

ROLE OF INDEPENDENT NON-EXECUTIVE DIRECTOR IN CORPORATE GOVERNANCE

Ria Jaiswal*
Trisha Dhara**

Introduction

Corporate Governance has a broad scope. It includes both social and institutional aspects. It ensures that the interest of the shareholders (major as well as minor) are safeguarded. Governance mechanism includes monitoring the actions, facilities, practices and decisions of corporation, their agents and affected shareholders. The Securities and Exchange Board of India Committee on Corporate Governance defines Corporate Governance as “acceptance by management shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, conduct and about making a distinction between personal and corporate funds in the management of a company”. Corporate Governance is a way of directing the company so that shareholders interest can be protected and legal regulatory requirements can be met.

“Good Corporate Governance is about maximising shareholder value on a sustainable basis while ensuring fairness to all stakeholders: customers, vendors, partners, investors, employees, government and society”. - N. R. Narayana Murthy.

Desire for more and more Indian Companies to get listed on International stock exchanges also focuses on a need for corporate governance. Infact, Corporate Governance has become a buzzword in the corporate sector. To promote good corporate governance, SEBI constituted a committee on corporate governance under the chairmanship of Kumar Mangalam Birla. There shall be a separate section on corporate governance in the Annual report of the company, with a detailed report on corporate governance. The company shall obtain a certificate from the auditors of the company regarding the compliance of conditions of corporate governance. This certificate shall be annexed with the director’s report sent to shareholders and also to the stock exchange. Absence of Corporate Governance leads to fraud, mismanagement, embezzlement and harm to society and environment.

The Act, 1956: no particular definition was given to Independent Directors. Inorder to recognize a director as an Independent Director one has to refer to clause 49 of the Listing Agreement which is applicable to all listed companies. The Act, 2013 has adopted many of the provisions of clause

49 of the Listing Agreement and has defined the term “Independent Director” u/s 2(47). The new act along with the definition of Independent Directors also provides the criteria for appointing, qualification, tenure, remuneration and liability of Independent Directors.

According to NASDAQ “Independent Director” means a person other than an executive officer or employee of the company or any other individual having a relationship which, in the opinion of the issuer’s board of directors would interfere with the exercise of independent judgement in carrying out the responsibilities of a director¹.

Companies Bill 2011: Concept of Independent Director

The Companies Bill, 2009 was introduced on August 3rd 2009. The Standing Committee presented its report on August 31st 2010 but the Central Government withdrew this bill in the winter session of 2011 and it got reintroduced on December 2nd, 2011.

First time in company law the concept of Independent Director has been proposed and clauses have been introduced to strengthen the institution of Independent Directors. The need for Independent Directors aroused due to the need of a strong framework of corporate governance in the functioning of the company. An entire schedule, Schedule IV has been introduced to define the roles, functions and duties of the Independent Directors and incidental provisions relating to their appointment, resignation and evaluation. All listed companies are required to appoint Independent Directors with atleast 1/3rd of the board of such companies comprising of Independent Directors. The Bill contemplates the establishment of data bank of Independent Directors from which persons may be chosen by companies. Under the bill Independent Directors are entitled only to fees for attending meetings of the board and possibly commissions within certain limits. The Bill expressly disallows Independent Directors from obtaining stock options in companies. The Bill limits the liability of an Independent Directors only in “respects of acts of omission or commission by a company which had occurred with his knowledge, attributable through board process and with his consent or connivance or where he had not acted diligently.” An Independent Director should not be an Independent Director for more than 5 listed companies and on the

* *Student Of Kiit School Of Law.*

** *Student Of Kiit School Of Law.*

¹ *NASDAQ Rule 4200 a(15)*

recommendation of Remuneration and Nomination Committee, an Independent Director should be appointed by the shareholders through a postal ballot. The initial term of an Independent Director is 5 years following further appointment would require a special resolution of the shareholders. However total tenure is not allowed to exceed 2 consecutive terms. A proposal in the new bill is that any undue gain made by a director by abusing his position will be disgorged and returned to company together with monetary fines. India has a chance with the Companies Bill, 2011 to take a lead in corporate governance innovation rather than following the developments in the United States or United Kingdom.

Difference between Independent Director and Non-Executive Director:

There is a slight difference between Non-Executive Directors and Independent Directors. Independent Directors are definitely Non-Executive Directors but vice-versa is not true always. A Non-Executive Director is the member of Board who is not in employment with the company, basically an “outside director” and custodian of the governance process. A Non-Executive Director may or may not hold shares in the company. They are not involved in day to day running of the business but monitor the executive activity and contribute to the development of strategy. An Independent Director is the member of Board who does not own any shares in the company and does not have any monetary relationship with the company except his remuneration.

Independent Non-Executive Director under Companies Act, 2013 in promoting good corporate governance

Role and Functions

The role of Independent Non-Executive Director has following key elements:

1. Setting strategy
2. Reviewing management performance
3. Analysing risk
4. Ensuring the human and financial resources are able to achieve objectives.

The Independent director shall:

- 1). Help in bringing an independent judgement to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standard of conduct;
- 2). Bring an objective view in the evaluation of the performance of board and management;
- 3). Scrutinise 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 financial controls;
- 5). Safeguard the interests of all stakeholders particularly the minority shareholders;
- 6). Balance the conflicting interests of the stakeholders;

As an Independent Director he has the same general legal responsibilities to the company as any director including all fiduciary duties, responsibilities, statutory obligations and liabilities of directors prescribed in law including the Companies Act, 2013. The code described in Schedule IV of the Act, 2013 lays down certain important duties to be performed by Independent Directors like keeping themselves updated about the company, undertaking appropriate induction and refreshing their knowledge, skills and familiarity with the company and regularly attending the general meetings of the company. The role they play broadly includes improving corporate credibility, governance standards, and the risk management of the company. They are expected constructively to challenge and help develop strategy, to participate actively in the decision making process of the board and to scrutinize the performance of management in meeting agreed goals and objectives. Where the Chairman of the Board of Director is a Non-Executive Director, at least 1/3rd of the Board should comprise of Independent Director and if he is an Executive Director, at least half of the board of the company shall consist of Independent Directors. Non-Executive and Independent Directors play a vital role in providing independent judgement in all circumstances. Independent Directors are appointed so that they can bring an outside perspective into the board meetings. Independent Directors also aid in the balancing of interest of the shareholders, employees and creditors. The balancing role is important in situations where conflict arises between interest of Executive Directors and Shareholders. Independent Directors play a crucial supervisory function, they are required to sit on a number of watch-dog committees, including the

Remuneration and Nominating Committee. Every Independent Director shall at the first meeting of the financial year or whenever there is any change in any circumstance which may affect his status as an Independent Director, give a declaration that he meets the criteria of Independence. The Companies Act, 2013 provides that Central Government shall create and maintain a data bank of persons willing and eligible to be appointed as Independent Director but Central Government shall not be held responsible for any contravention of any law committed by any company or its directors by reason of the fact that the person appointed by the company as an Independent Director was selected from the data bank nor it will be a defense in the court of law. The act also casts great responsibility on the Independent Directors. It specifies that decisions taken by the board in the absence of Independent Director must be circulated to all the directors and can be final only upon receiving the ratification from atleast one Independent Director. An Independent Director can be removed if they fail to attend any board meeting for 12 months period with or without the permission from the board. The requirements prescribed under the Companies Act, 2013 seem to be much more stringent than that of the Listing Agreement.

Appointment

Schedule IV of the Companies Act, 2013 provides for the “Code for Independent Directors”. The appointment process of Independent Director shall be independent of the Company Management. The appointment shall be approved at the meeting of the shareholders. The appointment is for a term of 5 years commencing from the date of appointment. The appointment is as per the Companies Article of Association. The explanatory statement attached to the notice of the meeting for approving the appointment shall include a statement that in the opinion of the board, the Independent Director proposed to be appointed fulfils the conditions specified in the Companies Act and the rules made thereunder and that the proposed director is independent of the management. During the term of appointment, the Independent Director may be asked to serve on one or more of the Board Committee including Audit Committee, Nomination and Remuneration Committee, Stakeholders Committee, Corporate Social Responsibility, or such committee of the Board of the directors from time to time and copies of the terms of reference for each of the committees will be provided to him. The appointment shall be formalised through a letter of appointment which shall include the terms and conditions of the appointment. The Re-appointment shall be on the basis of performance evaluation. This clause made it compulsory for all listed

companies to have Independent Directors on its Board. Section 149(11) mandates that reappointment after the expiry of second term can be done only after a cooling period of 3 years. The act under section 149(12) provides that Independent Director can be implicated only for offences committed with their knowledge, connivance or negligence. The explanation to sub-sections 10 and 11 of Section 149 further provide that the existing tenure of the Independent Director shall not be reckoned with for the purpose of calculating the tenure for one or two terms of five years, as the case may be.

Resignation:

The Independent Director may resign by sending a letter of resignation in writing to the company and such letter shall be considered in the board meeting, when accepted the prescribed return shall be filed with ROC. The Directors report shall contain a reference of such resignation. Appendix 1 Schedule IV prescribes that vacancy so arisen shall be filled within a period of 180 days from the date of either resignation or removal. The vacancy may not be filled if the company otherwise fulfils the requirement of Independent Directors. The Board of the Company shall satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management. Upon termination or resignation, the Independent Director will have to undertake to sign all appropriate paperwork that the company may require. An Independent Director can also be removed by the company by passing an ordinary resolution in general meeting after giving him a reasonable opportunity of hearing pursuant to a Special Notice permissible under Section 169 of Companies Act, 2013.

Separate Meetings:

The Independent Director of the company shall hold at least one board meeting during every financial year in-person. Also he will strive to attend the Board/ its committee's calls whenever scheduled as per the convenience of all the attendees. This meeting is expected to review the performance of non-independent directors and board as a whole, review the performance of chairperson after taking into account the views of executive directors and non-executive directors, assess the quality and 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.

Liabilities:

The Act, 2013 has sought to balance the wide nature of the obligations, functions, and duties imposed on an Independent Director. It restricts and limits the liability of Independent Directors to the matters which are directly relatable to them. Section 149(12) of the Act, 2013 defines the liability of an Independent Director. An Independent Director will be liable only in respect of such acts of omission or commission by a company which had occurred with his knowledge attributable through Board process and with his consent or connivance of where he has not acted diligently

Manner of Selection:

Section 150(1) of the Act, 2013 indicates that the Independent Directors may be selected from a data bank of eligible and willing persons maintained by any institute or association as may be prescribed by the Central Government. This section further stipulates that the appointment of Independent Director has to be approved by members in a General Meeting and the explanatory statement annexed to the notice must indicate justification for such appointment.

Remuneration:

An Independent Director is not entitled to any stock option. But he may receive sitting fees, reimbursement of expenses incurred for attending board or other committee meetings and omissions linked to profits. The reason for denying monthly/yearly remuneration is to preserve his independency :-

- 1) The aggregate remuneration to be paid to all the Independent and Non-Executive Directors would not exceed 1% of the total net profits of the Company during any financial year.
- 2) Subject to the provisions of the Companies Act 2013 and other applicable Indian laws, Fixed Commission of Rs13, 00, 000 (Rupees Thirteen Lakh only) per annum is to be paid to each Independent Director.
- 3) The company will pay sitting fee of Rs20, 000 (twenty thousand only) for attending each Board Meeting/ its Committee meetings in-person except for the Audit committee meeting for which the sitting fee is Rs40, 000 (Forty thousand only) for attending the same in-person. Attendance through video conferencing or by other audio visual means in terms of

the Companies Act, 2013 and the Rules made thereunder is also considered as valid presence and qualifies for the payment of above sitting fees.

- 4) The remuneration described above is the gross amount payable per financial year, which is subject to deductions of applicable taxes and any other deductions required, if any by any applicable laws. The Independent Director shall be responsible for the personal taxation. However the Company will assist him in tax fillings if any and compliance requirement in India.
- 5) If the term comes to an end due to resignation or termination any amount due shall be paid on pro-rata basis.
- 6) The Company has made provisions for Director and Officers(D & O) insurance policy which covers the risk of breach of duty, neglect or omission to act, error or misleading statement and failure to supervise etc.

Expenses:

In additional to the compensation described in above, the Company will reimburse the official travel expenses, hotel expenses and all other reasonable out of pocket expenses borne by the Independent Director for participating in Board and other Committee meetings and other Business meetings.

Qualifications of Independent Director:

Rule 5 of the Act, 2013 provides that an Independent Director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

Code for Independent Directors:

During the period of the appointment the Independent Director will be bound by the company Code of Directors and such other codes of conduct under applicable laws including the Companies Act, 2013 and the Securities and Exchange Board of India act, 1992.

Guidelines for professional conduct

- To uphold ethical standards of integrity and probity.
- To act objectively and constructively while exercising his duties.
- To exercise his responsibility in a bonafide manner in the interest of the company.
- To devote sufficient time to his professional obligations for informed and balanced decision making.
- To avoid abusing his position to the detriment of the company and refrain from any action that would lead to loss of independence.
- To assist the company in ensuring best corporate governance practices.

Training of Independent Directors:

The company shall provide suitable training to Independent Directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc. the details of such training imparted shall be disclosed in the annual report. There is no such explicit provision for training of Independent Director in the Act.

Confidentiality:

All information in relation to the company acquired by an Independent Director during the appointment and tenure as an Independent Director is confidential and should not be disclosed to any person or company. The Independent Director must apply the highest standards of confidentiality and should not disclose any information related to company to outsiders. On termination the Independent Director is bound to return all the property given to him by the company like books, documents, papers. The company will arrange for disposal of papers which he no longer requires.

- 1) The Independent Director must apply the highest standard of confidentiality and not disclose to any person or company (whether during the course of appointment or at any time after its termination) any confidential information concerning the Company and any Group Companies (including wholly owned subsidiaries) with which he comes into contact by virtue of his position as an Independent Director of the Company.

- 2) Any information concerning the Company's business, its customer, supplier etc. which is not in public domain and to which all employee do not have access, should be considered confidential for the purpose and should be held in confidence unless to do so and disclosure is required as a requirement of law .
- 3) The attention is drawn to the requirements under Indian regulations as to the disclosure of price sensitive information. The Independent Director shall not provide any information either formally or informally, to the press or any other publicity media without prior written clearance from the Chairman or Company Secretary.
- 4) The example of confidential information are, but not limited to the following:
 - a) Business plan, annual operation plan
 - b) Software developed/ under development
 - c) Technical information about software and computer systems
 - d) Performance against target
 - e) Costing pricing profitability, financial budget and related issues
 - f) Fees/ stipend evaluations, recommendation etc. related to any of the employee of the Company
 - g) Sales commission, third party commission and about reference agent
 - h) Details of past, present and future contracts and proposals
 - i) Information about suppliers and/ or customers
 - j) Communication facilities and equipment
 - k) Proposed venture and corporate plan
 - l) Technical marketing and financial strategy of the company and/ or its customers
 - m) Core competencies or activities of the Company and/ or its customers
 - n) Any other information, which like to be crucial for the business operation

Review Process:

The performance of Individual Directors and the Whole Board and its committee is evaluated annually. The Independent Director will have to make himself available for carrying out the annual/periodic performance review of himself and the Board Committee's where he is a part thereof for review process. Independent Director has to further confirm that he will extend his contribution to review of the Board of Directors individually as well as for its various committees on behalf of/ as desired by the Board of Directors on an annual periodic time frame.

Other directorship and business interest

- 1) The Company acknowledges that Independent Director may have business interest in other companies in the event that he becomes aware of any potential conflict of interest, then it should be disclosed to the Chairman and Company Secretary as soon as they become apparent.
- 2) During the appointment, he should consult with the Chairman prior to accepting any such other (or further) directorships of Indian companies or any major external appointments which may affect his interest in the company.

Relevant Sections defining the concept of Independent Directors:**1. Clause 49 of the Listing Agreement-**

It deals with Corporate Governance norms. On 17th April, 2014 SEBI amended the corporate governance norms for the listed companies in India and it will be effective from 1st October, 2014.

Objectives:

- Alignment with the Companies Act, 2013
- Disclosure and transparency on all material matters.

Meaning:

For the purpose of sub-clause (ii), the expression 'independent director' shall mean a non-executive director of the company who:

- a.) Apart from receiving director's remuneration, does not have any material pecuniary relationship or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the directors;
- b.) Is not related to promoters or persons occupying management positions at the board level or at one level below the board;
- c.) Has not been an executive of the company in the immediately preceding three financial years;
- d.) Is not a partner or an executive or was not a partner or an executive during the preceding three years, of any of the following:
- The statutory audit firm or the internal audit firm that is associated with the company, and
 - The legal firm(s) and the consulting firm(s) that have a material association with the company.
- e.) Is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director.
- f.) Is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares;
- g.) Is not less than 21 years of age.

2. Section 2(47) the Companies Act, 2013:of

As per Section 2(47), "independent director" means an independent director referred to in sub section (5) of Section 149.

3. Section 149(6) of the Companies Act, 2013:

This sections specifies as to who can be an independent director. In simple words, any of the following persons can be termed as independent director:

- A person who is not a Managing Director nor Whole-time Director nor a Nominee Director.

- A person with relevant experience, expertise and integrity in the opinion of Board of Directors.
- A person who neither was nor is a promoter of the company nor its holding or subsidiary or associate company.
- A person who neither was nor has any pecuniary relationship with the company, its holding, subsidiary, or associate company or their promoters, or directors during the preceding two financial years or during the current financial year.
- A relative who has or had pecuniary relationship or transaction with the company, its holding, subsidiary, or associate company or their promoters, or director and the value of such relationship or transaction does not exceed 2% of its gross turn-over or its total income of Rs. 55.00.000 or such higher amount as may be prescribed during the immediately two preceding financial years or during the current financial year.
- A person who neither himself nor his relative had held or holding the position of KMP or currently is or has been the employee of the company, its holding, its subsidiary or its associate company during any three financial years immediately preceding the financial year in which he is sought to be appointed.
- A person who neither himself nor any of his relatives is or has been
 - i. An employee or proprietor or a partner, in any of the immediately three preceding three financial years, in the firm of auditors, company secretaries in practice or cost auditors of the company or in its holding company or subsidiary company or associate company.
 - ii. In any legal or consulting firm that has or had any transaction with the company, its holding company, subsidiary company or associates company, amounting to 10% or more of the gross turn-over of such firm or
 - iii. A person who either holds together with his relatives two per cent or more of the total voting power of the company.
 - iv. A person who is neither Chief Executive nor Director, or by whatever name called, in any Non-Profit Organisation that receives twenty percent or more its receipts from the company or any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting of the company.

v. A person who possess such other qualification as may be prescribed.

4. Section 149(4) of the Companies Act, 2013:

It requires that every listed company to appoint minimum one-third of the total number of directors as independent directors. For companies, other than the listed companies, Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides that following class of public companies shall have atleast two persons as independent directors:

- a) Public companies having paid up share capital of Rs.10 crores or more.
- b) Public companies having turnover of Rs.100 crores or more.
- c) Public companies having outstanding loan, debentures, and deposits, in aggregate, in excess of Rs.50 crore or more.

5. Section 150(1) of the Companies Act, 2013

An Independent Director may be appointed from one of the data bank maintained by any association, body, and institute as may be notified by the Central Government. It is clarified that it is not mandatory that Independent Director should be appointed only from the data bank in view of the word “may” appearing in the section. Appointment of Independent Director shall be first considered at the meeting of the Board of Directors and later on approved by the company by way of ordinary resolution in general meeting as per Section 152(2). However the second tenure of five consecutive years shall be by way of ordinary resolution passed in the general meeting.

The data bank shall consist of the following particulars regarding persons willing and eligible to be an Independent Director. Those are:-

- DIN
- Name and Surname in full
- PAN number
- Father's/Spouse's name
- Gender
- Nationality
- Occupation
- Full address with pin code

- Educational and professional qualification
- Details of experience and expertise
- List of LLP's in which he was a designated partner
- List of the companies in which he was a director consisting of the name of the company, nature of industry, nature of directorship and duration with dates.

6. Section 149(9) of the Companies Act, 2013:

According to this section, Independent Director is entitled to receive

- Sitting fee for board/committee meetings as may be prescribed under the second provision under Section 197(5).
- Reimbursement of expenses for attending the board/committee meetings.
- Commission related to profits of the company subject to the provisions of the Section 197 and 198 (one percent of the net profits if there is a Managing Director or Whole-Time Director, or Manger or three percent of the net profits in any other case.) . The net profits shall be computed in accordance with Section 198. The Independent Director, however, shall not be entitled to receive any “stock option”.

7. Section 149(12) of the Companies Act, 2013:

This sections limits the liability of an Independent Director “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”.

8. Section 149(7) of the Companies Act, 2013

This section provides that every Independent Director shall give a declaration that he meets the criteria of independence when:

- He attends the first board meeting as Independent Director
- Thereafter at the first meeting of the board in every financial year and
- Whenever there is any change in the circumstances which may affect his status as an Independent Director.

9. Section 134(3)(d) of the Companies Act,2013

It deals with a statement on declaration of status of independent directors which will be attached with Director's Report of the company.

10. Section 135(1) of the Companies Act, 2013

It deals with constitution of Corporate Social Responsibility Committee in which one member should be an Independent Director.

11. Section 152 of the Companies Act, 2013

It deals with the total strength of the directors in which Independent Director will not be included in that total number of directors of the company.

12. Section 161 of the Companies Act, 2013

No person shall be appointed as an alternate director for an Independent Director unless he is qualified to be an Independent Director under the provision of this Act.

Section 178 of the Companies Act, 2013:

This section provides for appointment of Nomination and Remuneration Committee of the Board. This committee should consist of 3 or more Non-Executive Directors. Out of this atleast 50% should be Independent Directors.

13. Section 197(5) of the Companies Act, 2013:

It provides that a director (including independent director) shall be entitled to receive fees for attending a board meeting. Draft Rule 13.2 provides that such fees should not exceed Rs.1 lakh per meeting as the board may decide. It is also provided that different fees for Independent Directors and other Directors can be fixed within this limit.

Relevant Case Laws determining the liability of Independent Directors:

1. Satyam Scam – how a scandal changed corporate governance law in India

Satyam scam has been the greatest scam in the history of corporate world of India. Satyam is one of the largest IT Company in India. The CEO of the company Ramalinga Raju has made a scam of around \$2billion. The Satyam episode has brought out the failure of the present corporate governance structure. Ramalinga Raju was sentenced to 7 years in jail. Satyam serves as the back

office for some of the largest banks, manufacturers, health-care and media companies in the world. The scale of the scandal and the auditing firms neglect, brought to light the glaring loopholes in the regulatory and legal framework dealing with the directors and the auditors of the companies. Eventually it led to changes in law.

Before the scandal, Companies Act 1956 did not contain any provision for Independent Directors or impose any stringent obligations on auditors. The report of Kumar Mangalam Birla Committee in 1999 recommended improvements to the function and structure of the Board of Company and emphasised disclosures to shareholders. Clause 49 of Listing Agreement became a reflection of these recommendations. In 2003, the Narayana Murthy committee analysed the role of Independent Directors, related parties and financial disclosures. After the scandal, the Confederation of Indian Industries set up a task force to suggest reforms and the National Association of Software and Services Companies established a corporate governance and ethics committee headed by Narayana Murthy. In 2010, SEBI amended the Listing Agreement to include the provision dealing with the appointment of a chief financial officer but it did not insist on compulsory rotation of auditors. The new law under Companies Act, 2013 insisted on companies having Independent Directors, that is, who do not have a material or pecuniary relationship with a company. The requirement under clause 49 of Listing Agreement, which applied only to the listed companies, would thus apply to many more companies. There are laws to safeguard to investors invest but Satyam Scam has raised the question on fundamental role of the government and corporate governance. If Independent Directors are held liable for corporate fraud and severe penalties are imposed on them, it will be difficult to induct right people as Independent Directors in the board and companies will be deprived of the collective wisdom of people who can make it a difference in the performance of the companies. “This sentencing will make Independent Directors more cautious of their role on the board and now they will think twice before clearing any proposal which is against the shareholder’s interests,” said R S Loona of corporate law firm Alliance corp lawyers, adding according to law, the liability of the fine would be on individual directors and not on the company. The Companies Act, 2013 has made the provisions more stringent. The Non-Executive directors play a crucial role in implementing the principles of effective corporate governance. Therefore, there is an urgent need for appointment of independent officers at the top levels of the company due to gradual changes in the mindset of investors and

shareholders. Independent Directors would ensure effective Corporate Governance in the company.

2. Kailas Sizing Works vs Municipality of Bhivandi And Nizampur²

“The authority is not acting honestly where an authority has a suspicion that there is something wrong and does not make further enquiries. Being aware of possible harm to others, and action in spite thereof, is acting with reckless disregard of consequences. It was worse than negligence, for negligence action is that, the consequences of which the law presumes to be present in the mind of the negligent person, whether actually it was there or not.”

So an Independent Director cannot escape from his liability. They will be held equally if they will not take any action against the wrong committed in his knowledge.

3. KK Ahuja vs VK Vora³

SC observed that to be liable, a person should fulfil the legal requirements of being a person in law, responsible for the conduct of the business of the company. He should also be in charge of the business of the company. The law lists such persons as managing directors, whole-time directors, company secretaries, but there is no mention of non-executive directors. The apex court has provided a two-pronged test whether a person can be deemed responsible. The first is legal, statute-based test where it has to be proved that person is responsible for the conduct of the business. The second is a fact-based test, where through specific instances, the complainant has to allege that accused was in control of the day to day business. If a person does not satisfy the first test, neither he is required to meet the second test nor can he be held liable.

4. SMS Pharmaceuticals vs Neeta Bhalla⁴

The Delhi High Court stated that liability depends on the role that the person plays in the company and not on the designation or status. Another question before SC was whether liability under section 138 or 141 of the NI Act arise on account of holding office by the director as such. The court held that the conditions contained in section 141 are intended to ensure that a person who is

² AIR 1969 Bom 127

³ 2009 (3) JCC (NI) 194

⁴ (2005) 8 SCC 89

sought to be made vicariously liable for an offence of which the principal accused is the company, had a role to play in relation to the incriminating act and further that such a person should know what is attributed to him to make him liable.

Thus the independence of a director is of no importance and his liability will be seen with regard to the work delegated to him by the company.

Conclusion

Independent Directors have a big role to play in corporate. The concept of Independent Director was introduced to bring in independent judgement on board. Corporate Governance is the application of best management practices and discharge of social responsibility for sustainable development of all stakeholders. The Act empowers Independent Directors with proper checks and balances, so that extensive powers are not exercised in an irrational manner, but in a rational and accountable way. It empowers Independent Directors with a view to increase accountability and transparency. They should enhance corporate governance and ensure the management and affairs of the company are conducted in the interest of the stakeholders. However it is also important to keep in mind that good corporate governance is not just an outcome of appropriate selection and effective functioning of Independent Directors. Every Director whether Executive/Non-Executive or Dependent/Independent has a distinct role in the functioning of the company. It is when the entire Board functions properly which results to good corporate governance and benefit minority as well as majority shareholder in its long term which maintains a good corporate image in the market. Companies Act 2013 seeks to bring about greater standards of corporate governance, by imposing higher duties and liabilities for directors. While the act sets out specific duties, it does not clarify whether the duties of directors listed therein are exhaustive. Therefore it will be prudent for directors to comply with all the duties and not be merely be directed by the specified duties that should guide their behaviour. The provisions have been made stringent and compliance to these is also becoming difficult. The Independent Director definition is also not very clear as the pecuniary relationship is not defined. Introducing the concept of Independent Directors is to take unbiased decisions and to check various decisions taken by the management and majority stakeholders. The duties casted upon Independent Directors by provisions of Schedule IV are so onerous that many persons who joined the Board of some companies may not decide to continue

in such a position under the new Act. Once this position is accepted, an Independent Director will have to be ever vigilant about the activities of the company in which he has accepted this assignment. It is evident from the provisions of Companies Act 2013 that much emphasis has placed on ensuring greater independence of Independent Directors. The overall intent behind this provisions is to ensure that an Independent Director has no pecuniary relationship, nor he is provided any incentives which may compromise his/her independence. In view of the additional criteria prescribed in Companies Act, 2013, many listed companies may need to revisit the criteria used in appointing their Independent Directors. While the Listing Agreement provided that an Independent Director must not have any material pecuniary relationship or transactions with the company, Companies Act 2013 provides that an Independent Director must not have had any pecuniary relationship. Further Listing Agreement stipulated earlier that an Independent Director should have not had such transactions with the company at the time of its appointment, Companies Act 2013 extends this restriction to the current financial year or preceding two financial years.

It is necessary for the Independent Directors to-

- Prepare themselves thoroughly for the meeting.
- Be objective in forming sound decisions.
- Be open-minded, free and frank.
- Be committed to the decisions made.

The SEBI Circular has brought the provisions of Listing Agreement in line with the Companies Act, 2013. Further it seeks to hold Independent Directors liable for acts or omission or commission by a company that occurred with their knowledge and attributable through board process. This provision discourages many people who could have been potentially appointed as Independent Director. These Independent Directors are the trustees of good corporate governance

