The Chanakya Law Review (CLR)

Vol. I Issue I, July-Dec. 2020, pp. 26-44

DEFENSIVE TACTICS VIS A VIS HOSTILE TAKEOVER: AN INDIAN PERSPECTIVE

Rukhsaar Dhaliwal[1] &
Vanshika Tuteja[2]

ABSTRACT

One of the most effective ways to accomplish corporate prosperity is through Mergers & Acquisitions. However, to ensure regulated advancement, in India these endeavours are monitored and regulated by the SEBI and the Takeover Code. While the legislative set-up in India for Takeovers has been amended over twenty times since its outset, however several noteworthy issues are yet to be addressed. Hostile takeover, an important strategy in the world of acquisitions is rather uncommon and unusual in India. However, the expanding global corporate world has opened doors to adverse antagonistic competition

This paper commences with the history of hostile bids in India, and examines how the laws pertaining to the corporate takeovers and hostile acquisitions have been defined and redefined over the years. Its transverses the process of evolution of the law and deliberates upon the array of defences deployed by the target firms which are endorsed by the laws prevalent in our country. Towards the end of the paper the authors have examined the takeover of Mindtree Limited by L&T Limited, and have scrutinized and assessed the modus operandi of the hostile bidders along with examination of the predicament of the target corporations. Furthermore, the authors have analysed the hostile bid undertaken by L&T, and evaluated the rationale behind an adverse and inimical takeover.

KEYWORDS

Hostile Takeover, Takeover Code, Defences, Corporate Governance, Mergers & Acquisition

---

[1] 4th Year, B. Com LL. B (Hons.), University Institute of Legal Studies, Punjab University, Chandigarh.
[2] 4th Year, B. Com LL. B (Hons.), University Institute of Legal Studies, Punjab University, Chandigarh.

INTRODUCTION

In 2019, India saw its first ever-hostile takeover in the information technology sector. Larsen and Turbo, India's one of the biggest engineering giants made a hostile bid to acquire Bengaluru based IT company, Mindtree, and set the stage for a riveting drama in the Indian corporate sector.

It all started when V.G. Siddhartha, a shareholder in Mindtree, offered to sell his stake of 20.30% in the company. On 18 March 2019, a share purchase agreement was executed amongst L&T and Siddhartha through which L&T acquired 20.32% stake in the latter. The other promoters of Mindtree were not in favour of this merger. Hence, making the acquisition a hostile takeover. They tried all the defences possible to fend off the acquirer. However, L&T managed to acquire 60% stake in the company.[3]

The mergers and acquisitions ("***M&A***") market has certainly seen a boom in the past few years. There is much more competition in the economy, which stimulates a plethora of change in the structuring and management of the companies functioning in the present market. India has witnessed numerous takeovers in the past which have played a significant role in shaping the takeover law. Currently, the takeover in India is primarily regulated under by the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("***Takeover Code***"). A takeover is considered to be hostile when the company, which is being bought, does not intend to merge with the host company. Under these circumstances, the acquirer instead of negotiating with the target company goes directly to the shareholders and makes an open offer to buy their shares. In India, there have been only handful instances of hostile takeover. While the M&A market has prominently seen friendly takeovers. However, this does not imply that the companies are safe from hostile takeovers. The present market conditions, with the liberalisation policies that are being followed by the government have provided the much-required stimulus to the activities in the M&A market, but in turn the takeover regime does not create any unassailable impediments to protect the companies from such hostile takeovers. The Indian companies now face a real threat from hostile takeovers because most of the regulations make the use of takeover defences almost impossible, leaving the companies more vulnerable to acquisitions.

[3]Business Standard, 2019. L&T has 'acquired control' of the company with 60.06% stake: Mindtree. [online] Available at: https://www.business-standard.com/article/companies/l-t-has-acquired-control-of-the-company-with-60-06-stake-mindtree-119070301241_1.html.

In this paper, the authors will discuss the various defences that are available to prevent a hostile takeover and the legal position of these anti-takeover mechanisms in India. In the second half the paper, the authors will discuss the case study of the L&T- Mindtree takeover to illustrate as to how companies face a threat of hostile takeovers in present market conditions.

MAJOR HISTORICAL INCIDENTS PERTAINING TO HOSTILE BIDS

When the chronicles of hostile takeovers are narrated, they are unambiguously close to thrillers. The world has seen several heart racing hostile acquisitions of high-end corporations like Vodafone[4], Arcler[5] and Cadbury[6].

However, when it comes to India, it has not witnessed many hostile takeovers, as the pre liberalization era had stringent and anarchic laws which made hostile acquisitions impossible to achieve. In 1991, when the Narashima Rao Government opened Indian markets for foreign players, it also relaxed policies which exposed the Indian businesses to adverse foreign competition.

The first attempt of a hostile takeover in India was made by an England based NRI, Swaraj Paul, when he attempted to take over Delhi Cloth Mills (DCM) and Escorts Limited[7]in the year 1983 The DCM promoter, the Bharat Ram family owned about 10%of the stock, while the Nanda family, the promoters of Escorts Limited, had 5%of total shareholding in the corporation. The newly formed procedure by the Reserve Bank of India in 1982 restricted an NRI from purchasing more than one percent shareholding in any Indian company, and such purchases could be made only through a portfolio investment. Lord Paul overcame this hindrance by using thirteen different companies to a acquire 13% of stake of the DCM shares,

---

[4]The Hindu, Idea cellular took over Vodafone, Vodafone Idea embark on new journey, unveil brand identity VI**,** Lalatendu Mishra. [online] Available at: https://www.thehindu.com/business/Industry/vodafone-idea-embark-on-new-journey-unveil-brand-identity-vi/article32542515.ece.

[5]Mittal Steel took over Arcelor in 2006.
The Economic Times, 2016, Tale of two acquisitions: Mittal Steel's acquisition of Arcelor and Tata Steel's acquisition of Corus. [Online]. Available at: https://economictimes.indiatimes.com/industry/indl-goods/svs/steel/tale-of-two-acquisitions-mittal-steels-acquisition-of-arcelor-and-tata-steels-acquisition-of-corus/articleshow/51624431.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

[6] Independent, Kraft Foods took over Cadbury in 2010, In a final betrayal of the Cadbury brand, Kraft has quietly abandoned its promise to stick with Fairtrade, Hannah Fern, [online] Available at: https://www.independent.co.uk/voices/cadburys-chocolate-fairtrade-fair-trade-mark-farmers-kraft-american-brand-abandoned-promise-a7445826.html.

[7]Mathew, Shaun, Hostile Takeovers in India: New Prospects, Challenges and Regulatory Opportunities (November 12, 2007). Columbia Business Law Review, Vol. 2007, No. 3, Available at SSRN: https://ssrn.com/abstract=1693821.

and 7.5%of Escorts Limited[8]. This lead to a widespread panic among the Indian companies and the matter was taken up to the Supreme Court. The Supreme Court's verdict[9]was in favour of the promoters of the respective companies, following which extensive meditations took place between Lord Paul and the target companies which resulted in Swaraj Paul selling his share to respective promoters and pulling out of the Indian markets.[10]

Nearly two decades later, in 1997 another British Company, British Paints Major ICI PIC, bought 9.1% of Atul Choksey's shareholding in Asian Paints, much to the disapproval and disappointment of the other four promoters. The remaining three promoters held over 42%of share in the company and refused to approve the transfer of shares by citing clearance hurdle by the Foreign Investment Promotion Board (FIPB)[11]. The FIPB policies necessitated that all the board of directors of a company must approve the foreign acquisition. The British Paints Major didn't manage to get the board's approval, and had to give up its share to two of the promoters and to the Unit Trust of India (UTI), a mutual fund owned by the government, hence rendering the acquisition a blunder.

One of the first successful hostile takeovers in India was in 1998 by Indian Cements Limited when they made an open offer to buy the shares of Raasi Cements and Shri Vishnu Cements at INR 300 per share which was extremely high compared to the market value of the shares which were priced at INR 100 in stock exchange[12]. This led the market into a frenzy and the shares were frozen at INR 188.30 per share. The market mania came to end which ICL buying 85% of the holding in the company and resulted in a successful hostile takeover.

[8]Bhandari, 2018.Escorts -Fending off hostile takeover, surviving family split. Business Standard. [online] Available at: https://www.business-standard.com/article/companies/40-years-ago-and-now-escorts-fending-off-a-hostile-takeover-and-surviving-a-family-split-114110500008_1.html.
[9]Escorts Ltd. And Another vs. Union of India and Others, 1987 57 CompCas 241 Bom.
[10]Ninan, 1986. Supreme Court, RBI gives Swaraj Paul clean chit in Escorts, DCM share cases. [online]. Available at: https://www.indiatoday.in/magazine/economy/story/19860415-supreme-court-rbi-give-swraj-paul-clean-chit-in-escorts-dcm-share-cases-800784-1986-04-15.

[11]Foreign Investment Promotion Board (FIPB) was abolished on 24 May 2017, as announced by Finance Minister Arun Jaitley during 2017-2018 budget speech in Lok Sabha, and has been replaced by the Foreign Investment Facilitation Portal (FIFP).
[12]Supra note 5

DEFENCES

Following are a few widely popular takeover defences available to public target companies

STAGGERED BOARD

Staggered boards are extremely important elements of the modern corporate organization. A staggered board consists of three or five distinct classes or groups of directors[13]. These directors serve for different lengths of time and during the annual elections only one of these classes is open for appointment. Thus, implying that each class of directors has elections in different years and one third all the directors of the board retire annually.[14]A staggered board is distinct from a normal board as in the latter's case all the directors are appointed at once.

Such classification of directors makes it onerous for the hostile bidder to acquire the company. A bidder can acquire a corporation only if it manages to control the board of directors, and a staggered arrangement of the board makes it an extremely dreadful hurdle. An efficient staggered board defers the hostile bidder to gain control of the company by a substantial amount of time. Thus, if a bidder were to emerge it would take at least a year to gain control of the corporation, which is considered tedious in the world of hostile takeovers.[15]

Furthermore, staggered board is considered an efficient takeover defence as other than cost damage rendered by the bidder, he is also required to win at least 2 elections which are rather far apart in time[16]. The requirement of winning two elections loses itself as a hurdle for the bidder.

[13]Lucian, Bebchuk, John, Coates &Subramanian Journal of Financial Economics, 2006.Classified boards, firm value, and managerial entrenchment. Available at: https://web.cba.neu.edu/~ofaleye/doc/cboards.pdf.
[14] Ibid

[15]National Bureau of Economic Research. The Powerful Anti-takeover Force of Staggered Boards: Theory, Evidence, and Policy. Available at: https://www.nber.org/digest/oct02/w8974.html.
[16]Supra note 11

INDIAN LEGAL POSITION

Section 152[17] of the Companies Act, 2013("***Companies Act***") mirrors the elements of a staggered board as it states that out of the entirety of the board of directors in a public company (or of a private company which is a subsidiary of a public company),a minimum of 2/3rd must retire in rotation. Thus, only a one-third of the directors do not retire Clause (3) of the section 152 further goes on to substantiate that 1/3rd of the directors subjected to retirement by rotation are to retire each year.

While the staggered board proves to be an efficient anti-takeover shield against hasty bidders, it turns out to be quite fruitless and ineffectual in the Indian corporate sector. Under section 169 of the Companies Act[18], the shareholders have the capacity and the right to remove all the directors in a single shareholders meeting. Thus, a hostile bidder who acquired majority of shares and balloting rights has the capacity to easily replace the board of directors and overpower the staggered board defence.

Furthermore, shareholders have a legal right to replace the directors, making it easy for the majority shareholder to subdue the staggered board.

A. WHITE KNIGHT

The white knight is another anti-takeover defence for companies exposed to hostile bidders. A white knight typically is an individual investor or a company that acquires the target company in order to rescue it from an unwanted hostile takeover. In other words, a white knight is an amiable and proffered acquirer, as against hostile competitors colloquially referred to as the black knight.[19]

---

[17]Companies Act 2013. § 152(6) states as follows: "(a) Unless the articles provide for the retirement of all directors at every annual general meeting, not less than two- thirds of the total number of directors of a public company, or of a private company which is a subsidiary of a public company, shall-(i) be persons whose period of office is liable to determination by retirement of directors by rotation; and(ii) save as otherwise expressly provided in this Act, be appointed by the company in general meeting."

[18]Companies Act 2013. § 169 on Removal of directors states as follows: "(1) A company may, by ordinary resolution, remove a director, not being a director appointed by the Tribunal under § 242, before the expiry of the period of his office after giving him a reasonable opportunity of being heard:
(2) A special notice shall be required of any resolution, to remove a director under this
§, or to appoint somebody in place of a director so removed, at the meeting at which he is removed.
(3) On receipt of notice of a resolution to remove a director under this § , the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting."
[19] Barik, Nikhilesh, Takeover Defences and Corporate Governance (April 15, 2012) [Online]. Available at https://ssrn.com/abstract=2039844, or http://dx.doi.org/10.2139/ssrn.2039844.

The reason the target companies often prefer white knights as anti-takeover defence is because these friendly acquirers preserve the essence of the target company by retaining the existing management and board of directors. The white knight not only invests in the target company to save it from hostile bids but also conserves the core schema, the vision and the values of the company.[20] A white knight salvages a company at the brink of being taken over force fully by acquiring the corporation, buying out the corporate raider or simply by striking a deal with the management and the board of directors of the target company.[21]

WHITE SQUIRE

A white squire is very similar to the white knight and is referred to a friendly investor or a company. The white squire buys a considerable stake in the company that prevents the hostile takeover; however, unlike the white knight it does not acquire the company and has no intention of owning it.[22] In case of the white squire the target company remains independent as the white squire buys only partial shares, just enough to hinder the corporate raider from taking over the target corporation.

One of the most remarkable examples of a white knight was when a consumer goods company tried to acquire Prithvi Raj Singh Oberoi's EIH Limited, and the Reliance Industries turned white knight by acquiring 14.12% shareholding in EIH Limited.[23]In 2001, cigarette company, ITC Limited played a white knight by making a counter offer to British American Tobacco Industries which was at the brim of a hostile takeover by Radha krishan Damini's ITC offered a better value to the shareholders and subsequently outbid Damini.[24]

POISON PILL

Poison pill, also known as the shareholders right plan, is a defence tactic used by Target Company to make its shares unappealing. Under this scheme, the shareholders of the target company are offered shares of the company at a discounted price in the event of a hostile

[20]Eleftheriadou, I. 2018. Hostile Takeovers and Defence Strategies. .International Hellenic University, [online], pp.20. Available at: https://repository.ihu.edu.gr/xmlui/bitstream/handle/11544/29128/Dissertation%20Final.pdf?sequence=1.

[21]The Guardian, White Knight. The Guardian. [Online]. Available at: https://www.theguardian.com/business/2007/apr/12/businessglossary159.

[22] *Supra* note 18.

[23]Business Standard, 2013, As M&A activity picks up, white knights are riding into India Inc. [online]. Available at: https://www.business-standard.com/article/companies/as-m-a-activity-picks-up-white-knights-are-riding-into-india-inc-110092800051_1.html.

[24]Business Standard, 2018, British American Tobacco proposal to buy back shares not an option: ITC. [online] Available at: https://www.business-standard.com/article/companies/british-american-tobacco-proposal-to-buy-back-shares-not-an-option-itc-118100700631_1.html.

takeover. This offer is made as soon as the acquirer makes an open offer or when a shareholder crosses the threshold of the percentage of ownership shares (i.e., 25%) without prior consent. All the shareholders are offered the shares at a discounted price except the hostile bidder. This dilutes the stake of the hostile bidder in the company thus increasing the cost of acquisition. This is known as the flip-in poison pill.[25]

Another kind of poison pill is the flip-over. Under the flip-over poison pill scheme, the shareholders of the company are given an option to buy the stocks of the company at a discounted price after the merger. This way the wealth of the acquirer is transferred to the shareholders of the target company.

INDIAN LEGAL POSITION

Poison pill doesn't have much use in the Indian context due to the Takeover Code and SEBI Disclosure & Investor Protection Guidelines 2000 ("***DIP Regulations***")

An Indian company can issue a warrant as soon as any shareholder crosses the threshold limit. However, the DIP regulations read with the Takeover Code prohibit the companies to use these warrants to sell shares at a sizeable discount, making the process of poison pill ineffective. According to Regulation 26 of the Takeover Code[26], the target company cannot issue any of its authorised and unissued shares during the course of the offer period. However, they can be issued with prior consent of the shareholders. Although, during the process of a hostile takeover the company needs to respond quickly, and seeking prior consent of the shareholders would be a time-consuming process, which would render the shareholders, right plan ineffective.

Also, as per the DIP guidelines, the shares and the warrants cannot be issued at discount, as the price has to be determined in accordance with price in the market on the date it has to be issued.

For this strategy to work, important amendments need to be made to maintain balance and give the target company a fair chance to get a fair buy out price or save the company from a hostile takeover. It is suggested that the guidelines should be relaxed and the companies should be allowed to sell securities at substantial discounted prices.

[25] Dalal, 2020, Analysis of Takeover Defences and Hostile Takeover. NALSAR Law Review, 6(1), [online]. Available at: https://www.commonlii.org/in/journals/NALSARLawRw/2011/6.pdf.

[26] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. Regulation 26(2) states as follows: "the target company by way of a special resolution by postal ballot is obtained, the board of directors of either the target company or any of its subsidiaries shall not, —(a) alienate any material assets whether by way of sale, lease, encumbrance or otherwise or enter into any agreement therefor outside the ordinary course of business; (b)effect any material borrowings outside the ordinary course of business;(c) issue or allot any authorised but unissued securities entitling the holder to voting rights…"

This being said, there are some advantages to the poison pill strategy. This tactic does not come in a straightjacket formula and can be altered to suit the circumstances. The guidelines do not prohibit issue of non-convertible securities like debentures, preference shares, etc. A poison pill can be structured in a way where the shareholders are backed with rights to exchange securities held for senior securities[27]. These securities are issued to the shareholders when a hostile takeover bid is in play. The use of this scheme shoots up the cost of acquisition due to increasing cost of interest in the borrowings.[28]

Further, a poison pill can also be structured in a way where the target company add certain clause in its articles of association, which prohibit the acquirer to use the brand name of the target company.

Another tactic that maybe used by the companies is that of issuing employee stock options. Under this scheme, the employees are offered shares of the company at a discounted price. Use of this technique during a hostile takeover would dilute the share of the acquirer in the company. Hence, saving it from a prospective hostile takeover.

GREENMAIL DEFENCE

Under this defence, the target company offers the acquirer to buy back the shares acquired by the acquirer at a premium price, which is above the market price of shares. The target company makes this offer after conducting a cost benefit analysis.

It is often considered as blackmail; the acquiring company buys the shares of the target company and then threatens them with a hostile bid. In response the target company offers to buy back these shares at premium in order to defend any further hostile behaviour.[29] Typically, after the target company buys its shares back, the acquiring company signs an agreement with the target company to not make another takeover attempt for an agreed period of time.

For instance, the Renaissance Estates Limited (REL) led by Abhishek Dalmia as he attempted to take over the GESCO Corporation (GESCO) made an attempt at a hostile acquisition. Abhishek Dalmia attempted to buy 45%of the stake in the company at a price of INR 23 which

[27] Senior securities are those that ranks higher in terms of pay out ranking. The value of these securities is determined by the board of directors

[28] The Economic Times, 2020, Can India Inc. swallow the ‘poison pill’? [online] Available at: https://economictimes.indiatimes.com/view-point/can-india-inc-swallow-the-poison-pill/articleshow/3051566.cms?from=mdr.

[29] McChesney, 1993. Transaction Costs and Corporate Greenmail: Theory, Empirics and a Mickey Mouse Case Study, Wiley, Managerial and Decision Economics. Special Issue: Transactions Costs Economics.

was only a fraction of the actual value shares priced at INR 54.50. REL later raised the offer to INR 27 for 55% of shareholding in the corporation. In ordered to avoid a hostile takeover, GESCO's promoter of Mahindra Reality and Infrastructure Developers (MRID) and made a counter offer to buy the company's shares at INR 36 per share. After extensive lobbying and counteroffers, REL bought 10.5% stake in GESCO for INR 45 per share only to sell it to MRID at INR 54 per share. Thus, the joint share of GESCO promoters went to a total of 30%.[30]In this case, Abhishek Dalmia instead of dislodging the promoters of the target company sold his shares at a profit. This was a failed hostile takeover attempt and a successful use of the defence of greenmail defence tactic. [31]

Another example of the use of greenmail would be the case of Arjun Bajoria and Bombay Dyeing. In the year 2000, 5% of Bombay dyeing's shares were brought by Arjun Bajoria. It was only in June 2000, Bombay dyeing noticed Bajoria's attempt of a takeover. They filed a complaint with SEBI, Bombay Stock Exchange and Company Law Board. Bajoria claimed to have sent a notice to company. After, a lot of speculation relating to Bajoria's intentions with the target company, he finally sold his shares to Mr. Nusli Wadiaat a profit.[32]

GOLDEN PARACHUTE

A golden parachute is a relief or compensation payable to the top executives of a company in case of a takeover. This clause is part of the contractual agreement between the top executives and the company which results in a hefty payment that has to be made to the top executives in case of termination of their contract. This severance packages is opted by a lot of big and wealthy companies. The companies face a reduction in the amount of their assets when they make such payments. This makes the target company less attractive and also increases the cost of acquisition.

Moreover, this places the mangers and the shareholders of the target company on the same side and reduces the conflict between them as fulfilment of the clause of golden parachute has an impact on the premium that has to be paid by an acquirer. Therefore, they fight alongside the shareholders in order to get higher premiums. Various studies have been conducted to show a

[30] *Supra* note 5

[31]Business Standard, 2019, Dalmia Firm & #39; S Stake In Gesco Up At 7.27%. [Online]. Available at: https://www.business-standard.com/article/companies/dalmia-firm-39-s-stake-in-gesco-up-at-7-27-101080401025_1.html.

[32]Business Standard, 2019.Arun Bajoria At It Again, Buys 5.14% Bombay Dyeing Stake. [online] Available at: https://www.business-standard.com/article/companies/arun-bajoria-at-it-again-buys-5-14-bombay-dyeing-stake-101081401003_1.html.

positive correlation between golden parachute and the amount of premium paid that is offered to the shareholders.[33]

INDIAN LEGAL POSITION

In India, Section 196 read with Schedule V of the Companies Act provides for payments and appointment of directors. Under this section, the permissible limit of remuneration that can be given to a director without the approval of the Central government is not much. Therefore, it is not enough to defend a takeover even if the company is supposed to pay the maximum limit. According to section 197 of the Companies Act[34], a director can only aid 11% of the total profits.

However, the clauses relating to a golden parachute are administered by section 202[35]of the Companies Act, 2013. As per these provisions, only the whole-time directors[36] and an office manager[37] are eligible for severance packages. However, a director is not eligible to be paid in case he resigns from office when a company amalgamates with another entity or due to reconstruction. These provisions are not applicable to directors who are dismissed after a resolution has been passed in the board meeting. Further, Clause 3 of section 202 puts restriction on the amount of compensation that is payable to the director.[38]

CROWN JEWEL

A crown jewel refers to the most beneficial assets of a corporation. A crown jewel of a company can varies across an array of spheres both tangible and intangible as it could be a department

[33]Michael Jensen, Takeovers: Causes and Consequences, in Patrick A. Gaughan, ed. Readings in Mergers and Acquisitions, Oxford: Basil Blackwell, 1994

[34]Companies Act 2013- § 197 (1) The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent. of the net profits of that company for that financial year computed in the manner laid down in § 198 except that the remuneration of the directors shall not be deducted from the gross profits:

[35]Companies Act 2013. § 202(1) for Compensation for loss of office of managing or whole-time director or manager states as follows: "(1) A company may make payment to a managing or whole-time director or manager, but not to any other director, by way of compensation for loss of office, or as consideration for retirement from office or in connection with such loss or retirement."

[36]Companies Act 2013. § 2(94) defines "whole-time director" to as follows: "includes a director in the whole-time employment of the company."

[37]Companies Act 2013. § 2 (53) defines "manager" to mean as follows: "an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not"

[38]Companies Act 2013. § 202 on Compensation for loss of office of managing or whole-time director or manager states as follows: "(3) Any payment made to a managing or whole-time director or manager in pursuance of sub-§ (1) shall not exceed the remuneration which he would have earned if he had been in office for the remainder of his term or for three years, whichever is shorter, calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which he ceased to hold office, or where he held the office for a lesser period than three years, during such period…"

that renders the most profits, a particular team in research and development or an extravagant chain of shares. The crown jewel is also used as an anti-takeover defence in case of hostile mergers and acquisitions[39]. When the target company faces a threat from a corporate raider, they may take the radical step of selling off their most profitable and valuable assets also known as the '*crown jewel*'. This dire step by the target company will render the company less attractive and invaluable in the eyes of the corporate raider which will impel them to withdraw the bid[40]. Once the most profitable assets of a firm a sold, the prospective acquirers foresee a disoriented business and tend to pull out of the deal. This self-preservation technique by a target company is mostly seen as a last resort as it dismantles and severs the most valuable assets of the target company. The sale of crown jewels leaves a business with grim prospects of growth which is why the target companies often look for a friendly third part to sell off its crown jewel to. The friendly third party also known as the *white knight* (*as discussed above*) is likely to sell back the crown jewel to the target company at a premeditated price once the corporate raider has disengaged itself from the bid.[41]

INDIAN LEGAL POSITION

Regulation 26[42]of the Takeover Code provides for requirements by the board of directors and managers of a target company. Under this said regulation, it is rather demanding and problematic for the target company to sell, transfer, trade, eject or enter into any contract to, transferor dispose of assets once the corporate raider has made a public bid. Thus, the crown jewel defence can only be employed prior the public announcement by the hostile bidder to take over the target company.

The Companies Acthas contrived constraints on the power of the board. As per Section 180[43] of the Companies Act, the board cannot sell the whole or substantially the whole of its undertakings without obtaining the authorization of the shareholders in a general meeting. However, there are no restrictions on the sale of a single immovable property, which does not form an undertaking. Hence, primarily there are no restrictions on the power of the board to

[39]Supra note 23
[40] *Ibid*
[41]Mergers and Acquisitions, Alan Auerbach, Published in 1987 by University of Chicago Press by the National Bureau of Economic Research
[42]Supra note 24
[43]**Companies Act, 2013. § 180(1) states as follows "(1)** The Board of Directors of a company shall exercise the following powers only with the consent of the company by a special resolution, namely:**(a)** To sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings."

deal with the properties of the company, unless they are opposed to the interests of the company.

THE CASE STUDY OF L&T INFOTECH AND MINDTREE PARTIES TO THE TRANSACTION

- **THE ACQUIRER**

Larsen & Toubro Limited (L&T), a publicly listed company and a fragment of Larsen & Toubro Group, is a Mumbai based global IT Services Company. It is a company with miscellaneous services variegated across technology, engineering, construction, manufacturing and financial services, with global operations. L&T holds 74.58 % stake in **Larsen & Toubro Infotech Limited**, an IT company offering services across the globe. L&T's expansion in the information technology was perhaps one of the critical factors in its interest in the acquisition of the Target Company.

- **THE TARGET COMPANY**

Mindtree Limited (Mindtree) is a publicly listed corporation engaged in the business services related to Information Technology and distributing digital and transfiguration.

A Bangalore based software Service Company, it offers application development, and constitutes as one of the few companies to sense and seize opportunities by expanding their business through artificial intelligence, machine learning and automation.

B. RATIONALE OF L&T

According the statements given by L&T's top management personnel, it has a software services business under L&T Infotech and this acquisition was aimed at providing the best IT services to its clients worldwide which could take its technology portfolio among the top tier IT companies of the country.[44]. Mindtree was expected to expand client liaison and business ventures for L&T. Consolidation of these two entities was assumed to render $2.4 billion.[45] Since, there were no instances of overlap between the functioning of these two companies, as L&T Infotech primarily functions in BSFI (Banking, financial services and insurance) and

[44]Annual Report 2018-19, L&T Infotech. [Online]. Available at: https://www.lntinfotech.com/wp-content/uploads/2019/06/LTI-AR-2019_web-version.pdf?pdf=download.

[45]The Economic Times, 2019, How Mindtree became the object of a hostile takeover battle between its management and L&T. [online]. Available at: https://economictimes.indiatimes.com/tech/ites/how-mindtree-became-the-object-of-a-hostile-takeover-battle-between-its-management-and-lt/articleshow/68490409.cms.

manufacturing whereas Mindtree has a strong presence in hi-tech media, retail and consumer packaged goods.[46] This amalgamation was expected to help in expanding client base by decreasing client concentration. However, post the acquisition their client concentration was predicted to be brought down to mere 8.5 %.[47]Hence, this amalgamation was a major step to expand the client base and uplift L&T's position in the IT sector.

Another aspect, which made the acquisition of Mindtree attractive to L&T, was the likelihood of increased return on equity. This acquisition would help increase the profits and expand sources of revenue in the information technology and technology service sector.

C. RATIONALE OF PROMOTERS OF MINDTREE

The promoters of Mindtree were averse to the idea of a takeover. According to Mindtree, there was no strategic advantage of this takeover and it was a threat to Mindtree's unique setup. Krishna kumar Natarajan, the chairman of Mindtree wrote a letter to L&T board to urge against a hostile takeover and he expressed his shock with regard to the attempts of a hostile acquisition. He also emphasized that management does not want to be part of an institution that is anthropologically different from Mindtree and that amalgamation of the two organizations will not render benefits for any of the two.

D. V.G SIDDHARTHA'S PART IN THE TAKEOVER DEVELOPMENTS

VG Siddhartha, the founder of Café Coffee Day (CCD) and one of the promoters of Mindtree disposed of his stake of 20.32% in Mindtree to Larson and Turbo Limited. The private equity firms including Baring PE Asia, Chrys Capital, and KKR refused to buy VG Siddhartha's share as these companies wanted to secure the controlling stake in the company just like L&T Infotech.

Siddhartha sold his share in Mindtree to pay off his debt of Coffee Day Enterprises (CDE – holding firm for CCD) and other ventures[48]. The total debt of CDE amounted to INR 6550 crores before the sale of its Mindtree stake. Siddhartha's stake in the company was pledged by to various banks and financial institutions. In order to release these shares Coffee Day Group entity, Tanglin Retail Developments Private Limited issued non-convertible debentures of INR

[46]Annual Report 2018-19, L&T Infotech. [Online]. Available at: https://www.lntinfotech.com/wp-content/uploads/2019/06/LTI-AR-2019_web-version.pdf?pdf=download.

[47]Supra note 43.

[48]The Economic Times. L&T confident of taking control of Mindtree: AM Naik, Available at: https://economictimes.indiatimes.com/tech/ites/lt-confident-of-taking-control-of-mindtreeamnaik/articleshow/69764776.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

3000 Crore with tenure of a year and one month. This arrangement was made to ensure that the share transfer materialized easily and the hassle of obtaining no-objection certificate from several lenders could be avoided.[49]

E. TRANSACTION

The acquisition took place in a three-fold process.

It all started when V.G Siddhartha offered to sell his 20.30% stake in Mindtree. The takeover was initiated when a share purchase agreement was signed between L&T and Siddhartha. Under this agreement, Siddhartha sold 33,360,229 equity shares of Mindtree aggregating to 20.15% of shareholding of Mindtree at INR 980 per share.[50]

Since this was below the threshold limit, the need for an open offer was not triggered. However, L&T further placed an order to buy 15% more shares in Mindtree through a broker. They bought 24,834,858 more shares, which accounted for 15% equity shares in the voting capital.

After acquiring 15% more equity shares, L&T exceeded the threshold limit and were required to make an open offer, as mandated by the Takeover Code. L&T made an open offer to purchase 51,325,371 Equity Shares amounting to 31.00% of the share capital. As per Regulation 19(1) of the Takeover Code, there were no conditions imposed on the offer as to the amount of minimum subscription. The open offer was however oversubscribed, following which the shares were allotted on proportionate basis. [51]

F. DEFENCES USED BY MINDTREE

The promoters of Mindtree opposed this acquisition from the very beginning. The promoters never wanted to sell their shares to a third party. The promoters had an emotional connect with the company and opposed the idea of a third party intervening and controlling the affairs and events of their company. The promoters believed that a third party would not lead this company in the right direction and were of the opinion that Mindtree and L&T are very different companies with remarkably distinctive goals and were therefore not compatible. The promoters also outlined the negative consequences of a takeover in the present market conditions. They believed that Mindtree would lose all the progress it had made because a

---

[49]Vora K. Hostile takeovers and case of L&T Infotech and Mindtree, VORA Corporate Finance. [Online]. Available at: https://vorafin.com/insights/lt-infotechs-hostile-takeover-of-mindtree-and-theory/.

[50]Nishith Desai Associates, 2020, Don't Mind: You've been acquired! [Online]. Available at: https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Don_t-Mind-You_ve-been-Acquired.pdf.

[51]Post Open Offer Report. SEBI, Available at: https://www.sebi.gov.in/sebi_data/commondocs/jul-2019/poadmindtreead_p.pdf.

takeover could potentially ruin client relationships. Therefore, it wasn't considered to be profitable deal for the shareholders.[52]

The promoters of Mindtree planned a board meeting and informed the stock exchange about the same. The meeting was particularly set to discuss the buyback of shares. The buyback of shares is a commonly used defence strategy to protect a target from a possible takeover as a buy back increases the cost of acquisition and dilutes the number of shares available for purchase (*buy back of shares as a defence strategy has been discussed in detail above*).

According to section 68 of the Companies Act, a special resolution needs to be passed in case of the buy back, however, under the exemption's clause, 10% of the shares can be issued for buy back without a special resolution. Further this section imposes a limit of 25% of shares that can be bought back but only after a special resolution is passed by the company.

However, in the present case, this defence rendered itself to be ineffective. Mindtree's worth was INR 27,414.00 million which implied that INR 2,741.40 million could be bought back without a special resolution and INR 6,853.50 million after a special resolution[53]. Even after this, there were 163,900,000 equity shares outstanding. This implied that even if the company passed a special resolution to buy back 25% shares, the outstanding share capital would only be reduced by 4.20%. This was not enough to save the company from takeover. Moreover, a buy back at such a later stage is discouraged.

Further, the company resorted to the defence of *white knight*. Underlying idea being that a third party enters the negotiation by making a competing offer, which provides a fair chance to shareholders to choose the better offer. The target company approached individuals with high net worth hoping for a friendly takeover. However, no competing offers were made.

Another tactic that could have been used by the target company was that of crown jewel. Since, the company is part of the IT sector most of its assets are intangible. The target company could have sold off major chunks of its assets to make the deal look unattractive. However, Mindtree could not use this defence since the promoters of the company held a very small percentage of shares and did not have the ultimate power.

---

[52]Business Standard, 2019. What message is being sent to start-ups: Mindtree promoters to L&T. [online].Available at: https://www.business-standard.com/article/pti-stories/what-message-is-being-sent-to-start-ups-mindtree-promoters-to-l-t-on-hostile-bid-119031900766_1.html.

[53]Annual Report 2018-19, Mindtree. [Online]. Available at: https://www.mindtree.com/sites/default/files/201904/Mindtree%20Q4FY19%20Press%20Release.pdf.

Since, these three defences were ineffective to protect the company. The promoters constituted an independent committee to review the open offer as mandated under Regulation 26(6) of the Takeover Code.

G. SEBI GUIDELINES ON AN OPEN OFFER

As per Regulation 3[54] of the Takeover Code, when a company is attempting to acquire another company, it is required to make an open offer to public when the stake of the acquirer rises to more than 25%. Furthermore, as per the provisions of the takeover code, one cannot take control of a corporation unless an open offer is made to the public to acquire shares.

H. WHETHER THE HOSTILE TAKEOVER OF MINDTREE IS WITHIN THE BRACKET OF LAW

Larson and Turbo made a public announcement as per the terms of Regulation 3[55] and Regulation 4[56] of the Takeover Regulations 2011 despite the offer being considered as unsolicited and hostile. An open offer is normally made on accounts when acquirer wants to takeover at least 25% of the stake in a company. However, in this case the offer was of at least 51%, hence there was no need to reach 25% holding before a public announcement as mandated under Regulation 6 (1)[57] for a voluntary offer.

I. OUTCOME OF THE HOSTILE BID

L&T ended up purchasing 31% additional shares than it had intended to acquire in Mindtree for INR 4,988.82 Crores via an open offer. The offer to acquire 50.9 million shares of Mindtree from its public shareholders was subscribed 1.2 times on 26 June 2019 and it closed on 28 June

[54]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. Regulation 3(1) on Substantial acquisition of shares or voting rights states as follows: "No acquirer shall acquire shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, entitle them to exercise twenty-five per cent or more of the voting rights in such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations."

[55]Ibid

[56]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. Regulation 4 on Acquisition of control states as follows: "Irrespective of acquisition or holding of shares or voting rights in a target company, no acquirer shall acquire, directly or indirectly, control over such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations."

[57]Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. Regulation 6(1) states as follows: "An acquirer, who together with persons acting in concert with him, holds shares or voting rights in a target company entitling them to exercise twenty five per cent or more but less than the maximum permissible non-public shareholding, shall be entitled to voluntarily make a public announcement of an open offer for acquiring shares in accordance with these regulations, subject to their aggregate shareholding after completion of the open offer not exceeding the maximum permissible non-public shareholding."

2019. The shareholding of 60% in Mindtree gave L&T absolute control over the company's board of directors and its management. On 3 July 2019, L&T obtained the promoter status in the software company Mindtree by obtaining majority shares.[58]The Executive Chairman, the Executive Vice Chairman and Chief Operating Office and Managing Director of Mindtree resigned as the members of the board of directors and as employees of the company. They acted as board members and employees till 17 July 2019 as per their employment contracts. Promoters, Mr. Krishnakumar Natarajan, Mr. Subroto Bagchi, Mr. NS Parthasarathy and Mr. Rostow Ravanan together hold 13.32% of stake in Mindtree. 60% of shares are now owned by L&T, and domestic mutual funds and foreign portfolio investors hold the rest.[59]

J. RATIONALE BEHIND HOSTILE TAKEOVERS

When an acquirer sees a potential investment, it would first make an open offer. A takeover bid can either be friendly or hostile depending upon how it is received by the management of the company.

An acquirer can decide to make a hostile bid for the following reasons:

A hostile takeover is launched when the initial negotiations with the target companies do not follow through. More often than not, the parties involved are unable to land on a consensus to determine the offer price. This happens mostly because the management of the target company has access to insider information. The information available with them helps them understand the financial position of the company better and reject every offer they feel is inadequate. Furthermore, the management is likely to reject all offer in order to retain their job because post-acquisition there exists a high risk of the management losing their jobs.

An acquirer can also initiate a hostile bid without any negotiations. This way is opted to avoid the lengthy process of negotiation to determine the buyout price. This way the acquirer can set up a new management team without retaining any of the members of the management before. This would also give the target company an element of surprise and because of paucity of time the target company would fail to initiate any defence mechanism against the takeover.

[58]The Economic Times. L&T acquires 8.86 lakh shares of Mindtree. [Online]. Available at: https://economictimes.indiatimes.com/markets/stocks/news/lt-acquires-8-86-lakh-shares-of-mindtree/articleshow/69362228.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

[59]The Hindu, and so, after all the drama, L&T now owns Mindtree. [Online]. Available at: https://www.thehindu.com/business/and-so-after-all-the-drama-lt-now-owns Mindtree/article28191284.ece

CONCLUSION

The pre-liberalisation era did not facilitate hostile takeovers and ever since the year 1991, a change has been observed in the manner our country's bidders operate. The numbers of hostile takeovers are increasing each day and the plight of the management of the target companies worsens by day. The employment of defence tactics reduces the playing field of the hostile bidder tremendously. However, not all defences can be actively deployed in our country because of legal restrictions. Anti-takeover defences however play a crucial role in corporate reconstruction once a hostile bid is made. SEBI has endeavoured to keep its governance in consonance with the market, as can be seen from the scope of its regulations. However, it is time for the other substantive laws such as the Companies Act to be a more accommodative towards anti-takeover defences. Furthermore, legislative steps must be taken to keep the interests of the shareholders abreast with the board of directors to ensure equitable growth.

****