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Exploring the conception of Hostile Takeovers in India

Overviewing Defenses, Takeover Code & Barriers.

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ABSTRACT

When one firm obtains the voting shares of another corporation, either directly or indirectly, with the object of acquiring control over its management it is known as a 'takeover'. This process either occurs in a friendly or in a hostile manner. In the case of a hostile takeover, the acquirer obtains the corporation against the desire of the target company and the latter often makes attempts to dissuade the acquirer from taking over. In fact, these measures are frequently used as a leverage by target corporations in negotiations for larger offers. Some of these defenses are regulated strictly in India in comparison to others. Despite India's commercial boardrooms making several billion-dollar advancements in negotiating favorable agreements, the hostile takeover activities have been rather dormant. Moreover, India's business terminology is full of examples showing how the majority of hostile takeover efforts have been successfully averted. Through this paper, the researcher would attempt to: firstly, evaluate the conceptual viability of making hostile takeovers in India, as well as the defenses that local target companies may use to prevent such transactions; secondly, understand hostile takeovers vis-à-vis Takeovers Code, 2011 while shedding light upon its anti-acquirer nature; thirdly, examine the current barriers to hostile takeover activities in the country, including dominant promoter ownership and regulatory limits on obtaining finance and lastly, discuss the inefficiency of the defenses which renders the target firms in a vulnerable position against hostile bidders.

Keywords: *Takeovers, Takeovers Code, 2011, hostile takeovers, promoter, defenses, barriers.*

I. INTRODUCTION

India Inc. has changed into a profitable market for undertaking mergers and acquisitions ever since it embarked on the LPG bandwagon. In terms of mergers and acquisitions, 2010 was a booming year for India.[2] The numbers of M&A deals crossed a major threshold from $21.3

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[2] Thomson Reuters, '*Full Year 2011 Preliminary Review M&*A'.

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billion in 2009 to $68 billion in 2010.[3] Following that, the M&A deals in 2021 reached an **all-time surge** led by several first-time buyers that accounted for greater than 80% [which was less than 70% in 2017-19] of all the deals that concluded in 2020 and 2021.[4] In addition, plenty of other high-profile deals have signified the start of a boom in India's M&A activities. The Vodafone-Hutchison Essar $11.1 billion acquisition deal of a majority stake in India's fourth largest mobile phone firm along with the $13.2 billion Tata-Corus merger and the $11 billion Airtel-Zain agreement are some of the best instances of such deals[5]. Despite India's commercial boardrooms making several billion-dollar advancements in negotiating favorable agreements, the hostile takeover activities have been rather dormant. Moreover, India's business terminology is full of examples showing how the majority of hostile takeover efforts have been successfully averted[6].

As per the empirical studies, the lack of hostile takeover activities has been correlated with the presence of founding families' "promoters", with dominant ownership holdings. The promoters' position in India is fortified even further by the local financial institutions' long-standing support. Even the Indian Takeover Code has pre-promoter aspect to it, allowing promoters to consolidate their interests without having to bear penalties under the Code. Additionally, a typical hostile acquisition is also unlikely due to the requirement of numerous approvals and the intrinsic nationalist mentality prevalent in the Indian regulatory climate – making a successful hostile takeover to be an unlikely occurrence. **Through this paper**, the author seeks to evaluate the theoretical viability of undertaking hostile acquisitions in India as well as the defenses available to local targets for preventing such purchases. This paper further discusses the various components of the Takeover Code, 2011 while also questioning its efficiency. Lastly, the author delves into the various contemporary issues/barriers faced by local targets and gives suggestions posed by the author.

II. CONCEPTUAL VIABILITY OF MAKING HOSTILE TAKEOVERS IN INDIA

Even before the Takeover Code was enacted, the first ever hostile takeover effort in India was made by a British businessman, *Swaraj Paul* who was **unsuccessful** in his bid to purchase

[3] *Ibid.*
[4] IANS, *'India sees record M&A volume in 2021, first-time buyers lead',* THEECONOMICTIMES, (21st Dec, 2021, 11:55AM IST), *available at* - https://economictimes.indiatimes.com/news/company/corporate-trends/india-sees-record-ma-volume-in-2021-first-time-buyers-lead/articleshow/88406001.cms?from=mdr
[5] Agencies, '*Bharti, Zain to sign $10.7bn deal within days*', THEECONOMICTIMES, (25th Mar, 2010, 01:02 PM IST), *available at* - https://economictimes.indiatimes.com/industry/telecom/bharti-zain-to-sign-10-7-bn-deal-within-days/articleshow/5722231.cms
[6] The Raasi Cements acquisition by India Cements in 1998 was the only successful hostile takeover in Indian history.

Escorts Ltd. and DCM. Despite having a larger holding than the promoters[7], the corporation declined the registration of Paul's freshly acquired shares[8]. Additionally, he was also met with fierce opposition from the political groups and the Life Insurance Corporation [a financial organization owned by state with a minority shareholding]. Paul was eventually forced to withdraw his bid due to the unfortunate state of affairs. Fifteen years post Swaraj Paul's failed hostile takeover effort, the UK based ICI paint firm made a deal with one of the Asian Paint's co-founders to purchase his 9.1 percent ownership in the company. The remaining Asian Paints co-founders' growing criticism of such a strategy resulted in their refusal to register ICI's shares. Resultingly, the organization was pressured to sell off its ownership to UTI [which is a mutual fund owned by the government] and two other co-founders of Asian Paints. It was finally in 1998 that a predator successfully acquired an Indian Target by a hostile takeover strategy – India Cements purchased B.V. Raju's 32% ownership in Raasi Cements, as well as almost 20% of the shares in an open market. Despite the staunch opposition of Raasi Cement's founder and Indian financial Institutions, the company successfully acquired Raasi Cements in a privately settled arrangement.

Following that, in the year 2000, the Dalmia Group's aggressive effort to buy GESCO was halted by the white knight defense. The Dalmia Group had purchased a 10% stake in GESCO and had put up a bid for a further 45 percent of the company. The GESCO-famous Sheth family had teamed up with the Mahindra Group to purchase out the remaining float at a higher price. When the Mahindra-Sheth group purchased the Dalmia Group's 10% interest in GESCO, the hostile offer was averted. Emami Ltd.'s acquisition of Zandu Pharmaceutical Works Ltd., Pramod Jain's hostile attempt for Dalmia Group's Golden Tobacco Ltd., and HB Stockholding's moves to acquire DCM Shriram Industries Ltd. are all recent acquisitions having a heavy hostile nature. Other instances include the lengthy bidding fights between Temptation Foods Ltd. and Kohinoor Foods Ltd.; Grasim Industries Ltd. and Larsen & Turbo Ltd; and speculations of an Alcan Inc. and Sterlite Industry takeover of Hindalco Industries Ltd.

III. DISCUSSING THE DEFENSES AVAILABLE FOR LOCAL COMPANIES – *WHETHER SUFFICIENT?*

There exist at least two covert defensive systems in India that further obstruct the hostile acquisition methods/routes: *firstly,* **share transfer limitations** may limit the acquirer company's capacity to purchase shares from voluntary but contractually obliged sellers.

[7] Estimate of an 7.5% stake in Escorts and a 13% stake in DCM.
[8] The Companies Act of 1956, Ss. 111A (5), Acts of Parliament, 1956.

These limitations are difficult to apply in the settling of public enterprises. The Hon'ble Supreme Court of India has ruled that so as to the share transfer limitations be binding, they must be included into the Articles of Associations of a private origination[9]. However, the interplay of this obligation with the public enterprises is not totally obvious due to inconsistent High Court judgements[10]; *secondly,* to block the hostile takeover effort, **pooling arrangements** may make it essential for some shareholders to along with the promoters. These issues can be solved to some extent. It is contended that; these arrangements would not prohibit share transfers[11]. For example: requiring every organizational investor who buys an interest in a company to sign a pooling arrangement would not prevent the investor from exiting the company and selling his/her share to a hostile bidder. Indian enterprises are in a perilous situation due to the regulatory framework's lack of takeover protections. This section will look at how Indian corporate law renders standard takeover defenses useless, leaving target firms with few viable options for fending off aggressive bids. Indian enterprises are in a perilous situation due to the regulatory framework's lack of takeover protections. This section will look at how Indian corporate law renders standard takeover defenses useless, leaving target firms with few viable options for fending off aggressive bids.

A. *Poison Pills*

It is said that the poison pill has proven to be a powerful defense in the United States, as no hostile bidder has ever activated the contemporary poison pill.[12] However, the Indian regulatory structure has rendered the takeover defense of shareholder rights plans, sometimes known as "poison pills" worthless. Although an Indian corporation may be permitted to offer warrants that activate when an acquiring person crosses an ownership level that excludes the acquiring person, these warrants cannot be used to purchase shares at a significant discount. As a result, the pill mechanism is made useless as a takeover deterrent in India since an Indian firm would not be able to reduce the holding of the acquiring person without the capacity to allow its shareholders to acquire discounted shares.

B. *Staggered Boards*

A corporation with a poison pill may still be vulnerable to a takeover in the United States because a hostile acquirer may launch a proxy fight for control of the target board of

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[9] Rangaraj vs Gopalakrishnan, AIR (1992) SC 453.

[10] M/s Holdings Ltd. Vs Ruia, (2010) 159 Comp.Cas 29(Bom.)

[11] A. Chandrachud, *'The Merging Market for Corporate Control in India: Assessing Shark Repellents…',* 10 WASH. U. GLOBAL STUD. L. REV (2011), *available at* - https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1017&context=law_globalstudies

[12] L. Bebchuk, J Coates & G. Subramaniam, '*The powerful Antitakeover Force…*', 54 Stanford Law Rev. (May, 2022), *available at* - https://www.jstor.org/stable/1229689?seq=1

directors. If the acquirer gains control of the board of directors, it can simply vote to remove the poison pill and launch a tender offer for equity ownership of the company. Companies use staggered boards to avoid this scenario. As a result, just one-third of a company's board of directors is chosen each year. As a result, a hostile acquirer must typically win at least two consecutive proxy battles over a one-year period to gain control of the board and redeem the pill. In India, Section 256 of the Companies[13] Act requires companies to have staggered boards by default. However, the employment of a staggered board as a defensive strategy is complicated by the fact that in India, all directors can be dismissed at any moment without cause by a simple majority of voting shareholders. The right to dismiss directors as such is protected by the Indian Companies Act, according to the argument, and cannot be removed by amending an Indian company's charter or bylaws. As a result, unlike in the United States, the staggered design of the board does not function as a defense.

C. *Embedded defenses*

Faced with the real possibility of hostile takeovers without proper protection mechanisms like the poison pill, Indian companies seeking to protect themselves from foreign acquiring firms will undeniably seek out alternative defensive mechanisms. An "embedded defense" is a clause in a contract with a third party that prevents a takeover.[14] For example: Tata Sons has implemented a "brand pill", which is simply a contractual condition that precludes a hostile bidder who is successful in acquiring control of a Tata firm from utilizing the Tata brand name. Consider Larsen & Tubro, which has established trusts that ensure lifelong chairmanship provisions and long-term rights for promoters to select a specific percentage of the board of directors.[15]

IV. HOSTILE TAKEOVERS VIS-À-VIS TAKEOVERS CODE, 2011 – *SHEDDING LIGHT ON ITS 'ANTI-ACQUIRER' NATURE & OTHER CONTEMPORARY BARRIERS*

The 1997 Indian Takeover Code was based on the City Code on Takeovers in the United Kingdom. The leader of the commission tasked with developing the Code, Justice Bhagwati, saw the Code as a tool to help promoters consolidate their holdings and better fight foreign takeovers. Nonetheless, in the Indian corporate market, practitioners believe that the 1997 Code did not create any immediate hurdles to hostile takeover. Acquiescence of the

[13] The Companies Act, 1956 – Section 256 – '*Ascertainment of directors retiring by rotation and filling of vacancies'*

[14] G. Subramaniam, *'The emerging problem of embedded defenses…'*, Harvard Law Rev. Vol. 120:1239, *available at* - https://cdn.harvardlawreview.org/wp-content/uploads/pdfs/subramanian.pdf

[15] Shaun J. Mathew, *Hostile Takeovers in India: New prospects, Challenges and Regulatory Opportunities,* 3Colum. Bus. L. Rev. (1 Jun, 2007), *available at* - https://journals.library.columbia.edu/index.php/CBLR/article/view/2981

acquiree company's board of directors was not expressly needed under the 1997 Code for the effective operation of an unrestricted or conditional offer, which would be the path chosen by a possible hostile acquisition. The Report of the Takeover Regulations Advisory Committee [led by Mr. C. Achuthan] in 2010, did not condemn aggressive acquisitions or make any other recommendations against them. SEBI ultimately passed the Takeover Code in 2011, based on the TRAC's recommendations[16]. As per professionals, the New Code has made it more difficult for acquirers to make a hostile takeover of a publicly traded Indian firm. This chapter's main focus is on the anti-acquirer aspect of the Takeover Code of 2011, as well as how inventive lawyering might help a potential raider overcome such legal impediments.

- *Mechanism for Early Warning*

Due to the early warning systems established into India's Takeover Code, Indian firms are warned of predatory actions by potential raiders. When an acquirer's interests surpassed the 5%, 10%, 14%, 54%, and 74% levels, Regulation 7[17] of the former Takeover Code of 1997 mandates an acquirer to make a public statement within two days.[18] This disclosure obligation, according to Mr. S.J. Mathew, acts as an early warning system for both the target firm and its public shareholders. To begin, the corporation is notified to a potential raider risk and can offer shares to shareholders as soon as possible under a pill plan. Second, shareholders are advised to seek a control premium for open sales volume of their shares prior to any tender offer in anticipation of a prospective change of control.[19]

a) <u>Obligation to disclose</u>

The directors of the acquirer are accountable for the truthfulness of the information provided in the public statement, the letter of offer, and the post-offer marketing, according to Section 25(3)[20] of the Takeover Code, 2011. In the case of a takeover, these documents are distributed to the target stockholders. The practitioners attack this clause, querying why the acquirer should be required to vouch for publicly available facts about the target or face liability for any false or misleading representations made by the target directors, when the target directors should plainly be responsible.

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[16] Securities and Exchange Board of India, '*Report of the Takeover Regulations Advisory Committee under the Chairmanship of Mr. C. Achuthan'*, (2010), *available at* - http://www.sebi.gov.in/commreport/tracreport.pdf
[17] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 – Regulation 7 – *'Acquisition of 5 per cent and more shares or voting rights of a company'*
[18] Gazette of India, SEBI - Securities and Exchange Board of India [Substantial Acquisition of shares & Takeover Regulations] of 1997, *available at* - https://www.sebi.gov.in/acts/act15a.pdf
[19] Mathew, *supra* note 15.
[20] SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 – Section 25(3) – *'Obligations of the acquirer'*

b) Creeping Acquisition

According to the Takeover Code 2011, any Acquirer with a 25% or greater non-public shareholding but less than the acceptable limit for non-public shareholding can purchase up to 5% more shares or voting rights each financial year without having to make a public announcement for an open offer. The Takeover Code of 2011 further specifies how the amount of additional voting rights to be acquired is determined.[21] This would benefit both investors and promoters, particularly the latter, who would be able to grow their shareholding in the firm without having to buy shares on the public market.

c) Aggressive bidding

Competitive bids, as defined by Regulation 20[22] of the Code, tend to deter both friendly and aggressive takeover proposals. Competing bids (those that come after the first acquirer's offers) demand that a subsequent bidder hold at least the same number of shares as the first bidder if its offer is accepted. The second bid must be submitted within fifteen days following the initial offer's public release.

Regulation 6[23] has repercussions in India that make a traditional hostile takeover very difficult. To begin with, voluntary open proposals can only be made by those who own at least a 25% share in the target firm. In other words, a hostile acquirer who does not own any shares in the target or who owns less than 25% cannot make a voluntary offer. He would have to first fulfill the statutory public offer criterion by passing the 25% barrier, and only then could he use the voluntary open offer method to float an open offer for an additional 10% share. Second, although Regulation 6 provides the promoters with a possibility to consolidate their interests, it also imposes time and shareholding constraints on such offers, avoiding any unpleasant shocks from potential raiders. A hostile bidder, on the other hand, can get over the restrictions created by Regulation 6 of the Takeover Code, 2011 by using imaginative legal strategies. The requirements set out in Regulation 6 apply solely when a **voluntary offer intends to take advantage** of the smaller offer size of 10%, but not otherwise. In that sense, the voluntary offer mechanism is just an option available to acquirers; nevertheless, nothing in the Code prevents them from making a complete offer for all of the company's remaining shares (or even the new general offer size of 26 percent) without meeting these requirements. However, because these issues are susceptible to interpretation, clarification from regulators would aid in establishing the legal certainty that is necessary in the Indian legal context for

[21] Reg. 11 (1) and (2).
[22] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 – Regulation 20 – *'Competing Offers'*
[23] *Ibid* – Regulation 6 – *'Voluntary Offer'*

this critical part of takeovers.[24]

V. CONCLUSION & RECOMMENDATIONS

From the above discussion, we can assume that the Indian corporate law renders standard takeover defenses somewhat futile, leaving target firms with few viable options for fending off aggressive bids. Indian enterprises are in a perilous situation due to the regulatory framework's lack of takeover protections. Given the increasing possibility for hostile takeover fights in India's future and the lack of takeover defenses such as the poison pill and staggered board, India must mimic Delaware's well-developed takeover jurisprudence. Delaware courts have augmented the protection of the business judgement rule to directors defending against hostile takeovers who can demonstrate that they perceived a threat to their corporate policy and effectiveness in good faith and after reasonable investigation, and that the defensive measures they authorized were rational in relation to the threat posed. A military substitution norm modelled after Unocal in India would be most likely to arise after hostile takeovers in India became a reality. Finally, better coordination between the RBI and the FIPB will boost public trust in the Indian regulatory system. As a result, Indian officials should make it plain to potential foreign acquirers and investors what their position is on supporting or discouraging foreign hostile takeovers.

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[24] U. Varottil, *Hostile Takeovers under the New Code…,* INDIACORPLAW, (11th Oct, 2011), *available at* - https://indiacorplaw.in/2011/10/hostile-takeovers-under-new-code.html

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