INDEPENDENT DIRECTOR – A SIGNIFICANT PILLAR OF CORPORATE GOVERNANCE

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ABSTRACT

Corporate Governance refers to the governance or regulation of companies or corporate entities. It facilitates a smooth and an efficient functioning of a company by maintaining transparency in the overall regulatory framework of the company. It also looks after the rights and interests of its members. Corporate governance takes the centre-stage, especially in today’s age, where the corporate sector is a victim of several frauds and malpractices. This article will introduce the readers to the concept of Independent Directors, who play a pivotal role in facilitating a transparent and an impartial governance within a corporation. Thus, this paper throws light upon the role and the significance of Independent Directors, who occupy centre-stage when it comes to the issues of corporate governance. The first and the foremost thing which this paper talks about is the very meaning and interpretation of the term ‘Independent Director’ as defined under the relevant statutory legislations and provisions. It then moves on to trace the history and the origins or sources of Independent Directors as an institution. It is discussed as to how and why did India introduce and adopt into its corporate laws, the concept of independent directors. A comparison is drawn between the legal status and position of independent directors during the period before the year 2013, and during the period thereafter. Some of the most infamous corporate scandals in the country that put up a big question mark over the authority of independent directors have also been talked about. Further, the paper provides valuable and genuine suggestions by emphasizing upon the recent amendments approved by the Securities and Exchanges Board of India (SEBI) with respect to independent directors, for the purpose of strengthening their position and influence in the mechanism of corporate governance in the country. An analysis of the approved amendments is done at the end that is likely to be an appropriate step taken towards preserving corporate governance in its true and fair spirit. After going through this paper, the readers will be in a position to gather
a deep and a holistic understanding about the changing role and position of independent directors over time, with a fast developing and transforming business scenario. The paper strictly confines itself to the study of independent directors from the Indian corporate governance perspective. This paper has neither been published, nor has been sent for publication elsewhere.

Keywords- Independent Directors – A Significant Pillar of Corporate Governance, Recent Amendments Approved by the SEBI for Independent Directors, Position of Independent Directors in India Pre-2013, The Legal Parlance and Provisions for Independent Directors, The Current Position of Independent Directors under the Companies Act 2013, Corporate Scams and Scandals with respect to the Role of Independent Directors in Corporate Governance.

INTRODUCTION

Corporate Governance has undergone several reforms and developments in the last couple of years. Among these changes, the most significant development is that of Independent Directors. The emergence of independent directors as an institution can be traced to the developed economies of the West with the United Kingdom and the United States of America sharing the credit for its evolution during the 1950’s, even before the law mandated the induction of independent directors to ensure that the corporate entities did not make any intrusion into the public interest driven solely by a profit motive. As far as the Indian context is concerned, a major wave of economic reforms was initiated in India in the year 1991. In the year 1991, India entered the era of globalization. The reforms of 1991 opened the gates for India to the external world and the country had to adapt to the new trends or practices in the field of corporate governance for sustaining itself in the market. One of the new additions to the Indian corporate structure was the appointment of independent directors. Independent directors provided the right balance between the individual, economic, and societal interests. In India, independent directors first found their mention in the voluntary guidelines issued by the Confederation of Indian Industry (CII). As per these guidelines, any listed company with a turnover of Rs.100 crores or above must consist of highly professional, competent, and independent non-executive directors, who must comprise at least 30 per cent of the board if the Chairman of the company is a non-executive director, and at least 50 per cent of the board if the same person is both the Chairman and Managing Director. After all, the whole edifice of
good corporate governance depends upon the efficacy and effectiveness of independent directors. Independent directors, as the name suggests, are expected to be independent from the management and should act as trustees for the shareholders. This implies that they are obligated to be fully aware of and question the conduct of the organization on relevant issues. An independent director is responsible to look after the adequacy and effectiveness of the internal control and risk management systems. They should protect the interest of the minority shareholders, and should act as a watchdog in identifying the loopholes in the structure of governance in a company. Independence, when it comes to the board, allows a director to be objective and evaluate the performance and well-being of the company without any conflict of interest or undue influence of the interested parties. A board having a majority of independent directors can bring in expertise and objectivity that assures the owners that the company is being run legally and effectively, in the best interest of its owners and with no vested interest or hidden agenda. Independent directors are considered as mentors and supervisors of the management, who need to ensure that the acts of the management always create value and benefits for the shareholders. Independent directors are duty bound to work for the interest and well-being of the minority shareholders. An increase in the number of minority shareholders in a company enhances the need for having more number of independent directors. An independent director, being an outsider not involved in the day-to-day management of the company, is the most appropriate person to act as a watchdog for the company, ensuring that the company is functioning objectively and impartially. It is the responsibility of independent directors to hold the management accountable and responsible for any suspected mismanagement within the company. An independent director is an independent person appointed to the board to ensure that his view is not internally focused. Independent directors are taking a higher profile role than ever before in balancing the needs and interests of the shareholders and the management. Since the 1990’s, more and more professional non-executive directors (NEDs) have come into existence. Chief executives are beginning to realize the importance of the role of these highly experienced individuals. An independent board of directors in the public listed companies is seen as an integral element of a country’s corporate governance norms. Board independence has taken on a pivotal status in corporate governance and has become almost indispensable. Consequently, governance reforms in recent years have increasingly pinned hope as well as responsibility on the independent directors to enable higher standards of corporate governance. The company must maintain proper standards in appointing independent directors in order to ensure the integrity of decision making. The Independent
directors must be unhindered by the circumstances to ensure that their decision making is neutral. The independence of the board is an important aspect of a better and a smoother functioning of independent directors in corporate governance. Studies have shown that until corporate scams come into the media spotlight or into the judicial proceedings, researchers tend to ignore the inner dynamics of the board. As mentioned in the Report on Company Law prepared by the committee headed by JJ Irani (2005), independent directors would be able to bring an element of objectivity to the board process in the general interest of the company. This will also work in favour of the minority and weaker shareholders. Since independent directors have the major responsibility of safeguarding the interest of the shareholders and the company, choosing and appointing the right person is crucial. It was recommended by the Naresh Chandra Committee in 2009 that, the letter of terms and conditions for the appointment of any non-executive director or independent director must form a part of the disclosure made to the shareholders during the ratification of his or her appointment or re-appointment to the board. As far as the legislations governing the functioning of the company and the board are concerned, we enacted the Companies Act in the year 1956. This act, however, had no mention about independent directors. The security regulator (SEBI) came up with the Listing Agreement that was applicable to all the listed companies. Although it was made compulsory for the listed companies by virtue of clause 49 of the listing agreement to appoint independent directors, there were no relevant provisions under the Companies Act. The latest amendments in regards to independent directors emanate from the Committee on Corporate Governance that was set up under the chairmanship of Shri Uday Kotak in 2017. The Ministry of Corporate Affairs (MCA) introduced the idea of independent directors that was to be discussed in the Companies Act of 2013. A Code of Conduct for the independent directors was laid down. As per the Code of Conduct, the independent directors are expected to pay specific attention to the integrity of financial information and to the related party transactions, along with safeguarding the interests of the minority shareholders. Accordingly, the Audit Committee of the board is mandated to have at least two-thirds of its total number of members as independent directors. The independent directors are also expected to exercise independent judgement upon the board’s deliberations, especially on the issues of strategy, performance, risk management, resources, key appointments, and the standards of conduct. They are also expected to bring an objective view in the evaluation of the performance of the board and the management. The Companies Act, 2013, has extended the power of analysing the performance of the executive directors and has made them responsible for the acts done with
their connivance. The Companies Act, 2013, contains provisions for independent directors. Section 149(4) of the Act discusses the concept of independent directors. Every listed Public Company is required to have at least one-third of its total number of directors as Independent Directors. The central government may prescribe the minimum number of independent directors in the class or classes of public companies. The independent director must be in the opinion of the board, a person of integrity possessing the relevant expertise and experience as per section 149(4)(a), and should not be a promoter of the company or of the holding company or the subsidiary company. He should have no pecuniary relations with the company and no relative who has pecuniary relationships with the company. The actual role of an independent director varies among the most common roles such as, a part time chairman, confidant of the chief executive, an expert with specialist knowledge, a community conscience, a contact maker, or a conferrer of organization status. The actual role performed by the independent directors depends upon his background and experience, company situation, current composition of the board, relations between the chairman and the independent directors, board leadership structure, recruitment process, and training and development. Independent directors or non-executive directors of the company monitor and control the chairman and the chief executive. Apart from this, independent directors try to improve the board processes and bring in specialist knowledge. They provide continuity, help identify an alliance and acquisition, and help maintain an ethical climate in the organization. In 2009, the role of Independent Directors took a huge dent both in India as well as overseas after the Satyam scam. A great number of independent directors had resigned, which underpinned the powerless and helpless state of independent directors in the Indian corporate sector. The position of independent directors underwent a big blow and became too feeble, due to the subjection of influence and domination at the behest of the promoters and the controllers. Also, the role of independent directors has been under the radar of constant scrutiny with the resignation of independent directors of Satyam computers, and the case of removal of the chairman of Tata Sons, Mr. Cyrus Mistry, from the board of the company. The true meaning of independence can only be practiced as independence is a state of the mind, and depends upon an individual’s ability to challenge and question anything that is contrary to his or her independence. The need of the hour is to create such an environment that enables the independent directors to freely and openly practice and enjoy their independence.
THE LEGAL PARLANCE AND PROVISIONS FOR INDEPENDENT DIRECTORS

The Companies Act, 2013, is the legislation or act that deals with the concept of independent directors, under sections 149 and 150. The Companies (Appointment and Qualification of Directors) Rules, 2014, as well as the SEBI’s ‘Listing Obligations and Disclosure Requirements’ (LODR) Regulations, 2015, also deal with independent directors. As far as the Companies (Appointment and Qualification of Directors) Rules, 2014, are concerned, the provisions for independent directors are contained in rule numbers 4, 5, and 6. These rules relate to the compliances for adherence by the independent directors, and the qualifications required in order to get appointed as an independent director to the board of a company. The SEBI (LODR) Regulations, 2015 on the contrary, talk about the manner of appointment of independent directors, their duties, their rights, etc. The provisions for independent director under section 149 and 150 of the Companies Act, 2013, go hand in hand along with the SEBI (LODR) Regulations, 2015. As far as the Companies Act, 2013 is concerned, section 149 makes it mandatory for every public listed company to appoint independent directors. The sub-sections under section 149 discuss the very idea of independent directors, as far as their definition, roles, duties, and term of holding office, is concerned. These sub-sections are:

**Sub-Section 6** - An independent director in relation to a company, means a director, other than a managing director or a whole-time director or a nominee director:

(a) Who, in the opinion of the board, is a person of integrity and relevant expertise and experience?

(b) (i) who is or was not a promoter of the company and its holding, subsidiary, or associate company.

(ii) Who is not related to the promoters or directors in the company and to its holding, subsidiary, or associate company?

(c) Who has or had no pecuniary relationship with the company, and its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year.
(d) none of whose relatives has or had pecuniary relationship or transaction with the company, and its holding, subsidiary or associate company, or their promoters, or directors, amounting to 2% or more of its gross turnover or total income, or Rs. 50 lakhs or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year.

(e) Who neither himself, nor through any of his relatives:

(i) holds or has held the position of a key managerial personnel or is or has been an employee of the company and its holding, subsidiary, or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed.

(ii) is or has been, an employee or a proprietor or a partner in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

(A) a firm of auditors or company secretaries in practice, or the cost auditors of the company and its holding, subsidiary, or associate company.

(B) any legal or a consulting firm that has or had any transaction with the company, or its holding, subsidiary, and associate company, amounting to 10% or more of the gross turnover of such firm.

(iii) Holds together with his relatives 2% or more of the total voting power of the Company, or,

(iv) is a Chief Executive or a Director, by whatever name called, of any non-profit organisation that receives 25% or more of its receipts from the company, or from any of its promoters or directors, or its holding, subsidiary or associate company, or that holds 2% or more of the total voting power of the company, or

(f) Who possesses such other qualifications as may be prescribed.

Regulation 16(1)(b) of the SEBI (LODR) Regulations, 2015, is the complementary provision to section 149(6) of the Companies Act, 2013, which defines the expression ‘independent director’.

Sub-Section 4 – Makes it a mandate for every listed public company to have at least one-third of its total number of directors as independent directors, and the Central Government may
prescribe the minimum number of independent directors in case of any class or classes of public companies.

Regulation 17(1)(b) of the SEBI (LODR) Regulations, 2015, is the complementary and the supplementary provision to section 149(4) of the Companies Act, 2013. The regulation provides that, where the chairperson of the board of directors is a non-executive director, at least one-third of the board of directors shall comprise of independent directors. and where the listed entity does not have a regular non-executive chairperson, at least half of the board shall comprise of independent directors: The proviso attached to the provision provides that, where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or a person occupying management position at the level of the board of directors, or at one level below the board of directors, at least half of the board of directors of the listed entity shall consist of independent directors.

Sub-Section 5 – Makes it mandatory for every company, existing either on or before the date of the commencement of this act, to comply with the provisions of sub-section 4, within one year from such commencement or from the date of notification of the rules in this regard as may be applicable.

Sub-Section 7 – It is a mandate or a duty cast upon every independent director to give a declaration, at the first meeting of the board in which he participates as a director, and thereafter at the first meeting of the board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, that he meets the criteria of independence as provided under sub-section 6.

Sub-Section 8 - The Company and the independent directors shall abide by the provisions specified in Schedule IV of the act.

Sub-Section 9 – The independent directors are not bound by anything contained in any other provision of this act, but are subject to the provisions of sections 197 and 198, that makes an independent director ineligible to claim stock options in the company. The independent director may, as per section 197(5), receive remuneration in the form of fee for participation in the board and other meetings, and profit related commission as may be approved by the members.
Regulation 17(6)(d) of the LODR Regulations is the **complementary** provision to section 149(9) of the Companies Act, 2013 which says that, independent directors shall not be entitled to any stock options of the company.

**Sub-Section 10** - Makes an independent director subject to the provisions of section 152 by which, an independent director shall hold office for a term up to five consecutive years on the board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and the disclosure of such appointment in the board's report.

**Sub-Section 11** - Notwithstanding anything contained in sub-section 10, no independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years from the date of ceasing to be an independent director: The proviso imposes a restriction that an independent director shall not, during the said period of three years, be appointed in or be associated with the company in any other capacity, either directly or indirectly. For the purposes of sub-sections 10 and 11, any tenure of an independent director on the date of the commencement of this act shall not be counted as their term of office.

**Sub-Section 12** – It imposes limitations on the liability of independent directors. An independent director shall be held liable for only those acts by a company that had occurred with his knowledge, attributable through board processes, and with his consent or connivance or negligence.

Regulation 25 of the LODR Regulations deals with the obligations with respect to independent directors. **Sub-Rule 5 of Regulation 25** is the **complementary** provision to section 149(12) of the Companies Act, 2013.

**Sub-Section 13** - Makes the provisions of sub-sections 6 and 7 of section 152 with respect to the retirement of directors by rotation, non-applicable to the appointment of independent directors. (Taken from ‘Companies Act, 2013’)

Section 150 of the Companies Act, 2013, talks about the manner of selection of independent directors and the maintenance of their databank:

**Sub-Section 1** - An independent director may be selected from a data bank maintained by any body, and containing names, addresses, and qualifications of the people eligible and willing to
act as independent directors, as may be notified by the Central Government having expertise in this regard and put on their website for the use by the company appointing such directors. The proviso to the sub-section imposes responsibility of exercising due diligence before selecting a person from the data bank referred to above, upon the company making such appointment.

Sub-Section 2 - The appointment of an independent director shall be approved by the company in its general meeting as provided under sub-section 2 of section 152 of this act, and the explanatory statement annexed to the notice of the general meeting shall indicate the justification for appointing the appointee as the independent director.

Sub-Section 3 - The data bank shall, in accordance with such rules as may be prescribed, create and maintain data of all persons willing to act as independent directors in the company.

Sub-Section 4 - The Central Government may prescribe the manner and the procedure for the selection of those as independent directors, who fulfil the provisions of Section 149 of this act.xv

POSITION OF INDEPENDENT DIRECTORS IN INDIA

Pre-2013

An independent director is expected to act as a watch dog for the board and the company as a whole, in order to protect the interests of the shareholders. Under the Companies Act, 1956, independent directors were directly appointed by the promoters of the company. Due to this, mostly a friend of the promoter got appointed as an independent director, questioning the role and authority of independent directors to act as the watch dog for the board. There were numerous situations wherein, the independent directors were actually deprived of their right to exercise independence. Some of these situations are:

a) Selection procedure

A great deal of emphasis was placed upon the ‘independence’ of the independent directors. Their selection lay in the hands of the owners of the company. No procedure for selection had been prescribed for independent directors, as they were directly handpicked by the promoters.
While the promoters in control could take decisions that were against the interest of the small shareholders, an independent director had to bear in mind the interest of all the stakeholders. Such procedure for their selection raised serious doubts on their independence at the board.

b) No age limit

No age limit was prescribed by the Companies Act, 1956, and by the SEBI, for the appointment of independent directors to the board of a company. According to the act, even a minor could have become a director. A person below the age of 18 years cannot gather enough experience and knowledge in order to become an independent director of a company. It is not the quantity, but the quality of independent directors that makes the difference. There was a need for an age limit that could justify the position of an independent director.

c) No requirement of a specific qualification

There was no focus on the quality of independent directors who were to get appointed. It was however, important that the independent directors are qualified enough so that they ask the right questions at the right time when they are on the board. The most important requirement for an independent director was his ability to stand up for the cause of the minority shareholders, who were not represented on company boards. Independent directors needed to be sound in their judgment. Clause 49 of the Listing Agreement, and the Companies Bill, 2008, did not prescribe any minimum qualification or experience essential for appointing an independent director.

d) No right to interfere in the day-to-day operations

Independent directors had no right to interfere in the day-to-day operations and functioning of the company. They had the right to intervene in any misgivings or misdeeds. They were supposed to support the management in getting the delivery of what the objectives of the company were, to its shareholders. Non-involvement of a director in the day-to-day operations of the company, will keep him away from understanding how the company is governed and he will not be in the position to fulfil his responsibilities. There was no separate law under which an independent director could operate. He had no legal protection from the management for raising his voice fearlessly. For the involvement of independent directors in the day-to-day operations of the company, it was necessary that they be given the authority to raise their voice in a fearless manner.
e) **No time limit for replacement of an independent director**

There were no guidelines prescribing the time limit for the replacement of an independent director in case of resignation, or removal, or death, of an existing one, and the promoters took pleas that they had not been able to find a replacement that could stretch for an indefinite period. The fees or remuneration of an independent director had grown so substantially in the last three years, that an individual was often tempted to have an extended stay in the organization. Most of these directors would go by the decision of the promoters of the company, without examining the details of the company. To retain the independence of a director, there was a need to rotate such directors periodically, or by any other method, whereby, the independence of independent director is secured.xvi

**CURRENT POSITION OF INDEPENDENT DIRECTORS UNDER THE COMPANIES ACT, 2013**

The primary challenges in the current liability framework governing Independent Directors can broadly be categorised as follows:

(i) While the Companies Act (2013) contains certain safe harbours limiting the liability of independent directors and non-executive directors, there are various statutes governing offences including money-laundering, securities frauds, and tax evasions, which fail to provide safe harbours and to recognise the distinction between executive directors and non-executive directors.

(ii) The safe harbours under section 149(12) of the Companies Act, have their limitations in that such directors may be implicated not only for errors, but also for ‘passive’ negligence (for instance, where such directors have attended the board meetings or have received minutes of such meetings, but have failed to record their objections or concerns, they cannot evade the liability claiming that the decision was taken without their knowledge or consent).

(iii) Multiple enforcement agencies follow fragmented and inconsistent procedures for investigation and prosecution of corporate offences, including issuance of summons to the independent directors, even when there is no prima facie evidence available against them.
(iv) There are certain factors in the extant regime that compromise the independence of independent directors, namely, the procedures related to their appointment, removal, and payment of remuneration, which hampers their ability to discharge their functions effectively.xvii

In India, a large chunk of companies (including listed companies), are family businesses and the situation in these companies is that the majority of the shares are held or indirectly controlled by one large group of shareholders. Thus, these majority shareholders virtually operate and manage the companies in their own interest. Although there is a stake of the general public in the company, the actual involvement of the general public in the management is limited as the number of shares are being largely diffused and are not sufficient, even collectively, to affect the decisions of the large number of majority shareholders. Further, due to their control over the company, the appointment of the board members including independent directors, lies completely in the hands of the majority shareholders. Major corporate scandals or scams such as the one of Satyam, Tata-Cyrus Mistry, etc, has shown that independent directors are more like brand ambassadors rather than managers, and thus, their qualifications, experience, and expertise, are not given due consideration at the time of their appointment to the board of the company.xviii

Notwithstanding the crucial and significant role played by the independent directors in the functioning and governance of a company, India has seen several corporate scams and scandals get unleashed in the last couple of years.

MAJOR CORPORATE SCAMS AND SCANDALS WITH RESPECT TO THE ROLE OF INDEPENDENT DIRECTORS IN CORPORATE GOVERNANCE

1. The Satyam Scandal

Satyam was a public-listed company and had a good image in the market. The company was honoured with the Golden Peacock Global Award for Corporate Governance. However, the company colluded with its auditors for fraudulent accounting practices to mislead the investors, regulators, board, and other stakeholders. The scandal was unravelled when the company’s
Chairman, Mr. Ramalinga Raju, confessed about making misrepresentation in the accounting practices. Following this, regulators such as SEBI, stepped in and initiated action against the company.

The entire fiasco began with Satyam’s attempt to invest Rs. 7,000 crores in Maytas Properties and Maytas Infrastructure. These firms were owned by the family members of Mr. Raju. The investments were approved by the board, but were opposed by the investors. The accounts of the firm were manipulated by assets. Cash and bank deposits were being overstated, and debts were being understated. Consequently, the investors filed several lawsuits against Satyam.

Following the Maytas deal and the subsequent lawsuits, the decision of the Satyam board was reversed. The World Bank banned Satyam for 8 years to conduct any kind of business, and four of the company’s independent directors resigned.

The Satyam episode gave rise to a strong demand among the corporate sector, for a change in the policies with immediate effect. Agencies such as the CII (Confederation of Indian Industries), National Association of Software and Services Committee, and SEBI Committee on Disclosure and Accounting standards, etc, started looking into the policy changes in regards to the Audit Committee, Shareholder Rights, Whistle-blower policy, etc. These committees came up with a list of suggestions that were later dealt with by the legislature.

2. The Tata-Mistry Fallout

Cyrus Mistry was the Director of Tata Sons Limited since 2006. The majority of the shareholding was held by the trusts of the Tata family, in order to ensure that the control remains with the Tata family even when Cyrus Mistry joins the board of the company. The board often disagreed with the decisions of Mistry and ousted him during one such meeting. Mistry alleged that there was dominant control by the nominee directors of the trust, including Ratan Tata, who were considered to be the ‘shadow directors’ of Tata Sons Limited.

Mistry claimed that the promoters of the company never let him free from their control, precluding him to perform his role and manage the affairs of the company. The promoters were concerned and bothered only about their own projects. Further, he also alleged that there was no independence in the working of the independent directors. Nusli Wadia, an independent
director in Tata Sons Limited, was fired from his job for raising his voice in favour of Cyrus Mistry and the maintenance of the latter’s chairmanship in the group companies.

3. **Jet Airways**

Jet Airways was the country’s second largest airline until 2018, with a market share of 13.8%. It last flew on 18th April, 2019, after running out of funds to further carry out its operations. Over 15,000 employees were left jobless. The company had a debt of around Rs 8,500 crores on its head, that it owed to several banks. It also owed Rs. 25,000 crores in arrears to lessors, employees, and other firms. The downfall of the company was attributed to the failure of corporate governance at the hands of the Chairman of the company, Naresh Goyal.

Naresh Goyal and his family was the majority shareholder in the airline, with Naresh Goyal as the Chairman. The company had a promoter driven board that was concerned only about fulfilling the needs and interests of the promoter-chairman. The airline received an investment offer by the Tata Group. The board of the company refused to accept the said investment offer. This move by the company was seen to be as impractical and unreasonable, since the deal could have invested a great deal of capital, thus, saving and pulling out the company from losses. It seems that the decision was taken with the sole motive for the benefit of the promoters, at the expense of the employees and other stakeholders of the company. As a result of this, two independent directors of the company, Vikram Mehta Singh, and Ranjan Mathai, resigned from the board of the company in November, 2018.

4. **Infrastructure Leasing and Financial Services (IL&FS) Scam**

Various entities belonging to IL&FS group were found indulging in multiple circuitous transactions involving several illegalities. These included, fast disbursals to some borrowers despite their bad track record in servicing existing loans, and also delayed recoveries.

Investigation revealed that various entities of the IL&FS group continued to enjoy high ratings from various rating agencies. This was due to the window-dressing of the books of the companies, and ever-greening of their loans. The probe revealed that a number of borrowers, including listed firms, were not paying off their debts on time.
Despite being aware of the fact that some of the potential problem accounts were getting stressed, the top management of IL&FS continued to provide fresh loans to the defaulters, rather than classifying them as Non-Performing Assets (NPA’s). This process was repeated multiple times on the default by way of another round of funding through the same or another group company. This led to the piling up of outstanding liabilities against the group that in turn, had to be funded by way of market borrowings.

The final loan facility was declared as an NPA or written off, or still left outstanding in several cases resulting in delayed recognition of the NPA’s, expansion of the debt, as well as a major loss to the lender and the stakeholders. The top management of the company along with some auditors and rating agency officials, was found taking hospitality and favours from the defaulting borrowers. In its first chargesheet against the group’s NBFC arm (IFIN), the Serious Fraud Investigation Office (SFIO) charged the top management of the company as well as the auditors and the independent directors, of defrauding the company for their own personal interests.

The statutory auditors neither exercised their duties diligently, nor did they make use of professional scepticism to ensure a true and fair disclosure of the company’s state of affairs. They entered into a collusion with the officials of the group companies, including the independent directors, for concealing their fraudulent activities.xx

5. **Punjab National Bank (PNB) Scam**

The PNB scam turned out to be a misadventure wherein, the bank could not prevent an enormous fraud to the tune of Rs 11,400 crore. The then finance minister, Arun Jaitley, had raised serious concerns with respect to the auditors, regulators, and the top functionaries of the bank, for their failure and lack of oversight to detect a scam of such magnitude. Documents of the bank were inspected and they showed that the audit committee was well aware of the weakness of its audit and scrutiny system. In fact, another branch of the bank was found to be embroiled in a Rs 464 crore scam involving foreign exchange, black money, and shell companies.

Between 2015 and 2017, Punjab National Bank did not have an adequate number of independent board members in the audit committee. However, the regulations of the Securities and Exchange Board of India (SEBI) require two-thirds of the members on the audit committee
to be independent for ensuring a better scrutiny. But the bank’s statutory auditors, signing off the consecutive annual reports found that the bank was in breach of this regulation. Instead of resolving this breach, the bank justified it by saying that it was in compliance with the instructions and regulations of the Reserve Bank of India in electing the members of the audit committee. Meanwhile, the government nominee continued to be a member of the audit committee. To understand the lapses that made the PNB scam go undetected, a senior forensic auditor working for a public sector bank and the other senior officials were interviewed, who disclosed the true state of affairs of Punjab National Bank where red flags should have been raised long ago.

In its First Information Report to the Central Bureau of Investigation on the scam, Punjab National Bank explained as to how the key factors behind the scam went undetected internally for so long. Firstly, the software to log transactions were not connected. The 2 key software were the SWIFT, and the Core Banking Solution. Consequently, PNB said that its employees were able to send messages on SWIFT that provided credit to Nirav Modi’s companies (in the name of Letters of Understanding) which they did not log into the Core Banking Solution.xxx

Following these scandals, the Ministry of Corporate Affairs (MCA) in October, 2019, notified the Indian Institute of Corporate Affairs (IICA) to maintain an online databank of all existing and eligible independent directors to ensure a uniform procedure and integrity of independent directors being appointed by the companies. The said notification introduced a proficiency qualification examination for independent directors, mandating a minimum score of 60% for any individual to be appointed as an independent director.

The Ministry issued a general circular dated March 2, 2020, clarifying that civil or criminal proceedings should not unnecessarily be initiated against independent directors unless, enough evidence exists to the contrary. In case such proceeding is already initiated, it must be reviewed. The circular received a warm response since it intended to identify and fix the accountability of an ‘officer who is in default’, or other specific directors, or the Key Managerial Personnel, who voluntary take up specific responsibilities in a company. It makes important clarifications with regard to the prosecution framework of independent directors. Firstly, it highlights the distinction between independent directors and the other directors or KMP’s. Secondly, it pays close attention to the nature of the default while affixing the responsibility. Thirdly, the burden of proof is shifted or transferred from the shoulders of independent directors to the investigating
agencies. The circular enables to engage in greater deliberation at the ministerial level before initiating any proceeding against the independent directors.

However, despite all these measures, the magnitude and intensity of these scams have made the authority and the accountability of independent directors fall under great suspicion. The scams have made it clear that the corporate frauds could not be foreseen and protected even by the most experienced and skilled independent directors. As a result of this, the mind is occupied by doubts and confusion with respect to the need for independent directors, their role, and their restrictions and failure to act in the interest of the weaker and minority shareholders of the company.\textsuperscript{xxxii}

Against this backdrop, the ‘Securities and Exchange Board of India’ (SEBI) recently in its board meeting held on 29th June, 2021, proposed and approved a set of amendments to be tabled before the SEBI (Listing Obligations and Disclosure Requirements) Regulations (LODR Regulations), 2015. These amendments were concerned with the regulatory provisions for independent directors. Certain changes were made for strengthening the status of independent directors for an overall efficient corporate governance in the listed companies. The approved amendments will be effective from 1st January, 2022.

**RECENT AMENDMENTS APPROVED BY SEBI FOR INDEPENDENT DIRECTORS**

1. **Approval By Shareholders**

   **Existing Position**

   In the current scenario, an independent director can be removed through a simple majority in the first term of his appointment, and through a special majority in the second term. In the consultation paper on ‘Review of Regulatory Provision for Independent Directors’ released by SEBI on 1st March 2021, SEBI had proposed that the appointment, removal, and re-appointment of independent directors should be subject to a dual approval, that involves an approval by the shareholders and the majority of the minority shareholders, other than the promoters and the promoter group shareholders.
Approved Amendment

In its recently held board meeting, SEBI gave its approval for the appointment, removal, and re-appointment of independent directors that must only take place after passing a special resolution. Further, SEBI has also reduced the duration of time for the appointment of directors (including independent directors) to 3 months or to the next general meeting from the appointment of the director at the board, whichever is earlier. This is done in order to seek a quick approval of shareholders for appointing the directors.

2. Role of Nomination and Remuneration Committee

Existing Position

According to the SEBI (LODR) Regulations, the listed company is required to set up a Nomination and Remuneration Committee which should consist of at least 3 directors. All of these directors should be non-executive directors and at least½ of them should be independent directors. The NRC is entrusted with the task to find a suitable candidate for the post of an independent director.

Approved Amendment

SEBI has modified the composition of the NRC in such a way that, it consists of 2/3rd of the directors as independent directors. Further, SEBI has also enhanced the role of the NRC in the selection of independent directors. The NRC is also required to critically evaluate the skills of the candidate and make more disclosures. This step is taken for the evaluation of skills of the candidate by the companies against the competencies required by the board for optimal board composition.

3. Cooling-Off Period

Existing Position

The SEBI LODR Regulations provide a cooling-off period for the person who is proposed to be appointed as an independent director. This is as follows -
3 years for the person who has been an employee, or a Key Managerial Personnel (KMP), or his/her relative has been a KMP of the listed company, or the associate/holding/subsidiary of the holding listed company.

2 years where there is a material pecuniary relationship between the person, his/her relative and the listed company, or the associate/holding/subsidiary of the holding listed company.

In the consultation paper, SEBI has proposed to harmonize the cooling-off period for the above categories to 3 years.

**Approved Amendment**

Cooling off period of 3 years has been introduced for the former employees / KMP / his/her relatives, of the listed company, or the promoter group as an eligibility criterion for his appointment as an independent director in the listed company. Whilst the cooling off period for the appointment of independent directors, has been waived off for the relatives of the employees of the listed company and the associate/holding/subsidiary company of the listed company.

4. **Resignation of Independent Directors**

**Existing Position**

As per the LODR Regulations, an independent director tendering his resignation has to disclose to the stock exchanges, the reason for his resignation along with the confirmation that there is no other material reason for his resignation. This has to be done by the independent director within 7 days of his resignation. In the consultation paper, SEBI proposed that the independent director should make a disclosure of the entire resignation letter along with a list of his present and past directorships and memberships in the board committees.

**Approved Amendment**

SEBI has enhanced and made the resignation of independent directors more transparent by mandating the independent directors to disclose the entire resignation letter along with a list of all their present and past directorships and memberships in the board committees. Additionally, SEBI has introduced a cooling-off period for those independent directors who want to be
employed as whole-time directors in the same company, or its holding/associate/subsidiary company, or any company belonging to the promoter group.

5. Remuneration

Existing Position

Independent directors are paid sitting fees which is capped at Rs. 1 lakh, profit linked commission with an overall limit, and the reimbursement of expenses. They are not entitled to the stock options, according to the Companies Act, 2013, and the LODR Regulations. In the consultation paper, SEBI had considered giving stock options to independent directors, with a vesting period of 5 years to replace the profit linked commission so that the independent directors can have and enjoy a long term interest in the company.

Approved Amendment

SEBI has not approved any amendment with respect to the remuneration of independent directors. It has, however, decided to make a reference to the Ministry of Corporate Affairs to provide a greater flexibility to the companies for the purpose of remuneration of their independent directors. This may include perks like sitting fees, employee stock options, profit linked commission, etc., within the prescribed limit of the Companies Act, 2013.

6. Directors and Officer’s Insurance

Existing Position

According to the LODR Regulations, the top 500 listed companies are required to undertake insurance for all their independent directors of such quantum and risks, as may be determined by the board of directors.

Approved Amendment

SEBI has extended the requirement of undertaking insurance for all independent directors to the top 1000 listed companies by market capitalization.

Composition of the Audit Committee
Existing Position

According to the LODR Regulations, the audit committee is required to have 2/3rd of its members as independent directors. The listed company is required to obtain the prior approval of the audit committee for engaging in related party transactions. In the consultation paper, SEBI proposed that the audit committee must have 2/3rd of its members appointed as independent directors and 1/3rd of the members appointed as non-executive directors, who are not related to the promoters or the nominee directors, if any.

Approved Amendment

The composition of the audit committee was changed, however, all related party transactions were required to be approved only by the independent directors on the audit committee.

ANALYSIS OF THE AMENDMENTS APPROVED BY SEBI

Most of the proposals and amendments have been borrowed by India from the UK. In case of appointment of independent directors, a significant role has been extended to the public shareholders and the strong influence of the promoters is mitigated to an extent. In fact, to avoid the interim say of the promoters on such appointments, it is now proposed that the appointment of independent directors shall only be made by the shareholders. If an independent director resigns or dies, their replacement has to be done by the shareholders within 3 months from the date of their resignation or death. Further, if an independent director resigns stating personal reasons or any other commitment or preoccupation, they will not be able to join any other board for a period of 1 year. Resignation for the purpose of becoming a whole-time director will not be permitted. The shortlisting of independent directors has received a major boost through the requirement of disclosure of their selection or appointment.

The Audit Committee has a pivotal role in approving the related party transactions and accounts. Currently, it is required that two-thirds of the members of the audit committee should consist of independent directors and the rest of the directors may be of any kind, including promoter directors. However, with the amendment, one-third of the members of the audit committee should consist of non-executive directors or independent directors who are not
related to the promoters. The influence of both the promoters and the management is thus, sought to be removed.

As far as the remuneration of independent directors is concerned, the dilemma remains that if you pay too less, the director has less incentive to devote sufficient time, and if you pay too much, the concern is that they may get influenced. Currently, a maximum sitting fees of Rs 100,000 per meeting is permitted. Commission based on profits is allowed, but this has issues for the loss-making companies. Also, commission linked to the profit has notable concerns of conflict in approving the accounts. To resolve this issue, a compromise of sorts is proposed by two means. Firstly, by increasing the sitting fees. This would have to be decided by the Ministry of Corporate Affairs. Secondly, by permitting the grant of Employee Stock Options (ESOP’s) to the independent directors with a vesting period of at least 5 years. The directors who sustain for five years can probably be rewarded through appreciation in the value of the shares. However, it remains ambiguous whether the proposed solution will resolve the issue well. ESOP’s are usually, not common in the companies. Also, a waiting period of 5 years could be too long and many may not even benefit.

The changes as a whole, are positive in nature. However, there is still a long way to go. The powers and liabilities of independent directors are yet to be touched upon. Individually, independent directors have little power, however, their liability is significant and ironically, their enhanced status may raise it even more.

The remuneration of independent directors continues to remain an unaddressed issue on at least two counts. Firstly, the board and the promoters are given a decisive say in fixing the remuneration amount. Secondly, the amount and the manner of remuneration may still be not enough to attract the best of talent.

With the new reforms in place, it has to be seen as to how the companies adopt and adapt to the new demands of the market. A majority of the companies in the country are promoter-driven, where the promoters typically hold a significant stake in the company that often exceeds 50 percent. The investors invest traditionally, relying upon the reputation and entrepreneurship of the promoters, even if there are situations where there mistrust is created. It is therefore, always advisable and wise to maintain a check or supervision over the promoters and their activities. This must, however, not lead to the adoption of a relatively alien concept that actually becomes a hurdle in the functioning of the company. Hence, one must make sure that a proper
and an adequate balance is maintained between the regulation of the company, and its functioning.xxiv

CONCLUSION

Provided the significant role exercised by independent directors in improving the standards of corporate governance, the proposed reforms or amendments are certainly a step taken in the right direction.xxv The amendments approved by the SEBI will contribute in making the procedure for the selection, appointment, and resignation of independent directors, much more efficient and transparent at a holistic level. The current governance framework favouring the majority shareholders, will be overhauled. The approved amendments clearly indicate SEBI’s intention to strengthen the corporate governance framework of the listed companies. The efficacy and the success of these amendments can only be established once they are brought into application.xxvi

Overall, the changes are progressive as well as aligned with the objective of strengthening the framework of corporate governance in the country. It is hoped that in times to come, additional changes will be introduced to make corporates more accountable and self-disciplined for the greater public good.xxvii Taking a look at the introduced changes, it can be seen that they will push the board, independent directors, and the shareholders, to act against any act of corporate misgovernance, thus, encouraging better and high standards for corporate governance. However, the actual or real improvement would be visible only when there is independence not just in form, but also in spirit.xxviii
ENDNOTES

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