

History and Legality of Independent Directors in India

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The definition of Independent Directors changed with the amendments altogether with their responsibilities. The Companies Act, 1956 does not expressly provide for Independent Directors except Clause 49 of the listing agreement that is applicable on all listed companies which mandates the appointment of Independent Directors on the Board. Independent Directors constitute such category of Directors who are expected to have impartial and objective judgment for the proper functioning of the company.

As per sub-section (6) of section 149 of the Companies Act, 2013;

“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 possesses relevant expertise and experience;

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

(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) who has or had no pecuniary relationship with the company, 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, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees 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 any of his relatives

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(i) holds or has held the position of a key managerial personnel or is or has been employee of the company or 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 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 firm of auditors or consulting firm

(iii) holds together with his relatives two per cent. or more of the total voting power of the company;
or

(iv) is a Chief Executive or director, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company; or

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

The definition of Independent Director as per Companies Act, 2013 provides quantitative threshold for evaluation of significance of the relationship and considers all pecuniary relationship (both material and immaterial)."

Evolution of the Concept of Independent Directors

The concept of Independent Directors is of recent origin owing to the need of clear infrastructure to tackle chronic corporate governance and limiting the monopoly of directors' powers. A repository has been created for the sake of appointment of persons to the position of Independent Directors.

The Independent Directors repository is a joint initiative of the three professional statutory bodies namely "*The Institute of Chartered Accountants of India, The Institute of Company Secretaries of India and The Institute of Cost Accountants of India*" under the active encouragement of the Ministry of Corporate Affairs, Government of India. This repository has been developed to facilitate the individuals who are eligible and willing to act as Independent Directors and also to facilitate Companies to select the persons who are eligible and willing to act as Independent Directors under section 150 of the Companies Act, 2013 and Rules made there under.

Requirement of Independent Directors

The requirement or indispensability of Independent Directors is enshrined in sub section 4 of Section 149 of the Companies Act 2013, every listed public company is mandatorily required to have at least one-third of the total number of directors as independent directors.

Any unlisted public companies must appoint at least two independent directors in the following circumstances:

1. if the paid up share capital exceeds Rs.10 crores;
2. if the turnover exceeds Rs.100 crores;
3. if the aggregate of all the outstanding loans, debentures and deposits exceeds Rs 50 crores.

One who wishes to offer the candidature as Independent Director may enroll the name at The Independent Directors repository.

It is discretionary for the companies to choose suitable persons for the position as an “Independent Director” from the Independent Directors repository. The responsibility of exercising due diligence before selecting a person from the data bank referred to above, as an independent director lies with the company making such appointment.

As a part of Corporate Governance, the companies meeting some threshold criteria are required to constitute/ reconstitute board. The Companies Act 2013 has also emphasized on the appointment of an Independent Director as a member and as a chairperson in various committees.

Selection of Independent Directors

The selection of a candidate as Independent Director requires certain qualities that includes;

1. Impartiality
2. Loyalty
3. Decision- making (judgment)
4. Professional repute

The procedural guidelines for selection and requirement have been provided under Section 150 of Companies (Appointment and Qualification of Directors) Rules, 2014 which is to be

read along with Companies (Appointment and Qualification of Directors) Amendment Rules 2015.

A candidate wishing to become an Independent Director must follow the procedure as set out;

1. He has to submit the Consent to act as Director in Form DIR-2 to the Company.
2. He has to submit a declaration that he/ she is not disqualified to be appointed as a Director as per provisions of Section 164(1) & (2) of the Companies Act, 2013 in Form DIR-8 to the Company.
3. He has to submit a declaration of independence as per Section 149(6) of the Companies Act, 2013 before his/her appointment. Such declaration has to be placed before the 1st Board Meeting in which he/ she participates as a director and the subsequent first board meeting in each financial year.
4. By Schedule IV(IV)(4) to the Companies Act, 2013 the Company will have to issue the appointment letter to Independent Director. Also the terms and conditions of Independent Director's appointment have to be posted on the company's website.
5. Lastly the Company has to file the consent of Independent Director with Registrar of Companies within 30 days of his/her appointment in Form DIR-12;

Responsibilities and Liabilities of Independent Directors

The role of independent directors is considered to be of a great significance in shaping up the progress of the company as well the corporate sector's growth. The guidelines, role, functions and duties are broadly set out under Code of conduct under Schedule IV of the Companies Act, 2013. The code of conduct lays down the guidelines of professional conduct as well as role, functions and duties of independent director.

Responsibilities

An Independent Director owes the following duties and responsibilities to the Company

1. Help in 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;

2. Bring an objective view in the evaluation of the performance of board and management;
3. Scrutinize the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;
4. Satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
5. Safeguard the interests of all stakeholders, particularly the minority shareholders;
6. Balance the conflicting interest of the stakeholders;
7. Determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;
8. Moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

As a good Corporate Governance practice the Companies Act, 2013 raised need to establish Vigil (Whistle Blower) Mechanism which aims to provide a channel to the Directors and employees to report genuine concerns about disreputable behavior, actual or suspected fraud or violation of the Codes of Conduct or policy.

Liability

The Companies Act, 2013 restricts and limits the liability of Independent Directors only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently.

Independent Directors' Meetings

The procedural requirement is that the Independent Directors should have meeting at least once in a year. The meeting must be convened without the attendance of non-independent directors and members of the management.

The purpose of the meeting is to:

1. sort out and review the performance of non-independent directors and the Board as a whole;

2. analyzing the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
3. assessing the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

Independent Directors – Term, Remuneration, Resignation and Removal

There are various restrictions and preventive measures as per the Company Act, 2013 and its guidelines for the role of Independent Directors to ascertain the purpose of the position in the company:

Term

The term of office of Independent Directors is up to 5 consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report. As per MCA Clarification vide General Circular 14/2014, an Independent Director even if appointed for a lesser period than of 5 years will be held as appointed for one term.

No independent director shall hold office for more than 2 consecutive terms, but such independent director shall be eligible for appointment after the expiration of 3 years of ceasing to become an independent director provided that he shall not, during the said period of 3 years, be appointed in or be associated with the company in any other capacity, either directly or indirectly. Retirement of directors by rotation is not applicable to appointment of independent directors.

Remuneration

The Companies Act, 2013 provides a sitting fee for attending the Board Meetings pursuant to Section 197(5) which is maximum of Rs.1,00,000/- per meeting and is to be decided by the Board. Profit related commission may be paid to independent director subject to the approval of the shareholders.

As per General Circular 14/2014 provided by the Ministry of Corporate Affairs, an Independent Director would not be considered to have a pecuniary relationship under section 149(6)(c) for transactions with a company, its holding, subsidiary or associate

company, or their promoters, or directors, provided such transactions are in the ordinary course of business and are on an arm's length basis.

Resignation

There are specific rules to be followed for the resignation of Independent Directors to effect

1. An Independent Director may resign from his/her office by giving a notice in writing to the Company.
2. Within 30 days from the date of receipt of such notice the Board shall file same with Registrar of Companies in Form DIR- 12.
3. The director shall also forward a copy of resignation along with detailed reasons for the resignation to the Registrar of Companies within 30 days of resignation.

Removal

The removal of Independent Director is at the discretion of the company which appointed him. A Company may, by ordinary resolution, remove a director, before the expiry of his period after giving a reasonable opportunity of being heard. A special notice is required for any resolution, to remove a director under this section, or to appoint somebody in place of a director so removed. The vacancy shall be filled within a period of not more than 180 days.

Conclusion

Independent Directors are appointed for the whole purpose of achieving a reliable and good infrastructure as to Good Corporate Governance. Independent Director is expected to act as the trustees of stakeholders. Thus the Companies Act, 2013, has sought to balance the wide nature of the liabilities and the obligations imposed on Independent Directors. The Act restricts and limits the liability of Independent Directors only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently. Therefore, the position of Independent Directors acquires prominence in tackling all the hurdles we face in the Corporate Sector.