



**SHAREHOLDER'S RIGHT OF PRE-EMPTION:
UNDERSTANDING ITS SIGNIFICANCE,
IMPLEMENTATION, AND IMPACT IN
CORPORATE GOVERNANCE**



ABSTRACT

The shareholder's right of pre-emption stands as a cornerstone in corporate governance, embodying principles of equity, transparency, and shareholder protection. Through a comprehensive review of the Nigerian legal framework, the implementation of the right to the shareholder's pre-emption in the Nigerian clime is analyzed and its relationship with corporate governance structures. Furthermore, it evaluates the impact of the right of pre-emption on corporate governance structures, transparency, and investor confidence, considering their role in mitigating conflicts of interest and promoting sustainable corporate practices. Conclusively, this article aims to deepen understanding of the dynamics and regulatory implications of pre-emption rights within the Nigerian corporate environment.



INTRODUCTION

One of the ways of corporate financing for businesses is through Equity Financing. This entails issuing shares for monetary exchange to beget shareholding rights. The investment is applied according to the needs of the company to run its operations, reduce overhead, and accelerate its growth trajectory. Issuing shares can be a critical undertaking for a corporation looking to raise capital that enables the shareholder to rights such as the right to vote or be voted for, disclosure right, the right to share in the proceeds and loss of the company's business and predominantly the right to first be offered shares as an existing shareholder before extending same to a third party.

These rights are bestowed on the shareholder as protective, financial and pre-emptive rights.¹

In the Nigerian Legal framework, the Companies and Allied Matters Act (CAMA)

2020 attempts to safeguard the shareholder's interest by providing them with the opportunity to keep their fraction of the company's shares. Undoubtedly, the opportunity for legal preservation is paramount upon the company undertaking a capital raise.² Essentially, every shareholder is bestowed with the right of pre-emption or anti-dilution right. This right allows existing shareholders to purchase additional shares prior to being sold to new investors and protect shareholders. This right is given to prevent the dilution of their shareholdings and ensure that existing shareholders can maintain their proportionate ownership and interest in the company.³

In the Nigerian clime, the shareholder's right of pre-emption represents a critical component of corporate governance, embodying principles of fairness, shareholder empowerment, and regulatory compliance.⁴

¹ Mondaq "Khurana & Khurana" Shareholder's Right And Their Impact On Corporate Governance. 13th June 2024 accessed 23rd Of July 2024.

² Analyzing The Impact Of The Innovative Provisions Of Cama 2020 On The Growth And Development Of Business In Nigeria By Onyeka Christiana Aduma, PhD

³ Ibid

⁴ Mondaq Musa Kalejaiye & Fauziyah Oladosu Corporate Governance & Ease Of Doing Business In Nigeria: Innovations From The Business Facilitation (Miscellaneous Provision) Act, accessed 23rd of July 2024.

BENEFITS OF THE RIGHTS OF PRE-EMPTION TO SHAREHOLDERS

As an existing shareholder, certain benefits are accrued to pre-emptive rights, for example, the value of current shareholders' shares is maintained by the pre-emptive rights that are present when new shares are issued as the company issues new shares at a price lower than market value. This reduction encourages existing shareholders to purchase more shares. Thus, pre-emption rights operate by giving current shareholders the chance to take advantage of the discount before non-shareholders.¹⁰

Also, this right serves as a mode of control mechanism for shareholders to protect their interests in a company by preventing involuntary dilution of their shareholdings. Essentially, it allows shareholders to preserve their control, regardless of how many new shares are issued.¹¹ In the same vein, the right of pre-emption provides equitable treatment, protects the interest of minority shareholders and also promotes good governance in co-existence with other rights available to shareholders

IMPLEMENTATION OF PRE-EMPTION RIGHTS IN NIGERIA

In Nigeria, the procedure for the right of pre-emption entails the company giving written or electronic notice of their issuance to the existing shareholders with details on the number of shares they are entitled to, the price of the shares being offered and the duration of time such offer stands. It is essential to note that on the expiration of this duration or receipt of decline by all shareholders, the shareholders automatically waive the right.¹²

Also, a company can be bound by pre-

emption clauses provided by the shareholders or contractual agreements as agreed with the shareholder at the point of execution of the agreement. This protective clause is achieved by including shareholder protection clauses in the terms of the agreement. Practically, the courts would have recourse to the wording of the pre-emptive provisions in the contract or shareholders agreement should issues and inconsistency arise.¹³

¹⁰ *Analyzing The Impact Of The Innovative Provisions Of Camg 2020 On The Growth And Development Of Business In Nigeria* By Onyeka Christiana Aduma, PhD

¹¹ Mondaq Musa Kalejaiye & Fauziyah Oladosu Corporate Governance & Ease Of Doing Business In Nigeria: Innovations From The Business Facilitation (Miscellaneous Provision) Act, 2022 accessed July 23rd, 2024.

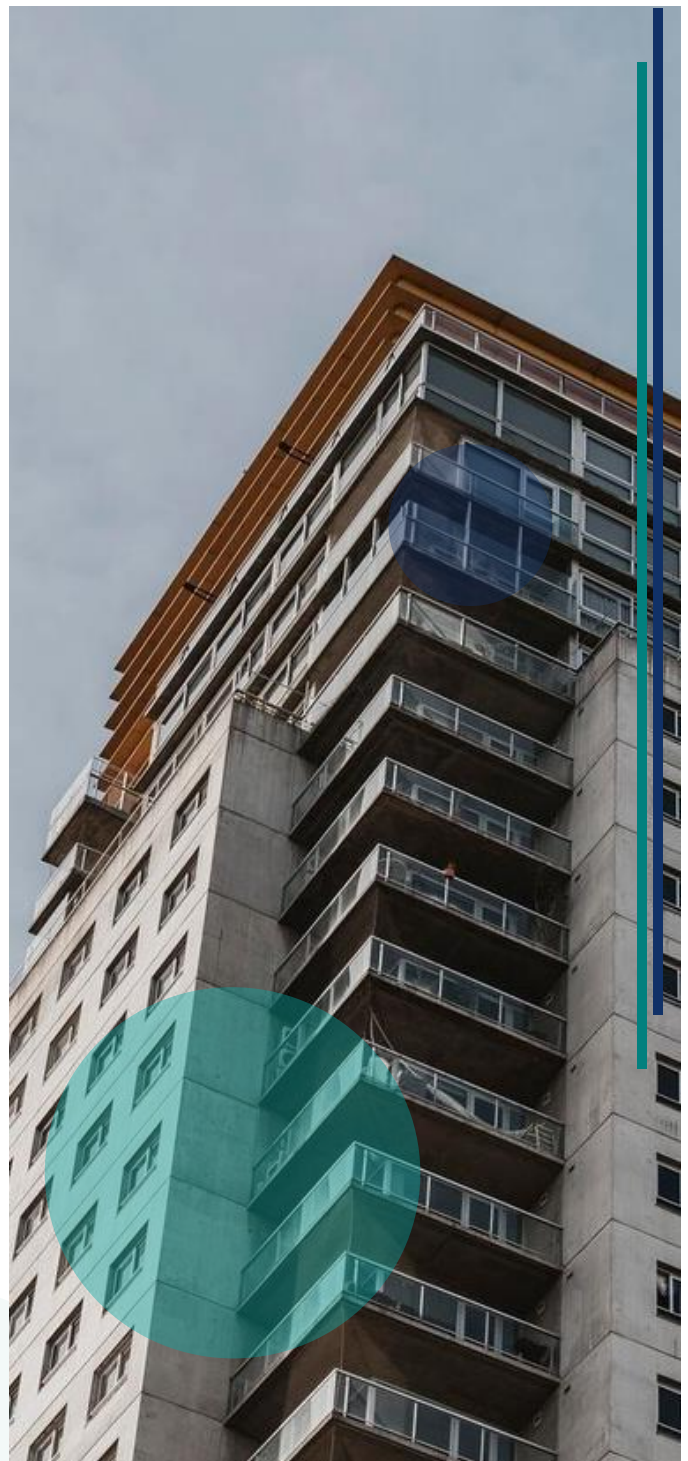
¹² Section 142(2) CAMA 2020

¹³ Merton Lawyers (2024) *What are pre-emptive rights in shareholders agreements?* Accessed 23rd of July 2024.

An instance of the exercise of this right of pre-emption in contracts can be seen in the 1990 Joint Operating Agreement (JOA) between Nigerian National Petroleum Corporation (NNPC) and Mobil Producing Nigeria Unlimited (MPNU), a subsidiary of ExxonMobil. In 2022, there was a proposed deal between Seplat Energy PLC and ExxonMobil for the sale of ExxonMobil's entire offshore shallow water business and consequently, the entire share capital of MPNU.¹⁴ It was reported that the NNPC intended to exercise its rights of pre-emption provided under Article 19.4 of the JOA, that any party intending to transfer its interest must first make a written notice of such offer to the other party.¹⁵ The NNPC obtained an interim injunction for the restriction of the proposed acquisition of MPNU by Seplat Energy PLC.¹⁶ Consequently, it is evident that in a contractual agreement, pre-emption rights can be contractual provisions that define the conditions and procedures governing how shareholders can acquire shares or interests that another shareholder intends to sell or transfer within the company.

THE SIGNIFICANCE AND IMPACT OF THE SHAREHOLDERS'S RIGHT OF PRE-EMPTION ON CORPORATE GOVERNANCE

The significance or impact of shareholders' pre-emptive right over corporate governance cannot be over emphasized. The Murthy Committee 2003 provides a more relatable definition of the interrelatedness of corporate governance and pre-emptive rights to mean



"The acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and their role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company."¹⁷

¹⁴ The Business Day Newspaper. Abubakar Ibrahim March 7, 2022 Seplat clarifies NNPC's pre-emption right report amid ExxonMobil assets acquisition. Accessed July 23rd 2024

¹⁵ Royal Heritage Law " pre-emptive Provisions In A Joint Operating Agreement" <https://royalheritagelaw.com/pre-emptive-provisions-in-a-joint-operating-agreement/> accessed July 23rd 2024

¹⁶ Ibid

¹⁷ The Report of Shri N R Narayana Murthy Committee on Corporate. Accessed 23rd of July 2024.

In terms of Nigeria's corporate governance, ensuring fairness and equity among shareholders is crucial as entrenched in the Nigerian Code of Corporate Governance.¹⁸ Specifically, the right of pre-emption supports these principles by ensuring that all shareholders have an equal opportunity to participate in any new share issuance, rather than allowing new shares to be issued exclusively to select investors or insiders, which could potentially dilute existing shareholders unfairly.

Furthermore, implementing pre-emption rights enhances transparency in corporate governance practices. Companies are typically required to disclose their intentions regarding share issuances to shareholders, providing clarity on capital raising activities and ensuring that decisions are made in the best interests of all shareholders. This transparency fosters trust and accountability between management and shareholders.¹⁹

Pre-emption rights have been closely linked to the context of Agency Theory under corporate governance, such that effective corporate governance mechanisms are crucial to monitor and align managerial actions with shareholder's interests. Pre-emption rights contribute to governance by enhancing transparency and accountability

in equity issuances. They ensure that managers, otherwise known as directors, consider the interests of existing shareholders before making decisions that affect the ownership structure and control of the company.²⁰

The right of pre-emption has improved corporate governance by allowing the preservation of stability and fairness in the company by preventing a third party or potential shareholders whose ideology or goal does not align with all other shareholders from suddenly appearing as a member. The shareholders having a common intention can dialogue with the directors on means of strategically improving the company's productivity, vote towards the company's accountability and exert influence to ensure better decision-making by the directors.²¹

In essence, the shareholder's right of pre-emption is a fundamental aspect of corporate governance that ensures that shareholders have a voice in key corporate decisions and helps maintain a balanced relationship between shareholders and management, thereby contributing to the long-term sustainability and success of the organization.



¹⁸ Principle 22 of the Nigerian Code of Corporate Governance 2018

¹⁹ Driver, Ciaran & Bo, Hong. (2012). *Agency Theory, Corporate Governance, and Finance*. Accessed July 2024

²⁰ Ibid

²¹ Ibid



FUTURE OUTLOOK ON SHAREHOLDERS' PRE-EMPTION RIGHTS

It is envisaged that there may be changes in the legal framework governing pre-emption rights in Nigeria. These changes could aim to clarify ambiguities, enhance investor protection, or streamline procedures related to the exercise of pre-emption rights as they come by.

Furthermore, the NCCG or similar guidelines may provide more specific recommendations regarding the exercise and management of pre-emption rights. This could include guidelines on transparency, disclosure requirements, and fair treatment of minority shareholders.

Notably, in the wake of the ongoing bank recapitalization process in Nigeria, private and public banks in a bid to meet the required threshold of the Central Bank of Nigeria (CBN) have issued shares to the public and through other capital raise structures respectively. Ultimately, this could equally lead to Increased activism for already existing shareholders and more awareness of corporate governance issues which incentivizes the need for a greater emphasis on protecting the already existing pre-emption rights for private banks and a

clamour for pre-emption clauses in the case of public companies who have not made such provisions in their articles.

Also, the adoption of technology in corporate governance practices could influence how pre-emption rights are managed. Digital platforms and blockchain technology might be utilized to facilitate more efficient and transparent processes for exercising pre-emption rights and processing share transactions.

Companies and shareholders may increasingly negotiate customized provisions regarding pre-emption rights in shareholder agreements or articles of association. This could allow for more flexibility and adaptation to specific business contexts or investor preferences. Alignment with international best practices and standards, such as those recommended by organizations like the International Corporate Governance Network (ICGN)²² or (OECD)²³ principles, could influence the evolution of pre-emption rights in Nigeria. This alignment might emphasize principles of fairness, transparency, and shareholder rights.

²² The International Corporate Governance Network (ICGN) <https://www.icgn.org/> accessed 23rd July 2024.

²³ Organization for Economic Co-operation and Development <https://www.oecd.org/en.html> accessed 23rd July 2024.



CONCLUSION

The interrelationship between the pre-emption rights and its significance to corporate governance cannot be overstated. The right of pre-emption is a fundamental aspect of corporate governance that supports fairness, transparency, shareholder rights, and the overall stability of the company's ownership structure. It enhances trust among shareholders and fosters a healthy corporate environment where decisions are made in the best interests of all stakeholders.

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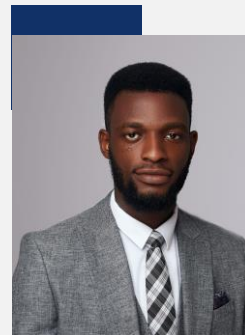
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