of that nature may apply to the FCCPC for clarification on the status of the transaction. This provision suggests then that a company intending to acquire a control right for the purpose only of controlling the composition of the management may be subjected to the same regulatory rigors as with companies undertaking a merger for some other purposes, since the FCCPC, by virtue of its functions and powers to investigate and order compliance with the provisions of the FCCPA, may upon investigation, order the acquiring company to apply to it for a review of that transaction once the threshold is attained.[108] This position is strengthened by the fact that the FCCPC is made superior to any

[108] See sections 17 and 18 of the FCCPA.

other Act including the ISA.[109] In the same vein, it is even possible that a transaction may have been concluded in compliance with the procedural requirements under the ISA and its Rules, and the FCCPC may still compel the acquirer to subject the transaction for its supervision pursuant to its powers under the Act,[110] especially if it perceives that the transaction may likely substantially present or lesson competition, a factor which is not directly contemplated in granting authority to proceed in a takeover regulation. Such back and forth movements implicated by this definitional fog do not appear business friendly and may constitute a major setback in the overall attempt to boost the Nigerian economy.

Under the UK law, acquisition of right control is regulated by the provisions of the City Code on Takeovers and Mergers, with well delineated contours in terms of the supervisory role of the Takeover Panel on takeovers and mergers.[111] In its meaning of mergers under section 904, the Companies Act offers a definition of mergers that does not intercept with the meaning of takeovers in any material way. Section 904 of the English Companies Act 2006 provides unequivocally that, [A] scheme involves a merger where under the scheme the undertaking, property and liabilities of one or more public companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing public company (a "merger by absorption"), or (b) the undertaking, property and liabilities of two or more public companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, (a "merger by formation of a new company").

> (2) References in this Part to "the merging companies" are—
> (a) in relation to a merger by absorption, to the transferor and transferee companies; (b) in relation to a merger by formation of a new company, to the transferor companies.

This implies that the challenge which may be encountered by parties undertaking transactions for acquisition of control rights are certain on which agency to approach in effecting such transactions, since under the City Code, it is clear that when a person or group intends to interests in shares carrying 30% or more of the voting rights of a company, there is no doubt that their transactions fall under the supervisory purview of the takeover

[109] See sections 104 and 164 of the FCCPA.
[110] Sections 17 and 18 FCCPA.
[111] See the City Code, Rule 21.

Panel.[112]

b. Strict Application of Competition Law in the Acquisition of Right Control Under the FCCPA, a merger is subjected to two major considerations – competition and public interest tests. Under section 94(1) FCCPA, when considering a merger, the FCCPC shall determine whether or not the merger is likely to substantially prevent or lessen competition,[113] or whether or not the merger can be justified on substantial public interest grounds. In assessing the competition effect of the merger, however, only two factors are made to override an adverse competition effect, that is, technological efficiency or anticompetitive gain of the merger and substantial public interest grounds.[114] The overall implication of the provisions above is that competition consideration prevails over any other considerations apart from technological efficiency and public interest factors.

In considering whether or not the merger will likely to substantially prevent or lessen competition, one of the factors that will help the Commission in forming its opinion is whether the business of part of the business of a party to the merger has failed or likely to fail. Sadly, the qualification of a failing corporation under the 2020 Regulations is poor and unappetizing. Accordingly, under the Regulations, the failing firm argument is a defence to a merger that would otherwise led to a substantial prevention and lessening of competition, and an undertaking is deemed to be failing or to have failed if and only if the firm's extinction from the market is inevitable at the point of the merger.[115] In coming to this conclusion, the Commission is guided by some qualifying elements, that is to say, among other things, that the firm must be unable to meet its financial obligations in the near future and that the merger remains a last resort to saving the firm from extinction.[116]

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112 See 'The Takeover Code' <https://www.thetakeoverpanel.org.uk/the-code/download-code> last accessed 25 March 2021.

113 See section 94(1)(a) FCCPA.

114 Section 94(1)(b) FCCPA.

115 See generally Reg 30 of the FCCPA Regulations 2020 (2020 Regulations).

116 Reg 30 of the 2020 Regulations. The Merger Notification Guidelines however provide that four limbs to which the failing firm arguments are subjected, that is to say, to succeed in the failing firm defence, i. the firm must be unable to meet its financial obligations in the near future (Limb 1); ii. there must be no viable prospect of reorganizing the business through the process of receivership or otherwise (Limb 2); iii. the assets of the failing firm would exit the relevant market in the absence of a merger transaction (Limb 3); and iv. there is no credible less anticompetitive alternative outcome than the merger in question (Limb 4). See generally section 6.3 of the Merger Review Guidelines 2020.

As stated earlier, these conditions for the failing firm defence are too restrictive and unappealing, reason being that, it is difficult to see an acquiring firm make effort at taking over control a firm that is at point of no return, except for cheery picking or other combination techniques which do not necessarily approximate to acquisition of control rights. The working of the market for corporate control will be greatly hampered if competition consideration requirement is slammed on an approval for the acquisition of control right with equal force as when the merger or takeover is for other business efficient purposes. In effect, the failing firm defence should not be limited to the conditions stipulated under the regulations as highlighted above. A firm need not be in an irredeemable condition before its acquisition can be allowed to override the anticompetitive effect test. Manne had envisaged also a situation where the target firm has some chances of survival even without the merger or takeover.[117] The yardstick given by Manne is a fall in the company's share price, which could be a considerable fall obviously reflective of mismanagement or poor leadership direction provided by the management of the failing company. The point being made here is that, a firm need not be in its worst state to be deemed a failing firm, the defence of which prevails over competition consideration.

Nigeria's economy is too fragile for all forms of mergers to be subjected to the same rigid consideration of competitive effect before granting an approval to proceed. Foreign companies which may desire to acquire a Nigerian company may be greatly discouraged if the only reason it can be allowed to scale through antitrust barriers is to enter into such transaction with a Nigerian company that is in an undesirable state, other factors being intact, of course.

Granted that the provisions of the FCCPA on the failing firms defence are in line with what obtains in some jurisdictions, but strict adoption of the criteria for determining what constitutes a filing firm in developed economies is only a blind copy with a dangerous trap.

In most developed economies, the approach adopted in arriving at a conclusion that a firm is failing is to reduce the merged entity's estimated market share in order to reflect its weaker potential, and require evidence to show that: i) a party to the merger is insolvent according to normal accounting usage; ii) the failing firm cannot be reorganised into a viable entity; iii) a good faith attempt has been made to identify a less anticompetitive alternative to the merger; and iv) were the merger to be

[117] See Henry Manne 'Mergers and the Market for Corporate Control', (1965) 73 *Journal of Political Economy* 110.s

blocked, the failing firm's assets would exit the industry.[118] However, there are nuances in their responses as to 'what exactly constitutes a failing firm. How bankrupt must it be; how soon does it have to be likely to fail; and what are the criteria that one can use to establish that there is a failing as opposed to a "flailing" firm'.[119] In the response provided by Canada, it explained that it does not regard a firm as failing merely because it is not making what its management considers to be an adequate rate of return.[120] In Norway, the position shifts considerably to consider the ability of the a transitory firm to recoup its expenses. In its submission of a brewery case,

> [I]t was critical to decide whether or not a probable inability to recoup in the long run the high costs of a modernization investment amounted to a firm being in the failing category. He then called on Norway for further elaboration. Norway noted that its failing firm defence requires a high probability that absent the merger, the firm will leave the market. The first task then is to assess whether the firm is really failing. In the brewery case, the target company's own financial statements revealed that there were merely transitory difficulties. There was also evidence that the firm could readily have expanded production using its modern production facilities and strong brand names. In addition, there were two probable alternative purchasers which would have posed less danger for competition. It was irrelevant to the analysis that they would likely have offered a considerably lower price for the failing firm. The Norwegian Price Directorate's recommendation to oppose the brewery merger was not followed by the Price Council, partly because the majority on the Council felt that the merger target would not have been able to survive in the long run as an independent agent.[121]

The United States have a more generous meaning of what constitutes a failing firm, taking into account industry-wide distress of the target firm.[122] The OECD noted that, in its submission on what criteria must be satisfied for the failing firm defence to be admissible, the United States

[118] See the 'OECD Policy Roundtables Failing Firm Defence 1995', https://www.oecd.org/competition/mergers/1920253.pdf > last accessed 25 May 2021.
[119] Ibid.
[120] Ibid.
[121] Ibid.
[122] Ibid.

Federal Trade Commission,

> [R]eferred to an increasing number of instances where failing/flailing firms or entire industries are associated with growing global competition, surging imports, falling outputs and rising unit costs. In the future, the U.S. and other countries may want to ensure that capacity is retired and firms exit in a way that enhances an industry's ability to globally compete. That would lead to a slightly different and perhaps more generous interpretation of a failing or flailing firm defence, one that takes into account industry-wide distress.[123]

It was also noted that the United Kingdom does not prohibit mergers of any sort and does not have a notification system. Accordingly, 'in practice U.K. authorities are much less concerned about whether a firm is failing or flailing, but instead focus on the underlying causes of the financial distress.'[124] A merger involving a failing firm in the UK 'would probably be opposed if it were likely to create a dominant position and if a more competitive outcome might well result by letting the firm fail.'[125] It is important to also note that in the UK, 'strategic considerations also apply in certain industries, notably defence where the peace dividend is showing up as a contraction in the market and increased concentration.'[126]

Summarily, in its adoption of the failing firm criteria, Nigeria should take a more liberal approach to see that there is a high survival rate of both firms after the merger. A firm having transitory difficulties for instance should be considered a failing firm for the purpose of undertaking a merge. That could increase the acquisition endearments and make the market for corporate control more vibrant than it presently is.

Management Interference in the Allocation of Acceptance Decision in a Takeover Bid

In the regulation of acquisition of control right through takeovers in Nigeria, Rule 447(4)(b) of the SEC Rules requires the bid to be made to the shareholders of the target company. The effect of this provision is that the approval of the directors of the target company is dispensed with during a takeover bid. If the target board's approval is required for an offer for takeover to be accepted, the possibility of having the board of the target

123 Ibid.
124 Ibid.
125 Ibid.
126 Ibid.

company block the takeover will be high, and that may slow down the takeover or diminish its viability. Allocating the acceptance decision to the shareholders alone thus constitutes a powerful incentive for the management of the target company to always act in the interest of the shareholders especially when such a bid is being made.[127] This provision is in line with the UK's City Code which allocates the acceptance decision to the shareholders alone.[128] Gower has explained that with this provision in the City Code, bidders are able to make hostile takeover offers which are in effect "offers which the board of the target opposes but which it is not able to prevent being put to their shareholders."[129] It is on this strength that Gower argues in favour of the market for corporate control as probably a much more powerful mechanism for the promotion of the interests of shareholders than all the corporate governance technics…, including the law of directors' duties."[130] This is because, since the transaction can be concluded between the shareholders of the target company and the bidder without the input of the board, the board will then be compelled to make adjustments that will favour the interest of the shareholders in terms of profit maximization, so as to avoid being fired upon the completion of the transaction in focus. Their response will thus be motivated by the fact that, they can only retain their position if and only if they optimize performance to the satisfaction of the shareholders, since optimal performance may discourage the continuation of the transaction that otherwise would see to their exit from the company.[131]

Seeing that the power to block the takeover is not within their reach, the management may explore other options that can upset the process of acquisition of control right through takeover bid, even in the absence of ostensible decision power. Such options available to the management will normally include refusal to register transfer of shares and other

[127] See Gower and Davies *Principles of Modern Company Law* (8th edn, London: Sweet & Maxwell 2008) 984-985.

[128] This position however differs from the German provision.

[129] Gower and Davies (n 26) 985.

[130] Ibid.

[131] It has however been argued that such response induced by the threat of takeover compels the management to come up with hasty decisions that yield only short terms results. Be that as it may, it has been accepted that the tension created by takeover induces a positive managerial response and is only possible in the absence of decision-accepting power of the management. See Gower, ibid, where it was noted that the short-term result produced by the MCC should be undermined for a long-term result, one which ultimately benefits the shareholders themselves as well as other stakeholders such as the employees of the company.

defence mechanisms available under the law.[132] In Nigeria, for instance, s. 140 ISA allows the directors of the target company to send to director's circular to the shareholders of the target company at least seven days to the day the bid is to take effect.[133] Where a director of an offeree company is of the opinion that a take- over bid is not advantageous to the shareholders of the offeree company, or where a director disagrees with any statement in a directors' circular, he shall be entitled to indicate his opinion or disagreement in the directors' circular requiring his opinion or disagreement, he shall include in the circular a statement setting out the reasons for his opinion or disagreement.[134] A take home point here is that, whilst the power to directly block the approval of a bid has been taken away from the management by the rules regulating takeover bid, the Nigerian law permits the management of the target firm to give opinion as to the impact of the bid on the welfare of the shareholders of the target firm.[135] The opinion expressed in the director's circular remains persuasive but has the potency to fetter the discretion of the shareholders in reaching a decision on merit, especially as there are no other provisions restricting the possibility of such opinion to go wide against the bid, unlike what obtains in the provisions in the UK City Code.

In the UK City Code, General Principle (GP) 3 provides that 'the board of directors of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the takeover bid.' Thus, in giving its opinion on the advantages a particular bid holds under the ISA, the board must base his judgment on the best interest of the shareholders alone.[136] This provision, as potent as it appears in shaping the opinion of the directors, is not sufficient to prevent further attempts by the management to frustrate the transaction.

The UK City Code thus goes further than General Principles as captured above in taking a 'no frustration' stand in the transactions affecting a bid for takeover.[137] Under City Code, Rule 21 requires shareholder approval for any action proposed by the directors of the target firm which could

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[132] See section 22(2) CAMA, for instance, empowering directors of a private company to refuse the registration of transfer of shares. This is potential defence mechanism not checked by the any other provisions in our law, and is capable of a backdoor exploitation by the board.

[133] Section I40(1) ISA.

[134] Section 140(4) ISA.

[135] Ibid.

[136] Ibid.

[137] See Gower and David (n 26).

have the result of preventing the shareholders of the target firm from deciding on the merit of the bid.[138] Rule 21.1(b) of the City Code goes further to list the such transactions where the approval of the shareholders will be required to include issue of shares, acquisition or disposal of the target company's assets of material amount and entering into contracts other than in the ordinary course of business.

There is no equivalent provision of Rule 21.1(b) of the City Code under the Nigerian law. The effect of such unchecked powers in our law could be that directors can, subject to the provisions in the Articles of Association, block an imminent bid by exercising its right of refusal to register the transfer of shares in a private company. Section 22(2) of CAMA provides that a private company may restrict the transfer of its shares. Such restriction may be provided in the Articles by authorising the directors to refuse to register the transfer of a share.[139] It then follows that, if the board perceives that a particular acquisition by a potential bidder is an attempt to acquire control right through acquisition of shares, it may block the potential bid by exercising its powers to refuse the registration of shares,[140] so as to retain its position in the target firm, even at the detriment of the shareholders' overarching interest. To effectively constitute a mechanism for management control, the law should be able to minimize or completely remove the influence of the board in an imminent takeover so as to allow the shareholders to arrive at a decision on merit, except, of course, where such interference would be to the advantage of the shareholders ultimately.

It would appear that since there is a possibility of unsophisticated shareholders who may not know the implication of the bid, there is need to allow a considerable interference by the management. The response to protecting the shareholders from exploitation that may inhere in a particular bid may not necessarily lie in increasing the board's interference. In the US, the principle of neutrality of the board is maintained[141] but they are other forms of protection offered to the shareholders. In the end, the success and failure of the bid is left to market forces and not to the discretion of the board, which may swing the discretion to suit their personal interest. Guido and Geoffrey noted that, as part of the protection offered to the shareholders under the Williams Act, schedule 13d imposes disclosure

138 Ibid, 986.

139 See the Default Articles of Association provided by the Corporate Affairs Commission upon registration of a company.

140 Ibid.

141 Guido Ferrarini and Geoffrey P Miller 'A Simple Theory of Takeover Regulation in the United States and Europe', *Cornell International Law Journal* (42)(3).

requirement on any purchaser who acquires five percent or more of a registered equity security even prior to the launching of a tender bid. 'Having provided the necessary information; the bidder may go forward with the bid, leaving the success or failure of the offer up to market forces.'[142] They further noted that, as implemented by the US SEC,

> [T]he Williams Act contains certain other protections for shareholders of the target firm. For example, shareholders are permitted to withdraw their shares as long as the bid remains open. The bidder must purchase all shares at the same price, even if it increases the offering price after a shareholder has tendered. If the bid is for only some of the shares and more are tendered, the shares must be purchased on a pro rata basis. The bidder cannot discriminate among shareholders by favouring some or excluding others. False or misleading statements or omissions in connection with a tender offer are prohibited. Although these provisions do limit the ability of bidders to apply pressure on target shareholders to tender into the bid, they in no way limit the ability of a bidder to succeed in a hostile acquisition if the offer is made at a fair price and on an even-handed basis.[143]

Even though the Williams Act confers no private rights of action in a takeover transaction, the US courts, however, 'have recognized several such rights by implication.[144] "Targets and bidders, as well as shareholders, have standing to seek injunctive relief to enforce both the statute and implementing regulations.'[145]

Rather than increase the management's involvement in the outcome of the bidder, there should be heightened protective mechanisms for especially unsophisticated shareholders in a dispersed or even closely held shareholding.

Recommendations

Having examined the current framework regulating the market for corporate control in Nigeria, and having identified the issues and challenges surrounding its effectiveness, the following recommendations are

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142 Ibid, 306.

143 Ibid.

144 In *Mobil Corp v Marathon Oil Co*, 669 F.2d 366 (6th Cir 1981), the US Court recognized the bidder's right to sue for injunctive relief. See Guido and Geoffrey (n 39), 306.

145 Ibid.

appropriate:

Amendment in the definition of merger and delineation of regulatory ambits of the relevant agencies

The definition of mergers should be given its technical meaning of amalgamation of undertakings, as obtainable in the UK and India,[146] so that the possibility of supervisory overlap will be minimized. Even though the FCCPA in its regulations has advised a party to a merger to approach the FCCPC for clarification on the status of a particular transaction,[147] that provision does not seem adequate as such pre-notification exercise could be time-consuming given the bureaucratic bottlenecks that characterise such processes in Nigeria. Ultimately, such back and forth movements could serve as a disincentive to parties undertaking transactions for control rights, and that will, at least in the long run, diminish the prospects of a vibrant market for corporate control in Nigeria.

Competition consideration should be relaxed during review of transactions involving control rights

There is strict application of competition law during merger review in Nigeria. A merger may be blocked if it is found that it will likely substantially prevent or lesson competition except where the outcome of the merger will lead to technological efficiency or other pro-competitive gain, or when the merger will affect in some positive way public interest such as employment.[148] The consideration should be extended to include situations where the interest is purely that of acquisition of right control. Accordingly, the failing firm defence should be accommodated as a third factor in the exception given under section 94(1)(b) FCCPA. Granted that the failing firm defence constitutes a test under section 94(2)(g) FCCPA, those criteria for assessment of a failing firm are too restrictive. A firm in a transitory stage, for instance, should be granted the status of a failing firm. Where the shares of a company have falling in value considerably, or where the shareholders' returns have diminished significantly overtime, the failing firm defence should prevail over competitive effect of the merger, whether or not the merging firms enjoy dominant markets. This is particularly because, if the only conditions that will allow a failing firm

[146] Merger is not usually defined with reference to acquisition of right control. This is because in most cases, there is usually no exchange of control right after merger. The English Companies Act in section 904 defines merger in terms of amalgamation of assets. The India Act copied the UK definition in its 2013 Companies Act.

[147] See Regs 9 and 10 of the FCCPA Regulations 2020 (2020 Regulations).

[148] See s. 94(1)(b) FCCPA.

defence to prevail are those listed in the regulations,[149] it will constitute a minimal incentive to acquiring companies intending to acquire the failing corporation. The point being made is that, the meaning of a failing firm should be given a more liberal interpretation so as to serve as an incentive to initiate and undertake a merger in Nigeria.

There should be adequate provisions that limit or exclude management interference in takeover bids.

It was noted in the work that in determining the outcome of a takeover, the Nigerian law maintains a neutral posture in that it allocates the acceptance decision power to the shareholders alone.[150] However, there are other provisions in the ISA that weaken that neutrality in acceptance decision.[151] For instance, under section 140 Sec Rules, the board is allowed to issue director's circular giving its opinions as to the effect of the outcome of the bid. In giving its opinions, however, the law stipulates that the interest of the shareholders should have pre-eminence.[152] This is not sufficient, as there are no provisions to guide against the exercise of that discretion. Under section 22(2) of CAMA, for instance, the directors can refuse to register the transfer of shares. It is possible then that where there is an imminent bid, the directors of a private company may block the takeover beforehand by exercising their power to refuse under section 22(2) CAMA. The mischief intended to be cured under Rule 447 Sec Rules would have been defeated through the back door. The UK City Code provides a useful guide, in that it prohibits any such transactions without the approval of the shareholders. That is to say, once there is an imminent bid, the board is no longer allowed to carry out certain transactions without the approval of the shareholders.[153] There should be equivalent provisions under the Nigerian law to check the excesses of the directors during an imminent bid. If it is clear to the directors that they cannot block a bid for takeover, they will often be induced by a threat of replacement that will follow a successful bid. This is the idea behind the market for corporate control. Thus, the market can be made more vibrant and active than it currently is if there are provisions in the relevant laws that prohibit the management from entering into certain transactions that can block an imminent bid.

149 See Reg 30 of the 2020 Regulations.
150 See Rule 447(4)(b) of the SEC Rules.
151 See section 140 ISA.
152 See section 140 ISA.
153 See Rele 21 of the UK City Code.

Conclusion

If the directors are allowed to manipulate the outcome of acquisition of control right in any material instance, it will be difficult to have them threatened by an imminent takeover bid or related transactions. It is then usual to see the directors advise or approve of mergers or takeovers only when they have negotiated an equivalent or more prominent position in the scheme or in an agreement following a bid or merger signal. The outcome of a bid or merger should not depend on the management otherwise the mechanism will be weak in having the management induced by a takeover threat. The market for corporate control produces optimal effect on managerial efficiency only when it can sufficiently induce a threat that is capable of beating the management into alignment with the utmost interest of the shareholders. The prevailing opinion is that the market for corporate control acts as a formidable complement to the internal control mechanisms of corporate control. The gains of this market in achieving optimum corporate governance can only be realised in Nigeria when the market is able to constitute an effective threat and influence on the actions of the management. To boost managerial efficiency and economic viability in the Nigeria's corporate sector, therefore, loopholes in the provisions regulating takeovers and mergers should be closed so as to allow the effective working of the Nigeria's market for corporate control.