

Independent directors are now a crucial part of Indian company law

by ACS Divesh Goyal *on* April, 2014

Let me now turn your attention to the role of independent directors in a company, an issue that has become increasingly important after the Enron and the Satyam scandals. Earlier Clause 49 of the listing agreement mandates appointment of independent directors on Board of listed Companies. With the passage of the new Companies Act of 2013, the concept of independent directors has found place in the Companies Act itself. The requirements prescribed under the Companies Act 2013 seem to be much more stringent than that of the listing agreement.

As I will discuss below, India's new company law has recognized independent directors as a vital facet in the operation of a company. Independent directors are considered to be the watchdogs of a company. Independent Director is the first and foremost "**independent watchdog**." As watchdogs the board of directors are appointed in a company to oversee its business and funds to protect the shareholders. They should be free of all external influences. To ensure their complete autonomy, an independent director should not have any material or pecuniary relationship with the company.

Hon'ble Minister Sachin Pilot Said, "We as a government can only provide the regulatory mechanism. We can only give an environment where good corporate governance takes place," he said. "Today, we have about 8.5 lakh companies and about two-third companies which are family-owned. So, the role of independent directors becomes all the more important. The companies are large and public funds are invested and independent directors play a crucial role," he said.



Meaning/Definition of Independent Director:

The Companies Act, 2013, for the first time, defines an “independent director”. Interestingly, the definition in Section 2(47) is similar to the one provided in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, a regulation applicable only to listed companies. The principle of impartiality is embedded in this definition. As per Section 2(47), “independent director” means an independent director referred to in sub-section (5) of section 149, an independent director can only be a person:



- who is **not** a managing director, whole-time director, or a nominee director;
- who is **not** or **was not** a promoter of the company or its holding, subsidiary, or associate company;
- who is **not related** to the promoters or the directors of the company, its holding, subsidiary, or associate company; and
- 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**
- 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 (2%) or more of its Gross Turnover OR
 - Two per cent (2%) or more of Total Income OR
 - Fifty Lakh Rupees (Rs. 50 Lakh) OR
 - such higher amount as may be prescribed,

- *whichever is **LOWER**,*
- During the **two immediately preceding financial years** or during the **current financial year**;

➤ who, **neither himself nor any of his relatives**:

- holds or has **held the position** in company or its holding, subsidiary or associate company in any of the **three immediately preceding financial years** in which he is proposed to be appointed as
 - Key Managerial Personnel OR
 - Employee of the company
- is or has been An **EMPLOYEE** or **PROPRIETOR** or a **PARTNER**, of-
 - Firm of Auditors or
 - Company Secretaries in Practice or
 - Cost Auditors **of the** company or its holding, subsidiary or associate company in any of **three immediately preceding financial years** in which he is proposed to be appointed, of:

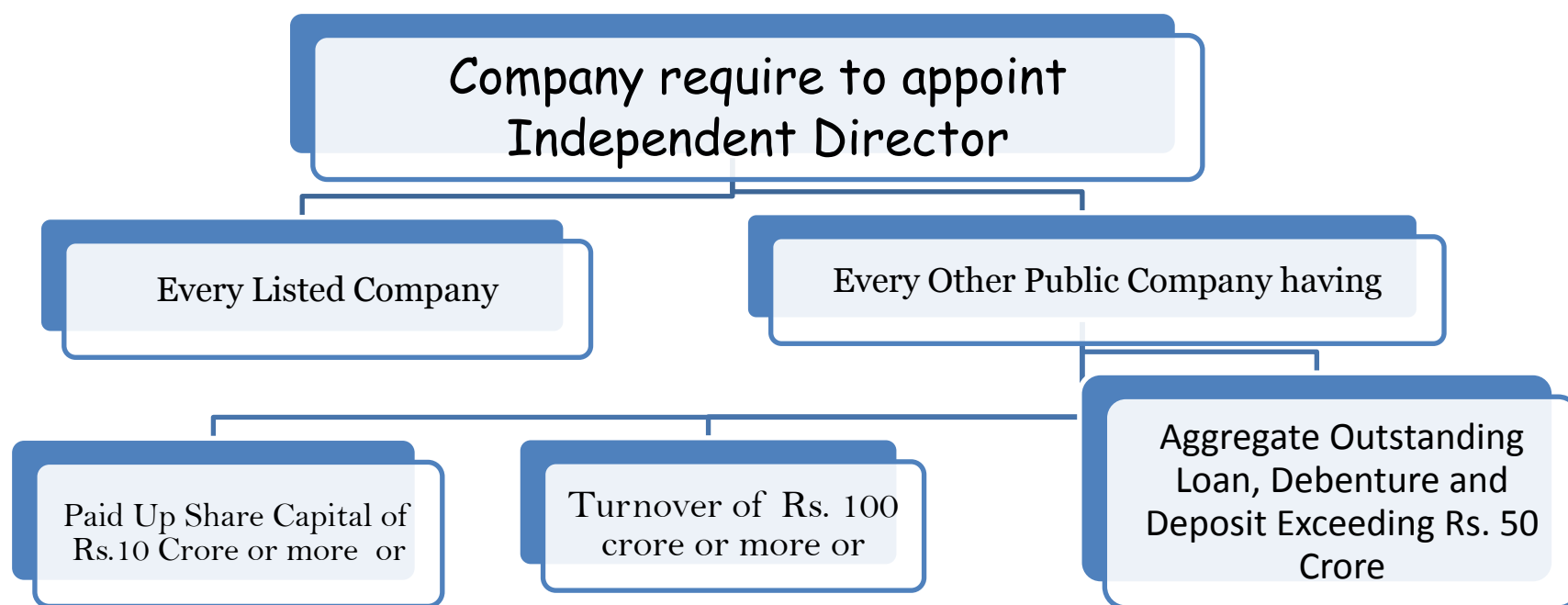
OR

 - Any **legal or a consulting firm** that has or had **any transaction with the company, its holding, subsidiary or associate company Amounting to TEN PER CENT (10%). OR More of the Gross Turnover of Such Firm**
- **Holds together with his relatives Two Per Cent (2%) . or more of the total voting power of the company OR**
- is a **Chief Executive or director**, by whatever name called, of any **NONPROFIT ORGANIZATION**
 - **that receives Twenty-Five Per Cent (25%) . 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 (2%). or more of the total voting power of the company;**
- is a **Material Supplier, Service Provider or Customer or A Lessor Or Lessee** of the company;

➤ Who is **above 21** years of age.

- Who 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.

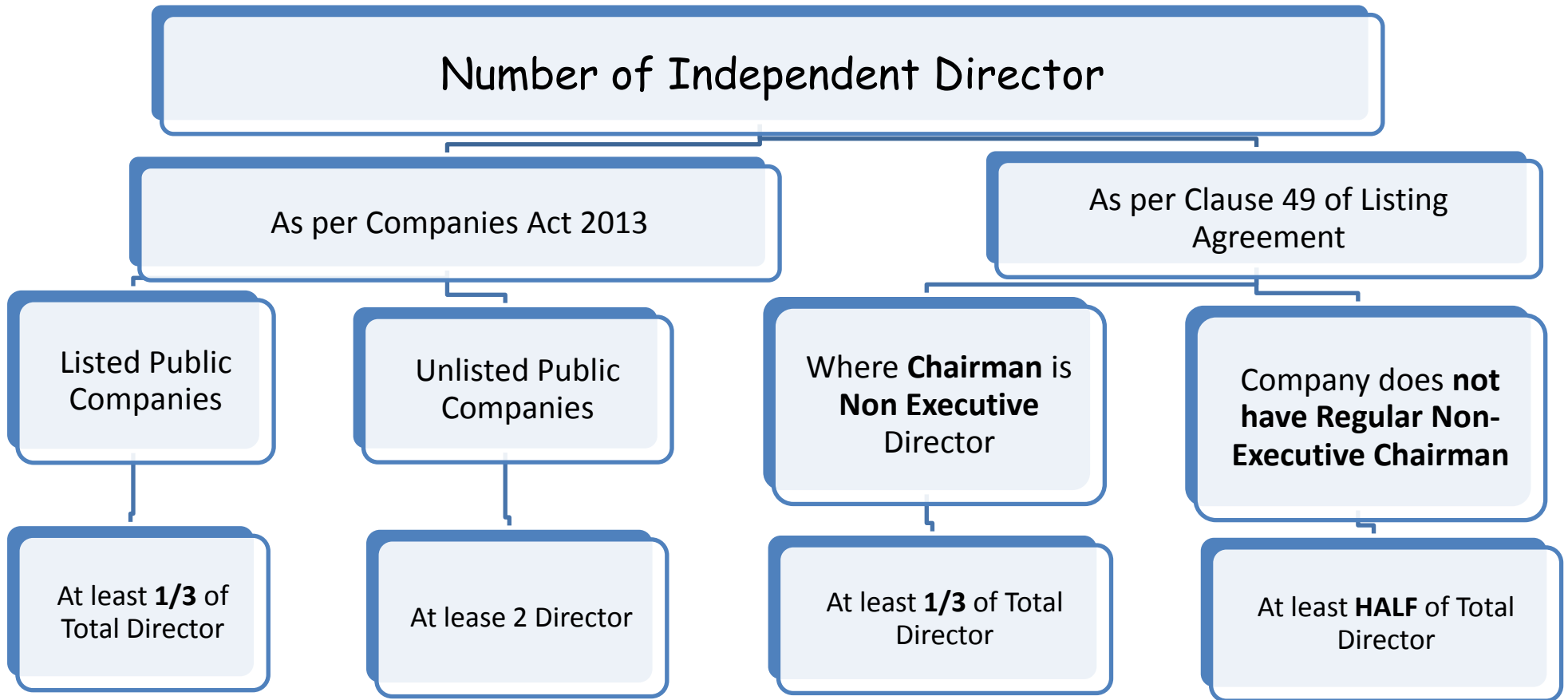
Applicability of Companies: Below mention companies are require to appoint Independent Director:



EXPLANATION:

1. The criteria specified for **Unlisted Public Companies** shall be applicable for the first year and shall continue to apply to that company in subsequent years during The Tenure Of The Independent Director even if the paid up share capital or turnover, or borrowings/deposits, as the case may be, fall below the limits specified therein.

COMPOSITION OF INDEPENDENT DIRECTORS:



EXPLANATION:

- 1.** Any fraction contained in the 1/3rd number shall be rounded off as one.
- 2.** A company belonging to any class of companies **for which a higher number of independent directors:**
 - ❖ **Required** due to composition of its audit committee, such higher number of independent directors shall be applicable to it.
 - ❖ Has been **prescribed** in or under the law/regulations governing such class of companies, shall comply with the requirements specified in such law/regulation.

{Example: As per Rule Unlisted Public Company should have minimum 2 Independent Directors, if company fulfills any of three conditions mentioned above. If the company touches the criteria given in sub rule- 6 of Companies (Registration Offices and Fees) Rules, 2014 for constitution of Audit Committee, such Company constitutes Audit Committee. If Company appoints 5 directors as member of Audit Committee so as per Section 177 of Company Act, 2013 majority of directors should be Independent directors. In our case will be 3 (form 5 Majority 3). So **“As per rule unlisted company should have 2 Independent directors but because of composition of Audit Committee our company requires to appoint Minimum 3 Independent Director”**.

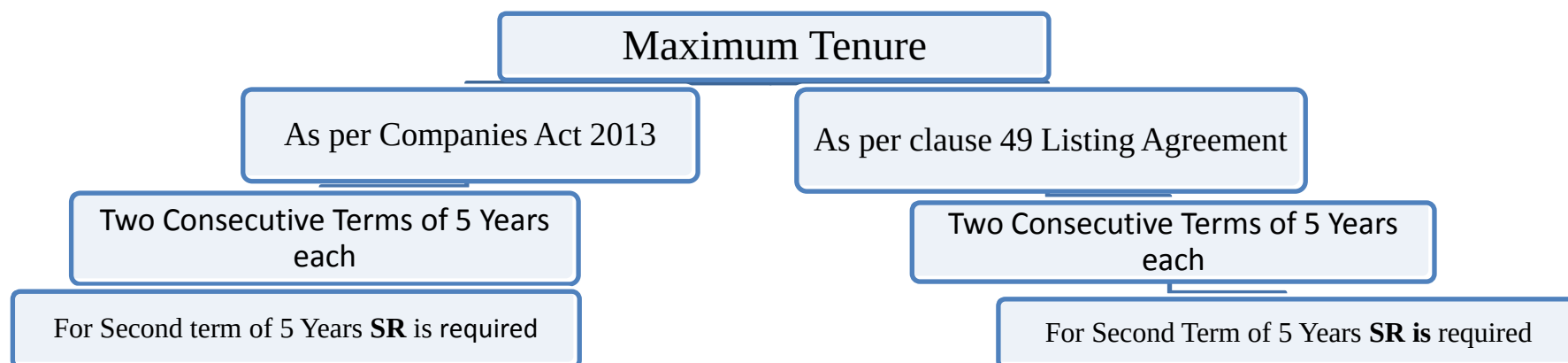
PROCEDURE FOR APPOINTMENT OF INDEPENDENT DIRECTOR:

1. Appointment process of independent directors shall be independent of the company management
2. Passing of **Resolution** at the **Meeting of Share holders {Ordinary Resolution in GM}**
3. **Explanatory Statement** attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made there under.
4. The company shall issue a Formal Letter of appointment to independent director, **which shall mention:**
 - the term of appointment
 - the expectation of the Board from the appointed director
 - the fiduciary duties along with accompanying liabilities
 - the Code of Business Ethics of company
 - the remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any
5. The Letter of appointment along with the detailed profile of independent director **shall be disclosed on the websites** of the company and the Stock exchanges.
6. The Letter of appointment along with the detailed profile of independent director shall be submitted with Stock Exchanges not later than one working day from the date of such appointment.

DECLARATION BY INDEPENDENT DIRECTOR: Every independent director **shall give a declaration** that he meets the criteria of independence as provided in the Section 149(6) of Companies Act, 2013:

- ❖ At the First Board Meeting in which he participates as a director Or
- ❖ At the first board meeting in every financial year Or
- ❖ At the first meeting held after whenever there is any change which may affect his status as an independent director

TENURE OF INDEPENDENT DIRECTOR:



Explanation:

- For Companies Act, 2013 **Tenure** of Independent Director, as **On the Date of Commencement** of Act **shall not be** counted as term under section 149 (11).
- For Listing Agreement Independent Director who **has already served as ID for 5 year or more** years as on October 1, 2014, shall be eligible for appointment of **ONLY ONE MORE TERM** on completion of term as on October1, 2014.

REMUNERATION TO INDEPENDENT DIRECTOR:

1. Independent director shall **not be entitled to any stock option**.
2. **May receive Remuneration** by way of **Sitting Fees which shall not exceed 1,00,000/- and Reimbursement of Expenses** for participation in the Board and other meetings
3. **Profit related commission** as may be **approved by the share holders** by passing of resolution **in General Meeting**.

RESIGNATION:

- ❖ An Independent Director **may** resign from his office by giving a notice in writing to the Company.
- ❖ The Board on receipt of such notice **shall file same with Registrar** in **Form DIR- 12** within 30 days from the date of receipt of such notice.
- ❖ The Company shall also place the fact of such resignation in Director Report laid in the immediately following general meeting by the Company.
- ❖ A director shall also forward a copy of resignation in DIR-11 within 30 days.

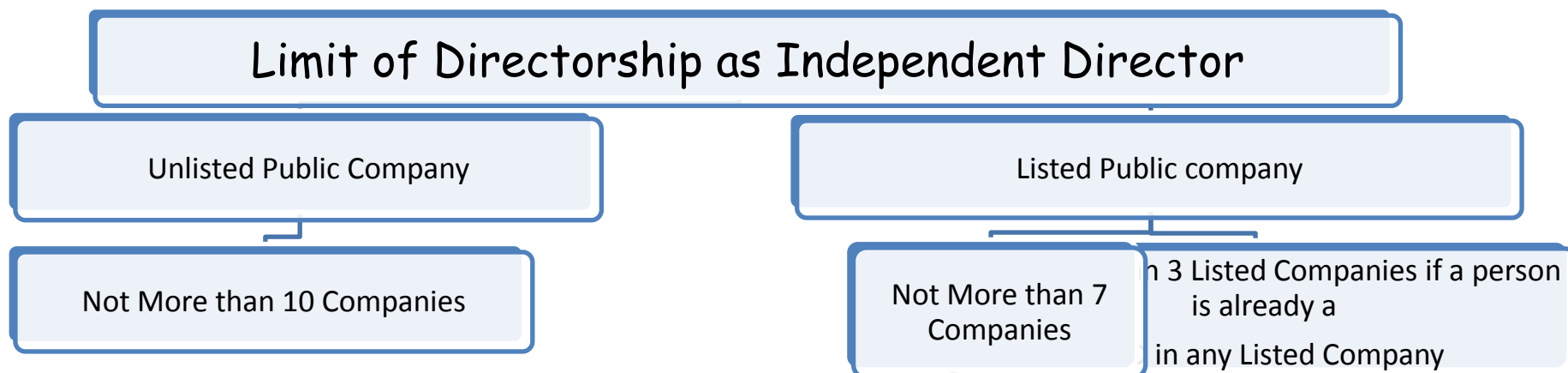
REMOVAL:

- ❖ 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**.

Intermittent vacancy of an Independent Director: Provided further that any **INTERMITTENT VACANCY** of an Independent director shall be filled-up by the Board of Directors at the earliest but not later than

- Immediate **Next Board Meeting** OR
- **3 (Three) Months** from the date of Such Vacancy, Whichever Is Later:

LIMIT ON NUMBER OF DIRECTORSHIP:





Separate Meeting of Independent Director:

The independent directors of the company **shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management.** All the independent directors of the company shall strive to be present at such meeting.

The meeting shall:

(a) Review the performance

- of **non-independent directors and the Board** as a whole;
- of the **Chairperson of the company,**

(b) Assess 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.

RE-APPOINTMENT OF INDEPENDENT DIRECTOR:

- **Require Special Resolution** in General Meeting and **Disclosure** of such re-appointment in **Directors Report**.
- On the basis of **Report of Performance Evaluation**.

LIMIT OF NUMBR OF MEMBERSHIP IN COMMITTEE BY INDEPENDENT DIRECTOR:

For the purpose of considering the limit of companies Private Company & Foreign Company & Section-8 Company are **excluded.**

A Director Shall not be

Member in more than 10 committees

Chairman in more than 5 Committees

For Reckoning the Limit

only Audit Committee and Stakeholder's Relationship Committee are considered

Points to be note:

- ❖ The Provisions relating to **Rotation of Directors shall not be applicable** to Independent Directors.
- ❖ An independent director **shall be held liable**, only in respect of such 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.

Manner to select Independent Director: The Act, 2013 has described the manner or procedure for selection of ID's under section 150. This section says that selection of an ID shall be done from a **Data Bank** maintained by anybody, institute or association, as may be notified by the Central Government, containing names, addresses and qualifications of persons who are eligible and willing to act as ID. It also says that the appointment of an ID shall be approved by the company in general meeting and the explanatory statement indicating the justification behind appointing such person, attached with the notice of general meeting.

Realizing the importance and arguent need for the independent directors in the corporate world Chamber of Indian Micro Small & Medium Enterprises (CIMSME) has taken a proactive initiative to address the requirement for suitable independent directors for companies by hosting a dedicated portal.

www.indianindependentdirectors.org

This will create a single window opportunity to the prospective independent directors to post their particulars in conformity with the rules framed under the new Companies Act 2013. Indianindependentdirectors.org is proposing to create the data of eligible independent directors which will be used by the eligible companies to have capable and qualified independent directors as per their requirement.

Indianindependentdirectors.org will contact the companies which requires to appoint Independent directors as per the provisions of the Companies Act 2013, to select and appoint the Independent Directors out of the databank managed by Indianindependentdirectors.org

Indianindependentdirectors.org proposes to conduct initial Due diligence of the information provided by the persons desirous to be enrolled under the databank at Indianindependentdirectors.org. The profile of the persons will be hosted on the website of Indianindependentdirectors.org only after initial Due diligence by the expert team. The details about the due diligence process are also placed under DUE DILIGENCE PROCESS.

Any company desirous to select any person as independent director from this data bank must carry out its own due diligence before appointment of any person as an independent director and the Chamber maintaining the databank or any State/ Central Government shall not be responsible for the person chosen for appointment on its board as independent director out of this databank.

CONCLUSION:

The Act empowers independent directors with proper checks and balances, so that such extensive powers are not exercised in an unbridled manner, but in a rational and accountable way. The changes are a step in the right direction. They should enhance **CORPORATE GOVERNANCE** and ensure the management and affairs of the companies are conducted in the interest of stakeholders. It is expected that these changes will thwart corporate scandals in future and insulate shareholders interest.

However it is also important to keep in mind that good corporate governance is not just the outcome of appropriate selection and effective functioning of ID's. Every director, whether independent/non-independent, executive/non-executive has a distinct role in the functioning of the company. It is only when the entire board functions effectively 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.

From the above we can conclude that Independent Directors have a very big role to play in Corporate. The Provisions have been made stringent & compliance to these is also becoming difficult. The Independent Director definition is also not very clear as the pecuniary relationship is not defined. The Government should give precise definition which can bring about clarity.

Thanx & Regards,

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