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THE EMERGING MARKET FOR CORPORATE CONTROL IN INDIA: ASSESSING (AND DEVISING) SHARK REPELLENTS FOR INDIA'S REGULATORY ENVIRONMENT

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ABSTRACT

Inbound and domestic hostile takeover activity in India has failed to make a dent in the corporate vocabulary for historical, cultural, and regulatory reasons. Instead, the scale of negotiated “friendly” deals in India has been on the rise. Under current regulations, Indian promoters are permitted to hold large stakes in their corporations and are warned in advance when potentially hostile acquirers gain toeholds in their corporations, enabling them to consequently consolidate their holdings. Severe restrictions imposed by India’s central bank on financing acquisitions add to the difficulties for potential buyers. Historically, the loyalty of domestic institutional investors to established promoter houses

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made it difficult to unseat the interests of entrenched Indian promoters. Culturally, nationalist sentiment has formed an invisible barrier to hostile takeover activity in India, as regulators continue to side with India's "national champions." Restrictive foreign investment regulations have long precluded the agility of the inbound raider. However, in recent times the regulatory and historical landscape in India has metamorphosed dramatically. Shareholding patterns in Indian corporations have undergone significant change with the inflow of foreign strategic and institutional investors as foreign investment restrictions have also been relaxed. Further, the market for corporate control in India has seen interesting movement in the past few years. This Article addresses two questions. First and foremost, it analyzes whether there is a legitimate possibility that the market for corporate control will gain a greater foothold in India and whether invisible barriers still preclude hostile acquisitions in India. Second, assuming that the answer to the first question is in the affirmative, this Article seeks to address the question of whether the most widely known conventional shark repellent deal defense mechanism, viz. the poison pill, is possible under the Indian regulatory regime, although it has been ruled out in previous academic writings.

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I. INTRODUCTION

Inbound and domestic hostile takeover activity in India has failed to make a dent in the corporate vocabulary. In two renowned incidents, hostile attempts by Swaraj Paul to acquire a stake in the Escorts Group, and by Imperial Chemical Industries (ICI) to acquire a position in Asian Paints Limited have been thwarted,¹ without the subsequent sounding of alarm bells in India's corporate boardrooms. Conversely, the scale of negotiated "friendly" deals in India has been on the rise; in the first two months of 2010 alone, the total dollar value of mergers and acquisitions (M&A) deals in India surpassed valuations seen in 2009.²

Hostile acquisitions in India have typically faced historical, cultural, and regulatory barriers. Indian regulations permit companies to go public with only a small slice of the company subject to mandatory public shareholding requirements. Consequently, Indian promoters typically hold vast stakes in their companies and consolidate their holdings without triggering penalties. Culturally, families and "friends-of-the-family" have dominated Indian corporations, seldom willing to enter into transactions that may adversely impact revenue streams accruing to future generations in the family. Historically, the loyalty of domestic financial institutions to Indian promoters has made it difficult to oust the dominant promoters of a corporation. Nationalist sentiment has also been an invisible barrier precluding hostile takeover activity in India,³ as policies requiring regulatory approval in the event of foreign investment were designed to shield domestic industry from foreign onslaught. This has not prevented India's "national champions" from seeking outbound synergies, even in hostile contexts.

However, in recent times the regulatory, cultural, and historical landscape in India has metamorphosed substantially. Shareholding patterns in Indian corporations have undergone significant change with the inflow of foreign strategic and institutional investors. Foreign investment has been made easier, or "automatic" for the overwhelming majority of sectors previously

1. Shaun J. Mathew, *Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities*, 2007 COLUM. BUS. L. REV. 800, 811–12.

2. See *infra* text accompanying note 38.

3. Cyril Shroff, *You Need a Defence Strategy*, 27 INT'L FIN. L. REV. 40, 40 (2008).

bracketed by sector-specific investment “caps.” Further, the market for corporate control in India has seen interesting movement in the past few years. In 1998, in a privately negotiated transaction, Indian Cements Ltd. became the first successful raider to acquire a stake in an unwilling Indian target,⁴ Raasi Cement Ltd.⁵ A decade later, in 2008, Emami Ltd.’s acquisition of Zandu Pharmaceutical Works Ltd., in a negotiated “friendly” deal that had deep hostile undertones, exposed the vulnerability of Indian corporations to hostile takeover.⁶ In 2007, Harish Bhasin’s HB Stockholdings Ltd. acquired a stake in DCM Shriram Industries Ltd., in an unsuccessful battle that witnessed share warrants being issued to promoters.⁷ More recently, Grasim Industries Limited’s hostile bid for Larsen & Toubro Ltd. (L&T) that was initiated by acquiring the stake of Reliance Industries Ltd.⁸ (which itself had tried to acquire L&T in the 1980s),⁹ Pramod Jain’s hostile takeover bid for the Dalmia Group’s Golden Tobacco Ltd.,¹⁰ rumors of a possible acquisition by Alcan Inc. and Sterlite Industry of Hindalco Industries, Ltd.,¹¹ Kohinoor Foods Ltd.’s fears that a Temptation Foods Ltd.-led consortium was attempting a covert hostile acquisition,¹² the Dalmia Group’s interest in Gesco Corp.,¹³ Jagajit Jaiswal’s bid for Jagatjit Industries, Ltd. which witnessed the use of shares with differential voting rights as a defensive maneuver,¹⁴ and the acquisition by Analjit Singh of a stake in East India Hotels, Ltd. with the reported intent of warding off hostile takeover

4. Mathew, *supra* note 1, at 813–14.

5. Satvik Verma, *Hostile Takeovers: Is India Inc. Ready?* ECON. TIMES, Oct. 1, 2009, <http://economictimes.indiatimes.com/Opinion/Comments-Analysis/Hostile-takeovers-Is-India-Inc-ready/article-show/5074233.cms>.

6. *Emami Acquires Controlling Stake in Zandu*, HINDU BUS. LINE, Oct. 17, 2008, <http://www.blonnet.com/2008/10/17/stories/2008101752470100.htm>.

7. HB Stockholdings Ltd. v. DCM Shriram Indus. Ltd., (2009) 175 D.L.T. 443 (Del.).

8. *L&T To Sell 11.5% in UltraTech; Aditya Birla Group May Pick It Up*, REUTERS, May 11, 2009, <http://in.reuters.com/article/2009/05/11/idINIndia-39544920090511>.

9. *10 Corporate Battles To Remember*, LIVEMINT.COM, May 9, 2010, <http://www.livemint.com/2010/05/09211443/10-corporate-battles-to-rememb.html>.

10. Dev Chatterji et al., *Pramod Jain Makes Hostile Takeover Bid for Dalmia’s Golden Tobacco*, ECON. TIMES, Nov. 13, 2009, <http://economictimes.indiatimes.com/news/news-by-industry/cons-products/tobacco/Pramod-Jain-makes-hostile-takeover-bid-for-Dalmias-Golden-Tobacco/articleshow/5224620.cms>.

11. Priya Nadkarni, *Hindalco Shares Rise 4% on Takeover Buzz*, BUS. STANDARD, June 5, 2007, <http://www.business-standard.com/india/news/hindalco-shares-rise-4takeover-buzz/286653/>.

12. *Basmati King Kohinoor Faces Hostile Takeover*, ECON. TIMES, June 27, 2008, <http://economictimes.indiatimes.com/articleshow/3170682.cms>.

13. C.R.L. Narasimhan, *Greenmail, Winners and Losers—The Gesco Takeover Battle*, HINDU, Jan. 10, 2001, <http://www.hinduonnet.com/2001/01/10/stories/0610000a.htm>.

14. Baiju Kalesh, *Promoters Set to Benefit from Clarity on DVRs*, LIVEMINT.COM, May 6, 2008, <http://www.livemint.com/2008/05/05235749/Promoters-set-to-benefit-from.html>; *see also* Anand Pershad Jaiswal v. Jagatjit Indus. Ltd., (2009) C.L.B. MANU/CL/0002/2009.

attempts from ITC, Ltd.,¹⁵ signifies that the hostile acquisition is an avenue that cannot be ruled out in India. One of India's finest transactional lawyers has even suggested that India faces a coming "wave of hostile acquisitions."¹⁶

In 2009, M&A deal volumes in India were valued at a meager \$10 billion with a total of 267 deals (142 domestic and 125 cross-border).¹⁷ This number was down 67% from 2008, during which 445 deals worth \$30.72 billion took place, and a further 80% from 2007, during which 676 deals worth \$51.11 billion took place.¹⁸ The largest attempted deal of 2009, a proposed \$23 billion stock swap between telecom giants Bharti Airtel, Ltd. and MTN Group of South Africa, fell through on account of regulatory hurdles.¹⁹ The 2008 financial crisis witnessed large scale capital outflows as foreign institutional investors withdrew their investments from Indian companies.²⁰ However, the global financial meltdown has also formed the backdrop to the rise of Asian economies with the M&A market in India in its nascent stages. In November of 2008, the world also witnessed the largest inbound investment in India ever, with the acquisition by Daiichi Sankyo Co., Ltd. of Japan of a 64% stake in Ranbaxy Laboratories, Ltd. for \$4 billion. Factoring into the statistical map the tendency of M&A activity to occur in cyclical waves,²¹ inbound deal activity in India may show signs of improvement.

This Article addresses two questions. Part II of this Article analyzes whether there is a legitimate possibility that the market for corporate control will gain a greater foothold in India and whether invisible barriers still preclude hostile acquisitions in India. Assuming that the answer to the first question is in the affirmative, Part III seeks to address whether the most widely known conventional "shark repellent" deal defense mechanism—the

15. *Analjit Entry Could Ward Off Hostile Takeovers at EIH*, ECON. TIMES, Oct. 18, 2009, <http://economictimes.indiatimes.com/Features/The-Sunday-ET/Companies/Analjit-entry-could-ward-off-hostile-takeover-at-EIH/articleshow/5135102.cms>.

16. Shroff, *supra* note 3, at 40.

17. Rupali Mukherjee, *With 267 Deals, Mergers and Acquisitions Cross \$10 Billion*, ECON. TIMES, Dec. 19, 2009, <http://economictimes.indiatimes.com/news/news-by-company/corporate-trends/With-267-deals-mergers-and-acquisitions-cross-10-billion/articleshow/5353946.cms>.

18. *Fewer Mergers in 2008 as Companies Hold on to Cash*, ECON. TIMES, Dec. 23, 2008, <http://economictimes.indiatimes.com/news/news-by-company/corporate-trends/Fewer-mergers-in-2008-as-companies-hold-on-to-cash/articleshow/3880367.cms>.

19. Amol Sharma, *India's M&A Comeback: Big Ticket Deals Should Return in 2010*, WALL ST. J., Jan. 4, 2010, <http://blogs.wsj.com/deals/2010/01/04/indias-ma-comeback-big-ticket-deals-should-return-in-2010>.

20. *See, e.g., India's External Liabilities Rise on FII Outflows*, ECON. TIMES, May 26, 2009, <http://economictimes.indiatimes.com/News/Economy/Indicators/Indias-external-liabilities-rise-on-FII-outflows/articleshow/4581507.cms>.

21. F.M. SCHERER & DAVID ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 153–59 (3d ed. 1990).

poison pill—is possible under the Indian regulatory regime, despite that it has been ruled out elsewhere.²²

In addition to outlining what this Article seeks to achieve, it is also important to define what this Article will not achieve: namely, any investigation into the policy merits of hostile acquisitions, or mergers and acquisitions generally, and whether their possible advent in India would have beneficial or disadvantageous consequences.²³ Rather, this Article focuses practically on the possibility of increased incidents of hostile takeovers and potential strategies that businesses may employ to defend themselves from hostile acquirers. Neither does this Article attempt to measure the financial viability of acquiring Indian corporations. It is often suggested that domestic hostile acquisition activity in India has not taken off primarily on account of the contrast between the inherent growth opportunities for domestic business and the heavy costs of acquisition, which may make more financial sense in saturated markets. Financial assessments aside, this Article seeks to examine the theoretical possibility of the hostile acquisition route in India, and the ability of industrial houses to defend themselves from the enemy at the gates.

Part II seeks to analyze and reassess the exogenous factors that have historically been associated with the absence of a market for corporate control in India in order to determine whether these still hold true today. For instance, what is the ability of Indian promoters to hold large stakes in their corporations against the present factual vulnerability of corporations to hostile takeover in India based on promoter holdings in corporations listed on the BSE-200 Index? An analysis of the acquisition by Emami, Ltd. of Zandu Pharmaceuticals, Ltd., for example, exposes the vulnerability of “cozy relationships” that defined Indian business decades ago as well as the ability of hostile acquirers to potentially negotiate with the target board by obtaining “blocking rights” in the target.

Next, this Article compares early warning mechanisms established by Indian takeover law against similar American regulations. It discovers that agile acquirers can thwart the potency of the early warning requirement by launching a mandatory tender offer within two days of acquiring a stake below fifteen percent. This Part identifies and assesses various hurdles relating to acquisition finance, and it concludes by finding that these apply equally to friendly and hostile acquisitions and do not hinder the foreign hostile acquirer from tapping foreign financing avenues.

22. Mathew, *supra* note 1, at 822–24.

23. For a study of the impact of mergers on corporate performance in India, see Murugesan Selvam et al., *Impact of Mergers on the Corporate Performance of Acquirer and Target Companies in India*, 5 J. MODERN ACCT. & AUDITING 55 (2009).

Part II also examines foreign investment restrictions that dominated the Indian regulatory environment in light of the “new” liberalization in 2006, where the overwhelming majority of sectors were opened to the “automatic” investment route. It examines two latent hostile acquisition defenses inherent in the structuring of Indian corporations—one based on Press Note 2 (2009) and the other on the size of the investment that the hostile acquirer proposes to make. This protection is based on the fact that some Indian corporations may have potentially large investments in diversified businesses or different business branches or undertakings in sectors prohibited to foreign investment. Finally, this Part examines potential changes in antitrust law in India, and other invisible hurdles to the hostile acquisition, including due diligence, the dominance of litigation, and the likely effects that these two may have on takeover activity.

Part III attempts to answer the question of whether a conventional flip-in poison pill can be designed for India’s regulatory environment. It begins by analyzing the features of a conventional pill plan that would not be workable in the Indian environment and tries to address these difficulties. After briefly setting out the blueprint of the takeover battle provided in India’s Takeover Code, this Part sets out several possible shark repellent poison pill-type mechanisms that an Indian board may adopt, for example, the share warrant defense, the rights issue defense, and the employee stock option defense. It concludes by identifying the possibilities of a staggered board and other embedded defenses in India, and assessing the general difficulties that shark repellent tactics may pose to Indian corporate law and policy.

II. BARRIERS TO HOSTILE ACQUISITION: ARE THEY INSURMOUNTABLE?

The regulatory landscape of India is punctuated by overlapping functions.²⁴ There are three identifiable spheres of regulation with which the prospective hostile acquirer may have to contend. In the first sphere, foreign investment policy is regulated at a high level by the Department of Industrial Policy and Promotion in the Indian government’s Ministry of Commerce and Industry.²⁵ Accordingly, foreign investment restrictions are promulgated by the department in a series of periodically reviewed press notes, now released in periodically reviewed consolidated circulars. The restrictions constitute

24. PLANNING COMM’N OF INDIA, REPORT OF THE COMMITTEE ON FINANCIAL SECTOR REFORMS: A HUNDRED SMALL STEPS, Sept. 12, 2008 (headed by Raghuram Rajan).

25. The Department of Industrial Policy and Promotion (DIPP) was established in 1995 and reconstituted in 2000. Its primary role consists of “facilitating investment and technology flows and monitoring industrial development” in India. *See Roles and Functions of the Department of Industrial Policy and Promotion*, <http://dipp.nic.in/dippsub.htm> (last visited Mar. 31, 2011).

executive action and are enforceable, if at all, under the theory of promissory estoppel or legitimate expectations, unlike statutory law.²⁶ The Department has periodically set out “sectoral caps” for foreign investment in India,²⁷ and certain types of investment, described in greater detail below, require the prior approval of the Foreign Investment Promotion Board (FIPB), a nodal government agency.

In the second regulatory sphere, the Reserve Bank of India (RBI), India’s central bank, regulates banks and all borrowing and lending activities.²⁸ Interestingly, the government’s foreign investment policy is also concretized in RBI guidelines.²⁹ As established by statute in 1934, RBI regulations and guidelines have the status of secondary legislation.³⁰

In the third regulatory sphere, the Securities and Exchange Board of India (SEBI), established by statute in 1992, regulates the securities market and protects the interests of investors.³¹ SEBI regulations span takeovers, insider trading, raising capital, and more. SEBI regulations prescribe the manner in which listed company stock can be valued, and require the registration of foreign institutional investors. With respect to the steps required to consummate a hostile acquisition in India, the Indian regulatory landscape can be understood from two perspectives. The first and primary perspective consists predominantly of SEBI regulations, which serve as a blueprint for the takeover battle. The second and subsidiary perspective includes regulations that deal with matters incidental to the hostile acquisition such as finance and foreign investment. The latter may still play a large role in determining the vulnerability of Indian corporations to hostile takeovers.

26. However, the Reserve Bank of India, which has a statutory basis, periodically issues circulars and directions which mirror the Department’s circulars. For a discussion on the doctrine of legitimate expectations in India, see *Punjab Commc’ns Ltd. v. Union of India*, (1999) 4 S.C.C. 727.

27. For the current effective listing of sectoral caps, see DEP’T OF INDUS. POL’Y & PROMOTION, CONSOLIDATED FDI POLICY CIRCULAR 1 OF 2011 (effective Apr. 1, 2011), available at http://dipp.nic.in/Fdi_Circular/FDI_Circular_012011_31March2011.pdf [hereinafter CONSOLIDATED FDI POLICY]. For example, the sectoral cap for the insurance and print media sectors in India is presently 26%. *Id.* §§ 5.2.16, 5.2.20.

28. See *Brochure Explaining RBI’s Role and Functions In Brief*, RESERVE BANK OF INDIA, <http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/RBI290410BC.pdf> (last visited Mar. 31, 2011); *Functions and Working*, RESERVE BANK OF INDIA, <http://rbidocs.rbi.org.in/rdocs/Content/PDFs/FUNCWWE080910.pdf> (last visited Mar. 31, 2011).

29. RESERVE BANK OF INDIA, MASTER CIRCULAR NO. 02/2009-10, MASTER CIRCULAR ON FOREIGN INVESTMENT IN INDIA (July 1, 2009), available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/22MCFDI90701_F.pdf.

30. Reserve Bank of India Act, 1934, No. 2, Acts of Parliament, 1934 (India), available at http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/RBIAM_230609.pdf.

31. The Securities and Exchange Board of India was established on April 12, 1992, as per the provisions of the Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992 (India), available at <http://www.sebi.gov.in/acts/act15ac.html>. About SEBI, SEC. & EXCH. BD. OF INDIA, <http://www.sebi.gov.in/Index.jsp?contentDisp=AboutSEBI> (last visited Mar. 31, 2011).

In FY 2009–2010, the Indian economy had attracted a total of about \$19.8 billion in foreign investments.³² The services sector accounts for approximately 22% of the more recent figure, while sectors such as computer software and hardware, telecommunications, real estate, and construction account for 7–9% each.³³ On December 1, 2009, the FIPB had approved seventeen foreign investment proposals worth \$984 million,³⁴ even as another set of investments worth approximately \$100 million were approved a few weeks later.³⁵ Although India's GDP had dipped from levels as high as 9% in recent financial years to 6.7% in FY 2008–2009,³⁶ the outlook on the Indian economy remains positive.³⁷ Within the first forty-five days of 2010, deals totaling \$14 billion had already been announced, surpassing the total value of all 2009 deals.³⁸

While the attractiveness of targets for strategic and financial buyers may vary based on their aspirations for the short-, medium-, and long-term futures, there appear to be no inherently unattractive features in Indian corporations which reduce their susceptibility to hostile takeover. However, exogenous factors may make the process of launching a hostile takeover less appealing. These may range from the cultural, historical, or political uniqueness of Indian businesses to visible and latent regulatory hurdles. However, the potency of these exogenous factors deserves to be analyzed and reassessed.

32. DEP'T OF INDUS. POLICY & PROMOTION, FACT SHEET ON FOREIGN DIRECT INVESTMENT: FROM AUGUST 1991 TO NOVEMBER 2009, available at http://dipp.nic.in/fdi_statistics/india_FDI_November2009.pdf.

33. See FACT SHEET ON FOREIGN DIRECT INVESTMENT FROM AUGUST 1991 TO NOVEMBER 2009, *supra* note 32, at 2.

34. *India Approves \$984 mn of Foreign Investment Plans: Govt*, ECON. TIMES, Dec. 1, 2009, <http://economictimes.indiatimes.com/news/economy/foreign-trade/India-approves-984-mn-of-foreign-investment-plans-Govt/articleshow/5288437.cms>.

35. *Foreign Investment Proposals Worth Rs. 524 Crore Approved*, ECON. TIMES, Dec. 31, 2009, <http://economictimes.indiatimes.com/news/economy/finance/Foreign-investment-proposals-worth-Rs-524-cr-approved/articleshow/5397472.cms>.

36. FIN. MINISTRY GOV'T OF INDIA, KEY FEATURES OF BUDGET 2009–2010, available at <http://indiabudget.nic.in/ub2009-10/bh/bh1.pdf>.

37. Deeptha Rajkunmar, "India's Long-Term Growth Story Remains Intact," ECON. TIMES, Apr. 6, 2009, <http://economictimes.indiatimes.com/opinion/interviews/Indias-long-term-growth-story-remains-intact/articleshow/5755833.cms>; Pallavi Mulay, *Despite Economic Crisis, India Inc. Is Counting Its Blessings*, ECON. TIMES, May 30, 2009, <http://economictimes.indiatimes.com/article/show/4595682.cms>; *Indian Economy Returning to Potential Growth Path: Goldman*, ECON. TIMES, June 21, 2009, <http://economictimes.indiatimes.com/News/Economy/Indicators/Indian-economy-returns-to-potential-growth-path-Goldman/articleshow/4683272.cms>; Anurag Joshi, *Moody's Ups Rupee Rating Outlook to Positive*, REUTERS, Dec. 15, 2009, <http://in.reuters.com/article/idINIndia-44729720091215>.

38. *India Inc. Announces \$14 Bn M&A Deals in Just 45 Days in 2010*, ECON. TIMES, Feb. 16, 2010, <http://economictimes.indiatimes.com/news/news-by-company/corporate-trends/India-Inc-announces-14-bn-MA-deals-in-just-45-days-in-2010/articleshow/5577824.cms>.

A. Formidable Promoters and Cozy Relationships

In addition to the historical and cultural reasons behind why Indian families that serve as promoters are hard to unseat in a hostile scenario, there is a significant legal factor explaining the entrenchment of promoter interests in Indian corporations. Namely, promoters are not required to subject their corporations to large public shareholding. Corporations that have 20 million or more shares outstanding and a market capitalization of Rs. 10 billion (approximately \$217 million) are required to maintain a public shareholding of only 10%,³⁹ while others must maintain 25% public shareholding.⁴⁰ Theoretically, promoters and those whose shareholding is aggregated with promoters (termed “persons acting in concert”⁴¹ with the promoters), can hold up to 75% in an Indian corporation.⁴² The Indian Takeover Code,⁴³ under the “creeping acquisition” rule, permits promoters (or for that matter, anybody else) who hold 15% to 55% in a corporation to consolidate their holding by up to 5% each financial year, but it does not allow them to exceed 55% voting rights post-acquisition without otherwise making a public announcement or setting off any of the triggers requiring a mandatory tender offer.⁴⁴ Additionally, inter-se transfers within the promoter group are ordinarily exempt from the mandatory tender offer requirements of the Takeover Code.⁴⁵

Historically, it has been recognized that domestic financial institutions vote in concert with the promoters.⁴⁶ These “cozy relationships” between domestic financial institutions and industrial houses originate from the pre-

39. BOMBAY STOCK EXCH., LISTING AGREEMENT, cl. 40A(iii).

40. Rule 19(2)(b) of the Securities (Contracts) Regulation Rules, 1957, read together with Regulation 41 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and Clause 40A of the Listing Agreement of the Bombay Stock Exchange. However, Rule 19(2)(b) was amended on June 4, 2010 by a Ministry of Finance Notification, by which: (i) only companies whose post issue capital calculated at offer price is more than Rs. 40,000 million (i.e. \$868 million) can maintain public shareholding of 10%; (ii) such companies must raise their public shareholding levels up to 25%, by a minimum of 5% in any given year.

41. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, Gazette of India, section 2(1)(e) (Feb. 20, 1997) [hereinafter Takeover Code].

42. Violating this rule for up to three months after the initial six-month offering period discussed in § 9.4 triggers compulsory delisting, and promoters may be required to acquire the securities of the remaining public shareholders at fair market value, subject to their option to remain shareholders in the corporation. Securities and Exchange Board of India (Delisting of Securities) Guidelines, 2003, Gazette of India, sections 9.4, 17.1, 17.2 (2003).

43. Takeover Code § 20A.

44. *Id.* § 11(1).

45. *See id.* § 3(1)(e).

46. Mathew, *supra* note 1, at 833–34.

liberalization “license-permit-quota raj” in India.⁴⁷ Firms granted a license to do business in India were almost guaranteed financial backing by state-run domestic financial institutions.⁴⁸ Although the regulatory regime changed in 1991, mindsets have not appeared to change in India, where it has been said that if Wall Street in New York was built by “sharks,” Dalal Street in Mumbai was built by “relationships.” Pooling agreements have been held enforceable by the Bombay High Court,⁴⁹ and may facilitate such arrangements.

In order to gain control over a corporation, a hostile acquirer would have to replace the majority of the corporation’s board of directors, or otherwise gain control over management.⁵⁰ The steps to replacing the board are relatively straightforward and can begin as early as when the hostile acquirer achieves a 10% stake in a corporation. First, when the hostile acquirer achieves a 10% stake in the corporation, it can requisition the board to hold an extraordinary general meeting.⁵¹ Second, the hostile acquirer can seek to control the agenda of the meeting: an acquirer who has more than a 5% stake in the corporation can gain proxy access, as a result of which it can pitch a resolution to replace board members.⁵² Alternatively, if a general meeting is fast approaching, the hostile acquirer can take this step first, and seek to gain proxy access to set the hostile acquisition in motion. However, an application can be made by the incumbent board to seek to exclude shareholder proposals.⁵³ Third, the hostile acquirer can replace the board with a 50.1% majority stake.⁵⁴ The removal of directors and appointment of new directors

47. For a discussion on the extant license-permit-quota raj system, see *infra* notes 91, 92, 94 and accompanying text.

48. Tarun Khanna & Krishna Palepu, *Globalization and Convergence in Corporate Governance: Evidence from Infosys and the Indian Software Industry*, 35 J. INT’L BUS. STUD. 484, 488 (2004).

49. *Rolta India Ltd. v. Venire Indus. Ltd.*, (2000) 100 Comp. Cas. 19, ¶¶ 27, 30 (Bom.) (India).

50. The Takeover Code defines “control” as

the right to appoint the majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

Takeover Code § 2(1)(c).

51. The Companies Act, 1956, No. 1, Acts of Parliament, 1956 (India), § 169(1).

52. The option is also available to 100 shareholders acting together. *Id.* § 188(2) (1956).

53. *Id.* § 188(5) (1956).

54. However, the single largest shareholder in a corporation, who holds a stake under 50% may, in certain circumstances, succeed in controlling the majority of directors on the board. Consider the following example: Company X has three substantial shareholders, A, B, and C, and the remaining stake is held by the public. Company X has 1000 shares, held in the following proportion: A: 400, B: 100, C: 100, Public: 400. There is an informal arrangement between B and C, which they adhere to, to pool their votes together. Although Indian law presently requires companies to incorporate pooling agreements into the company’s articles in order for them to be enforced, I assume that B and C adhere to their agreement and do not wish to contest it. The board of Company X consists of ten members.

requires an ordinary resolution where the votes cast in favor of the resolution exceed the votes cast against.⁵⁵ While the staggered board is a default structure⁵⁶ in Indian company law—from which corporations may opt out, save in certain circumstances discussed later—all the directors can be removed without cause by ordinary resolution.⁵⁷ After removing previous directors at a shareholder meeting, the hostile acquirer would require a simple majority to replace the directors.⁵⁸ Consequently, assuming that 100% of the shareholders vote at the meeting, an acquirer would have to obtain 50.1% of the votes in favor of its resolution to replace directors.

Indian company law also makes the waging of a proxy war relatively hassle-free. The register of shareholders is open for inspection by any shareholder during ordinary business hours without the payment of a fee and to others with the payment of a fee.⁵⁹ The register of members is required to maintain the name, address, and occupation of members,⁶⁰ which makes it easier to contact them for proxy solicitation. Additionally, when an acquirer makes a tender offer to the shareholders of a target corporation, the board of

While it is theoretically possible for any shareholder to nominate a directorial candidate, such candidates may not have much of a chance on account of the limited resources of individual shareholders with minimal stakes. For the purpose of this hypothetical, I therefore assume that there are no stray directorial candidates nominated by individual shareholders. If the directors are voted into office by proportional representation, where each shareholder can only vote to the extent of its entitlement for each director, then no single shareholder would have a stake sufficient to nominate the majority on the board. For example, if A votes in favor of its candidates (i.e., a total of 400 votes per candidate), then assuming that B, C, and the public shareholders do not agree with the candidate choice of A, there would be a total of 600 votes against the resolution proposed by A. However, assuming that the public shareholder vote is splintered, if even 101 votes are cast in favor of A's candidate (in addition to A's own votes), A would succeed in controlling the board, which would be relatively easier for A to achieve as opposed to B or C, who would require 301 votes from the public in addition to their own 200 votes in order for their candidates to succeed. Similarly, assuming cumulative voting, where each shareholder can concentrate its votes on certain candidates, then A can concentrate its 400 votes in favor of six candidates, giving 66 votes to each of six candidates of its choice. Since B and C know that they cannot divide their 200 votes into six candidates and win, they would divide their votes between two to three directors so as to nominate the directors of their choice. Assuming that the public shareholder vote would be splintered, this would still place A at a distinct advantage as compared to B or C, to control board composition.

However, given that the distinct advantage available to the single largest shareholder whose stake is below 50% still theoretically leaves open the possibility that A would not succeed in controlling the majority of the board, this paper assumes that a hostile acquirer would succeed in controlling a corporation beyond doubt, by acquiring a 50.1% stake in the target, thereby placing itself beyond doubt in a position to appoint the majority of the board of directors.

55. The Companies Act, 1956, No. 1, Acts of Parliament, 1956 (India), § 189.

56. *Id.* § 255.

57. *Id.* § 284(1).

58. Section 189(1) of the Companies Act, 1956 defines an ordinary resolution as a resolution in which the number of votes cast in favor of a resolution exceeds those cast against a resolution.

59. *Id.* § 163(2).

60. *Id.* § 150(1)(a).

directors of the target is required under India's Takeover Code to provide the acquirer with information regarding shareholders eligible to participate in the tender offer.⁶¹

1. A BSE-200 Index Analysis

The question which arises next is: is it factually possible for a hostile acquirer to acquire a 50.1% stake in an Indian corporation? The following results are the culmination of an investigation into the shareholding patterns of 200 corporations listed on the Bombay Stock Exchange and forming a part of the BSE-200 Index.⁶² The analysis revealed that 107 companies, representing 53.5% of the sample set, have promoters who hold stakes below 50%, thus, in theory, permitting an ordinary resolution to replace their boards of directors. Moreover, taking into account the historical likelihood of domestic institutional investors ("DII") voting with promoters, if domestic institutional investors stakes are counted with promoter stakes, the study found that fifty-seven companies, representing 28.5% of the sample set, are vulnerable to hostile acquisition. Tables 1 and 2 present the conclusions of the study conducted, identifying those companies from the sample set where the promoter holding was under 50% (Table 2), and companies from the sample set where the combined promoter and domestic institutional investor holding was less than 50% (Table 1).

However, at least three latent defense mechanisms additionally inhibit the hostile acquisition route in India. First, share transfer restrictions may impede the ability of acquirers to acquire shares from willing but contractually bound sellers. Second, pooling agreements may make it mandatory for some shareholders to vote with promoters to thwart the hostile acquisition attempt. These concerns are to some extent capable of being addressed. The enforceability of transfer restrictions in the context of public companies is tenuous. The Supreme Court of India has held that share transfer restrictions must be incorporated into the articles of a private corporation in order for them to be binding.⁶³ However, as a result of conflicting High Court opinions, the interaction of this requirement with public corporations is not entirely clear.⁶⁴ Further, this Article presumes that pooling agreements exist

61. Takeover Code § 23(2).

62. The complete analysis, listing out the shareholding patterns of all 200 corporations analyzed, is on file with the author and available upon request.

63. Rangaraj v. Gopalakrishnan, A.I.R. 1992 S.C. 453 (India); *see also* IL & FS Trust Co. v. Birla Perucchini Ltd., (2004) 121 Comp. Cas. 335 (Bom.) (India).

64. *See* Messer Holdings Ltd. v. Ruia, (2010) 159 Comp. Cas. 29 (Bom.) (India) (holding that preemptive rights are enforceable against public companies and that shareholders' agreements need

predominantly between promoters and domestic institutional investors. As noted above, that still leaves 30% of the sample set presented in Table 1 vulnerable to hostile takeover. In addition, pooling agreements would not restrict share transfers. Accordingly, if every institutional investor that acquires a stake in a corporation is required to sign a pooling agreement, that would not restrict the ability of the investor to exit the corporation and transfer its holding to the hostile acquirer.

The third latent hurdle may be more problematic than the previous two. The shares of many corporations in India are presumed to be held by “friends” of promoters, who are not considered a part of the promoter group, but whose loyalties reside with promoters. Since information on friends is not publicly available, it would be hard to ascertain those corporations in which friends of promoters have defensive stakes. It remains to be seen, however, if a hostile acquirer can legitimately claim that sufficient shareholders did not tender shares on account of the existence of such friendships, which, if proved, would trigger penalties under Indian delisting guidelines. Further, the acquisition of Zandu Pharmaceutical Works by Emami in 2008 (described below), despite friendly ties between two groups of promoters within the target, exposes the vulnerability of Indian corporations to takeover once relationships collapse, even as the importance of blocking rights became apparent in the acquisition.

It is important to note that the hostile acquirer who holds a mere 50.1% majority is still substantially constrained in the management of the corporation. Several matters require a “special resolution,” where the votes for a resolution must be three times the votes against the resolution.⁶⁵ Important decisions, such as the alteration or amendment of the memorandum and articles of the corporation,⁶⁶ reduction of share capital,⁶⁷

not even be incorporated into the articles of association); *W. Maharashtra Dev. Corp. Ltd. v. Bajaj Auto Ltd.*, (2010) 154 Comp. Cas. 593 (Bom.) (India) (holding that restrictions of transferability of shares, in this case a right of first offer or “ROFO,” are not enforceable against a public company); *Pushpa Katoch v. Manu Maharani Hotels Ltd.*, (2006) 131 Comp. Cas. 42 (Del.) (India); *Mafatlal Ind. v. Gujarat Gas Co.*, (1999) 97 Comp. Cas. 301 (Guj.) (India); *see also Karamsad Invs. Ltd. v. Nile Ltd.*, (2002) 108 Comp. Cas. 58 (A.P.) (India); *Bombay Dyeing & Mfg. Co. v. Bajoria*, (2001) 107 Comp. Cas. 535 (C.L.B.) (India). Further, SEBI has reportedly taken the view that put/call options and rights of first refusal are unenforceable against public companies since they violate Indian securities law dealing with spot delivery contracts and derivatives contracts. SEBI apparently took this view in a confidential letter addressed to the Vedanta group (in the context of the Vedanta-Cairn deal) dated March 18, 2011, which was disclosed by the Vedanta group in a letter of offer dated April 2011 to public shareholders of Cairn India Limited. *See* Letter of Offer, filed by Cairn India Ltd. with SEBI, on Aug. 20, 2010, at 4, available at <http://www.sebi.gov.in/takeover/cairnlof.pdf>.

65. The Companies Act § 189(2)(c).

66. *Id.* §§ 17, 31.

67. *Id.* § 484.

voluntary winding up or liquidation,⁶⁸ preferential allotment of shares as a means of raising capital,⁶⁹ or even sanctioning of a merger or asset sale,⁷⁰ require a 75% majority in order to obtain the special resolution.

Conversely, what this also means is that a hostile acquirer can throw a spanner in the works by acquiring a mere 25.1 percent stake in a corporation. A hostile acquirer who acquires a 25.1 percent stake in an Indian corporation has obtained de facto “blocking rights” capable of being exercised against promoters.⁷¹ These rights can be used to negotiate with the promoters, either to acquire the promoters’ stake in the corporation or to sell out their own stakes to the promoters at a premium. The numbers in the BSE-200 Index analysis change dramatically when one measures the ability of a hostile acquirer to acquire a 25.1 percent stake in an Indian corporation. A total of 173 out of 200 companies, representing 86.5% of the sample set analyzed, are corporations in which the promoters have stakes below 75%. And a total of 149 companies, representing 74.5% of the sample set, are corporations in which the combined stake of the promoters and domestic institutional investors is less than 75%. Looking at these figures, it becomes clear that blocking positions could potentially be taken by activist hedge funds, or institutions focusing on corporate governance issues, and that the blocking rights would result in sufficient leverage to be able to negotiate better corporate governance.

TABLE 1: ALL CORPORATIONS FORMING A PART OF THE BSE-200 INDEX OF THE BOMBAY STOCK EXCHANGE, WHERE THE PROMOTER + DII HOLDING IS <50%

Name of Company	Promoter Holding	Foreign Promoter Holding	FII Holding	DII Holding	Other	Sector
ACC Ltd.	36.26	0.23	8.751	8.52	46.2	Cement
Alston Projects India Ltd.	5.153	38.1	1.302	36.8	18.7	Possibly power, (also railways)
Ambuja Cements Ltd.	0.797	45.9	23.02	22.8	7.47	Cement
Apollo Hospitals Enterprise Ltd.	35.68	0	26.4	2.29	35.6	Cement
Axis Bank Ltd.	38.34	30.4	8.297	8.3	22.9	Banking – Private Sector

68. *Id.* § 100.

69. *Id.* § 81(1)(a).

70. *Id.* § 391 (read with § 394(a)-(b)).

71. In this context it is important to consider that under Indian law, even minority shareholders are capable of committing “oppression,” (i.e., fiduciary duty breaches) concerns typically raised against majority shareholders.

Name of Company	Promoter Holding	Foreign Promoter Holding	FII Holding	DII Holding	Other	Sector
Bajaj Auto Ltd.	45.8	0	15.19	7.08	31.9	Automotives
Bharti Airtel Ltd.	43.62	21.6	17.71	3.86	13.2	Telecom
Cipla Ltd.	16.92	20.2	15.88	4.36	42.6	Drugs and Pharmaceuticals
Cummins India Ltd.	2E-04	46.5	9.125	37.3	7.09	Technologies
EIH Ltd.	37.62	0	2.701	11	48.7	Hotels
Essar Oil	38.27	20	11.72	8.25	21.8	Petroleum
Glenmark Pharmaceuticals Ltd.	45.86	0	26.43	3.78	23.9	Drugs and Pharmaceuticals
Grasim Industries Ltd.	26.56	0	24.16	21.7	27.6	Textiles
Great Eastern Shipping Company Ltd.	27.69	0	9.451	20.8	42.1	Shipping
GTL Ltd.	28.74	3.08	9.909	6.83	51.4	Telecom services
Gujarat NRE Coke Ltd.	43.25	0	21.82	5.14	29.8	Coal
HCL Technologies Ltd.	48.64	17.6	18.12	0.52	15.1	Technology
HDFC Bank Ltd.	26.18	0	30.13	12.2	31.4	Private Banking
Housing Development and Infrastructure Ltd.	41.32	0	22.22	2.34	34.1	Construction
Hero Honda Motors Ltd.	27.46	24.7	27.04	2.38	18.5	Automotive
Infrastructure Development Finance Co Ltd.	19.53	0	42.51	22.4	15.6	Leasing and Finance (NBFC)
India Cements Ltd.	24.47	0	23.53	16.7	35.3	Cement
Indiabulls Financial Services Ltd.	25.12	0	49.08	2.89	22.9	Financial consultancy (NBFC)
Indiabulls Real Estate Ltd.	16.88	0	68.06	3.78	11.3	Construction/SEZ
Infosys Technologies Ltd.	19.23	0	42.07	9.43	29.3	Technology
Ispat Industries Ltd.+ IVRCL Infrastructures and Projects Ltd.	16.55	20.6	4.738	15.8	42.3	Steel
Jain Irrigation Systems Ltd.	8.852	0	52.81	12.1	26.2	Construction
Jaiprakash Associates Ltd.	28.8	0	44.55	3.66	23	Construction
Jet Airways (India) Ltd.	29.36	0	16.76	16.8	37.1	Cement/Power/ construction Scheduled Air transport services
Jindal Steel and Power Ltd.	0.006	36	2.337	33.6	28.1	Steel
JSW Steel Ltd.	38.21	5.86	16.2	10.3	29.4	Steel
Jubilant Organosys Ltd.	26.3	1.91	19.55	17.6	34.6	Drugs and Pharmaceuticals
Lanco Infratech Ltd.	15.98	3.03	20.48	17.5	43.1	Construction
Lupin Ltd.	17.96	35.4	15.19	20.3	11.1	Drugs and Pharmaceuticals
	34.65	0.01	12.65	12.6	40	

Name of Company	Promoter Holding	Foreign Promoter Holding	FII Holding	DII Holding	Other	Sector
Mahindra and Mahindra Ltd.	17.61	2.09	15.76	13.7	50.9	Conglomerate
Max India Ltd.	32.66	0	26.74	6.23	34.4	Conglomerate
Moser Baer India Ltd.	10.18	0.08	16.57	16.5	56.7	Technology
Nagarjuna Construction Co. Ltd.	18.71	0	32.63	20.4	28.3	Construction
Opto (Circuits) India Ltd.	13.52	3.56	20.21	16.6	46.1	Technology oriented electronics
Praj Industries Ltd.	19.76	0	7.533	9.63	63.1	Power
Proctor and Gamble Hygiene and Health Care Ltd.	1.044	37.6	1.128	36.5	23.8	Drugs and Pharmaceuticals
Punj Lloyd Ltd.	13.48	22	18.18	3.79	42.6	Power
Rei Agro Ltd.	32.1	0	11.18	0.06	56.7	Horticulture/development of seeds
Religare Enterprises Ltd.	45.95	0	2.914	2.91	48.2	Conglomerate
Rolta India Ltd.	40.34	0	28.04	3.22	28.4	Conglomerate
Shree Renuka Sugars Ltd.	20.58	0.45	18.16	17.7	43.1	Agriculture
Shriram Transport Finance Co. Ltd.	38.55	0	20.51	5.8	35.1	Finance (NBFC)
Sintex Industries Ltd.	26.94	0	24.74	20	28.3	Power
Sterling Biotech Ltd.	27	0	2.374	0.03	70.6	Drugs and Pharmaceuticals
Sterlite Industries (India) Ltd.	2.495	39.7	10.7	29	18.2	Mining
Unitech Ltd.	24.43	0.09	20.33	20.2	34.9	Construction
United Phosphorous Ltd.	15.42	0.63	19.76	19.1	45.1	Seeds
United Spirits Ltd.	32.49	0	33.49	9.49	24.5	Alcohol distillation and brewing
Welspun Gujarat Stahl Rohren Ltd.	28.06	6.17	12.88	6.71	46.2	Engineering
Yes Bank Ltd.	30.51	0	46.37	8.53	14.6	Private Banking
Zee Entertainment Enterprises Ltd.	18.61	17.1	22.18	5.12	37	Entertainment

Notes:

Of the 200 corporations analyzed in the BSE-200 Index, 57, representing 28.5% of the sample set, are companies in which the promoter stake and the DII stake combined is less than 50%.

Sectors have been identified for the purposes of determining the vulnerability of these corporations to foreign (inbound) hostile takeover, based on foreign investment regulations discussed below. Based on foreign investment regulations, one finds that a total of 49 of 200 companies, representing 24.5% of the sample set, are vulnerable to foreign (inbound) hostile acquisition.

For conglomerate sectors, issues under Press Note 2 (2009) and Press Note 4 (2009) (discussed below) may arise.

TABLE 2: ALL CORPORATIONS FORMING A PART OF THE BSE-200 INDEX OF THE BOMBAY STOCK EXCHANGE, WHERE THE PROMOTER HOLDING IS <50% BUT THE PROMOTER + DII HOLDING IS >50%

Name of Company	Promoter Holding	Foreign Promoter Holding	FII Holding	DII Holding	Other	Sector
Tech Mahindra Ltd.	30.1	26.7	0.83	25.8	16.6	Telecom Outsourcing/IT Infrastructure
Torrent Power Ltd.	47.48	0	0.849	21.6	30.1	Power
Voltas Ltd.	25.57	0	10.43	28.3	35.7	Engineering
Suzlon Energy Ltd.	49.75	0	14.2	7.3	28.7	Power
Tata Chemicals Ltd.	27.9	0	11.78	28.7	31.6	Conglomerate
Tata Motors Ltd.	46.4	0	12.85	20.5	20.2	Automotive
Tata Power Company Ltd.	32.66	0	19.21	29.1	19	Power
Tata Steel Ltd.	30.67	0	18.5	22.7	28.1	Steel
Tata Tea Ltd.	34.77	0	8.006	34.9	22.3	Tea
Reliance Infrastructure Ltd.	36.49	0	17.58	25.6	20.3	Construction
Crompton Greaves Ltd.	38.29	0	13.01	24.5	24.2	Power
Reliance Industries Ltd.	45.55	0	16.23	9.84	28.4	Conglomerate
PTC India Ltd.	15.29	0	21.98	40	22.7	Power trading
Oriental Bank of Commerce	49.45	0	10.66	27.5	12.4	Public Sector Bank
Pantaloon Retail (India) Ltd.	45.83	0	19.71	12.4	22.1	Single Brand
Petronet LNG Ltd.	48.46	0	10.07	2.58	38.9	Petroleum PSU
Piramala Healthcare Ltd.	47.06	0	23.55	8.91	20.5	Drugs and Pharmaceuticals
Madras Cements Ltd.	38.02	0	3.015	18.2	40.7	Cement
ITC Ltd.	48.75	0	12.55	34.3	4.38	Cigarettes
LIC Housing Finance Ltd.	35.34	0	31.66	16.2	16.8	Housing finance
Kotak Mahindra Bank Ltd.	47.16	0	28.64	4.03	20.2	Private banking
Indian Hotels Company Ltd.	27.89	0	12.58	27.3	32.2	Hotels
India Infoline Ltd.	32.61	0	19.96	17.8	29.7	Financial Information
IFCI Ltd.	39.95	0	11.36	36.2	12.5	Financial consultancy (NBFC)
Hindalco Industries Ltd.	37.63	0	17.41	19.7	25.2	Mining
Hindustan Construction Co Ltd.	37.56	0	24.34	14.8	23.3	Construction
Hindustan Petroleum Corporation Ltd.	49.26	0	9.139	27.9	13.7	Petroleum – PSU
ICICI Bank Ltd.	48.63	0	28.67	20.3	2.38	Private Banking

Name of Company	Promoter Holding	Foreign Promoter Holding	FII Holding	DII Holding	Other	Sector
Idea Cellular Ltd.	48.25	0	7.591	7.97	36.2	Telecom
Housing Development Finance Corp Ltd.	44.88	0	30.25	24.2	0.7	Construction
Gujarat State Petronet Ltd.	35.63	0	11.89	24.2	28.2	Petroleum (PSU)
Exide Industries Ltd.	44.04	0	7.695	18.2	30.1	Power
Financial Technologies (India) Ltd.	44.38	0	23.37	7.64	24.6	Technologies
GlaxoSmithkline Consumer Healthcare Ltd.	39.87	0	7.362	21.9	30.8	Drugs and Pharmaceuticals
Divis Laboratories Ltd.	38.64	0.03	11.1	11.1	39.2	Drugs and Pharmaceuticals
Dr. Reddy's Laboratories Ltd.	28.71	0	25.92	22.8	22.5	Drugs and Pharmaceuticals
Educomp Solutions Ltd.	48.41	0	37.96	1.45	12.2	Education
Biocon Ltd.	39.18	19.8	4.151	15.7	21.2	Drugs and Pharmaceuticals
Century Textiles and Industries Ltd.	36.85	0	5.739	16.3	41.1	Textiles
CESC Ltd.	49.38	0	15.59	17.9	17.1	Power
Chambal Fertilizers and Chemicals Ltd.	45.86	0	4.763	9.24	40.1	Agriculture
Chennai Petroleum Corporation Ltd	49.37	14.7	4.676	9.98	21.3	Petroleum PSU
Colgate Palmolive India Ltd.	48.78	0	13.97	7.26	30	Toothpaste
Bajaj Holdings and Investments Ltd.	27.59	0	8.69	15.7	48.1	Conglomerate
Balrampur Chini Mills Ltd.	34.64	0	12.04	26.1	27.2	Agriculture
Bharat Forge Ltd.	40.26	0	10.74	16	33	Manufacture
Ashok Leyland Ltd.	43.36	0	12.35	23.5	20.8	Automotives
Asian Paints Ltd.	47.13	0	14.14	12.2	26.5	Paints
Aditya Birla Nuvo Ltd.	41.29	19.2	15.87	15.9	23.7	Conglomerate
Aban Offshore Ltd.	36.77	20.9	6.644	14.2	21.4	Shipping

Notes:

Of the 200 corporations analyzed in the BSE-200 Index, 50 are companies where the promoter stakes are less than 50%, but where the promoter and DII stakes combined are greater than 50%. When this data is consolidated with the data in Table 1, one finds that a total of 107 companies, representing 53.5% of the sample set, are companies in which the promoter stake is less than 50%.

Sectors have been identified for the purposes of determining the vulnerability of these corporations to foreign (inbound) hostile takeover, based on foreign investment regulations discussed below. Based on foreign investment regulations, one finds a total of 26 companies are vulnerable to hostile acquisition.

When this data is consolidated with the data in Table 1, one finds that a total of 86 of 200 companies, representing 43% of the sample set, are vulnerable to foreign (inbound) hostile acquisition.

For conglomerate sectors, issues under Press Note 2 (2009) and Press Note 4 (2009) (discussed below) may arise.

2. *The Emami-Zandu Deal*

In 2008, Emami Ltd., a cosmetics products manufacturer, acquired a controlling stake in Zandu Pharmaceuticals Works, Ltd., an Ayurvedic pharmaceutical company, for a total price of Rs. 7.5 billion (approximately \$150 million), after a hostile battle with the promoters of the target.⁷²

Zandu Pharmaceuticals, the target, was a listed corporation controlled by two promoter groups, the Vaidya and Parikh families. Emami, along with others “acting in concert” with it, had acquired an initial stake of 14.81% in the target.⁷³ In May 2008, consequent to conditional share purchase agreements with members of the Vaidya family, at a price of Rs. 6,900 (approximately \$138) per share,⁷⁴ Emami contracted to acquire an additional 10 to 11% in the target, which would increase its stake in Zandu Pharmaceuticals to 27.5%. The share purchase agreements were subject to compliance with the Takeover Code failing which the purchase would not take place. With an over 25% stake in the target, Emami would thereby succeed in gaining blocking rights in Zandu Pharmaceuticals. At this stage, even if Emami went no further and merely complied with its obligations under the Takeover Code, it would still have sufficient leverage in terms of its blocking rights to negotiate a deal with the board, with the aim of either selling its stake to the promoters or buying them out. When the Vaidya family initially appeared to have bailed out on its long-term partners, the Parikh family was suddenly left starkly vulnerable to the “enemy at the gate.”

The Parikh family, which owned an approximately 18% stake in the target, approached friends and members of the extended Vaidya family for the support of an additional 8–10% in the target.⁷⁵ At the same time, the Parikh family started buying shares of the target on the open market. Consequently, by June of 2008, the price of Zandu Pharmaceuticals had

72. See Rumi Dutta, *We May Buy Companies Overseas*, ECON. TIMES, May 21, 2009, <http://economictimes.indiatimes.com/opinion/interviews/We-may-buy-companies-overseas-/articleshow/4557842.cms>.

73. See Letter of Offer, filed by Emami Ltd. with SEBI, on June 13, 2008, available at <http://www.sebi.gov.in/takeover/zandupharmalof.pdf>.

74. See *id.*

75. *Battle Hots Up Over Controlling Stakes in Zandu Pharmaceutical*, LIVEMINT.COM, June 24, 2008, <http://www.livemint.com/2008/06/24225815/Battle-hots-up-over-controllin.html>.

already risen above Rs. 15,000 (approximately \$314) per share,⁷⁶ and prices continued to skyrocket during the ongoing takeover battle.⁷⁷ As Emami sought to make the mandatory tender offer prescribed by India's Takeover Code, the Parikh family challenged Emami's advances before the Company Law Board, the Bombay High Court, and the Securities and Exchange Board of India.⁷⁸ At this stage, if Emami's tender offer were successfully subscribed to by shareholders, Emami would secure a 47.5% stake in the target.⁷⁹ Emami made an all-cash tender offer to the shareholders of the target on June 2, 2008, for Rs. 7,315 (approximately \$146) per share, revising its offer twice: first, on September 19, 2008, to Rs. 15,000 (approximately \$300) per share,⁸⁰ and then on October 3, 2008 to Rs. 16,500 (approximately \$330).⁸¹ The final offer price reflected a premium of 239% to the price paid by Emami to members of the Vaidya family, and a similar premium to the minimum price prescribed by the Takeover Code's pricing guidelines.

Eventually, following over four months of protracted negotiations, Emami bought the 18.18% stake of the Parikh family pursuant to a share purchase agreement dated October 15, 2008, for Rs. 2.2 billion (approximately \$44 million), at a price of Rs. 15,000 (approximately \$300) per share, and a non-compete fee of Rs. 220 million (approximately \$4.4 million)⁸² which, along with the tender of shares by shareholders consequent to the mandatory tender offer, put Emami in control of Zandu Pharmaceuticals⁸³ with a 70.34% stake in the corporation.

76. Aveek Datta, *Truce Talks Begin Between Zandu, Emami*, LIVEMINT.COM, June 20, 2008, <http://www.livemint.com/2008/06/20235055/Truce-talks--begin-between-Zan.html>.

77. *CLB Refers Zandu Issue Back To SEBI*, BUS. STANDARD, Aug. 28, 2008, <http://business-standard.com/india/storypage.php?autono=332783>.

78. *CLB Reserves Order on Zandu-Emami Row*, HINDU BUS. LINE, Aug. 21, 2008, <http://www.thehindubusinessline.com/2008/08/21/stories/2008082152680100.htm>; Sambit Saha, *Emami Faces Open Offer Delay*, TELEGRAPH, July 21, 2008, http://www.telegraphindia.com/1080721/jsp/business/story_9578395.jsp. It seems that the Company Law Board passed an order dated July 28, 2008 dismissing the case. Thereafter, on August 7, 2008, the Bombay High Court directed the Company Law Board to decide the application for interim relief. Finally, the Company Law Board passed an order dated August 20, 2008, by which it dismissed the case for lack of jurisdiction. See Corrigendum to the Public Announcement to the Equity Shareholders of the Zandu Pharmaceutical Works Ltd., June 2, 2008, available at <http://www.sebi.gov.in/takeover/zanducorri.pdf>.

79. *To Get Control at Zandu, Emami May Offer a Premium to Parikhs*, LIVEMINT.COM, June 2, 2008, <http://www.livemint.com/2008/06/01220710/To-get-control-at-Zandu-Emami.html>.

80. See Corrigendum to the Public Announcement, *supra* note 78, cl. III.

81. See Post Offer Public Announcement for the Attention of Equity Shareholders of the Zandu Pharmaceuticals Works Limited, Nov. 3, 2008, available at <http://www.sebi.gov.in/takeover/zandu post.pdf>.

82. *Zandu Sells Stake to Emami*, FIN. EXPRESS, Oct. 17, 2008, <http://www.financialexpress.com/news/zandu-sells-stake-to-emami/374306>.

83. *Emami Acquires Controlling Stake in Zandu*, HINDU BUS. LINE, Oct. 17, 2008, <http://www.thehindubusinessline.in/2008/10/17/stories/2008101752470100.htm>.

Emami's acquisition of Zandu Pharmaceuticals exposes, in particular, the weaknesses of cozy relationships that have dominated Indian business in previous decades, underscoring the possibility that financial relationships in India do in fact sour, and that being best friends may not be the best defense.

B. Early Warning Mechanisms

Indian corporations may believe themselves to be invulnerable to hostile takeover because of the early warning mechanism which is built into India's Takeover Code. Under the provisions of Regulation 7 of the Takeover Code, an acquirer must make a public disclosure within two days to the corporation and to the stock exchanges where its shares are listed when its holdings exceed the 5%, 10%, 14%, 54%, and 74% thresholds.⁸⁴ While this may preempt a stealthy attempt to acquire control over a corporation, such early warning mechanisms are not unknown to systems which have been conducive to robust markets for corporate control.

For example, section 13(d)(1) of the American Securities Exchange Act of 1934 has not thwarted the hedge funds' "wolf pack" that takes positions of 4.99% each in corporations.⁸⁵ The primary difference between the American and Indian "early warning" provisions lies in the time within which the disclosure must be made. The 1934 Act requires disclosure within ten days as opposed to two days under Indian takeover law.⁸⁶ The American hostile acquirer accordingly benefits from ten days of permissible silence, within which time it can presumably do much more than an acquirer can do in two days in India.

Of course, the hostile acquirer can make a hostile acquisition in India despite this provision. First, a nimble hostile acquirer may acquire up to 14.9% of the shares of a corporation within two business days without having to make any disclosures. Next, by making a mandatory public offering for a minimum 20% of the voting rights of the company, as required by India's Takeover Code, a hostile acquirer can severely diminish the capacity of the target's board to adopt reactive defensive measures; Regulation 23 of the Indian Takeover Code provides that after a public announcement is made by an acquirer, the board cannot employ scorched earth tactics, enter into material contracts, or issue or allot any authorized but unissued securities

84. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, Gazette of India, section 7 (Feb. 20, 1997), available at <http://www.sebi.gov.in/acts/act15a.pdf>.

85. See Laurie Smilan, David A. Becker & Dane A. Holbrook, *Preventing "Wolf Pack" Attacks*, NAT'L L.J., Nov. 20, 2006, available at http://www.lw.com/upload/pubContent/_pdf/pub1710_1.pdf.

86. Securities Exchange Act of 1934 § 13(d)(1), 15 U.S.C. § 78a (2010).

carrying voting rights during the offer period.⁸⁷ Accordingly, the hostile acquirer that acquires a 14.9% stake in the target within two days can avoid the drawbacks of the early warning mechanism by making a public announcement to acquire an additional stake in the target on the second day.

C. Acquisition Finance

Several restrictions on acquisition finance make hostile acquisitions of Indian corporations seem unattractive. First, there exist several regulatory restrictions limiting the ability of an acquirer to tamper with the assets of the target, both within hostile and friendly contexts. In friendly deals, the leveraged buyout of a public company or its subsidiary using the assets of the target as collateral is prohibited by Indian company law. However, this restriction applies only to public companies and their subsidiaries, theoretically leaving open the possibility of taking a company private using this route.⁸⁸ Within the hostile context, Indian takeover law prohibits the acquirer from selling, disposing of, or otherwise encumbering “any substantial asset” of the target “except with the prior approval of the shareholders,”⁸⁹ thereby limiting its ability to refinance its acquisition.⁹⁰

Second, the Reserve Bank of India, India’s central bank, heavily regulates the borrowing and lending of funds for acquisition purposes. The universe of Reserve Bank regulations can be analyzed using the following variables: the identity of the target, the identity of the acquirer, and the source of funds. Generally speaking, an Indian acquirer is severely restricted from obtaining either Indian or foreign funds for an acquisition, unless the target is a foreign corporation. While a foreign acquirer would be subject to similar restrictions for obtaining Indian funds to support Indian acquisition, foreign acquirers generally have wider access to foreign funds.⁹¹

Under these rules, consider the following three hypothetical scenarios. In Scenario 1, both the target and the acquirer are domestic Indian corporations. Indian corporate houses are restricted in their use of both domestic and foreign funds in any attempt to acquire a hostile Indian target. Under the

87. Takeover Code § 23.

88. The Companies Act § 77(2).

89. Takeover Code §§ 16(ix), 22(18).

90. However, it is unclear if “prior approval” would require a special resolution, or if it would suffice for the acquirer to obtain an “ordinary resolution” to sell or encumber the target’s “substantial asset,” which would arguably be easier in the post-acquisition scenario.

91. Needless to say, this applies equally to foreign targets, depending on the national regulation to which the corporation is subject.

Reserve Bank's guidelines, popularly referred to as the "ECB Guidelines,"⁹² Indian corporate houses cannot borrow funds from international banks or financial institutions for the purposes of acquiring a company, or any portion thereof, in India.⁹³ There is, however, an exception under the "approval route" in favor of financial institutions dealing exclusively with infrastructure or export finance.⁹⁴ Indian domestic banks are prohibited from granting advances enabling the acquisition of shares, although an exception has been carved out for financing the acquisition of shares of infrastructure companies.⁹⁵ Additionally, bank credit is prohibited to "non banking finance companies" for investment in any company's shares.⁹⁶

The ability of Indian domestic corporations and promoters to raise finances using share capital as collateral is also limited. The total available credit against share capital to any single individual is limited to Rs. 2 million (approximately \$42,500).⁹⁷ Further, an Indian domestic bank cannot hold shares in a company—whether as pledgee, mortgagee, or absolute owner—exceeding 30% of the company.⁹⁸

In Scenario 2, the target is a foreign corporation and the acquirer is a domestic Indian corporation. Indian corporate houses can more easily obtain funds in order to acquire a hostile foreign target. Indeed, Indian companies have been given general permission to obtain funds from a domestic bank (authorized dealer) to participate in a bidding or tender offer process overseas,⁹⁹ subject to ceilings. For example, the total financial commitment may not exceed 400% of the net worth of the Indian party as on the date of

92. RESERVE BANK OF INDIA, MASTER CIRCULAR NO. 07/2009-10, MASTER CIRCULAR ON EXTERNAL COMMERCIAL BORROWINGS AND TRADE CREDITS (July 1, 2009), available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/27ECB010709_F.pdf.

93. *Id.* pt. I(A)(vi), B(vi).

94. *Id.* pt. I(B)(vi) (read with pt. I(B)(i)(a)–(b)).

95. RESERVE BANK OF INDIA, MASTER CIRCULAR DBOD.No.DIR.BC.90/13.07.05/1997-98, MASTER CIRCULAR ON BANK FINANCE AGAINST SHARES AND DEBENTURES (Aug. 28, 1998); RESERVE BANK OF INDIA, MASTER CIRCULAR DBOD No.DIR.BC.17/13.03.00/2008-09, MASTER CIRCULAR—LOANS AND ADVANCES—STATUTORY AND OTHER RESTRICTIONS § 2.3.7.5(iv) (July 1, 2009), available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/69SR010709_F.pdf.

96. RESERVE BANK OF INDIA, MASTER CIRCULAR DBOD.BP.BC.No.4/08.12.01/2008-09, MASTER CIRCULAR—BANK FINANCE TO NON-BANKING FINANCIAL COMPANIES (NBFCs) § 5.1(ii) (July 1, 2008), available at <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/85374.pdf>.

97. RESERVE BANK OF INDIA, MASTER CIRCULAR DBOD No.DIR.BC.15/13.03.00/2009-10, MASTER CIRCULAR—EXPOSURE NORMS § 2.4.1 (July 1, 2009), available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/71ME010709_F.pdf.

98. *Id.* § 2.3.2.1.

99. Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Amendment) Regulations, 2004, Gazette of India, section 14 (Nov. 19, 2004), available at <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/60901.pdf> [hereinafter FEMA Transfer Rules]; see also MASTER CIRCULAR—EXPOSURE NORMS, *supra* note 92, § 2.4.13(a).

its last audited balance sheet.¹⁰⁰ RBI approval is required in other cases.¹⁰¹ Moreover, under the ECB Guidelines, overseas direct investment in joint ventures or wholly owned subsidiaries is permissible, although subject to existing guidelines on Indian direct investment in such ventures.¹⁰² For this purpose, a “joint venture” is defined as a foreign entity in which an Indian party makes a direct investment.¹⁰³ However, “all-in-cost ceilings,” including interest and some other fees and expenses, presently stand at 300 basis points over six-month LIBOR for loans between three and five years and 500 basis points over six-month LIBOR for loans over five years.¹⁰⁴ Generally, RBI guidelines do not apply where the acquisition takes place through the use of funds held in a Resident Foreign Currency account or through foreign currency resources outside India (in circumstances where the Indian acquirer is not “permanently resident in India”).¹⁰⁵

In Scenario 3,¹⁰⁶ the target is an Indian corporation, and the acquirer is a foreign corporation. While foreign corporations may be subject to similar restrictions in obtaining funds from Indian banks, they would not be prohibited, under Indian regulations, from obtaining funds from foreign banks in order to carry out acquisitions in India, unless the national regulations to which the foreign bank is subject provide otherwise.

Clearly, the avenues for domestic Indian corporations to obtain funding to finance domestic acquisitions are limited. However, this does not in any way limit the ability of foreign corporations to assume positions in Indian corporations using overseas financing opportunities. While the general collapse of the debt markets following the financial crisis may constitute an exogenous reason that has reduced hostile takeover activity generally, a subsequent upsurge in debt market activity might just spur inbound hostile

100. FEMA Transfer Rules § 6, *as amended by* Foreign Exchange Management (Transfer or Issue of Any Foreign Security) (Third Amendment) Regulations, 2007, Gazette of India, (Mar. 25, 2008), available at <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/88452.pdf>.

101. FEMA Transfer Rules § 9.

102. RESERVE BANK OF INDIA, MASTER CIRCULAR NO. 07/2009-10, MASTER CIRCULAR ON EXTERNAL COMMERCIAL BORROWINGS AND TRADE CREDITS pt. I(A)(v)(b) (July 1, 2009), available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/27ECB010709_F.pdf.

103. FEMA Transfer Rules § 2(m).

104. MASTER CIRCULAR ON EXTERNAL COMMERCIAL BORROWINGS AND TRADE CREDITS, *supra* note 102, pt. I(A)(iv).

105. RESERVE BANK OF INDIA, MASTER CIRCULAR NO. 01/2009-10, MASTER CIRCULAR ON DIRECT INVESTMENT BY RESIDENTS IN JOINT VENTURE (JV)/WHOLLY OWNED SUBSIDIARY (WOS) ABROAD (July 1, 2009) § A.4, available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/21DWR010709_FULL.pdf.

106. For the purposes of this paper, I ignore Scenario 4, where the target is a foreign corporation, and the acquirer is a foreign corporation, since the focus of this paper is the Indian market for corporate control. Scenario 2 has been discussed merely to highlight the contrast between the ability of Indian promoters to fund domestic acquisitions, and to fund foreign acquisitions.

activity in the future. Further, these restrictions do not apply to hostile acquisitions alone but also to friendly deals, which continue to take place despite these restrictions.

D. Foreign Investment Restrictions

Despite a productivity surge around the 1980s attributable to the Indian government's pro-business (not pro-market) stance, India faced a severe balance of payments crisis in 1991.¹⁰⁷ Until then, Indian economic policy was overwhelmingly punctuated by controls, tariffs, subsidies, and quotas. Against this backdrop, the Indian government negotiated loans from the International Monetary Fund, the World Bank, and donor countries, loans which entailed obligations.¹⁰⁸ On August 27, 1991, the Finance Minister of India, Dr. Manmohan Singh, wrote a letter to the International Monetary Fund outlining the macroeconomic objectives of the Indian economy.¹⁰⁹ What followed was the New Economic Policy and endeavors to achieve fiscal stabilization and structural adjustment. Under the policy, the government undertook the following objectives: first, reducing the deficit in the central government's budget by devaluing the rupee by 20% and changing the export-import policy by encouraging exports and containing imports; second, obtaining stand-by rights to \$2.26 billion from the International Monetary Fund with the purported objective of restoring confidence in the Indian economy; third, seeking a budget with a better balance between revenue and expenditure; fourth, reforming the industrial licensing system; fifth, relaxing antitrust policy; and sixth, permitting foreign investment.¹¹⁰

Foreign investment policy in India has periodically been liberalized, culminating in Press Note 4 (2006), in which almost all sectors were opened to foreign investment. Today, besides eight sectors in which foreign investment is prohibited in India (retail trading which is not single-brand product retailing, atomic energy, the lottery business, gambling and betting, the business of chit funds, nidhi companies, trade-in transferable

107. A.S. Bhalla, *Sino-Indian Growth and Liberalization: A Survey*, 42 *ASIAN SURV.* 419, 421 (2002).

108. Ramashray Roy, *India in 1992: Search for Safety*, 33 *ASIAN SURV.* 119, 120 (1993).

109. *Id.* at 120–21.

110. *See generally* Arun Ghosh, *New Economic Policy: A Review*, 27 *ECON. & POL'Y WKLY.* 1175 (1992).

development rights, and any sectors not open to private sector investment),¹¹¹ foreign investment is permitted either under the “automatic route” or consequent to the prior approval of the Foreign Investment Promotion Board (FIPB) or the Reserve Bank of India. Under the automatic route, no prior approvals are required from any governmental entity or from the Reserve Bank of India, although there are some notification and filing obligations that must be carried out at the latter.¹¹² However, there are two¹¹³ exceptions to the automatic route. First, prior government approval is required where more than 24% foreign equity is proposed to be inducted for the manufacture of items reserved for the small scale sector.¹¹⁴ Second, foreign investment in purely “investing companies,” i.e., companies that conduct only monetary operations, requires prior government approval,¹¹⁵ even though their subsidiaries may be amenable to foreign investment under the automatic route.

Significantly, when submitting an application to make an investment in a sector which is not automatic, a foreign investor is required to submit a board resolution passed by the target company,¹¹⁶ a resolution which would be impossible to obtain in the hostile context. In this manner, nationalist sentiment forms an invisible barrier to the hostile acquisition under the approval route.

111. See Press Note No. 7 (2008 Series), Dep’t of Indus. Policy & Promotion, Consolidated Policy on Foreign Direct Investment (June 16, 2008), available at http://siadipp.nic.in/policy/changes/pn7_2008.pdf.

112. See CONSOLIDATED FDI POLICY; RESERVE BANK OF INDIA, NO. 13/2010-11, MASTER CIRCULAR ON FOREIGN INVESTMENT IN INDIA § I.18 (July 1, 2010), available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/13MFIN010710_F.pdf.

113. Prior to March 31, 2011, there were three exceptions. The third exception was that where the acquirer had an existing joint venture or technology transfer or trademark agreement as of January 12, 2005, foreign investment in the “same” field required government approval, except under certain circumstances. Press Note No. 1 (2005 Series), Dep’t of Indus. Policy & Promotion, Guidelines Pertaining to Approval of Foreign/Technical Collaborations (Jan. 12, 2005), available at http://siadipp.nic.in/policy/changes/pn1_2005.pdf. There were primarily three circumstances in which such investments required no approval: (1) investments to be made by Venture Capital Funds registered with the Securities and Exchange Board of India; (2) where the investment of either party in the existing joint venture was less than 3%; or (3) where the existing venture or collaboration was defunct or sick. This third exception has now been removed by the consolidated foreign direct investment circular dated March 31, 2011. CONSOLIDATED FDI POLICY at 88.

114. See CONSOLIDATED FDI POLICY § 5.2.4.

115. Press Note No. 4 (2009 Series), Dep’t of Indus. Policy & Promotion, Clarificatory Guidelines on Downstream Investment by Indian Companies (Feb. 25, 2009), § 4.2.3, available at http://siadipp.nic.in/policy/changes/pn4_2009.pdf.

116. See Check List for FIPB Plain Paper Application, Dep’t of Indus. Policy & Promotion, cl. 7(a)–(b), available at http://finmin.nic.in/fipbweb/fipb/fipb_index.html.

In the following paragraphs, foreign investment regulation in India is analyzed from three standpoints: general restrictions, restrictions specific to institutional investors, and restrictions under takeover regulations.

There are several sectors of the Indian economy in which foreign investment is permissible under the automatic route where the foreign investor seeks to hold more than half of the domestic company's holdings, which would make an Indian corporation amenable to the inbound hostile acquisition.¹¹⁷ Those sectors which are not amenable to foreign hostile acquisition are as follows: tea, certain mining activities, cigars and cigarettes, defense, asset reconstruction, broadcasting, commodity exchanges, courier services, credit information companies, insurance, investing in infrastructure or services, public sector petroleum companies, print media, telecommunications, trading, single-brand product retailing, and satellites.¹¹⁸ These sectors are identified as being shielded from inbound hostile acquisition for one of two reasons: either the permissible foreign investment may be capped at less than 50% or the prior approval of the FIPB would be required, an approval which may be difficult to obtain given the possibility of nationalist sentiment arguments. This approval, as noted above, would be especially difficult to obtain in a hostile scenario, given that the FIPB presently requires a target board resolution prior to conferring approval.¹¹⁹ Accordingly, the eight sectors identified above as ones in which no foreign investment is permissible at all can be thought of as invulnerable to the inbound hostile acquisition.¹²⁰

However, all other sectors are amenable to foreign investment in excess of 50% under the automatic route, theoretically leaving open the possibility of inbound hostile acquisition. Tables 1 and 2 set out those corporations which are amenable to hostile acquisition, based on the promoter or combined promoter and DII holdings, identified from a list of 200 companies listed on the BSE-200 Index. These tables identify the foreign investment sector under which these corporations would possibly be categorized.¹²¹ Viewing foreign investment restrictions through the lens of the previous

117. The sectors amenable to foreign investment are set out in Press Note 7 (2008 Series), *supra* note 111. An analysis of the regulation, based on those sectors which are amenable to hostile acquisition and those that are not, is on file with the author, and available upon request.

118. *See* CONSOLIDATED FDI POLICY *passim*.

119. *See supra* note 100 and accompanying text.

120. In this context, it is important to note that the hostile foreign acquirer may also be an acquirer of Indian origin, as Indian policy does permit Non Resident Indians (NRIs) to invest in certain sectors where other foreign investment is not as easily permitted (e.g., scheduled air transport services).

121. It is assumed for sectors that do not fall under any identified category that foreign investment is permissible in such companies under the automatic route, consequent to page 10 of the latest consolidated foreign direct investment policy. Press Note 7 (2008 Series), *supra* note 111.

study conducted, one finds that a total of 86 out of 200 Indian companies (constituting 43% of the total sample set) are vulnerable to inbound hostile takeover, i.e. where foreign investment is permitted under the automatic route, based on the stakes of promoters being below 50%. On the other hand, a total of 49 companies (constituting 24.5% of the sample set) are vulnerable to foreign hostile acquisition based on the combined stake of promoters and domestic institutional investors being below 50%.

Additionally, assuming that the policy of the FIPB becomes neutral toward the hostile acquirer, twenty-eight more sectors, which are presently shielded from hostile acquisition purely because any foreign acquisition in these sectors requires regulatory approval, would become vulnerable to hostile takeover. Further, in the telecommunications sectors, the FIPB's approval is required beyond a certain percentage stake (49%), which leaves open the possibility of a collaborative effort between domestic and foreign hostile acquirers, although telecommunications companies are subject to antitrust and other regulations.¹²² In some sectors (e.g., telecommunications) foreign investment permissible under the automatic route may still be sufficient to obtain a 25.1% stake in the corporation, thereby gaining blocking rights and the consequent power to negotiate with the target board.

Nonresidents of India are prohibited from investing or trading directly in securities listed on India's stock exchanges.¹²³ However, this broad rule has several exceptions. First, subsidiaries wholly or partially owned and controlled by foreigners can invest and trade on India's stock exchanges since they would be considered "resident" in India.¹²⁴ Second, private

122. See Guidelines for Intra Service Merger of Cellular Mobile Telephone Service (CMTS)/Unified Access Services (UAS) Licenses, Apr. 22, 2008 (issued by the Department of Telecommunications).

123. CONSOLIDATED FDI POLICY § 3.1.

124. If the primary business of the subsidiary is investment, then it will be considered a "non-banking financial company" and be subject to relevant regulations, including minimum capitalization norms. See RESERVE BANK OF INDIA, NO.DFC.118/DG(SPT)-98, NON-BANKING FINANCIAL COMPANIES ACCEPTANCE OF PUBLIC DEPOSITS (RESERVE BANK) DIRECTIONS (Jan. 31, 1998), available at <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/71239.pdf>; RESERVE BANK OF INDIA, NO.DNBS.193/DG(VL)-2007, NON-BANKING FINANCIAL (NON-DEPOSIT ACCEPTING OR HOLDING) COMPANIES PRUDENTIAL NORMS (RESERVE BANK) DIRECTIONS, 2007 (Feb. 22, 2007), available at <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/85290.pdf>; RESERVE BANK OF INDIA, NO.DNBS.192/DG(VL)-2007, NON-BANKING FINANCIAL (DEPOSIT ACCEPTING OR HOLDING) COMPANIES PRUDENTIAL NORMS (RESERVE BANK) DIRECTIONS, 2007 (Feb. 22, 2007), available at <http://rbidocs.rbi.org.in/rdocs/content/PDFs/75943.pdf>; RESERVE BANK OF INDIA, NO.DNBC.39/DG(H)-77, MISCELLANEOUS NON-BANKING COMPANIES (RESERVE BANK) DIRECTIONS, 1977 (June 20, 1977), available at http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/8MNBE010709_Full.pdf. Foreign investment rules regulating indirect and downstream investment will continue to apply. See CONSOLIDATED FDI POLICY § 4.1. If the subsidiary's total assets are greater than Rs. 1 billion, then it would be treated as a "systemically important core investment company." See RESERVE BANK OF INDIA, RBI/2010-11/168, REGULATORY FRAMEWORK FOR CORE INVESTMENT COMPANIES pmbl.

arrangements negotiated outside of the context of the stock market between resident Indian shareholders and foreigners are permissible. Third, listed companies can issue stock to foreigners, for example, by way of a preferential allotment or rights issue (although this is highly unlikely in a hostile scenario). Fourth, non-resident Indians and SEBI-registered foreign institutional investors can purchase listed securities on the stock exchange directly.

However, foreign institutional investors are prohibited from investing in more than 10% of the total issued capital of a company.¹²⁵ The total shareholding of all foreign institutional investors put together cannot exceed 24% unless the board passes a resolution, and a special resolution is passed.¹²⁶ The combined power of these restrictions would not, however, thwart complex workarounds; for example, three foreign institutional investors with stakes each of 9.9%, 9.9%, and 5.1%, respectively may team up with a strategic foreign acquirer with a stake of 26.2%.

Under the Takeover Code, the sale of shares by “residents” to “non-residents” requires the approval of the Reserve Bank of India when the transaction would attract the provisions of the Takeover Code.¹²⁷ When such transactions occur, though, the RBI may implement protectionist strategies if it so wishes.¹²⁸ But this potential hurdle is easily overcome because under Indian foreign exchange law, a “resident” includes a corporation incorporated or registered in India.¹²⁹ Accordingly, a foreign hostile acquirer that incorporates a wholly owned subsidiary in India can trigger the provisions of Indian takeover law, without simultaneously conferring upon the RBI the authority to thwart its hostile acquisition attempt.¹³⁰

(Aug. 12, 2010), available at <http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/ICICNO97D130810.pdf>.

125. Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995, Gazette of India, section 15(5)–(6) (Nov. 14, 1995), available at <http://www.sebi.gov.in/acts/Foreign Institutional.html>; RESERVE BANK OF INDIA, MASTER CIRCULAR NO. 02/2009-10, MASTER CIRCULAR ON FOREIGN INVESTMENT IN INDIA, pts. I, II(2)(i)(a) (July 1, 2009).

126. MASTER CIRCULAR ON FOREIGN INVESTMENT IN INDIA, *supra* note 125, pt. I § II cl. 2.

127. *Id.* pt. I, § I, cl. 22.

128. *Id.*

129. The Foreign Exchange Management Act, 1999, No. 42, Acts of Parliament, 2000 (India), § 2(v)(ii).

130. While such subsidiaries would be subject to the financing restrictions highlighted above, this would not prevent the foreign parent corporation from borrowing funds and lending these to the subsidiary. However, it is important to consider clause 5 of Press Note 4 (2009 Series), *supra* note 115, which provides that investment into shell companies that neither carry out operations or have downstream investments would require the approval of the Foreign Investment Promotion Board.

1. *The Press Note 2 Defense*

Foreign investment restrictions can also help domestic companies to devise interesting defensive tactics to ward off hostile overtures by foreign acquirers, based on the Indian government's Press Note 2 (2009). An investigation into the distinction between three categories of companies in India is instructive: operating, operating-cum-investing, and investing. For the purposes of this Article, an "operating company" is a company with no subsidiaries/investments; an "investing company" is a company with no operations, but only subsidiaries/investments; and an "operating-cum-investing company" is a company with both operations and subsidiaries/investments.

Foreign investments comprised of pure investing or holding companies that have no operations would require prior government approval.¹³¹ Accordingly, the foreign hostile acquisition of pure holding companies could possibly be thwarted by the nationalist sentiment of the FIPB.

Pure operating companies that are conglomerates (i.e., companies with ingredients of business prohibited to foreign investment) pose an interesting dilemma to the foreign hostile acquirer.¹³² For example, when an operating company carries out operations in both power and atomic energy, foreign investment would be permissible in the power sector under the automatic route, but investment in the atomic energy sector would be prohibited.¹³³ Accordingly, such an operating company would be shielded from the foreign hostile takeover attempt.

Operating-cum-investing companies similarly pose an interesting problem to the foreign acquirer. Investment exceeding 50% by a foreign investor in a holding company is considered an indirect investment in its subsidiary (to the full extent of the holding company's investment in the subsidiary unless the subsidiary itself is wholly owned) and may therefore constitute a violation of FDI policy, without (or sometimes irrespective of) approval. Consider the following hypothetical: Company A, a foreign acquirer, invests 50.1% in Company B, an Indian holding company, which has a 90% stake in Company C, a company engaged in the gambling/lottery business, a sector prohibited to foreign investment. The 90% stake of Company B in Company C is considered indirect investment by the Company A in Company C, thereby exposing the Company A to breach of foreign investment policy. This would not have occurred had the foreign

131. Press Note 4 (2009 Series), *supra* note 115, § 4.2.3.

132. *Id.* § 4.2.1.

133. *See* CONSOLIDATED FDI POLICY § 5.2.6.

investment by Company A in Company B been less than 50%. Similarly, if Company B has a 100% stake in Company C, then the entire investment of Company A in Company B, 50.1%, is considered indirect investment in Company C. In this context, there is some uncertainty about what percentage stake in a corporation would be considered sufficient for a corporation to qualify as an operating-cum-investing company. For example, using the hypothetical above, if Company B had a mere 2% stake in Company C, it is uncertain if Company A's investment in Company B would be prohibited.¹³⁴

In this manner, Indian companies which have diversified holdings or operations in sectors requiring government approval for foreign investment may be less vulnerable to foreign hostile acquisition, based on Press Note 2.¹³⁵

2. *The Cabinet Committee Defense and Antitrust Law*

Foreign investments exceeding Rs. 1200 crore (approximately \$260 million) require the approval of the Cabinet Committee on Economic Affairs (CCEA).¹³⁶ Therefore, all Indian companies that have a market capitalization in excess of \$520 million, where a majority investment would exceed \$260 million, are additionally shielded from the foreign hostile acquisition by the potential nationalist sentiment of the CCEA. Big business would accordingly be shielded from hostile inbound acquisition by another layer of bureaucracy. The difficulties faced in the consummation of the friendly Vedanta-Cairn deal¹³⁷ highlight how potent this defence could potentially be if a hostile acquirer were to approach the Cabinet Committee.

134. See *FIPB Redefines Holding Companies—Sweeping Impact on India Inc.*, THE FIRM, http://thefirm.moneycontrol.com/news_details.php?autono=350277 (last updated Sept. 15, 2008).

135. Press Note 2 (2009 Series) may prove to be a hurdle, enabling this defense. See Pramugtha Mamgain, *L&T, EADS Defence JVs Hit Hurdle*, ECON. TIMES, Aug. 15, 2009, <http://economictimes.indiatimes.com/news/news-by-industry/indl-goods/-svs/engineering/LT-EADS-defence-JVs-hit-hurdle/articleshow/4895294.cms>.

136. Press Note 1 (2010 Series) § 3.1(a), Dep't of Indus. Policy & Promotion, Mar. 25, 2010.

137. Vedanta Resources plc, Twin Star Energy Holdings Limited, and other "persons acting in concert" sought to acquire 51% of the voting capital of Cairn India Limited, with the remaining 10.63% stake of the promoters in Cairn India Limited subject to rights of first refusal in favor of the Vedanta group. However, on account of the sheer size of the investment proposed, and objections by a state-run entity (which was a partner of the target in its oil field business) to the present royalty arrangements, the deal has faced considerable bureaucratic obstacles. See Sanjay Dutta, *ONGC Raises Bar, Vedanta to Miss Cairn India Takeover Date*, TIMES OF INDIA, Jan. 30, 2011, http://articles.timesofindia.indiatimes.com/2011-01-30/india-business/28373771_1_cairn-vedanta-cairn-s-barmer-barmer-fields; Garry White, *Royalty Dispute Hits Vedanta-Cairn Deal*, TELEGRAPH, Apr. 6, 2011, <http://www.telegraph.co.uk/finance/newsbysector/industry/mining/8432801/Royalty-dispute-hits-Vedanta-Cairn-deal.html>; James Lamont & Amy Kazmin, *Delhi Delays Cairn-Vedanta Deal*, FINANCIAL TIMES, Apr. 6, 2011, <http://www.ft.com/cms/s/0/309ba64c-601d-11e0-abba-00144feab49a.html#axzz1NdtS6u91>

India's Monopolies and Restrictive Trade Practices Act, 1969, inspired by socialist era philosophies of the state acquiring the "commanding heights" of the economy, sought to curb monopolies and big business.¹³⁸ Notwithstanding, it is widely believed that the command-and-control licensing regime had nurtured a few large businesses. Though the law was amended in 1991 to suit India's liberalization outlook with changes that included the removal of merger controls, there was a sense that the regulatory mindset had not changed. In his budget speech on February 27, 1999, the Finance Minister of India, Yashwant Sinha stated that competition law in India had become "obsolete" and that the focus had to shift from "curbing monopolies to promoting competition."¹³⁹ The resulting Competition Act of 2002¹⁴⁰ had not entirely been notified. However, its provisions dealing with mergers and acquisitions are proposed to be notified very soon by the government, such that they will come into force on June 1, 2011.¹⁴¹

At present, Indian company law prohibits the acquisition of more than 25% of a public corporation without prior central government approval (ordinarily conferred by the Ministry of Corporate Affairs),¹⁴² where either the acquirer is or the resulting entity would be a "dominant undertaking."¹⁴³ A dominant undertaking would broadly include any entity that has a 25% market share.¹⁴⁴ Such government approval would arguably be more difficult for the foreign hostile acquirer to obtain.

Conversely, the new competition law of India, unenforceable for now, regulates "combinations" of a certain size that would have an "appreciable adverse effect" on competition in India.¹⁴⁵ When the law comes into force, it would give the newly established antitrust regulator, the Competition

(available by subscription); *GoM Refers Cairn-Vedanta Deal to CCEA*, ECON. TIMES, May 27, 2011, <http://economictimes.indiatimes.com/news/news-by-industry/energy/oil-gas/gom-refers-cairn-vedanta-deal-to-ccea/articleshow/8606687.cms>.

138. The Monopolies and Restrictive Trade Practices Act, 1969, No. 54, Acts of Parliament, 1969 (India), § 2(d), available at http://www.mca.gov.in/Ministry/actsbills/pdf/The_Monopolies_and_Restrictive_Trade_Practices_Act_1969.pdf.

139. Yashwant Sinha, Minister of Fin., Gov't of India, Union Budget Speech of 1999–2000 (Feb. 27, 1999).

140. The Competition Act, 2002, No. 12 of 2003, Gazette of India (Jan. 13, 2003); see Gireesh Chandra Prasad & Suchetana Ray, *CCI Blessings To Be Must For M&As, Rejigs*, ECON. TIMES, June 8, 2009, <http://economictimes.indiatimes.com/Economy/CCI-blessing-must-for-MAs-rejigs/articleshow/4629250.cms>.

141. Draft notifications have been submitted to the Ministry of Corporate Affairs of the Government of India. E.g., MINISTRY OF CORPORATE AFFAIRS, F.NO. 5/4/2003-IGC/CS (Mar. 4, 2011).

142. The Companies Act § 108A.

143. *Id.* § 1086.

144. The Monopolies and Restrictive Trade Practices Act § 2(d).

145. The Competition Act §§ 5–6.

Commission of India (CCI), the authority to look into a variety of factors in order to determine whether a “combination” is anti-competitive. Such factors include barriers to entry, extent to which substitutes are available in the market, market share, nature of vertical integration, level of “combination” in the market, and others.¹⁴⁶ Initially, the new law made notification voluntary, but pursuant to an amendment in 2007, notification is now mandatory.¹⁴⁷ If the CCI has not passed any orders, a “combination” comes into effect within 210 days from the date of notice.¹⁴⁸ However, the CCI would still be entitled to investigate “combinations” within one year of their taking place.¹⁴⁹ Potential enforcement of the new law carries with it the hope that hostile acquisitions, especially inbound acquisitions involving foreign investment, might be somewhat facilitated. This is because the new law permits companies with a market share that exceeds 25% to go ahead with their acquisition, so long as their assets fall below the threshold or their acquisitions are not anti-competitive.¹⁵⁰

E. Other Invisible Barriers: Due Diligence and Litigation

Finally, there may be other exogenous factors that contribute to the absence of hostile takeover activity in India. Consider that friendly deals are often concluded consequent to extensive financial and legal due diligence. Conversely, the information available to the hostile acquirer would be comparatively limited in India. While the target’s incorporation documents, audited financials, and litigation information may be publicly available, the hostile acquirer would still not be able to obtain third-party contracts (especially agreements with lenders)¹⁵¹ and employment agreements. These contracts or agreements could contain embedded takeover defenses—often in the form of penalties or severance packages—that are triggered upon a

146. *Id.* § 20(4).

147. Competition Amendment Act, 2007, No. 39 of 2007, Gazette of India, section 5(a) (Sept. 25, 2007), available at http://www.mca.gov.in/Ministry_hn/actsbills/pdf/Competition_Amendment_Act_2007.pdf.

148. The Competition Act, 2002, No. 12 of 2003, Gazette of India, section 6(2)(a) (Jan. 14, 2003).

149. *Id.* § 20(1). Further, under § 31(11), where a prior application has been made to the Competition Commission of India, and the regulator does not respond within ninety days, the “combination” is deemed to have been accepted.

150. Although conversely, the law theoretically permits acquisitions that result in a market share of less than twenty-five percent to still fall within the scanner, since they may be viewed as anti-competitive. However, the requirement of market share as an element in determining the anti-competitiveness or otherwise of a combination may make this position less likely.

151. Shareholders’ agreements would not be required since they would be unenforceable under Indian law presently, since they must be incorporated into the articles of association of the corporation, which is a publicly available document.

change of control. Without advance knowledge, such measures would come as an unwelcome surprise to the acquirer. Indeed, the recent scandal involving Satyam Computer Services, Ltd., where the Indian outsourcing giant's chairman, Ramalinga Raju, resigned after "admitting to years of accounting malpractices,"¹⁵² exposed corporate governance flaws in India, while underscoring the importance of financial and legal due diligence.

Further, promoters often use the tool of litigation in India's courts to construct hurdles for a hostile acquirer, which may act as substantial deterrents to risk-averse acquirers, especially in an inbound or foreign context where domestic promoters are more likely to be favored by domestic tribunals. Promoters have been known to petition tribunals and the SEBI to challenge an acquirer's advances. While litigation in India risks souring a business relationship, the path of the hostile acquisition has generally been known to create litigation, and the hostile acquirer would therefore presumably proceed with the acquisition conscious of the risks of litigation. Finally, litigation in India can certainly be used as a tool to strengthen parties' relative bargaining positions, and can also be used by the hostile acquirer.

III. DEVISING A POISON PILL WITHIN INDIA'S RESTRICTIVE REGULATORY REGIME

The poison pill has previously been ruled out in academic writings as precluded by regulatory restrictions in India,¹⁵³ but is it possible to devise a takeover defense which mimics the crippling effects of a conventional flip-in poison pill? Simply said, a plain vanilla poison pill is a shark repellent defensive shareholder rights plan which gives rights to the shareholders of a corporation exclusive of the hostile acquirer and is exercisable upon the crossing of a threshold, or occurrence of a "trigger event," by the hostile acquirer.¹⁵⁴ In the typical scenario, shareholders of a corporation are given a right (distributed by dividend) to purchase additional common or preferred stock in a corporation—a right which is at first financially unviable to

152. *India Satyam Fraud Office Probe*, BBC NEWS, Jan. 13, 2009, <http://news.bbc.co.uk/2/hi/business/7826967.stm>.

153. See, e.g., Mathew, *supra* note 1; Shroff, *supra* note 3; Rajiv K. Luthra, *Can India Inc Swallow the "Poison Pill"*, ECON. TIMES, May 19, 2008, <http://economictimes.indiatimes.com/opinion/view-point/can-india-inc-swallow-the-poison-pill/articleshow/3051566.cms>.

154. Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred*, 97 HARV. L. REV. 1964, 1964–65 (1984). For a detailed investigation into poison pill mechanics, see William J. Carney & Leonard A. Silverstein, *The Illusory Protections of the Poison Pill*, 79 NOTRE DAME L. REV. 179 (2003) and Guhan Subramanian, *Bargaining in the Shadow of PeopleSoft's (Defective) Poison Pill*, 12 HARV. NEGOT. L. REV. 41 (2007).

exercise since the exercise price is too high, reflecting the “long-term value” of the corporation.¹⁵⁵ However, when a hostile acquirer’s stake in the target crosses a certain threshold, the pill triggers the rights plan by which all shareholders, to the exclusion of the acquirer, may exercise their rights at a discount to market price. In theory, the ensuing capital infusion makes it financially unviable for the acquirer to carry on with the acquisition. Although the pill’s defensive ability has been challenged in academic writings,¹⁵⁶ the factual absence of a deliberate pill trigger speaks to its relative durability in the corporate control arena. Ever since the invalidation of the dead-hand version of the pill under Delaware law,¹⁵⁷ the motive force of the poison pill has been to force acquirers to negotiate with the target’s board, which has the right to redeem the rights before the trigger event occurs.¹⁵⁸ The flip-over poison pill gives target shareholders the right to acquire shares in the hostile acquirer, in the event that the acquirer attempts a merger following the acquisition.¹⁵⁹ Since attempting a merger following the hostile acquisition would require a difficult 75% majority vote in the Indian context, this Article focuses primarily on the flip-in version of the pill. Strategies to work around the poison pill focus on waging a proxy contest to remove board members and to thereby revoke the pill.

In the Indian environment in particular, three distinctive features of a typical flip-in poison pill are widely believed in the legal community as making the pill difficult to utilize. The first feature, and perhaps least significant hurdle, is that Indian company law prohibits non-cash dividends to be paid to shareholders (except as fully paid-up bonus shares),¹⁶⁰ which rules out the distribution of exercisable defensive rights to shareholders in the conventional manner. What this also means, however, is that—unlike the issue of dividend, which is gratuitous and would typically require no protective disclosures or regulatory filings—a pill plan involving the issue of shares in India may entail copious filings with the SEBI.¹⁶¹

155. Anthony Augliera, *Shareholder Rights Plans: Saying No to Inadequate Tender Offers*, 57 *FORDHAM L. REV.* 803, 808 (1989).

156. *See, e.g., id.*

157. *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998); *see also Omnicare Inc. v. NCS Healthcare, Inc.*, 2002 WL 31767892 (Del. Dec. 10, 2002).

158. *See Subramanian, supra* note 154.

159. R. Matthew Garms, *Shareholder By-Law Amendments and the Poison Pill: The Market for Corporate Control and Economic Efficiency*, 24 *J. CORP. L.* 433, 437 (1999).

160. The Companies Act § 205(3).

161. Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, Gazette of India (Aug. 26, 2009), available at <http://www.sebi.gov.in/guide/sebiidcreg.pdf> [hereinafter ICDR Regulations].

The second and third features are perhaps more difficult hurdles to overcome. The second feature, a conventional plain vanilla poison pill, requires that the acquirer be excluded from the rights plan. The third feature requires the rights conferred by the poison pill plan to be exercisable by shareholders at a discount to market price. Excluding the hostile acquirer from the plan precipitously increases the acquirer's costs of acquisition, since the equilibrium price that the market will require the acquirer to pay following the rights issue would typically be higher than the discounted price that the shareholders pay for the additional shares. The discount is key since it makes it financially viable for shareholders to exercise their rights under the poison pill plan. Ironically, this is designed to ensure that shareholders will not tender their shares to a hostile acquirer, as they anticipate making a tidier profit by exercising rights to purchase discounted shares consequent to a pill trigger, thereby preventing the pill trigger in the first place (unless the acquirer is prepared to pay a premium which meets the benefits of the discount). Indian regulation, it is widely believed, permits corporations to either exclude the acquirer or issue shares at a discount to all shareholders, but not to do both. This widely held belief is examined in greater detail below, where this Article seeks to establish that it is possible in the Indian corporate regulatory context to devise a poison pill plan that both excludes the acquirer and issues shares at a discount.

A. Background: Relevant Takeover Code Provisions

Any analysis of takeover defenses under Indian law must be prefaced by a brief summary of India's takeover law. Under the complexly worded and often confusing body of regulations termed the Takeover Code,¹⁶² no acquirer can—either by itself or with others—acquire stock exceeding certain thresholds without making a mandatory offer to the shareholders of a corporation for a minimum of 20% of the stock so as to enable minority shareholders to exit and to partake of the control premium. Specifically, an acquirer that wants to cross the 15% threshold,¹⁶³ buy 5% or more when its stake in a corporation is between 15% and 55%,¹⁶⁴ or buy any stock at all when it holds between 55% and 75%,¹⁶⁵ must make a public announcement in the manner prescribed by the Takeover Code to buy a minimum 20% of

162. Takeover Code § II(3)(11).

163. Takeover Code § 10.

164. *Id.* § 11(1).

165. *Id.* § 11(2).

the voting capital of the corporation.¹⁶⁶ Acquiring control, i.e., the ability to appoint the majority of directors or to control management or policy decisions,¹⁶⁷ also triggers the mandatory tender offer requirement.¹⁶⁸ The hostile acquirer must factor this mandatory tender offer regime into its strategy when attempting any hostile acquisition.

However, the Takeover Code also severely limits the universe of reactive defensive tactics that the target's board can employ to defend the interests of the shareholders and the corporation (assuming that such interests are paramount) when a tender offer has been made by a hostile acquirer. The acquirer's tender offer must remain open for a period of at least twenty days,¹⁶⁹ during which the actions that a target board can take are limited; for instance, scorched earth tactics (such as selling off crown jewels) or white knight arrangements are prohibited.¹⁷⁰ The target board is also prohibited during this time from issuing any authorized but unissued shares.¹⁷¹ However, in a narrow exception under the Takeover Code, the target board is *not* prohibited from issuing or allotting shares pursuant to a "rights issue" in "respect of which the offer document has already been filed with the Registrar of Companies or Stock Exchanges," or shares "upon exercise of options against warrants."¹⁷²

Of course, the target board is not prohibited from issuing shares or adopting defensive measures when the acquirer crosses any threshold below 15%, i.e., before the acquirer makes a mandatory tender offer. In fact, the acquirer must inform the target every time it crosses certain thresholds: 5%, 10%, 14%, 54%, and 74%.¹⁷³ Accordingly, the target board could wait for an acquirer to announce that it has, say, 14% and then issue shares to shareholders under a pill plan. However, as elaborated before, the acquirer would have a two-day period of silence within which it has to make these disclosures. An agile acquirer could theoretically acquire 14.9% (whether by itself or in concert with others in order to avoid suspicion) and make a public announcement within two days, thereby freezing the board's ability to adopt defensive measures reactively. Therefore, the target board's most reliable defense would be one which operates during the mandatory tender offer period.

166. *Id.* § 21(1).

167. *Id.* § 2(c).

168. *Id.* § 12.

169. Takeover Code § 22(5).

170. *Id.* § 23(1)(a).

171. *Id.* § 23.

172. *Id.* § 23(1), *Explanation*.

173. *Id.* § 7.

A poison pill plan in India can either seek to issue discounted shares to all shareholders (excluding the hostile acquirer) pursuant to a rights issue where the offer document has already been filed, or it can give shareholders the option to convert previously issued rights (termed “warrants”) in the event that an acquirer crosses a threshold. The difficulties with both of these approaches are analyzed and addressed below.

B. The Tenuous Ex-Post Share Warrant Defense

Indian corporations may raise capital using primarily three methods: (1) a public issue, (2) a rights issue,¹⁷⁴ or (3) a private placement. A public issue may take the form of either an initial public offering (for unlisted corporations) or a further public offering (for listed corporations). A private placement may take the form of a preferential allotment of shares to strategic buyers or a qualified institutions placement to institutional buyers. For the purpose of devising a poison pill, the public issue route would not work because of the obvious ability of the hostile acquirer to participate in the issue. Furthermore, a corporation which seeks to raise equity capital from outsiders would require the approval of a special majority of its shareholders,¹⁷⁵ which may be difficult to obtain.

The board of directors of a corporation may use the private placement/preferential allotment route to issue shares to some shareholders (or to anybody else) to the exclusion of other shareholders, a mechanism that could be used in a defensive rights plan to exclude the hostile acquirer. However, shares so issued are required to be issued at a price prescribed by regulatory guidelines, which would make exercise of the right expensive and therefore ineffective as a defensive tactic, unless issued to those willing to pay the price to defend the corporation, e.g., the promoters. Like a public issue, a preferential allotment would again require a special resolution of shareholders, which could be difficult to obtain, considering that poison pills have typically been equated with board entrenchment interests.¹⁷⁶

Indian company law permits public corporations with the prior approval of the central government to issue share warrants to shareholders, entitling the warrant holders to a prescribed number of equity shares.¹⁷⁷ In fact, the promoters of many Indian corporations hold share warrants, and consequently, offers under the Takeover Code are sometimes made

174. The Companies Act § 81.

175. The Companies Act § 81(A).

176. See Garms, *supra* note 159.

177. The Companies Act § 114.

contingent upon the warrants not being exercised.¹⁷⁸ However, share warrants have limited defensive abilities. Indian securities law prohibits companies to be listed if there are outstanding rights (including warrants) entitling holders to receive equity.¹⁷⁹ For this reason, warrants cannot be issued before the company is listed (but they can be issued after the company goes public)¹⁸⁰ when the promoters would presumably have greater control over the corporation, and share warrants would not be subject to pricing guidelines.

Issuing warrants after the corporation is listed entails various difficulties.¹⁸¹ First, since warrants are issued on a preferential basis to some shareholders over others, they require special resolutions of shareholders to be passed, which may be difficult for listed entities where promoters and their affiliates have stakes substantially below 75%. Second, warrants issued for listed entities are subject to pricing guidelines,¹⁸² although such warrant holders are required under Indian law to pay only 25% of the price of the warrants at the outset and can pay the remaining 75% at the time of exercise.¹⁸³ Although this exercise price may amount to a discount under the market price as time goes by, the fact that warrants can lapse if not exercised within a relatively short, prescribed period of time—usually eighteen months—limits the discount that this bifurcation would otherwise have achieved for the promoters. Third, this avenue would require additional promoter investment, which may be substantial, unlike a poison pill, where the costs of the defensive shark repellent mechanism are shared among the shareholders. The warrants would have to be issued to promoters alone since the absence of a discount due to pricing guidelines would make it unlikely that ordinary shareholders would exercise their options and convert the warrants to stock. Fourth, the warrants so issued are subject to timing restrictions. The allotment of specified securities must be completed within

178. See Post Offer Public Announcement by Allsec Technologies Ltd., Jan. 12, 2007, available at <http://www.sebdi.gov.in/takeover/allsecpostoffer.pdf>.

179. Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2009, Gazette of India, section 26(5) [hereinafter Disclosure Requirements], available at <http://www.sebi.gov.in/guide/sebiidcrreg.pdf> (Aug. 26, 2009).

180. A “public company” under Indian company law is a company that: (i) does not restrict rights to transfer shares; (ii) does not limit its members to fifty; (iii) does not prohibit invitation to the public to subscribe for its shares or debentures; and (iv) has a minimum paid up capital of Rs. 50 million (approximately \$1 million). A private company which is a subsidiary of a public company also counts. See The Companies Act § 3(1)(iii)–(iv).

181. These difficulties would also largely apply to other convertible securities such as optionally convertible preferred shares which can convert to equity at the company’s option.

182. Disclosure Requirements § 76.

183. *Id.* § 77(2).

fifteen days of the special resolution,¹⁸⁴ and the tenure of convertible securities cannot exceed eighteen months from the date of allotment.¹⁸⁵ The possibility of obtaining repeated special resolutions every eighteen months may make the defensive process more difficult.

C. The Rights Issue Pill

A rights issue is an issue of shares to the existing shareholders of the corporation in proportion to their respective stakes in the corporation. The rights issue route does not require either a shareholder vote or a special resolution, and it can be affected by board resolution. However, considering that the benefits of a rights issue must accrue to every shareholder of the corporation, including a possible hostile acquirer, the exclusion of the hostile acquirer from a rights issue-based poison pill plan would have to be explored. It is argued below that, despite the inability of the board to completely exclude the hostile acquirer from participating in a rights issue, it is certainly possible to partially exclude the acquirer in a manner conducive to the purposes of a conventional poison pill.

1. Excluding the Acquirer: The Record Date

Procedurally, the rights issue is governed by the provisions of the Issue of Capital and Disclosure Requirements Regulations of 2009 (“ICDR Regulations”) recently issued by the SEBI, and the Listing Agreement that a corporation enters into with a stock exchange. In order for a rights issue to be permissible, at least 90% of the shares issued must be subscribed.¹⁸⁶ It is unclear if an offer by existing shareholders to subscribe to the unsubscribed portion of the rights issue, thereby exceeding their own entitlements, would satisfy the 90% requirement. Shares so issued can typically be issued at a discount to market price.

A rights issue involves several steps,¹⁸⁷ which a corporation must undertake in order to consummate the offering, including, but not limited to, filing the offer document with SEBI and the stock exchange, declaring a record date, and sending the offer document to the shareholders. These steps can be divided into three categories. First, a corporation may be required to undertake several standalone steps, which may be carried out only once.

184. *Id.* § 74(2).

185. *Id.* § 75.

186. ICDR Regulations sched. VIII, pt. D, § XVII(B).

187. A rights issue requires the completion of a total of thirty-six steps, which have been identified by the author, and are available upon request.

Notifying the exchange of a board meeting is an example of such a requirement.¹⁸⁸ Second, a corporation may be required to complete several time-triggering steps, e.g., filing documents with regulatory authorities such as SEBI or the stock exchange. These time-triggering steps commence a time period within which the rights issue must be consummated. Third, corporations are required to engage in rights issue-consummating steps, e.g., declaring a record date or issuing letters of offer.¹⁸⁹

For an Indian corporation wishing to use the rights issue route as a shark repellent defensive tactic, the second of these steps is the most problematic. Though the standalone steps can be accomplished easily, and the rights issue-consummating steps may not arise until the pill's triggering event has occurred, the time-triggering steps may need to be performed by the corporation at periodic intervals. The most significant time-triggering step is the filing of the draft offer document with SEBI. Following this filing, a corporation has either three months to carry out the rights issue or twelve months of any observations issued by SEBI if such observations are issued.¹⁹⁰ Consequently, in order for a corporation to set up a rights issue-based poison pill, it would have to either periodically file the required documents with SEBI or renew its previous filings with SEBI. The offer document must state that the offer is conditional upon the occurrence of a triggering event, such as an acquirer crossing a threshold stake.¹⁹¹ Such filings would entail unavoidable agency and transaction costs, since the Takeover Code prohibits the issuance of securities (including those under a potential poison pill plan) unless documents have been filed with the Registrar of Companies or the stock exchange.¹⁹² The ICDR Regulations provide that the filings made with the stock exchange must be preceded by a filing with SEBI.¹⁹³ Although the ICDR Regulations permit SEBI to relax the strict enforcement of regulations that appear to be procedural in nature,¹⁹⁴ there appears to be no reason to believe that SEBI would relax the filing requirement for each successive offer document filed in the context of a defensive rights issue.

188. Sec. & Exch. Bd. of India, Listing Agreement for Securitised Debt Instruments Cir./IMD/DF/5/2011 cl. 13(h) (Mar. 16, 2011).

189. ICDR Regulations §§ 52, 54.

190. ICDR Regulations § 11(1).

191. The offer document is required to contain all "material disclosures" that are "true and adequate" in order to "enable the applicants to take an informed investment decision." ICDR Regulations § 57(1).

192. Takeover Code § 23(1)(c)(ii).

193. ICDR Regulations § 4(1).

194. Disclosure Requirements § 109(a).

Tracking the steps delineated by Indian regulation surrounding the rights issue, would it be possible for a corporation to exclude a hostile acquirer from participating in a rights issue? After all, it is the board's prerogative to determine the record date by which the eligibility of shareholders to participate in the rights issue will be determined, and all shareholders of a corporation on that date are entitled to participate in a rights issue. While it may be clear that a record date cannot go as far back as a decade, it may be legitimate for the board of directors of a corporation to declare, consequent to a hostile tender offer, that the date on which the hostile acquirer makes the voluntary tender offer under the Takeover Code is the record date for the purposes of the rights issue. In this manner, the hostile acquirer would be preempted from exercising any rights issued to shareholders who tender their shares, although it would still be able to participate in the rights issue to the extent of its preexisting stake.

As an alternative to giving directors the authority to subsequently declare a record date, which may then weaken their bargaining position by virtue of the fact that they would have the last look on the pill's devastating consequences,¹⁹⁵ the record date could also be stated in the offer document filed with SEBI and the stock exchange as the date on which any triggering event occurs. Under this approach, the pill becomes irrevocable in the event that the threshold is crossed, thus sharpening its defensive effectiveness. This approach would have to balance competing interests between ensuring that the pill becomes irrevocable upon the hostile crossing of a threshold and giving the directors the authority to carve out exemptions for friendly deals. One possible solution would be to define a triggering event in the offer document as excluding a tender offer or other acquisition consequent to a "Memorandum of Understanding" or other agreement executed by the target board. This exception would not cover *ex ante* agreements executed by the target board, and accordingly, they would be able to maintain a strong bargaining hand, because a hostile acquirer would require the prior approval of the target board in order to avoid the poison pill trigger.

2. *The Indian Poison Pill in Motion*

The board of directors of a corporation may adopt a poison pill in the following manner: first, comply with the previously highlighted standalone steps; and second, periodically pursue time-triggering steps, (i.e., make all filings with the pertinent regulatory authorities). It is important to note that

195. See Subramanian, *supra* note 154 (arguing that PeopleSoft's poison pill was defective because it gave its directors the "last look").

penalties for withdrawing the issue only arise once a record date has been declared,¹⁹⁶ and the board can then decide not to go through with the rights issue, which thereby ensures that the board has leverage in its negotiations with the hostile acquirer. The dynamics of the poison pill devised using the rights issue route are analyzed in the hypothetical below.

Company B is a domestically listed Indian corporation, amenable to foreign investment up to 100% under the automatic route, and one in which the promoters' and domestic institutional investors' stake is less than 30%. The board of directors of Company B has issued a board resolution authorizing a rights issue, and has completed all standalone rights issue steps. It also periodically makes its time-triggering filings in a timely manner. Either no record date has ever been declared for a rights issue or the record date is the date on which any potential triggering event occurs. The total number of outstanding shares of Company B is 1 billion, and the market price of each share is Rs. 200. The market capitalization of Company B is Rs. 200 billion. Under the proposed rights issue, a total of one billion shares would be issued to all eligible shareholders at a discount of 12.5 percent to the market price upon the occurrence of a trigger event. The trigger event is defined as the making of a mandatory tender offer by an acquirer, which, upon completion, would result in the acquirer owning more than 15% stock in the corporation.

Company A, a foreign hostile acquirer, assumes a 14.9% stake in Company B. Desirous of crossing the 15% threshold, Company A makes a tender offer conditioned on a minimum level of acceptance of 35.2% of the shares¹⁹⁷ of Company B on January 15, 2011, thus complying with and exceeding the minimum requirements (i.e., making an offer for a minimum 20%) of the Takeover Code. If all shares are tendered, Company A would obtain a 50.1% stake in Company B.

In order for the board of Company B to defend the corporation from Company A's hostile overtures, directors of Company B would have to declare a record date, assuming that all other documents have been filed with the appropriate authorities. Accordingly, the board of Company B would declare January 15, 2011, the date on which Company A made the tender offer, or any date before then to be the record date. Alternatively, if the record date has been described in the offer document as the date on which the trigger event occurs, then the same result would be achieved.

196. Disclosure Requirements § 52(3).

197. Section 21A of the Takeover Code permits offers which are conditioned on a minimum level of acceptance, which "may be less than 20%."

The simplified schematics below accompany an analysis of the costs of acquisition to the hostile acquirer if the pill were not in place and if the pill were in place:

Scenario 1: No Poison Pill

Number of Shares Outstanding: 1 billion
Market Capitalization: Rs. 200 billion
Market Price of Each Share: Rs. 200
Total Cost of Acquisition: Rs. 100 billion

Scenario 2: Poison Pill

Number of Shares Outstanding: 1 billion
Number of Shares Outstanding Consequent to Rights Issue: 2 billion
Share Price: Rs. 187.50
Market Capitalization: Rs. 375 billion
Price Paid Per Share for 14.9%: Rs. 200
Price Paid Per Share to Retain 14.9% in Rights Issue: Rs. 175
Price Paid Per Share for Remaining 35.2%: Rs. 187.50
Total Cost of Acquisition: Rs. 187.5 billion

In Scenario 1, in order to acquire a 50.1% stake in Company B, Company A would have to pay Rs. 200 for each of 501 shares, amounting to a little over Rs. 100 billion. The total cost of acquisition would therefore be Rs. 100 billion. Assuming that Company A would have to pay a premium of Rs. 15 per share to the tendering shareholders of Company B, the total cost of acquisition would be Rs. 107.5 billion.

In Scenario 2, Company A acquires a 14.9% stake in the corporation before the poison pill is triggered. Accordingly, Company A would pay Rs. 200 for each of 149 million shares, amounting to a little under Rs. 30 billion. Thereafter, upon the pill being triggered, Company A would be entitled to participate in the rights issue to the extent of 14.9% but not to the extent of the shares tendered to it in the tender offer due to the record date. In order to maintain its 14.9% stake in Company B, Company A would have to pay a sum of Rs. 175 (reflecting a discount of 12.5% to the market price) for each of 149 million shares, amounting to a little under Rs. 26.25 billion. Since the total number of shares has increased to 2 billion and the market capitalization has increased to Rs. 375 billion, the price of each share in an efficient market would typically reach equilibrium around Rs. 187.50 per share. In order to raise its stake to 50.1%, Company A would have to pay Rs. 187.50 for each of 701 shares, amounting to a little over Rs. 131.25 billion. The total cost of acquisition for Company A would be Rs. 187.5 billion reflecting an 88.5%

increase, almost in inverse proportion to the discount issued to the shareholders under the rights issue. Assuming that Company A would have to pay a premium of Rs. 15 per share to the tendering shareholders of Company B, the total cost of acquisition would be Rs. 200.25 billion.

Indian takeover law also requires an acquirer to price its offer based on certain parameters.¹⁹⁸ Thus, in Scenario 2, Company A would not be able to make an offer to the shareholders of Company B at a discount to market price (accounting for the rights issue), even if it were able to convince Company B's shareholders to tender shares at a discount, which is unlikely. Since all shareholders would believe that they would stand to gain if the rights issue were triggered, typically none of them would tender their shares, thwarting the acquirer's takeover attempts.

Of course, had the acquirer not been entitled to participate in the rights issue at all, the cost of acquisition would have gone up even more, since Company A would not have been able to avail itself of a discount in order to maintain its stake in Company B. Conversely, if Company A negotiates a friendly deal with Company B, then the board needs only to pass a resolution approving the deal, assuming that an exception has been carved out in the rights issue offer documents for friendly deals.

3. *Possible Difficulties With The Rights Issue Approach*

There are difficulties with the rights issue route, in addition to the agency costs and transaction costs problems highlighted above. One such difficulty for target corporations is the prospect of the hostile acquirer replacing the board before the rights issue is consummated. This difficulty is capable of being addressed. First, a hostile acquirer may not be able to buy sufficient time to replace the board. The Takeover Code provides that the offer to tender shares must remain open for a period of twenty days.¹⁹⁹ During this offer period, the acquirer is prohibited from replacing the board.²⁰⁰ This ensures that, during the offer period, the target board of directors can freely pursue the rights issue under the exception to the prohibition against scorched earth tactics discussed above. The rights issue period must remain open for a mandatory period of fifteen days, which means that a rights issue, in theory, is capable of conclusion prior to the close of the tender offer period.²⁰¹ Additionally, even assuming that a rights issue has not been

198. *Id.* § 20.

199. Takeover Code § 22(5).

200. *Id.* § 22(7).

201. Takeover Code § 22(12).

entirely consummated as the tender offer concludes, the hostile acquirer would still have to go through the process of convening an extraordinary general meeting in order to replace the board, a process which could take another forty-five days from the date of deposit of requisition to convene the meeting.²⁰² Second, a truly staggered board, as discussed below, may make it impossible for the hostile acquirer to replace the board before the rights issue is triggered.

The next difficulty is one of interpretation: what if the aforementioned interpretation of the record date provision of the ICDR Regulations meets regulatory hurdles? In other words, what if the hostile acquirer cannot be excluded from participating in the rights issue through the record date tactics? The poison pill may still work, since the consequent capital infusion may still make it inordinately expensive for the hostile acquirer to acquire the corporation even at the discount. Using the previous hypothetical, if Company A gains a 50.1% stake in the corporation and is entitled to participate in the rights issue, it would still have to pay a total of over Rs. 87.5 billion for 501 million newly issued shares. The only difficulty with this approach is that Company A may refuse to participate in the rights issue altogether. Recall that a rights issue requires 90% subscription. However, it is unclear if an offer by a shareholder to subscribe beyond its own shareholding in a proposed rights issue would satisfy this 90% requirement.²⁰³ If so, the promoters of Company B would be entitled to subscribe to more than their entitlement, in the event that the rights issue is unsubscribed, and perhaps sidestep this difficulty. As a result, the promoters would then incur heavy costs in thwarting a takeover attempt. Although the promoters may then perhaps be able to pay themselves out through dividend or a share buyback, regaining control over the corporation would not come cheaply and burdensome transaction costs would still be incurred.

There is one final difficulty that may hinder the defensive capabilities of the rights issue. A rights issue typically carries a right of renunciation: shareholders entitled to participate in a rights issue may renounce their rights in favor of the acquirer. However, there are two reasons for which renunciation may have only a minimal effect on the defensive rights issue. First, even if the shareholders renounce their rights in favor of a hostile acquirer, the hostile acquirer may either incur heavy costs of acquisition by participating in the offer or simply refuse to exercise the rights. The latter option exposes the acquirer to the risk that the promoter group subscribes

202. See The Companies Act § 169(c).

203. While this appears to be done in practice, the decision of the Gujarat High Court, within a different context, is instructive. See *In re Mafatlal Indus. Ltd.*, (1995) 84 Comp. Cas. 230 (Guj) (India).

(either directly or through a white knight) to the shares. Of course, if this Article's interpretation of the record date provision does not hold water, a hostile acquirer entitled to participate in the offer may renounce its rights in favor of a third party. As a practical matter, though, this entire problem can be obviated by placing a provision in the articles of the corporation that provides that a rights issue does not carry with it the right of renunciation.²⁰⁴

D. The Ex Ante Employee Stock Option Plan Defense

The Takeover Code seems only to prohibit a reactive issue of shares by the target's board, but makes no mention of the exercise by employees of a previously issued option to purchase equity during the hostile acquirer's mandatory offer period. It has thus been suggested that an employee stock option plan (ESOP) could be used as a takeover defense in India.²⁰⁵ In fact, a prudent corporation might even be able to use this route to defend itself from potential acquisition *ex ante*, before the company's shares are listed on a national stock exchange.²⁰⁶ While an ESOP scheme, including one containing a potential defensive mechanism, adopted after listing would require a special resolution of shareholders to enact it,²⁰⁷ a preexisting plan appears to require nothing more than mere disclosure in the offer document at the stage of listing.²⁰⁸ If an ESOP does require a special resolution of shareholders, such a resolution would likely be easier to obtain before a company is listed rather than after. Further, employees (but not promoters)²⁰⁹ can be given non-transferable²¹⁰ rights to purchase stock in the corporation at discounted²¹¹ levels that may be exercised or accelerated when an acquirer crosses a certain threshold.

An ESOP-based pill would achieve the dual purpose of diluting the acquirer's holding by excluding the acquirer and providing shares at a discount. It could also be justified by the target board more easily as safeguarding other constituencies' interests: employees whose services may

204. The Companies Act § 81(1)(c).

205. Luthra, *supra* note 153.

206. Section 26(5)(b) of the ICDR Regulations permits a corporation to continue with its employee stock option plan, provided accounting guidelines and rules are followed.

207. Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, Gazette of India, section 6.1 (1999), *available at* <http://www.sebi.gov.in/acts/stockoption.pdf> [hereinafter Stock Option Guidelines].

208. *Id.* § 15.3.

209. *Id.* § 4.2-4.3 (prohibiting promoters or directors with more than a 10% stake from participating in an ESOP scheme).

210. *Id.* § 11.

211. *Id.* § 8.1.

be terminated consequent to hostile acquisition. However, in order for the ESOP scheme to achieve the dilution and capital infusion ends of a poison pill, it would have to confer substantial rights on its employees, and ESOP schemes are not conventionally designed to achieve such high levels of dilution. The dilution achieved by an ESOP-based pill would also tend to dilute the stakes of all existing shareholders, which may raise concerns of minority shareholder oppression. In order to be effective, an ESOP-based defensive mechanism may therefore have to work in tandem with some other form of discounted equity issuance to existing shareholders.

Alternatively, a rights issue pill could potentially be used in tandem with an “Employee Stock Purchase Scheme,” which may enable the target’s employees to participate²¹² in the issue at a substantially discounted price,²¹³ a route which may not otherwise be open to the target since any issue of shares besides a rights issue is prohibited by the Takeover Code during the hostile acquirer’s tender offer period.

IV. STAGGERED BOARD, EMBEDDED DEFENSES, AND THE FUTURE OF THE INDIAN BOARDROOM

Besides the Press Note 2 defense and the poison pill defense (which may take the form of share warrants, a rights issue, or an ESOP plan), there exist other defensive mechanisms for thwarting hostile acquisition attempts, either in conjunction with the poison pills or by themselves. As previously discussed, although the staggered board is the default position under Indian company law from which corporations may opt out, any director of a corporation can be removed without cause by ordinary resolution.²¹⁴ However, directors cannot be removed in this way when the articles of the corporation provide that two-thirds of the directors may be appointed by proportional representation.²¹⁵ Since the articles of an Indian corporation can only be amended with a whopping 75% supermajority, attempting to “un-stagger” the board by making directors amenable to summary removal would be exceedingly difficult for the hostile acquirer to achieve.

212. Under the Stock Option Guidelines, an “employee stock purchase scheme” is defined as “a scheme under which the company offers shares to employees as part of a public issue or otherwise.” Stock Option Guidelines § 2.1(4). This tends to indicate that an employee stock purchase scheme (ESPS) does not enable a corporation to offer shares to its employees by itself, but only permits it to enable employees to participate in an offer of securities.

213. *See id.*

214. The Companies Act § 284.

215. *Id.* § 265.

Embedded defenses are not unknown to the Indian corporate world,²¹⁶ although they are typically adopted for value-enhancing purposes. For example, corporate managers may incorporate penalty provisions into third-party contracts that are triggered upon a change of control.²¹⁷ Although these typically seek to protect third-party interests, they can certainly be adopted for defensive purposes. One Indian industrial house may even have devised a mechanism by which the hostile acquisition of a subsidiary would preclude the use by the hostile acquirer or the acquired target of the trademarks which vest in the target's parent.²¹⁸ Such embedded defenses are known to have at least two drawbacks. For one, they may reduce the value of the firm. For two, they may deter friendly deals.²¹⁹ Since the payout following the hostile acquisition trigger would be made to third parties as against shareholders (who, in a pill plan, would theoretically be able to benefit by purchasing discounted shares in the corporation), embedded defenses tend to reduce the value of the company more than a pill plan, assuming efficient markets and the absence of information asymmetries (i.e., the market is aware of the contents of such agreements and of embedded defenses). Multiple third-party contracts that trigger penalties upon a change of control without the prior written consent of the third party would accrue costs that are likely to deter a friendly deal unless the third party is a holding company in the same promoter group as the target and consent can easily be obtained. Third-party embedded defenses also leave open the possibility of the hostile acquirer renegotiating penalty triggers, where the contracts are entered into with true third parties rather than with holding companies. A conventional poison pill plan may therefore involve fewer costs to the target board than embedded value-reducing defenses.

This Article has focused primarily on the vulnerability of Indian corporations to hostile takeover and the ability of promoters to defend themselves from hostile onslaught. However, in so doing, the Article has intentionally eschewed policy questions relating to whether such defensive tactics are in the best interests of the corporation. Nevertheless, it is worth noting that Indian courts have consistently held that actions taken to benefit

216. In 1995, the Supreme Court of India upheld a provision in a contract which enabled a party to terminate the contract in the event of a "change of control" in the other party (corporation). It held that the provision did not violate the principle of free transferability of shares. *Gujarat Bottling Co. Ltd. v. Coca Cola Co.*, (1995) 5 S.C.C. 545 (India).

217. For a complete description and analysis of "embedded defenses" as against conventional shark repellent tactics, see Jennifer Arlen & Eric Talley, *Unregulable Defenses and the Perils of Shareholder Choice*, 152 U. PA. L. REV. 577 (2003).

218. Luthra, *supra* note 153.

219. See Arlen & Talley, *supra* note 187, at 630.

the directors alone, as opposed to the larger interests of the corporation, would constitute an “abuse of fiduciary power.”²²⁰ Decades ago, Delaware’s courts acknowledged the “omnipresent specter” of the board acting in its own self-interest when employing defensive tactics.²²¹ Current debates center on the board’s fiduciary duty to redeem the pill in the face of a hostile acquisition.²²² Speaking in a historic decision over two decades ago, the words of Chancellor William T. Allen still resonate in both India and the United States: “shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”²²³

India’s Takeover Code shields shareholders of the target corporation from certain coercive tender offers by requiring the acquirer to take up shares on a proportionate basis²²⁴ rather than on a hasty first-come, first-served basis, by keeping the offer open for a minimum period of twenty days,²²⁵ and by theoretically foreclosing the possibility of a partial or two-tiered tender offer.²²⁶ These inherent defenses call into question the need for additional shark repellent defensive mechanisms. While shark repellent tactics devised to benefit shareholders and the corporation may certainly assuage duty of loyalty-type fears, the entrenchment of promoter interests may satisfy neither the requirements of the duty of loyalty nor the needs of a robust economy.

On July 19, 2010, the Takeover Regulations Advisory Committee (TRAC) appointed by SEBI issued recommendations to substantially modify India’s Takeover Code.²²⁷ Their recommendations have not been enforced as this Article goes to print, but six proposed changes are particularly relevant if they are eventually adopted by SEBI. (1) *Early Warnings*: TRAC has suggested that every acquisition of 2% or more beyond 5% triggers a disclosure requirement.²²⁸ However, the ability of an acquirer to circumvent

220. *See, e.g.*, *Needle Indus. v. Newey*, A.I.R. 1981 S.C. 1298 (India); *Nanalal Zaver v. Bombay Life Assurance*, A.I.R. 1950 S.C. 172 (India).

221. *Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 953–55 (Del. 1985).

222. Marcel Kahan, *Paramount or Paradox: The Delaware Supreme Court’s Takeover Jurisprudence*, 19 J. CORP. L. 583 (1994); Augliera, *supra* note 155.

223. *Blasius Indus. Inc. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Ch. 1988).

224. Takeover Code § 21(6).

225. *Id.* § 22(5).

226. Once the hostile acquirer has complied with its obligations of making a tender offer for a minimum 20% of the target’s shares, while complying with the Takeover Code’s pricing guidelines, the acquirer may not, going forward, cross the 15% threshold by upwards of 5% without making a mandatory tender offer at prescribed prices. Similarly, after crossing the 55% threshold, any acquisition would trigger a mandatory tender offer requirement.

227. SEC. & EXCH. BD. OF INDIA, REPORT OF THE TAKEOVER REGULATIONS ADVISORY COMMITTEE, proposed regulation 28 (July 19, 2010), available at <http://www.sebi.gov.in/commreport/tracreport.pdf> [hereinafter Takeover Report].

228. *See id.*

this provision within two business days²²⁹ remains unchanged. (2) *Tender Offer Trigger*: TRAC has proposed raising the mandatory tender offer trigger from 15% to 25%.²³⁰ This would enable potential hostile acquirers to aggregate larger stakes in corporations before triggering tender offer requirements. (3) *Creeping Acquisition*: TRAC has advised permitting “creeping acquisitions” to exceed 55%²³¹ subject to 5% caps, thereby enabling promoters to consolidate their holdings. (4) *Offer Size*: TRAC has recommended that the minimum tender offer size should now be “all the shares held by all the other shareholders of the target,”²³² from 20%. This requirement hurts friendly acquirers more than it does potentially hostile ones, since friendly acquirers who want to hold stakes larger than 25% in listed entities must now face the financial risk of the tender of shares by all remaining shareholders in a mandatory tender offer. Thus, they can no longer limit their exposure to 20% if the TRAC recommendations become law. On the other hand, the prospect of larger stakes in the target would perhaps not dissuade hostile acquirers to the same extent, although they too must face the risk of purchasing all shares tendered, not merely those sufficient to enable them to control the corporation. (5) *Asset Alienation*: TRAC has recommended that acquirers be permitted to declare their intention to alienate “material assets” of the target,²³³ which may enhance their ability to raise finances for hostile acquisitions. (6) *Defensive Measures*: Perhaps TRAC’s most significant recommendation is its recommendation to explicitly inhibit the target board’s ability to pursue defensive tactics. If TRAC’s recommendations become law, ESOP-based pills²³⁴ and the rights issue-based pill²³⁵ suggested in this Article would no longer be possible, thereby rendering Indian corporations that much more vulnerable to the hostile acquisition.

229. See discussion *supra* Part II.B.

230. See Takeover Report proposed regulation 3(1).

231. See *id.* proposed regulation 3(2).

232. See *id.* proposed regulation 7(1).

233. See *id.* proposed regulation 25(2).

234. See *id.* proposed regulation 26(2)(f).

235. See *id.* proposed regulation 26(2)(c)(iii).