EVALUATING THE PROSPECTS OF EFFECTUATING A HOSTILE TAKEOVER IN THE INDIAN CORPORATE LANDSCAPE

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Abstract

The central premise of this paper is to assess the theoretical possibility of conducting hostile acquisitions in India, as well as the defenses exercisable by the domestic targets to forestall such deals. To further this premise, the paper comprehensively analyses the extant hurdles to hostile takeover activity in India, arising due to dominant promoter holdings, regulatory restrictions imposed on the acquisition of finance and foreign direct investment in India. Thereafter, the author examines the anti-acquirer character of the Takeover Code, 2011, that inhibits a potential raider from effectuating a hostile takeover. Finally, the paper discusses the ineffectiveness of the traditional takeover defenses in India, which leaves target companies with few viable strategies to fend off hostile suitors.

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I. INTRODUCTION

Ever since India hailed the LPG bandwagon, India Inc. has transformed into a lucrative market for conducting mergers and acquisitions. A review of the M&A activity by Thomson Reuters illustrates that 2010 proved to be a banner year for India. The M&A deal volume was up more than threefold from $21.3 billion in 2009 to $67.2 billion in 2010.[1] Thereafter, in the first nine months of 2011, M&A deal volumes were valued at $26.8 billion, with a total of 177 transactions.[2]

In fact, a series of high profile transactions have heralded the arrival of booming M&A activity in India. In this regard, one may recall Vodafone's $11.1 billion acquisition of a controlling interest in Hutchison Essar, India's fourth-largest mobile phone company.[3] The $13.2 billion dollar Tata-Corus deal[4] and the $11 billion Airtel-Zain deal also proffer fitting examples to this effect.[5]

Thus, India's corporate boardrooms have witnessed multi-billion strides in negotiating friendly deals. Nevertheless, hostile takeover activity in India has remained rather dormant. In fact, India's

[1]Thomson Reuters' Full Year 2011 Preliminary Review M&A.
[2]According to Thomson Reuters the overall deal activity for announced M&A involving India slowed down as value and deal count declined 43.7% and 27.0% compared to M&A transactions in 2010.
[3]Phineas Lambert, *Vodafone: Hutchison Essar on Track to Close*, DAILYDEAL, http://www.thedeal.com.
[4]Jonathan Braude, *Tata Wins Corus Auction*, DAILYDEAL, http://www.thedeal.com.
[5]*BhartiZain to sign $10.7 billion deal within days*, THE ECONOMIC TIMES, http://economictimes.indiatimes.com/news/news-by-industry/telecom/bharti-zain-to-sign-10-7-bn-deal-within-days/articleshow/5722231.cms.

corporate vocabulary is strewn with instances of how most hostile takeover attempts have been convincingly thwarted.[6]

The existing literature on the dearth of hostile takeover activity has attributed this trend to the prevalence of founding families 'promoters', with dominant shareholding positions. The standing of the Indian promoters is further strengthened by the historic allegiance displayed by the domestic financial institutions. Even the Indian Takeover Code has a pro-promoter undertone, which allows promoters to consolidate their stakes without triggering penalties under the Code. Furthermore, the copious approvals and the inherent nationalist sentiment prevailing in the Indian regulatory environment, makes a classic hostile takeover fairly implausible.

This paper traces the advances in India's regulatory landscape to rebut the aforesaid contentions. An examination of the policy considerations articulated by the Department of Industrial Policy and Promotion, the Reserve Bank of India and the Securities and Exchange Board of India, reveal that hostile takeovers of Indian companies is now a real possibility. Nevertheless, there exist inconsistencies in the current regulations as regards the effectuation of hostile takeovers and the subsequent defenses available to the target companies.

In view of this, the author shall discuss how the Indian policymakers face an important regulatory opportunity at present. India's policy vis-à-vis hostile takeovers must weigh the benefits of scale, globalization and managerial efficiency, against the potential drawback of rendering domestic corporations vulnerable to unsolicited foreign control. Therefore, in order to foster greater investor confidence, India's policy intention as regards encouraging

[6]The only successful hostile deal in Indian history was the acquisition of Raasi Cements by India Cements in 1998.

or desisting hostile takeovers must be more consistent and coherent. In fact, the sprawling jurisprudence evolved by Delaware in this regard can serve as an educative blueprint for Indian regulators to emulate.

In a nutshell, the author attempts to assess the theoretical possibility of conducting hostile acquisitions in India, as well as the defenses exercisable by the domestic targets to forestall such deals. Part II deals with the protracted history of hostile takeover attempts in India. Under Part III the author shall examine the pro-promoter lineage of the Indian corporate landscape. Part IV and Part V assess the extant hurdles apropos of acquisition of finance and foreign direct investment in India, and its consequent effect on hostile takeover activity in India. To further this premise, Part V illustrates the various features of the Takeover Code, 2011, while Part VI evaluates the possibility of employing takeover defenses in India. It is imperative to state that the paper shall not analyze the policy merits or demerits associated with the advent of hostile takeovers in India. Moreover, an investigation into the financial viability of acquiring Indian corporations also, shall not form part of the paper's central inquiry.

II. HOSTILE TAKEOVER ATTEMPTS IN INDIA

The first hostile takeover attempt in India, even before the promulgation of the Takeover Code, pertains to the British businessman, Swaraj Paul's failed endeavour to acquire Escorts Ltd. and DCM. In spite of accumulating a greater stake than the promoters,[7] the company refused to register Paul's newly purchased shares.[8] He also received stiff resistance from the political lobby and the Life Insurance Corporation, a state owned financial institution with a minority stake. Eventually, in the face of unfavourable circumstances, Paul was compelled to retract his bid.

Fifteen years after Swaraj Paul's unsuccessful hostile takeover attempt, the UK based I.C.I. paint company negotiated an agreement with one of the co-founders of Asian Paints to acquire his 9.1% stake in the company. Mounting disapproval of such a move by the remaining co-founders of Asian Paints, culminated in them refusing to register I.C.I.'s shares. Consequently, I.C.I. was pressurized to sell its stake to U.T.I. (a government owned mutual fund) and two other co-founders of Asian Paints.

The year 1998 witnessed the first successful acquisition of an Indian target by a predator via the hostile takeover route. India Cements acquired B.V. Raju's 32% stake in Raasi Cements, along with amassing nearly 20% shares on the open market. Notwithstanding, the vaulting resistance demonstrated by the founders of Raasi Cements and the Indian financial institutions, India Cements successfully acquired Raasi Cements, through a privately negotiated transaction.

Thereafter, in the year 2000, the Dalmia Group's predatory attempt to acquire GESCO was precluded by the recruitment of the white knight defense. The Dalmia Group had acquired a 10% stake in GESCO, and floated a bid to acquire a further 45% in the said target. The Sheth family of the GESCO fame had allied with the Mahindra Group to

[7]Roughly 7.5% and 13% stakes in Escorts and DCM, respectively.
[8]The Companies Act, 1956, § 111A(5), No. 1, Acts of Parliament, 1956 (India) (Pursuant to an amendment to the Companies Act providing for free transferability of shares, companies may not refuse to register shares unless the Indian Company Law Board finds the transfer to violate the law and suspends the voting rights of the shares).

buy out the remaining float for an even higher premium. The hostile bid was eventually thwarted when the Mahindra-Sheth group bought the Dalmia Group's 10% stake in GESCO.

Some recent deals with a deep hostile undertone include Emami Ltd.'s acquisition of Zandu Pharmaceutical Works Ltd; Pramod Jain's hostile bid for Dalmia Group's Golden Tobacco Ltd. and HB Stockholdings attempts to takeover DCM Shriram Industries Ltd. A few other examples to this effect include the protracted bidding wars between Grasim Industries Ltd. and Larsen & Turbo Ltd; Temptation Foods Ltd. and Kohinoor Foods Ltd. as well as rumors of a possible acquisition of Hindalco Industries Ltd. by Alcan Inc. and Sterlite Industry.

III. ROLE OF PROMOTERS

This part shall preview how the Indian corporate landscape is punctuated with dominant promoter holdings, which in effect forestalls any hostile takeover attempt. Generally, in order to defend against a potential takeover, the promoters of a corporation allocate their capital to their companies. It is submitted that while such a strategy may be effective as a takeover defense, it proves to be deleterious to the growth of the Indian economy. In view of the proposition, this part shall examine the various ways in which a predator can acquire *control* over a company, and how substantial promoter holdings can inhibit such predatory tactics.

A. Categories of Investors in Indian Corporations

To take the discussion forward, let us first discuss the major categories of shareholders in Indian companies.

The most prominent category of shareholders in India is that of the promoters. The ICDR Regulation of 2009 defines the term *promoter* as, "*i) the person or persons who are in control of the issuer; (ii) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to public; (iii) the person or persons named in the offer document as promoters.*"[9] Thus, typically, promoters are founders or members of founding families of corporations, but for purposes of the Code, even a non-founder with de facto control would also qualify for *promoter* designation.[10]

Another relevant set of investors is the Indian Financial Investors. Historically, it has been recognized that domestic financial institutions vote in concert with the promoters. This trend owes its genesis to the pre-liberalization license permit quota raj, whereby firms granted the license to do business in India were almost guaranteed financial assistance by state run domestic financial institutions.[11] It is submitted that the historical loyalty of domestic financial institutions to promoters is a significant impediment to hostile takeovers.

The next category of investors is the Foreign Institutional Investors, which include many U.S. mutual funds, university endowments, and hedge funds investing in India.[12] FIIs must be registered with the Reserve Bank of India and SEBI. However, this special designation gives them the right to buy and sell Indian securities, repatriate any gains made in India and realize capital gains from Indian investments,

[9]Securities Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 § 2 (za).
[10]Shaun J. Mathew, *Hostile Takeovers in India: New Prospects, Challenges and Regulatory Opportunities,* 3 COLUM. BUS. L. REV.(2007).
[11]Tarun Khanna & Krishna Palepu, *Globalization and Convergence in Corporate Governance: Evidence from Infosys and the Indian Software Industry*, 35 J. INT. BUS. STUD 484-88 (2004).
[12]MATTHEW, *supra* note 10.

inter alia. In contrast to the domestic financial institutions, foreign institutional investors have fewer links to the old business family elites. Thus, they would vote based purely on economic interest so as to fulfil their fiduciary duty toward the investors. In other words, foreign financial institutions are more likely to vote in favor of a hostile acquisition that offers a significant premium as against securing promoter interests. In view of the aforesaid analysis, it is submitted that the rapidly increasing influence and stakes of FIIs in Indian corporations, may herald the onslaught of hostile takeover activity in India.[13]

B. Whether a Hostile Acquirer Gains Control Over a Corporation, Irrespective of the Dominant Promoter Holdings

In order to gain control over a corporation, a hostile acquirer would have to replace the majority of the corporation's board of directors, or otherwise gain control over the management.[14]

Firstly, when the hostile acquirer achieves a 10% stake in the corporation, it can requisition the board to hold an extraordinary general meeting.[15]

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[13]*Id.* According to a study conducted by Shaun J Mathew in 2007 the average FII stake in the BSE 100 exceeds 18%, or roughly nine times the average stake of the once-powerful Indian financial institutions.

[14]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 defines Control in Regulation 2(1)(e) ("Control" *includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner*).

Secondly, the hostile acquirer can seek to control the agenda of the meeting, by acquiring more than a 5% stake in the corporation and thereby gaining proxy access; as a result of which it can pitch a resolution to replace board members.[16] However, an application can be made by the incumbent board to seek to exclude shareholder proposals.[17]

Thirdly, the hostile acquirer can replace the board with a 50.1% majority stake. The removal of directors and appointment of new directors requires an ordinary resolution where the votes cast in favor of the resolution exceed the votes cast against.[18] After removing previous directors at a shareholder meeting, the hostile acquirer would require a simple majority to replace the directors.[19]

It is important to note that the hostile acquirer who holds a mere 50.1% majority is still substantially constrained in the management of the corporation. Several matters require a special resolution, where the votes for a resolution must be three times the votes against the resolution.[20] Important decisions, such as the alteration or amendment of the memorandum and articles of the corporation,[21] reduction of share capital,[22] voluntary winding up or liquidation,[23] preferential allotment of shares as a means of raising capital,[24] or even sanctioning of a merger or asset sale,[25] require a 75% majority in order to obtain the special resolution. Thus,

[15]The Companies Act, 1956, § 169(1), No. 1, Acts of Parliament, 1956 (India).
[16]*Id.* § 188(2). The option is also available to 100 shareholders acting together.
[17]*Id.* § 188(5).
[18]*Id.* § 189.
[19]*Id.*§ 189 (1). (It defines an ordinary resolution as a resolution in which the number of votes cast in favor of a resolution exceeds those cast against a resolution).
[20]*Id.* § 189(2)(c).
[21]*Id.* §§ 17, 31.
[22]*Id.* § 484.
[23]*Id.* § 100.
[24]*Id.* § 81(1)(a).
[25]*Id.* § 391 (read with § 394(a)-(b)).

a promoter with just over a 25% stake attempting to combat a hostile take-over could threaten to hold its shares and block all future special resolutions, including the corporate restructurings needed by the hostile acquirer to effectuate a change of control. Hence, while holding a 25% stake cannot prevent a hostile bidder from acquiring a majority stake and appointing a new board of directors, it could serve as a credible threat sufficient to deter potential hostile bidders from making bids in the first place.
Conversely, what this also means is that a hostile acquirer can throw a spanner in the works by acquiring a mere 25.1 percent stake in a corporation. A hostile acquirer who acquires a 25.1% stake in an Indian corporation has obtained de facto blocking rights capable of being exercised against promoters.[26] These rights can be used to negotiate with the promoters, either to acquire the promoters' stake in the corporation or to sell out their own stakes to the promoters at a premium.

Fourthly, Indian company law also makes the waging of a proxy war relatively hassle-free. The register of shareholders is open for inspection by any shareholder during ordinary business hours without the payment of a fee and to others with the payment of a fee.[27] The register of members is required to maintain the name, address, and occupation of members,[28] which makes it easier to contact them for proxy solicitation. Additionally, when an acquirer makes a tender offer to the shareholders of a target corporation, the board of directors of the target is required under India's Takeover

[26]In this context it is important to consider that under Indian law, even minority shareholders are capable of committing ―oppression, (i.e., fiduciary duty breaches) concerns typically raised against majority shareholders.
[27]The Companies Act, 1956, No. 1, Acts of Parliament, 1956 (India),§ 163(2).
[28]*Id.* § 150(1)(a).

Code to provide the acquirer with information regarding shareholders eligible to participate in the tender offer.[29]

C. Defenses that Inhibit the Acquisition of 'Control' by a Hostile Acquirer

However, at least three latent defense mechanisms additionally inhibit the hostile acquisition route in India.

Firstly, share transfer restrictions may impede the ability of acquirers to acquire shares from willing but contractually bound sellers. The enforceability of transfer restrictions in the context of public companies is tenuous. The Supreme Court of India has held that share transfer restrictions must be incorporated into the articles of a private corporation in order for them to be binding.[30] However, as a result of conflicting High Court opinions, the interaction of this requirement with public corporations is not entirely clear.[31]

Secondly, pooling agreements may make it mandatory for some shareholders to vote with promoters to thwart the hostile acquisition

[29] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 23(2).

[30]Rangaraj v. Gopalakrishnan, A.I.R. 1992 SC 453.

[31]Messer Holdings Ltd. v. Ruia, (2010) 159 Comp.Cas. 29 (Bom.) (holding that pre-emptive rights are enforceable against public companies and that shareholders' agreements need not even be incorporated into the articles of association); W. Maharashtra Dev. Corp. Ltd. v. Bajaj Auto Ltd., (2010) 154 Comp.Cas.593 (Bom.) (holding that restrictions of transferability of shares, in this case a right of first offer or ―ROFO, are not enforceable against a public company); Pushpa Katoch v. Manu Maharani Hotels Ltd., (2006) 131 Comp. Cas. 42 (Del.); Mafatlal Ind. v. Gujarat Gas Co., (1999) 97 Comp.Cas. 301 (Guj.) ; see also KaramsadInvs. Ltd. v. Nile Ltd., (2002) 108 Comp.Cas. 58 (A.P.); Bombay Dyeing & Mfg. Co. v. Bajoria, (2001) 107 Comp.Cas. 535 (C.L.B.).

attempt.[32] These concerns are to some extent capable of being addressed. It is submitted that, pooling agreements would not restrict share transfers. For instance, if every institutional investor that acquires a stake in a corporation is required to sign a pooling agreement, that would not restrict the ability of the investor to exit the corporation and transfer its holding to the hostile acquirer.

The shares of many corporations in India are presumed to be held by friends of promoters, who are not considered a part of the promoter group, but whose loyalties reside with promoters. According to scholars this third latent defense may actually be more problematic than the previous two. This is because information on friends is not publicly available; therefore, it would be hard to ascertain those corporations in which friends of promoters have defensive stakes.[33]

IV. ACQUISITION OF FINANCE

This part shall analyze how the regulatory restrictions with respect to the acquisition of finance make it rather unattractive to effectuate a hostile takeover.

Firstly, according to §77(2) of the Indian Companies Act the leveraged buyout of a public company or its subsidiary using the assets of the target as collateral is prohibited. [34] Additionally, the

[32]A. Chandrachud, *The Emerging Market for Corporate Control in India: Assessing (And Devising) Shark Repellents for India's Regulatory Environment,* 10 WASH. U. GLOBAL STUD. L. REV. (2011).

[33]*Id.*

[34]The Companies Act, No. 1, Acts of Parliament, 1956 (India),§ 77(2). However, this restriction applies only to public companies and their subsidiaries,

Indian Takeover Code limits the ability of a hostile acquirer to re-finance its acquisition, by prohibiting the acquirer from disposing off, selling, or otherwise encumbering any substantial asset of the target or its subsidiaries or enter into any material contracts.[35]

The next set of restrictions is imposed by the Reserve Bank of India, which heavily regulates the borrowing and lending of funds for acquisition purposes. To better understand the sweep of the RBI regulations, let us consider the following three hypothetical scenarios.

In the first situation, both the target and the acquirer are domestic Indian corporations. Under the Reserve Bank's guidelines, popularly referred to as the ECB Guidelines,[36] Indian corporate houses cannot borrow funds from international banks or financial institutions for the purposes of acquiring a company, or any portion thereof, in India.[37] Thus, Indian corporate houses are restricted in their use of both domestic and foreign funds in any attempt to acquire a hostile Indian target. Additionally, bank credit is prohibited to non-banking finance companies for investment in any company's shares.[38]

In the second situation, the target is a foreign corporation and the acquirer is a domestic Indian corporation. Indian companies have been given general permission to obtain funds from a domestic

theoretically leaving open the possibility of taking a private company using this route.

[35]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 Regulation 23(1).

[36]Reserve Bank of India, Master Circular No. 07/2009-10, MASTER CIRCULAR ON EXTERNAL COMMERCIAL BORROWINGS AND TRADE CREDITS, http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7353.

[37]*Id.* at I(A)(vi), B(vii).

[38]Reserve Bank of India, Master Circular DBOD.BP.BC.NO.4/08.12.01/2008-09, MASTER CIRCULAR- BANK FINANCE TO NON-BANKING FINANCIAL COMPANIES (NBFCS) § 5.1(ii) http://rbidocs.rbi.org.in/rdocs/notification/PDFs/85374.pdf.

bank to participate in a bidding or tender offer process overseas,[39] subject to ceiling.[40] RBI approval is required in other cases.[41] Moreover, under the ECB Guidelines, overseas direct investment in joint ventures or wholly owned subsidiaries is permissible, although subject to existing guidelines on Indian direct investment in such ventures.[42] Further, the RBI guidelines do not apply in circumstances where the Indian acquirer is not permanently resident in India; for instance where the acquisition takes place through the use of funds held in a Resident Foreign Currency account or through foreign currency resources outside India.[43]

In the third situation, the target is an Indian corporation, and the acquirer is a foreign corporation. While foreign corporations may be subject to similar restrictions in obtaining funds from Indian banks, they would not be prohibited, under Indian regulations, from obtaining funds from foreign banks in order to carry out acquisitions in India, unless the national regulations to which the foreign bank is subject provide otherwise.[44]

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[39]Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004, http://rbidocs.rbi.org.in/rdocs/notification/PDFs/60901.pdf [hereinafter FEMA Transfer Rules].
[40]See, FEMA Transfer Rules § 6, as amended by Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Third Amendment Regulations, 2007, http://rbidocs.rbi.org.in/rdocs/notification/PDFs/88452.pdf.
[41]FEMA Transfer Rules, § 9.
[42]Reserve Bank of India, Master Circular No. 07/2009-10, MASTER CIRCULAR ON EXTERNAL COMMERCIAL BORROWINGS AND TRADE CREDITS pt. I (A)(v)(b), http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7353.
[43]Reserve Bank of India, Master Circular No. 01/2009-10, MASTER CIRCULAR ON DIRECT INVESTMENT BY RESIDENTS IN JOINT VENTURE (JV)/WHOLLY OWNED SUBSIDIARY (WOS) § A.4,
http://rbidocs.rbi.org.in/rdocs/notification/PDFs/21DWR 010709_FULL.pdf.
[44] MATTHEW, *supra* note 10.

Clearly, the avenues for domestic Indian corporations to obtain funding to finance domestic acquisitions are limited. However, this does not in any way limit the ability of foreign corporations to assume positions in Indian corporations using overseas financing opportunities. Further, these restrictions do not apply to hostile acquisitions alone but also to friendly deals, which continue to take place despite these restrictions.

V. RESTRICTIONS ON FOREIGN DIRECT INVESTMENT

The inability to conduct a hostile takeover in India is also heightened in view of the general restrictions imposed by the Indian regulatory environment. This part shall preview some such restrictions and their repercussions, to substantiate the query at hand.

A. General Restrictions on FDI

The defining feature of India's liberalization oriented reforms in 1991 was the adoption of the New Economic Policy, which sought to achieve fiscal stabilization and structural adjustment of the Indian economy. Prior to 2006, the Government of India required a foreign investor to comply with two sets of requirements. *Firstly,* the Government of India had placed sector specific ceilings that restricted foreign investment in India.[45] *Secondly,* even if FDI sectoral restrictions did not inhibit a foreign entity's acquisition of control over an Indian company, the Government of India required FIPB and RBI

[45]Press Note 7 (2008), Ministry of Commerce and Industry, CONSOLIDATED POLICY ON FOREIGN DIRECT INVESTMENT, http://pib.nic.in/newsite/erelease.aspx?relid=39600. For instance, foreign entities may invest up to 100% in the production of alcohol-distillation and brewing industry, but investment in defense production is restricted to 26%.

approval for a foreign entity's acquisition of control over an Indian company through the acquisition of shares.[46]

Thereafter in 2006 India's foreign investment policy was significantly liberalized with the issuance of Press Note 4 (2006 Series) by the Department of Industrial Policy and Promotion which opened the retail sector subject to certain conditions.[47]Subsequently, almost all the sectors were opened for foreign investment under the automatic route. Presently, besides eight sectors in which foreign investment is prohibited;[48] foreign investment is permitted either under the automatic route or consequent to the prior approval of the Foreign Investment Promotion Board and the Reserve Bank of India.

Under the automatic route, no prior approvals are required from any governmental entity or the Reserve Bank of India, although there are some notification and filing obligations that must be complied with.[49] But the automatic route is subject to two exemptions. *Firstly*, prior

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[46]See Secretariat for Industrial Assistance, Department of Industrial Policy And Promotion, Ministry Of Commerce And Industry, Govt Of India, MANUAL ON FOREIGN DIRECT INVESTMENT IN INDIA 11-12 (2003) (stating that "government approval . . . through the FIPB shall be necessary . . . [for] (iii) All proposals relating to acquisition of shares in an existing Indian company in favour of a foreign/NRI/OCB investor.").

[47] Press Note 4 (2006), Department of Industrial Policy and Promotion, RATIONALISATION OF THE FDI POLICY, § 2 (e). (The Indian Government permitted the transfer of shares from Indian residents to a foreign acquirer without any FIPB Approval and subject only to FDI sectoral caps).

[48]Press Note No. 7 (2008 Series), Department of Industrial Policy & Promotion, CONSOLIDATED POLICY ON FOREIGN DIRECT INVESTMENT, http://siadipp.nic.in/policy/changes/pn7_ 2008.pdf. (Retail trading which is not single-brand product retailing, atomic energy, the lottery business, gambling and betting, the business of chit funds, Nidhi companies, trade-in transferable development rights, and any sectors not open to private sector investment).

[49]CONSOLIDATED FDI POLICY, Department of Industrial Policy and Promotion, http://dipp.gov.in/English/Policies/FDI_Circular_02_2011.pdf.

government approval is required where more than 24% foreign equity is proposed to be inducted for the production of items reserved for the small scale sector.[50] *Secondly*, FDI under the automatic route is prohibited for investment in purely investing companies, i.e. companies that conduct only monetary operations,[51] even though their subsidiaries may be amenable to foreign investment without any prior governmental approval.

Let us now discuss the procedural requirements for sectors that are not open to foreign investment under the automatic route and thereby require the approval of the Foreign Investment Promotion Board and the Reserve Bank of India. The RBI approval is only a matter of technical compliance, which requires that the consideration paid meets the basic SEBI and RBI pricing guidelines.[52] On the other hand, the FIPB approval requires a foreign investor to submit a no objection certificate by obtaining a board resolution passed by the target company,[53] a resolution which would be impossible to obtain in the hostile context. Consequently, nationalist sentiment forms an invisible barrier to the hostile acquisition under the approval route.

After having analyzed the regulatory landscape governing the inflow of FDI into India, the author shall examine the sectors in the Indian economy, which are most amenable to inbound hostile acquisition. Theoretically, the sectors in which foreign investment exceeding 50%

[50]*Id.*

[51]Press Note No. 4 (2009 Series), Department of Industrial Policy and Promotion, CLARIFICATORY GUIDELINES ON DOWNSTREAM INVESTMENT BY INDIAN COMPANIES, §4.2.3, http://siadipp.nic.in/policy/changes/pn4_2009.pdf.

[52]Although this formality at least technically provides the RBI with an opportunity to delay consummation of a transaction by a politically unpopular hostile foreign acquirer.

[53]CHECK LIST FOR FIPB PLAIN PAPER APPLICATION, Department of Industrial Policy and Promotion cl. 7(a)–(b), http://finmin.nic.in/fipbweb/fipb/fipb_index.html.

is permissible under the automatic route are most likely to be acquired by a foreign raider.[54] From this perspective, Indian companies in the IT, mining, non-banking financial company ("NBFC"), agriculture, pharmaceuticals, and power sectors, amongst others, would be viable targets.[55]

Those sectors which are not amenable to foreign hostile acquisition are as follows: tea, cigars and cigarettes, defense, asset reconstruction, single-brand product retailing, commodity exchanges, courier services, telecommunications, credit information companies, insurance, certain mining activities, investing in infrastructure or services, public sector petroleum companies, broadcasting, print media, trading, and satellites.[56] These sectors are identified as being shielded from inbound hostile acquisition for one of two reasons: either the permissible foreign investment may be capped at less than 50% or the prior approval of the FIPB would be required, an approval which may be difficult to obtain given the possibility of nationalist sentiment arguments.

B. Investment by Foreign Institutional Investors

FIIs can invest up to a maximum of 10% of the total issued capital of an Indian company.[57] The cumulative holdings of all the FIIs put

[54]The sectors amenable to foreign investment are set out in Press Note 7 (2008 Series).
[55]CONSOLIDATED FDI POLICY, *supra* note 49.
[56]*Id.*
[57]Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995, §15(5)–(6), http://www.sebi.gov.in/acts/Foreign Institutional.html.

together cannot exceed 24%.[58] This limit of 24% can be increased to the sectoral cap as applicable to the Indian company concerned, by passing a resolution of its Board of Directors followed by a special resolution to that effect by its General Body and subject to prior approval from the Reserve Bank.[59]

C. Sale of Shares by Residents to Non-Residents

The transfer of shares by residents to non-residents by way of sale requires the approval of the RBI, when the transaction would attract the provisions of the Takeover Code.[60] Thus, the RBI may adopt protectionist strategies to thwart a potential inbound hostile acquisition.

But according to practitioners, this hurdle can be easily overcome. Per the Foreign Exchange Management Act, 1999, the term *resident* is inclusive of a corporation incorporated in India.[61] Accordingly, a foreign hostile acquirer that incorporates a wholly owned subsidiary in India can trigger the provisions of the Indian takeover law, without simultaneously conferring upon the RBI the authority to thwart its hostile acquisition attempt.[62]

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[58]RBI, Investment in Indian Companies by FIIs/NRIs/PIOs Regulations, Foreign Institutional Investors List, http://www.rbi.org.in/scripts/BS_FiiUSer.aspx.
[59]*Id.*
[60]RBI/2012-13/15 Master Circular No. 15/2012-13, MASTER CIRCULAR ON FOREIGN INVESTMENT IN INDIA, http://rbidocs.rbi.org.in/rdocs/notification/PDFs/15MF010712FLS.pdf.
[61]The Foreign Exchange Management Act, § 2 (v)(ii), No. 42, Acts of Parliament, 1999 (India).
[62]CHANDRACHUD, *supra* note 32.

D. The Defense under Press Note 2 and 4, 2009 Series

Press Note 2 and 4 (2009) allow Indian targets to devise interesting defensive strategies to ward off an enemy at the gate.[63] An understanding of the three kinds of companies, i.e. investing companies, operating companies and operating-cum-investing companies, can be instructive in understanding the scope of Press Note 2 and 4 (2009).

An investing company is one with no operations but only subsidiaries or investment. According to Press Note 4 (2009), foreign investment of pure holding or investing companies would require prior governmental approval.[64] Consequently, the nationalist sentiment underlying the decision making protocol of the FIPB may be detrimental to the interests of a potential raider.

An operating company is one with no subsidiary or investment in India. According to the renowned legal writer Mr. A Chandrachud companies that are conglomerates (i.e., companies with ingredients of business prohibited to foreign investment) pose an anomalous situation before a foreign raider.[65] For instance, when an operating company is functioning in both power and atomic energy, foreign investment would be allowed in the power sector under the automatic

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[63]Press Note 2 (2009 Series), Department of Industrial Policy and Promotion, GUIDELINES FOR CALCULATION OF TOTAL FOREIGN INVESTMENT I.E. DIRECT AND INDIRECT FOREIGN INVESTMENT IN INDIAN COMPANIES, *See also* Press Note 4 (2009 Series), Department of Industrial Policy and Promotion, CLARIFICATORY GUIDELINES ON DOWNSTREAM INVESTMENT BY INDIAN COMPANIES,§ 4.2.3.
[64]Press Note 4 (2009 Series), Department of Industrial Policy and Promotion, CLARIFICATORY GUIDELINES ON DOWNSTREAM INVESTMENT BY INDIAN COMPANIES,§ 4.2.3
[65]*Id.* 115 § 4.2.1.

route, but investment in the atomic energy sector would be forbidden. Consequently, such an operating company would be protected from the foreign hostile takeover attempt.

Operating-cum-investing companies also pose a similar problem to the foreign acquirer. Investment exceeding 50% by a foreign investor in a holding company is deemed to be an indirect investment in its subsidiary.[66]The said investment is to the full extent of the holding company's investment in the subsidiary unless the subsidiary itself is wholly owned. According to Mr. A Chandrachud, this may constitute a violation of the FDI policy, without (or sometimes irrespective of) approval.[67] To substantiate his standpoint, he articulates the following hypothetical: Company A, a foreign acquirer, invests 50.1% in Company B, an Indian holding company, which has a 90% stake in Company C, a company engaged in the gambling/lottery business, a sector prohibited to foreign investment. The 90% stake of Company B in Company C is considered indirect investment by the Company A in

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[66]Press Note 2 (2009 Series), Department of Industrial Policy and Promotion, GUIDELINES FOR CALCULATION OF TOTAL FOREIGN INVESTMENT I.E. DIRECT AND INDIRECT FOREIGN INVESTMENT IN INDIAN COMPANIES § 5.2.2.3. (To illustrate, if the indirect foreign investment is being calculated for Company A which has investment through an investing company B having foreign investment, the following would be the method of calculation:

(i) where Company B has foreign investment less than 50%- Company A would not be taken as having any indirect foreign investment through Company B.

(ii) where Company B has foreign investment of say 75% and:

a. invests 26% in Company A, the entire 26% investment by Company B would be treated as indirect foreign investment in Company A;

b. Invests 80% in Company A, the indirect foreign investment in Company A would be taken as 80%

c. where Company A is a wholly owned subsidiary of Company B (i.e. Company B owns 100% shares of Company A), then only 75% would be treated as indirect foreign equity and the balance 25% would be treated as resident held equity. The indirect foreign equity in Company A would be computed in the ratio of 75: 25 in the total investment of Company B in Company A).

[67]CHANDRACHUD, *supra* note 32.

Company C, thereby exposing the Company A to breach of foreign investment policy.[68]

VI. HOSTILE TAKEOVER UNDER THE TAKEOVER CODE, 2011

The Indian Takeover Code, 1997 was modelled on the U.K. City Code on Takeovers. Justice Bhagwati, the head of the panel empowered to develop the Code, envisaged the Code as a tool to enable promoters to consolidate holdings and better resist foreign takeovers. Nevertheless, the practitioners in the Indian corporate market are of the opinion that the 1997 Code did not present any direct barriers to hostile acquisition. No provision in the 1997 Code expressly required the acquiescence of the target company's board of directors for the successful operation of an open or conditional offer, which would be the route undertaken by a potential hostile acquirer.

In 2010, the Report of the Takeover Regulations Advisory Committee chaired by Mr. C. Achuthan, also did not frown upon or otherwise make recommendations against hostile acquisitions in its report.[69] Relying on the recommendations of the TRAC, SEBI eventually promulgated the Takeover Code, 2011. According to practitioners, the New Code has created impediments for acquirers in carrying out a hostile acquisition of a listed Indian company.

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[68] *Id.*

[69] Securities and Exchange Board of India, *Report of the Takeover Regulations Advisory Committee under the Chairmanship of Mr. C. Achuthan* http://www.sebi.gov.in/commreport/tracreport.pdf.

The central inquiry of this part deals with the anti-acquirer nature of the Takeover Code, 2011, along with explaining how creative lawyering can enable a potential raider to surmount such regulatory barriers.

A. *Early Warning Mechanism*

Indian corporations are cautioned about the predatory attempts of a prospective raider because of the early warning mechanism, which is built into India's Takeover Code. According to Regulation 7 of the erstwhile Takeover Code of 1997, an acquirer had to make a public disclosure within two days when his holdings exceeded the 5%, 10%, 14%, 54%, and 74% thresholds.[70]

Thereafter, relying on the recommendation of the TRAC Report, the Takeover Code of 2011 altered the said regulation significantly.[71] Thus, currently Regulation 29 of the Takeover Code, 2011 mandates that in cases where the acquired shares and voting rights together with any existing shares or voting rights of the acquirer and PAC amount to 5% or more of the shareholding of the target company, then the acquirer shall make disclosures of their aggregate shareholding and voting rights in such target company.[72] The said disclosures shall be made to the target corporation at its registered office and every stock exchange where its shares are listed. After having crossed the 5% threshold, every acquisition or disposal of shares of such target company representing 2% or more of the shares or voting, shall also be disclosed by the acquirer.

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[70]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, Gazette of India, § 7, http://www.sebi.gov.in/acts/act15a.pdf.
[71]CHANDRACHUD, *supra* note 32.
[72]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 29.

According to Mr. S.J. Mathew, this disclosure requirement serves as an early warning system to both the target corporation and its public shareholders. *Firstly*, the corporation is alerted about a potential threat from a raider and can avertibly issue shares to the shareholders under a pill plan. *Secondly*, the shareholders are signaled that in anticipation of a potential change of control they should demand a control premium for sales of their shares on the open market prior to any tender offer.[73]

Furthermore, the disclosure requirement under the present Takeover Code has to be made within two working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights in the target company. At this juncture, the author shall discuss the ramifications of the varying time-frames for filing the disclosures, prescribed under the Indian and American Takeover Codes. § 13(d)(1) of the American Securities Exchange Act, 1934 requires disclosure within ten days as opposed to two days under India's Takeover Code.[74] Thus, the American hostile acquirer benefits from ten days of permissible silence, as opposed to a meagre two days in India. In other words, after triggering the early warning scheme, a raider in America can make a mandatory public offering within the ten-day time frame granted for filing disclosures, and thereby diminish the capacity of the target's board to adopt reactive defensive measures. On the contrary, a raider in India gets an inadequate period of just two days, to this effect. This severely restricts the ability of an

[73]MATTHEW, *supra* note 10.
[74]See Laurie Smilan, David A. Becker & Dane A. Holbrook, *Preventing "Wolf Pack" Attacks,* NATIONAL LAW JOURNAL, http://www.lw.com/upload/pubContent/_pdf/pub1710_1.pdf.

Indian raider to circumvent the rigors of the early warning mechanism.

a) Disclosure Requirement

§ 25(3) of the Takeover Code, 2011 provides that the directors of the acquirer are responsible for the veracity of the information contained in the public statement, the letter of offer and the post-offer advertisement. These documents are circulated to the target shareholders in the context of a takeover. The practitioners criticize this provision by questioning why the acquirer should have to vouch for the publicly available information regarding the target or bear the liability for any false or misleading statements when that clearly should be the responsibility of the target directors. The stipulation of such an ambiguous requirement by SEBI imposes unnecessary due diligence requirement on the acquiring company and tends to regulate the hostile takeover activity in India in an opaque and indirect manner.[75]

b) Creeping Acquisition

Per the Takeover Code 2011, any Acquirer, holding 25% or more but less than the maximum permissible limit for non-public shareholding can purchase additional shares or voting rights of up to 5% every financial year, without requiring to make a public announcement for open offer. The Takeover Code, 2011 also lays down the manner of determination of the quantum of acquisition of such additional voting rights.[76]

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[75]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 25 (3).
[76]*Id.* Regulation 11 (1) and 11 (2).

This would be beneficial for the investors as well as the promoters, and more so for the latter, who can increase their shareholding in the company without necessarily purchasing shares from the stock market.

c) Competitive Bidding

Regulation 20 of the Takeover Code, 2011 delineates the concept of competitive bids, which tend to stave off both friendly and hostile takeover bids. Competing bids (i.e. those following the bids of the initial acquirer), requires that a subsequent bidder at least match the total number of shares that a first bidder would own if its offer were successful. The second bid must be made within fifteen days of the public announcement of the first offer.[77]

Renowned legal writer, Mr. A. Chandrachud, provides a fitting illustration elucidating the hurdles created by competitive bids to a potential raider. He explains that if a potential acquirer who previously owned no stock in a company launched an open offer for 51% and was topped by a counteroffer from the promoter, who already held 35% of the stock, for a total of 75% of the common stock, the potential acquirer would also have to offer to purchase up to 75% of the stock. Since the promoter is only offering to buy 40% of the stock as compared to the acquirer's 75% he can usually afford to pay more. Therefore, the pro-promoter undertone of competitive bids is more pronounced in India’s corporate environment due to the high level of share ownership by the Indian promoters.[78]

[77] *Id.* Regulation 20.
[78] *Supra* note 39.

Thus, it is fair to conclude that requiring a prospective raider to match the total potential holdings of the promoter works to the advantage of the promoter and makes bidding expensive for competitors.

d) Voluntary Open Offer

Taking a cue from the City Code on Takeovers and Mergers in the UK, the concept of *mandatory tender offer* or *open offer* was incorporated in the erstwhile Takeover Code of 1997.[79] The objective underlining the concept of *open offer* is to enable the minority shareholders to exit a corporation, after receiving the control premium from a predator who seeks to acquire their company. Accordingly, a shareholder or shareholder group on acquiring more than 15% of a company's shares was obligated to make a tender offer for at least an additional 20% of the target's shares.

The TRAC Report, 2002, which had articulated significant changes to the Takeover Code, 1997, had proposed to raise the open offer trigger from 15% to 25%. Moreover, the TRAC had recommended that the minimum tender offer size should be increased from 20% to the entire remaining share capital of the company (i.e. up to 100%).[80]

Furthermore, the Committee was of the opinion that increasing the mandatory open offer size to 100% would restrict the ability of substantial shareholders to consolidate their stake. Therefore, TRAC had proposed the concept of *voluntary open offer,* as an exception to the mandatory tender offer requirement. It is worth mentioning that in the Takeover Code, 1997, there was no distinct category as a

[79]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 14.
[80]Securities and Exchange Board of India, *Report of the Takeover Regulations Advisory Committee under the Chairmanship of C. Achuthan*, http://www.sebi.gov.in/commreport/tracreport.pdf.

voluntary tender offer. Under the proposed framework of the *voluntary open offer* route, the acquirers who collectively held shares entitling them to exercise 25% or more voting rights in the target company could voluntarily make an open offer with a minimum offer size of 10%.[81]

The Committee also observed that inasmuch as the *voluntary open offer* was permitted as an exception to the general rule on the offer size, the ability to voluntarily make an open offer was not be available if in the proximate past, any of such persons had acquired shares within the creeping acquisition limits. Similarly, such an acquirer was prohibited from making acquisitions outside the open offer during the offer period, and from making any further acquisitions for six months after the open offer. Also, such an offer had to conform to the maximum permissible non-public shareholding.[82]

The latest Takeover Code promulgated by SEBI in 2011, partially mirrors TRAC's recommendation as regards the introduction of a voluntary open offer, as an exception to the mandatory tender offer protocol. Under the Takeover Code, 2011, SEBI has increased the threshold for triggering the mandatory open offer requirement from 15% to 25%, along with increasing the open offer size from 20% to 26%. In addition to the mandatory tender offer route, the concept of voluntary tender offer has also been introduced. Regulation 6 of the new Takeover Code sets out the conditions for consummating a voluntary open offer, which can be summarized as follows:

[81] *Id.*
[82] *Id.*

1. A voluntary offer can be made only by a person who holds at least 25% shares in a company, but not more than 75% (taking account of the maximum permissible public shareholding).
2. A voluntary offer can be made only by a person who has not acquired any shares in the target company in the preceding 52 weeks prior to the offer. In other words, there is a 52-week moratorium on acquisitions before the acquirer can make a voluntary offer.
3. During the offer period, the acquirer cannot acquire shares other than through the voluntary offer.
4. Once the voluntary offer is completed, the acquirer shall not acquire further shares in the target company for 6 months after completion of the offer. However, this excludes acquisitions by making a competing offer.[83]

To take the discussion forward, the author shall now explain how Regulation 6 of the Takeover Code, 2011 has disregarded the context in which TRAC had imposed the conditions contingent to a voluntary open offer. It is submitted that the TRAC report had appended various conditions to a voluntary open offer, because a voluntary offer (with a size of only 10%) was considered as a lenient exception to the stringent general offer size of all the remaining shares of the company (i.e. up to 100%). While the final form in which the new Takeover Code was accepted makes significant deviations from the overall offer size requirements by limiting it to 26%, there was no attempt to address the consequential conditions for voluntary offer that were based on the general offer size being 100%. Although the purpose for the introduction of these conditions loses relevance with the non-acceptance of the 100% offer size requirement imposed by TRAC,

[83]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 6.

they have nevertheless found their way into the new Code leading to possible difficulties in effecting hostile takeovers.

Let us now examine the ramifications of Regulation 6 that make a classic hostile takeover almost impossible in the Indian context. *Firstly,* voluntary open offers can only be made by persons who already hold at least 25% stake in the target company. In other words, a hostile acquirer who does not hold any shares, or holds less than 25% shares, in the target cannot make a voluntary offer. He would first have to trigger the mandatory public offer requirement by crossing the 25% threshold, and only then can he float an open offer for an additional 10% shares under the voluntary open offer route. Consequently, deals like Mphasis (2006) are wholly implausible in the Indian context. In the instant deal, the US outsourcing major EDS had made a voluntary open offer to buy 52% of Jerry Rao promoted Mphasis. It is worth noting that EDS completed the Rs 1,750 croredeal by buying 83 million shares, even though it did not have any prior shareholding in Mphasis. But a similar deal cannot be orchestrated under the Indian Takeover Code.[84]

Secondly, the remaining conditions under Regulation 6 while arming the promoters with a provision to consolidate their holdings, puts in place time and shareholding restrictions on such offers; thereby, averting any nasty surprises from prospective raiders.

But through creative lawyering, a hostile bidder can circumvent the impediments erected by Regulation 6 of the Takeover Code, 2011. The requisites stated under Regulation 6 become applicable only

[84]*New Takeover Code will keep raiders away,* BUSINESS STANDARD (Sept. 30, 2011), http://www.business-standard.com/india/news/new-takeover-code-will-keep-raiders-away/450958/.

when a voluntary offer seeks to avail of the lower offer size of 10%, but not otherwise. In that sense, the voluntary offer mechanism is only an option that can be availed of by acquirers, but nothing in the Code prohibits them from making a full offer for all of the remaining shares of the company (or even the general offer size of 26% that has been now prescribed) without complying with these conditions. However, these matters are open to interpretation, and clarity from regulators would help create the certainty required of the legal environment on this essential aspect of takeovers under Indian law.[85]

VII. TAKEOVER DEFENSES

The lack of takeover defenses in the Indian regulatory framework places Indian firms in a precarious position. This part shall examine how Indian corporate law renders ineffective the traditional takeover defenses common in the United States, leaving target companies with few viable strategies to fend off hostile suitors.

A. Poison Pills

It is submitted that the in the U.S. context, the poison pill has proved a formidable defense, as no hostile bidder has ever triggered the modern poison pill[86] But the Indian regulatory framework has rendered ineffective the takeover defense of shareholder rights plan, or "poison pill" used by many U.S. corporations.

[85]Umakanth Varottil, *Hostile Takeovers under the New Code*, http://indiacorplaw.blogspot.in/2011/10/hostile-takeovers-under-new-code.html.
[86]Lucian A. Bebchuk, John C. Coates IV &Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STANFORD LAW REV. 887, 904 (2002).

In the United States a company with a traditional flip-in poison pill distributes special stock warrants or rights to its shareholders entitling them to purchase shares of the company at a substantial discount in the event of a hostile takeover attempt.[87] When a potential hostile acquirer crosses a threshold of share ownership (usually between 10% and 15%) without the permission of the company's board of directors, all target shareholders, with the important exception of the hostile bidder, become entitled to exercise these special rights and purchase the company's stock at a substantial discount.[88] Such a flip-in provision would dilute the value of the bidder's stake in the company substantially.[89]

It is imperative to note that a U.S. style shareholder rights plan would not function properly under Indian law. While an Indian company may be able to issue warrants that trigger when an acquiring person would cross a shareholding threshold to the exclusion of the acquiring person, these warrants cannot be exercised to buy shares at a substantial discount. In fact, per the ICDR Regulations, the exercise price of the warrant must not be lower than the average of the weekly high and low of the closing prices of the share on the stock exchange in the preceding six months or two weeks, whichever is higher.[90]

Thus, the pill mechanism is rendered ineffective as a takeover deterrent in India because without the ability to allow its shareholders to purchase discounted shares, an Indian company would not be able to dilute the stake of the acquiring person.

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[87] *Id.*
[88] *Id.*
[89] *Id.*
[90] Security and Exchange Board of India (Disclosure and Investor Protection) Guidelines (2000), 13.1.2.1 [hereinafter DIP Guidelines].

B. Staggered Boards

Let us now discuss how the much sought after defense option of staggered boards in the US is also rendered impotent by India's regulatory regime.

In the United States, a company with a poison pill may nevertheless, still remain vulnerable to a takeover because of a hostile acquirer may run a proxy contest for the control of the target board of directors. If the acquirer wins control of the board, it can simply vote to redeem the poison pill and commence a tender offer for equity control of the corporation. To prevent this situation, companies install staggered boards. Accordingly, only one-third of a company's directors are elected per year. Hence, for taking control of the board and redeeming the pill, a hostile acquirer usually must win at least two consecutive proxy contests over a minimum period of one year.[91]

In India, § 256 of the Companies Act by default mandates companies to maintain staggered boards.[92] But the problem in using staggered board as defense strategy arises because in India all directors can be removed without cause at any time by a simple majority of voting shareholders. It is submitted that the right to remove directors as such is guaranteed by Indian Companies Act and cannot be revoked by amendment to the charter or bylaws of an Indian company.[93] Thus, the staggered nature of the board does not serve as a defense as it does in the United States.

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[91]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 14.
[92]The Companies Act, 1956, § 256, No. 1, Acts of Parliament, 1956 (India).
[93]Saviprasad Rangaswamy, *An Effective Market for Corporate Control: Exploring its Practicability and Possible Benefits in India,* 49 LL.M THESIS, HARVARD LAW SCHOOL (on file with Harvard Law School library, Harvard University).

C. Scorched Earth Tactics

According to the renowned legal scholar, Shaun Mathew the only option before Indian target companies is to engage in tactics once prevalent in the United States before the advent of the poison pill. Scorched Earth tactics include threat to sell off crown jewel assets; raze factories or other measures intended purely to destroy the value of the target company in order to deter potential hostile suitors.

The Takeover Code, however, explicitly bars such behavior. § 23 provides that after the announcement of the tender offer the target company may not (i) sell, transfer, encumber or otherwise dispose of an asset outside of the ordinary course of business; (ii) issue or allot authorized but unissued securities carrying voting rights; or (iii) enter into any material contracts- without the approval of shareholders voting at a special meeting.[94]

According to Shaun Mathew creative advisors, however, may be able to circumvent the strict prohibitions of the Takeover Code. While the provision prohibits *entering* into material contracts, it does not enjoin *terminating* material contracts, actions that could quite significantly diminish the value of a target company.[95] Moreover, the Code permits the target company to encumber or sell its material assets if a simple majority of those voting at a special meeting acquiesce. In view of the historically low shareholder turnout at such meetings, most

[94]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Regulation 23.
[95]MATTHEW, *supra* note 10.

resolutions are very easy to pass given the typically high concentration of promoter holding.[96]

But it is worth noting that the Indian Companies Act has erected an inherent barrier to the exercise of the Scorched Earth tactics in India. It is submitted that calling a shareholder meeting to ratify such scorched earth tactics requires a minimum of twenty-one days' notice, which may not allow sufficient time for the target company to respond and call the meeting in the context of a pending open offer.[97] Additionally, according to practitioners, SEBI has indicated that it would take an extremely hard and fast line against a target company that acted inequitably in these settings.[98]

In nutshell it may be said that even the application of the scorched earth tactics in the context of deterring hostile takeover attempts in India also stands on tenuous grounds.

D. Embedded Defenses

Faced with the real prospect of being subject to hostile takeovers without adequate protective mechanisms such as the poison pill, and setting aside the putatively illegal scorched earth tactics described above, Indian companies seeking to protect themselves from foreign acquirers will undoubtedly seek out alternative defensive

[96] *Id.*
[97] The Companies Act, 1956, § 171, No. 1, Acts of Parliament, 1956 (India).
[98] MATTHEW, *supra* note 10.

mechanisms.[99] A so-called "embedded defense" is a term in an agreement with a third party that has an antitakeover effect.[100]

For instance, Tata Sons, according to one practitioner, has put into place a so-called "brand pill", essentially a contractual term that prevents a hostile bidder who succeeds in taking control of a Tata company from using the Tata brand name.[101] One may also consider the example of Larsen & Tubro that has created trusts that guarantee lifetime chairmanship provisions and long term rights of the promoters to nominate a certain percentage of the board of directors.[102]

Another type of defense substitution involves embedding takeover defenses into ordinary commercial contracts. Change of control provisions are the most common examples of embedded defenses, for example the contract may provide for rights to termination or some monetary penalty upon a change of control by the other party.[103]

Confronted with a hostile bid, managers (in the case of Indian companies, often managers appointed by boards controlled heavily by promoters) could offer extremely generous change of control penalties in their ordinary business contracts that would make the company significantly more expensive for a hostile bidder. The most

[99]This phenomenon is known in the United States corporate law literature as "defense substitution." See, e.g., Jennifer Arlen, *Regulating Post-Bid Embedded Defenses: Lessons from Oracle versus PeopleSoft* N.Y.U. LAW AND ECON. WORKING PAPER 64, 11 (2006) (discussing the "Problem of Defense Substitution").
[100]Guhan Subramanian, *The Emerging Problem of Embedded Defenses: Lessons from Airline Pilots Ass'n, Intn'l v. UAL Corp*., 120 HARV. L. REV.1239 (2007).
[101]RANGASWAMY, *supra* note 93.
[102]MATTHEW, *supra* note 10.
[103]Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV.577 (2003).

notable example of an embedded takeover defense in the United States is the People Soft Customer Assurance Plan, or CAP, which would have required a successful hostile bidder (Oracle) to make exorbitant payments to People Soft's existing customers if the level of customer service fell within the first four years of the customer's contract, thereby making a hostile takeover potentially more expensive and less attractive.[104]

Note that for an Indian company contemplating installing an analogous embedded defense, these contractual provisions could be entered into long before the offer period and hence would not run afoul of any of the §23 Takeover Code restrictions.

VIII. CONCLUSION

The principle argument in favor of hostile takeovers is their ability to "*perform a desirable disciplinary function by replacing inefficient management, deterring fiduciary abuse and enforcing greater sensitivity on the part of management to the market's judgment"*. These benefits notwithstanding, Indian regulators are concerned over how foreign hostile acquisitions might discourage entrepreneurship by inhibiting the development of home-grown Indian companies.

Given the new potential for hostile takeover battles in India's future and the absence of takeover defenses such as the poison pill and staggered board, India must replicate Delaware's well-developed takeover jurisprudence is an illustrative model for India to replicate. In its *Unocal* line of cases, Delaware courts have extended the

[104]Subramanian, *Bargaining in the Shadow of PeopleSoft's (Defective) Poison Pill,* 12 HARV. NEGOT. LAW REV.41 (2007). (By August 2004, the potential liability under the CAP was approximately $2billion, more than one-third of PeopleSoft's pre-bid market capitalization).

protection of the business judgment rule to directors defending against hostile takeovers who can demonstrate in good faith and after reasonable investigation that they perceived a threat to their corporate policy and effectiveness and that the defensive measures they authorized were reasonable in relation to the threat posed. A standard modelled after *Unocal* in India would effectuate *defense substitution* which is most likely to emerge once hostile takeovers in India become a reality.

Finally, improved co-ordination between the RBI and the FIPB, would instil greater confidence in the Indian regulatory apparatus. Thus, Indian policymakers should ensure that their stance vis-à-vis encouraging or discouraging foreign hostile takeovers should be clear to potential foreign acquirers and investors.