INDEPENDENT DIRECTORS AND THE PREVAILING COMPANIES ACT, 2013

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Abstract - With a view to ensure better corporate governance the Stock Exchange Listing Agreement requires the appointment of independent directors on the boards oflisted companies. Going further the Companies Act, 2013 has made it mandatory for companies to appoint independent directors and has also prescribed the requisite qualifications. This article explains the implications of the new provisions relating to independent directors.

Index Terms - Independent Director, Corporate Governance, New Companies Act 2013

I. INTRODUCTION

The concept of corporate governance has become the buzzword these days. The concept is more significant these days as the foreign investors also expects Indian companies to govern with transparency and professionally.

As stated by the Narayana Murthy Committee Report, "Corporate Governance is about ethical conduct in business. The Corporate Governance is beyond the realm of law. It stemsfrom the culture and mindset of management and cannot be regulated by legislation alone". As Martin Luther King, Jr. once remarked "Morality cannot be legislated, but behaviour can be regulated. Judicial decrees may not change the heart, but they can restrain the heartless". While it is recognised that ethical Corporate Governance cannot be really enforced by law, it cannot be left totally to the whims and fancies of individual conduct to the detriment of larger interest.

II. INDEPENDENT DIRECTORS IN INDIAN CONTEXT

A. Independent director in Indian Context

For the first time, as a result of the Kumar Mangalam Birla Committee Report, the term 'Independent director' became a part of corporate lexicon. To give legal character to the newly introduced concept and to make it compulsory for the listed companies, SEBI effected changes in the listing agreement by introducing a new clause in the form of clause 49, exclusively devoted to Corporate Governance. Clause 49 also prescribes several other requirements, Audit Committee being the most important. The thrust of this article is confined to the role of independent directors in the scheme of corporate governance and more particularly, the provisions contained in the recently passed Companies Act, 2013 (the new Act). The Government has incorporated Section 149 in the new Act that defines the term 'independent director'. Although, in reality, the said section does not define the term 'independent director' it mentions several negative attributes or disqualifications which would render a person incapable of being appointed as an independent director.

B. Concept of Independent Director.

Who is an independent director and what is meant by an independent director? Do we mean a person who is independent of the influence of the promoters and the management or is he a person who does not care about the management and is always in an adversarial roles? Or is he a person of experience and expertise whose wise counsel will be available for the benefit of the company? Well, keeping in view the role and responsibilities an independent director is expected to perform, it would be fair to say that he or she will be an amalgam of all these and much more. While there can be no denying the fact that the expertise and experience of an independent director would prove immensely useful to the company on whose board he is a director, he also has to be the conscience keeper of the stakeholders by ensuring that the decisions taken by the board are in the larger interest of the company and not merely in the interest of the promoter group.

C. Independent Director: Qualifications under the new companies act

Section 149(6) of the new Act prescribes several qualifications expected of an independent director in relation to a company. One requisite is that he should be a person of integrity. On first thought it may sound ludicrous that it is necessary to specify that a person wanting to be an independent director should be a man of integrity, because it should be without saying that every person on the board of a company should be a man of integrity.

Unfortunately, experience indicates that many directors over the years have failed in discharging their fiduciary duties; perhaps that is why the lawmakers have felt the need to provide in law that such a person should be a man of integrity. However, at the same time it should be noted that ethics and morality cannot be legislated though ethical standards of conduct may be specified by the law. As if the so many

qualifications listed in the clause are not enough, the Government has kept for itself the residuary power to prescribe such other qualifications as the Government may deem fit. One can only hope that the additional qualifications that may be prescribed by the Government should not make the task of getting independent directors still more difficult.

The ten requisites mentioned in Section 149(6) of the new Act for eligibility to be an independent director indicates the intent of the Government to ensure that an independent director is not only a capable and experienced person, but he should not have any material pecuniary or other relationship with the company that would come in the way of his discharging his duties without fear or favour.

D. Role of Independent Directors

In the existing Act there is no provision for appointment of independent directors; it is only the listing agreement which provides for the same. Strictly viewed, under the Act, except for the managing and whole-time directors, all the other directors being non-executive directors, also called ordinary or part-time directors, enjoy similar status and responsibilities. Therefore, one could wonder as to the exact nature of the role to be played by independent directors. One thing that is certain is that the success of the system of corporate governance is directly dependent upon the discharge of duties by the independent directors. Onerous responsibilities have been laid on the shoulders of independent directors and they are expected to play the assigned role effectively.

III. CODE FOR INDEPENDENT DIRECTORS: AS PER NEW ACT

1. Guidelines of professional conduct: An independent director is required to uphold ethical standards of integrity and probity and work objectively and constructively while exercising his duties. He is expected to act in a bona fide manner in the interest of the company and devote sufficient time and attention to his professional obligations for informed and balanced decision making. At the same time he should not abuse his position and must refrain from any action that would lead to loss of his independence. He is under an obligation to assist the company in implementing the best corporate governance practices

2. Role and functions: The role that he has to play includes bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct. In addition, he is also expected to bring an objective view in the evaluation of the performance of the board and the management. He has to scrutinize the performance of the management in meeting agreed goals and monitor the reporting of performance and ensure the integrity of financial information, financial controls and the systems of risk management. He has a role to play while fixing the remuneration of executive directors and key managerial personnel and plays a prime role in appointment and removal of executive

3. Duties: The Schedule has stipulated thirteen different duties to be performed by an independent director. Some of the duties include:

i) Regularly updating and refreshing the skills, knowledge and familiarity with the company;

ii) Strive to attend and participate actively in all meetings of the Board and the committees and general meetings.

iii) Keep well informed about the company and the external environment in which it operates.

Interestingly, the list of duties also stipulates that an independent director should not unfairly obstruct the functioning of a proper Board or committee. He is also expected to pay attention and ensure that adequate deliberations are held before approving related party transactions and assure himself that the same are in the interest of the company. He has to ensure that the company has an adequate and functional vigil mechanism and also has to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use. He cannot disclose confidential information, including commercial secrets, technologies, unpublished price sensitive information, etc., except as required by law.

4. Manner of appointment: For the first time the law stipulates that a formal letter of appointment has to be given to an independent director mentioning all those items stated in earlier of this clause in the schedule.

5. & 6. Re-appointment & Resignation or removal: For the first time the law makes a provision about resignation by a director including an independent director and in the process has removed the prevailing ambiguity in the law.

7. Separate meetings: An interesting duty that has been cast upon the independent directors is that they will have to hold at least one meeting in a year, without the attendance of non-independent directors and members of management. The objective of such a meeting being to afford an opportunity to the independent directors to review the performance of the company, flow of information from the management to the Board, etc. It is expected that such a meeting must be attended by all the independent directors of the company.

8. Evaluation Mechanism: The most revolutionary provision is the one that requires the performance evaluation of independent directors. As of now there is no formal requirement for conducting any evaluation of non-executive directors or independent directors. The evaluation of independent directors has to be done by the entire Board of Directors, excluding the director

being evaluated. The Board will keep in view the report of performance evaluation while determining the suitability of extending or continuing the term of appointment of the independent director.

IV. APPOINTMENT AND TERM

There is a provision in Schedule IV regarding the manner ofappointing an independent director, but Section 150 of the newAct stipulates that an independent director has to be selectedfrom a data bank maintained by authorised bodies / institutions.Such bodies / institutions will be notified by the Government. It isonly to be hoped that the Government will not have any direct rolein the appointment of independent directors. An independentdirector shall hold office for a term up to five consecutive years onthe Board of a company. However, he will be eligible forreappointment on passing of a special resolution by the company;disclosure to that effect has to be made in the Board's reportabout the intention to re-appoint such independent director.

V. LIABILITY OF INDEPENDENT DIRECTOR

Section 149(8) of the new Act states that the company andindependent directors shall abide by the provisions specified in Schedule IV. Section 149(12), inter-alia, states thatNotwithstanding anything contained in this Act an independent director shall be held liable, only in respect of such acts ofomission or commission by a company which had occurred withhis knowledge, attributable through Board processes, and withhis consent or connivance or where he had not acted diligently.

This in a way limits the scope of offences for which anindependent director can be personally held liable. However, itis imperative that independent directors act diligently whilediscbarging their duties and be conscious and cautious when itcomes to giving consent to any proposal, else they will have tobe prepared to face the consequences of their actions. At thesame time, it is evident that by using a phrase like 'attributablethrough Board processes', law has left room for vagaries of interpretation and consequent uncertainties.

It would have been better if the provision was made more specific and direct in nature. Further, although, the law is attempting to limit the scope of offences in respect of independent directors, at the time ofprosecution, all directors irrespective of their category are issued summons. It is only after leading evidence that a conclusion isdrawn whether the independent director was diligent in the discharge of his duties or not and that whether he had acted ina bona fide manner or not. However, till such a conclusion is drawn, the independent director suffers a lot of inconvenience and embarrassment which is avoidable.

CONCLUSION

Even if all the listed companies which are required to have independent directors, on their boards have done so, would that automatically result in better Corporate Governance? Will suchboards ensure that there would be no recurrence of HarshadMehta and Ketan Parekh and NSEL scams? Quite unlikely. Iflegal provisions alone could change the scene, then India shouldhave been miles ahead of all the countries as India is one of themost legislated countries in the world. Therefore, it would beextremely short sighted or even naïve to believe that a mereprovision in the law for appointment of directors would achievemiracles. As mentioned earlier, law by itself can only render alimited assistance. Mere provision or even actual appointment ofindependent directors would not solve all the problems of thecorporate sector nor will it mean a quantitative jump in CorporateGovernance.

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