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Defensive Tactics vis-à-vis Hostile Takeovers: An Indian Perspective

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ABSTRACT

Merger and acquisition ("M&A") activity in India is booming. A hostile takeover is an acquisition directly to the business owners and manufacturers to replace management and get the transaction accepted of one business by a new company. India has experienced only a handful of hostile takeover attempts. Hostile takeovers have been rare and will likely continue to be rare in the immediate future, but not for the reasons typically proffered.

On the regulatory side, the Indian Takeover Code does not erect any insurmountable obstacles to hostile acquisitions, and recent liberalizations by the Government of India make foreign acquisitions of Indian companies in most industrial sectors possible without material government approvals. Hostile takeovers of Indian companies are now a real possibility. And these Indian companies, unlike their counterparts in the United States, are particularly susceptible to hostile acquisitions, as Indian law prevents them from utilizing takeover defenses such as the poison pill and staggered board. Despite the lack of a prohibiting framework for a hostile takeover, India seems to persist in its shyness from engaging in these corporate blood-battles. One of the reasons for such hesitance may be located in how our corporate houses have traditionally been structured.

This article focuses on the lacunas today in the hyperspectral world of digital investment and M & A deals, inspecting the Indian regulations and suggesting how it can made more iron clad and companies given more ammo vis-à-vis defense tactics by taking example from different countries. The article bridges the gap between years old research articles and India positioning itself as a prime marketplace for investment according to the latest trends.

Keywords: *Merger and Acquisition, Hostile Takeovers, Takeover Defenses, Poison pill, Indian Regulation.*

I. INTRODUCTION

When discussing mergers and acquisitions, several authors suggested several forms used as part of these systems. When two or more companies agree to consolidate their assets and liabilities and operate as a single entity, a merger occurs. There are various types of mergers,

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such as statutory and triangular mergers, as well as consolidations. In general, people think that mergers are pleasant, even though the transaction was an acquisition, but both companies decided to call it a merger for reputational concerns. On the other hand, acquisition, sometimes known as a takeover, is a direct action by the acquiring corporation to purchase the target company. There are two types of acquisition. The acquirer owns the company if it buys the shareholders' shares, and those shares have controlling authority over the acquired company. ‘Company ownership control translates into effective control of the company's assets.' This transaction is known as a takeover, and it comprises gaining control of the company and controlling its assets and the weight of its liabilities. Asset purchase transactions are another type of acquisition. The acquirer purchases the target company's assets in part or whole. If the target firm sells all of its assets, it must either liquidate or remain a shell business. A hostile takeover is an acquisition directly to the business owners and strugglers to replace management and get the transaction accepted by a new company. Even a management firm defends itself against unwelcome hostile takeovers by using various contentious tactics, including a poison pill, the protection of a crown jewel, a gold parachute, or protection against Pac-Man.

The takeover offer is a direct or indirect purchase to obtain leverage of the corporation's management of a company's stock holding voting rights. These purchases are often carried out through cooperative or aggressive talks. When the transaction takes place hostilely, i.e., in contrast to the interests of the target organization, the target firm also takes certain actions to avoid or deter the bidder from taking over the target organization. Target companies most frequently use these defenses to negotiate better prices. In the last 50 years, most of this defense has developed. Some of them must be accepted before the owners execute them, but some do not. In addition, some in India, while others are not, are regulated very strictly. These defenses offer advantages such as delays, competitive competition for the bidder and tend to result in high transaction costs. The majority of countries control those interventions by implementing regulations. The acquirers also contest these safeguards in the court of law. The way these protections are used and controlled in India is different from those in other countries.

Overall, hostile takeovers in the field of corporations have become an acknowledged practice. Some of the most significant transactions were made through aggressive control offers. RJR Nabisco is considered one of the leading examples of hostilities purchased by investment bank KKR in 1980. However, India appeared very reluctant to consider the notion of aggressive acquisitions. In pre-liberalization, that is to say, before 1991, conservative government regulations made a complex proposition for hostile takeovers. Even after liberalization, India has seen very little struggle to conquer it.

In the early 1980s, India's most prominent incidents of the hostile takeover attempt took place. Swraj Paul, a businessman, based in London, wanted ownership of Escorts Limited and Delhi Cloth Mills ("DCM"), two Indian firms. On 14 April 1982, a circular setting out, among other things, how NRIs should invest under the investment scheme of a portfolio was released by the Reserve Bank of India. Video and following reforms, NRIs were allowed, given the securities were acquired via a stock exchange and the acquisition by one NRI firm of securities with a paid-up capital, to make investment portfolio in the shares exchanged on the capital invested and the revenue gained on the capital invested were no more than 1 percent. Swraj Paul hires 13 independent firms registered in the Isle of Man to purchase 13% of the DCM shares, with the Shri Ram family (promotor) jointly owning 10% (the remaining shareholdings were with public financial institutions) in order to escape the law of capping interest in 1 percent of Indian shareholdings.[3]

II. Takeovers and their Regulation in India

Business acquisition is an embraced and proven corporate expansion technique. In India, the promoters and existing companies are moving towards consolidating market share and diversifying in new sectors by acquiring businesses and fusions and takeovers in a more pronounced manner. Introduced conditionally, a first effort was made to control takeovers. Clause 40 of the listing agreement requires the purchase of 25% or more of voting rights for any entity to make a public bid in a business. This was reduced to 10 percent later. The 1994 SEBI Takeover Regulations came, and the Bhagwati Committee was formed to amend these regulations in 1995. The 1997 SEBI Acquisition Regulations are based on the Bhagwati Committee report. In 2002, Regulations were notified of the second amendment. The general responsibilities of the target company are covered by Regulation 23 of the SEBI Takeover Regulations 1997[4]. The Bhagwati Committee recommended that the regulations ensure that it is necessary, until the acquirers meet their responsibilities under the Regulations, the target corporation should change the Board of Directors and pass shares.

Bhagwati Committee recommended that until the bid's formalities are concluded, the target party is prohibited from getting into the target company's board or management of the target company any individual or individuals appointed by the purchaser or belonging to its party during the offering time. The Target Entity shall preclude from engaging in the bid an individual or persons related to the acquirer. Management changes can be made until the deal

[3] Ashima Obhan, Hostile Takeovers In India - Corporate/Commercial Law – India, Mondaq.com (2019), https://www.mondaq.com/india/shareholders/804526/hostile-takeovers-in-india.
[4] Securities and Exchange Board of India (Substantial Acquistion of Shares and Takeovers) Regulations, 1997, s. 23.

is completed and the final balance invested in a separate bank account. If the board of directors of the target company wants to introduce a healthier pattern as accomplished in emerging markets, it may give its objective comments on any proposals to shareholders, in view of the directors' fiducial obligations, and requesting the opinions of an independent commercial banker or an independent committee of directors for this reason. Any errors or hiding confidential information in the discharge of this role is the responsibility of the target company's directors. In reviewing securities awarded for admission, the Board of Directors of the target organization shall assist the acquirer. The target company shall pass shares on behalf of the acquirer unless the acquirer fulfills his obligations under the conditions certified by the merchant banker, Make proportionate representation of the acquirer on board or grant power over the company as necessary.

III. Regulatory obstacles to hostile takeovers

The Indian Companies Act, 1956, has been substantially adopted from the English Act. The establishment, operation, and dissolvement of companies in the Union of India are governed by this Act. Although the legislation is specific in nature, the terminology "takeover: has not been defined in the Act itself. It has been left out as it is covered by wider legislations with broader definitions of reconstruction and amalgamation.

The development of legislative measures and regulations to govern the takeover scenario of India started in the early 1990s, and the first act was enacted in 1994. The Regulations of 1994 were amended in 1997 to take its current form and was called the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.[5]

Regulations that are analogous to corporate activities amongst many others also include:

- The Partnership Act, 1932.
- The Indian Trusts Act, 1882.
- SEBI (Prohibition of Insider Trading) Regulations, 1992.
- The Code of Civil Procedure, 1908.

Besides having the force of statutory law, the Regulations have penalising provisions to deal with violations of the SEBI Act and of the provisions of the Regulations.

IV. Methods of hostile takeover

Tender and Proxy Fights are the two main techniques of carrying out a hostile takeover.

A tender is a bid by the government for a substantial share of the stock of the target company at a preset price, often more in comparison to the present market value. To allow the owners to

[5] Ibid.

sell their shares, the investor uses a premium offer. The bid has a time limit, and the target business will have specific conditions to comply with before shareholders approve the deal. The bidder must announce the plans for the target organization and request the necessary documentation.

The consumer is not seeking to purchase shares in a proxy fight. Instead, they attempt to ask the owners to opt for a team that approves the takeover, either the new management or the present board. The word "proxy" applies to the capacity of shareholders to allow anyone to vote for them—the buyer votes by proxy for the new board. In the organization itself, a proxy fight occurs. A coalition of unwanted shareholders or even management may be looking for a change in ownership to persuade others to merge. The proxy fight is famous because many of the protections that businesses set up to deter takeovers are circumvented. Most of these protections seek to avoid take-over by purchasing a managed stock interest, and the shareholder battles by shifting the views of those who already own it.

V. Vulnerability of Companies to Takeover Bids "Determining Factors"

An investigation into such tactics is best started by looking at the characteristics that indicate a company's "vulnerability" to takeover bids. These elements can be discovered which make a company an appropriate purchase potential from the purchaser's point of view. Thus, the following factors make a company vulnerable:

- A low stock price in proportion to the assets' replacement cost or earning potential;
- A highly liquid balance sheet with large cash, a robust securities portfolio and enough borrowing capacity ;
- Positive cash flow when compared to current stock values;
- Subsidiaries and properties that might be sold off without causing severe cash flow problems;
- Stockholdings that are relatively small and controlled by the present management.

A combination of these qualities could make a company an attractive proposal or investment opportunity and simplify its financing. The assets of the company may secure the bonds of an acquirer and cash flows out of operations and divestitures can be utilised to pay off their liabilities.

VI. Analysis of Different Defenses

Hostile Takeover Financial Defensive Measures

(A) Adjustments in Asset and Ownership Structure

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To begin, procedures involving defensive restructuring that create barriers specific to the bidder must be considered. These are some of them:

1. Purchasing assets that may result in legal issues, such as purchasing stakes in companies with surplus cash before the target firms, in firms involved in major litigation could affect the latter's future performance.[6]
2. Purchase of the bidder's controlling shares.
3. Assets that made the target appealing to the bidder were sold to a third party.
4. Issuance of new securities, including restrictions that are incompatible with elements of the takeover bid. Lenox's resistance against Brown-Forman Distillers Corporation's takeover offer in June 1983 is an example of this defense style.

The creation of a consolidated vote block in conjunction with target management is a second recurring element. As a result, securities are issued to parties friendly to or in business alliance with management and management itself through private placements. Another option is to repurchase publicly traded shares to add to an already big management-affiliated block.

The issuing of fresh stock claims has diluted the bidder's vote percentage, a recurring motif. However, under Section 81A and Regulation 23 of the Takeover Code, 1997, this option is carefully regulated in India. A hostile bidder normally loses the deal in these situations if it lacks the resources to increase its interest proportionately.

(B) The "Crown Jewel" Strategy

The "crown jewel approach," or the divestment of a critical operating unit most wanted by the bidder, is a central component in such a strategy. The hostile bidder is left in the dark about the takeover bid's principal goal. The more popularly known radical "scorched earth approach" is a version of the "crown gem strategy." Using this unique tactic, the target sells off not only the crown gem but also properties to devalue it.

On the other hand, experts believe that such a drastic measure would be self-destructive and unwise in the company's best interests. To begin with, divesting assets by the target company in response to a hostile takeover proposal will send the market the wrong signals. The market will be aware that the divestiture was necessary due to the company's need for self-preservation. This will allow potential purchasers to bid their time, allowing the corporation to reduce the selling price of such assets to the bare minimum, even below market value. As a result, the corporation will reap only minor profits as a result of such defensive restructuring.

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[6] A.S. Dalal, *Analysis of Takeover Defenses and Hostile Takeover*, 6 Nalsar Law Review 85-98 (2006), https://www.nalsar.ac.in/pdf/Journals/Nalsar%20Law%20Review-Vol.%206.pdf.

On the contrary, the divestment profits will be used, as is customary, to repurchase stocks at inflated market prices, which have risen in response to reports of a possible takeover bid. A closer examination reveals that the shares being bought on the market at inflated prices are worthless, as the company's "scorched earth strategy" would have left it with no valuable assets. The eventual effect would be that the company's biggest owners would own an excessively large amount of stock with no real value.

(C) The “Pac-man” Defense

The Pac-Man Defense is a deterrent strategy employed by targeted businesses to avoid hostile takeovers. The target company uses this takeover prevention approach to turn things around by attempting to take over the acquirer. Like any defensive strategy against a hostile takeover, the Pac-Man Defense aims to make a hostile acquisition extremely difficult for the acquiring business in the hopes that it will give up.

The Pacman strategy is the name given to this unique technique. The target company attempts to buy the raider company's stock under this technique. If the raider company is smaller than the target firm and the target firm has a significant cash flow or liquidates the asset, this is frequently the case.

(D) Yellow Knight

A corporation that was considering a takeover bid but ended up contemplating a merger with the target: yellow knights have a variety of reasons for abandoning a takeover effort, but one of the most common is the target company's ability to resist a takeover. The colour "yellow" in "yellow knight" could be a reference to its relationship with timidity. Because a yellow knight abandons a takeover effort in favour of merger talks, he or she may be perceived as weak. Different coloured knights are used in mergers and acquisitions to distinguish the nature of a takeover or impending takeover. A black knight is a corporation that offers the target company a hostile acquisition. A white knight offers a target company a friendly takeover against a hostile takeover. A second unsolicited bidder in a corporate takeover is called the grey knight.

(E) Targeted Share Repurchase or “Buyback”

This technique entails the target business's management using up a portion of the firm's assets to expand its holdings while also disposing of some of the assets that make the target firm undesirable to the raider. As a result, the strategy entails a creative use of share buybacks to reinforce control and deter a potential raider. However, “buyback” is utilized worldwide when a firm's excess cash does not provide appropriate returns on investing in production or capital, nor does it allow the corporation to redistribute it to shareholders without negative consequences.

(F) “Golden Parachutes”

Golden parachutes are employment contract "separation" clauses that reward managers who lose their jobs due to a change in management. The provision calls typically for a one-time payment or a series of payments at full and partial rates of average compensation over a set period of time. Even the largest Fortune 500 companies are increasingly using this form of severance arrangement. By the mid-1980s, nearly a quarter of Fortune 500 companies had included golden parachute provisions in their executive employment contracts. According to experts, golden parachutes, which are control-related contracts by nature, eliminate conflict of interest between shareholders and managers in changing companies.

A “golden parachute” is a clause and can be often found in an executive's contract that provides them with a sizable severance package in the form of cash or equity if the takeover attempt succeeds. The provision makes acquiring the company more expensive and less appealing because the acquirer will be saddled with a hefty debt to pay the senior executives. The clause primarily protects top managers, who are at risk of being fired if the acquisition is successful. However, some executives may purposefully include the condition to make the forced acquisition less appealing to the acquirer.

(G) Anti-takeover Amendments or “Shark Repellants”

Changes in the corporate constitution or association articles, commonly called as "shark repellents," are becoming a more prevalent defence technique. Like all other adjustments to a company's charter/articles of association, the shareholders must vote on and accept anti-takeover amendments. Companies change their articles, regulations, bylaws, and other documents to make them less appealing to corporate bidders.

Shark repellant refers to a company's defenses against hostile takeover efforts. Management's efforts to make unique adjustments to its bylaws could be done periodically or continuously. When the company's management and shareholders are informed of a takeover attempt, the bylaws go into effect. It deters hostile takeover attempts by making the target less appealing to the acquiring firm's shareholders, preventing them from pursuing the hostile takeover.

(H) Refusal to Register Transfer of Shares

The executive boards’ refusal to record a transfer is an integral approach for avoiding a takeover. The articles of association may include the ability to refuse. As an event of the contract between them, i.e., the memorandum and articles of association, this would bind the company and its members. Consequently, the registration of a transfer or transmission as a right cannot be insisted on. The articles of a public company can be used to provide the

Management Board with complete discretion as to whether or not a share transfer should be registered. The purpose of such a provision is to provide the board of directors with powers that can be used in extraordinary and extraordinary circumstances if the transfer is deemed to be unsuitable for the company's best interests. As in private corporations, clauses like this does not necessarily imply a limit on the free transferring of shares. The authority is fiduciary, and it must be used in the company's best interests.

Only in the following conditions can the courts intervene if the directors refuse to register the share sale:

- Malafide
- Inadequacy of reasons
- Irrelevant considerations

The Apex Court decided in **Bajaj Auto v. N.K. Firodia**[7] that if the directors' grounds are legitimate, it will not overrule the decision only on the grounds that it would not have reached the same conclusion. However, after 1988, the CLB has broad powers to intervene if the board abuses its authority.

In **V.B.Rangarajan v. V.B.Gopalakrishnan**[8], the Supreme Court decided that the vendee can be denied registration of shares purchased based on the articles. As a result, rejection to register on the grounds stated in the articles qualifies as "sufficient cause" under the Companies Act's Section 111(2) proviso. Due to the deletion of Section 22A of the Securities Contract Regulation Act of 1956, the grounds for refusing to register have expanded and are no longer limited to those listed in the section. It resulted, however, in a strengthened judicial examination of the refusal to determine if it falls under the term "suficient cause."

(I) Poison Pill Defenses

The creation of securities known as "poison pills" is a contentious but common defense mechanism against hostile takeover bids. These pills give their owners specific rights that can only be exercised after a certain amount of time has passed since a triggering event, such as a tender offer for control or the accumulation of a certain proportion of target shares. These rights exist in various shapes and sizes, but they all make gaining control of the issuer or target company difficult and expensive. The board of directors routinely adopts poison pills without shareholder approval. The rights given by the poison pill can usually be amended or redeemed by the corporation at any time after they become exercisable following the triggering event by the board of directors. These laws require the acquirer to communicate directly with the target

[7] AIR 1971 SC 321
[8] AIR 1992 SC 453

company's board of directors and allow some takeover efforts to go forward. While the poison pill might not prevent all takeovers, supporters argue that it does strengthen the board of directors' ability to negotiate for a "fair price."

Poison pills, also known as shareholders' rights plans, entail creating a particular class of stock with the sole intention of discouraging or deterring hostile takeovers by considerably boosting the final price tag. According to one version of the pill, existing shareholders can acquire more stock for half the current market price.

When a hostile suitor buys a preset percentage of a company's stock, these pills are usually triggered. At that moment, all current shareholders, except the suitor, are given options to purchase additional stock at a steep discount, effectively diluting the acquirer's share and preventing a change in control of the company. Martin Lipton, the corporate lawyer, credited with creating the poison pill defense nearly 20 years ago, said, "We strongly advise companies to continue to have a pill." According to Lipton, a partner at Wachtell, Lipton, Rosen & Katz in New York City, "very few firms fail to renew the pill after it expires."[9]

VII. Other countries

The UK has explicitly rejected managerial discretion in favour of a shareholder-focused approach to takeover regulation, whereas the US Takeover Code is less welcoming. To keep those bids at bay, target company managers can deploy a number of defenses. In contrast to the UK's decidedly shareholder-oriented takeover regulations, the managers of corporations in US with both a classified board and a poison pill have almost total discretion to reject an undesired takeover attempt. The disparity in takeover defenses is most striking. Once a takeover bid has been accepted, UK executives are not entitled to take any "frustrating action" without the stockholders' agreement. Like every other defense, Poison pills are expressly prohibited, trading stocks to interfere with a bid or agreeing to a lock-up agreement with a preferred bidder impairing target shareholders' capacity to evaluate the merits of a takeover offer. However, other characteristics in UK laws, such as regulations against effective staggered boards, ensure that embedded defenses are not used to the extent that they are in the US.

The Shareholder Rights Plan is the most prevalent defense instrument in Canadian firms. Several hundred Canadian businesses have implemented rights plans. The Canadian poison pills are fundamentally similar to US pills, where a 'flip-in event' happens when a person buys unless a 'permitted offer' is made, a specific proportion of the issuer's stocks (typically 20%), which causes severe dilution. Only if the pill is in place for more than six months is the

[9] Craig Schneider, Is Your Company Shark-Proof? - CFO CFO (2001), https://www.cfo.com/banking-capital-markets/2001/01/is-your-company-shark-proof/.

shareholder agreement necessary. However, Canadian regulators do not permit a target company to use a rights plan to shield itself indefinitely and often removes it at the request of the hostile bidder.[10]

In Germany, 75% AGM consent is needed either immediately after the notification of the takeover threat or up to 18 months in advance; a court process can also be employed to safeguard further minority shareholders who do not agree with the resolution of the AGM on the anti-takeover measures.[11] In Italy, the anti-takeover regulations subject only certain anti-takeover tactics to the approval of a shareholder meeting.[12] A comprehensive restriction on actions that would thwart the hostile tender exists in several nations, such as Czech Republic, Chile. Again, it may be hard for a court to enforce these requirements.

VIII. Conclusion

In recent years, many shareholders believe that defenses are management-entrenchment tactics that obstruct a company's value growth. “Having a takeover defense in place can narrow the field for possible acquirers” says Shez Bandukwala, senior vice president of Hilco Enterprise Valuation Services LLC in Northbrook, Illinois. “As a result, the type of premium they will be paid is limited.” Shareholders are becoming increasingly dissatisfied with poison pill and staggered board takeover defenses.

According to an IRRC survey done in the United States, at least 60% of corporations approved shareholder motions to eliminate classified boards and supermajority vote restrictions and eliminate or allow a shareholder vote on poison pills. According to a study done in the United States, companies are becoming less likely to utilize takeover defenses. In comparison to other defenses, only the Golden Parachute defense is becoming more popular. Takeover defenses, on the other hand, are crucial in corporate reorganization. The majority of takeover defenses utilized by target corporations in the United States are banned in India by legislation and acts. This type of corporate synergy necessitates that the legal paradigm changes itself to maximize the benefits of such reorganization. In the case of takeovers, the need for such regulation has never been clearer. The legislature has recognized this and has entrusted SEBI with the duty. SEBI has endeavored to keep up with the market in this sector, as evidenced by the Bhagwati Committee's scope of reference. The time has come for the Companies Act, the other

[10] Tatiana Nenova, *Takeover Laws and Financial Development*, World Bank Policy Research Working Paper 4029 (2006), https://openknowledge.worldbank.org/bitstream/handle/10986/9003/wps4029.pdf?seque=.

[11] Gordon, Jeffrey N., *An American Perspective on the New German Anti-Takeover Law*. ECGI - Law Working Paper No. 02/2002; Columbia Law and Economics Working Paper No. 209, Harvard Law and Economics Discussion Paper No. 407, http://dx.doi.org/10.2139/ssrn.336420.

[12] Supra note 7.

substantive statute, to accommodate such defenses. As a result, takeovers could be used to eliminate inept management and/or traditionally family-owned enterprises, boosting efficiency in a more competitive global market.

In countries where boards can frustrate a bid, then as one saw, countless strategies can be applied as pre-bid or post-bid measures. As a general thought, I believe that companies should apply a non-frustration rule; shares/stocks are investments of the shareholders/stockholders; thus, they are the ones who must decide what is in their best interest, not the board or the management which should have an advisory role when it comes to company restructuring events. Regarding the poison pill, one saw that to be effective, it should combine all three elements, flip-in, flip-over, and redemption provisions. It is crucial to have the redemption provision; otherwise, the target risks suffering harsh consequences and creating a deadlock when a white knight appears. However, as one saw, the flip-in pill can cause a drop in the company's value, and the flip-over pill can prevent any merger; this is a situation that can tremendously harm the target. In addition, for instance, golden parachutes can be very effective for an acquirer because it knows that it will pay off certain managers and it will in a way get rid of them, plus the acquirer can calculate this payment towards the bid it makes to the shareholders.

Similarly the post-bid defenses, one can argue, offer protection; however, they can backfire on the target. For instance, the board of the target cannot keep using greenmail for every potential bidder. And even other strategies like white knights can turn out to be unfriendly, like in the case with Lady Macbeth's strategy. Therefore, caution should be paid.

Hostile takeovers are not outlawed in the code, and they are not discouraged either. The Indian legislators' ultimate aim was to safeguard the interests of stockholders during such a deal. However, policymakers adopted a very protective strategy in the process, making aggressive takeovers appear to be a dreaded ghost. Major economic actors worldwide did not favour this unduly protectionist attitude due to globalization trends and opening up domestic markets to overseas rivals. To sum up, this article attempts to assess and analyze the new opportunities and problems provided by India's acquisition regulatory framework.

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