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19 October 2023

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TEMPLARS ThoughtLab

Minority Investors' Special Rights: A Slippery Slope in Nigeria's Merger Control Regime

Introduction

The landscape of global finance is undergoing a significant transformation, marked by a series of impactful events such as the worldwide interest rate hikes, escalating tensions with Israel, the Russia/Ukraine crisis, and the persistent spectre of global inflation. These macroeconomic forces have collectively signalled the end of the era of "easy money" in global finance, with resulting uncertainties that pose substantial challenges to deal-making strategies across diverse markets.[1]

In response to the prevailing market conditions and increased volatility, private equity investors have found it imperative to reassess their deal-making approaches. Notably, the initial half of 2023 witnessed a decline in control leveraged deal-making across various markets due to the rising interest rates which made access to debt financing more challenging.[2]

Rather than retreating from the dealmaking arena, some private equity funds have adapted their strategies by opting to acquire minority stakes in businesses. This approach allows them to retain the potential for acquiring a majority stake through various mechanisms at a later stage. Some experts suggest that this shift towards minority investments is likely to persist and define the deal-making landscape in the foreseeable future.[3]

Whilst the acquisition of minority stakes appears to be a strategic response by many investors to the prevailing market situation, it is essential for investors to recognize that a careful consideration of related merger control issues is imperative, as these issues are far from straightforward, given the intricacies often associated with even minority investments in the context of merger control and approvals.

[1] Bain & Co's Global Private Equity Outlook 2023.
2 Global private equity report 2023 (2023) Bain & Company. Available at: https://www.bain.com/insights/topics/global-private-equity-report/ at page 11 (Accessed: 04 October 2023).
3 European Private Equity in 2023: A broadly positive outlook despite economic headwinds (2023) Financier Worldwide. Available at: https://www.financierworldwide.com/european-private-equity-in-2023-a-broadly-positive-outlook-despite-economic-headwinds (Accessed: 04 October 2023).

An insight into Nigeria's Merger Control Regime

Merger Control in Nigeria is regulated principally under the Federal Competition and Consumer Protection Act ("**FCCPA**") and the regulations made pursuant thereto by the Federal Competition and Consumer Protection Commission ("**FCCPC**"). Under the FCCPA, approval of the FCCPC is required prior to the implementation of any transaction where: (a) a merger occurs which occasions a change of control; and (b) the merging entities meet the statutory turnover threshold.

A merger is deemed to have occurred when one or more undertakings directly or indirectly acquire, or establish direct or indirect, control over the whole, or part of the business of another undertaking. This could be achieved through: (i) the purchase or lease of the shares, an interest in, or the assets of, the other undertaking; (ii) an amalgamation or other combination with the other undertaking; or (iii) a joint venture between the two entities.

An undertaking will be said to have control over the business of another undertaking where it acquires or has:

a. the beneficial ownership of more than 50% of the issued share capital or assets of the undertaking;
b. control of a majority of the votes that may be cast at a general meeting of the undertaking;
c. the ability to appoint or veto the appointment of majority of the directors of the undertaking;
d. the status of a holding company over the undertaking;
e. (for trust undertakings) the ability to control majority of the votes of the trustees; to appoint majority of the trustees; or to appoint or change majority of the beneficiaries of the trust; and
f. the ability to materially influence the policies of the undertaking in a similar fashion as a person who can exercise any of the preceding powers, together (the "**Control Test**").

Where the Control Test is satisfied and in addition to that, the transaction meets the relevant statutory turnover threshold *(which is that the combined annual turnover of the acquirer and the target in, into or from Nigeria is up to NGN 1,000,000,000.00 or more (approx. USD 1,300,000); or the annual turnover of the target in, into or from Nigeria is at least NGN 500,000,000 or more (approx. USD 650,000) (the "**Turnover Test**"),* the merger is deemed to be a notifiable merger which requires the FCCPC's prior approval.

Complexities Surrounding Minority Special Rights

In the context of a merger or transaction which has a connection to the Nigerian market, where an investor acquires a majority stake of 50% of the shareholding in a target undertaking, whether accompanied by Special Rights (as defined below) or not, and the Turnover Test is met, the process of determining and resolving merger considerations tends to be more straightforward. In such a situation, the merger parties can readily establish that the merger indicators (namely the Control Test and Turnover Test), have been triggered and thus that the FCCPC must grant prior approval for the implementation of such a transaction.

However, the factors at play may not be as straightforward in cases where an investor obtains a minority stake (typically less than 50%) and that stake is coupled with specific investment protection provisions, such as veto rights, pre-emption rights; control over critical business contracts; assumption of critical creditor rights; access to key business insights related to the target company strategic minority shareholding involvement, etc. (the "**Special Rights**").

At first glance, the presence of Special Rights may not appear to involve elements of control significant enough to immediately warrant consideration under merger control regulations. However, in reality, these rights could potentially disrupt the status quo and lead to a thorough examination of complex merger control issues in Nigeria.

These Special Rights can manifest and be relevant in multiple scenarios within the Nigerian merger control system, including, but not limited to:

a. Veto rights

When a minority holder has the power (contractual or otherwise) to veto or influence the policies of an undertaking, that minority investor may be deemed to have Special Rights that could trigger the Control Test requirements for a merger.

Ordinarily, where an investor has a minority stake that is coupled with a veto right that enables it to exercise some influence on the day-to-day running of a target undertaking, it should not be bugged down by merger control restrictions or considerations. The key factor here should be whether such veto rights are so substantial as to empower the investor to effectively shape the strategic business decisions of the relevant company.

Indeed, some minority investors have objected to the applicability of the Nigerian merger control requirement in such context, arguing that their intention was not to actively influence the strategic business decisions of the target company but to merely reserve those veto rights should the need arise for them to protect their investments. Nevertheless, the FCCPC has, in several cases, rejected these views because the merger control rules specify that the mere presence of veto rights is enough to trigger the requirement, regardless of whether they are actively used.

It is also worth noting that it is not necessary for a minority investor to have all the veto rights required to determine the overall strategic business behavior of the relevant undertaking, rather it is sufficient that only some, or even one exists.

b. Strategic Minority Involvement

Where an investor acquires a minority stake without more, it typically does not trigger the merger control requirement. However, where the minority stake is such that gives the investor certain rights, powers, and privileges in respect of the target undertaking, then legitimate merger concerns are likely to arise in such scenarios. Below, we provide examples of situations where such concerns may arise:

(i) Scenario I

Where an investor acquires up to 25% of the shareholding of the target undertaking, it acquires the unique ability to (without more) block special

resolutions of the target undertaking, which requires a threshold of 75% voting rights threshold under Nigerian law.

A 25% minority stake therefore confers upon such investor a rebuttable presumption of the ability to materially influence the business policy of the target undertaking. This rebuttable presumption is particularly strengthened where the 25% stake is attached with other Special Rights. Rebutting the presumption, particularly in instances where such a minority stake is coupled with Special Investor Rights, is usually difficult.

(ii) ***Scenario II***

Where an investor acquires up to 15% of the shareholding of the target undertaking, this also places the investor in a unique position to block strategic business decisions such as a mandatory takeover as contemplated under the Investment and Securities Act 2007.

There is currently no regulatory presumption of material influence for shareholdings below 25%, however, the FCCPC may in certain instances decide to assess the potential material influence of shareholdings of over 15%, and exceptionally, shareholdings of less than 15% in certain market sectors.[4]

(iii) ***Scenario III***

When an investor secures a minority equity stake in a target undertaking and also obtains the authority to appoint a majority of the board members, it grants the investor a distinctive position to exert influence on the alter ego of the target undertaking. This influence may be wielded in such a manner that may lead to the target undertaking adopting a less aggressive competitive stance or behaving in a less competitive manner to safeguard the investor's financial interests.

(iv) ***Scenario IV***

Where a minority shareholder is the beneficiary of certain contractual rights in a shareholders' agreement, investment agreement (or howsoever called), the transaction in which the minority shareholder acquires such rights may be notifiable. Some of the common rights or factors that may trigger such a merger review include: (i) the existence of preferential voting rights for the shareholding in question; (ii) the existence of any convertible loan arrangement or other shareholder loan arrangement that confers influence over certain decisions; (iii) the extent of information rights available to the acquirer; (iv) any restrictive covenants or benefits attaching to the acquired shares; (v) any pre-emption rights in relation to the sale of shares or assets; (vi) the power to influence the budget, the business plan, major investments or the appointment of senior management; (vii) the provision of consultancy services by the acquirer to the target undertaking; (viii) control over critical business contracts; (ix) assumption of critical creditor

[4] The two scenarios above (25% and 15%) are rather interesting considering that a holder of even 5% shareholding could, in reality, also block the decision of a 95% holder if such decision is required to be unanimous. Should such a de minimis shareholder be considered to have "material influence" such that the acquisition of 5% shares by it, coupled with the right to unanimous votes on selected matters immediately trigger merger notification?

rights; and (x) access to key business insights related to the target undertaking; etc.

Navigating the Special Rights Slippery Slope: Investor Takeaways

Surveys conducted in different jurisdictions reveal that competition authorities in most markets acknowledge that minority shareholding, particularly when coupled with Special Rights, can give rise to merger control-related concerns. As a result, it is crucial for investors to proactively address these concerns at an early stage in the deal-making process to adeptly manage the intricacies of Nigerian merger control.

While the determination of what constitutes "material influence" or "special rights" will ultimately depend on the peculiar facts of each case and will be determined on a case-by-case basis, investors and transaction parties should watch out for the nature of special rights which they assume or reserve for themselves in their investment agreements, shareholders' agreements, etc. This is because the mere assumption of certain "special rights" by an investor may well be a slippery slope towards triggering merger notification and review, even if such investor only holds a minor or insignificant stake.

Seeking expert guidance enables investors to explore alternative strategies to ensure the transaction remains compliant while reflecting the commercial intention of the parties. These strategies may encompass but are not limited to exploring the "ordinary course exemptions", which involves a careful examination of the transaction structure to determine if it qualifies as acquisition and resale by credit institutions, financial institutions, or insurance companies. This exemption applies when these entities acquire securities of target undertakings as part of their ordinary course business operations on a temporary basis, or when the target undertaking is raising capital.

While the ordinary course exemption might appear appealing, there is a critical regulatory time limit for the disposal of such stakes.[5]

Another potential navigation approach when one is getting into the "prohibited zones" might be to carefully consider whether the rights assumed relate to the acquirer's ability to materially influence policy relevant to the behaviour of the target undertaking in the marketplace, and whether the rights or influence relate to the strategic direction of the target undertaking, or the ability to define and achieve the target undertaking's commercial objectives. To qualify for merger control considerations, the rights should ideally go beyond the veto rights normally accorded to minority shareholders in order to protect their financial interests as investors in an undertaking.[6]

Lastly, expert engagements, detailed analysis of transaction structures, early regulatory interface, and in appropriate cases, seeking regulatory "No-objection" rather than a full-blown approval that entails going through the standard merger control/approval process may be key to navigating any intricacies or challenges that minority stakes versus special rights may pose for transaction parties.

[5] There may be some flexibility to request an extension of the time frame from the FCCPC, although these extensions are typically evaluated on a case-by-case basis.

[6] One is able speculate about this based on the FCCPC's thought process in its guidelines and on some other transactions.