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# Shareholders' Rights & Shareholder Activism 2023

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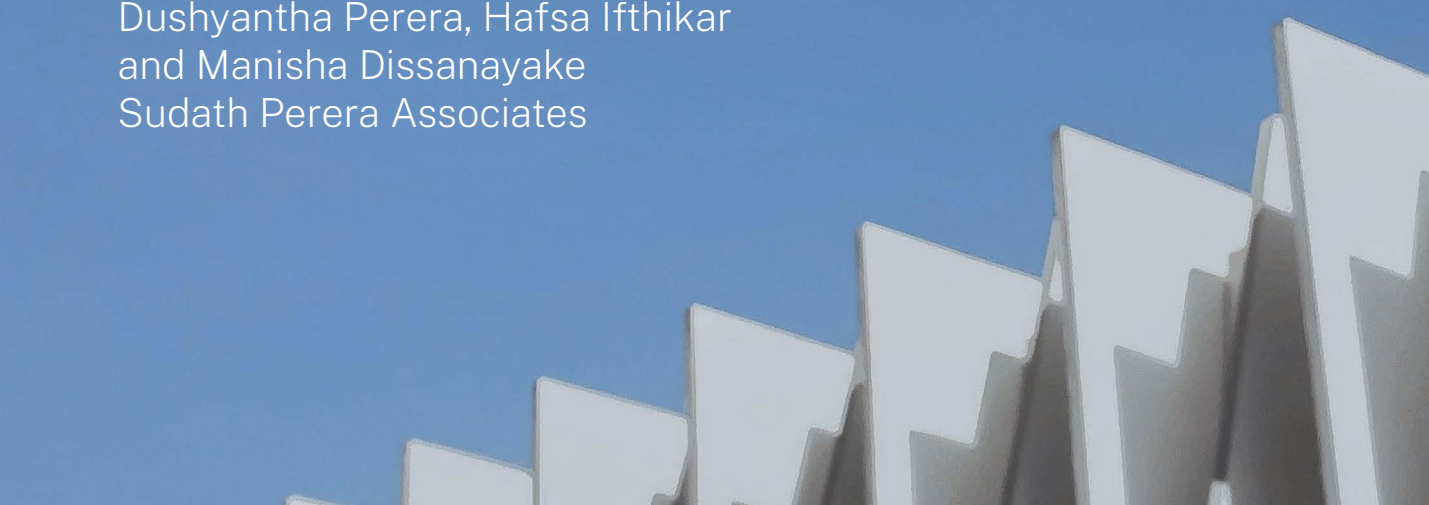
**Sri Lanka: Law & Practice**

Dushyantha Perera, Hafsa Ifthikar and Manisha Dissanayake
Sudath Perera Associates



# SRI LANKA


## Law and Practice

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**Sudath Perera Associates** is one of Sri Lanka's leading full-service law firms, with over 40 attorneys (including 11 partners and three consultants) practising across eight departments: banking and finance, corporate and commercial, company secretarial, dispute resolution, intellectual property, labour and employment relations, tax, and real estate. The firm is consistently ranked as one of the top-tier law firms in Sri Lanka by reputed international legal directories, and a number of its senior lawyers are also recognised as leading domestic practitioners in their respective fields.

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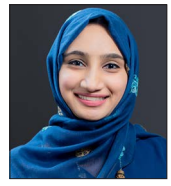

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## 1. Types of Company, Share Classes and Shareholdings

### 1.1 Types of Company

A company incorporated under the Companies Act No 07 of 2007 (the "CA 2007") may be either:

- a limited liability company (which may be a public or private company);
- an unlimited liability company; or
- a company limited by guarantee.

In addition:

- a company (whether incorporated in Sri Lanka or overseas) can seek registration under Part XI of the CA 2007 as an "offshore company", in order to carry on any business outside Sri Lanka (but would not be permitted to carry on any business within Sri Lanka); and
- any company incorporated outside Sri Lanka can establish a "place of business" within Sri Lanka (eg, a branch, liaison, marketing or project office, etc) and obtain registration as a "registered overseas company" under Part XVIII of the CA 2007.

For the purposes of this practice guide, however, discussion is based on the laws applicable to companies incorporated in Sri Lanka (ie, under the provisions of the CA 2007).

### 1.2 Types of Company Used by Foreign Investors

In the authors' experience, foreign investors generally opt for the incorporation of a private limited liability company. This is due to various factors, such as:

- higher confidentiality regarding their operations;
- limited liability; and
- overall simplicity and flexibility for management and operations (ie, compared to a public or unlimited liability company).

Guarantee companies are commonly utilised for charitable ventures (including NGOs) and other not-for-profit ventures.

### 1.3 Types or Classes of Shares and General Shareholders' Rights

The CA 2007 permits the issuance of various classes of shares, such as:

- ordinary shares;
- redeemable shares;
- preference shares; and
- shares which confer special, limited or conditional voting rights, or no voting rights.

As per the CA 2007, a standard share (commonly referred to or designated as an "ordinary share") would confer on the holder:

- the right to one vote on a poll at a meeting of the company on any resolution;
- the right to an equal share in dividends paid by the company; and
- the right to an equal share in the distribution of the surplus assets of the company on liquidation.

However, if a company's articles of association so provide, shares can be issued with rights that vary from the aforesaid standard rights. Variations may be with respect to dividends, voting rights and liquidation preference. A company is also generally permitted to have multiple share classes.

### 1.4 Variation of Shareholders' Rights

The CA 2007 states that any action affecting rights attached to shares must be approved by

a special resolution. A special resolution is a resolution which has been passed by a majority of 75% of shareholders entitled to vote and who vote on the relevant question (although it may also be passed as a written resolution in certain circumstances, in accordance with the provisions of Section 144 of the CA 2007). Shareholders' rights may also be varied through an amendment to the articles of association of the company (which should be approved by a special resolution or written resolution as aforesaid) or through contractual arrangements (such as shareholders' agreements).

### 1.5 Minimum Share Capital Requirements

Generally, there is no minimum share capital requirement for the types of company listed in **1.1 Types of Company**. However certain regulated sectors may have such requirements (such as banking, finance business, insurance and retail trade). There may also be minimum investment requirements for becoming eligible for certain tax benefits and other investment concessions (such as enhanced capital allowances).

### 1.6 Minimum Number of Shareholders

A private company is required to have a minimum of one shareholder, while a company limited by guarantee requires a minimum of two members. There is no requirement that any such shareholder be resident in Sri Lanka, although certain regulations issued under the Foreign Exchange Act No 12 of 2017 and certain sector-specific laws impose various ownership and management restrictions on foreign citizens and non-residents. Companies listed on the Colombo Stock Exchange (CSE) would also have certain minimum public float requirements, which are set out in the Listing Rules of the CSE.

### 1.7 Shareholders' Agreements/Joint Venture Agreements

Shareholders' agreements and joint venture agreements are frequently used in Sri Lanka for private companies with multiple shareholders, particularly for joint ventures with sophisticated parties (such as HNIs, larger corporate entities and institutional investors).

### 1.8 Typical Provisions in Shareholders' Agreements/Joint Venture Agreements

Typical provisions in most shareholders' agreements and joint venture agreements pertain to:

- the share capital of the company (eg, classes of shares, rights attached to shares and ownership, further share or other security issuances, transfer rights and pre-emption rights);
- management matters (including board composition and appointment rights, matters pertaining to the holding of shareholder and board meetings);
- distributions (including dividends);
- raising capital;
- minority or investor protection matters (including veto/reserved rights);
- restrictive covenants;
- notices;
- governing law and dispute resolution; and
- termination events and arrangements.

Other provisions (that are perhaps less frequently used) in such agreements include those pertaining to deadlock resolution mechanisms, call options, put options and drag-along/tag-along rights.

Shareholders' and joint venture agreements are generally enforceable in Sri Lanka in accordance with their terms, provided that they are legal, valid and binding. Most shareholders' agreements are generally not publicly available documents.

## 2. Shareholders' Meetings and Resolutions

### 2.1 Types of Meeting, Notice and Calling a Meeting

A company incorporated in Sri Lanka is required to hold an annual general meeting (AGM) once every calendar year, and such AGM should be held within six months of the balance sheet date of the company and prior to the lapse of 15 months from the date of the previous AGM.

There are two exceptions to the aforementioned rule:

- a company is not required to hold the first AGM in the calendar year of its incorporation, but must do so within 18 months of its incorporation; and
- shareholders may pass a written resolution in lieu of holding an AGM if everything required to be done at such meeting is done by resolution.

Section 135 of the CA 2007 requires the notice period for an AGM to be at least 15 working days; and any provision in the company's articles of association that provides for a shorter notice period would be void. However, Section 135 also states that an AGM may be called by a shorter notice period if all the shareholders entitled to attend and vote at the AGM agree to this.

The following matters are generally discussed and approved at an AGM for a private company:

- appointment of auditors and fixing their remuneration;
- financial statements;
- declaration of dividends;
- annual report; and
- the appointment of directors in the place of those retiring (if any).

A company may hold an "extraordinary general meeting" (EGM) (ie, other than an AGM), although it is not statutorily mandated to do so. However, a shareholders' agreement may require a company to hold an EGM a certain number of times in a financial year.

### 2.2 Notice of Shareholders' Meetings

Section 135(1) of the CA 2007 states that meetings, other than AGMs or meetings for the passing of a special resolution, require:

- ten working days' written notice for a company other than a private or an unlimited company; and
- five working days' written notice for a private or an unlimited company.

Any provision in the company's articles of association providing for a shorter notice period would be void. However, a shorter notice period for such meetings is permitted, if agreed to by shareholders holding shares which carry not less than 95% of the voting rights.

Shareholders must be given a minimum of 15 working days' notice in respect of meetings at which a special resolution is to be passed, as per Section 143 of the CA 2007. However, shareholders having the right to attend and vote at any such meaning, and collectively holding at least 85% of the total voting rights at that meeting, may agree to a shorter notice for this.

### 2.3 Procedure and Criteria for Calling a General Meeting

A shareholders' meeting called and held under the CA 2007 may be either an AGM or an EGM. The board of the company must call an AGM

once in each calendar year. However, if an AGM is not called as per the CA 2007, the Registrar of Companies may, on the application of a shareholder, call or direct the calling of an AGM.

An EGM of a company may, however, be held at any time and any place as the board so decides. Additionally, one or more shareholders holding not less than 10% of the votes that may be cast on a particular issue can requisition an EGM under Section 134 of the CA 2007. In such a situation, the directors are statutorily mandated to convene a meeting of the company within 15 working days of the depositing of such requisition; and such meeting must be held within 30 working days of the depositing of the requisition. The requisition must:

- state the issues to be considered and voted on at the meeting in question;
- be signed by the requisitionists; and
- be deposited at the registered office of the company.

Further rights to requisition or convene an EGM can also be granted through express provisions in the articles of association or in a shareholders'/joint venture agreement.

As per Section 142 of the CA 2007, the company is mandated to give shareholders notice of any resolution to be passed or business to be dealt with at the next AGM or at any EGM, respectively, where shareholders are entitled to receive notice of this. This provision is applicable if such shareholders are 50 or more in number, or represent 5% of the total voting rights of all the shareholders having a right to vote at the relevant meeting to which the requisition relates.

## 2.4 Information and Documents Relating to the Meeting

Notice of a general meeting must be served on every shareholder of the company.

Section 119 of the CA 2007 mandates a company to keep certain records available for inspection by the shareholders, such as:

- minutes of all meetings and resolutions of shareholders;
- copies of written communication to shareholders;
- certificates issued by directors; and
- the interests register.

Certain other records of the company are available for inspection by the public, upon written request to the company and on working days between 9am and 4pm (though the company may alternatively deliver certified true copies of the relevant documents to the requesting person). These include:

- the certificate of incorporation;
- articles of association;
- the share register;
- the register of directors and secretaries;
- particulars of the registered office of the company;
- copies of instruments creating or evidencing charges; and
- the register of charges.

Separately, any person can search the public records maintained by the Department of the Registrar of Companies with respect to a company (such records include the various forms filed by the company and the articles of association).

A company is also required to send every shareholder a copy of the annual report, including its audited financial statements. The annual report should contain certain information on the company's affairs, including details of:

- remuneration/benefits of directors;
- auditors; and
- accounting policies.

There are also additional information rights afforded to shareholders of listed companies and certain regulated companies.

## 2.5 Format of Meeting

The CA 2007 does not expressly state whether meetings can be held virtually/remotely, but such meetings are generally not considered precluded. Shareholders' meetings can be held virtually/remotely:

- if permitted by the articles of association of the company;
- if contractually agreed to in a shareholders'/joint venture agreement; or
- in the case of a private company, if all shareholders so agree.

In July 2020, taking into account the impact of the COVID-19 pandemic, the CSE issued guidelines (Reference CSE/GN/20/07/01) for listed companies regarding the holding of virtual AGMs.

## 2.6 Quorum, Voting Requirements and Proposal of Resolutions

The quorum requirement for a general meeting is generally stated in the articles of association of a company. However, Section 136 of the CA 2007 sets out quorum requirements in the event that the articles of association are silent on this. Said section states that the quorum requirement for a general meeting is:

- two shareholders for a private company; and
- three shareholders for any other company (ie, incorporated in Sri Lanka).

## 2.7 Types of Resolutions and Thresholds

The CA 2007 refers to different types of shareholder resolutions, as follows.

- Ordinary resolution – approved by a simple majority of the votes of shareholders entitled to vote and who vote on the subject matter of the resolution.
- Unanimous resolution – approved by all the shareholders of the company.
- Special resolution – generally passed by a majority of 75% of shareholders entitled to vote and who vote on the matter in question. However, it should be noted that in computing the majority, if a poll is demanded on a question of whether a special resolution was passed (the poll can be demanded by at least five shareholders having the right to vote at the meeting or by a shareholder/shareholders holding at least 10% of the voting rights that may be cast at the meeting), reference shall be made to the number of votes cast for and against the resolution.

A written resolution can also be passed in lieu of a meeting, if signed by 85% of the shareholders who would be entitled to vote on that resolution at a meeting of shareholders, and who together hold not less than 85% of the votes entitled to be cast on that resolution. Such resolution shall be as valid as if it had been passed at a meeting of those shareholders. This threshold is, however, subject to the provisions of a company's articles of association, and therefore can be varied.

The aforementioned resolutions and the thresholds in relation thereto are provided for in the CA 2007. The CA 2007 requires certain matters to be approved by certain types of resolutions – for example:

- articles of association should be amended by way of a special resolution; and
- directors can be appointed and removed by way of an ordinary resolution.

## 2.8 Shareholder Approval

Most powers reserved for shareholders in the CA 2007 can be exercised by an ordinary resolution (Section 91 CA 2007). However, as per Section 92 of the CA 2007 (and notwithstanding the provisions of the articles of association of the company), the following matters require shareholder approval by way of a special resolution:

- alteration of the articles of association of the company;
- approval of a "major transaction";
- approval of an amalgamation;
- reduction of the stated capital of the company;
- the voluntary winding-up of the company; and
- the change of the name and status of the company.

A special resolution is a resolution generally passed by a majority of 75% of the shareholders entitled to vote and who vote on the relevant matter in question at the meeting. However, if a poll is demanded (the demand can be made by at least five shareholders having the right to vote at the meeting or by a shareholder or shareholders holding at least 10% of the voting rights that may be cast at the meeting), reference shall be made to the number of votes cast for and against the resolution.

A company's articles of association may also contain provisions regarding matters that require shareholder approval and the percentage of approval that is required (without prejudice to the conditions set out in Section 92 of the CA 2007, as aforesaid).

## 2.9 Voting Requirements

A shareholder is entitled to vote by way of a proxy, whether such proxy is a shareholder or not. A proxy appointed by a shareholder has the same rights as the shareholder to vote and speak at the relevant meeting. Voting may be conducted by:

- voice;
- show of hands; or
- way of a poll.

Shareholders are entitled to demand a poll at a general meeting on any question (other than the election of the chairman of the meeting or the adjournment of the meeting) if the demand for the poll is made by:

- not fewer than five shareholders having the right to vote at the relevant meeting; or
- by a shareholder or shareholders representing at least 10% of the total voting rights of all the shareholders having the right to vote at said meeting.

Furthermore, Section 138 of the CA 2007 allows for the representation of a company at meetings of other companies and of creditors, through the authorisation of a person who may act as a representative of said company at:

- any meeting of the company;
- any meeting of any class of shareholders of the company; or
- any meeting of creditors of the company.

Weighted voting is possible if such rights have been attached to the relevant shares in accordance with the provisions of the CA 2007. Such rights would then be set out in the company's articles of association or in any contractual arrangements (such as a shareholders' agreement or joint venture agreement).

Shareholders may cast their votes at a virtual/remote meeting electronically, if suitably facilitated by the articles of association or by a contractual arrangement such as a shareholders' agreement or joint venture agreement.

## 2.10 Shareholders' Rights Relating to the Business of a Meeting

Shareholders have a right to require that specific issues be considered at a shareholders' meeting under Section 142 of the CA 2007. Upon requisition in writing by shareholders representing 5% of the total voting rights of all shareholders having a right to vote at the meeting to which such requisition relates, or by shareholders of not less than 50 in number, it is the duty of a company to:

- give to shareholders entitled to receive notice of the next annual general meeting notice of any resolution which may be moved and is intended to be moved at such meeting; and
- circulate to shareholders entitled to have notice of any general meeting any statement with respect to a matter referred to in any proposed resolution or to the business to be dealt with at said meeting.

Additional provisions, regarding the rights of any shareholders to have specific issues be considered or resolutions put forward at a shareholders' meeting, may be included in the articles of association of a company, or in a contractual arrangement such as a shareholders' agreement or joint venture agreement.

## 2.11 Challenging a Resolution

Under the CA 2007, shareholders can potentially challenge a resolution passed at a general meeting on various grounds, such as the following.

- On procedural grounds – for example:
  (a) that due notice of the resolution was not provided;
  (b) that the relevant meeting was not quorate or otherwise properly held; or
  (c) that the resolution itself was not duly approved.
- On substantive grounds – for example:
  (a) that the affairs of the company are being conducted in a manner oppressive to any shareholder or shareholders (under Section 224 of the CA 2007); or
  (b) that the affairs of the company are being conducted in a manner prejudicial to its interests (under Section 225 of the CA 2007).

The articles of association or contractual arrangements (such as shareholders' agreements or joint venture agreements) may also provide additional grounds for a shareholder to challenge a resolution purportedly passed at a general meeting, such as where veto rights over certain matters are given to a shareholder (or group of shareholders).

## 2.12 Institutional Shareholder Groups

The CA 2007 contains various provisions that protect certain groups or classes of shareholders, which can be utilised depending on the applicable circumstances. For instance, the board cannot authorise a dividend distribution in respect of some shares in a class and not others of that class, or of a greater amount in respect of some shares in a class than other shares in that class, except where:

- the amount of the dividend is reduced in proportion to any liability attached to the shares under the company's articles; or
- a shareholder has agreed in writing to receive no dividend or a lesser dividend than would otherwise be payable.

Furthermore, as per Section 99 of the CA 2007, a company cannot take any action that would affect the rights attached to shares, unless such action has been approved by a special resolution by each interest group. An "interest group" is defined in the CA 2007 as a group of shareholders:

- whose affected rights are identical; and
- whose rights are affected by the action or proposal in the same way.

Apart from the above provisions, however, there are no provisions in the CA 2007 stipulating how institutional investors and other shareholder groups may influence or monitor a company's actions (ie, as opposed to exercising their general rights, individually or collectively, as shareholders). However, rights regarding influencing or monitoring a company's actions in favour of specific institutional investors and shareholder groups may be procured through contractual arrangements (such as shareholders' agreements) or the inclusion of express provisions in the articles of association of a company.

### 2.13 Holding Through a Nominee

The CA 2007 does not have specific provisions dealing with the rights of shareholders holding their shares through nominees. However, certain provisions of the CA 2007 make stipulations as to trusts. For instance, Section 129 of the CA 2007 states that notice of trusts must not be entered on the share register of a company or be received by the Registrar of Companies (except where the trustee is a central depository approved by the Minister of Finance in consultation with the Securities and Exchange Commission of Sri Lanka).

However, shareholders legally holding shares through nominee arrangements may seek to enforce their rights under contractual arrangements which bind the company, such as shareholders' agreements or the articles of association of the company, or through specific "information right" provisions in the articles of association.

### 2.14 Written Resolutions

Shareholders may generally pass written resolutions in lieu of a meeting under Section 144 of the CA 2007. Such resolutions in writing may be passed by not less than 85% of shareholders who would be entitled to vote on such resolution at a meeting, and who collectively hold not less than 85% of the votes entitled to be cast at such meeting. There is no requirement that shareholders be given notice prior to the passing of such a resolution. However, these requirements (including as to the applicable approval threshold) may be varied through the articles of association of the company.

However, the company is statutorily mandated to send a copy of the resolution to each shareholder who did not sign it, within five working days of the passing of such resolution.

## 3. Share Issues, Share Transfers and Disclosure of Shareholders' Interests

### 3.1 Share Issues

The CA 2007 states that when a company issues shares that rank equally with or above existing shares in relation to voting or distribution rights,

those shares should first be offered to the existing shareholders. However, this pre-emption right can be removed by the articles of association of a company or otherwise overruled by way of a unanimous resolution of the shareholders.

### 3.2 Share Transfers

As per the CA 2007, a share in a company is transferable in the manner provided for by its articles of association, and such articles may limit or restrict the extent to which a share is transferable (although in terms of the Listing Rules of the CSE, shares listed on the CSE cannot be subject to any such restrictions and must be freely transferable, except to the extent necessary under any other statutory requirements). However, the CA 2007 does not itself impose any restrictions on the transfer of shares.

There may be sector-specific restrictions/requirements in relation to a transfer/disposal of shares (eg, where a particular regulatory authority is required to be notified, or where the consent of such authority is required for such a transfer/disposal). Furthermore, under Section 182 of the CA 2007, the Registrar General of Companies (ROC) has the power to restrict the issuance or transfer of shares, or voting or distribution rights in respect of certain shares. However, this is only pursuant to an investigation being initiated by the ROC in respect of such shares, and where the ROC is unable to obtain sufficient information regarding ownership of the relevant shares.

### 3.3 Security Over Shares

Shareholders are generally entitled to grant security interests over their shares, in accordance with applicable laws (including those pertaining to execution and registration requirements). However, such rights may be restricted by way of contractual arrangements (eg, shareholders' agreements or undertakings to banks and other financiers).

### 3.4 Disclosure of Interests

Every company which has issued shares must maintain a share register that contains various shareholding-related details, including:

- the shares issued by that company;
- the name and latest known address of each shareholder;
- the number of shares of each class held by each shareholder; and
- the date of any issue, repurchase, redemption or transfer of shares within the last ten years.

The share register should also be made available for public inspection (under Section 120 of the CA 2007).

A company must also file notices with the ROC in the prescribed form and within the prescribed timeframes regarding any share issuances, share repurchases and share redemptions, and this information is made publicly available. Additionally, a company must file an "annual return" with the ROC each year, containing up-to-date information on its shareholding (including any share transfers that took place within such year).

There are additional interest disclosure obligations under other applicable laws, regulations and rules, including for listed companies and in certain regulated sectors such as banking, insurance and freight-forwarding.

## 4. Cancellation and Buybacks of Shares

### 4.1 Cancellation

As per Section 63(3) of the CA 2007, shares of a company will be cancelled immediately upon repurchase or redemption. Shares may also be cancelled pursuant to an amalgamation (ie, merger) of companies.

### 4.2 Buybacks

A company can buy back (ie, repurchase) its shares only if permitted by its articles of association. As per the CA 2007, the approval of the board and shareholders is required for a repurchase exercise.

Furthermore, as a repurchase of shares is a "distribution", the "solvency test" should also be satisfied, and the auditors are required to provide a "certificate of solvency" and a written opinion that the consideration paid for the shares is a "fair value". A company shall be deemed to have satisfied the solvency test if it is able to pay its debts as they become due in the normal course of business, and if the value of the company's assets is greater than:

- the value of its liabilities; and
- the company's stated capital (being the total of all amounts received by the company or due and payable thereto in respect of the issuance of shares and in respect of calls on shares).

Sector-specific laws and regulations may require the approval of certain regulatory authorities and impose other requirements prior to a repurchase of shares (and/or a connected distribution).

## 5. Dividends

### 5.1 Payments of Dividends

As per the CA 2007, a "dividend" is a distribution out of the profits of the company.

In general, a distribution requires that the solvency test be satisfied, and the auditors are required to provide a certificate of solvency in that regard. A company shall be deemed to have satisfied the solvency test if it is able to pay its debts as they become due in the normal course of business and the value of the company's assets is greater than:

- the value of its liabilities; and
- the company's stated capital.

The CA 2007 also requires that the distribution be approved by the board and the shareholders of the company; however, the requirement that a distribution also be approved by the shareholders is subject to the company's articles of association (which may instead only specify board approval as a requirement). The shareholders of a private company may also unanimously approve the payment of a dividend, without requiring board approval, under Section 31 of the CA 2007.

Sector-specific laws and regulations may also require the approval of certain regulatory authorities and impose other conditions in connection with a dividend declaration or distribution.

## 6. Shareholders' Rights as Regards Directors and Auditors

### 6.1 Rights to Appoint and Remove Directors

As per the CA 2007, directors can be appointed and removed by way of an ordinary resolution. However, this is subject to the company's articles of association, which may contain alternative provisions in this regard.

Director appointments and removals can also be addressed in contractual arrangements (such as shareholders' agreements and joint venture agreements).

### 6.2 Challenging a Decision Taken by Directors

The CA 2007 provides a number of mechanisms through which the shareholders can challenge a decision of the directors or require the directors to take certain actions – for instance, as follows.

Shareholders have the right to requisition:

- an EGM under Section 134 of the CA 2007; and
- circulation of a notice of a particular resolution under Section 142 of the CA 2007.

Shareholders are also entitled to make an application to court under Section 224 of the CA 2007, on the basis that the affairs of the company are being conducted in a manner that is oppressive to the shareholders, thereby challenging the actions of the directors who are responsible for the management and supervision of the business and affairs of the company (ie, minority oppression).

Shareholders can make an application to court to make an order under Section 225 of the CA 2007 on the basis of mismanagement:

- where the affairs of the company are being conducted in a manner prejudicial to the interests of the company; or
- where a material change has taken place in the management or control of the company (whether by an alteration in its board of directors or of its agent or secretary, in the constitution or control of the firm or body corporate acting as its agent or secretary, in the ownership of the shares of the company, or in any other manner whatsoever) and that by reason of such change it is likely that the affairs of the company may be conducted in a manner prejudicial to the interests of the company.

It should be noted that applications under Sections 224 and 225 can only be made by shareholders who satisfy the pre-conditions specified in the CA 2007, which include the requirement that the application must be made by a shareholder or shareholders who at any time during the six months prior to the making of the application:

- constituted not less than 5% of the total number of shareholders; or
- held shares which together carried not less than 5% of the voting rights.

A successful application under the aforesaid sections may result in a court order providing for, inter alia, regulation of the conduct of the company's affairs or termination/modification of an agreement between the company and a director, or such other order as the court deems fit.

Shareholders are also entitled to apply for restraining orders restraining a company, or a

director of a company, that proposes to engage in a conduct that would contravene the articles of the company or any provision of the CA 2007, preventing them from engaging in that conduct.

A derivative action can also be instituted by a shareholder on behalf of a company or subsidiary of a company (with the leave of the Commercial High Court).

Shareholders can also apply to the Commercial High Court to require the ROC to investigate the affairs of the company.

Shareholders may also potentially complain to the relevant regulatory bodies (including the Securities and Exchange Commission of Sri Lanka, for listed companies) in relation to any misconduct or other perceived wrongdoings of directors/officers.

### 6.3 Rights to Appoint and Remove Auditors

An auditor is appointed by the shareholders at each AGM, and the appointment of the auditor shall continue until the next AGM. However, the board also has the power to fill a casual vacancy in the office of an auditor and to appoint the first auditor of the company (if the appointment is before the AGM).

## 7. Corporate Governance Arrangements

### 7.1 Duty to Report

The board of each company is required to prepare and send to every shareholder an "annual report" covering the affairs of the company during the accounting period ending on that date. The annual report should be prepared within six months of the balance sheet date of the company, and a copy of the annual report should be sent to every shareholder not less than 15 working days before the date fixed for holding an AGM.

The annual report would contain the following.

- The financial statements of the company for the completed accounting period.
- The auditor's report.
- Other information concerning the company, such as:
  - (a) changes in accounting policies;
  - (b) details on benefits and remuneration paid to directors;
  - (c) donations made by the company;
  - (d) names of the directors;
  - (e) changes in the board;
  - (f) changes in the nature of the business of the company; and
  - (g) the class of business in which the company has an interest.

In their published annual reports, companies listed on the CSE are required to confirm whether they are in compliance with the Corporate Governance Rules of the CSE, as per Rule 7.10 of the Listing Rules issued by the CSE (this will be as per Rule 9 from October 2024, following the revised Corporate Governance Rules issued in September 2023). Listed companies are also required to have a written policy on corporate governance and to make it available to shareholders on request (effective from October 2024, following the revised Corporate Governance Rules issued in September 2023).

Certain sector-specific laws and regulations may also require directors to report to shareholders on corporate governance arrangements.

## 8. Controlling Company

### 8.1 Duties of a Controlling Company

Generally, a parent company does not have duties and liabilities to the other shareholders of the company it controls (ie, in the capacity of a shareholder). However, the CA 2007 has provisions in relation to protection of minority shareholders, which seeks to prevent potential abuse of the rights of the shareholders. Certain regulatory bodies may also utilise their powers and authorities to ensure that controlling shareholders comply with certain obligations.

## 9. Insolvency

### 9.1 Rights of Shareholders If the Company Is Insolvent

A shareholder (with leave of the court) is entitled to propose a "compromise" under Part IX of the CA 2007, if such person has reason to believe that a company is or is likely to become unable to pay its debts as they fall due. This involves providing notice of such person's intention to do so (along with other specific information) to the company, creditors, any receiver, administrator or liquidator, and the ROC. A "compromise" means a compromise between a company and its creditors, including a compromise:

- cancelling all or part of any debt of the company;
- varying the rights of its creditors or the terms of a debt; or
- relating to an alteration of a company's articles that affects the likelihood of the company's ability to pay a debt.

Shareholders can also resolve to wind up a company (by way of a special resolution) or make an application for the winding-up of a company. Shareholders are also entitled to appoint liquidators and fix the remuneration thereof under certain circumstances. Separately, if the company is being wound up by court, shareholders have the right via resolution to direct the liquidator with respect to certain matters (such as administration of assets of the company and distribution thereof). Furthermore, the CA 2007 requires the court to have regard to the wishes of the shareholders (regarding all matters concerning the winding-up of a company) as proved to it by any sufficient evidence.

Even when an administrator has been appointed in accordance with the CA 2007, the shareholder is entitled to apply to the court for an order under Section 425 of the CA 2007 on the grounds that:

- the company's affairs, business and property are being managed by the administrator in a manner which is unfairly discriminatory or unfairly prejudicial to the interests of the shareholder; or
- any actual or proposed act or omission of the administrator is or would be unfairly discriminatory or unfairly prejudicial to the interests of such shareholder.

The court may accordingly make an order:

- regulating the management by the administrator of the company's affairs;
- requiring the administrator to refrain from performing or from continuing an act complained of by the applicant, or to perform an act which the applicant has complained they have omitted to do;
- requiring the calling of a meeting for the purpose of considering such matters as the court may direct; or

- discharging the administrator and making such consequential provisions as the court thinks fit, among other things.

## 10. Shareholders' Remedies

### 10.1 Remedies Against the Company

Shareholders may have various legal remedies (both statutory and common law) against a company, depending on the nature of the grievance and other relevant circumstances.

For instance, shareholders are entitled to make an application to court under Sections 224 and 225 of the CA 2007 (see **6.2 Challenging a Decision Taken by Directors**).

Shareholders can also apply to the ROC to investigate the affairs of the company. For listed companies, complaints can also be raised with the CSE (in terms of the Listing Rules) or the Securities and Exchange Commission of Sri Lanka (under the provisions of the Securities and Exchange Commission Act No 19 of 2021). Companies subject to the purview of other regulators may potentially have recourse thereto under the applicable laws and regulations (such as the Central Bank, in respect of financial institutions such as banks and finance companies).

Shareholders are also entitled to apply for restraining orders restraining a company, or a director of a company, that proposes to engage in a conduct that would contravene the articles of the company or any provision of the CA 2007, preventing them from engaging in that conduct.

Shareholders can also seek legal remedies against the company for breach of contractual arrangements (such as shareholders' agreements or joint venture agreements).

### 10.2 Remedies Against the Directors

Shareholders may have various legal remedies (both statutory and common law) against a company, depending on the nature of the grievance and other relevant circumstances.

For instance, shareholders are entitled to make an application to court under Sections 224 and 225 of the CA 2007 (see **6.2 Challenging a Decision Taken by Directors**), and under Section 234 of the CA 2007 to bring proceedings in the name and on behalf of the company or any of the subsidiaries of that company (ie, a derivative action), including for breach of statutory and common law directors' duties.

Shareholders can also apply to the ROC to investigate the affairs of the company. Directors/officers may be held liable pursuant to such actions. See **10.1 Remedies Against the Company**.

Furthermore, if during the course of winding up a company it appears that a person who has taken part in the formation or promotion of the company, or that a past or present director or manager, has misapplied, retained or become liable or accountable for money or property of the company, or has been guilty of negligence, default or breach of duty or trust in relation to the company, a shareholder is entitled to make an application to the court in that regard. The court may:

- inquire into the conduct of such person;
- order such person to repay or restore the money or property, or any part of it, with interest at a rate the court thinks just; or
- order such person to contribute such sum to the assets of the company by way of compensation as the court thinks just.

Separately, a shareholder can apply to the court under Section 382 of the CA 2007 to have an officer of the company prosecuted, if it appears to the court in the course of a winding-up or subject to the supervision of the court that such officer has been guilty of any offence in relation to the company for which they are criminally liable. An "officer" under the CA 2007 would include a director, manager and secretary.

As previously stated, shareholders are also entitled to apply for restraining orders restraining a company, or a director of a company, that proposes to engage in a conduct that would contravene the articles of the company or any provision of the CA 2007, preventing them from engaging in that conduct.

### 10.3 Derivative Actions

Section 234 of the CA 2007 permits shareholders (with leave of the court) to:

- bring proceedings in the name and on behalf of the company or any of the subsidiaries of that company; or
- intervene in proceedings to which the company or any subsidiary is a party, for the purpose of continuing, defending or discontinuing the proceedings on behalf of the company or subsidiary, as the case may be.

In deciding whether to grant leave for a derivative action, the court will consider a number of factors, such as:

- the likelihood of the proceedings succeeding;
- the costs of the proceedings in relation to the relief likely to be obtained;
- any action already taken by the company or subsidiary to obtain relief; and
- the interests of the company or subsidiary in the proceedings being commenced, continued, defended or discontinued, as the case may be.

## 11. Shareholder Activism

### 11.1 Legal and Regulatory Provisions

Some of the generally available and utilised legal and regulatory tools for activist shareholders include the following.

The provisions of the CA 2007 set out various statutory rights and remedies for company shareholders, including:

- the right of access to certain documents and information;
- the right to call for and participate at general (ie, shareholder) meetings;
- the right to vote on certain matters which are reserved for shareholders, such as the appointment and removal of directors and auditors; and
- remedies for mismanagement, oppression and the ability to bring derivative actions for and on behalf of the company.

Of course, in certain instances these rights are subject to qualification thresholds and other conditions, including those imposed under other laws and regulations and by the company's own articles of association. The rights are generally available to shareholders of both listed and unlisted companies.

The provisions of the Securities and Exchange Commission Act No 19 of 2021 (the "SEC Act"), and the regulations and rules issued thereunder, contain various provisions for the protection of investors in listed companies, including:

- the ability to complain to the Securities and Exchange Commission (SEC) against market misconduct activities (such as stock market manipulation and the making of false or misleading statements); and
- the right to directly institute action against listed companies for any losses or damages arising therefrom.

In addition, investors may have a general right to complain to the Complaints Resolution Committee (which has the power to hold inquiries into such matters and make recommendations to the SEC) regarding any breach of the provisions of the SEC Act, or of any regulations or rules made thereunder, by a listed company.

The Listing Rules of the CSE set out ongoing compliance obligations for companies listed on the CSE (being the only presently authorised securities exchange in Sri Lanka). In particular, the corporate governance rules for listed companies (revamped in September 2023 and set out in Rule 9 of Listing Rules) stipulate detailed requirements for listed companies regarding:

- board matters (including composition, director independence, fitness and propriety, and board subcommittees);
- certain "related party transaction" matters; and
- the need to maintain various corporate policies, including on relations with shareholders and investors (focusing on the need to have effective communication and relations with shareholders and investors, designated investor relations personnel and clear processes to make directors aware of major issues and concerns of shareholders).

Activist shareholders can make complaints to the CSE regarding perceived non-compliance with the Listing Rules, and the CSE has the power to investigate and take certain remedial action, including trading suspension and delisting.

Regarding litigation, activist shareholders can (and, particularly in the case of institutional, corporate or HNI investors, frequently do) resort to litigation in the Sri Lankan courts to pursue their objectives, including seeking interlocutory relief such as interim injunctions and enjoining orders. These are usually filed in the Commercial High Court of Colombo for company law matters or for matters where the value of the claim is greater than LKR50 million; in other cases, this occurs in the District Courts. This is also commonly pursued in tandem with other available legal and practical processes, as part of an overall strategy.

## 11.2 Aims of Shareholder Activism

In most cases, activist shareholders in Sri Lanka are concerned with:

- direct economic considerations (eg, the payment of dividends or the pricing for private placements, rights issues or a delisting); or
- management input/control (eg, through board representation or composition).

## 11.3 Shareholder Activist Strategies

Activist shareholders pursue a myriad of different strategies to achieve their objectives, depending on the circumstances (including the nature of the grievance and their own resources). These include:

- dispute resolution processes (eg, litigation against the company and the seeking of interim relief such as injunctions);
- complaints to the CSE, the SEC and/or other regulators;
- the holding of media conferences;

- the making of print media or social media statements; and
- raising issues and disputes at shareholder meetings.

### 11.4 Recent Trends

Shareholder activism in Sri Lanka is perceived as being driven by specific (and short- to medium-term) ad hoc concerns and personal objectives of individual investors or certain classes of shareholders, as opposed to by any industry/sector-specific strategies and issues.

Unlike in certain other jurisdictions (for instance, the SIAS in Singapore), there are also no formally established investors' rights lobby groups/associations presently operating in Sri Lanka.

### 11.5 Most Active Shareholder Groups

Retail investors (ie, as opposed to institutional shareholders) are generally considered to be more commonly engaged in shareholder activism matters in Sri Lanka.

### 11.6 Proportion of Activist Demands Met

Such information is not readily available in the public domain.

### 11.7 Company Prevention and Response to Activist Shareholders

Companies are generally advised to take proactive steps to ensure compliance with their applicable legal framework, particularly those pertaining to corporate governance and shareholder rights, to minimise any adverse exposure to shareholder activism.

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