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COMPANY'S PROSPECTUS AS VITAL RECIPE IN ULTRA VIRES PRACTICE

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Abstract

A prospectus is a printed document that describes the main features of an enterprise often a corporation's business which is distributed to prospective buyers or investors especially a written description of securities offering, purchase of shares or debentures. Under the Security Exchange Commission Regulations, a public company must provide a prospectus before offering to sell stock in the company. Contrary to this regulation, there is usually an insider trading by the company's officers who might have allotted a number of shares to themselves behind the scene before issuing its prospectus to the general public. This practice is ultra vires, especially keeping the innocent prospective subscribers in perpetual disadvantage by the culpable officers. The ultra vires practice and the perpetual disadvantages of the prospective subscribers gave rise to this research. Thus this research employed the doctrinal legal research methodology in investigating the mode and manner in which a company's prospectus is used as a veritable recipe in ultra vires practice by corporate officers. On this premise the research recommends that a Special Pre-Prospectus Inspectorate Committee (SPIC) with Inspectorate Divisions in all the States of the Federation be established. It is hoped that this committee, when put in place shall collaborate with the Security and Exchange Commission so as to mitigate the identified problem by inspecting all the activities of the company prior to the issuance of its prospectus to the public.

Keywords: Company, Prospectus, Ultra Vires, Practice

1. Introduction

A prospectus is a printed document that describes the main features of an enterprise (often a corporation's business) and that is distributed to prospective buyers or investors; especially a written description of securities offering. Under the Security Exchange Commission Regulations, a publicly traded corporation must provide a prospectus

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before offering to sell stock in the corporation.¹ A prospectus has also be defined as any notice, circular, advertisement, or other invitation inviting members of the public to come and subscribe or purchase the shares or debentures of a company.²

Furthermore, the Investment and Securities Act³ has defined prospectus as any written or electronic information, notice, advertisement or other forms of invitation offering to the public for subscription or purchase, any shares, debentures, or other approved and recognized securities of a company or other issues or scheme. A prospectus, simply put, is any legal means through which an incorporated company invites the public for subscription to any of its shares, debentures or other recognized form of securities.

2. When to issue Prospectus

A prospectus is issued when the need arises for a company to dispose of or acquire any securities for the company in accordance with the stipulations or provisions of the ISA, 2007.

Thus, it shall be lawful to make an invitation to the public to dispose of or acquire any securities of a company if within 6 months before the invitation, there has been delivered to the Securities and Exchange Commission, a prospectus relating to such securities and complying in all respects to sections 75, 76, and 79 of the Act⁴. Again, the prospectus that is being issued must be in conformity with the requirements for registration and notification as required under the provisions of the ISA 2007.

However, as provided under the ISA,⁵ a copy of the prospectus must have been sent to every person to whom the invitation is made unless those exempted⁶.

¹ Bryan A. Garner, *Black's Law Dictionary* 11th Edn. (USA: Thomson Reuters, 2019) 1477

² Akpederin E.K, *Foundation in Nigerian Company Law*, (Kaduna: Simplicital Publishers, 2005) 42

³ Section 315 Investment and Securities Act (ISA), 2007.

⁴ ISA 2007

⁵ S. 67 ISA 2007.

⁶ S. 78 (2) ISA 2007.

3. Content of a Prospectus

A prospectus usually contains the following:

- i. The amount to raise by the company from the public offer.
- ii. The purchase price of any property purchased by the company or to be purchased by the company.
- iii. The names and address of the company's directors, auditors, etcetera.
- iv. The company's proprietorship, management and its capital requirement.
- v. The details of the offer, commissions, property acquired or to be acquired by the company.
- vi. Preliminary expenses, contracts, interest of directors, rights attached to different classes of shares.
- vii. Auditor's and Accountant's Reports which are to attest to the liquidity and profitability of the company.⁷

4. Procedure for the Issuance of a Prospectus

The followings are the procedures for the issuance of a prospectus:

- i. A draft of a prospectus is first prepared where applicable, a certificate of exemption from complying with the relevant section of the Act may be considered upon application made if the Stock Exchange believes that it will be unreasonable and burdensome to comply with the relevant provisions as contained in Companies and Allied Matters Act 2020.
- ii. Secure approval of the draft from the appropriate authority. The draft prospectus will be submitted to the Securities and Exchange Commission along with the application for the registration of the securities.⁸

⁷ Part 1, 3rd Schedule ISA 2007.

⁸ Section 78 ISA 2007.

- iii. The final copy of the prospectus as approved by the Securities and Exchange Commission will be printed and consents of experts whose reports or statements are contained in the prospectus must be obtained respectively.
- iv. All persons named as directors shall duly sign the printed prospectus.
- v. The printed prospectus will thereafter be submitted to the Securities and Exchange Commission, Stock Exchange Commission and Corporate Affairs Commission for registration.

It should be noted that a prospectus must be dated and the date written on it is taken as the date of publication unless otherwise stated.

5. Statement in Lieu Of Prospectus

A statement in lieu of prospectus as provided for under ISA⁹ is a statement issued and delivered to the Securities and Exchange Commission by public company having a share capital which does not issue a prospectus on or with reference to its formation or which has such a prospectus but has not proceeded to allot any of its shares offered to the public for subscription and that it intends to allot such shares.

Under this, the issuing company shall not allot any shares unless 3 days before the first allotment of shares, it has delivered its statement in lieu of prospectus signed by every person named in it as a director or a proposed director or by his agent authorized in writing, to the Securities and Exchange Commission for registration.

It is a requirement for a public company to issue a prospectus or statement in lieu of prospectus to invite members of the public to buy its shares or other securities. The motive behind the public issuance of prospectus or statement in lieu which is to raise fund from members of the public may not be realized where close attention and monitoring is not given to the content of the prospectus which spells out how the capital is to be raised and value added statement of

⁹ Fourth Schedule, ISA 2007.

professionals involved in the issuance.¹⁰ Hence, the Security Exchange Commission Rules 2013 imposes responsibilities on the part of individual involved in the making of the statement contained in the prospectus for the company issuing public securities in Nigeria.¹¹

6. Public Issue of Securities

The securities mostly issued to the public are shares or debentures. Public issues of shares or debentures take three principal forms:

- i. Rights issues and open offers: This is a situation where the company invites its existing shareholder or debenture holders to subscribe to further capital required.
- ii. Placing or selective marketing: This is a situation where the company agrees to allot the whole issue of the securities at an agreed price to a merchant bank, issuing houses, insurance companies or one or more firm of stock brokers or dealers and the intermediary then sells the securities to purchasers whom they find.
- iii. Invitation to the public generally to subscribe for or purchase securities of a company.¹²

7. Civil and Criminal Liabilities for Misstatement in Prospectus

Under the Investment and Securities Act,¹³ where a prospectus of a company invites persons for subscription for shares, the persons that are responsible for it shall be liable to pay compensation to all persons who subscribe for shares or debentures relying on the prospectus for any loss or damage they may have sustained by reason of any untrue statement contained in the prospectus.

¹⁰ Akin Oluwadayisi, "An Analysis of Liabilities for Misstatement in Public Offer for Securities in Nigeria" Vol.6 No.4, 2015, *The Gravitas Review of Business & Property Law*, 8

¹¹ *Ibid.*

¹² Sotonye I. Etomi, "Public Offer of Company Securities: The Legal Perspective"; Paper Presented at the Alpha Juris Workshop Series in Port Harcourt, Rivers State, Nigeria, 6th- 7th February 2003.

¹³ S 62 ISA, 2007.

Those to be held liable in respect of the above are:

- i. A promoter of the company
- ii. A director of the company at the time the prospectus was issued.
- iii. A person who authorized the issuance of the prospectus
- iv. A person who authorized himself to be named and is named in the prospectus as a director or as having agreed to become a director either immediately or after an interval of time.¹⁴

Moreover, where the consent of a person is required for the issue of a prospectus and that consent is duly obtained, he shall not by virtue of his given consent be held liable as a person who has authorized the issue of prospectus except in respect of untrue statement purporting to be made by him as an expert¹⁵.

There are certain cases in which a person may be exonerated from liability upon certain circumstances such as:¹⁶

- i. If it can be established that having consented to become a director of the company, he withdrew his consent before the prospectus was issued and that issuance was done without his authority or consent.
- ii. A prove that the prospectus was issued without his knowledge or consent and that on becoming aware of its issue he forthwith gave reasonable public notice that it was issued without his knowledge or consent.
- iii. When it can be established that after the issue of the prospectus and before allotment, he, on becoming aware of any untrue statement in it withdrew his consent and gave reasonable public notice of his withdrawal and the reason for such withdrawal.
- iv. In the same vein, with regards to untrue statement that not purporting to be made on the authority of an expert or of a public official document or statement, he had reasonable ground to

¹⁴ S 85 *ibid*

¹⁵ S. 62 (3) *ibid*

¹⁶ S. 85 (4) *ibid*

believe up to the time of the allotment of the shares as the case may be that the statement was true and it was a fair and correct representation of the statement.

A person is not under the ISA provision deemed to have authorized the issue of a prospectus by reason only of his given consent to the inclusion in it of a statement purporting to be made by him as an expert.¹⁷

Criminally, where a prospectus contains any false or untrue statement, any officer who authorized the issue is guilty of an offence¹⁸. Where a statement in lieu of prospectus includes any false or untrue statement any person who authorized the delivery of the statement in lieu of prospectus for registration, commits an offence and will be liable unless he is able to establish a proof either that the untrue statement was immaterial or that he had reasonable grounds to believe and did (up to the time of delivery for registration of the statement in lieu of prospectus) believe that the untrue statement was true in that regard.

It is submitted that the Security and Exchange Commission should operate proactively by taking reasonable regulatory and supervisory step on the internal activities of companies prior to the issuance of prospectus. Where a statement in a company's prospectus turns out to be untrue or misleading to the innocent subscribers or members of the public, an exemplary fine should be imposed on the company's officers who are liable.

As earlier mentioned, a Special Pre-Prospectus Inspectorate Committee (SPIC) with Inspectorate Divisions in all the States of the Federation be established. This Special Pre-Prospectus Inspectorate Committee (SPIC) shall collaborate with the Security and Exchange Commission for regular periodic inspections on all the activities of the company prior to the issuance of its prospectus to the public.

It is argued that the deliberate or negligent practice of misstatement in a company's prospectus amounts to a professional misconduct which often put innocent subscribers or members of the public in a

¹⁷ S. 85 (8) *ibid*

¹⁸ S. 63 *ibid*

disadvantage position of economic loss. It paves way for ultra vires practice in the company's activities as hereunder evaluated.

8.1 The Ultra-Vires Doctrine

The Companies and Allied Matters Act, 2020 hereinafter referred to as CAMA¹⁹ provides to the effect that a company shall not carry on any business not authorized by its memorandum of association and shall not exceed the powers conferred upon it by its memorandum.

Furthermore, notwithstanding the provision above, no act of a company and no conveyance or transfer of property to or by a company shall be invalid by reason of the fact that such act or conveyance or transfer was not done or made for the furtherance of any of the authorized business of the company or that the company was otherwise exceeding its objects or powers²⁰.

The ultra vires doctrine therefore is a doctrine that posits to the effect that every company shall carry on its business within the confines of its authorized business or object clause for which it is registered. Thus, a company will be said to be acting ultra vires when the company is carrying on business outside the scope or limit of its powers with regards to its registered business as contained in its memorandum of association. If a company transacts any business which is outside its objects, the transaction is ultra vires²¹, such ultra vires act cannot be validated even by the unanimous approval of the members.

8.2 The Legal Effect of Ultra-Vires Transactions

The legal effect of an ultra vires practice has been greatly degenerated by the provisions of CAMA. Though one of the significant consequences of incorporation is that the company becomes a body corporate, that is, a legal person quite distinct and separate from the individuals who are its members,²² the individual

¹⁹ S. 44 CAMA, 2020.

²⁰ S. 44 (3) CAMA, 2020.

²¹ *Ashbury Railway Carriage and Iron Co. Ltd v. Riche* (1875) LR 7 HL 457; *Continental Chemist v. Ifekandu* (1966) 1 All NLR 1.

²² J.A Dada, *Principles of Nigerian Company Law* (Calabar: Wusun Publishers, 2008) 73.

members must as of law act within the sphere of powers conferred on it.

It is argued that a company should not act under the façade of implied powers which consequently pave way for ultra vires practice on the basis that a company is allowed to do everything reasonably necessary and incidental to or consequential to its objects expressly authorized in its memorandum of association. Thus, the memorandum of association determines the capacity or powers of every company and controls its contractual capacity.²³

In the old English case of *Ashbury Railway Carriage & Co. v. Riche*,²⁴ a company was formed under the 1862 English Companies Act with the object which include among others, to carry on business as "mechanical engineers and general contractors". The directors entered into an agreement for financing the construction of a railway in Belgium. The agreement was initially ratified by all members, but it was later repudiated by the company. The issue that came up was whether the company was bound by the contract. The House of Lords held that the contract was ultra vires the company and therefore void.²⁵

The court stated that the aim of the ultra vires doctrine is for the protection of investors in the company so that they know the objects for which their money is used and secondly to protect creditors of the company so that the fund of the company are not used in an unauthorized activities. Any action taken by or on behalf of the company outside its object is therefore void under the doctrine of ultra vires; it will be void ab initio, completely dead and of no legal effect whatsoever.²⁶

²³ M.E Ekpo, *Company Law, Management and Practice* (Calabar: University of Calabar Press, 2005) 198

²⁴ (1875) L.R.H.L. 653 in EniAlobo, *Company Law and Practice in Nigeria*, (1st Edn., Ikeja-Lagos: Princeton & Associate Publishing Co. Ltd, 2022) 272

²⁵ *Standard Bank Nigeria Ltd v. Bolokor Enterprises Ltd* (1980) FNR, *Bell Houses Ltd v. City Wall Properties Ltd* (1966) 2 Q.B. 656, Ibid (n. 22)

²⁶ M.A Olong and R Idubor, 'Trends in the Concept of Ultra Vires: The Nigerian Rethink' Vol.3, No.3 (2015)Global Journal of Politics and Law Research, in EniAlobo, *Company Law and Practice in Nigeria*, (1st Edn., Ikeja-Lagos: Princeton & Associate Publishing Co. Ltd, 2022) 270

Similarly, in the case of *Continental Chemists v. Ifekandu*,²⁷ the company's main business was that of chemists. The memorandum of association in one of its items provided that the company could enter into any business which the directors think will increase the profit of the company and that the company can do all such business and things as may be incidental and conducive to the attainment of the above objects and powers or any of them. It was contended whether the company could validly carry on the business of running a hospital. The Supreme Court held that the words "to enter into any business which the directors think will increase the profits of the company" are indefinite and useless and did not give power to the company to run a hospital.

Notwithstanding the above position, by the provision of section 44 subsection (3) of the Act, the mere fact that a company acted ultra vires with regards to its transactions done or made for the furtherance of any of its authorized business or that it was otherwise exceeding its objects or power, will not invalidate such transaction. But this could be frustrating to third parties who subscribed to the business of the company.

The above provision appears to create some challenges on the relevance of the ultra vires doctrine by sustaining the validity of ultra vires acts as against subsection (1) of section 44. However, there is a relief in subsection 4 of section 44 of the Act to the effect that when there is a breach or ultra vires transaction, any member of the company or a holder of any debenture secured by a floating charge over all or any of the company's property or by the trustee of the holder of any such debenture can apply to the court for an order of injunction to prohibit the doing of any ultra vires transaction.

Although the ultra vires doctrine has not been abolished, it has been modified by the Act²⁸. The reason for this modification is not farfetched as it was borne out of the realization that the rule has ceased to be a protection to anyone and became merely a trap for unwary innocent third party and a nuisance to the company itself.

²⁷ (1966) 1 All NLR 1 SC, Ibid (n. 22)

²⁸ S. 44 (2) CAMA, 2020.

The current position on the effect of ultra vires transactions is that such transactions will not be void ab initio.²⁹ In other words, the creditors under an ultra vires transaction will be able to recover their investments by application to the court for order of injunction under subsection (4) of section 44 of the Act.

Sequel to the application for court's order of injunction as contained in subsection (4), the court may in the circumstance order compensation for any loss or damage sustained by the other party to the ultra vires transactions.³⁰

9.1 Alteration of Memorandum and Articles of Association

By the provisions of the Act,³¹ a company may alter the conditions contained in its memorandum of association in accordance with the cases and in the manner and to the extent for which express provision is made in respect of such alteration.

A company may alter its memorandum in respect of the name of the company, business or objects, powers and share capital of the company.³² A company desiring to alter its business or objects as contained in its memorandum must begin such process by calling for a meeting of which notice in writing shall be duly given to all members to meet and pass a special resolution for alteration of the company's business or objects.³³

On alteration of articles of a company, section 53 subsection (1) of CAMA provides that a company may by a special resolution alter or add to its articles subject to the provisions of the Act and to the conditions or other provision contained in its memorandum. Thus, any alteration or addition so made in the articles shall, subject to the provisions of the Act be as valid as if originally contained therein and be subject in like manner to alteration by special resolution.³⁴

²⁹ *Ibid* S. 44 (3)

³⁰ *Ibid* S. 44 (5)

³¹ *Ibid* S. 50

³² *Ibid*

³³ *Ibid* S. 51

³⁴ *Ibid* S. 53 (2)

9.2 Legal Effect of Memorandum and Article of Association

By the provision of section 46 of CAMA 2020, the memorandum and articles of association, when registered, bind the company and the members to the effect as if they had been signed and sealed by each member and contain such agreements on their part to observe and perform the provisions thereof.

Specifically, the Act³⁵ provides that the memorandum and articles, when registered shall have the effect of a contract under seal between the company and its members and officers and between the members and officers themselves whereby they agree to observe and perform the provisions of the memorandum and articles as altered from time to time in so far as they relate to the company, members or officers as such.

From the above provision, every member of a company, in his individual capacity as a member is bound to the company by the provision of the Articles.³⁶

10. Conclusion and Recommendation

The deliberate or negligent practice of misstatement in a company's prospectus amounts to a professional misconduct which often put innocent subscribers or members of the public in a disadvantage position of economic loss. It paves way for ultra vires practice as against best practice.

As earlier stated, a company whether private or public, as soon as it is duly registered and has also be issued its certificate of registration or incorporation, it acquires the status of a legal personality distinct from its members. From that time, it can sue and be sued in its corporate name. Any natural person or artificial person as the case may be can enter into a contract with it. This also includes its members since it is distinct from its members. This is why a company may be insolvent but the members may be wealthy. While the members may die, the company does not die hence it lives on.

³⁵ *Ibid* S. 46(1)

³⁶ *Hickman v. Kent Romney Marsh Sheep Breeders Association* (1915) 1 Ch. 881.

However, every company must act within the scope or object for which it is incorporated. A company that engages itself in a business outside its object of registration will be acting ultra vires the company. An incorporated company has power under the Act to issue shares subject to any limitation in the articles of the company with respect to the number of shares which may be issued and any pre-emptive rights prescribed in the articles in relation to the shares, the company shall have the power at such times and for such consideration as it shall determine to issue shares up to the total number authorized in the memorandum.

Conclusively, in the case of a public company, which is the main focus of this article, issuance of prospectus must be done with due diligence to avoid putting innocent subscribers or members of the public in a frustrating condition. Procedures for the issuance of prospectus must be properly followed as laid down under the ISA and CAMA so that it does not pave way for ultra vires practice. Officers who are responsible for any misstatement in a prospectus should be civilly and criminally liable for such professional misconduct.

This paper recommends that the Security and Exchange Commission should operate proactively by taking reasonable regulatory and supervisory step on the internal activities of companies prior to the issuance of prospectus. Where a statement in a company's prospectus turns out to be untrue or misleading to the innocent subscribers or members of the public, an exemplary fine should be imposed on the company's officers who are liable to such act.

A Special Pre-Prospectus Inspectorate Committee (SPIC) with Inspectorate Divisions in all the States of the Federation should be established. This Special Pre-Prospectus Inspectorate Committee (SPIC) shall collaborate with the Security and Exchange Commission for regular periodic inspections on all the activities of the company prior to the issuance of its prospectus to the public.