

Questioning the independence of independent directors

Compliance to corporate governance principles can attract huge capital for business as fair and transparent transactions/operations of a company, having an effective and efficient board of directors, will induce investors to invest in it. Independent Directors play an important role in improving corporate governance and credibility standards of companies and securing the interests of stakeholders, especially minority shareholders vis-à-vis company's management. Independent Directors are governed by the Companies Act, 2013 and SEBI (LODR) Regulations, 2015. Additionally, the Companies (Appointment and Qualification of Directors) Rules, 2014 contain few provisions on Independent Directors such as number of independent directors to be appointed, their qualifications/eligibility and requisite compliances. Even though the statutory framework ensures independence of independent directors, recent trends have raised questions/debates on their independence in practice. The Article thus seeks to highlight the issues relating to real independence of independent directors and effective discharge of their duties. Following are the provisions of the Companies Act, 2013 which provides a framework on independence and proper functioning of independent directors:

Appointment of Independent Directors – Appointment process of independent directors should be independent of the Company management. Section 149(4) of Companies Act mandates every public listed company to have one-third of total no. of directors as Independent Directors and every unlisted public company, subject to thresholds, to have minimum two Independent Directors. SEBI had revised rules in 2020 for appointment of Independent Directors in Public listed Company through special resolution in both terms. The manner of appointment, re-appointment and resignation or removal is provided in Schedule IV of the Companies Act.

Conduct/Independence/Remuneration of Independent Directors - Section 149(6) while defining Independent Directors, provides a list stating that Independent Directors should, subject to few thresholds/limits, not have pecuniary/other relationship, other than remuneration (sitting fees), with the company (holding/subsidiary/associate) and its promoters and directors. Additionally, Independent Directors must abide by the provisions specified in Schedule IV of the Companies Act [Code/guide to professional conduct for Independent Directors]. Companies Act amendment of 2020/revised Schedule V has made changes regarding certain/minimum remuneration payments subject to specified limits, fee slabs to Independent Directors, non-provision of profit percentage as fees if non-profit situation. Removal of Independent Directors in public listed



Rudra Srivastava
Partner
E: rsrivastava@singhania.in



Neha Meena
Senior Associate
E: neha@singhania.in

companies can be through special resolution only [new SEBI Rules]. As per Section 149(7), independent directors must make a declaration in the first board meeting that they meet the criteria of independence. Also, they must refrain from participating in meetings concerning business in which they are interested.

Liability of Independent Directors for acts of omission/commission by companies – According to Section 149(12), such liability would arise only if the said acts had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

Despite the above provisions, regulations and code, case studies pertaining to India's Public Sector Undertakings and scams by companies show insufficient duty performance by independent directors, fraud/influence and acquaintance/support to promoters or political parties. Thus, there is a need for a reality check on independence of independent directors from implementation perspective.

Independence of Independent Directors is not only in terms of pecuniary relations with a company's management but also close association and political independence. Such non-material associations/ties can also affect the director's judgment and decision-making. A 2021 investigation report showed that out of 172 Independent Directors on 98 Public Sector Undertaking (PSU) boards, 86 had ties to ruling party. This is alarming as if Independent Directors in PSU's are politically aligned to political parties, they will have non-independent and biased relationship/interest with the entity's decision making and functioning. Another issue is the control of promoters in appointments/reappointments/removal and functioning of Independent Directors especially in family-owned Indian Companies. Following are the instances which show the impact of promoter control: (i) Satyam scam wherein the independent directors neglected the misrepresentations made by defrauding promoters in the company's books and without taking shareholder's interest into account, approved the acquisition of company named Maytas Infra (unrelated business) as it was owned by one of the promoters ; (ii) TATA-Mistry dispute wherein Nusli Wadia who was acting as an independent director was removed (via motion) from the boards of TATA group firms for raising voice in favour of minority shareholder's interests ; (iii) Reappointment of former SEBI chairman UK Sinha as Independent Director in Vedanta board which was strongly objected by minority shareholders/institutional investors/banks but due to promoter groups (owning 60%) backing, he was reappointed through special resolution. The above instances defeated the purpose of having Independent Directors i.e., to have independent/impartial third-party view on board, affecting corporate governance concept and led to addition of the following parameter in the SEBI (LODR) Regulations in 2021- approval of shareholders by way of a special resolution is required for appointment/re-appointment/removal of an independent director of a listed entity (Regulation 25(2A)). Additionally, the SEBI had also proposed the "dual approval" model for nominating or dismissing/removing independent directors i.e., first, approval by majority of all shareholders, and second, the approval by majority of minority shareholders (other than promoters). However, the same was not added in the SEBI (LODR) Regulations.

Though SEBI keeps revising rules for combating such issues, a revised regulatory framework is the need of the hour for effective implementation of Independent Directors regime. For this purpose, following suggestions can be taken into account: (a) prescription of minimum qualification and requisite experience for appointment of independent directors, which can also be reviewed by the SEBI; (b) SEBI may nominate independent directors for appointment from its data base and may prescribe a remuneration cap while prohibiting additional benefits; (c) All companies should be mandated to hold short training sessions for independent directors, so that they have requisite information about the affairs of the companies, important duties and their contribution in the decision-making process; (d) Measures like higher standards of due diligence proof by independent

directors in cases implying their direct involvement/knowledge can also help in ensuring their independence and accountability in practice.

© 2024 All rights reserved. This article is for information purposes only. No part of the article may be reproduced or copied in any form or by any means [graphic, electronic or mechanical, including photocopying, recording, taping or information retrieval systems] or reproduced on any disc, tape, perforated media or other information storage device, etc., without the explicit written permission of Singhania & Partners LLP, Solicitors & Advocates ("The Firm").

Disclaimer: Though every effort has been made to avoid errors or omissions in this article, errors might creep in. Any mistake, error or discrepancy noted by the readers may be brought to the notice of the firm along with evidence of it being incorrect. All such errors shall be corrected at the earliest. It is notified that neither the firm nor any person related with the firm in any manner shall be responsible for any damage or loss of action to anyone, of any kind, in any manner, therefrom