INDEPENDENT DIRECTORS – HOW INDEPENDENT ARE THEY?

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INTRODUCTION

It was in June 1991 that the Economy saw widespread economic reforms take root. This ensued a variety of reforms in the service and manufacturing sectors. The period was marked by the corporatization of industries, and there was a dramatic increase in investments in the securities market. As per data available till 2019, there are over 4744 companies listed on the Bombay Stock Exchange (BSE) in India and as per the report of the World Bank. It was reported to be 75.81% in 2019.[1]Therefore, it is essential that governance in listed companies is made straightforward and culpable. The idea of Independent Directors was brought forward for the first time in India at the beginning of the 21st century and formed part of what subsequently became the concept of Good Corporate Governance.

ORIGIN OF CONCEPT OF INDEPENDENT DIRECTORS – UNITED KINGDOM

The 1992 Cadbury Report is generally considered, what led to the concept of the Independent Director.[2]It brought forth the idea of an Independent Director as well as that of a Non-Executive Director. The Non-executive Directors have been primarily awarded two functions in accordance with the Cadbury Report i.e.: (i) Evaluating the functioning of the board and its Directors; and (ii) to resolve the conflict of interests by taking charge in the decision-making process.

Independent Directors form a subset of Non-Executive Directors. Independent Directors should be separate from any trade or other associations that would substantially obstruct the exercise of free and unbiased decision making, aside from their shareholdings and Director's wages.[3] Sufficient discretion is conferred to the Company's Board to decide whether the criteria of an Independent Director have been met while considering each Director.

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[1]https://tradingeconomics.com/india/market-capitalization-of-listed-companies-percent-of-gdp-wb-data.html
[2]Financial Reporting Council, Committee On the Financial Aspects of Corporate Governance Report, 1992
[3]*Id.* At ¶4.

Furthermore, nomination committees are to be formulated by the Company Boards to designate Board members and audit committees to establish the sincerity of financial reporting. The Cadbury Report is responsible for the evolution of corporate governance norms in the U.K. and it would be fair to say that the report made an indelible impact outside the U.K .as well.

The Greenbury Committee endorsed the creation of remuneration committees of boards to ascertain the compensation of Company Board members. The Hampel Committee submitted a much simpler report which re-established the position of the non-executive Directors.[4] The 1999 Combined Code on Corporate Governance was the result of all the prior committees and their reports.

In a successive series of reforms, the Higgs Report stated the idea that fifty percent or more representatives of the Board should be independent.[5] To introduce the suggestions of the Higgs Report, amendments were made to the 1999 Combined Code. Independence of the board has become an intrinsic factor of corporate governance in the U.K. and the present rendition of the 2008 Combined Code continues this trend.

This policy of independence has further been followed by the judiciary in consonance with the legislature. For instance, in **Equitable Life v. Bowley,**[6] Langley J. held: ***"It is well known that the role of the non-executive directors in corporate governance has been the subject of some debate in recent years. It is arguable, I think, that a company may reasonably at least look to non-executive directors for the independence of judgment and supervision of the executive management."***

The primary interest of the Courts is to prevent mismanagement and streamline the conduct of the management of the company to safeguard the interests of the shareholders, which is precisely the role envisaged for Independent and Non-ExecutiveDirectors.

ORIGIN OF THE CONCEPT IN INDIA

Indian legislators have also had to make several endeavours at defining the significance attached to the idea of 'independence'. Although the report of the Confederation of Indian

[4]FINANCIAL REPORTING COUNCIL, COMMITTEE ON CORPORATE GOVERNANCE, FINAL REPORT, (1998).
[5]DEPARTMENT FOR BUSINESS, INNOVATION, AND SKILLS, DEREK HIGGS, REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS (2003).
[6]Equitable Life v. Bowley,[2003] EWHC 2263 (Comm) 41 (U.K.).

Industries did realize the relevance of their being Independent and Non-Executive Directors, it did not sufficiently describe the term.

It can be seen that this definition predominantly takes into account financial considerations only, which would be a very limited test and does not seem to do much justice to the role and responsibility desired of an Independent Director. When considering the Indian context, looking through the lens of pecuniary considerations only would be very constrictive due to the influence of social and familial associations in the corporate world. Though the committee did not adequately succeed in resolving the definition; the committee had realized the significance of the problem of the excessive power of the controlling shareholders in Indian businesses, and had the foresight to encompass that in the catalogue of prohibited relations.

Clause 49 of the Listing Agreement guaranteed that all the advisory group proposals were remembered for the authoritative system which manages corporate administration worries of recorded organizations. Condition 49 developed the reasoning set forth by the Kumar Mangalam Birla Committee Report by precluding from the rundown of qualified people, different people who might be partnered to the Board individuals and advertisers by familial ties.[7] It also ruled out various other persons who had financial stakes in the corporate which would invariably cause a loss of independence. The people avoided incorporated the individuals who had two percent or a greater amount of casting a ballot offers, or who have had a leadership position in the business in the former three monetary years.

Individuals who have been partners of a law firm, or consulting firm, or audit firm which have had considerable dealings with the Company, during the preceding three years are also excluded. It also prohibits material suppliers, service providers, lessor/lessee, and customers from being treated as independent. Nonetheless, it was still unsuccessful in capturing certain social relationships that are likely to affect the independence of the Directors.

Section 149 of the Companies Act, 2013 seems to have resolved this misstep. The Companies Act, 2013 was a considerable step in the regulation of corporate governance as it undertakes to bring the notion of the Independent Director into the legislative realm[8].

[7] *Id.*at¶6.5.
[8] MadhuryyaArindam, The Independent Director: Has it been Indianised Enough? 6 NUJS L. Rev. 231 (2013).

POSITION OF INDEPENDENT DIRECTORS UNDER COMPANIES ACT, 2013

The definition of the term "Independent Director" was prescribed in the 2013 Act for the first time. The Act of 1956 did not contain any rules regarding the same so in accordance with Clause 49 of the Listing Agreement only listed companies were required to adhere to this condition but with the 2013 Act, Independent Directors were made obligatory for unlisted large public companies as well.

WHO CAN BE AN INDEPENDENT DIRECTOR?

The 2013 Act has gotten an immense change by running through the models as for the plan of Independent Directors. Any promoter of the Company or its holding, helper or accomplice association or anyone related to them or any person who has or had a financial relationship with the Company during the two rapidly going before money related years or current financial year have been dodged from being appointed as Independent Directors. The Act additionally gives arrangement to a term of five years, which can be restored, by uncommon goal for resulting periods and they not will undoubtedly resign on a rotational premise. This gives the position a degree of solidness which would empower them to work unafraid of expulsion.

NUMBER OF INDEPENDENT DIRECTORS

Each recorded public organization is committed to guaranteeing that in any event, 33% of their Board of Directors ought to be made out of Independent Directors and further qualifies the Central government for joining different classifications of Companies inside the domain of this specification.[9] To simplify the process further, it is stipulated that an Independent Director has to be named from a data bank of persons, containing particulars of individuals who have consented to be appointed, as may be notified by the Central government.[10] Initially, the registration with Data Bank was optional, however, the option was removed vide the fifth amendment to Companies (Appointment and Qualification of Directors) Rules, 2014[11], which made it mandatory for every individual who was an Independent Director as on the date of the amendment or for people in future who wanted to be appointed as an

[9]The Companies Act, 2013, § 149(4), The Gazette of India, pt. II sec. 1 (August 30, 2013).
[10]*Id*. § 150(1).
[11] Enforced vide Gazette No. G.S.R. 804(E) dated 22.10.2019

Independent Director to enroll with the Data Bank within three months from the enforcement of the amendment which was extended till 30th June 2020.

REMUNERATION

An extensive advance taken by the Act puts a limitation on the number of offers that can be held in a Corporate by a relative of an Independent Director. The Act further explicitly keeps them from accepting investment opportunities. Commission relative to the benefits might be compensated to them, however, similar would be reliant on the endorsement of the investors. The worry which may emerge here is an irregularity between the compensations and the obligations that are to be performed.

RESPONSIBILITIES

The Act has placed diverse duties on Independent Directors. The individuals applying for the position are required to furnish a self-declaration affirming that they fulfill the criteria mandatory for the position.[12] It is also prescribed that any Board meeting that is convened at short notice mandates the appearance of at least one Independent Director and if no such Independent Director is present, the matter considered at the meeting will be deemed to be sanctioned only once an Independent Director approves it. All the Directors are obligated to attend Board meetings regularly and they may be dismissed on the off chance that they neglect to show up for any executive gathering for a time of a year with or without authorization from the Board.[13]

SEPARATE MEETINGS

This Act makes it essential for all the Independent Directors to hold at any rate one gathering every year, without the presence of some other individuals from the board. In this gathering, they are to investigate the tasks of the Chairperson, non-Independent Directors, and the Board in general.

INDEPENDENT DIRECTOR'S LIABILITY

To arrange an environment where Independent Directors feel free to exercise their powers prudently, the 2013 Act, to a certain extent assures them protection from liability. It is stated

[12] *Id*. §149(7).
[13] *Id*. §167.

that they are accountable only if the fraudulent actions were perpetrated with the knowledge of such an Independent Director or where the Independent Director has not acted with due diligence and if such act is attributable to the Board process.[14]

CODE FOR INDEPENDENT DIRECTORS

The organization and its Independent Directors are committed to agree with the arrangements portrayed in Schedule IV of the Act, which outfits an itemized Code for the Directors. Though the code appears to be mandatory, it is mired by vagueness and unexplained provisions which creates disarray when interpreting them. The code puts forth that an Independent Director shall hold to ethical standards of integrity and probity, at the same time, what would comprise ethical behaviour is not outlined, leading to interpretations that may defeat the objectives of the Code.[15] Furthermore, it stipulates the nomination of an Independent Director by the Board after assessing certain attributes. However, the method in which the Companies need to carry out this evaluation remains unanswered.

CONCLUSION

It is evident that the representatives of the Board and its management can elect the shareholders and manipulate the election process without difficulty, due to the scattered nature of the shareholdings and lack of unity amongst the various associations of shareholders. This is applicable uniformly to executives as it does to the Non-Executive Directors. Further, only 1% had gotten the job through advertisements to the public. The figures for India are dismally poor as well with about 90% being inducted through the Chairman's social relations. These Directors would behave more favourably to the executives, instead of protecting the interests of the shareholders against those in senior management as they are supposed to.

In such Corporate entities, the tally is usually not in support of a person selected by the minority share-holders unless the majority is also backing him.

Further, the majority shareholder would not require the security of the Independent Director because taking into account a large number of its shareholdings would be able to apply its authority over the Board anyway. Despite the fact that companies have separate and well-

[14] *Id*. §149.
[15] PwC India, *Companies Act,2013 Key highlights and analysis*, PWC INDIA(8th December 2020), https://www.pwc.in/assets/pdfs/publications/2013/companies-act-2013-key-highlights-and-analysis.pdf

defined election committees, the applicants do not stand much chance to get nominated unless they receive the support of the majority as well. One method to rectify this problem is to amend the selection process. One way this can be achieved is to establish a scheme of proportional representation during nominations. This would assure that the applicant of the minority shareholders would have the opportunity to get nominated without the express support of the majority. The other possible choice would be to give the power of nomination of Independent Directors exclusively to the minority shareholders.

Given the issue of nonattendance of autonomy in the current situation, it is dubious that the Independent Directors would have the option to do the obligation expected of them - which is to administer the activities of the senior administration and the heads in light of a legitimate concern for the gatherings that don't have critical assurances. In the event that such a Director is generously subject to the installment got from the Company, his autonomy might be risked.

A possible solution to this could be to recommend proportional nomination as the arrangement for the appointment of Independent Directors. Separate from the simple majority voting scheme in which the shareholders possess the ability to vote the number of shares he owns for each applicant standing for nomination; under cumulative voting, each shareholder would get a set amount of votes to match the number of shares owned by him multiplied by the total number of Directors required to be nominated. The shareholder would then have the choice to distribute all his votes amongst multiple candidates or cast them all in favour of one candidate. This method of voting gives the minority shareholders the freedom to select some members that would be appointed to the Board if they can band together behind a few nominees.

Legislative authorities may also look for insight from administrations of other domains that are facing a comparable dilemma with respect to majority-minority shareholders. Regardless of whether the current establishment can be ever custom-made consummately is yet unsure; be that as it may, endeavours in the correct heading will go far.