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Legal Framework Regarding Independent Directors in India: A Critical Evaluation

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ABSTRACT

The Board of Directors of a Company play a key role in ensuring the sustenance and success of the Company. The major responsibilities of the Board of Directors include providing leadership and strategic guidance to the workforce of the organization, monitoring and supervising the day-to-day activities of the business and fulfilling the goals of the Company. Independence of the Board is important to ensure the implementation of best practices in the Organization.

The Independent Directors form a crucial part of the Board of Directors. They aim to achieve good Corporate Governance by acting as a watchdog. They ensure the following: accountability of the Board of Directors, protection of the interests of the shareholders, prevention of oppression against the minority shareholders and improvement of internal controls.

Keywords: *Independent Directors, Companies Act 2013.*

I. INTRODUCTION

Section 149(6) of the Companies Act, 2013 provides the criteria regarding who can be an Independent Director of a Company. The statute identifies the independence of a person based on the positions held by him/her or his/her relatives in that particular Company or its Group Companies in the given capacities and pecuniary relationship or transaction of that person or his/her relatives with the Company or its Group Companies or their Promoters or Directors.

However, in India because of the diverse cultural backgrounds, there are different kinds of relationships between individuals apart from blood relations such as family friendships and relationships with extended families. Therefore, it is important to incorporate these kinds of associations as well in the definition of independence.

Though it is not possible to include every kind of social relation/situation in this definition, at least guiding principles can be set out. The Independent Directors are required under the statute to provide a declaration of their independence. While providing this declaration, the Independent Directors should not only consider their positions held, pecuniary relationships

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and blood relations, however, they should also consider other possibilities which can affect their independence. Hence, it is important that a holistic view of the definition of the word “independence” is taken to maintain the highest standards of independence and transparency.

II. APPOINTMENT OF INDEPENDENT DIRECTORS

To ensure that the Independent Directors are independent in the true sense of the word, it is important to evaluate the procedure for the appointment of the Independent Directors. It is crucial that this procedure should be free from any form of bias or favouritism on the part of the Promoter Group and the controlling shareholders.

In India, the Independent Directors are recommended by the Nomination and Remuneration Committee after the evaluation process [It will be pertinent to note that the Nomination and Remuneration Committee is constituted by the Board of Directors itself. And the majority shareholders influence the formation of the Board]. The recommendations of the Nomination and Remuneration Committee are then placed before the Board of Directors for their approval. After the Board accords its approval to the recommendations of the Nomination and Remuneration Committee, the proposal is then placed before the shareholders in the General Meeting for their consent.

Hence, it is clear that in the current process, the Board of Directors and the majority shareholders have significant influence in the appointment of the Independent Directors. In India, where mostly the business houses are family businesses, the positions in the Board and the majority stake in the Company are held by family members. Therefore, it is difficult to have a fair selection process of the Independent Directors.

Taking into consideration the above-mentioned concerns, on March 01, 2021, SEBI released a consultation paper on a review of regulatory provisions related to Independent Directors.² In this paper, with an object to protect the interests of the minority shareholders from the controlling powers of the promoter group, the SEBI proposed a dual approval process for the appointment of the Independent Directors. As per this process, the first approval would be accorded by the shareholders and the second one by the majority of the minority shareholders. The SEBI also specified that the minority shareholders shall exclude the promoters or the promoter group. This kind of model for the appointment of Independent Directors has been successful in jurisdictions such as Israel and the United Kingdom. This process would ensure

² Securities and Exchange Board of India (SEBI), *Consultation Paper on Review of Regulatory Provisions related to Independent Directors*, (March 01, 2021), available at https://www.sebi.gov.in/reports-and-statistics/reports/mar-2021/consultation-paper-on-review-of-regulatory-provisions-related-to-independent-directors_49336.html (last visited on 13/11/2021).

that the Promoters or Promoter Group would not act against the interests of the minority shareholders, in instances where the minority shareholders are not aligned with their wishes with respect to the appointment of the Independent Directors.

However, on June 29, 2021, SEBI in its Board meeting³ approved the agenda regarding the proposals made after considering the public opinion on the consultation paper. The initial proposal regarding the dual approval process for the appointment of the Independent Directors was discarded. And the only change with respect to the appointment of the Independent Directors is that the shareholder's approval will now be taken by special resolution instead of ordinary resolution. Also, in the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2021, the aforementioned changes have been carried out.

This decision of SEBI of discarding the proposed dual approval process has been vehemently criticized by all stakeholders. It has been reported that the reason for the withdrawal of such a note-worthy proposal by SEBI has been the resistance of the Promoter Groups⁴ because they would lose their dominance and controlling powers over this process. Hence, despite the laudable efforts by SEBI, there have been no significant changes in the provisions relating to the appointment of the Independent Directors.

To ensure that the appointment process of the Independent Directors is not influenced by the Promoter group or the majority shareholders, either of the following two steps needs to be taken. Firstly, the minority shareholders should be involved in a more significant way. The proposal of the dual approval process should be reconsidered. This process has two important advantages: the Independent Directors will not be accountable only to the majority shareholders but to the minority shareholders as well and the Board will view the opinion of the minority shareholders as relevant and important. If this process is not brought into effect, then the appointment of the Independent Directors made through the present procedure (recommendation by Nomination and Remuneration Committee, approval of the said recommendation by the Board of Directors and approval by the shareholders by special resolution) should at least be approved by an independent body constituted at the National level. These are the ways that can ensure the independence of the Independent Directors. Also,

³ Securities and Exchange Board of India (SEBI), *Agenda of the Board Meeting- Review of regulatory provisions related to Independent Directors*, held on June 29th, 2021, available at <https://www.sebi.gov.in/sebiweb/about/AboutAction.do?doBoardMeeting=yes> (last visited on 13/11/2021); Securities and Exchange Board of India (SEBI), *Decision of the Board Meeting*, held on June 29th, 2021, available at https://www.sebi.gov.in/sebi_data/meetingfiles/sep-2021/1631694866923_2.pdf (last visited on 13/11/2021).

⁴ Umakanth Varottil, *SEBI's backtrack on Independent Directors*, THE INDIAN EXPRESS (E-paper) July 14, 2021, available at <https://indianexpress.com/article/opinion/columns/tata-mistry-corporate-dispute-nusli-wadia-sebi-appointment-removal-of-independent-directors-7403380/> (last visited on 13/11/2021).

from the latest instance where the SEBI discarded its effective proposal of dual approval, it can be said that it is important that the Regulators should not give in to the pressures of the influential corporate houses and rather focus on working towards the attainment of good corporate governance in the system.

III. REMOVAL OF INDEPENDENT DIRECTORS

As per Schedule IV of the Companies Act, 2013, section 169 of the Companies Act, 2013 applies to the removal of the Independent Directors. As per this provision, the Independent Director can be removed by the Shareholders by passing an Ordinary Resolution. However, as per the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment), 2021 notified on 3rd August 2021, for the removal of the Independent Directors the shareholders will have to pass a Special Resolution. Though SEBI has carried out this Amendment with an objective to ensure a fairer process while removing an Independent Director, this change will not be sufficient to ensure a transparent and unbiased process.

There are many instances where the Independent Directors have been removed by the controlling shareholders just because the Independent Directors have fallen out of their good books or they have raised concerns regarding any activity or transaction in the Company which may prove to be detrimental to the interests of the shareholders. In a recent instance, during the legal battle between Tata Sons and Cyrus Mistry, Mr. Nusli Wadia, an Independent Director was removed from the Board of Directors. It has been reported that the main reason behind his removal was that he spoke in favour of the minority shareholders which did not go down well with the Promoters.⁵ It will also be pertinent to note that the Extra-Ordinary General Meeting for the removal of Mr. Wadia was requisitioned by Tata Sons, the promoters, who also voted for the Resolution. Also, 61% of retail shareholders and almost 50% of Institutional shareholders voted in favour of Mr. Wadia.⁶ However, the Resolution was passed for his removal because of the majority received from the controlling shareholders. Mr. Wadia, in his letter to the shareholders⁷, stated:

“Independent Directors are your custodians...If they can be removed at the whim and fancy of

⁵ Umakanth Varottil, *SEBI's backtrack on Independent Directors*, THE INDIAN EXPRESS (E-paper) July 14, 2021, available at <https://indianexpress.com/article/opinion/columns/tata-mistry-corporate-dispute-nusli-wadia-sebi-appointment-removal-of-independent-directors-7403380/> (last visited on 13/11/2021).

⁶ Ketan Thakkar, *Nusli Wadia terms his removal from Tata Motors as costly victory for Tatas*, THE ECONOMIC TIMES (E-paper) December 14, 2016, available at <https://economictimes.indiatimes.com/news/company/corporate-trends/nusli-wadia-terms-his-removal-from-tata-motors-as-phrrhic-victory-for-tatas/articleshow/56145905.cms?from=mdr> (last visited on 13/11/2021).

⁷ *Letter sent by Mr. Nusli. N. Wadia & addressed to Tata Shareholders* (December 20, 2016), available at <https://www.tatasteel.com/media/2882/letter-to-shareholders-20dec16.pdf> (last visited on 13/11/2021).

a promoter then their role will be reduced to that of 'yes men'....

I have chosen not to attend the meeting as I understand that recent meetings held of other Tata Companies have been inappropriately and shamefully stage managed by the requisitionist controlling the entry into the hall as also in the selection and choice of speakers as never before seen in Indian Corporate history....”

Therefore, it can be concluded from the above instance that the removal of the Independent Directors should not be controlled by the Promoter Group and the majority shareholders. As suggested above, either the dual approval process should be implemented or the decision of the removal of the Independent Directors should be approved by an Independent Party after ascertaining if there is a reasonable and sufficient cause to remove an Independent Director.

IV. COMMITMENT OF INDEPENDENT DIRECTORS

In today's era, because of the nature of business transactions and the huge responsibilities of an Independent Director towards the shareholders and the Organization in general, it is not sufficient for the Independent Directors to only have the required skills or expertise for holding the office of an Independent Director. For using their knowledge and proficiency to perform their duties, it is equally important that they have a sufficient amount of time to devote to the Organizations in which they are serving as Independent Directors.

As per Section 165 of the Companies Act, 2013, a person can hold directorships in twenty Companies at the same time. And the maximum number of public companies in which a person can hold directorships at the same time is ten. Also, as per Regulation 17A of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, a person can be an Independent Director in only seven listed entities at the same time. Hence, a person can hold a substantial number of directorships simultaneously. Also, most of the Independent Directors are usually engaged in some other vocation, activity or profession alongside performing their responsibilities as Independent Directors. And hence, it becomes difficult for them to provide a hundred percent commitment to their duties as Independent Directors in all the Organizations in which they are appointed. This may result in negligence on account of them while performing important tasks as Independent Directors.

A solution to this issue is providing momentum to the concept of “Professional Independent Directors”. These Directors work only as Independent Directors on different Boards and do not engage in any other “day-job”. A Professional Independent Director can direct his/her entire focus on the responsibilities of Independent Directors. Also, as they can devote more time, there is an increase in interaction between the Board and the stakeholders which results in better

communication. Presently, the Independent Directors are available only before any mandatory meeting to read the Reports and documents and then to attend such meetings. However, these Professional Independent Directors are available not only for a few days in a year, but they are dedicatedly present at all times. They would not work only for completing the formalities of their appointment but to ensure positive contribution on their part for attaining good Corporate Governance in the Organizations in which they serve as Independent Directors. Therefore, this concept should be implemented in our legal framework for strengthening the role of the Independent Directors.

V. OTHER IMPORTANT ASPECTS

1. Involvement of independent directors in day-to-day operations:

The Independent Directors are not usually actively involved in the day-to-day operations of the Company. Instead of only attending meetings and reviewing transactions of the business, the Independent Directors should also be involved in the day-to-day activities of the business. Only then they would understand the nuances of the operations and the dealings taking place.

Therefore, the statutes must be suitably amended so that the Independent Directors are given the authority to closely monitor the day-to-day operations of a business.

2. Tenure, remuneration, performance evaluation and re-appointment of independent directors:

As the tenure, remuneration, performance evaluation and the re-appointment of the Independent directors is at the mercy of the Board of Directors and the majority shareholders (which can be dominated by the Promoter Group), the Independent Directors cannot be expected to be completely independent as they would want to remain aligned to the views of the Promoters.

Therefore, the process relating to the approval of tenure, remuneration, performance evaluation and re-appointment of Independent Directors should be free from the influence of the Promoters and the controlling shareholders. This can be achieved by the dual approval process as stipulated above or by the appointment of an independent agency.

3. Minimum educational qualifications for independent directors:

As per the Companies Act, 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2013, the Independent Directors should possess relevant expertise and experience. However, no minimum educational qualifications are prescribed for a person to be appointed as an Independent Director.

The mantle on the shoulders of the Independent Directors is huge. Along-with experience and skills, possession of good educational qualifications should also be a must for an Independent Director. The statutes should provide minimum educational qualifications for the Independent Directors to ensure that competent persons are handling the responsibility of ensuring good Corporate Governance.

4. Woman Independent Directors:

In India, the segment of Independent Directors is highly male-dominated. As per Section 149 of the Companies Act, 2013, the prescribed class and classes of Companies should have at least one woman Director and as per Regulation 17 of the SEBI (Listing Obligations and Disclosure Requirements), 2015, the Board of Directors of top one thousand listed entities should have at least one independent woman director.

The above-mentioned provisions in law seem to be insufficient and there should be an encouragement for the appointment of an equal number of Independent Woman Directors (like that of men) on the Board of Directors. Only then the Board can be called diverse in its true sense.

5. Age of independent directors:

As per Regulation 17 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, the maximum age stipulated for the Non-Executive Directors of the Listed Companies is seventy-five years. The Companies Act, 2013 does not stipulate any maximum age for the Independent Directors. In India, it is generally seen that the average age of the Independent Directors is on a higher side.

The legal framework should encourage a lesser average age for the Independent Directors to maintain a balance between young Directors with new ideas and the seasoned Directors with vast experience.

VI. CONCLUSION

Therefore, from the above contentions, it is clear that though the new provisions have been notified by the Regulators regarding the Independent Directors, a more critical evaluation of the present legal framework is required. As the Independent Directors are the pillars of good Corporate Governance in any Organization, it is crucial that their role is effective and progressive.
