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Sri Lanka: Law and Practice

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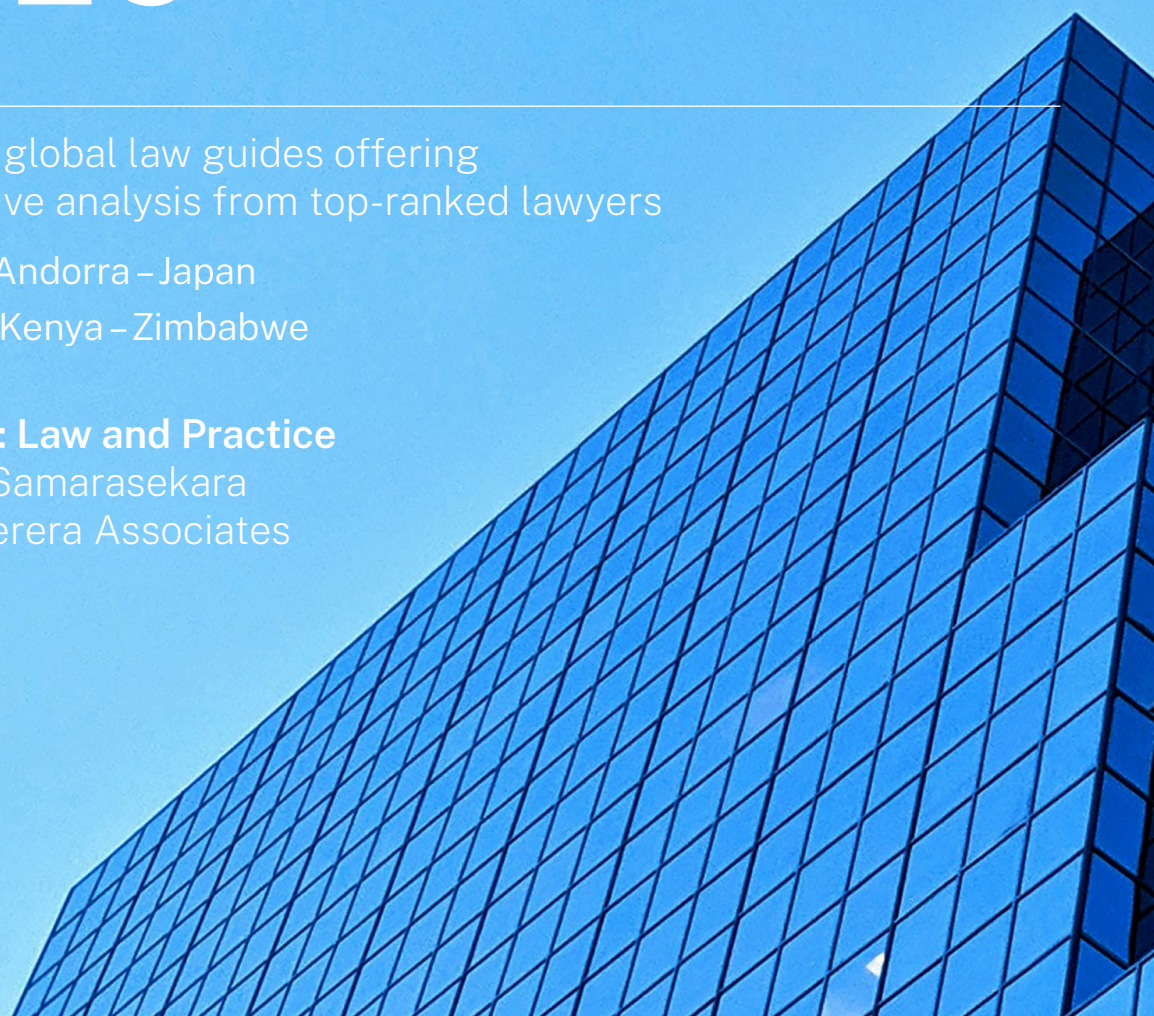

SRI LANKA

Law and Practice

Contributed by:
Nipuni R Samarasekara
Sudath Perera Associates

Contents

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1. Trends

1.1 M&A Market

Market Recovery in 2024

Sri Lanka is recovering from significant economic downturn, with a declaration of sovereign debt default in 2022 that resulted in a major upheaval in the financial and political arenas. The resulting downgrading of all Sri Lankan securities caused a significant drop in interest in the M&A market that continued through 2023. Highly restrictive import controls were placed on many items, except those deemed as *"essential"*, most notably on vehicles, and overall consumer spending and investment interest remained very low for most of 2023. The austere measures resulted in recovery, with Sri Lanka recording its first real GDP growth in Q3 2023 after consecutive GDP contractions for six quarters. By 2024, there was an uptick in foreign investment interest. Notably, the liberalisation of the petroleum industry in line with IMF commitments led to investments by foreign petroleum supply and distribution companies in 2024. Post-COVID-19 interest in Sri Lanka as a destination for tourism also increased interest in the F&B and hospitality services sectors, driving further economic improvement, reduction and stabilisation in inflation, as well as appreciation of the Sri Lanka Rupee. (Source: Central Bank of Sri Lanka)

The improving economic indicators have brought renewed interest in some cross-border M&A (in the form of FDI) with interest from regional economic powerhouses, such as China, India and Japan. By Q3 2024, the World Bank revised growth forecasts to 4.4% in 2024, stating that the economy was recovering faster than expected (Source: The Hindu, 10 October 2024). Several factors have led to Sri Lanka now being on the road to economic recovery. These include the completion of the international Debt Restructuring Process, a new Executive-President, and his party, the National People's Power being elected in November 2024 as the new government after recording a landslide two-third majority win in parliamentary elections on the promise of significant reforms with a focus on anti-corruption. The resultant upgrading of Sri Lankan securities has also led to investors - who could not previously consider Sri Lanka as an investment market due to its sovereign default status - considering investing in both the debt and equity markets. Political stability and the promise of policy continuity has also boosted confidence in the Colombo Stock Exchange (CSE), driving M&A and listings on the CSE.

Private M&A has mostly been domestic and focused on several key sectors in the services and exports sectors, but little public aggregated data can be cited in this regard.

The government of Sri Lanka initially attempted to restructure a number of state-owned enterprises (SOEs) by selling a portion of the government's stake through a bidding process, as part of the economic reform after the financial crisis. These included listed entities such as Lanka Hospitals PLC and Sri Lanka Telecom PLC, and public companies such as Hotel Developers (Lanka) Ltd and Sri Lankan Airlines Ltd. The restructuring, sale and privatisation of key SOEs was part of the IMF Extended Fund Facility programme for economic reforms. However, with the change of government in November 2024, restructuring and sale of shares has come to a halt as the government reconsiders its position (Source: The Sunday Times, February 2025).

1.2 Key Trends

CSE Re-Rating Resulting in a Bull Run From End of 2024

The re-rating of the stock market, with P/E ratios increasing to P/E 9-10 has driven interest in investment in listed securities. The CSE closed higher in 2024 with a turnover of LKR537,639.68 million, compared to LKR410,629.35 million in 2023 (Source: CSE). Declining interest rates and the Sri Lanka rupee's appreciation over 2024 have made investments in stock more attractive. Increase in bank liquidity, through consolidation and expenditure rationalisation, has driven increase in macroeconomic indicators as well. Overall, macroeconomic reforms under the IMF, including debt restructuring, have contributed to the positive indicators of the Sri Lankan economy, which in turn have driven renewed interest in investment in the country. (Source: Echelon Magazine interview with CSE Chairperson, January 2025)

1.3 Key Industries

Several deals have made headlines in Sri Lanka over 2024, although not focused on a single industry. They include the following.

Financial Sector

- Hatton National Bank PLC taking over the total shareholding of Acuity Partners (Pvt) Ltd, which was an investment banking joint venture it held with DFCC Bank and renaming the business *"HNB Investment Bank."*
- LB Finance PLC merging with Multi Finance PLC, in furtherance of the financial sector consolidation plan of the CBSL.

FMCG Sector

- Acquisition of Heineken Lanka Limited, formerly a subsidiary of Heineken Asia Pacific Pte Ltd, by Distilleries Company of Sri Lanka PLC, which will continue to produce Heineken branded beverages under licence from Heineken.
- A stake of the Colombo Coffee Company group (the representative for international coffee brands such as Lavazza and supplier to 80% of large hotels in Sri Lanka) acquired by an investment consortium led by Capital Alliance, from previous private equity firm Ironwood Capital Partners.
- Browns Investments acquisition of Lipton tea companies in Kenya and Rwanda from their UK- and Netherlands-based parent companies.

Other Sectors

- Dialog Axiata PLC acquired the shares of Bharti Airtel Lanka (Private) Limited, the Sri Lankan subsidiary of the Indian telecommunications giant, Barti Airtel.
- Brown and Company PLC acquired Isin Lanka (Pvt) Ltd, a BOI approved company, to facilitate warehouse operations of the Browns Group.
- Merger of Regnis (Lanka) PLC and Singer Industries (Ceylon) PLC with its parent company Singer (Sri Lanka) PLC.

(Sources: Daily FT, EconomyNext, Dialog)

Major consulting firms and investment bankers point to local and some foreign investment interest in tourism, especially in relation to acquiring existing hotel properties. Further, service sector investments (eg, IT) and investments in renewable energy sectors appear to be popular industries to attract investment activity, driving M&A markets.

An increase in construction activity in the Colombo Port City (set up under the Colombo Port City Economic Commission Act No 11 of 2021), a special economic zone, and the related tax and

foreign income benefits, have garnered interest in setting up within the Colombo Port City, especially for the IT and services sectors.

The recent political upheavals in Bangladesh and the USA-China trade relations have also driven renewed interest in the apparel sector in Sri Lanka, which is one of its key manufacture and export industries, allowing investors to take advantage of more relaxed trade regulations governing exports originating from Sri Lanka.

2. Overview of Regulatory Field

2.1 Acquiring a Company

Share Acquisitions

The primary means for acquiring a company in Sri Lanka are through share acquisitions. This may involve the purchase of issued shares from existing shareholders or subscription to new shares issued by a company, which are governed by the provisions of the Companies Act No 7 of 2007 (as amended) (the *"Companies Act"*). However, in an unlisted, private company transaction, the parties are free to contract as to the structure of the transaction (subject to foreign exchange laws, certain sector specific laws and regulations). In addition, acquisition of shares of companies listed on the CSE may be done on the open market, or by way of crossings or private placements which are governed by the Listing Rules (the *"Listing Rules"*) and Automated Trading Rules (the *"ATS Rules"*) of the CSE, and the Takeovers and Mergers Code 1999, as amended in 2003 (TOMC).

Asset Acquisitions

Asset acquisitions, which may involve asset-stripping of existing businesses and sale of assets/businesses *"as a going concern"* are also recognised methods, although a transfer of ownership of a company itself does not take place.

Relevant information is also included in **2.2 Primary Regulators** and **2.3 Restrictions on Foreign Investments**.

2.2 Primary Regulators

There are several regulators for M&A activity in Sri Lanka. The Department of Registrar General of Companies (ROC) plays *"registry"* role in registering and maintaining records of changes to companies.

Securities and Exchange Commission

The Securities and Exchange Commission of Sri Lanka (SEC), which operates under the framework of the Securities and Exchange Commission of Sri Lanka Act No 19 of 2021 (the *"SEC Act"*), is the securities market regulator and regulates, inter alia, the CSE, market intermediary institutions and any person dealing in listed securities on the CSE. Transactions within the purview of the TOMC and M&A involving market intermediary businesses (such as stockbrokers) require SEC approval. The SEC may also take several remedial or punitive measures against persons engaging in market manipulation activities and insider trading.

The CSE

The CSE has oversight of daily trading activity by listed companies. The CSE undertakes a disclosure-based oversight approach, where the Listing Rules require companies to disclose price-sensitive information. The CSE's powers in the event of non-compliance with the Listing Rules include transfer of the company to *"Watch List"* to inform investors of such non-compliance, issuing trading halts and suspensions.

Sector-Specific Regulators

Further approvals will need to be obtained for M&A activity in the following regulated sectors:

- the Central Bank of Sri Lanka (CBSL) would need to approve proposed acquisition of banks or licensed financial institutions;
- specialist regulated industries include shipping (Merchant Shipping Secretariat) and aviation (Civil Aviation Authority); and
- foreign investment beyond 40% in key export sectors as defined in the Foreign Exchange Act No 12 of 2017 (FEA) and regulations thereunder (described in **2.3 Restrictions on Foreign Investments**) would require the board of investment (BOI) approval, in accordance with the Board of Investment Law No 4 of 1978 (as amended).

The BOI of Sri Lanka

The BOI generally encourages investors to invest in new projects, and not in reconstitution of existing businesses, and has several focus segments such as apparel and renewable energy. The BOI is geared towards facilitating investment in manufacturing and export sectors, and grants investors access to custom-built BOI zones around the country. It is empowered to provide customs duty concessions for imports of project goods for the project implementation period (eg, specialist machinery and equipment required for construction or operationalisation of factories). BOI-approved entities also enjoy benefits in terms of residence visa/work permits for foreign investors/ specialist foreign staff.

However, BOI approval is not mandatory (except in the limited circumstances stated above), although many investors view BOI approval as being the government of Sri Lanka's official seal of approval on investment into Sri Lanka.

2.3 Restrictions on Foreign Investments

The FEA and Regulations

The FEA and regulations thereunder put in place restrictions on foreign investment in Sri Lanka. The restrictions take two forms:

- the introduction of regulated bank accounts to channel investments through; and
- regulated sectors where foreign investment is restricted.

Regulated Channels for Foreign Investment

The FEA holds Authorised Dealers (ADs) (generally licensed commercial banks and licensed specialised banks) responsible for monitoring and regulating the channels of foreign investment into Sri Lanka. For example, a bank is required to open an *"Inward Investment Account"* (IIA) to channel the consideration for investment for capital transactions into Sri Lanka, and to channel the returns and proceeds of the realisation of such investment back out of Sri Lanka. In practice, it is mandatory for foreign investors to open the IIA to invest in shares in a company in Sri Lanka (whether listed or unlisted), to repatriate distributions such as dividends, and to repatriate the proceeds of sale of shares or the winding-up of the company. Foreign loans to companies are channelled through External Commercial Borrowing Accounts and must be of a tenure of at least three years. Any deviation from the regulated channels requires the approval of the CBSL, which is a time-intensive process. The regulated accounts also serve as the method of implementing anti-money laundering and counter financing of terrorism (AML/CFT) measures through enhanced KYC requirements for foreign investors.

Regulated Sectors for Foreign Investment

The FEA and regulations thereunder have carved out several areas where foreign investment is restricted, as follows.

- No permission for foreign investment:
  - (a) pawn brokering;
  - (b) retail trade with a capital of less than USD5 million; and
  - (c) coastal fishing.
- Up to 40% of investment into businesses carrying out the following business activities, unless a higher shareholding percentage has been approved by the BOI:
  - (a) production of goods where Sri Lanka's exports are subject to internationally determined quota restrictions;
  - (b) growing and primary processing of tea, rubber, coconut, cocoa, rice, sugar and spices;
  - (c) mining and primary processing of non-renewable natural resources;
  - (d) timber based industries using local timber;
  - (e) deep sea fishing;
  - (f) freight forwarding;
  - (g) mass communication;
  - (h) travel agencies;
  - (i) education; and
  - (j) shipping agencies.
- Sectors which require approval from specific regulators/or legal or administrative bodies:
  - (a) air transportation;
  - (b) coastal shipping;
  - (c) industrial undertaking in (i) manufacturing arms, ammunitions, explosives, military vehicles and equipment, aircraft and other military hardware; (ii) manufacturing poisons, narcotics, alcohol, dangerous drugs and toxic, hazardous or carcinogenic material; and (ii) producing currency, coins or security documents;
  - (d) large-scale mechanised mining of gems; and
  - (e) lotteries.

Other Laws Restricting Foreign Investment

Land ownership

The Land (Restrictions on Alienation) Act No 38 of 2014 (as amended) (LRAA) imposes restrictions on foreign ownership of land and real estate, with exceptions for ownership of condominium properties and ownership of land by companies listed on the CSE. The LRAA caps foreign ownership of companies holding freehold land at less than 50% of voting shares. Investment in companies that lease land (up to 99 years) remains unrestricted. Given these limitations, companies frequently adopt structured land ownership models and mixed debt/equity financing mechanisms to maintain foreign investor control, in accordance with investor risk appetite. Structuring investments in compliance with the LRAA is common in sectors such as hotels, tourism, and agriculture, where substantial investment in land holdings is essential.

Foreign employment

In terms of the Sri Lanka Bureau of Foreign Employment Act No 21 of 1985 (as amended), a company will only be eligible for a licence to carry on *"foreign employment agency"* in Sri Lanka if the majority of its shares are held by Sri Lankan citizens.

2.4 Antitrust Regulations

Consumer Affairs Authority

As a relatively small market, Sri Lanka does not have significant or complex anti-trust regulation in place. The main source of anti-trust regulations stem from the Consumer Affairs Authority Act No 9 of 2003 (as amended) (the *"CAA Act"*), which set up the Consumer Affairs Authority

(CAA), which ostensibly intervenes in anti-competitive practices against the public interest.

The CAA Act empowers the CAA to control or eliminate restrictive trade agreements and abuse of dominant position in the market (Section 8). No public information is available as to rulings preventing M&A creating market monopolies; eg, ACL Cables PLC acquired the major shareholding of Kelani Cables PLC, creating a monopoly in the Sri Lankan power and telecommunication cables supplier market, in 1999. The CAA's primary focus, from a competition and anti-trust perspective, is on ensuring competitive prices of goods and services to consumers, protecting consumers against hazardous goods and services, and to protect and provide redress against unfair trade practices (Section 7, CAA Act).

Other anti-trust regulations may indirectly apply through various regulatory processes, as set out below.

- M&A in the banking and financial sector is governed by the CBSL and the SEC, which will need to approve every proposed merger or acquisition of a bank or regulated financial institution.
- Any transfer or amalgamation of insurance business must be approved by court and the observations of the Insurance Regulatory Commission of Sri Lanka must be taken into account by the court. It must also be in line with the guidelines on takeovers and mergers issued by the SEC (Section 102 of the Regulation of Insurance Industry Act No 43 of 2000, as amended).
- The telecommunication industry is regulated by Telecommunications Regulatory Commission of Sri Lanka (TRCSL) set up under the aegis of the Sri Lanka Telecommunications Act No 25 of 1991 (as amended) (SLTA). By virtue of SLTA, the TRCSL is empowered to license telecommunications service providers, and, of its own motion or on a complaint or request made to it, investigate and remedy any anti-competitive practices or abuse of dominant market position, including the *"creation or construed creation of a merger situation"* (Section 9A, SLTA).

2.5 Labour Law Regulations

Sri Lanka has a gamut of labour-related laws and regulations that govern employment, retiral benefits (provident fund), work hours, holidays, disciplinary action and termination of employment. Most legislation has roots in the country's socialist and labour-centric government policies from the 1950s–1970s, and lean heavily towards protection of labour rights, and include laws allowing collective bargaining in certain industries. Further, separate laws govern shop and office employees and factory workers, as well as employees of various trades who fall under the purview of wages boards.

Acquirers must consider whether targets have correctly computed and made up-to-date payment of provident fund contributions to the Employees' Provident Fund (set up under the Employees' Provident Fund Act No 15 of 1958, as amended) and Employees' Trust Fund (set up under the Employees' Trust Fund Act No 46 of 1980, as amended). If the contributions have not been correctly made, the Commissioner of Labour has the power to impose surcharges and penalties of up to 50% of the contributions and returns which have been delayed or incorrectly filed. A further area of concern is the correct computation of gratuity, which is a benefit on cessation of employment of those employed for five years or more, as mandated by the Payment of Gratuity Act No 12 of 1983. Acquirers should also consider whether target companies

observe correct working hours including work on public holidays (for which extra payment is required), payment of overtime and leave policies, in accordance with the various applicable acts.

A further area of concern for potential acquirers would be the strict laws relating to the termination of employment of employees, should employers wish to restructure the labour force or undertake employee redundancies. The Sri Lankan law does not generally provide for the termination of employment at the discretion of the employer, except for disciplinary reasons based on narrowly construed grounds of misconduct (Industrial Disputes Act No 43 of 1950, as amended), or limited non-disciplinary circumstances governed by the Termination of Employment of Workmen (Special Provisions) Act No 45 of 1971, as amended (TEWA). Generally, the employee's consent (in the form of resignation or a mutual separation agreement) should be obtained, or the prior written approval of the Commissioner of Labour must be obtained, especially in situations of redundancies relating to restructuring of businesses. The TEWA also provides for a scheme of compensation to such employees whose employment is terminated in accordance with its provisions.

2.6 National Security Review

A national security review would generally entail Ministry of Defence clearance – and this is reserved for areas of national importance, such as military related investments or industries (eg, arms and ammunition procurement or construction) or aviation. Industries or businesses that may require Ministry of Defence clearance and supervision for investments also concern Sri Lanka's borders and Sri Lankan waters such as coastal shipping, fishing and ferry/transport services (eg, ferry services between India and Sri Lanka).

3. Recent Legal Developments

3.1 Significant Court Decisions or Legal Developments

No significant court decisions have been delivered in relation to M&A in the past three years. Parties to M&A transactions prefer to adopt arbitration or other ADR mechanisms for dispute resolution, which keep the details of transactions away from the public domain.

The SEC Act came into force in 2021, replacing the SEC Act of 1987 and introducing a wider regime of securities that comes under the purview of the SEC.

The Personal Data Protection Act No 9 of 2022 (PDPA), which was initially expected to come into effect on 18 March 2025, has now been repealed by Gazette Extraordinary No 2427/34, dated 14 March 2025. The implementation of certain parts of the PDPA is to be extended by a further six months (ie, 18 November 2025) as per a media release from the Ministry of Digital Economy, dated 24 February 2025. However, this date has not been confirmed by way of an official government Gazette or as an amendment to the PDPA. Thus, at the time of writing, the timeline for the implementation of the PDPA is uncertain.

3.2 Significant Changes to Takeover Law

The TOMC was last amended in 2003. No other changes have been made since that date, and no information on proposed changes is available at the time of writing this article.

4. Stakebuilding

4.1 Principal Stakebuilding Strategies

Stakebuilding in companies listed on the CSE could take place when investors seek to build controlling interests or significant minority stakes over time in the growth stage or expanding businesses. It is also likely for investors to consider stakebuilding strategies when they own between 30%-50% of the shares of a listed company to obtain a controlling interest.

Strategies for stakebuilding on the CSE include making a voluntary offer for takeover, buying stock on the open market up to the mandatory offer threshold (30% of voting rights of the company), crossings or private placements for shares of a target. Any acquisition of over 10% of shares in a listed entity must be disclosed to the SEC. Once the 30% mandatory offer threshold is crossed, the investor is required to make mandatory offers for every acquisition of over 2% of voting rights in a given 12-month period, up to a maximum of 50%. The rules apply to investors and persons acting in concert with such investor, as defined in the TOMC.

These strategies are largely unregulated in private companies, and it is common for investors to obtain a significant minority over time. In sectors such as banking and finance, agriculture and other sectors regulated by the FEA, investors are free to acquire shares from other willing sellers up to the statutorily permitted threshold.

4.2 Material Shareholding Disclosure Threshold

As stated in **2.3 Restrictions on Foreign Investment** s, where foreign ownership of shares in private, unlisted entities in regulated industries is expected to exceed the permitted thresholds (eg, 40% ownership) then such investors must seek approval from the relevant regulatory authorities (eg, the BOI). In addition, in a situation of a mandatory offer being made, as stated in **4.1 Principal Stakebuilding Strategie,** s, disclosures will be required to the CSE.

In the banking sector, no single shareholder and persons acting in concert with such shareholder may hold more than 10% of a licensed commercial bank and must immediately disclose such holding.

A further disclosure requirement arises for AML/CFT measures under the Financial Transactions Reporting Act No 6 of 2006, where banks and certain other designated non-finance businesses are required to collect information on ultimate beneficial ownership of shares, the threshold of which is set at 10% of the ownership of shares of any legal entity (Guidelines for Designated Non-Finance Businesses on Identification of Beneficial Ownership No 02 of 2019).

4.3 Hurdles to Stakebuilding

In private companies, the articles of association and other constitutional documents of a company and shareholders' agreements may include pre-emptive rights, rights of first refusal for sale of shares, tag-along/drag-along provisions or call/put options on shares, that may create hurdles to stake building. As the parties are free to contract in private M&A transactions, the deals may be structured in accordance with the requirements of the parties. The articles of association and shareholders' agreements may also introduce higher thresholds for transactions, such as the requirement of a special resolution (75%) to approve sale or issuance of new shares, which may create hurdles to stakebuilding. The TOMC largely governs stakebuilding in listed companies.

4.4 Dealings in Derivatives

Dealings in derivatives are allowed in Sri Lanka. Banks are specifically permitted to deal in over-the-counter derivatives for their clients and for themselves by Directions issued under the Banking Act No 30 of 1988, as amended (the *"Banking Act"*). The SEC Act contemplates the set up and operation of derivative exchanges, although no exchange for trading of derivatives currently exists. At the time of writing, Expressions of Interest have been called by the SEC for establishment and operation of a Multi-Asset Class Derivatives Exchange. The SEC Act specifically states that any exchange traded derivative transaction will not be considered *"gaming and wagering"* contract. No other specific laws govern dealings in derivatives, and private counterparties are free to contract accordingly. Counterparties to derivative transactions must ensure that the transaction does not fall foul of the laws restricting gaming contracts and transactions

4.5 Filing/Reporting Obligations

There are no specific provisions dealing with filing and reporting obligations for derivatives in Sri Lanka. Transactions will be governed by general disclosure obligations by listed companies based on applicable Listing Rules. Any transactions undertaken by banks will be governed by the relevant directions under the Banking Act, referenced in **4.4 Dealings in Derivatives**.

4.6 Transparency

Acquisitions of private companies remain largely in the private domain and do not require disclosure. The intentions of the parties may be captured in a shareholders' agreement or in the articles of association of the target company (which is publicly available).

Disclosure of acquisitions of listed entities would be governed by the Listing Rules. Intentions regarding control would be evident by mandatory offers being made to acquire shares above the 30% threshold or offers for acquisition of shares between the 30%-50% threshold. Such disclosure would include detailed offer letters and information issued to the target's shareholders.

Any control of the board of directors would depend on the articles of association and other governing/constitutional documents of the company and thresholds set for appointing nominees to the board.

5. Negotiation Phase

5.1 Requirement to Disclose a Deal

Unlisted companies are not required to disclose a deal in a private unregulated transaction environment. If such companies are subject to any form of litigation or scheme of arrangement, such companies may be required to disclose a deal to the judicial or quasi-judicial authority or tribunal.

For listed companies, all transactions and offers must be kept strictly confidential and the principle of disclosure applies where the deal contains price-sensitive information and can (or does) cause *"untoward price movement"* before the deal is completed, or during the negotiation phase.

The Listing Rules require listed companies to presume in favour of disclosure when undertaking transactions, including mergers, acquisitions or takeovers, and require immediate disclosure of such transactions. Limited exceptions include when an entity is holding negotiations and has not reached an agreement in-principle on the transaction. The TOMC provides for joint state-

ments to be made on the CSE, and the instances range from where after an offer is made to the board of a target and such target is the subject of rumour and speculation causing untoward price movement, to even prior to an offer being made, price fluctuations are caused due to a potential offeror's actions. The onus of making a disclosure may fall on the offeror alone when the offer is made and such offer causes untoward price movement whilst the disclosure requirement may fall on the board of the target company where an offer has been made and when negotiations on such offer have reached a point at which the board is reasonably confident that the offer shall be made for its shares.

5.2 Market Practice on Timing

Generally, market practice follows the rule of thumb that price-sensitive information must be disclosed immediately upon such information arising. In the context of an M&A transaction, this would generally be when heads of terms are finalised by the parties.

5.3 Scope of Due Diligence

Potential acquirers generally conduct due diligence reviews of legal, financial and tax matters as well as business due diligence (based on the industry and the acquirer's business needs). In negotiated business deals, it is more likely for parties to conduct *"red flags due diligence exercises"* above an indicated materiality threshold. In depth due diligence exercises can be ineffective from a time and cost perspective but may be undertaken except in complex deals. Potential acquirers rely on representations, warranties and indemnities of the seller as well as mechanisms such as purchase price adjustments/retention for a short period after closing.

5.4 Standstills or Exclusivity

Standstill provisions are not generally prevalent, and the requirement is usually addressed in Material Adverse Change clauses in heads of terms and definitive agreements – the target company is permitted to carry out activities in the *"ordinary course of business"* until completion of the transaction.

Exclusivity is more common, with potential acquirers requiring exclusivity starting at the negotiation stage, during the period of due diligence and until closure of the transaction at *"long stop date"* agreed between the parties, especially where there are competing potential acquirers for start-ups or growth stage businesses in high demand industries (eg, software development sector).

5.5 Definitive Agreements

It is both permissible and common for tender offer terms, including commercial terms, conditions precedent/subsequent, representations, warranties and indemnities to be contained in heads of terms at the start of a transaction. This may be followed by a due diligence review and valuation exercise (in certain circumstances). The parties also negotiate on definitive agreements, such as share sale and purchase agreements, share subscription agreements and shareholder agreements or joint venture agreements during such period. Terms and conditions included in the heads of terms are reflected in the definitive agreements, subject to negotiations and matters arising out of the due diligence review.

6. Structuring

6.1 Length of Process for Acquisition/ Sale

While a definitive timeline cannot be stated, transactions that do not require regulatory approvals will conclude in a few weeks from the time the initial offer is made to the target. Timelines can significantly increase if regulatory approvals, such as from the CBSL or BOI, are required, due to documentation and approval requirements.

It is pertinent to note that the opening of the regulated investment accounts under the FEA, as mentioned in **2.3 Restrictions on Foreign Investments**, will generally also take four to six weeks based on the amount of customer due diligence the bank is required to undertake to satisfy itself of all AML/CFT requirements, and may add to the lead time to complete a transaction

6.2 Mandatory Offer Threshold

Mandatory offer rules only apply to companies listed on the CSE. As discussed in **4.1 Principal Stakebuilding Strategies**, the prescribed threshold in the TOMC is the acquisition of 30% of the voting rights of a company, or if voting rights of between 30% and 50% are acquired in increments of over 2% in any given 12-month period, by an investor and persons acting in concert.

The SEC must approve any such mandatory offer and must be satisfied that the offeror is financially capable of carrying out the offer in full, or may require the offeror to divest shares to bring itself below the mandatory offer threshold, if it is not so satisfied.

6.3 Consideration

Cash consideration is generally favoured in M&A transactions in Sri Lanka. Certain transactions (usually where related parties are involved) may consider shares (eg, share swaps) or such other assets as consideration. A variety of assets as consideration may be considered subject to applicable laws, when the parties to a transaction are Sri Lankan residents. However, when non-resident investors are involved in the transaction, consideration other than cash may require additional approvals of the CBSL, unless expressly permitted by the FEA and its regulations.

The TOMC permits cash or securities being offered as consideration for mandatory offers, although states that cash alternatives must also be offered.

In industries with high valuation uncertainty, such as technology-based businesses (usually, tech start-ups), tools to bridge value gaps between parties include *"earn outs"*, where payments are made upon achieving projected earning milestones, staggered exits for sellers and purchase price retention for milestone-based payouts. Another commonly used tool is convertible instruments as consideration for the sale of shares. However, it must be noted that many of these tools are used only in a private M&A environment and not in a listed company environment, which is more heavily regulated.

6.4 Common Conditions for a Takeover Offer

In a private M&A environment, offerors are free to impose conditions, (eg, minimum level of acceptance) for takeover offers.

For listed companies, however, conditions for takeover can only be imposed for *"voluntary*

offers" as stated in the TOMC (which do not commonly take place in Sri Lanka). The offer must remain open for at least 21 days until it is declared *"unconditional as to acceptance"*, after which shareholders who have accepted the offer may not withdraw from the acceptance.

Mandatory offers cannot contain any such conditions and are strictly governed by the SEC through the provisions of the TOMC.

6.5 Minimum Acceptance Conditions

As stated at **6.4 Common Conditions for a Takeover Offer**, voluntary offers in a listed M&A setting are uncommon in Sri Lanka and have not taken place in the past 12 months. However, the threshold for significant shareholding of companies is usually at least 10% (when a declaration to the SEC as to acquisition will need to be made as per the TOMC) and may entitle the shareholder to appoint a nominee to the board of the target company. Control of companies is usually sought through the acquisition of 25% of the shareholding. The mandatory offer threshold is 30%. Generally, a shareholding granting over 50% of the voting rights will enable the shareholder to pass ordinary resolutions, and shareholding granting 75% or more of voting rights will enable the shareholder to pass special resolutions. This is generally the highest control threshold for companies in Sri Lanka.

6.6 Requirement to Obtain Financing

There is no restriction on an acquirer making a transaction conditional on obtaining financing (although this is not commonplace) in a private, unregulated environment.

However, in terms of Rule 31 of the TOMC, an offeror must have sufficient financial resources to implement a mandatory offer in full to all shareholders to whom such offer should be extended, and will need to be confirmed by the financial advisor on record for the offeror. The board of the target must also be satisfied that an offeror is able to carry out the offer in full.

6.7 Types of Deal Security Measures

For private M&A transactions, acquirers and targets are free to decide on deal security measures to be included in their negotiations and heads of terms. Common measures include non-solicitation/exclusivity provisions in heads of terms at the stage the deal is being negotiated. Break-up fees are not popular options.

For listed companies, voluntary offers, which are uncommon, may include certain deal security measures, although mandatory offers, by their very nature, do not. However, as detailed in the TOMC, offerors and boards of target companies are required to provide shareholders with information of every offer made so that they may consider them, and this may serve, in practical terms, as *"force-the-vote"* provision.

6.8 Additional Governance Rights

In many instances, acquirers who do not seek 100% ownership of a target would seek to appoint nominees to the board of directors in proportion with the acquirer's shareholding, with a larger percentage holding providing control of the board.

Such acquirers may also, depending on their percentage shareholding, avail themselves of Section 9 of the Listing Rules, enumerating corporate governance requirements (the *"Corporate Governance Rules"*) and the general legal framework which is geared towards protecting minority interests in order to protect their interests.

6.9 Voting by Proxy

Shareholders may vote by proxy at a meeting of shareholders, upon the duly completed proxy documents being made available to the company, on or before the meeting date.

6.10 Squeeze-Out Mechanisms

The focus of the SEC Act and Listing Rules is the protection of minority shareholding interests. Therefore, squeeze-out mechanisms are not commonly employed and may trigger oppression and mismanagement actions under the Companies Act against the company and its directors/majority shareholders. However, occasionally, listed companies employ a combination of methods (mandatory offer, share re-purchase, etc) that lead to de-listing of the company, in order to squeeze out shareholders who have held out against mandatory or voluntary takeover offers. Action may be instituted in court to invoke minority buy-out rights as per the Companies Act.

6.11 Irrevocable Commitments

An acquirer may specify irrevocable commitments to tender or vote by a principal shareholder in a target company, in a private M&A transaction. Such undertakings are usually given at the point of negotiation of the deal and entering into the initial heads of terms.

However, no such commitments may be undertaken by principal shareholders in a listed M&A transaction as per Rule 33, TOMC, if *"such agreement or arrangement to deal in or make purchases or sales of shares of the offeree company […] have attached thereto favourable conditions which are not being extended to all shareholders"*.

7. Disclosure

7.1 Making a Bid Public

As stated in **5.5 Definitive Agreements**, bids for listed company shares are made public at several instances. Rule 8, Listing Rules requires disclosure of any price-sensitive information, including the entering into of M&A transactions. The disclosures should be by way of an announcement on the CSE.

In addition, the TOMC requires announcements to be made in the event of a voluntary offer upon notification of the offer to the target's board. However, an announcement may be needed even before such an offer is made to the board, if any speculation in that regard causes an *"untoward price movement"* of the share price. Mandatory offer disclosures must be made immediately upon the offeror reaching the required threshold of voting rights (30%).

In a private, unlisted M&A deal, no disclosure is required, unless required in specific regulated sectors. However, changes in shareholding and the board will need to be notified to ROC.

7.2 Type of Disclosure Required

In a private, unlisted M&A deal, the issuance of shares will need to be notified to the ROC by way of filing a form within 20 working days of such share issue (Section 51, Companies Act). Any issuance of shares by a listed company will need to be disclosed by an announcement on the CSE when the decision to issue such shares is made (Section 8, Listing Rules).

7.3 Producing Financial Statements

The TOMC requires bidders to present financial statements to the board and shareholders as part of their offer documents. The bidder must possess at least three years' financial informa-

tion and present this as part of the offer document. As stated in **6.6 Requirement to Obtain Financing**, financial advisors are responsible for ensuring that the offeror has the means to fulfil a mandatory offer.

Financial statements are usually prepared and audited and must meet Sri Lanka Accounting Standards (SLFRS)/International Financial Reporting Standards.

7.4 Transaction Documents

Transaction documents are not generally disclosed, and the offer document would usually carry the salient terms of the offer, which may be disclosed on the CSE.

8. Duties of Directors

8.1 Principal Directors' Duties

General Directors' Duties

The general principle encapsulated in the Companies Act, which applies to all companies, is that directors' duties are owed to the company (although the duties of a director of a wholly-owned subsidiary could be owed to a parent company if expressly authorised by the articles – Section 187, Companies Act). Directors' duties are viewed as fiduciary duties and the common law position that such duties may extend to the company, its shareholders and even its creditors has been adopted by the Sri Lankan law. Primary duties in the Companies Act include:

- the duty to act in good faith in the interests of the company (Section 187),
- the duty to exercise due care and skill (Section 189); and
- duty to avoid conflicts of interest by disclosing interest in transactions and entering the same in the interest register of the company (Section 192).

These duties govern directors in both private and listed company environments and are the foundational standards for directors' duties.

Private Companies

No other specific duties apply to private companies in the event of a business combination. However, directors are required to provide certificates that any amalgamation will be in the best interests of the amalgamating companies, and that the solvency test will be satisfied immediately after the amalgamation.

Listed Companies

The TOMC places specific requirements on directors of listed companies in the event a voluntary or mandatory offer is made. The underlying principle in the TOMC, SEC Act and Listing Rules is the protection of minority shareholder interests. Thus, when an offer to take over a company is made, the board is required to obtain competent independent advice and make such advice available to its shareholders, and also provide fair and accurate views and advice to all shareholders of the company to enable them to make an informed decision on such offer.

8.2 Special or Ad Hoc Committees

Board Committees

Boards may delegate most of their functions to committees of the board, a director or an employee, so long as the articles of association of the company allow for such delegation (Section 186, Companies Act). The Corporate Governance Rules mandatorily require the following board committees to be formed: the Nominations and Governance, Remuneration, Audit and Related-Party Transaction Review committees. These board committees are required to be com-

prised of a majority of independent directors and cannot generally include executive directors.

Conflict of Interest

While no specific board committee needs to be formed to consider business combinations, the Audit Committee of a listed company formed as per the Corporate Governance Rules is required to review the financial statements before tabling the same to the board, with special reference to *"conflict of interest situation that may arise within the Listed Entity […] including any transaction, procedure or course of conduct that raises questions of management integrity"* (Rule 9.13.4(ii)). The Related Party Transaction Review Committee also may review such related-party transactions where directors are required to disclose information about any conflicts of interest.

8.3 Business Judgement Rule

There do not appear to be court decisions that relate directly to the point of the *"business judgement rule"* in takeover situations. However, it is an established principle of common law recognised by the courts of Sri Lanka, (see Data Management (Pvt) Ltd vs IDM Nations Campus (Pvt) Ltd and Others 2020 (1 SLR 83)) that the courts will not interfere with management decisions of the company acting within its powers.

The board of a listed target company is entitled to be satisfied that an offeror is or will be in a position to implement the offer in full (Rule 6, TOMC) and is required to provide fair and accurate advice (including independent expert advice) to shareholders (Rule 12, TOMC) in order to decide whether or not the shareholders wish to accept any offer for takeover. The board itself is not allowed to make any decisions with regard to whether a takeover offer may be accepted or not. The board is also prevented from taking measures that could scuttle a bona fide offer as per Rule 34, TOMC, described further in **9.2 Directors' Use of Defensive Measures**.

8.4 Independent Outside Advice

Section 190 of the Companies Act permits directors to rely on reports, statements, financial data and other information, including professional or expert advice, in exercising their duties. This principle extends to listed companies where the TOMC states that the board of a target shall obtain competent independent advice (Rule 12) and, in particular, in the preparation of profit statements and asset valuations related to an offer, the financial advisor (auditor or consultant accountants) must also report on the accuracy of such forecast (Rule 17).

8.5 Conflicts of Interest

Conflicts of interest are extensively dealt with in the Companies Act (which contains the general legal provisions), the SEC Act, the TOMC, and the Corporate Governance Rules. The Corporate Governance Rules require disclosure of any conflicts of interest to board committees and also in the listed company's annual reports. The principle of avoiding conflicts of interest in listed company M&A centres on the prevention of market manipulation.

Generally, the CSE is empowered to impose sanctions (including warnings, fines, trading suspensions and possible delisting) on companies that contravene conflict of interest disclosure provisions (due to contravention of broader corporate governance requirements).

9. Defensive Measures

9.1 Hostile Tender Offers

The TOMC does not recognise or provide for *"hostile tender offers"*, which are not common

in Sri Lanka. However, mechanisms exist for hostile takeover offers to be executed through a combination of stakebuilding strategies and mandatory offers as discussed at **4.1 Principal Stakebuilding Strategies**.

9.2 Directors' Use of Defensive Measures

Rule 34, TOMC prevents boards of target companies from taking defensive measures without the approval of the majority of shareholders at a general meeting. The decision as to whether or not any offer is accepted lies with the shareholders.

However, directors are permitted, in terms of Rule 8(3) TOMC, to request the CSE to grant a temporary suspension in share dealings (although this is not common and is not easily implemented due to any adverse effects on minority shareholders).

9.3 Common Defensive Measures

Hostile takeovers are not common and not recognised as a distinct method of takeover. Subject to shareholder approval, and disclosure requirements, directors may adopt any means available to defend against hostile takeover bids. Restricted defensive measures include the issuance of new shares, options or securities, alienation of 5% or more of the total value of the assets prior to acquisition or entering into contracts except in the ordinary course of business (Rule 34, TOMC). However, it is pertinent to note that any such measures must not unfairly prejudice the minority shareholders of the company.

9.4 Directors' Duties

Directors must present all bona fide offers to shareholders for consideration. Directors are mandated to act in good faith, in the best interests of the company as stated in **8.1 Principal Directors' Duties**. They are also required to obtain competent independent advice on any offer and such advice, together with the board's view of the offer, must be made known to shareholders.

9.5 Directors' Ability to "Just Say No"

All offers made in terms of the TOMC must be made available to the shareholders and are subject to shareholder acceptance. Therefore, the board does not have the right to refuse any offers made.

10. Litigation

10.1 Frequency of Litigation

There is very little publicly available information on trends relating to litigation or disputes in M&A transactions. This is mainly because disputes are generally resolved in private forums such as arbitration and are not publicised, especially in private, unlisted company M&A or unregulated industries. Legal action is commonly instituted in relation to rights of minority shareholders, or by employees who have been made redundant due to a business restructuring.

10.2 Stage of Deal

It is common for parties to sign off on heads of terms prior to completion of due diligence reviews. It is unlikely that parties would seek to litigate against each other at the initial stages of a deal, due in part to restrictive costs and time-consuming processes related to litigation. Binding heads of terms may occasionally carry liquidated damages clauses or break fees, in the event of deal negotiations falling through, and may give rise to disputes.

Once the details of the transaction are more certain, parties enter into definitive agreements with

post-closing requirements that may be completed within a short period of time. Longer closing periods are set when regulatory approvals or property transfers are required to be completed as part of the transaction. While litigation may be filed for failure to close, no recent instances have been publicly reported.

In practice, it is likely that disputes may arise after the signing of definitive agreements and before the closing of the transaction (eg, because of failure to obtain regulatory approvals or compliance failures); while disputes due to misrepresentations/non-disclosures of financial, legal or tax matters may arise after the completion of an M&A transaction. In general practice, representations, warranties and indemnities are built into definitive agreements, as well as purchase price retention clauses for extended warranty periods, to remedy loss or damage arising from such misrepresentations or non-disclosures.

10.3 "Broken-Deal" Disputes

As stated at **10.1 Frequency of Litigation**, there is little publicly available information with regard to recent M&A-related disputes in Sri Lanka. Redress for *"broken deals"* may be damages for loss and expense incurred in the negotiation of the deal and conducting due diligence, or breaching exclusivity and non-circumvent provisions in heads of terms or definitive agreements. Whether such claims can be maintained in court would depend largely on whether the heads of terms are binding in nature and carry liquidated damages/break fees clauses, and also would depend on the stage of transaction at which the negotiations broke down; these would be a matter of fact in each case.

11. Activism

11.1 Shareholder Activism

Shareholder activism is not commonly seen in Sri Lanka in relation to driving M&A transactions. However, interest in ESG principles, eco-friendly projects and off-setting carbon credits have led institutional investors to consider investment into projects such as renewable energy and eco-friendly tourism. The Corporate Governance Rules require listed companies to have ESG policies in place.

Shareholder activism is prevalent in transactions where minorities are oppressed by majority shareholders. In such situations, actions may be instituted under the Companies Act to protect against mismanagement or oppression of minorities. The Sri Lanka Law Reports (official publication of judgements of the Sri Lankan Courts published by the Ministry of Justice) have published many court decisions filed under Sections 224 and 225 of the Companies Act relating to oppression and mismanagement.

11.2 Aims of Activists

There are no clear trends that emerge with regard to the aims of activists in Sri Lanka, at present.

11.3 Interference With Completion

No interference with completion has been reported due to reasons of shareholder activism in M&A transactions in the recent past.

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