Regulatory Alert

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Key consideration for business reorganisation

Introduction

Many businesses are passing through turbulent times: to stay afloat, a business may elect to adjust its structure, operations, or ownership in such a way that enables it to remain a going concern. The process of making this adjustment is commonly referred to as business reorganisation.

This publication highlights what business reorganisation is and the forms of business reorganisation available to businesses in Nigeria
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1 What is Business Reorganisation?

Business reorganisation is a type of corporate action taken that involves significantly modifying the debt, operations, or structure of a company as a way of limiting financial harm and improving the business. It also means re-organisation of the business of a company to increase its efficiency and profitability.

A business reorganisation may occur either internally, such as arrangement and compromise, arrangement on sale etc or externally, such as merger, take-over, acquisition, etc.

2 Reasons for business reorganisation

- When a company is under duress, which in most cases can be a financial duress or when a company wants to make significant changes to its financial or operational structure (Financial restructuring).
- When a company is preparing for a sale, buyout, merger, change in overall goals, or transfer of ownership or when a company wants to reorganise its management. (Organisational Restructuring).
- Technological restructuring for the purpose of exploring technological expertise; and
- Market restructuring with respect to products, market segments, industry alignment etc.

3 Advantages of business reorganisation

One of the advantages of reorganising for many businesses is simply survival. While reorganising a business is clearly a lifeline for those in debt or suffering terrible market conditions, the process may also inspire a number of benefits that enhance a business's long-term prosperity including:

- Increased efficiency
- Improved debt management
- Cost reduction
- Refined brand identity

[1] Rule 449 (a) SEC Rules 2013

4 Types of business reorganisation

Business Reorganisation may take any of the following forms:

• Internal reorganisation

Internal reorganisation is typically used when a business has a high debt profile and wants to keep its corporate identity without the involvement of a third party.

Types of internal reorganisation

- **Arrangement and compromise**
  Any change in the rights or responsibilities of a company's members, debenture holders, or creditors, or any class of them, is characterised as an arrangement. A compromise is simply an agreement made by the business with its creditors and/or members or a class of them to accept less than they are truly entitled to in full and final satisfaction of the obligations owed to them by the business.

- **Arrangement on sale**
  A business enters into an arrangement on sale when, by special resolution, it decides to enter into a members voluntary winding-up and appoints a liquidator to sell all or part of its undertaking and assets to another corporate body, whether or not it is a company, in exchange for partially or fully paid shares that will be distributed to the company's members in accordance with their rights in liquidation.

- **Increase or reduction of share capital**
  Internal reorganisation might include increasing or reducing a company's share capital. Changes to the business's share capital can help it overcome financial obstacles and reorganise.

- **Management buy-out**
  Management buy-out occurs when a company's management team obtains ownership of the business or its subsidiary, with or without third-party investment, in order for the company to survive.[1] The management is normally made up of the company's directors and officers. This reorganisation option is used to avoid an external takeover, acquisition, or merger by other parties who may not share the company's objectives.

• External reorganisation

The procedure known as "external reorganisation" entails several companies restructuring the company's vital components, including ownership, management, assets and liabilities.

Types of external reorganisation

- **Mergers**
  A merger is the combination of two or more companies. It occurs when one or more undertakings directly or indirectly acquire or establish direct or indirect control over the whole or part of another undertaking. Merger can take the form amalgamation, consolidation, or absorption or by forming a new company. Some advantages of merger include diversification, increased profitability, lower cost, new market etc.
  Generally, the merger can be concluded in either of the following ways:

  i. Horizontal merger
  It is a merger of two or more companies that compete in the same industry. It is designed to achieve competitive advantages.

  ii.Vertical Merger
  It is a merger which takes place upon the combination of two companies which are operating in different parts of the same supply chain. It is a fusion of two or more companies in business that appear to be complimentary.

  iii.Conglomerate Merger
  It is a merger of companies involved in totally unrelated business activities i.e., the business of two companies is not related to each other horizontally nor vertically.

  It is a merger of different kinds of business under one flagship Company.

- **Acquisition**
  An acquisition is a business reorganisation where one firm buys all or part of another company's stock or assets for the purpose of gaining control and expanding its business. This may also take the form of a takeover or a buyout. An acquisition may be friendly or hostile. Generally, the acquisition of a company can be concluded in two common ways i.e. shares or assets acquisition.

  Advantages of acquisition include diversification, access to more capital, fresh ideas and perspectives, market power etc.

- **Take-over**
  A take-over is the acquisition of sufficient shares in another company by another company to give the acquiring company control over the other company. Take-over will occur if at least 30-50% of the shares or voting rights is acquired and there must be a take-over bid. To proceed with the take-over bid, approval has to be granted by the Securities and Exchange Commission("SEC").[3]

5 Major Asset Transaction

This is a new introduction in CAMA 2020, it provides an opportunity for companies to dispose of their major assets without going through the formal process of a merger or obtaining court approval.

6 Key consideration

Subject to the form of restructuring a party is considering, the following are the key considerations:

- **Regulatory Due Diligence**
  The acquirer would need to carry out an extensive due diligence on the entity to be acquired or merged, this is to determine that there are no undisclosed regulatory infractions like fines, litigations and contingent liabilities arising from them, non obtaining of relevant licences / permits, non filing of returns and penalties are rectified before the acquisitions or merger proceeds. The due diligence will normally reveal the conditions precedents and subsequent to finalise the transactions.

- **Tax Due Diligence**
  Either the acquirer or the target can initiate a tax due diligence to review the existing tax exposures and anticipate potential deal breakers. The party conducting the tax due diligence would determine prerequisites for the transaction to be concluded such as covenants and clauses in the sale and purchase agreement or even hold-harmless letters.

- **Financial Due Diligence**
  The acquirer would need to carry out an investigative analysis of the financial performance of the entity to be acquired. It covers a review of balance sheets, financial statements, tax records, indebtedness, equity and debt infusions, quality of revenue, cost structures of the business etc.

- **Major Contracts**
  During a reorganisation, major contracts such as labour contracts, contracts imposing continuous and future obligations, litigations etc would need to be assigned or novated to the surviving entity.

- **Valuation**
  The parties would need to carry out a valuation to determine the actual value of the transaction or share price for a business reorganisation to take place.

7 Industry Regulators

Regulated industries must notify or get clearance from their regulators before proceeding with reorganisation that involve merger, acquisition or divestments.

8 Pre Merger Notification

Regulated industries must notify or get clearance from their regulators before proceeding with reorganisation that involve merger, acquisition or divestments.

- **The Federal Inland Revenue Service**
  The Federal Inland Revenue Service must be notified of any corporate merger, takeover, transfer or restructuring of the trade or business of a company before the merger is concluded.

- **FCCPC Approval**
  Companies are required to give a pre-merger notification to the FCCPC at least two weeks before a formal notification is made to the FCCPC.
  For unrelated entities and public companies, The Federal Competition and Consumer Protection Act ("FCCPC Act") states in Section 93 that a proposed merger may not be executed unless it has been notified and approved by the FCCPC, subject to the notification thresholds determined by the FCCPC.

Implementing a notifiable transaction without regulatory approval deems every action done to implement such a transaction null and void. Furthermore, failure to acquire regulatory approval is an offence punishable by a fine if convicted.

- **Negative Clearance**
  A negative clearance is a procedure in which the FCCPC conducts a preliminary assessment for clearance under the Merger Review Regulations for the benefit of parties who are unsure whether a proposed transaction constitutes a notifiable merger.

- **Securities & Exchange Commission**
  The approval of the SEC is usually to be obtained for acquisition of majority stakes in a Public Company or merger of a public company.

- **Merger Scheme**
  The scheme document essentially denotes the major terms of a merger and it is the basis upon which the sanction of SEC / FCCPC "the Commissions" is granted. It stipulates the share exchange price and contains major provisions on how the tax obligations, litigations and employees will be treated under the restructuring.

- **Fairness Opinion**
  For parties with unrelated shareholding, a fairness opinion on the share price and price of the asset is carried out by a third party to ascertain that the share price fair or asset valuation is fair to the shareholders.

- **Approval of the Federal High Court**
  The merger will not be effective unless it is approved by the Federal High Court. CAMA now provides that all activities involving business reorganisation should be sanctioned by the Federal high court, there are exceptions to these provisions such as a major asset transaction etc.

9 Post Merger notifications

The Corporate Affairs Commission should be notified for registration of the notice of merger.

10 Claim of treaty benefits

The tax jurisdiction of the parties in the transaction will determine whether the benefits from claim of treaty benefits can be enjoyed after the reorganisation.

How PwC can help

PwC's Regulatory Business Solutions team help businesses navigate the Nigerian regulatory terrain by providing corporate restructuring services, Advisory, Entity Governance and Compliance Services.

Also, certain unanticipated issues may occur after the business reorganisation. Organisations always need trusted advisers to help them navigate through all types of uncertain terrain.

[2] Section 117 Investment and Securities Act 2007
[3] Section 134(1) Investment and Securities Act 2007

PwC's Regulatory Business Solutions team help clients to monitor, assess and comply with regulatory requirements by providing Regulatory Advisory, Compliance services and Company Secretarial Services.

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