The Scheme of Arrangement: A Viable Option for Nigerian Companies in a Downturn?

By DIPO OKURIBIDO

In Nigeria, large corporate bankruptcies are a rarity, and available literature on the subject tends to deal more with theory and provisions of existing law than with actual precedents and examples of lenders seeking liquidation, or to otherwise enforce security. Reasons abound for this situation, but perhaps the most striking of these is the fact that existing corporate insolvency legislation generally focuses on the actual liquidation of the insolvent company, as opposed to establishing buffers or moratoriums to create opportunities for its turnaround or rescue.

The result of the limited insolvency regime is that Nigerian companies simply do not surrender to bankruptcy proceedings until there is clearly and absolutely no hope of survival. Up to that point, in the gap between limping and dying, the tool of choice has been the Scheme of Arrangement.

The Nigerian Scheme of Arrangement

The Nigerian Scheme of Arrangement is loosely based on the UK Scheme of Arrangement. Similarly with its source material, the Scheme of Arrangement provisions under Nigerian law establish a process for a Nigerian company to enter into a compromise or arrangement with its creditors or shareholders (or any class of either of them).

Under the rules contained in the Principal Companies Legislation[1] (and supplemented in recent iterations of the Securities and Exchange Commission Rules and Regulations[2]), a public company would need to file an application for the proposed scheme with the Nigerian Securities and Exchange Commission ("**SEC**") and, following the SEC's approval of the scheme, would then need to make an application to the Federal

High Court ("**FHC**") to convene a court ordered meeting of the shareholders or creditors at which the scheme of arrangement or compromise will be proposed. Notice of the court ordered meeting is to be dispatched to all shareholders/creditors and to be published in newspapers with national circulation within Nigeria. There is no quorum requirement for the meeting however, in the case of a listed company (in line with additional rules introduced in 2014), any director or controlling shareholder who is interested in the transaction will be required to abstain from voting at the meeting.

To the extent that the scheme is approved by holders of up to seventy five percent (75%) in value of the shares or debt of the company *present and voting at the court ordered meeting*, then a report will be made back to the FHC for a court sanction (to the extent that the FHC is satisfied as to the fairness of the scheme)[3] and once the court sanction is obtained and filed at the Corporate Affairs Commission (i.e. the Nigerian Companies Registry), the scheme will be effective and binding on all shareholders or creditors as the case may be.

The process can normally be concluded within three (3) to six (6) months, depending on the complexity of the proposed scheme and the time required for the review by the Nigerian SEC. The CAMA also permits the Nigerian SEC to appoint one or more inspectors (if deemed necessary) to investigate the fairness of the scheme and to make a written report to the FHC.

As with the UK Companies Act, the language of the CAMA with respect to Schemes of Arrangement is relatively wide. As a result of this broad language, the manageable approval threshold (i.e. not 75% in value of **all** shareholders/creditors but only those voting in person or by proxy) and, the fact that schemes bind **all** shareholders/creditors not just those who consent to them, scheme of arrangements tend to be employed to achieve a wide range of objectives.

The most common use of schemes in relation to troubled companies in Nigeria is for the reorganization of the share capital of a company and the injection of additional capital to resuscitate the business. In these scenarios, rather than simply increasing the share capital of the company further, particularly where some of the existing capital is already lost, existing shareholders of the company will be required to surrender a portion of their shareholding or such pre-determined portion of their shareholding will be cancelled. Thereafter, new shares would be issued to a strategic investor who is willing to finance the company's recovery.

This structure was employed in relation to Starcomms Plc. in 2013 and, prior to that, for the rescue of several commercial banks (including Finbank Plc., which is discussed below) following the declaration by the Central Bank of Nigeria in 2009 that such banks were in a grave situation.

While schemes are particularly popular for the capital injection form of rescue in Nigeria, there are no restrictions within the existing legal provisions to suggest that such schemes cannot be similarly used to alter creditor rights and or secure debt moratorium. Indeed, based on current law, schemes do offer some other benefits, which make them a useful tool for

NIGERIAN SCHEMES OF ARRANGEMENT
CASE STUDY #1

Starcomms Plc.

In 2012, it was reported that Starcomms Plc. had incurred unsustainably high levels of debt and was facing a severe liquidity crisis. There were serious doubts as to the company's continued status as a going concern. The dire situation had made securing further debt impossible and there was no likelihood of success of a public offering or rights issue.

A pool of investors led by Capcom Limited and including the Asset Management Corporation of Nigeria ("AMCON") agreed to inject further capital into the company through a scheme, which would involve the reorganization of the company's capital to a manageable structure. Under the scheme, the capital of the company was restructured such that existing shareholders retained one share for every 100 shares held and the issued share capital of the company was restructured from 6.9 billion shares to 69 million shares. Fractional shares resulting from the restructuring were acquired by the company for cash and the nominal value of the surrendered shares was transferred to the capital redemption reserve account. This paved the way for the company to issue an additional 662 million shares in consideration for the new capital injection. The effect was the dilution of the existing shareholder base to 9.5%.

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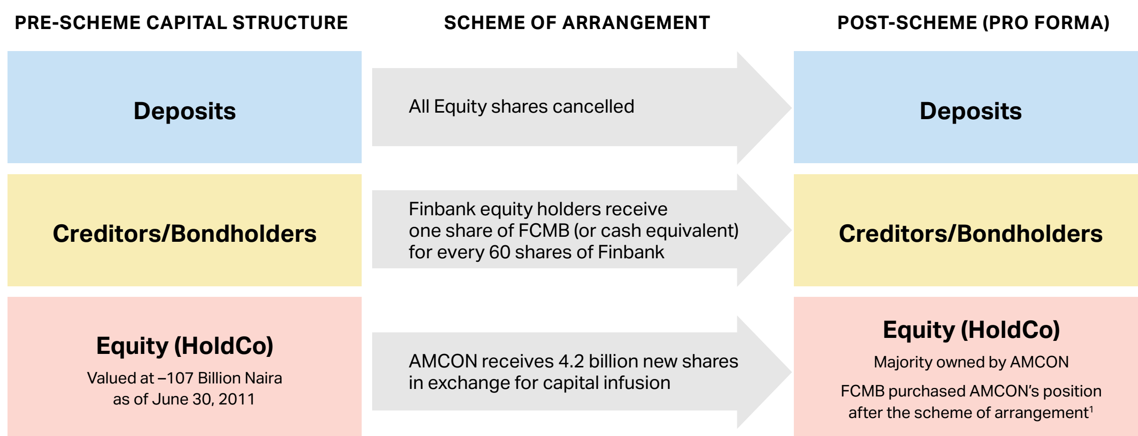
NIGERIAN SCHEMES OF ARRANGEMENT CASE STUDY #2

Finbank Plc.

In 2009, Finbank was among several banks deemed by the Central Bank of Nigeria to be in a "grave situation" with sub-par capital adequacy and liquidity ratios. By June 30, 2011, its shareholders funds were negative N107 billion and the bank was technically insolvent, continuing as a going concern mainly by virtue of regulatory forbearances and guarantees.

To save the bank, an agreement was reached with AMCON and First City Monument Bank Plc. ("FCMB") whereby a scheme of arrangement would facilitate the injection of additional capital and ultimately the sale of the bank to FCMB, with which it subsequently merged.

Finbank Plc.'s Scheme of Arrangement
by Asset Management Corporation of Nigeria ("AMCON") and First City Monument Bank Plc. ("FCMB")



[1] Finbank was subsquently merged into First City Monument Bank Plc.

corporate restructuring. Perhaps the most notable of these benefits relates to the tax implications. The current view of the Federal Inland Revenue Service appears to be that, irrespective of the underlying transactions undertaken through a scheme of arrangement, the scheme is tax neutral and does not give rise to any new tax liabilities or extinguish any existing tax benefits. This means that assets transfers that might otherwise give rise to capital gains tax or withholding tax can be executed under a scheme of arrangement in order to avoid such taxes. Also, because schemes derive their effectiveness from a court sanction, parties generally accept them as particularly binding and feel less inclined to renege from the sanctioned commitments. These are all features of a scheme, which would be particularly useful in relation to a compromise or arrangement involving some variation of lenders' rights.

Presently however, such variations of creditor rights and or moratoriums tend to be secured through informal and semi-formal agreements rather than through the use of Schemes of Arrangements. This is probably not unconnected with the fact that the Nigerian corporate bond market is still relatively green and the main lenders to most big corporations are a handful of financial institutions with which bilateral talks can generally be had and from whom concessions can easily be sought informally.

As the Nigerian corporate bond market further develops and the lenders to corporations expand beyond just commercial banks and similar institutions to include a wider range of investors, including many who do not have other relations with the borrower to worry about, informal deals are likely to become increasingly difficult to negotiate. The use of schemes in this regard is thus likely to grow. ■

1. The Companies and Allied Matters Act, Cap C20 Laws of the Federation of Nigeria 2004 ("**CAMA**")
2. Rules 440 – 444 of the Rules and Regulations of the Securities and Exchange Commission (External Restructuring Rules)
3. In practice, the FHC will not normally raise any issues with the fairness of the scheme unless petitions in this regard have been submitted by affected parties.

▼ **Dipo Okuribido** is a manager in the legal department of the Nigerian private equity firm Verod Capital Management Limited. Mr. Okuribibido's areas of practice are Mergers & Acquisitions, Corporate Restructuring, Private Equity, Finance, Capital Markets and Taxation.