

# TAKE-OVERS AND MERGERS IN SRI LANKA; LEGAL PERSPECTIVES, DRAWBACKS AND THE WAY FORWARD

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## 1. Introduction

Significant changes in technology and globalisation that took place in and around the 1990s have transformed and continue to transform how we, as human beings live and work. These changes have not only had an impact on us, but

*“they have forced firms to reshuffle the cards they hold and remix ownership of assets in the economy.”<sup>1</sup>*

According to statistics, over five hundred thousand mergers and acquisition deals have taken place in the last eleven years, making it the highest number of deals in any period in recent history.<sup>2</sup> Whilst the 2018 global M&A market was resilient throughout the majority of the year, the

2019 M&A market sustained its robust volume and strong pace.<sup>3</sup>

When diverting one’s attention from the global arena to Sri Lanka, a similar trend is evident - an increase in the number of take-over and merger transactions in recent years. This increase has been facilitated by changes in the domestic economy which have been taking place in the latter part of the 1900s, the most significant change being the opening of Sri Lanka’s economy. The Central Bank of Sri Lanka states that

*“far reaching policy reforms were introduced to free the economy from an array of controls”*

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<sup>1</sup>Benjamin Gomes Casseres, ‘What the Big Mergers of 2017 Tell Us About 2018’ (*Harvard Business Review*, 28 Dec. 2017) <<https://hbr.org/2017/12/what-the-big-mergers-of-2017-tell-us-about-2018>> accessed 15 Sep. 2019)

<sup>2</sup>*Ibid.*

<sup>3</sup>J.P Morgan, *2019 Global M&A Outlook* (first published 2019, J.P Morgan’s M&A team 2019) 28

in 1977,<sup>4</sup> thereby signifying to us the genesis of an economy conducive for take-over and merger transactions. However, with the civil war spanning for three decades and ending only in 2009, Sri Lanka's economy has been struggling while much of the benefits envisaged by the said policy did not materialise until now—almost a decade after the end of war. This is not to say all that was planned have come to fruition, but that significant progress has been achieved in comparison to having attained nothing at all. It is the growth of a healthy and dynamic economy which has paved the way not just for take-over and merger transactions, but also for an increased number of such transactions as

*“companies morph to stay competitive. Some companies may be better off merging or closing, while others are born through spin-offs and entrepreneurship,” [and] “all these*

*possibilities keep our economy moving forward.”<sup>5</sup>*

While the above signify how take-overs and mergers are gaining ground in the world, and in Sri Lanka, we are able to see how crucial take-overs and mergers are to the growth of an economy, thereby contributing to the development of a country. The very fact that take-over and merger transactions could contribute both directly and indirectly to raising our country from a lower middle-income country to an upper-middle income country means that greater attention ought to be paid to this area without further ado. One crucial way in which this could be done is by having well thought out laws and/or rules and/or regulations framed specifically for the purpose of governing these transactions. In this light, this paper will examine the existing legal and regulatory regime on take-overs and mergers of companies in Sri Lanka, the drawbacks prevalent in the existing legal and regulatory regime on take-overs and

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<sup>4</sup>The Central Bank of Sri Lanka, *Economic Progress of Independent Sri Lanka 1948-1998* (CBSL 1998)

<sup>5</sup>Emily Liner, 'What's Behind the All-Time High in M&A?' (*Harvard Law School Forum on Corporate Governance and Financial*

*Regulation*, 16 March 2016) <<https://corpgov.law.harvard.edu/2016/03/16/whats-behind-the-all-time-high-in-ma/>> accessed 20 September 2009

mergers of companies in Sri Lanka and the way forward as a country to ensure their effectiveness and success.

## **2. The Existing Legal and Regulatory Regime on Take-overs and Mergers of Companies in Sri Lanka**

An examination of the way in which Sri Lanka's legal system has facilitated take-overs and mergers calls for an analysis of the Companies Act No.07 of 2007 and the Securities and Exchange Commission Act No. 36 of 1986. Thus, the proceeding sections are dedicated to this task.

### ➤ The Companies Act No. 07 of 2007

The provisions pertaining to amalgamation in Sri Lanka's Companies Act No. 07 of 2007 draws its inspiration from Canadian legislation and the New Zealand Companies Act.<sup>6</sup>With no

definition of the term in the Act, it ordinarily refers to

*“the blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which will carry on the blended undertakings.”*<sup>7</sup>

Dr. Arittha Wickramanayake identifies amalgamation as “a true merger,”<sup>8</sup> and one of many ways in which a merger of separate entities could be accomplished based on their structure.<sup>9</sup>The provisions relevant to it are found in part VIII of the Act in Sections 239 – 246, and are applicable to any company<sup>10</sup> be it a listed public company<sup>11</sup>or otherwise. In the words of the learned K. Kanag-iswaran PC,

*“amalgamation is a voluntary process and is done without the sanction of the court. It is a statutory method of company re-organisation where two or more companies*

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<sup>6</sup>Dr. K. Kanag-Iswaran, ‘Legal nature of amalgamation and the procedure to amalgamate’ *Daily FT* (Sri Lanka, 24 June 2014)

<sup>7</sup>*Ibid.*

<sup>8</sup>Arittha Wikramanayake, *Company Law in Sri Lanka* (first published 2007, Arittha Wikramanayake 2007)

<sup>9</sup>*Ibid.*

<sup>10</sup> See § 529 of the Companies Act No. 07 of 2007 for the interpretation of ‘a company’ and § 5 of the Act.

<sup>11</sup>Rule 2 of the Company Take-overs and Mergers Code of 1995, as amended in 2003, states that the Code applies to “take-overs and mergers [only] where the offeree is a listed public company.”

*combine and continue as one company. Shareholders in the amalgamating companies either take shares in the amalgamated company or receive other consideration in exchange for their shares. The assets and liabilities of the amalgamating companies become the assets and liabilities of the amalgamated company by operation of law. Amalgamations are generally used where, for commercial reasons, an internal group restructuring or merger of separate companies is deemed desirable. Amalgamations may also be used to “freeze out” minority shareholders, and consequently amalgamation attracts minority buyout rights. When upon an amalgamation two or more companies “continue as one company,” the merged entity is the equivalent of each of the amalgamating companies. It is generally recognised that the amalgamating companies do not cease to exist but continue, and that the amalgamated company is not a new company. This metaphysical process has been explained by the analogy of streams coming together to form a river and strands of fibre intertwining to form a rope.”<sup>12</sup>*

This being said, it is pertinent to note that Part X of the Companies Act entitled ‘Approval of Arrangements,

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<sup>12</sup>Supra note 6

Amalgamations and Comprises by Court’ caters to amalgamation as much as the aforementioned Part VIII of the Act. Part X empowers Court to declare that an amalgamation would be binding on the company and such other persons or classes of persons as the court may specify only in instances where it is satisfied that it is not reasonably feasible to do so under Part VIII of the Companies Act.<sup>13</sup>

The provisions on amalgamation found in the Companies Act alone do not signify the legal framework pertaining to take-overs and mergers in Sri Lanka in its entirety. This is because Sri Lanka has a code of rules made solely for the purpose of governing take-over and merger transactions under the purview of the Securities and Exchange Commission.

- Securities and Exchange Commission of Sri Lanka Act No. 36 of 1986

The Securities and Exchange Commission of Sri Lanka Act No. 36 of 1986 as amended by Act No. 26 of 1991, Act No.

<sup>13</sup>Supra note 6

18 of 2003 and Act No. 47 of 2009 has been enacted to,

*“provide for the establishment of the Securities and Exchange Commission of Sri Lanka, regulate the securities market of Sri Lanka, grant licenses to stock exchanges, managing companies in respect of each unit trust, stock brokers and stock dealers who engage in the business of trading in securities, register market intermediaries, set up a compensation fund and, deal with matters connected therewith or incidental thereto.”<sup>14</sup>*

As per section 53 (1) (g) of the Act, the Commission has been endowed with the power to make rules. The Company Take-overs and Mergers Code of 1995 has come into being as a direct result of the Commission exercising this power as per the aforementioned section.

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<sup>14</sup>Preamble, Securities and Exchange Commission Act No. 36 of 1986

<sup>15</sup>Saleem Marsoof, 'Take-over offers and their Ramifications' (LawNet) <<https://www.lawnet.gov.lk/1960/12/31/takeover-offers-and-their-ramifications/>> accessed 14 September 2019

<sup>16</sup>See Chapter 28 of *Principles of Modern Company Law* by Davies and Worthington for a detailed explanation on the history of the London City Code and the Panel

### ➤ The Company Take-overs and Mergers Code of 1995

The Company Take-overs and Mergers Code of 1995 as amended in 2003, acts as a body of rules having force of law in Sri Lanka. Following in the footsteps of Asian countries such as Malaysia and Singapore, Sri Lanka's Code has drawn much of its inspiration from the London City Code on Take-overs and Mergers,<sup>15</sup> which is deemed to be one of the very first regulatory systems, introduced in 1968. Both the London City Panel<sup>16</sup> and the Code on take-overs and mergers are said to have been created to curb public criticism of the strategies adopted by bidders and targets in a number of significant “*bid battles*.”<sup>17</sup> Ever since, both the Panel and the London City Code have supervised a considerable number of announced bids, while also setting a precedent to countries around the world on how take-overs and mergers

See *Pipe dreams and nightmares of the Sri Lanka Company Takeover Code* by Saleem Marsoof for an elaborate description on the composition and the powers of the Commission. . It is important to note that the Securities and Exchange Commission is in Sri Lanka what the Panel is in the United Kingdom.

<sup>17</sup>Prof. Blanaid Clarke, *Takeover Regulation – Through the Regulatory Looking Glass* [2007] Comparative Research in Law and Political Economy 2-39

ought to be set in motion within a legal framework.

The British regulation of Take-overs has at its core two central tenets;

1. the shareholders alone should decide on the fate of the offer, and
2. the equality of treatment of shareholders.<sup>18</sup>

As Justice Saleem Marsoof who has written quite extensively on the Code very rightly points out, these two tenets ultimately boil down to the protection of shareholders of a target company in the course of a take-over or merger operation.<sup>19</sup>This proves to be the ultimate objective of the Sri Lankan Code albeit slightly different means<sup>20</sup> have been adopted by the two codes to achieve the said objective. Despite the different means, both Codes do so by;

- ensuring that all shareholders of a target company are treated equally and fairly;

- ensuring that such shareholders receive “adequate, accurate and timely” information so that they would be able to ascertain as to whether they should accept or reject a take-over offer;
- attempting to establish and maintain a fair and orderly securities market devoid of turbulence;
- doing its utmost to manage and curb defensive and detrimental action that the management of target companies may take to frustrate the take-over bid.<sup>21</sup>

It is in furtherance of the above that mandatory offers<sup>22</sup> and voluntary offers<sup>23</sup> are regulated by the Code.

Thus is the legal framework within which take-overs and mergers are to take place. The provisions of the Companies Act and the Securities Exchange Commission Act are proof of how the legal system has

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<sup>18</sup>Paul Davies and Sarah Worthington *Principles of Modern Company Law* (Sweet and Maxwell 2014)

<sup>19</sup>Saleem Marsoof, ‘Pipe dreams and nightmares of the Sri Lanka Company Takeover Code’ (*Academia*) <<https://www.academia.edu/9415975/T>

[he\\_pipedreams\\_and\\_nightmares\\_of\\_the\\_Sri\\_Lanka\\_Company\\_Takeover\\_Code](#)> accessed 5 September 2019

<sup>20</sup>*Ibid.*

<sup>21</sup>*Ibid.*

<sup>22</sup>*Ibid.*

<sup>23</sup>*Ibid.*

facilitated take-over and merger transactions. However, whether these provisions and the results emanating from them are in keeping with the needs of this day and age is a question that remains to be answered, and this paper will briefly shed light on several drawbacks identified both at the inception of the Company Take-overs and Mergers Code of 1995 and in the course of working within the legal framework pertaining to take-overs and mergers.

### **3. Drawbacks and the Way Forward**

Over two decades have passed since the introduction of the Code in 1995 and the time is ripe for change. Both time and experiences of the past have afforded us, and most importantly the Securities and Exchange Commission a better vantage point from which the shortcomings prevalent in the said field could be seen. The most significant shortcomings appear to be the inherent flaws of the Code and its stagnation which could result in a great deal of inevitable litigation.

Several inherent flaws/ drawbacks were observed at the time of the Code's

inception and concerns were raised. It would be remiss on the part of this paper if attention is not drawn to such detriments at least in brief. The said inherent flaws or drawbacks are as follows;

- the lack of any sort of procedure in the Code which could be followed by parties to approach the Commission for the purpose of consultation or approval. Parties are also not able to appeal against the decisions of the Commission to any court of law or an administrative body due to the very same reason – the lack of procedure.<sup>24</sup>
- The Sri Lankan Code ensues from authority delegated by the Parliament. Therefore, the Code is statute based and rigid instead of flexible.<sup>25</sup>
- Another problem that prevails is the lack of discretion on the part of the Securities and Exchange Commission and thus has prevented the Commission from amending the rules of the Code on

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<sup>24</sup>*Ibid.* pages 35 and 36

<sup>25</sup>*Ibid.* pages 26 -28

a case by case basis. This is further aggravated by the lack of General Principles which plays a key role in enabling flexibility as well as in increasing the discretion of the Commission.<sup>26</sup>

- The omission of anti-frustration rules.<sup>27</sup>
- The inadequacy of sanctions to be applied internationally.<sup>28</sup>
- The absence of anti-fraud provisions.<sup>29</sup>
- The lack of stringent disclosure requirements in the Code unlike the London City Code.<sup>30</sup>

To the above list, the following too could be added.

In the recent past, it has been observed that the Code has facilitated unlisted companies which control listed companies to be acquired by investors, much to the detriment of small shareholders. The interests of the market have begun to supersede both the interests and protection of shareholders with the mandatory offer

being disregarded thus resulting in the rights of minority shareholders being ignored.<sup>31</sup>

Further, although the Companies Act and the Company Take-overs and Mergers Code facilitate take-over and merger transactions, nowhere has what ought to be done in the event of an overlap of the two been specified, and this remains so to date.

Through all that has been set out above, the fact that the legal framework relating to take-overs and mergers is in need of reform is indisputable. Although the Securities and Exchange Commission is conferred with the power to bring about reform as called for, as and when needed by the Securities and Exchange Commission Act, this very Act has tied down the hands of the commission. Hence, only one amendment has been made to the Code in the year 2003 since its inception in 1995, although a committee was appointed by the Securities and Exchange Commission that very same year to study

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<sup>26</sup>*Ibid.* page 30

<sup>27</sup>*Ibid.* page 24

<sup>28</sup>*Ibid.* pages 24- 26

<sup>29</sup>*Ibid.* pages 30-34

<sup>30</sup>*Ibid.*

<sup>31</sup>Duruthu Edirimuni, 'SEC Flaw in Take-over Code Hurts Small Shareholders' *Sunday Times* (Sri Lanka)



the existing Code and make recommendations so that the Code could be revised. The working draft of the Sri Lanka Code on Take-overs and Mergers 2014 was its result, and it was to come into operation on a date appointed by the Securities and Exchange Commission of Sri Lanka by an Order published in the Gazette. However, the truth of the matter is that the working draft is yet to come into operation though it could be considered as both a commendable effort made to bring about reform and a progressive step forward from the existing legislation that is stagnant and far from satisfactory.

#### **4. Conclusion**

The adoption of the Company Take-overs and Mergers Code in 1995 and the inclusion of Parts VIII and X into the Companies Act No.07 of 2007 is a bold step forward for Sri Lanka in relation to take-overs and mergers. However, little to no progress has been seen or achieved ever since. At present, the legal framework within which take-overs and mergers are to take place are fraught with many a drawbacks. The present state of affairs is none other than an eye opener; a call for both the legal and commercial fraternity to

be more sensitive and attentive to the issues prevalent in this area of law, so that they could be remedied to facilitate its progress. It is true that the progress of laws does not emerge from thin air, but from experiences gained through practice and discourse surrounding such laws. While Sri Lanka has much to learn from experiences gained over a period of two decades, it suffers from a deficiency of adequate legal discourse on take-overs and mergers and the courage it once had back in 1995- the courage to act, and the courage to set change in motion. There is no better time to act than now. Any hesitation to do so would undoubtedly cause the present state of affairs or the prevailing shortcomings to fester. Inaction would mean the weakening of take-over and merger transactions thus obscuring Sri Lanka's ability to see the promise it holds for our economy.

