HOSTILE TAKEOVERS IN INDIA: NEW PROSPECTS, CHALLENGES, AND REGULATORY OPPORTUNITIES

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I. INTRODUCTION

Merger and acquisition ("M&A") activity in India is booming. The Indian economy grew by 9.2% in 2006,[1] but M&A deal volumes grew much faster, up 54% to $28.2 billion in 2006.[2] The beginning of 2007 saw the signing of the largest inbound deal in India's history, Vodafone's $11.1 billion acquisition of a controlling interest in Hutchison Essar, India's fourth-largest mobile phone company,[3] while Tata Steel's $13.2 billion dollar acquisition of the European steelmaker, Corus, which closed in early January 2007, headlined a frenzy of acquisitions of foreign companies by Indian corporate enterprises in the past year.[4] From senior politicians to

[1] *India on Fire*, ECONOMIST, Feb. 1, 2007, *available at* http://www.economist.com.

[2] Ruth David, *Indian M&A Deals Set Yearly Record – By May*, June 12, 2007, *available at* http://www.forbes.com/markets/2007/06/12/india-mergers-record-markets-equity-cx_rd_0611markets39.html.

[3] Phineas Lambert, *Vodafone: Hutchison Essar on Track to Close*, DAILY DEAL, Mar. 29, 2007, *available at* http://www.thedeal.com.

[4] *See* Jonathan Braude, *Tata Wins Corus Auction*, DAILY DEAL, Jan. 1, 2007, *available at* http://www.thedeal.com. Wipro, Suzlon, Ranbaxy, Bharat Forge, and United Breweries, amongst others, each also completed major foreign acquisitions in 2006. *India's Acquisition Spree*, ECONOMIST, Oct. 12, 2006, *available at* http://www.economist.com. At the time of this

ordinary citizens, Indians have joined the business community in celebrating the recent M&A boom, confident that it is yet another indicator of India's recent and rapid economic ascent.[5] Even the wholly European takeover of Arcelor by Mittal Steel, orchestrated by Indian-born Lakshmi Mittal, drew the vocal support of the Indian government, with the Indian Commerce Minister, Kamal Nath, publicly imploring the French government to recognize that "globalization is not just a one-way street."[6]

The Indian government's relatively recent embrace of globalization and move away from the socialist policies of its past have inured to the advantage of its economy and its people, but at least one aspect of a truly global Indian economy remains undeveloped: a well-functioning market for corporate control. India's recent M&A boom has consisted exclusively of friendly deals, and since its economic liberalization in 1991, India has experienced only a handful of hostile takeover attempts.[7] The tide, however, may be turning. While Kamal Nath and much of the Indian establishment celebrated Lakshmi Mittal's hostile acquisition of Arcelor, the Tatas and Birlas, two of India's most prominent business families, openly acknowledged their fear of becoming Mittal's

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writing, Indian M&A deal volume in 2007 had already surpassed $50 billion. David, *supra* note 2.

[5] *See* Anand Giridharadas, *India is Reveling in Being the Buyer*, N.Y. TIMES, Feb. 6, 2007, at C8 ("Much of India erupted with jubilation last week when [Tata Steel won the bidding war for Corus] . . . as numerous Indian acquisition deals have been announced, a sense of new nationalism has emerged.").

[6] *Mittal Steels a Global March*, ECON. TIMES (India), June 26, 2006, *available at* https://news.helplinelaw.com/0606/econ_mittal.php ("Indian chests have swelled up with pride. Listen to finance minister P Chidambaram: '[w]e are happy and proud that an Indian-born entrepreneur is the biggest steel maker in the world.' Commerce and industry minister Kamal Nath, who did his bit to throw his voice behind Mittal in his hour of need, has this to say: 'I am happy that some countries have finally realised that globalisation is not a one-way street.'").

[7] The only successful hostile deal in Indian history was the acquisition of Raasi Cements by India Cements in 1998, described in detail in Part III, *infra*.

next target and took measures explicitly designed to protect themselves against a potential hostile foreign acquisition.[8]

But do the powerful Tatas and Birlas really have reason to worry? Many bankers and lawyers I met in India dismissed the potential for hostile takeovers in India as almost wholly implausible.[9] Hostile takeovers by foreign enterprises will not occur, they say, because of (i) the prevalence of founding families ("promoters") with dominant shareholding positions in most Indian corporations and the substantial shareholding of Indian financial institutions that generally side with promoters,[10] (ii) the necessity of obtaining onerous government approvals for foreign acquisitions that would make hostile takeovers impossible,[11] and (iii) provisions in the Indian Takeover Code that favor promoters.[12]

This paper challenges these contentions. Hostile takeovers have been rare and will likely continue to be rare in the immediate future, but not for the reasons typically proffered. The dearth of hostile takeover activity can be primarily explained by India's currently favorable economic climate:

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[8] *See Threat Distant, Says India Inc.*, BUS. STANDARD (India), July 6, 2006, *available at* http://news.india-travelers.com/422/threat-distant-says-india-inc; *Retail Holdings in Tata Steel Dip, Institutional Stakes Rise*, ECON. TIMES (India), July 6, 2006, *available at* http://economictimes.indiatimes.com/articleshow/msid-1709065,prtpage-1.cms.

[9] I spent three weeks in January 2007 interviewing corporate lawyers, investment bankers, and business leaders in India. I will keep the names of individuals I interviewed anonymous.

[10] *E.g.*, A leading investment banker I interviewed said that the primary reason for the dearth of hostile deals in India was the heavy concentration of promoter holdings, which he estimated at 20-30% in the average Indian company, and Financial Institutions ("FI") holdings, which he estimated also made up roughly 20-30% in the average Indian company. Another investment banker estimated the FI holdings at 10-15% on average.

[11] Interviews with practitioners.

[12] Interview with practitioner. *See also* Jairus Banaji, *Thwarting the Market for Corporate Control: Takeover Regulation in India*, QEH Conference Paper (Oxford), 3 *available at* http://www.qeh.ox.ac.uk/dissemination/conference-papers/banaji.pdf (citing the "widespread perception that the takeover regulations skew the balance in favour of the incumbent management (and, to this extent, make hostile takeovers more difficult)").

share prices continue to grow at record paces across the board among Indian companies, leaving few viable targets for hostile acquisitions.[13] However, assuming the business cycle ultimately runs its course and share prices fall, Indian companies will actually face the risk of hostile acquisitions, including those undertaken by foreign entities. My analysis of the shareholding composition, legal impediments and regulatory restrictions facing the BSE 100 companies in India suggests that at least 15% of Indian companies, including some of India's most prominent, face the prospect of being taken over by foreign acquirers without the consent of their respective promoters.[14] Indian financial institutions, it turns out, constitute a minuscule portion of shareholding in modern Indian companies, and hence have minimal influence on these takeover battles.[15] On the regulatory side, the Indian Takeover Code[16] does not erect any insurmountable obstacles to hostile acquisitions, and recent liberalizations by the Government of India make foreign acquisitions of Indian companies in most industrial sectors possible without material government approvals. Hostile takeovers of Indian companies are now a real possibility. And these Indian companies, unlike their counterparts in the United States, are particularly susceptible to hostile acquisitions, as Indian law prevents them from utilizing takeover defenses such as the poison pill and staggered board; indeed, aside from attempting to increase the already large stake of existing promoters, Indian companies today have few viable means with which to fend off hostile suitors.

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[13] *See Threat Distant, Says India Inc.*, *supra* note 8 ("Though a low stake could make these companies easy acquisition targets, promoters of most of these companies are not worried – their current high market capitalisation makes any hostile takeover bid a very costly affair.").

[14] *See* Part VI, *infra*. This analysis was based on the state of Indian law as of April 2007 and Indian company shareholding data as of December 31, 2006.

[15] *Id.*

[16] SEC. AND EXCH. BD. OF INDIA (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 1997, *available at* http://www.sebi.gov.in/acts/act15a.html [hereinafter TAKEOVER CODE].

Indian policymakers face an important regulatory opportunity. While the government has enacted policies that now permit foreign hostile takeovers, regulators still have the time and discretion to decide the extent to which the free market for corporate control that its policies currently permit (even if current economic conditions do not) is desirable for Indian companies, investors, and other stakeholders. Policymakers must first decide whether allowing increased foreign control of Indian companies, which comes with the associated benefits of scale, globalization, and improvements in managerial efficiencies, will outweigh the potential costs of weakening the development of powerful, home-grown Indian corporations like Tata Steel and Ranbaxy, which have made billion-dollar acquisitions of American and European companies. Irrespective of the course they ultimately choose, Indian regulators concerned with fostering foreign investment and promoting confidence in the Indian markets should ensure that, unlike under the current scheme, they make their policy intentions on hostile takeovers and defenses clear and consistent. I suggest that SEBI, India's securities regulator, drawing from the rich experience of Delaware takeover practice and jurisprudence, adopt a principles-based standard in the Takeover Code governing the actions that a takeover target would be permitted to undertake in response to a hostile bid. This standard should attempt to strike a balance between nurturing India's newly emerging global corporations and promoting efficient and value-creating investment into India.

This paper proceeds as follows. Part II offers a brief synopsis of the relevant Indian corporate law, with particular emphasis on the Indian Takeover Code. Part III discusses four hostile takeover attempts that have taken place in India in recent years. Part IV highlights the various challenges imposed by the current regulatory environment. Part V discusses takeover defenses available to Indian target boards of directors. Part VI analyzes the extent to which promoters inhibit hostile takeover activity in India through an examination of the shareholding composition of the BSE 100 and BSE 500 Indian companies, and Part VII concludes with a discussion of policies the Indian government and regulators should consider as they develop and refine the regulation of hostile takeovers in India going forward.

II. INDIAN CORPORATE LAW BACKGROUND

A. Takeover Code

The primary forms of business combinations in India resemble those found in the United States: mergers and tender offers. Because the merger process in both countries requires the consent of the board of directors of the target company, hostile transactions necessarily entail utilization of the tender offer route.[17]

The tender offer mechanism is governed by the Securities and Exchange Board of India ("SEBI") Takeover Code (the "Takeover Code" or the "Code").[18] The Takeover Code imposes disclosure requirements and governs the conditions for mandatory tender offers. When a shareholder or shareholder group[19] accumulates holdings in an Indian company

[17] Conducting a merger in India, governed by §§ 391-394 of the Companies Act, additionally requires the merging entities to propose a merger scheme for approval by the relevant regional High Court as well as by the majority of each company's shareholders and creditors. This process takes an average of six months, and shareholder or creditor objections can significantly lengthen the process. While it may appear peculiar to the American reader, the notion of mandatory judicial and creditor approval over a merger descends from British company law, and continues to be a fixture among many Commonwealth nations and several European nations. Entities choose the court-arranged route, despite its timing disadvantages, to minimize income taxes and also to insure against future liabilities stemming from the transaction. Interview with Practitioner.

[18] TAKEOVER CODE, *supra* note 16.

[19] A shareholder group, under the Takeover Code, includes the acquiring shareholder and "persons acting in concert" with the shareholder. TAKEOVER CODE, *supra* note 16, § 2(1)(b). "Persons acting in concert" are defined as "persons who, for a common objective or purpose of substantial acquisition of shares or voting rights or gaining control over the target company, pursuant to an agreement or understanding (formal or informal), directly or indirectly co-operate by acquiring or agreeing to acquire

exceeding 5%, 10%, 14%, 54%, or 74%, the Takeover Code requires the shareholder to disclose this shareholding to the company and to the relevant stock exchange.[20] This disclosure requirement serves as an early warning system to both the target corporation and its public shareholders, alerting the corporation to a potential threat and signaling to shareholders 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.

The Takeover Code also dictates conditions for mandatory tender offers. When a shareholder or shareholder group acquires more than 15% of a company's shares, it must make a public tender offer for at least an additional 20% of the company's shares (an "open offer").[21] The acquirer must make the offer at a price that by statute cannot be less than either (i) the average trading price of the company stock over a twenty-six or two-week period prior to the public announcement, whichever is higher, or (ii) any price paid by the acquirer and any persons acting in concert during a twenty-six week period prior to the announcement.[22] This rule seeks to ensure that public shareholders gain at least some of the control premium by forcing the acquirer to make a public offer. The concept of a mandatory offer is not unique to India: the City Code on Takeovers and Mergers in the U.K. also contains a mandatory tender offer provision, although it only applies after a shareholder acquires at least a 30% stake in a company, at which point the acquirer is required to make an offer for the entire company.[23]

If a shareholder holds between 15% and 55% of a company's shares, under what is known as the "creeping acquisi-

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shares or voting rights in the target company or control over the target company." *Id.* § 2(1)(e)(1).

[20] *Id.* § 7(1). *Compare* Williams Act, § 13(d)(1)(a). The Williams Act, which governs tender offers in the United States, requires public disclosure when a shareholder's holding exceeds 5% of a company's stock.

[21] TAKEOVER CODE, *supra* note 16, §§ 10, 21.

[22] *Id.* at § 20(4).

[23] THE CITY CODE ON TAKEOVERS AND MERGERS, 8th Ed., RULE 9.1, (UK), May 20, 2006.

tion" rule, it may continue to acquire up to 5% in the company stock each year.[24] If such a shareholder acquires more than 5% in a given year, this triggers a mandatory open offer for at least an additional 20% of the company's shares.[25] Once the shareholder's holding exceeds 55%, any additional share acquisition requires a mandatory open offer.[26] Some critics have denounced this rule as an unfair boon to promoters, who are able to slowly increase their stake by 5% without paying the control premium that would be required in an open offer.[27] The creeping acquisition has been the mechanism of choice for both the Tata and Birla groups in consolidating their holdings to protect against potential hostile acquirers.[28]

The specific percentage thresholds notwithstanding, the Takeover Code also imposes a principles-based standard that an acquirer may not acquire control over a company without making an open offer as specified above.[29] This provision attempts to cover indirect acquisitions of control through acquisition of parent companies and other mechanisms.

An acquirer seeking control over a corporation has the option to make either an open offer or a conditional offer. An open offer, as described above, must offer to purchase a minimum of 20% of the company shares; in a contest for control, the offer would conceivably be for a higher percentage. The major drawback to an open offer in a control contest, however, is that if shareholders do not tender sufficient shares for the acquirer to gain control, the acquirer must still purchase the shares tendered. In a conditional offer, on the

[24] TAKEOVER CODE, *supra* note 16, § 11.

[25] *Id.*

[26] This applies when shareholding is between 55% and the company's delisting threshold, which is either 75% or 90%. Once a shareholder or group exceeds the delisting threshold, the company may be delisted, but this currently is an extremely expensive and cumbersome process involving severe holdout problems with regard to the price that must be offered to shareholders.

[27] Banaji, *supra* note 12, at 5, 6.

[28] *See Threat distant, Says India Inc.*, *supra* note 8.

[29] TAKEOVER CODE, *supra* note 16, § 12.

other hand, the purchase of shares from the public is made conditional upon a certain level of shareholder acceptance.[30] While a conditional offer thus seems ideally suited to the hostile takeover situation, the primary drawback is that for shareholders who tender in a conditional offer that does not attain its conditional threshold, their shares remain stuck in escrow for thirty days, preventing them from selling out on the open market.[31] A hostile acquirer facing competition from a promoter seeking to consolidate its holdings using an open offer, which provides tendering shareholders immediate payment for their shares, may be better off taking the risk of an open offer.

The Takeover Code permits an acquirer to withdraw a bid under three limited circumstances: (i) when statutory approvals are denied; (ii) when a sole acquirer who is a natural person dies; and (iii) at SEBI's discretion.[32] Historically, SEBI has not granted exemptions and will force payment to shareholders despite requests to withdraw bids.[33] Without the bona fide possibility of withdrawing a bid, the *ex ante* risk and cost of making a bid increases tremendously, thereby deterring potentially efficient bids.

Competing bids (those following the bid of the initial acquirer) must be made within twenty-one days of the public announcement of the first offer.[34] While this provides some order to the bidding process, a three-week limit on competing bids may serve to stifle competition.

B. Categories of Shareholders

Understanding Indian corporate law also requires a discussion of the major categories of shareholders in Indian companies: promoters, Indian financial institutions, and for-

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[30] *Id.* § 21A. A conditional offeror may offer to purchase less than 20% of the company's shares so long as the acquirer deposits 50% of the consideration in escrow. *Id.* § 22(8)(i).

[31] Interview with practitioner.

[32] TAKEOVER CODE, *supra* note 16, § 27.

[33] Interview with practitioner.

[34] TAKEOVER CODE, *supra* note 16, § 25.

eign institutional investors. The Code defines a promoter broadly as "(a) any person who is in control of the target company [or] (b) any person named as promoter in any offer document of the target company or any shareholding pattern filed by the target company with the stock exchanges...."[35] Typically, promoters are founders or members of founding families of corporations, but for purposes of the Code, a non-founder with *de facto* control would also qualify for "promoter" designation. As will be illustrated in Part VI, *infra*, promoters maintain sizable stakes in most Indian companies today.

Indian financial institutions ("FI's") represent another relevant set of investors. Nearly every banker and lawyer I interviewed cited the historical loyalty of FI's to promoters as a significant impediment to hostile takeovers. These institutions, claimed the practitioners, often make decisions based on old business and personal contacts rather than purely economic considerations.[36] In the past, their sizable stakes in most major enterprises in India made them particularly influential. But today, as noted in Part VI, *infra*, given the increasing presence of mutual funds and foreign institutional investors, the average stake (and hence influence) of FI's in Indian companies has shrunk dramatically, averaging only a 2% share among the BSE 100 companies.[37]

Foreign institutional investors ("FII's"), which include many U.S. mutual funds, university endowments, and hedge funds investing in India, are rapidly increasing their stakes and influence in Indian companies. FII's must be registered with SEBI and the Reserve Bank of India ("RBI"), but this special designation gives them the right to buy and sell Indian securities, realize capital gains from Indian invest-

[35] *Id.* § 2(h).

[36] Interview with practitioners. *See also* Saviprasad Rangaswamy, *An Effective Market for Corporate Control: Exploring its Practicability and Possible Benefits in India*, 49 (May 2004) (LL.M Thesis, Harvard Law School) (on file with Harvard Law School library, Harvard University).

[37] *See infra* Part VI.

ments, and repatriate any gains made in India, *inter alia*.[38] The average FII stake in the BSE 100 exceeds 18%, or roughly nine times the average stake of the once-powerful Indian financial institutions.[39] In contrast to the FI's, foreign institutional investors (who have fewer links to the old business family elites and must take seriously the fiduciary duties they owe their investors to maximize returns) would be expected to vote based purely on economic interest and hence more likely in favor of a hostile acquisition that offered a significant premium.

III. HISTORY OF HOSTILE TAKEOVER ACTIVITY IN INDIA

Hostile takeovers occur rarely even in the most mature economies, so it should not be surprising that in India, where the economy was only liberalized in 1991, a mere dozen or so hostile takeovers have been attempted. The four cases below are meant to provide historical context to the current situation and illustrate some of the political and technical barriers that a foreign hostile acquirer might face today.

A. Swaraj Paul's failed bids for Escorts and DCM

In 1984, long before the liberalization of the Indian economy or the promulgation of the Takeover Code, British businessman Swaraj Paul attempted to unilaterally take control of two Indian corporations, Escorts Limited and DCM. Although he accumulated more than the promoters of each corporation (roughly 7.5% and 13% stakes in Escorts and DCM, respectively), the two companies resisted his takeover attempts and each blocked the transactions by refusing to register Paul's newly purchased shares.[40] The promoters

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[38] AMARCHAND MANGALDAS, DOING BUSINESS IN INDIA: A PRIMER, 3[RD] ED., 2006, at 26 [hereinafter AMARCHAND MANGALDAS].

[39] *See infra* Part VI.

[40] *See* John Elliott, *International Companies and Finance: India Gives Green Light to Paul Share Deals*, FIN. TIMES (UK), Sept. 20, 1983, at 22; Mahesh Kumar Tambi, *Indian Takeover Code: In Search of Excellence (A*

used their political clout against Paul, despite his personal ties to Prime Minister Indira Gandhi.[41] Paul was also opposed by The Life Insurance Corporation of India, a state-owned financial institution that held a minority stake in the companies. Paul finally retracted his bid.[42] Although unsuccessful, Paul's hostile threat sent shockwaves through the otherwise complacent Indian business world.

Current Indian law highly constrains the ability of a target company to refuse to register shares. 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.[43]

B. Asian Paints/ICI

Nearly fifteen years after Swaraj Paul's failed hostile bids, the Indian government and business community were still not prepared to accept a hostile foreign acquisition. ICI, a paint company headquartered in the U.K., agreed with Atul Choksey, the managing director and co-founder of an Indian paint company, Asian Paints, to purchase his 9.1% stake.[44] His three other co-founders, however, opposed his sale to a foreign party, and threatened to refuse to register ICI's shares in the same fashion as Escorts and DCM.[45] Ultimately, the government of India, through its Foreign Investment Promotion Board, ("FIPB") thwarted the bid, ruling that foreign acquirers taking control of an Indian company needed first to obtain approval of the board of directors of the

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Case Study Approach), ECONPAPERS, Apr. 15, 2005, *available at* http://econpapers.repec.org/paper/wpawuwpma/0504021.htm.

[41] *See* Tambi, *supra* note 40.

[42] *See id.*

[43] *See* Companies Act § 111A(5) (1956); Rangaswamy, *supra* note 36, at 36 (illustrating section 111A of the Companies Act as the new section allowing for free transferability of shares).

[44] *See India Rejects ICI Bid for Stake in Asian Paints, Ltd*, ASIA PULSE, Nov. 3, 1997.

[45] *Id.*

Indian target.[46] This was peculiar, given that the remaining co-founders retained well above ICI's 9.1% stake and hence would have maintained control over the company.[47] Without the support of the other three founders, however, the deal failed to win the ICI board's approval, and, as a result, ICI was ultimately forced to sell its stake in Asian Paints to UTI, a government-owned mutual fund, and to two other co-founders.[48]

According to a leading investment banker I interviewed, the FIPB was influenced by significant political lobbying in this situation.[49] As will be discussed in the next section, government approval of most foreign takeovers today only involves industrial sector-specific enforcement of limitations on foreign direct investment. Of course, a government keen to block a foreign takeover may find ways outside of the formal regulatory structure to scuttle such a bid.[50]

C. India Cements/Raasi Cements

The only hostile takeover in Indian history resulting in ultimate acquisition of the target by the hostile bidder occurred in 1998 when BV Raju sold his 32% stake in Raasi Cements to India Cements.[51] India Cements made an open offer for Raasi shares, and it acquired roughly 20% on the open market,[52] but faced resistance from the founders of

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46 *Id.*

47 *Id.*

48 Jayanthi Iyengar, *India's Takeover Restrictions Under Scrutiny*, ASIA TIMES ONLINE, Feb. 5, 2003, *available at* http://www.atimes.com/atimes/South_Asia/EB05Df02.html.

49 Interview with practitioner.

50 *See* Heather Timmons, *Marketplace: Nations Rebuild Barriers to Deals*, N.Y. TIMES, Feb. 28, 2006, at C1 (discussing increasing pattern of protectionism by U.S. and European politicians including the U.S. political outcry in response to proposed acquisitions by CNOOC and Dubai Ports and the French political response to the acquisition of Arcelor by Mittal Steel).

51 *ICL Succeeds in Raasi Cements Takeover*, STATESMAN (Kolkata), Apr. 6, 1998.

52 This preceded the current Takeover Code, which would have required a mandatory open offer after crossing the 15% threshold.

Raasi as well as the Indian financial institutions which also owned substantial stakes in the firm.[53] However, following a protracted battle which involved press conferences featuring the children and grandchildren of the founding family protesting the hostile bid, Raju ultimately sold out to India Cements in a privately negotiated transaction.[54]

D. GESCO

The Dalmia group's purchase and sale of its 10% stake in the real estate firm GESCO for an approximate 125% premium in 2000 is the closest India has come to greenmail.[55] This hostile bid, for 45% of the company, was only averted thanks to a white knight recruited by the founding Sheth family, the Mahindra group, which offered to buy-out the entire remaining float for an even higher premium.[56] After an intense bidding war that drove the initial offer price up roughly 100%, the Mahindra-Sheth group agreed to buy-out the Dalmias' 10% stake.[57]

IV. REGULATORY OBSTACLES TO HOSTILE TAKEOVERS

A foreign hostile acquirer no longer faces any insurmountable obstacles to executing a hostile takeover of an Indian company under India's current regulatory structure. While certain aspects of the Takeover Code make a hostile takeover challenging, nothing in the Code directly inhibits

[53] *Corporate Report: Drama in Hyderabad*, BUS. INDIA, Jan. 26, 1998.

[54] *Id.*

[55] Greenmail refers to a tactic that gained notoriety in the United States in the 1980s, where a raider buys up a significant stake in a target company, threatens to launch a hostile takeover, and then accepts a substantial above-market premium to sell back this stake in a privately negotiated transaction with the company. *See generally*, Jonathan R. Macey & Fred S. McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13 (1985) (arguing that greenmail actually advances shareholder interests).

[56] C. R. L. Narasimhan, *Greenmail: Winners and Losers – the GESCO Takeover Battle*, HINDU (India), Jan. 10, 2001.

[57] *Id.*

this process. Moreover, although some confusion exists with regard to foreign acquisitions of companies in the financial services sector, the current policies of the Ministry of Finance and RBI effectively permit foreign hostile acquisitions subject only to industrial sector-specific limitations on foreign direct investment ("FDI").

A. Takeover Code

The Takeover Code presents no direct barrier to a hostile acquisition. No provision in the Code expressly requires the acquiescence of the target company's board of directors for the successful execution of an open or conditional offer, which would be the route undertaken by a potential hostile acquirer. Indeed, the concept of open offers and creeping acquisition limits creates a mechanism by which hostile takeovers can be accomplished while balancing the need for shareholders to be paid a control premium.

Before addressing specific aspects of the Code, it should be noted that while the Indian Takeover Code was ostensibly modeled after the takeover-friendly U.K. City Code on Takeovers,[58] Justice Bhagwati, the head of the panel empowered to develop the Code, consistently proclaimed it to be a tool for allowing promoters to consolidate holdings and better resist foreign takeovers.[59] Indeed, the Indian press characterized the first draft of the Code as a "blueprint for shielding Indian managements."[60] Hence it is not a surprise that some Indian lawyers and bankers still tend to view the Takeover Code as biased against hostile acquirers.[61]

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[58] *See* Banaji, *supra* note 12, at 1.

[59] The notion of creeping acquisitions was defended as a measure "to protect Indian entrepreneurs from the big multinational corporations as the former cannot match the latter in financial strength." *Id.* at 4 (quoting *Takeover Code to Create Level Playing Field*, BUS. STANDARD, Jan. 20, 1997).

[60] *Id.* (quoting *Takeover Panel Drafts Plan to Shield Local Firms*, BUS. STANDARD, Nov. 26, 1996).

[61] I observed no consensus among the bankers and lawyers I interviewed, but some did believe the Code was biased in favor of incumbents.

According to some practitioners, certain disclosure requirements in the Code, as interpreted by SEBI, may require the acquirer to disclose and vouch for non-public information about the target, which would naturally be impossible without the cooperation of the target board and would in effect preclude a hostile takeover. Section 22(6) of the Code requires directors of the acquirer to accept responsibility for information contained in the various documents circulated to target shareholders in the context of a takeover including the public announcement of offer, brochure, letter of offer and any other promotional material sent to shareholders.[62] Ostensibly intended as a check on fraudulent promotion of the acquiring firm and the benefits of the takeover, the provision seems fairly pedestrian as securities regulations go. According to one set of practitioners I interviewed, however, including only publicly available information about the target in certain of the documents sent to shareholders may not be sufficient to satisfy SEBI. Attorneys for acquiring directors would be worried about liability for relying on potentially false or misleading information contained in the target's public filings in their offering documents. Such an interpretation appears to diverge from the purpose of the provision, which would be to encourage directors to ensure the veracity of information about their company. It is not at all clear 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 a responsibility of the target directors. However, if this interpretation is valid, SEBI would be regulating away the possibility of hostile takeovers by way of an ambiguous statutory interpretation that imposes a due diligence requirement on the acquiring company. Regulating hostile takeovers in such an opaque and indirect manner is not desirable. For the remainder of the paper, I will operate under the assumption that the Section 22(6) obligations, which at least on their face impose no due diligence requirement on acquiring com-

Id. at 3 ("The widespread perception that the takeover regulations skew the balance in favour of incumbent management . . . .")

[62] TAKEOVER CODE, *supra* note 16, § 22(6).

panies, do not irrevocably stand in the way of hostile takeovers.

Hostile acquirers must also cope with challenges imposed by the Takeover Code that even friendly acquirers face. Section 25, which deals with competitive bids, requires that a subsequent bidder at least match the total number of shares that a first bidder would own if its offer were successful.[63] For instance, 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.

This provision favors promoters in most cases in India because promoters in Indian companies tend to maintain high levels of share ownership. If the point of the provision is to ensure fairness to shareholders, it would require that each bidder offer to purchase up to the same number of shares; e.g., in the case above, since the promoter was willing to buy up to 40% of the company's shares, the potential acquirer, who had already bid for even more shares (51%), would not need to increase the size of his offer. Requiring the potential acquirer to match the total potential holdings of the promoter serves no ostensible purpose other than to advantage the promoter and make bidding expensive for competitors.

B. Government and RBI Approval of Foreign Acquisitions

While sector-specific caps on foreign direct investment and mandatory FIPB and RBI approvals previously eliminated the possibility of a hostile takeover of an Indian company by a foreign entity, recent government liberalizations now make a foreign hostile takeover a legal possibility. Foreign acquirers may face two special hurdles in mounting hostile takeovers: (i) foreign direct investment limitations in cer-

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[63] *Id.* § 25.

tain industrial sectors ("FDI caps") and/or (ii) the approval of one or both of the Reserve Bank of India, which regulates foreign investment for purposes of foreign exchange control, and the Foreign Investment Promotion Board, a division of the Ministry of Finance, which regulates foreign investment with regard to the government's industrial policy. While FDI caps were once very high in the most important industries, FDI limitations on percentage of foreign ownership now only materially affect a few important industries, increasing the number of targets available to foreign acquirers.[64] Moreover, while the current regulatory environment remains somewhat murky, it seems fairly clear that in areas not subject to FDI caps and not in the financial services sector, FIPB approval is no longer required, leaving only the technical formality of attaining RBI approval for adequacy of consideration.

C. FDI

The Indian government prescribes limits on foreign ownership of Indian companies based on industrial sector.[65] Following the liberalization of the Indian economy in 1991,[66] many sectors were opened up to foreign ownership, and under the so-called automatic route, FDI into certain sectors could be executed without FIPB or RBI approval.[67] In the telecom industry, for instance, foreign entities may own up to 74% of a mobile phone company, but FIPB approval is required for investments above 49%.[68] In the IT industry, on the other hand, foreign entities may control up to 100% of a company without prior approval under the automatic route.[69] Figure A below summarizes current Indian FDI policy for

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[64] *See* PLANNING COMM'N, GOV'T OF INDIA, REPORT OF THE STEERING GROUP ON FOREIGN DIRECT INVESTMENT 22 (2002).

[65] *Id.*

[66] This liberalization is known as India's New Industrial Policy. *See generally*, Mohan Pillay, ed., DOING BUSINESS IN INDIA, (Mohan Pillay, ed., Sweet and Maxwell Asia (Singapore), 2004), at 69 (discussing the historical context and some of the major economic reforms of 1991).

[67] *Id.*

[68] AMARCHAND MANGALDAS, *supra* note 38, at 39.

[69] *Id.* at 30.

ten major sectors. From the perspective of a foreign hostile acquirer, Indian companies in the IT, petroleum, non-banking financial company ("NBFC"), agriculture, pharmaceuticals, and energy sectors, amongst others, would be viable targets.

Figure A: FDI Sectoral Restrictions[70]

Sector	**FDI Permissible Without Regulatory Approval**	**Additional Restrictions**
Information Technology	100%	N/A
Telecommunications	49%	FDI up to 74% permitted with FIPB approval; management control must remain with Indian citizens
Petroleum	100%	Only 26% FDI permitted in public sector petroleum refining companies
Private Sector Banking	5%	FDI up to 74% permitted, but RBI approval required for any shareholding above 5%, and RBI policy against any single shareholder owning more than 10% in a bank; liberalization of banking sector expected in 2009
Non-Banking Financial Companies (NBFCs)	100%	Subject to minimum capitalization requirements

[70] Data compiled from AMARCHAND MANGALDAS, *supra* note 38, at 30-40, and PRESS NOTE NO. 4 (2006 SERIES), DEP'T OF INDUS. POLICY & PROMOTION, MINISTRY OF COMMERCE & INDUS., GOV'T OF INDIA, RATIONALISATION OF FDI POLICY ANNEX, 3-11 (2006) [hereinafter PRESS NOTE NO. 4].

Print Media	0%	FDI up to 100% permitted in publishing scientific/technical periodicals subject to regulatory approval; FDI up to 26% permitted in newspapers subject to regulatory approval
Agriculture	100%	FDI up to 100% permitted in tea sector subject to government approval and compulsory divestment of 26% equity to Indian partner within 5 years
Defense and Strategic Industries	0%	FDI up to 26% permitted subject to government approval
Pharmaceuticals	100%	N/A
Energy	100%	Excludes atomic energy, which requires government approval

D. FIPB/RBI

Until early 2006, 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 approval for a foreign entity's acquisition of control over an Indian company through the acquisition of shares.[71] While RBI approval required only that the consideration paid met minimum SEBI and RBI pricing guidelines, FIPB approval required a no-objection certificate from the board of the target company, thereby eliminating the possibility of conducting a hostile takeover. The Government of India lifted the FIPB approval requirement in February 2006. In a proclamation issued by the Department of Industrial Policy and

[71] *See, e.g.*, SECRETARIAT FOR INDUS. ASSISTANCE, DEP'T OF INDUS. POLICY AND PROMOTION, MINISTRY OF COMMERCE AND INDUS., GOV'T 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.").

Promotion, the Indian government decided to permit the transfer of shares from Indian residents to a foreign acquirer without any FIPB approval and subject only to FDI sectoral caps.[72] The only exception that remains is for Indian target companies with existing foreign joint-venture partners; however, even in these cases, the FIPB would require permission not of the target board but of the foreign joint-venture partner.[73] RBI approval also remains a requirement,[74] but its mandate that consideration be at or above market value is a matter of technical compliance that any serious hostile acquirer would be able to meet.[75] Thus, in most sectors of the Indian economy today, the Indian government no longer stands in the way of the free transfer of shares between Indian shareholders and foreign acquirers.

Some confusion currently exists with regard to acquisitions of shares by foreigners of Indian companies in the financial sector. An RBI Circular dated July 1, 2006, which summarizes its prior rulings (but fails to reconcile them with the FIPB rulings) currently insists that acquisitions of shares of Indian companies by foreigners in the financial sec-

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[72] PRESS NOTE NO. 4, *supra* note 70, at § 2e:

> To allow under the automatic route transfer of shares from residents to non-residents in financial services, and where Securities & Exchange Board of India (Substantial Acquisition and Takeover) Regulations are attracted, in cases where approvals are required from the Reserve Bank of India/Securities & Exchange Board of India (Substantial Acquisition and Takeover) Regulations/Insurance Regulatory & Development Authority. With this, transfer of shares from residents to non-residents, including acquisition of shares in an existing company would be on the automatic route subject to sectoral policy on FDI.

[73] *See* DEP'T OF INDUS. POLICY & PROMOTION, MINISTRY OF COMMERCE & INDUS., GOV'T OF INDIA, PRESS NOTE NO. 1 (2005).

[74] *See* RESERVE BANK OF INDIA A.P. DIR SERIES CIRCULAR NO. 16, FDIS: NO PRIOR FIPB APPROVAL FOR TRANSFER OF SHARES, para. 2 (2004).

[75] 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.

tor, contrary to the express intent of Press Note 4 of 2006,[76] requires both FIPB and RBI approval.[77] It is unclear whether this was an error or was intentional. A prominent attorney I spoke with insists that this is not a result of the RBI deliberately contradicting the FIPB, but of poor drafting and carelessness.[78] Whether intentional or mistaken, this regulatory inconsistency reduces confidence in Indian regulators and their commitment to facilitating foreign investment. The FIPB and RBI should more closely coordinate their regulatory statements to avoid such confusion.

V. TAKEOVER DEFENSES

Indian corporate law renders ineffective the traditional takeover defenses common in the United States, namely, the poison pill and staggered board, leaving target companies with few viable strategies to fend off hostile suitors. Given that the government's new policies now permit foreign hostile takeovers, the lack of takeover defenses places Indian firms in a precarious situation.

A. Poison Pills

The shareholder rights plan, or "poison pill" used by many U.S. corporations would be of no use to an Indian company. A company with a traditional flip-in poison pill in the

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[76] *See* PRESS NOTE NO. 4, *supra* note 70.

[77] RESERVE BANK OF INDIA MASTER CIRCULAR NO. 02/2006-07, at 15 (July 1, 2006) [hereinafter RBI MASTER CIRCULAR]

> A person resident in India who proposes to transfer any share or convertible debenture of an Indian company engaged in financial sector (*i.e.* Banks, NBFCs, Asset Reconstruction Companies and Insurance), and which attract the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, etc., by way of sale to a person resident outside India will have to obtain prior approval of FIPB, Ministry of Finance & Company Affairs, Government of India followed by permission from RBI. The above two stage approval is applicable even when the transfer is made on non-repatriation basis.

[78] Interview with practitioner.

United States distributes special stock warrants or rights to its shareholders that entitle shareholders to purchase shares of the company at a substantial discount in the event of a hostile takeover attempt.[79] In the event an "acquiring person" 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 (usually around 50%) discount.[80] This would dilute the value of the bidder's stake in the company substantially.[81] In the U.S. context, the pill has proved a formidable defense, as no hostile bidder has ever triggered the modern poison pill.[82]

A U.S.-style shareholder rights plan, however, would not function properly under Indian law. While an Indian company may be able to issue warrants that trigger upon the occasion of an acquiring person crossing a shareholding threshold and that exclude the acquiring person,[83] these warrants cannot be exercised to buy shares at a substantial discount; in fact, 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 pre-

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[79] *See* Lucian A. Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 904 (2002).

[80] *Id.*

[81] *Id.*

[82] *Id.* at 904-05.

[83] I cannot find any provision of the Indian Companies Act of 1956, the DIP GUIDELINES, *infra* note 84, or the Takeover Code that would proscribe this type of warrant, but nearly every banker and lawyer I interviewed asserted that any kind of security that discriminated against an acquiring person would be invalid. Some practitioners cite Section 81 of the Companies Act, which requires that any post-IPO issuance of securities to company shareholders be offered in proportion to existing shareholding absent a special resolution, *see, e.g.*, Rangaswamy, *supra* note 36, but poison pill warrants could be distributed in proportion to shareholding without impairment—the discriminatory element of the pill comes in the ability to exercise the rights, not in the initial distribution of the rights.

ceding six months or two weeks, whichever is higher.[84] 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, thereby rendering the pill mechanism ineffective as a takeover deterrent.

While an exact replica of a flip-in pill may not be effective under Indian law, creative lawyering may yet devise a suitable analogue that complies with Indian law. Indeed, note that the impediment to a U.S.-style poison pill in India comes from the Disclosure and Investor Protection Guidelines and not the Takeover Code. The Takeover Code can actually be read to encourage a U.S.-style pill: while Section 23 prohibits the issue or allotment of authorized but unissued securities during the voting period without shareholder approval, it makes an explicit exception for the right of a target company to issue or allot shares upon exercise of warrants as per pre-determined terms of conversion.

B. Staggered Boards

Staggered boards, another staple in the American takeover defense arsenal, are also rendered impotent as takeover defenses by Indian law. In the United States, a company with a poison pill remains vulnerable to a takeover because of the ability of a hostile acquirer to 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, in which case only one-third of a company's directors are elected per year. Hence, a hostile acquirer usually must win at least two proxy contests over a minimum period of one year (and usually longer) in order to take control of the board and redeem the pill.[85]

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[84] SEC. AND EXCH. BD. OF INDIA (DISCLOSURE AND INVESTOR PROTECTION) GUIDELINES (2000), 13.1.2.1 [hereinafter DIP GUIDELINES].

[85] *See generally* Bebchuk et al., *supra* note 79 (arguing that courts should not allow target boards to maintain a poison pill after having lost one election conducted over a hostile acquisition offer). Note that while an

In India, Section 256 of the Companies Act actually requires companies to maintain staggered boards by default.[86] However, because all directors can be removed without cause at any time by a simple majority of voting shareholders, the staggered nature of the board does not serve as a defense as it does in the United States.[87] Indeed, the right to remove directors as such is guaranteed by statute and cannot be revoked by amendment to the charter or bylaws of an Indian company.[88]

Proxy contests, which are critical in U.S. takeover battles, are both unnecessary and essentially prohibited in India. Acquirers in the United States run tender offers parallel with proxy contests for control over the board because the poison pill prevents them from gaining majority control of the company's shares through a tender offer. Without the hindrance of the pill, an Indian hostile acquirer need not bother running a parallel proxy contest; if he can win the proxy contest he should also be able to acquire sufficient shares in an open offer to take control of the company. More importantly, however, Section 22(7) of the Takeover Code prohibits an acquirer from being appointed to the board of the target company during the offer period.[89]

C. Scorched Earth Tactics

What defenses are available to a besieged Indian company? According to a leading investment banker I interviewed, target companies may engage in tactics once prevalent in the United States before the advent of the poison pill. Threatening to sell off crown jewel assets and employing

acquirer may also attempt in the first proxy contest to hold a shareholder vote to remove the directors not standing for election, this may involve an onerous supermajority requirement or even be completely proscribed by charter provisions or bylaws that prevent removal of directors by shareholders without cause. Attempting to remove a director for cause would also be possible but unlikely to succeed.

[86] The Companies Act § 256 (1956).

[87] *See id.* § 284.

[88] Rangaswamy, *supra* note 36, at 46.

[89] TAKEOVER CODE, *supra* note 16, § 22(7).

other scorched earth tactics such as threatening to raze factories or other measures intended purely to destroy the value of the target company have apparently been used successfully as threats to deter potential hostile suitors.[90]

The Takeover Code, however, explicitly enjoins such behavior. Section 23 restricts the behavior of the target board of directors during the offer period. Primarily, the section provides that without approval of shareholders voting at a special meeting after the announcement of the 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.[91]

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. 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.[92] According to several practitioners I interviewed, shareholder turnout has historically been very low at such meetings, making most resolutions very easy to pass given the typically high concentration of promoter holding. What's more, even without shareholder ratification, sale of a material asset, for instance, might trigger a lawsuit. Since a lawsuit might take a significant amount of time to resolve, particularly in the notoriously congested dockets of Indian courts, the timing of the bid and perhaps the economics of the transaction would certainly be disrupted.

On the other hand, 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

[90] Interview with practitioner.

[91] TAKEOVER CODE, *supra* note 16, § 23.

[92] *Id.*

target company to respond and call the meeting in the context of a pending open offer.[93] Moreover, it is also unclear that the traditional patterns of shareholder attendance would remain consistently low in a situation where a hostile suitor has offered a significant premium and is being fought off through value-destroying moves by the target company. Indeed, 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.[94]

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 mechanisms.[95] According to some lawyers I interviewed, this "defense substitution" has already begun. For instance, at least one Indian company 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.[96] 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.[97] To my knowledge, none of these provisions have been tested in any Indian court for adherence to any sort of fiduciary duty.

[93] The Companies Act § 171 (1956).

[94] Interview with practitioner.

[95] 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").

[96] Interviews with practitioners. *See also* Rangaswamy, *supra* note 36, at 44 (discussing Larsen & Toubro's use of company-financed employee trusts which guarantee two directors on the board).

[97] Interview with practitioner.

Another type of defense substitution involves embedding takeover defenses into ordinary commercial contracts. A so-called "embedded defense"[98] is a term in an agreement with a third party that has an antitakeover effect.[99] Change of control provisions are the most common examples of embedded defenses: to protect the interests of a counterparty customer, supplier, or lender, e.g., the contract may provide for rights to termination or some monetary penalty upon a change of control by the other party. Such provisions often serve legitimate business purposes that reduce the costs of contracting and hence create value,[100] but such provisions could also be used by a company's management to deter hostile bidders. 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 notable example of an embedded takeover defense in the United States is the PeopleSoft Customer Assurance Plan, or CAP, which would have required a successful hostile bidder (Oracle) to make exorbitant payments to PeopleSoft'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.[101] 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 Section 23 Takeover Code restrictions.

[98] The term was first introduced to the literature in Jennifer Arlen & Eric Tally, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577, 582 (2003).

[99] 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).

[100] Arlen & Tally, *supra* note 98, at 582-83.

[101] "By August 2004, the potential liability under the CAP was approximately $2 billion, more than one-third of PeopleSoft's pre-bid market capitalization." Subramanian, *supra* note 99, at 1244.

Most importantly, because they would be embedded into customer contracts, such provisions could not be easily rescinded by the new owner.

While scorched earth tactics have the clear potential to destroy shareholder value and reduce the number of efficient takeovers, the propriety of embedded defenses is far less clear. On one hand, target companies need a reasonable means of responding to situations where hostile bids threaten to severely disrupt their day-to-day business operations. In the case of PeopleSoft, Oracle's public threats to either substantially diminish, not support, or completely discontinue PeopleSoft's software presented an immediate business problem for PeopleSoft in dealing with its own customers, who were understandably worried about the future support obligations of their products.[102] The CAP, which provided a significant reimbursement in case Oracle were to acquire the company and follow through on its threats, could be seen as calibrated to address that concern. On the other hand, embedded defenses allow target boards to block takeovers without the transparency of enacting a poison pill or other explicit takeover defense. Unlike enacting a poison pill or staggering a board—actions which require formal actions of the board of directors, management can embed defenses into ordinary contracts unilaterally and without board approval. Viewed in this light, these defenses have the potential to do legitimately through customer contracts what scorched earth tactics did illegitimately: threaten to destroy company value upon a change of control.

E. Appealing to Political Nationalism

Indian companies attempting to fend off hostile bids from foreign acquirers may also resort to the political arena. As described in Part III, *supra*, Indian politicians intent on stopping a deal could probably do so by imposing regulatory barriers, employing delaying tactics with SEBI, or using other indirect means. Of course, such behavior is not con-

[102] Arlen, *supra* note 95, at 16.

fined to developing countries, as the CNOOC and Dubai Ports episodes in the United States amply demonstrated.[103]

F. Promoter Stakes

Finally, in the Indian context, perhaps the most effective defense against a hostile takeover is a dominant promoter. As will be quantified in the following section, most Indian companies have promoters with substantial, if not majority, stakes. A promoter seeking to deter future hostile bids might follow the lead of Tata Sons and the Birla group and begin consolidating its holdings under the creeping acquisition allowance each year.[104] While such a strategy may be effective as a takeover defense, the allocation of capital by some of India's largest industrialists to their respective companies for the sole purpose of defending against potential takeovers may be deleterious to the efficiency and growth of the Indian economy. By permitting some form of takeover defense for Indian companies, SEBI could help ensure that India's capital is allocated efficiently, based on economic, rather than defensive, considerations.

Clearly, a promoter owning more than 50% of a company renders the company takeover-proof, but even owning over 25% can serve as an effective defense. Mergers and certain other substantial undertakings must be approved by special resolutions, which require three-fourths majorities of shareholders under Indian company law.[105] Thus, a promoter with just over a 25% stake attempting to combat a hostile takeover 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 hos-

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[103] *See* Timmons, *supra* note 50 (discussing the increasing pattern of protectionism by U.S. and European politicians, including the U.S. political outcry in response to proposed acquisitions by CNOOC and Dubai Ports and the French political response to the acquisition of Arcelor by Mittal Steel).

[104] *See Threat Distant, Says India Inc.*, *supra* note 8.

[105] *See* Rangaswamy, *supra* note 36, at 47.

tile 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.

VI. EMPIRICAL ANALYSIS OF SHAREHOLDING DATA

Since they operate in a regulatory environment that no longer inhibits unsolicited foreign acquisitions and that prevents companies from utilizing traditional takeover defenses, Indian companies appear quite vulnerable to hostile takeovers by foreign acquirers. Yet, as an empirical matter, hostile takeover attempts in India have been and remain exceptionally rare. Why? The dearth of hostile takeover activity by foreign firms is a product of the relatively recent and somewhat confusing regulatory changes that now permit foreign hostile acquisitions, the currently robust Indian stock market that has made Indian targets fairly expensive,[106] and most importantly, the prevalence of promoters with sizable stakes in Indian companies. Yet these factors will not protect Indian companies forever. The regulatory regime will likely become clearer and stock prices will inevitably drop off from their current highs. Moreover, as the data suggests below, even today, a significant portion of Indian companies are vulnerable to hostile acquisitions, despite the presence of promoters.

[106] One of the best defenses to a hostile takeover bid is a high share price, and with the Indian economy growing at a rapid 8% pace, very few investors are eager to sell. Indeed, the brief period during which hostile takeover attempts occurred in the late 1990s and early 2000s came during a period of depressed share prices in India. Currently, the Indian stock market is at an all-time high, with several analysts warning of a potential bubble. This is hardly the opportune moment for hostile takeovers, which make more economic sense when companies are undervalued. Of course, if the analysts are correct and the bubble does burst, it may present a large opportunity for potential hostile bidders to make structural and managerial changes to improve financially weak companies, while exploiting low share prices to make quick profits.

A. Promoters: India's Most Potent Takeover Defense?

Notwithstanding a regulatory environment that permits hostile takeovers and prevents takeover defenses, the Indian practitioners I met almost universally rejected the prospect of foreign hostile takeovers because founding families typically hold large stakes in most Indian companies. I decided to further examine the shareholdings of Indian companies to test their intuition. Through an analysis of shareholding pattern data from 500 Indian companies, I found that while promoters on average do retain remarkably high stakes in Indian companies, a small but significant number of Indian companies, including some of India's largest and most prominent, have promoters with sufficiently low holdings such that they could be subject to a successful hostile takeover acquisition.

I gathered data on company shareholdings from the shareholding pattern disclosures available from the websites of India's two largest stock exchanges, the Bombay Stock Exchange and the National Stock Exchange.[107] I examined data from the 100 companies constituting the BSE 100, a broad-ranging national index with a total market capitalization of nearly $850 billion,[108] and the 500 companies of the BSE 500, which represents nearly 93% of the total market capitalization of the entire Bombay Stock Exchange.[109] The NSE website provided the most recent and detailed shareholding data, from December 31, 2006, so I extracted company data from the NSE website whenever possible. Since most Indian companies list on both exchanges, I only needed to consult the BSE website data for a few companies.[110]

The shareholding pattern data supplied to the stock exchanges provide a detailed glimpse into the shareholding

[107] *See* http://www.bseindia.com and http://www.nseindia.com.

[108] As of April 13, 2007, the BSE 100 had a total market capitalization of 36,602,388,300,000 Indian Rupees ("INR"), and I converted using the exchange rate as of April 15, 2007 of 42.4 INR/USD.

[109] *See* http://www.bseindia.com/about/abindices/bse500.asp.

[110] Another difference is that the BSE data lump together shareholding of insurance companies and financial institutions.

composition of the company. The relevant data points I analyzed were the respective shareholding stakes of the (i) promoters, (ii) Indian financial institutions, (iii) mutual funds, (iv) insurance companies, (v) central and state governments, (vi) foreign institutional investors, and (vii) non-institutional public investors.

As illustrated in Figure B, the average BSE 100 company has a promoter who owns over 48% of the company. Only ten of the BSE 100 companies have promoters holding stakes below the critical 25% threshold,[111] although this list includes new economy leaders Infosys and Satyam Computers. Looking at the broader BSE 500 set of companies produces similar results: the average promoter owns roughly 49%, and fewer than 9% of promoters have stakes below 25%. This high average concentration of promoter holdings was consistent with the predictions of practitioners.

Figure B: Summary of BSE 100 and BSE 500 Shareholding Data

	BSE 100	BSE 500
Average Promoter Stake	48.09%	49.55%
Average Indian Financial Institution Stake	2.00%	1.73%
Average Foreign Institutional Investor Stake	18.56%	12.31%
Average Non-Institutional Public Stake	20.24%	26.33%
Percentage of Companies Vulnerable to Hostile Takeover *	15.00%-27.00%	8.20%-22.00%

* I define a company as vulnerable to hostile takeover as having (i) promoter + FI stake < 45%; (ii) Mutual Fund + FII + Insurance Company + 0.5(Non-institutional public) stake > 50% or Mutual Fund + FII + Insurance Company + 0.75(Non-institutional public) stake > 50%; and (iii) being in an industrial sector that permits FDI > 50% without FIPB or RBI approval.

[111] Three-fourths majorities are required for special resolutions. *See* Rangaswamy, *supra* note 36, at 47.

However, the Indian FI's, which practitioners often suggested would play a major role in deterring takeovers, as they have historically sided with promoters, held a minuscule 2% average stake in the BSE 100 companies (1.73% in the BSE 500). Whether or not these financial institutions continue to place loyalty to promoters above any fiduciary duties to shareholders, given their inconsequential shareholding they will play very little role in blocking hostile takeover attempts. It might be interesting to study how precipitously their shareholdings have fallen over the years, given that practitioners had estimated their holdings to be much higher.

Foreign institutional investors, on the other hand, held an average stake of nearly 20% of the average BSE 100 company (12% on average in the BSE 500).[112] Given their relatively high average stake, a figure which can be expected to rise over time, FII's can be expected to play an increasingly influential role in future hostile takeover fights in India. For the purposes of my analysis, I have also included stakes of foreign venture capital investors ("FVCI's") in the FII category, but this only affected a very small number of BSE 100 companies.

Non-institutional public shareholders hold 20% on average in BSE 100 companies and over 25% on average in the BSE 500. These figures should also be expected to rise over time as the rapidly expanding middle and upper classes of Indians begin investing their money in the stock market.

I attempted to analyze which companies could be viable hostile takeover targets based on the shareholding of promoters and other investors. Myriad factors come into play in assessing vulnerability to a hostile takeover beyond mere shareholding composition, but, as a threshold matter, more than 50% of the shares must be outside the hands of the promoter and publicly available for a tender offer. While this would prove to be a trivial exercise in the United States, where a vast majority of the S&P 500 companies have no

[112] FII stakes in BSE 500 companies may be lower because foreign investors on the margin prefer to invest in the larger, more profitable, and more well-known Indian companies.

controlling shareholder at all, remember that American companies, unlike their Indian counterparts, can resist unsolicited and unwanted overtures using takeover defenses.

As I have defined the term, an Indian company is susceptible to being taken over if (i) its promoter and the FI's do not together own a majority of its stock,[113] (ii) it is not in an FDI sector that prohibits greater than 49% control by a foreigner without government approval,[114] and (iii) there is public shareholding sufficient to tender over 50% of company shares.

I eliminated all companies designated as "Finance" from my tally of companies susceptible to hostile takeovers despite the FDI policy of allowing up to 100% ownership of non-banking financial companies ("NBFCs") because of the difficulty in determining which firms are NBFCs rather than normal banking firms (which may not be acquired without government approval) and the confusion that still persists with regard to the RBI's requirement that acquisition of shares of financial institutions by foreign companies requires RBI and FIPB approval.[115] Interestingly, finance companies were otherwise the most susceptible companies, with many having zero promoter stakes. Further liberalization of the banking and financial services sector is expected in 2009,[116] and at least one practitioner maintained that these companies may be prime targets for takeovers when that occurs.

With regard to public shareholding, I added the shares of mutual funds, FII's, insurance companies, and the non-institutional public; that is to say, the sum of everything besides the promoters, the FI's, and the government. However, I assume that the Indian market is still not entirely liquid and hence even in a hostile situation in which an acquirer

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[113] I used 45% as the cut-off point because promoters can accumulate up to 5% of company stock each year under the creeping acquisition rule in the Takeover Code.

[114] Banking and Telecom are two major sectors that cannot be penetrated without government approval today.

[115] *See* Part IV, *supra*, and RBI MASTER CIRCULAR, *supra* note 77, at 15.

[116] *See* AMARCHAND MANGALDAS, *supra* note 38, at 35-36.

submits a clearly superior bid, I do not expect that all non-institutional shareholders will tender. It is not clear what the turnout rate for such a battle would be, given the lack of precedent, but based on my conversations with practitioners, I believe the non-public institutional turnout would not be close to 100%. Hence, in tabulating the available non-promoter aligned voting stakes, I weight the non-institutional public shareholder stake by both 50% and 75%. These numbers are admittedly arbitrary. I hope a future analysis with better data on turnout will be able to improve on the measure.

Of the thirty-five BSE 100 companies in which the combined stakes of promoters and FI's was under 45%, fifteen companies had enough public shareholding that could be tendered to a potential hostile bidder, assuming a 50% tender rate among non-institutional public shareholders. Changing the assumption to one in which 75% of non-institutional public shareholders tender to a hostile acquirer offering a superior bid adds twelve more companies to this list, bringing the tally up to twenty-seven of the BSE 100. Figure C below lists these twenty-seven companies susceptible to hostile takeover under this crude calculation.

Figure C: BSE 100 Companies Susceptible to Hostile Takeover*

Rank	Company	Sector	Promoter	FI	FII	50% Turnout	75% Turnout
1	Satyam Computer Services	IT	9.11%	0.07%	48.19%	**75.10%**	82.96%
2	ITC	FMCG**	0.00%	0.30%	12.89%	**74.04%**	86.10%
3	Mahindra & Mahindra	Transport Equipments	22.99%	0.10%	34.21%	**66.06%**	71.45%
4	United Phosphorous	Agriculture	29.55%	0.12%	35.13%	**60.81%**	65.43%

5	Larsen & Toubro	Capital Goods	0.00%	16.32%	17.53%	**59.85%**	70.24%
6	Grasim Industries	Diversi-fied	25.07%	0.10%	23.14%	**59.40%**	67.11%
7	India Cements	Housing Related	26.88%	0.11%	25.43%	**59.08%**	64.59%
8	Dr. Reddy's Laboratories	Health-care	25.18%	0.08%	30.44%	**59.08%**	66.91%
9	Infosys	IT	16.94%	2.90%	33.89%	**58.76%**	69.45%
10	Reliance Energy	Power	29.71%	0.95%	22.06%	**58.30%**	62.19%
11	Gujarat Am-buja Cement	Housing Related	31.19%	1.87%	34.31%	**55.93%**	59.59%
12	Tata Power	Power	32.26%	1.04%	19.14%	**55.15%**	60.78%
13	Tata Steel	Metal	30.26%	0.64%	18.11%	**53.97%**	61.52%
14	Hindalco	Metal	26.79%	0.83%	19.13%	**53.46%**	62.92%
15	Tata Chemi-cals	Diversi-fied	31.59%	1.14%	4.18%	**50.55%**	58.88%
16	Essar Oil	Oil & Gas	19.13%	0.51%	3.63%	42.17%	**61.26%**

17	Balrampur Chini Mills	Agriculture	31.81%	0.72%	21.24%	49.10%	**58.21%**
18	Bajaj Auto	Transport Equipments	29.84%	0.69%	18.91%	47.02%	**57.29%**
19	Crompton Greaves	Capital Goods	39.32%	0.07%	16.19%	49.67%	**54.91%**
20	Indian Hotels	Tourism	28.28%	11.17%	22.43%	48.16%	**54.04%**
21	Ashok Leyland	Transport Equipments	38.81%	0.51%	10.72%	45.57%	**53.08%**
22	Ranbaxy Laboratories	Healthcare	34.87%	0.62%	18.49%	48.27%	**53.92%**
23	United Spirits	FMCG	38.77%	0.06%	28.47%	45.62%	**53.14%**
24	Tata Motors	Transport Equipments	33.44%	0.17%	22.63%	47.56%	**52.41%**
25	Bharat Forge	Transport Equipments	36.04%	4.65%	22.75%	44.77%	**52.04%**
26	Bajaj Hindusthan	Agriculture	37.71%	0.51%	25.81%	45.15%	**51.90%**
27	Zee Telefilms	Media & Publishing	43.89	0.10%	31.90%	49.59%	**51.63%**

* I define a company as vulnerable to hostile takeover as having (i) promoter + FI stake < 45%; (ii) Mutual Fund + FII + Insurance Company + 0.5(Non-institutional public) stake > 50% or Mutual Fund + FII + Insurance Company + 0.75(Non-institutional public) stake > 50%; and (iii) being in an industrial sector that permits FDI > 50% without FIPB or RBI approval.

**FMCG: Fast moving consumer goods.

Notably, this list includes several prominent high-tech and pharmaceutical firms and four companies controlled by the Tata Sons group. Analysis of the broader BSE 500 companies indicates a lower percentage of susceptible companies. Of the 172 companies with promoter/FI stakes below 45%, 8.20% of these companies are susceptible using the 50% turnout threshold, and 22.00% are susceptible using the 75% estimate.

Hostile takeovers of several major Indian companies in today's regulatory and economic environment are by no means a far-flung fantasy. While promoters do maintain very high average stakes in Indian companies, many companies, including some of India's most prominent and revered, remain viable hostile takeover targets.

VII. POLICY CONSIDERATIONS FOR INDIAN REGULATORS

Indian policymakers face a tremendous regulatory opportunity. Some of India's most prominent companies may be subject to hostile takeover bids from foreign acquirers in the near future, and Indian law offers them almost no legal means with which to defend themselves against such attempts. Before it is caught off-guard, the Indian government should take this opportunity to craft a policy on hostile takeovers that is suitable to the needs of its companies, their shareholders, and other stakeholders in society. I have set forth below certain factors that I believe the Indian government, practitioners, and corporate law scholars should consider in formulating a policy toward hostile takeovers.

A. Submitting to Globalization or Controlling its Own Destiny?

The threshold question for Indian regulators is whether India should permit hostile takeovers by foreign acquirers at all. While its February 2006 missive technically cleared the way for such takeovers,[117] the Government of India has not

[117] *See* PRESS NOTE NO. 4, *supra* note 70.

yet made an unequivocal policy statement addressing its stance on foreign (or domestic, for that matter) hostile takeovers, and given that the RBI and others may disagree or prefer more debate on the matter,[118] the benefits and costs of foreign hostile takeovers should be considered.

The traditional argument in favor of hostile takeovers is that hostile takeovers, whether domestic or foreign, "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."[119] At first glance, it might seem that the benefits of hostile takeovers in this regard would be less pronounced in India given the high concentration of promoter share ownership. Managerial and board agency problems arise from the separation of ownership and control, a phenomenon quite common in the United States, where company shareholding is overwhelmingly dispersed.[120] These incentives should theoretically be far better aligned in most Indian companies, where promoters presumably appoint management and boards of directors. However, experience dictates otherwise, as Indian managers are known to be motivated less by efficiency than by familial ties and pride,[121] and so may well benefit from the disciplining force of a vibrant takeover market. Indeed, foreign acquirers particularly may be able to add value through importation of foreign

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[118] *See* RBI MASTER CIRCULAR, *supra* note 77.

[119] John Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1152 (1984) (describing the traditional law and economics argument in favor of hostile takeovers). For the seminal piece describing the benefits of the market for corporate control, see Henry Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

[120] *See* John Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534, 1557 (2006). For the traditional argument against hostile takeovers, see Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 Bus. LAW. 101 (1979) (arguing that hostile takeovers jeopardize the vitality and long-term interests of the nation's corporate system while serving only to benefit speculators intent on achieving short-term profits).

[121] *See* Rangaswamy, *supra* note 36, at 8.

managerial practices that could help improve the efficiency of Indian organizations and the overall culture of professionalism.

These benefits notwithstanding, Indian regulators might be concerned that foreign hostile acquisitions might inhibit the development of home-grown Indian companies and discourage Indian entrepreneurship. Indian companies today are beginning to grow large and wealthy enough to take over companies all across the world, but if Indian companies become subject to foreign takeovers, while the very richest companies might survive, many successful Indian companies could fall into foreign hands, especially because foreign companies will continue to have access to greater financing capacities.[122] Preferring domestic over foreign owners of companies doing business in India may appear jingoistic, but as Indians from all walks of life have recently embraced the spirit of economic patriotism, it would be hard to fault regulators seeking to ensure that India's continued development and growth is directed by companies controlled by Indian owners.[123]

B. Transparent Regulation

Whether they decide to promote or discourage foreign hostile takeovers, Indian policymakers should ensure their stance is clear to potential foreign acquirers and investors and consistent throughout the regulatory structure. The current regulatory stance is confusing, sloppy, and at times contradictory. Improved coordination between the RBI and FIPB and a revision to the Takeover Code would help attract more foreign investment into India and instill greater confidence in the Indian regulatory apparatus.

At a minimum, the various Indian regulators should ensure they issue regulations consistent with one another. As mentioned in Part IV, *supra*, while the Government of India through the FIPB plainly authorized the acquisition of

[122] Indian companies are limited in their financing options for takeovers; for instance, they may not use bank financing for acquiring shares.

[123] *See* Giridharadas, *supra* note 5.

shares of Indian companies by foreigners without need for government approval, the RBI just a few months later issued its own regulation that ostensibly contradicted this policy in the case of financial companies. According to practitioners, this is just one of many instances of sloppy regulatory drafting that has led to investor and other stakeholder confusion. If India is serious about opening its markets to the world, it must ensure its regulators clearly and consistently articulate this policy. Even one embarrassing incident involving a multinational corporation's hostile bid thwarted by inconsistent Indian regulations could prove to be not only an international embarrassment but a deterrent of future efficient cross-border economic activity.

The same principle of transparent regulation should apply to the Takeover Code. If SEBI wants to prohibit hostile takeovers, it should do so explicitly through a provision of the Takeover Code; however, if it wants to allow such transactions, it should ensure that the Takeover Code and its interpretations of it do not indirectly counteract this policy. SEBI should revise the disclosure requirement under Section 23 of the Takeover Code, as discussed in Part IV, *supra*, to make clear that acquirers do not have a due diligence obligation under the Takeover Code. While the Code does not obviously require acquirers to vouch for non-public information about the target, according to practitioners, SEBI has requested such assurances in practice.[124] This type of regulatory behavior allows the Indian government to have it both ways: it can project to the world a superficially permissive Takeover Code while allowing itself several points of interference on the ground-level.

C. Enacting Principles-Based Obligations for the Target Board

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, regulators should develop provisions and principles-based standards in the Takeover

[124] Interview with practitioners, *see* Part IV, *supra*.

Code that govern the actions that a target board would be permitted to undertake in response to a hostile bid. These regulatory changes should seek to strike a balance between providing Indian companies with some means and discretion with which to defend themselves against a potential onslaught of foreign hostile acquirers and promoting efficient and value-creating foreign investment in India through the facilitation of a cross-border market for corporate control.

Delaware's well-developed and sophisticated takeover jurisprudence offers India a viable template for striking such a balance. Delaware courts have developed a jurisprudence to regulate actions of a board subject to the threat of a hostile takeover. In its *Unocal* line of cases, Delaware courts have extended the 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.[125] A standard modeled after *Unocal* in India should prove broad enough to govern the "defense substitution" that will undoubtedly emerge once hostile takeovers in India become a reality. Moreover, by adopting the lessons of Delaware jurisprudence as a *principles-based* standard in the Takeover Code rather than as a *rules-based* proscription of specific activities such as those presently found in Section 23, Indian regulators will make it more difficult for creative advisors to justify unreasonable and entrenchment-motivated defensive tactics by exploiting loopholes in specific regulations, while also giving target boards the discretion they need to erect reasonable and legitimate business-related protections in the face of *bona fide* threats from hostile suitors. Whether or not they decide to adopt the lessons of its takeover law, Indian regulators should use this important period of regulatory opportunity to learn as much as possible from Delaware's rich and unparalleled experience in the field.

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[125] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).