



INDEPENDENT DIRECTORS- A MISNOMER

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ABSTRACT

The announcement of the Clause 49 in SEBI Listing Agreement brought about the introduction and growth of the independent directors, which provided for the need for having an independent directors on the boards of the company and defined the term 'independence' as well as laid down their duties and responsibilities. Also the Companies Act 1956 was amended and there was introduction of Companies Act 2013 which brought along with it provisions relating to the Independent directors and provided for a wider perspective in terms of their independence.

The appointment of the independent directors on the board provides support as well as contributes in better corporate governance performance. They also play the role of balancing the interests of the various stakeholders and protect the interest of the company which helps in its growth. However in the recent time, the occurrence of scams and other such incidence have increased taking for example scams like Enron, World com, Satyam or for that matter the controversy between the Tata sons and Cyrus Mistry , or the Infosys board issue and other global scandals. These scams have questioned the 'Independence' of the independent directors and the role they play in ensuring good corporate governance. Concerns regarding their appointment, selection procedure, removal have cropped up taking into account the increasing number of resignations by them. .

Large number of companies are promoter driven and are being controlled by one person, on a close observation it is evident that he is the person who is responsible for the management and also the appointment and removal of the independent directors, and they instead of playing the role of the watchdog of the board they prefer to be 'friends' of the promoters.

All these issues have questioned the corporate culture, ethics, norms of business organisations, and if we look closely we will find that the core problem of the business world today is seen to be the failure of the corporate governance, which means that the Boards are failing to execute their responsibilities and duties properly, And that the term 'independent' seems to be a myth and a misnomer as these incidences clearly shows that there is no such thing as independence and that they

are just dolls in the hands of the promoters. Thus there is an urgent need to relook at the role of the independent directors and analyse the emerging challenges and issues faced by them.

Keywords: *independent directors, corporate governance, Companies Act 2013, Scams, SEBI Listing Agreement, promoters.*

INTRODUCTION

Corporate governance is the system by which a company is expected to be controlled and directed, it involves a set of relationship between the management, board, shareholders and various stakeholders.¹ It is recognised as a paradigm for improving competitiveness, enhancing the efficiency and improving the shareholders confidence.² The companies Act 2013 was implemented with the view of bringing about better corporate governance through provisions relating to the independent directors which aims at increasing the accountability and transparency in the companies.

The Dr. Jamshed Jiji Irani (JJ Irani Committee) which was constituted for bringing about reforms in the company law was of the view that if the board consisted of a neutral entity it would facilitate better corporate governance since the board of a company was required to balance a number of interests. It laid importance on the role of independent director's functions and stated how it could bring about objectivity to the board, by bringing fresh and an unbiased perspective on corporate affairs. The Companies Act 2013 and Securities and Exchange Board of India (SEBI) regulations have made independent directors responsible for ensuring good governance. Independent directors have become the focus of corporate governance and their role in the corporate environment has increased significantly over the time. Independent directors act as fulcrum as they hold a special place in terms of the governance of a company, its board and its management. They are required to exercise judgment on corporate affairs objectively. This role is especially critical when there is a difference of opinion between shareholders, the company and its management.

However in the recent times Independence of the independent director has emerged as one of the critical issues in the present time as they are not conferred with enough independence to carry out their operations further, the law provides no protection to independent directors against the vindictive management. Presently, there exist no formal rules and regulations defining the powers, duties, rights, disabilities, privileges, and so on, of independent directors and there have been too much interference by majority shareholders/promoter group.

The independent directors are under constant threat of being removed and the institution of independent directors is quite nascent and if one allows their independence to be compromised at this stage then things can go wrong. In view of the current issues relating to the corporate governance especially the role of independent directors, the SEBI had also constituted a committee under the

¹ Bajpai, G.N, '*The Essential Book of Corporate Governance*' SAGE Publications, 2016.

² Calder Alan, '*Corporate Governance: A Practical Guide to the Legal Frameworks and International codes of practice*, konan page limited, 2008.

chairmanship of Uday Kotak to look into the issues of corporate governance and based on those recommendations the SEBI amended the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015. The amended SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2018³ dealt with the emerging issues and challenges relating to the corporate governance.

Thus, there is an on-going need for the constant review and corrections and there is a need to understand the emerging issues of the independent who play a significant role in corporate governance structure so that the lacunas and loopholes in the system can be filled up and that India can also have a strong corporate governance framework like other countries.

INDEPENDENT DIRECTORS: AN OVERVIEW

An independent director is vested with numerous roles, duties and liabilities for good corporate governance. They help a company to protect the interest of minority shareholders and ensure that the board does not favour any particular set of shareholders or stakeholders. An Independent director is said to bring about credibility and accountability in the board's process, they are considered to be the trustees of maintain a good corporate governance. Thus an independent director is a non-executive director of a company who helps the company in improving corporate credibility and governance standards. They act as watchdog and play a pivotal role in risk management and also in various committees to ensure good governance.

In a broader term, an independent director is a person who does not have any kind of relationship be it, pecuniary or personal with that of the company which might affect their independence.⁴ They are expected to be independent from the management and protect the interest of the shareholders which means that they are obligated to be fully aware of and question the conduct of organizations on issues relating to corporate governance. The sole reason for the introduction of independent directors was that it would bring independence in the board process and would help in maintain a strong framework of corporate governance in the functioning of the company⁵.

MANNER OF SELECTION AND APPOINTMENT OF INDEPENDENT DIRECTOR

Appointment-

Under the Companies Act, 2013, rules relating to the independent director have been laid down for their appointment for example; an independent director or his relatives should not be related to the company nor have any kind of interest in the company, he/she should be independent at the time of appointment. The term of Independent director is 5 years, but can be re-appointment by passing of a special resolution by the company and disclosure of such appointment in the board's report.

³ https://www.sebi.gov.in/legal/regulations/may-2018/sebi-listing-obligations-and-disclosure-requirement-amendment-regulations-2018_38898.html

⁴ Zhao Yuan, 'Corporate Governance and Directors' Independence' kluwer law international, 2011.

⁵ Dravis Bruce F., 'The Role of Independent Directors in Corporate Governance' American Bar Association, Business Law Section, 2nd edition 2015.

Manner/procedure of selection-

Section 150 of the companies Act 2013 deals with the procedure for selection of an Independent director. It states that selection of an independent director shall be done from a Data Bank which can be maintained by anyone, be it institute or an association, as may be notified by the Central Government. It must contain the names, addresses and qualifications of persons who are eligible and willing to act as Independent directors. It is to be approved by the company in their general meeting and a statement which indicates the justification behind appointing of such person, attached with the notice of general meeting. They are handpicked by the majority shareholders.

MEETINGS AND COMMITTEES

The companies Act 2013 requires all the Independent to meet at least once in a year, and the meeting is to be conducted without the members of the management and in the absence of the non-independent directors. The Act also speaks about the appointment of an Independent director as a member or as a chairperson in various committees for example; Nomination and Remuneration Committee.

LIABILITY OF INDEPENDENT DIRECTORS

Section 149 (12) of the companies act 2013 limits the liability of an Independent director to the acts which are committed by a company , which had occurred with his knowledge, attributable through board processes, and with his consent or where he had not acted diligently.

ROLE AND DUTIES OF INDEPENDENT DIRECTORS

Schedule IV of the Companies Act 2013 deals with the duties, roles, functions etc relating to the independent Directors. The code provides for certain important duties like regularly attending the general meetings of the company, keeping themselves updated, refreshing their knowledge and skills, actively participating in the board committees etc. ⁶ The code also provides for certain important functions like analyzing the managements performance, harmonizing the conflicting interest of the various stakeholders etc.

REGULATORY FRAMEWORK: INDEPENDENT DIRECTORS

The term ‘independent Directors’ are dealt with in SEBI listing agreements,2000 in clause 49 and the companies Act 2013 has borrowed much of the provisions from the listing agreements and incorporated the same in the Act . The Companies Act 1956 does not deal with the independent directors or does it provides any provision relating to their compulsory appointment on the Board.

SEBI STOCK EXCHANGE LISTING AGREEMENT 2000 (CLAUSE 49)

Clause 49 of the SEBI listing agreement was based on the recommendation of the Kumar Mangalam Birla committee recommendations which dealt with corporate governance norms. Clause 49 of the SEBI listing agreements mandates the appointment of the independent directors on the board.

⁶ Dangi Vandna, ‘*Corporate Governance*’ ocean book (P) Ltd, 2013.

The revised Clause 49 requires at least one third of the directors on the board of the company to comprise of independent directors.

SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018.⁷

The SEBI had recently in the year May, 2018 amended the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 on the recommendation of the Kotak committee. It took into account the emerging issues and challenges in corporate governance and the board of directors and made certain changes relating to the appointment, selection procedure, and removal etc of the board of directors. .

COMPANIES ACT 2013- Section 149 of the companies Act 2013 deals specifically with the independent director's⁸ appointment and qualification, tenure, liability of the Independent and the role they play in ensuring corporate governance⁹. This Act has adopted many of the provisions of Cl 49 of the SEBI listing agreements¹⁰

SCAMS AND FRAUDS: A REALITY CHECK!

After the outbreak of some of the largest scams and frauds in the corporate sector in India and the subsequent increase in the no. of resignations by the independent directors, the need to relook at their role and duties have increased. The reoccurrence of the frauds and scams have clearly depicted the loopholes which are prevailing in the current laws and the failure to take note of the fact has led to more of such incidences which are shaking the corporate world.

With the occurrence of the Satyam scandal¹¹, the role of independent directors came to limelight. The admitting of the fault of the chairman of Satyam Computers that he had mismanaged the funds of the company and that none of the independent directors present on the board could possibly sniff any of that shocked the investors.¹² And during that phase companies in India witnessed an increase in the resignations among the independent directors which depicted very clearly that all was not well in the companies and that there was a need to re-look at the role of the Independent. Following the Satyam scam, recently in the year 2017 there came up the controversy between Ratan tata and Cyrus Mistry where in issues relating to the independence of the Independent directors again cropped up. And more recently, issues with regard to the Independent directors also came up in the most renowned company Infosys, which was considered to have best corporate governance practices wherein *the founder of Infosys Mr NR Narayana Murthy disclosed about the corporate governance failure and issues relating to the independent director.*

⁷ https://www.sebi.gov.in/legal/regulations/may-2018/sebi-listing-obligations-and-disclosure-requirement-amendment-regulations-2018_38898.html

⁸ Section 2(47) of the Companies Act 2013

⁹ Section 149 of the Companies Act 2013

¹⁰ Ibid.

¹¹ Fernan A.C. 'Corporate Governance: Principles, Policies and Practices' Pearson, 2nd edition 2012.

¹² Mallin Christine, 'Corporate Governance' oxford university press, 5th edition, 2012.

Thus, the major incidents that shook the corporate world can be Chronologically summarised in the following table:-

YEAR	INCIDENTS
2002	World com scam
2004	Enron scam
2009	Satyam computers scam
2017	Tata sons and Cyrus P.Mistry episode
2017	Infosys board issue

Taking into consideration the ongoing controversies and wave of scams SEBI chairman also stated that there is an issue with corporate governance, wherein the Independent directors are any independent, there are improper functions of the auditors committee and there is lack of stewardship code.

All these incidences portrays that the independent directors are at a risk, especially when it comes to their independence and that there is a need to protect them against the whims and fancy of the majority shareholders or else they will be left nothing more than a yes man in the company. Thus it is an issue which needs to be looked into urgently.

EMERGING ISSUES AND CHALLENGES

The impact of certain factors like personal liability, compliance penalty, legal cost, risk of reputation faced by the Independent directors in the recent times has made their role even more risky than before. These factors have led to an increase in the number of resignations among the independent directors which is considered to be one of the many emerging issues in India. If we look closely, then it can be noticed that Independent directors do not have any real powers at its disposal. They are not the ones who are operating the company and that they rely on only those information which is put in front of them in the board meetings. No doubt, they are given the authority to ask questions on the relevant matters but that does not make them liable for all the offences being committed in the company and make them personally liable.

Some of the emerging issues and challenges faced by the Independent Director in the recent times are as follows:-

1. Increase in resignations among the independent directors

It has been noticed that there is an increase in the number of resignations by the Independent directors in the recent years. A recent study conducted depicts that from the year 2016-2017 982 Independent directors resigned¹³. One of the reasons for such increase of resignations being the regulatory

¹³ Prime data base; <https://economictimes.indiatimes.com/news/company/corporate-trends/independent-directors-head-for-exit-doors-on-compliance-stress/articleshow/60977881.cms>

interventions becoming more intrusive and in-depth in nature and some of the other reasons being the increasing personal liability of the directors.¹⁴

2. Gender diversity in the boardroom

SEBI in the year 2017 has recommended the inclusion of at least one independent women director in all the listed companies. The Companies Act 2013 also requires companies to have at least one woman director on their boards, this have indeed helped in improving the gender diversity in the boardroom. However it has been noticed that almost 25% of the women who are appointed on the Boards are family members of the owners whose one qualification of being a woman does not really add value to the organisation's problem solving capabilities or creative thinking.

3. Family owned business

In case of India, most of the business groups are owned and controlled by family. In such a scenario, the interest of the promoters often overshadows that of the shareholders and further the appointment and removal of the Independent directors is often at the whims and fancies of the majority shareholders.¹⁵

4. Appointment Process

There is a need to look into the appointment process of an independent director as it has been noticed that companies while appointing an independent director takes into consideration only the 'independence' requirement and other areas are not looked into for example their skills, competence, experience etc which would ultimately be the deciding factor or justify their role as independent director.

5. Institutionalisation of Independent directors

There no database which is credible enough from where companies can select persons with the required skills to take the role of independent director as per the specific requirements of the companies. Therefore the companies are devoid of the opportunity to access wide data base and ultimately rely on their own search. Therefore there is an urgent need of institutionalization of Independent directors.

6. Lack of training of independent directors

It has come to light that the training which is provided to the Independent directors to analyse issues and risks relating to the company is grossly lacking. Therefore there is an urgent need for well planned induction programme as well as training programmes for the Independent directors at the time of their appointment so that they are able to keep themselves updated with the recent developments.

7. Lack of transparency, disclosure and accountability

¹⁴ <https://www.theweek.in/theweek/business/2018/04/14/increased-scrutiny-is-making-independent-directors-quit-their-jobs.html>

¹⁵ <https://www.businesstoday.in/opinion/columns/why-questions-being-raised-on-independence-of-independent-directors/story/252581.html>

Indian Companies being family dominated has some threats to the accountability and the transparency in the companies which is one of the major issues in maintaining a good corporate governance. As effective disclosures are pivotal to corporate governance. It becomes a difficult task for the Independent directors to keep a check on the transparency and accountability as the majority shareholders being family members camouflage the pivotal information from the Independent directors.

8. Failure of compliance with Section 149(6) of Company's Act 2013

Taking into consideration the recent incidents and controversies it can be clearly stated that the provisions of the companies Act 2013 is not being complied with. Section 149(6) deals specifically with the Independent directors and it has been noticed that Companies are failing to comply with the requirements of the said provision.

RECENT DEVELOPMENTS:

UDAY KOTAK COMMITTEE RECOMMENDATIONS

SEBI had constituted a committee under the chairmanship of Uday Kotak in the year 2017 in order to recommend changes and to enhance corporate governance norms. In the month of March 2018, SEBI accepted several recommendations of the Kotak committee without any kind of modifications and a few others with certain amount of modifications¹⁶ The key recommendations of the Kotak Committee with respect to the Independent directors as accepted by SEBI are as follows:¹⁷

- **Maximum number of directorships**

As per the SEBI Regulations 2015, there is a limitation placed on the Independent directors as he cannot serve as an independent director in more than seven listed entities. However, if a person is a whole time director in one or more listed entities, then such a person cannot serve as an independent director in more than three listed entities.

The Kotak committee is of the opinion that a person is allowed to hold a number of directorships, beyond the required number it would ultimately result in failure of effective exercise of their duties towards the company and thereby affecting its role as that of a director. Therefore the Kotak committee recommended that a limit should be placed with respect to the number of directorships which can be held by a person in listed entities to eight by 1 April 2019, and to seven by 1 April 2020 not taking into consideration whether the person is an independent director or not .

- **Expanding the eligibility criteria for independent directors**

Independent directors play a pivotal role in ensuring good corporate governance. Independence of the independent director is considered to be the crucial element in their role. Taking these into consideration, the Kotak committee recommended that there is a need for both subjective and objective

¹⁶ https://www.sebi.gov.in/legal/circulars/may-2018/circular-for-implementation-of-certain-recommendations-of-the-committee-on-corporate-governance-under-the-chairmanship-of-shri-uday-kotak_38905.html

¹⁷ https://www.sebi.gov.in/media/press-releases/oct-2017/submission-of-report-of-the-committee-on-corporate-governance_36180.html

assessments. Therefore, it specified the exclusion of persons who constitutes the promoter group of a listed company.

- **Disclosure of expertise/skills of directors**

The Companies Act 2013 provides for the skills and expertise relating to the independent directors in the process of their appointment. And SEBI Listing Regulations, requires disclosure of the skills and expertise to the shareholders at the time of the appointment of the directors. The Kotak Committee in order to ensure that that the shareholders of the company are fully are fully apprised of the ability of the board recommended that it would be mandatory for every listed entity to disclose in its annual report, a chart which depicts the competence, skills, expertise of the BOD and the name of the directors as well who posses such expertise. From the year 31st march 2020.¹⁸.

- **Enhanced obligations on the listed companies with respect to subsidiaries**

It is mandatory for a listed entity to appoint one independent director on its board of a foreign material subsidiary, in addition to the Indian material subsidiary.

- **Gender diversity**

The Kotak Committee made the appointment of at least one women independent directors on the Board. It was of the opinion that it would bring in gender diversity in the board room.

SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018.¹⁹

The SEBI have recently in the year May, 2018 amended the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

The highlights of the amendment in relation to the *independent directors* are as follows:-

- **Evaluation criteria of Independent directors**

The evaluation of independent directors would be done by the entire board of directors which shall include the performance of the directors and fulfilment of the criteria of independence and they should be independent from the management.²⁰

- **Maximum number of directorships.**

A person cannot be an Independent director in more than 7 listed entities including any alternate directorships that can be held by them at any point of time, However a person who is a whole time director or a managing director in any listed entity can serve as an independent director in not more than three listed entities.²¹

- **Quorum**

¹⁸ https://www.sebi.gov.in/media/press-releases/mar-2018/sebi-board-meeting_38473.html

¹⁹ https://www.sebi.gov.in/legal/regulations/may-2018/sebi-listing-obligations-and-disclosure-requirement-amendment-regulations-2018_38898.html

²⁰ Regulation 17(vi)

²¹ 17A, newly inserted.

The quorum which would be required for the meeting of the nomination and remuneration committee would consist of either two members or one third of the members of the committee, whichever is greater, wherein the presence of the at least one independent director in attendance is mandatory.²² The quorum which is required for the meetings of the BOD would be one-third of its total strength or three directors, whichever is higher, including at least one independent director²³

- **Minimum directorship in committee**

At least three directors, with at least one being an independent director, shall be members of the Committee.²⁴

- **Unlisted material subsidiary**

At least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not²⁵

- **Alternate directorship**

A person cannot be appointed or allowed to continue as an alternate director for an independent director of a listed entity.²⁶

- **Disclosure of independence**

Every independent director has to submit a declaration that he meets the criteria requirement of independence as provided by law and that he is not aware of any such situations that could interfere in his discharge of duties as an independent director.²⁷

- **Mandatory directors and officers (D&O) insurance**

Mandatory directors and officers (D&O) insurance for the independent directors of the top listed 500 entities. It would BOD would take into account the quantum as well as the risks in determining the insurance for its Independent directors.²⁸

- **Disclosure**

An Independent director has to provide a declaration that he/she was not aware of any circumstances that could have had a impact on his/her ability to discharge their duties.²⁹ And also, Disclose detailed resignation of an independent director before the expiry of their tenure within 7 days of their resignation to the stock exchange.³⁰

- **Resignations**

If an independent director of a listed entity resigns then within 7 days from the date of such resignation, he has to provide the following- The reason of the resignation in details, which has to be

²² Regulation 19 (2A)

²³ Regulation 17 (iv) (2A)

²⁴ Regulation 20 (2A)

²⁵ Regulation 24(J)

²⁶ Regulation 25 (1)

²⁷ Regulation 25(8)

²⁸ Regulation 25 (10)

²⁹ Regulation 25 ; sub clause (8) newly inserted.

³⁰ Schedule 5 (j)

disclosed by the listed entities to the stock exchanges, further a confirmation has to be provided stating that there is no other material reasons other than those which have been already provided.³¹ Further, the same disclosures are to be made if an independent director resigns before the expiry of his tenure.³²

- **Women Directors**

The appointment of at least one woman director on the board has been made compulsory which is believed to bring in about gender diversity in the boardroom. The top 500 listed entities and the top 1000 listed entities is to have minimum of one woman independent director on the board.³³

CONCLUSION

With the increase in the recent scams, frauds, violation of regulatory norms, breach of data, etc the expectation from the Independent directors have increased. In fact, the whole edifice of good corporate governance is dependent on the efficacy and effectiveness of independent directors. However, concerns are being expressed time about their real independence and effectively discharging their duties, role and responsibilities. Time and again it has been proved that the independency of the independent director is a *myth* and there is no such independence and that they are just another doll in the hands of the monstrous promoters. Thus there is an urgent need to strengthen the corporate governance by providing protection to the independent directors. The fact that a promoter can remove an independent director because of his shareholding capacity by an ordinary resolution is a serious issue and should be looked into.

Investors and minority shareholders still look up to the Independent Directors with the hope that their interest will be protected in the company, and that their independence would not be compromised in the coming years. Therefore, in order to safeguard the role of independent directors and to ensure their independency, the Kotak committee had made recommendations taking into account the current status of the corporate governance, some of which have also been accepted by SEBI, and has resulted in SEBI amending the SEBI Regulations 2015. Implementation has always been an issue in India with respect to any rules and regulations, so in order to find out the effectiveness of the amendment, sometime has to pass by so that the loopholes in the amended provisions crop up and there is a need to amend it again in order to maintain a strong corporate governance system.

Therefore, it can be concluded that in spite of the fact that the independent directors are appointed to safeguard the interest of the company, shareholders, especially the minority shareholders and other stakeholders they are just toys in the hands of the promoters and ultimately benefit them. And that the term ‘independent’ is a myth and a misnomer and that it would be prudent to name the Independent as ‘dependent’ direct

³¹ Schedule III, (7B)

³² Schedule V, (j)

³³ Regulation 17 (i)