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Group Companies and the Daunting Challenges for Regulation Under Nigerian Corporate Law

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Abstract

Formation of company groups has become prevalent on the corporate scene in several jurisdictions including Nigeria. Using the doctrinal method, this article, aimed at unraveling the operations of company groups and the capacity of the existing legal framework to contain the governance challenges posed by them has found that Company groups confer some benefits, for example, achievement of synergies and efficiencies in resource allocation and the fostering of greater integration of markets across borders, which contribute positively to economic growth and development. But the development of complex groups of companies has raised important issues in all areas of company law and practice. Corporate legal personality and limited liability enjoyed by entities within the groups have adverse effects on creditors of under sourced subsidiaries. Company groups typically engaged in frequent related-party transactions and the more complex the structure of the group the greater the opportunity for such transactions to be carried out in less transparent manner, which may benefit some group companies at the expense of others. Allocation of business opportunities is one area where many company groups present particular agency challenges. Beyond agency related issues, company groups give rise to concentration of economic power with attendant anti-competitive effect. Concentration of economic power in group companies also has adverse effects- regulatory capture, rent-seeking and corruption of the political system. In spite of these, Nigerian law has not developed a general law of group enterprise. Consequently, a separate legal framework is advocated for company groups in Nigeria along the German model.

Key Words: Group Company, Holding Company, Subsidiary Company, Conglomerate, Related-Party Transaction, Directors, Fiduciary Duties.

1.1 Introduction

Once incorporated, a company becomes a body corporate under the law[1]. It is a distinct legal entity from the persons that constitute it. This separate and independent legal personality of a registered company which was firmly established in *Salomon v Salomon Co. Ltd*[2] and followed in subsequent cases[3] has continued to be applied till date. Companies are, however, established with

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[1] Companies and Allied Matters Act (CAMA) 2020, section 42

[2] *Salomon & Salomon & Co. Ltd* (1897) AC 22 HL

[3] *Lee v Lee's Air Farming Ltd* (1961) AC 12 PC; *Macaura v Northern Assurance Company* (1925) AC 619 HL; *Korubo v Zach-Motison (Nig) Ltd* (1992) 5 NWLR (pt 239) s 102, 115; *Adeoti v Ayorinde* (2001) 6 NWLR (Pt 709), 336 at 346; *Tsokwa Oil Marketing Co Ltd v UTC (Nig) Plc* (2002) 12 NWLR (Pt 782), 437 and 468; *Ogbodu v*

different structures. These structures begin with stand-alone companies and extend to group companies, that is, holding and subsidiary companies, conglomerates and multinational companies. The doctrine of corporate legal personality also applies to group companies.[4] However, the corporate form of business organisation creates problems of control and public regulation, for example, there are possibilities for abuse of the limited liability system and the manipulations of the holding and subsidiary company networks by way of intra corporate dealings within groups of companies. The companies may, in the circumstances, be readily converted into engines of fraud to the detriment of creditors and the interest of the public[5].

Concentrated ownership is common with company groups and company group structures present the potential for inequitable treatment of shareholders and other stakeholders and other negative consequences for the efficiency and development of capital markets and economies generally[6]. A group structure comprises the holding or parent company and many other legal entities, each with their own separate legal personality, rights and liabilities and, importantly, their own directors[7]. There are large subsidiaries within company groups that trade with the benefit of limited liability and interest of their own customers, employees, suppliers and other stakeholders[8]. These subsidiaries, with their own boards, are answerable to regulators, sometimes in different parts of the world to those their parents answer, and are prone to come up against regulatory issues as there could be non-compliance with law along the subsidiary structure[9]. This is particularly true of multinational corporations (MNCs) headquartered in developed countries with subsidiaries in other countries, especially developed countries.

The application of corporate legal personality to group companies therefore raises serious problems. Where two or more technically independent commercial entities are under the same control, it is obviously possible for such entities to arrange transactions and transfers between themselves on terms which would not otherwise be commercially acceptable, and thus create profit or loss in respect of each individual company at will [10]. This is especially easy in respect of the transfer from one company to another of real property and other assets without a readily ascertainable market value since the price may be fixed either at exaggerated or nominal level.

Quality Finance Ltd (2003) 6 NWLR (Pt 815) 147, 168; *AIB Ltd v. Lee & Tee Industries Ltd* (2003) 7 NWLR (Pt 818) 366, 395, et cetera

[4]*EBBW Vale UDC v South Wales Licensing Authority* (1951) 2 KB 366 at 373-374 per Cohen LJ; *Re Southard & Co. Ltd* (1979) 1 WLR (1198 at 1208 per Templeman J; *Marina Nominees Ltd v FBIR* (1986) 2 NWLR (pt20) 48; *Union Beverages Ltd v Pepsi Cola International Ltd* (1994) 2 SCNJ 157 at 172: AC*B Plc & 1 Other v. Emostrade Ltd* (2002) NSCQR (Pt2), 22 at 31 per Uwaifor JSC.

[5] TAT Yagba and BB Kanyip and SA Ekwo, *Elements of Commercial Law* (Tamaza Publishing Company Limited 1994), 231-232

[6] OECD, 'Duties and Responsibilities of Boards in Company Groups' <https://www.oecd.library.org> Accessed 19 April, 2021

[7] ICLG, 'Corporate Governance of Subsidiaries and within Groups: Corporate Governance Laws and Regulations' <https://www.iclg.com> Accessed 11 April, 2021

[8] Ibid

[9] Lauren McMenemy 'Corporate Governance and Subsidiary Structure 2019' https://www.insights.diligent.com> Accessed 11 April, 2021

[10] Tom Hadden, *Company Law and Capitalism* (2nd edn, Weidenfeld and Nicolson 197), 391

There is a similar problem in respect of the transfer of loans with or without security between members of the same group[11].

In addition, it is difficult to ascertain the precise financial position of any individual company in the group from its separate accounts, given the facility with which assets and liabilities can be transferred from one member company to another[12]. Transfer pricing is prevalent and pervasive in company groups and the prices of goods and services between the holding company and its subsidiaries are fixed artificially. This destroys the notion of fair market price determined by the interplay of demand and supply. Apart from commercial frauds, these practices create other problems such as missing or distorted information, unreliable government statistics, tax avoidance and capital flight.

Group companies therefore, pose serious challenges to legal regulation. In spite of all these daunting challenges, Nigerian corporate law has not come to terms with group companies and there is no general law of group enterprise. Nigerian law does not deny that serious issues for creditors can arise with group companies, for example, they go unpaid when an individual subsidiary with whom they have transacted, is undercapitalised but limited liability means that they cannot seek redress from the wider group but only from the individual company that transacted with them. The situation is the same with employees who are made redundant and customers who are left high and dry when the individual company that employed or traded with them is underfunded and distressed[13].

There is also the problem of conflict of interests and duties. The pertinent question is, to whom do directors of group companies owe their fiduciary duties of loyalty? Nigerian law has not yet developed a concept of group interest or a coherent doctrine of fairness in respect of group transactions for the purposes of directors' fiduciary duties. The emphasis is still on the interest of individual companies. It appears it is only in the areas of accounting and taxation that Nigerian law has defined rules regarding group companies[14]. The challenges group companies pose to legal regulation and the obvious gap in the law to regulate them has provoked this research.

1.2 Conceptual Clarification

1.2.1 Group Companies

A group of companies is an economic entity formed of a set of companies which are either companies controlled by the same company, or the controlling company itself[15]. Controlling company means having power to appoint the majority of its directors[16].

According to Wikipedia, 'A corporate group or group of companies is a collection of parent and subsidiary corporations that function as a single economic entity through a common source of

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[11] Ibid
[12] Ibid, 390
[13] ICLG, 'Corporate Governance of Subsidiaries and Within Groups: Corporate Governance Laws and Regulations 2020' <https://www.iclg.com> Accessed 11 April, 2020
[14] CAMA 2020, sections 378 (10) & (11), 379 and 380; Companies Income Tax Act (CITA) 2004, sections 21 and 22
[15] INSEE, Group of Companies: Definitions, <https://www.insee.fr> Accessed 11 April, 2021
[16] Ibid

control'[17]. The concept of a group is often used in tax law, accounting and (less frequently) company law to attribute the rights and duties of one member of the group to another or the whole, and if the corporations are engaged in entirely different businesses, the group is called a conglomerate[18]that is, a corporation that owns unrelated enterprises in a wide variety of industries[19].

Law Insider defines group company as a company and its subsidiaries[20]**.** It goes on to explain that 'group company means any subsidiary or holding company of the Appointee and any subsidiary of any holding company of the appointee (other than the Appointee)'[21]. It states further that 'group company means member of a group' and that group company of a company means:

i. a company which, directly or indirectly, holds ten per cent (10%) or more of the share capital of the company; or

ii. A company in which the company, directly or indirectly, holds ten per cent (10%) or more of the share capital of such a company; or

iii. a company in which the company directly or indirectly, has the power to direct or cause to be directed the management policies of such company whether through the ownership of securities or agreement or any other arrangement or otherwise; or

iv. a company which, directly or indirectly, has the power to direct or cause to be directed the management policies of the company whether through ownership of securities or agreement or any arrangement or otherwise; or

v. a company which is under common control with the company, and control means ownership by one company of at least ten per cent (10%) of the share capital of the other company or power to direct or cause to be directed the management and policies of such company whether through the ownership of securities or agreement or any other arrangement or otherwise. However, they explicate that above mentioned provisions are not applicable in case of public sector undertakings/enterprises[22]. They add that group company means, in respect of the generator, any wholly-owned subsidiary of the generator, any company of which the generator is a wholly-owned subsidiary (a parent company) and any other wholly-owned subsidiary of any parent company[23].

The Companies and Allied Matters Act (CAMA) 2020 has not defined group companies but has explained group financial statements. Under the Act[24], 'group financial statements' has the meaning assigned to it by section 379 (1) of the Act which provides that:

[17] Wikipedia 'Corporate Group' <https://www.enm.wikipedia.org> Accessed 19 April 2021
[18] Ibid
[19] Bryan A Garner (ed), *Black's Law Dictionary* (9thedn, Thomson Reuters 2009), 342
[20] Law Insider, 'Group Company' <https://www.lawinsider.com> Accessed 19 April, 2021
[21] Ibid
[22] Ibid
[23] Ibid
[24] CAMA 2021, section 868 (1)

> *If, at the end of a year a company has subsidiaries, the directors shall, as well as preparing individual accounts of each subsidiary for that year, also prepare group financial statements being accounts or statements which deal with the state of affairs and profit or loss of the entire company and the subsidiaries.*

1.2.2 Holding and Subsidiary Companies

The legal relationship of "holding and subsidiary" companies is defined in the Companies and Allied Matters Act[25] in terms of control of one company by another. Such control may be exercisable either directly through ownership by the holding company of more than half (50%) in nominal value of the equity share capital of the subsidiary or through its control by any other means of the composition of the board of directors of the subsidiary[26]. For this purpose, it is beneficial rather than legal control that matters. Thus, shares or voting shares held on trust for another, do not count and are ignored, while the shareholdings of nominees are deemed to be those of the principal for whom they are held[27]. Similarly, it is effective control over the appointment of the majority of directors on the subsidiary's board or their removal from the board which counts regardless of the legal form by which that control is exercisable[28].

In addition, a holding company is deemed to be a holding company in respect of any company which is a subsidiary of its subsidiary[29], and a body corporate shall be deemed to be the wholly-owned subsidiary of another, if it has no member except that other and that other's wholly-owned subsidiaries are its or their nominees[30].

What is common and clear in these definitions of group companies is the issue of control within the group. Accordingly, there is a network of relationships between the companies which embark on related-party transactions as opposed to the case of stand-alone companies. The main purpose of the statutory definitions under the Companies and Allied Matters Act is to make special provisions for group accounting to deal with the problem of artificial transactions within the group.

1.3 Development Of Group Companies Groups And Rationale/Benefits

1.3.1 Formation of Company Groups

Incorporation of a wholly-owned private company as a subsidiary of another company, be it a public company or a conglomerate gives rise to groups. Group relationship arise in different ways. A group relationship may arise as a result of a take-over, that is, one company takes over another which then becomes its subsidiary when its shares have been acquired by the first company[31]. Accordingly, the formation of corporate groups usually involves consolidation through mergers and acquisitions although the group concept focuses on the instances in which

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[25] Ibid, section 381(1), (b), (b) & (c)
[26] Ibid, see also Tom Hadden (n 10), 390
[27] Ibid, section 381 (4)
[28] Ibid, section 381 (2)
[29] Ibid, section 381 (1) and (5) (a)
[30] Ibid, section 381 (5) (b)
[31] JH Farrar and N Furey and B Hannigan *Farrar's Company Law* (2[nd]edn, Buttermorths 1988), 486

the merged and acquired companies remain in existence rather than the instance in which they are dissolved by the parent[32]. Invariably, subsidiaries enter a group as a result of merger or acquisition, with a corporate entity inheriting a subsidiary structure from its acquisition or merger target[33].

Groups may also be founded as such[34], that is, wholly-owned or partially-owned subsidiaries are also frequently created by established companies quite apart from the ordinary processes of take-over or merger[35]. Hadden posits that in either case, it may be simpler for the parent company to maintain a number of formally separate subsidiary companies than to organize a series of informal managerial or accounting units or divisions within a single company[36].

1.3.2 Rationale/Benefits of Company Groups

Deloitte succinctly summarised the rationale for formation of corporate groups thus:

> *Subsidiaries are created to serve several business needs ranging from corporate structuring, developing new products and services, regulatory compliance, tax efficiencies and mergers and acquisitions, to expanding into new geographical markets*[37].

Corporate group structures, in which related-party transactions are common, are said to be beneficial because well-managed company groups can contribute to economic development and employment through achievement of economics of scale, synergies and other efficiencies[38]. Indeed, Corporate Governance of Company Groups in Latin America, Published by the Organisation for Economic Cooperation and Development (OECD) in 2015, contained a subchapter on the benefits of and economic rationale for corporate groups. Positive contributions of properly managed company groups cited in that study include efficiencies in resource allocation, reduced need for external finance (internalised capital markets), fewer informational asymmetries, lower transaction costs and less reliance on (often unreliable) contract enforcement mechanisms[39].

More recently, the results of a 2018 survey conducted by Japan's Ministry of Economy, Trade and Industry reported the following top four benefits/rationales cited by parent companies for owning a listed subsidiary: (i) maintaining and improving motivation of the employees of the subsidiary; (ii) maintaining the higher-status and brand value of being a listed company; (iii) hiring high-quality talents in the subsidiary; and (iv) ensuring trust with the business partners of

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[32] Wikipedia (n 17)
[33] Lauren McMenemy (n 9)
[34] JH Farrar and N Furey and B Hannigan (n 31)
[35] Tom Hadden (n 10), 389
[36] Ibid
[37] Deloitte Touche Tohmatsu Limited (DTTL)'s Global Centre for Corporate Governance, 'Governance of Subsidiaries: A Survey of Global Companies' <https://www.2.deloitte.com> Accessed 11 April 2021
[38] Organisation for Economic Cooperation and Development (OECD), 'Duties and Responsibilities of Boards in Company Groups' <https://www.oecd.library.org> Accessed 19 April 2021
[39] Ibid

the subsidiary. Complementary to items (i) and (iii) above is the capacity to directly link compensation of key employees to the value of the subsidiary's own shares[40].

The existence of company groups has also been rationalised on the bases of protection of intellectual property rights and facilitation of cross-border investment and operation. Formation of company groups has an additional benefit of fostering greater integration of markets across borders. All these can contribute positively to economic growth and employment[41]. Finally, the ability to establish listed subsidiaries and unlisted joint ventures may encourage entrepreneurship, providing limited liability for the parent and the prospect for minority shareholders of exposure to "pure plays"[42].

1.4 THE DAUNTING GOVERNANCE CHALLENGES PRESENTED BY COMPANY GROUPS

The development of complex groups of companies raises important issues in all areas of company law and practice. In the simplest form where one company merely owns a block of shares in another and takes no other interest in its operations than the collection of dividends and the exercise of its ordinary rights of a shareholder, there are a few problems other than the need for special tax provisions to deal with the dividends passing from one company to another[43]. However, where one company effectively controls the operations of another, whether it owns all its shares or not, more difficult problems of responsibility and accounting arise. There is an obvious risk in such circumstances that the controlling company will dictate the affairs of its subsidiaries in such a manner as to prejudice minority shareholders or creditors of the subsidiaries[44].

The regulatory challenges in this type of company are the fair treatment of stakeholders including among others, employees and creditors such as banks. This is more so that there are limits in terms of its financing. It cannot raise capital from the public and its financial life line is through the banking sector and personal funds of the owners[45]. It is rather curious that, Nigerian law does not reflect the fact that a private company may be floated as a subsidiary of another company, and seemingly, most of the large private companies in Nigeria are subsidiaries of large foreign companies.

In a single company, the rational goal of investors is to get the largest return on their investment consistent with the risk which they are prepared to take, but the goal of investors in a group of companies is to maximise profit for the group as a whole. The interests of any single company are irrelevant except in so far as they increase the overall profitability of the group[46]. There may be commercial or fiscal advantages in operating one or more companies within the group at a loss or on a break even basis. The economic rationale of the group may, therefore, be at odds with legal norms which consider the group in a more atomistic way, that is, by separating it into

[40] Ibid
[41] Ibid
[42] Ibid
[43] Tom Hadden (n 10), 389
[44] Ibid
[45] Ibid
[46] JH Farrrar and N Furey and B Hannigan (n 31), 487

different parts. This gives rise to a contradiction that management pursuing rational economic goals may breach their fiduciary duties to the companies of which they are directors. One may be tempted to consider the law being irrational in this regard, but one should also remember that each constituent company within the group has its own creditors who will look to its assets for recovery in case of default in payment or insolvency of the debtor company[47].

The potential conflicts raised by the agency problem, that is, the fact that companies are owned by their shareholders but run by their directors, is not restricted to stand-alone companies with defined control; it extends to company groups, for example, parent companies, like other majority or controlling shareholders, may attempt to appropriate to themselves undue private benefits of control at the expense of other shareholders and stakeholders[48]. Company groups typically engage in frequent related-party transactions[49] as they arrange transactions between themselves which are otherwise not commercially acceptable, that is, not at arms-length, and thus create profit and loss in respect of each individual company more or less at will. This is especially so and easy in respect of the transfer from one company to another of real property and other assets without readily ascertainable market value since the price may be fixed either at an exaggerated or nominal level[50].

Even in the ordinary course of commercial operations, it is often difficult to determine a proper level of pricing for transactions with wholly-owned subsidiaries which are sole suppliers of components or materials within an integrated production chain. This is a similar problem in respect of transfer of loans with or without security between members of the same group[51]. This flexibility in channeling the liquid assets is one of the obvious advantages of group organisation, and it may also be used to breed confusion as to the exact financial position or even the solvency of individual companies or indeed the group as a whole[52]. This is more so that a debt owed by an insolvent subsidiary may give rise to a false solvency to a holding company, and similar problems may arise in giving a realistic value to the holding company’s shares in its subsidiaries. Consequently, many of the most notorious corporate frauds are offshoots of inherent obscurity in group accounts[53].

Invariably, cash pooling is common in company groups, as are other intra-group arrangements, including joint borrowing, cross-guarantee, common branding, use of intellectual property (trademarks, patents and copyrights) and shared management services[54]. The legality of intra-group transfer of assets was considered in the case of *AvelingBarofrd Ltd v Perion Ltd*[55]. In that case, the company, which was solvent (in the sense that it could pay its debts as they fell due) but had accumulated heavy losses, and so was not in a position to meet the general rule requiring distributions only out of accumulated profits, transferred to another company, controlled by the same person as was its controlling shareholder, an important asset at undervalue as compared to

[47] Ibid
[48] OECD (n 38)
[49] Ibid
[50] Tom Hadden (n 10), 391
[51] Ibid
[52] Ibid
[53] Ibid
[54] OECD (n 38)
[55] (1989) BCLC (626)

its current market value. It was held that the transfer was unlawful as being an unauthorized return of capital to the controlling shareholder, the fact that the payment was made to a company controlled by its main shareholder rather than to the shareholder directly being disregarded as irrelevant.

This phenomenon of intra-group, transfer of assets is of course, a common occurrence as a result of carrying on business through group companies, and such transfers are usually effected on the basis of the book value of the asset as stated in the company's accounts, that is, its historical 'book value' which may not reflect the current market price of the asset[56].

The group enterprise has created problems for the law which have not yet been solved. The group enables not only vertical integration but also horizontal integration. As a result, there have developed large groups known as conglomerates with subsidiaries in a number of different industries[57]. In vertically-integrated groups, frequent business transactions between parent company and subsidiary company are an integral part of the business model. The more complex the structure of a company group, the greater the opportunity for such transactions and arrangements to be carried out in less transparent manner, which may benefit some companies at the expense of others[58]. Therefore, like other majority shareholders, parent companies in groups may engage in transactions that do not benefit all shareholders equally, such as intra-group mergers and sales of control to third parties effected on questionable terms[59].

These practices in company groups affect creditors adversely. Creditors of a subsidiary might suffer a disadvantage as a result of the company becoming, or being a member of group of companies because decisions may be taken on the basis of maximising the wealth of the group as a whole or of the parent company, rather than of a particular subsidiary of which the claimant is a creditor[60]. This phenomenon may manifest itself in a variety of ways. First, the parent company may instruct the board of the subsidiary to do something which is not in the best interest of the subsidiary, because the decision will maximise the benefits of the group. In another vein, a parent company may allocate business opportunities to the subsidiary which can maximise the benefit of the group, even though another subsidiary could develop the opportunity effectively, if less profitably. Finally, if a subsidiary becomes insolvent the parent may decline rescuing it, even though the group has sufficient funds to do so[61].

From the above examples, it is clear that these actions would adversely affect any outsiders of the subsidiary where it is not wholly-owned by the parent or some other group company as well as upon the subsidiary's creditors. Thus, just as in the case of single companies, which are going concerns, the protection of creditors often comes as an indirect consequence of the measures taken to protect the interest of the shareholders. However, protection of minority shareholders,

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[56] Paul L Davies (ed), *Gower and Davies Principles of Modern Company Law* (8thedn, Sweet & Maxwell 2008), 291
[57] JH Farrar and N Furey and B Hannigan (n 46)
[58] OECD (n 38)
[59] Ibid
[60] Paul L Davies (n 56), 229
[61] Ibid

both within and outside groups, is based on techniques other than the qualification of limited liability[62].

Minorities within a larger group are especially in a vulnerable position. There are risks of abuse in respect of minority holdings where the subsidiary is not wholly owned, or more simply by so organising prices and profit margins within the group as to deny it any substantial profit or dividend. Major policy decisions are taken in the interest of the group as a whole rather than each individual company within it. There may be good reasons, in a group context, for running down the business of a partly owned subsidiary in favour of another enterprise within the group, or there may be important tax consideration for minimising profit or distributions within a particular unit.

There is clear authority that such conduct may amount to oppression. In *Scottish Co-operative Wholesale Society Ltd v Meyer*[63], Scottish Textile and Manufacturing Company was a private company formed in 1946 by the appellant society and the respondents, Meyer and Lucas, to manufacture rayon cloth at a time when this product was subject to a system of state licensing. The society held the majority of the shares issued and had appointed three of its own directors to the board; the respondents who held the rest of the shares, were joint managing directors and as such filled the remaining seats on the board. The society had formed this subsidiary because it could not have secured a licence to produce rayon cloth without experienced managers, and the respondents held the necessary experience. After licencing ceased in 1952, the society by transferring the company's business to another branch of its organization and cutting off supply of raw materials on which the company was dependent, caused its activities to come to a stand-still with the result that it made no profits and the value of its shares fell greatly. The respondent petitioned for relief under section 210 of the United Kingdom (UK) Companies Act, 1948 (now section 994 U.K Companies Act, 2006) in *parimateria* with sections 353–356 of the Companies and Allied Matters Act.

The court in discussing the special position of 'a nominee director', was concerned with the manner in which the affairs of the textile company were being conducted, that is, the conduct of those in control of its affairs, be they some of the directors themselves, or, behind them, a group of shareholders who nominated those directors or whose interests those directors serve. If those persons- the nominee directors or the shareholders behind them- conduct the affairs of the company in a manner oppressive to the other shareholders, the court can intervene to bring an action to end the oppression. The House of Lords thus, held that the Scottish Co-operative Whole Society had acted towards the minority in an oppressive manner and that this conduct, through its nominee directors who were also directors of the society, amounted to conduct of the affairs of the company within section 210 of the Companies Act 1948 (now Section 994 Companies Act, 2006).

Accordingly, allocation of business opportunities is one area where company groups present particular agency challenges because they often engage in overlapping activities. A business opportunity presented to or developed by the group can frequently represent a potentially profitable activity that more than one of its members might be positioned to pursue. Deciding

[62] Ibid, 230
[63] (1959) AC 324 HL

which company in the group takes up a new business idea can present conflicts of interest for boards, individual directors and managers of group companies[64].

Groups also present non-agency related problems, some with potentially macro economic impacts. Concentration of resources and economic power has adverse effects, for example, it gives rise to monopoly with attendant restrictive practices. Therefore, domination of an economy by company groups, especially those that are diversified across industries and that internalise financing, may ultimately slow the development of broader, deeper and more efficient national capital markets[65]. The organisation of industry into networks of related companies can reduce competition in product and service markets. The anti-competitive effect can be especially problematic in smaller or developing economies like Nigeria[66]. This is antithesis to their goal of promoting small and medium scale enterprises and greater competition to boost their economies and promote growth. Indeed, concentration of economic power in fewer hands can breed adverse effects, for instance, it could give rise to regulatory capture, rent-seeking and corruption of the political system[67]. These business ills are associated with company groups who use their wealth and power to influence internal politics of the country in which they operate by bribing the legislators not only directly but also indirectly, to make laws in their interests.

1.5 The Existing Position of Nigerian Law on Company Groups

In Nigeria, there is limited recognition of the group in the Companies and Allied Matters Act[68]which defines 'holding company' and 'subsidiary'. The provision excludes shares held or power exercisable in a fiduciary capacity under a trust and includes those held by a nominee subject to certain exceptions. Although section 381 is wide, it does not cover all cases of control. Control is a matter of degree ranging from absolute legal ownership to a tenuous *de facto* control[69]. The section does not cover cross-shareholdings of less than 50 percent (because its talks of holding more than half equity share capital), interlocking directorships or other forms of minority control. A 'group' of companies may consist of a holding company and one or more subsidiaries and sub-subsidiaries, or a number of companies which have substantially the same shareholders and directors, but it is obviously possible to have an infinite variety of arrangements connecting either closely or loosely a number of companies which carry on associated business or different parts of the same business[70]. A paradigm illustration of such arrangement is the use of interlocking shareholdings to entrench control.

The Companies and Allied Matters Act contains some provisions governing groups but they are limited to the areas of financial disclosure and taxation. For instance, the Act[71]requires that the accounts prepared and presented by a holding company must contain the consolidated financial statements of the group. To the balance sheet and profit and loss accounts there must be attached

[64] OECD (n 38)
[65] Ibid
[66] Ibid
[67] Ibid
[68] CAMA 2020, section 381
[69] JH Farrar and N Furey and B Hannigan (n 31), 490
[70] Len Sealy and Sarah Worthington, *Cases and Materials in Company Law* (8thedn, Oxford University Press 2008), 65
[71] CAMA 2020, section 377 (k)

notes to the accounts dealing with matters set out in Part 3 of Schedule 2, if so desired or the miscellaneous matters in Schedule 3, where applicable[72].

The most striking of the requirements of Schedule 3 is the need to give full information about subsidiaries and other companies in which shares are held, as well as the ultimate holding company in the notes to the accounts. These appear to be an amplification of the general stipulations in Schedule 2, that all accounts must deal with the financial implications of inter-company transfer, technical or management agreements involving any of the company's significant overseas supplier or any holding, subsidiary or associated enterprise. Taking together, these provisions seem to provide the apparatus for effectively dealing with artificial inter-group transactions using transfer-prices in the future[73]. However, the attempt stops far short of a distinct legal regime for group of companies. That notwithstanding, the provisions have introduced another dimension in our disclosure regime because they are targeted at a much wider audience than investors who were sole targets of the old accounting provision[74]. In addition, in the case of a holding company submitting group accounts, the auditor's report must state whether the group financial statements have complied with the Act as to the form and substance and adequately cover all subsidiaries and associated companies[75].

The tax laws have many rules dealing with such matters as the transfer of assets between member companies of a group. For the purposes of taxation, unlike of accounting, the law does not take general note of the special position of subsidiaries. Each company is assessed for corporation tax as an independent unit on the basis of its own annual account[76]. Certain undistributed profits may be treated as distributed where it appears to the Federal Board of Inland Revenue that a Nigerian Company controlled by not more than five persons, with a view to reducing the total tax chargeable in Nigeria on the profits or income of the company and these persons, has not been distributed to its shareholders as dividend[77]. Similarly, in respect of transfer of assets from company to company within the group, the Federal Board of Inland Revenue is entitled to disregard artificial transactions capable of affecting the tax payable[78]. In other words, it is entitled to disregard any purported capital gain or loss arising from the transaction, and to, in effect, to ignore any changes of ownership within the group[79].

Generally, however, Nigerian law has not come to terms with group companies and there is no general law of group enterprise. Nigerian law does not deny that serious issues for creditors can arise with group companies but has not developed a distinct body of rules applicable to their relationship with outsiders. This is in contrast to the approach in German law dealing with public companies which contains a separate section dealing with the issue of creditor and minority shareholder protection within groups[80]. The German statutory regulation of public companies,

[72] Ibid, section 382 Second Schedule Part III and Third Schedule
[73] TAT Yagba and BB kanyip and SA Ekwo,*Elements of Commercial Law* (Tamaza Publishing Company Ltd (1994), 278
[74] Ibid
[75] CAMA 2020, Fifth Schedule Paragraphs 1,2,3, & 4
[76] Tom Hadden (n 10), 393
[77] Companies Income Tax Act (CITA) 2004, section 21
[78] Ibid, section 22
[79] Tom Hadden (n 10), 393
[80]*Aktiengesetz*, Book Three; Paul L Davies (n 56)

provides two models of regulation-one contractual and thus, optional, the other, mandatory[81]. Under the optional provision, in exchange for undertaking an obligation to indemnify a subsidiary for its annual net losses incurred during the term of the agreement, the parent acquires the power to instruct the subsidiary to act in the interests of the group rather than its own best interests[82].

The second aspect of the German statutory regime is mandatory and applies to *de facto* groups. The core provision is that the parent company is liable for the damage to the subsidiary if the parent cause the subsidiary to enter into a disadvantageous transaction, unless within the fiscal year, the parent has compensated the subsidiary for the loss or agreed to do so[83]. Although, there could be difficulty of proof, both in relation to identification of particular disadvantageous transactions where exists a continuous course of dealing between the parent and subsidiary, and to identification of loss caused by that transaction thereby providing a ready incentive for companies to migrate into the optional regime, German law has at least provided a model. Besides, a possible partial solution, which the German Courts have used for private companies (GmbH), is to use the contractual group model under which exercise of influence to disadvantageous ends would make the parent company liable for all the subsidiary's losses, whether they could be related to a particular disadvantageous contract or not[84].

Under ordinary rules of company law, a holding company, while the owner of whole or part of the share capital of a subsidiary, is not regarded as the owner of the assets of the subsidiary in the absence of an express agency or trust relationship[85]. However, the courts sometimes adopt a liberal attitude in treating the matter by looking to the economic enterprise as the court then look upon the group as one economic unit. This has been manifested by the English Courts when dealing with compensation cases but perhaps better explained as a desire not to allow the doctrine of separate legal personality to produce manifest injustice. Thus, in *Little Woods Mail Order Stores Ltd v McGregor (Inspector of Taxes)*[86]. Lord Denning stated that the doctrine laid down in *Salomon's* case had to be carefully watched. It has often been supposed to cast a veil over a limited liability company through which the courts could not see but that was not true. The courts can and often do draw aside the veil and look at what really lies behind. Parliament had shown the way; the courts should follow suit.

A similar line was taken in the case of *DHN Food Distributors Ltd v London Borough Tower Hamlets*[87]which involved compulsory acquisition. The court of Appeal was prepared to recognise the economic unit of the group as a single entity to enable them recover their compensation. DHN ran a wholesale cash-and-carry grocery business from the premises owned by its wholly-owned subsidiary company ('Bronze'). Bronze had the same directors as DHN, but it carried on no business. Its only asset was the freehold properties which DHN occupied as a licensee. A second wholly-owned subsidiary owned vehicles used by DHN in its business, but it,

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[81] Ibid
[82] Ibid
[83] Ibid
[84] Paul L Davies (n 56), 231
[85]*Salomon v Salomon & Co Ltd* (1897) ac 22 HL; JH Farrar and N Furey and B Hannigan (n 31), 487
[86] (1969) 3 ALL ER 855 at 860 CA
[87] (1976) 3 ALL ER 462 CA

too, carried on no operations of its own. The council in 1970 compulsorily acquired the premises and as a result DHN had to close down its business. Substantial compensation for disturbance (over and above the value of the land itself, which had already been paid to Bronze) could be claimed by DHN only if it had an interest in the land greater than that of a bare licensee. The Court of Appeal reversing a ruling of the Lands Tribunal, held that the group of companies should be treated as a single economic entity and that in consequence compensation for disturbance should be paid. In effect, DHN was treated as if it had owned the land itself.

The different members of the Court of Appeal seem to have been influenced by different factors. Lord Denning, MR referred to the fact that the subsidiaries were wholly owned. Goff, L.J. made it clear that not every group would be treated in this way but pointed to ownership, no separate business operations and the nature of the question to be answered. Shaw, LJ pointed to common directors, shareholdings and common interest. Essentially, in both cases, there were special elements such as trusteeship which justified the decisions.

The separate personality of each company in the group means a lot. The directors of a particular group company are not entitled to sacrifice the interest of that company. This means the directors of a holding company as such owe no duties to protect the interests of its subsidiaries when the subsidiaries have independent boards[88]. If the directors of the group company have acted in the best interests of that company the fact that they did so inadvertently because they actually considered only the interests of the group as a whole, will not render them liable for breach of duty. Thus, *in Charterbridge Corp Ltd v Lloyds Bank Ltd*[89], the directors of a company (Castleford') forming part of a group had considered the benefit of the group as a whole without giving separate consideration to that of the company alone when they caused the subsidiary company of which they were directors to give security for a debt owed by the parent company to a bank. It was alleged that the guarantee was ultra vires because at the time when it was given, the directors had not *bonafide* intended to further the interest of Castleford. The court held that this was irrelevant. The memorandum of a company sets out its objectives and proclaims them to persons dealing with the company and it would be contrary to the whole function of the memorandum that objects unequivocally set out in it should be subject to some implied limitation by reference to the state of mind of the parties concerned. Each company in the group is a separate legal entity and the directors of a particular company are not entitled to sacrifice the interest of that company.

This becomes apparent when one considers the case where the particular company has separate creditors. The 'proper test' in the absence of actual separate consideration must be whether an intelligent and honest man in the position of a director of the company concerned could have reasonably believed that the transactions were for the benefit of the company. The challenge to the directors' decision failed in this case because the collapse of the parent company would have been "a disaster" for the subsidiary. The law as stated in the *Charterbridge* case was accepted in *Extrasure Travel Insurances Ltd v Scattergood*[90]but the court came to a different conclusion on the facts because (a) the directors of the subsidiary never considered whether the survival of the parent was crucial to the subsidiary and (b) no reasonable director would have concluded that the

[88] JH Farrar and N Furey and B Hannigan (n 31), 488; Paul L Davies (n)< 232
[89] (1970) Ch 62
[90] (2003) 1 BCLC 598

steps taken by the directors would lead to the survival of the parent. Despite the *Charterbridge* decision, it must be emphasised that the core duty of loyalty does not recognise a duty "to the group" or to other companies in the group, for the duty insists that the main focus of the directors should be on the interests of the subsidiary even if it accepts that the interests of the subsidiary are in many cases intimately related to the continuing existence of the group.

In Common law jurisdictions worldwide, it is well established that the fiduciary duties of directors and boards of a subsidiary company relate solely to the company itself and not to its parent or larger group. This is not limited to common law jurisdictions as most non-common law jurisdictions including- China and France have also subscribed to the classic fiduciary duties approach, that subsidiary companies are autonomous entities and not to be regarded as subordinate to the interests of their parent companies or group of companies with which they are associated[91]. Thus, in *Lindgren v Land P Estates Co Ltd*[92]the court held that no duty was owed by a director of a holding company to a subsidiary and in *Bell v Lever Brothers Ltd*[93], the court held that no duty was owed by a director of a subsidiary to the parent company. This principle was also applied to group companies in EBBW *Vale UDC v South Wales Area Licensing Authority*[94]and *Re Southard and Co Ltd*[95]. Its acts are not acts of the parent company and the parent company is not responsible for its acts and defaults in the absence of special provisions in some contracts between the parties.

Nigerian corporate jurisprudence has not taken a different route. It was held in *MO Kanu, Sons & Co Ltd v First Bank of Nigeria Plc*[96]that a holding company and its subsidiaries are each a distinct and separate legal personality; each owns its own assets and properties and recourse cannot be had to the assets of subsidiaries for the purpose of liquidating the holding company's debt. This means a holding company and other companies in the group are not liable for debts incurred by a member of the group unless they have guaranteed them or have participated in carrying on the subsidiary's business with intent to defraud creditors within the meaning of section 672 of the Companies and Allied Matters Act, 2020 or they are only members when the subsidiary's membership has remained below the statutory minimum of two and the company continues to trade for more than six months within section 118 of the Companies and Allied Matters Act 2020. Generally, it has been held variously in Nigeria that the act of a subsidiary company cannot be imputed to the parent company nor can the act of the parent company be imputed to the subsidiary company[97]. Davies[98] argues that the overruling of limited liability within corporate groups is likely to require sophisticated and nuanced regulation if it is to make sense in policy terms.

The pertinent issue is whether, in the context of Nigerian law, such sophisticated regulation requires the development of distinct rules for corporate group or it is better based on the

[91] (1968) Ch 572 Per Harman LJ
[92] OECD (n 38)
[93] (1932) AC 161 at 229 per Lord Atkin
[94] (1951) 2 KB 366 at 373-374 per Cohen LJ
[95] (1979) 1 WLR 1198 at 1208 per Templeman LJ
[96] (1998) 11 NWLR (pt 572) 116 at 129
[97]*Union Beverages Ltd v Pepsi Cola International Ltd (1994) 2 SCNJ 157 at 172; African Continental Bank Plc & 1 Other v Emostrade Ltd (2002) NSCQR (pt 2) 22 at 31 per Uwaifor JSC*
[98] Paul L Davies (n 56), 230

extension of existing creditor-protection rule to deal with this particular situation of group creditors, for example, the application of rules against fraudulent trading to all those privy to it and of wrongful trading to shadow directors, both of which extensions may bring in parent companies, at least in the circumstances. In the United Kingdom, directors were disqualified for causing debts due to a subsidiary to be paid to a parent company in *Re-Genosyis Technology Management Ltd*[99].

It is also arguable that directors of a holding company who sacrifice the interests of a subsidiary may, in appropriate circumstances, be parties to the carrying of the subsidiary's business with intent to defraud its creditors within the fraudulent trading provisions of section 672 Companies and Allied Matters Act, 2020. If this is the case they can be made personally liable for its debts[100]. In the United States of America (USA), there is a duty to treat a subsidiary with fairness and it has been argued that there should be a tougher rule requiring sharing of opportunities within the group[101]. Under Nigerian Law (like English Law) the directors of subsidiary are as such under no fiduciary duties to the holding company merely as a majority shareholder[102]. They cannot, therefore, rely on a transaction as being for the good of the group as a whole or other members of the group when it is not in the interest of the particular company of which they are directors[103]. In the absence of evidence of what they did in fact consider, the test of their obligations is what they or an honest and reasonable director would consider to be in the interests of the subsidiary[104].

Nigeria law has not yet developed a concept of group interest or a coherent doctrine of fairness in respect of group transactions for the purposes of directors' fiduciary duties. The emphasis is still on the individual companies, and indeed, the directors of a subsidiary must not simply act as puppets of the holding company or obey the holding company where this will still amount to a breach of their fiduciary duties to the subsidiary[105]. In a case where the directors of a subsidiary company who are nominees of the holding company sacrifice its interests for those of the holding company, minority shareholders may have a remedy for unfairly prejudicial and oppressive conduct under sections 353-356 of the Companies and Allied Matters Act, 2020

The position in Nigeria is radically different from other jurisdictions. Several jurisdictions within and outside the European Union-Latvia, Portugal Slovenia Poland, New Zealand, Brazil, Czech Republic- have followed Germany's autonomous body of company group law (*Konzernrecht*-generally translated as "law on company groups")[106]. The German model contemplates two types of company groups: defacto and contractual. Defacto groups exist when one company owns shares or voting rights in another company that grants it effective control. In such cases the

[99] (2007) 1 BCLC 208
[100] JH Farrar and N Furey and B Hannigan (n 31), 488
[101] Ibid; Brudney and Chirelsein [1974] (88) *Harvard Law Review, 297*
[102]*Bell v Lever Brothers Ltd* (1932) AC 228 HL
[103] JH Farrar and N furey and B Hannigan (n 31), 488-489
[104] Ibid; *CharterbridgeCorpn Ltd v Lloyds Bank Ltd (1970) Ch 62; Re Halt Garage (1964) Ltd* (1982) 3 ALL ER 1016
[105] See Selangor United Rubber Estates Ltd v Gradock (a Bankrupt) (No. 3) (1968) 2 ALL ER 1073
[106] OECD (n 38)

negative impact of any influence of the parent over the subsidiary must be disclosed, audited and compensated in the same fiscal year in which the subsidiary's losses are realised[107].

The shareholders of a company whose board declares that the negative impact caused by the parent was not sufficiently compensated can request a special investigation of the circumstances. Consequently, the parent and its directors can be held liable to the subsidiary for uncompensated losses. They may also be held liable to the shareholders of the subsidiary for additional damages arising from impairment of the share price. The directors and members of the supervisory board of the subsidiary can also be held liable to the company's shareholders if they did not act with due care or concealed the extent of the negative impact on the company caused by the parent[108].

A contract agreement between the parent and its subsidiary creates a contractual group. The control agreement must be approved by the shareholders of both companies and must bind the parent company to compensate the subsidiary for losses annually thereby preserving the latter's capital for the protection of creditors and potentially, other stakeholders[109]. Control agreements typically also provide for transfer of profits to the parent, fixed dividends and provide exist rights for shareholders of the subsidiary[110].

1.6 CONCLUSION

The development of complex groups of companies raises important issues in all areas of company law and practice. The complexity arises from the numbers of operating subsidiaries and dormant companies and the low priority given to rationalisation. This complexity makes it difficult for shareholders and employees to monitor the affairs of the group and throws up daunting governance challenges.

Related-party or intra-group transactions are a common feature of company groups. In addition, concentration of economic power in the hands of company groups has adverse effects including but not limited to regulatory capture, rent-seeking and corruption of the political system. Finally, domination of the economy by company groups especially those that are diversified across industries with internalised financing can create monopolies with anti-competitive effects. Ultimately, the challenge of regulation of company groups is to secure the recognised micro and macro economic benefits that company groups can confer while managing the potential risk of abuse and inequitable treatment of shareholders and other stakeholders. Curiously, Nigerian law has not come to terms with group companies and there is no general law of group enterprise in Nigeria.

Against the backdrop of the foregoing, it is recommended that Nigerian law should develop a separate legal framework for group companies. In this connection, Nigerian law should draw on the German model of company group law, which has been followed by several other countries, for inspiration.

[107] Ibid
[108] Ibid
[109] Ibid
[110] Ibid