



INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS

Open Access, Refereed Journal Multi Disciplinary
Peer Reviewed Edition :

www.ijlra.com

DISCLAIMER

No part of this publication may be reproduced or copied in any form by any means without prior written permission of Managing Editor of IJLRA. The views expressed in this publication are purely personal opinions of the authors and do not reflect the views of the Editorial Team of IJLRA.

Though every effort has been made to ensure that the information in Volume 2 Issue 7 is accurate and appropriately cited/referenced, neither the Editorial Board nor IJLRA shall be held liable or responsible in any manner whatsoever for any consequences for any action taken by anyone on the basis of information in the Journal.

Copyright © International Journal for Legal Research & Analysis

IJLRA

EDITORIAL TEAM

EDITORS



Megha Middha

Megha Middha, Assistant Professor of Law in Mody University of Science and Technology, Lakshmanagarh, Sikar

Megha Middha, is working as an Assistant Professor of Law in Mody University of Science and Technology, Lakshmanagarh, Sikar (Rajasthan). She has an experience in the teaching of almost 3 years. She has completed her graduation in BBA LL.B (H) from Amity University, Rajasthan (Gold Medalist) and did her post-graduation (LL.M in Business Laws) from NLSIU, Bengaluru. Currently, she is enrolled in a Ph.D. course in the Department of Law at Mohanlal Sukhadia University, Udaipur (Rajasthan). She wishes to excel in academics and research and contribute as much as she can to society. Through her interactions with the students, she tries to inculcate a sense of deep thinking power in her students and enlighten and guide them to the fact how they can bring a change to the society

Dr. Samrat Datta

Dr. Samrat Datta Seedling School of Law and Governance, Jaipur National University, Jaipur. Dr. Samrat Datta is currently associated with Seedling School of Law and Governance, Jaipur National University, Jaipur. Dr. Datta has completed his graduation i.e., B.A.LL.B. from Law College Dehradun, Hemvati Nandan Bahuguna Garhwal University, Srinagar, Uttarakhand. He is an alumnus of KIIT University, Bhubaneswar where he pursued his post-graduation (LL.M.) in Criminal Law and subsequently completed his Ph.D. in Police Law and Information Technology from the Pacific Academy of Higher Education and Research University, Udaipur in 2020. His area of interest and research is Criminal and Police Law. Dr. Datta has a teaching experience of 7 years in various law schools across North India and has held administrative positions like Academic Coordinator, Centre Superintendent for Examinations, Deputy Controller of Examinations, Member of the Proctorial Board



Dr. Namita Jain



Head & Associate Professor

School of Law, JECRC University, Jaipur Ph.D. (Commercial Law) LL.M., UGC -NET Post Graduation Diploma in Taxation law and Practice, Bachelor of Commerce.

Teaching Experience: 12 years, AWARDS AND RECOGNITION of Dr. Namita Jain are - ICF Global Excellence Award 2020 in the category of educationalist by I Can Foundation, India. India Women Empowerment Award in the category of "Emerging Excellence in Academics by Prime Time & Utkrisht Bharat Foundation, New Delhi.(2020). Conferred in FL Book of Top 21 Record Holders in the category of education by Fashion Lifestyle Magazine, New Delhi. (2020). Certificate of Appreciation for organizing and managing the Professional Development Training Program on IPR in Collaboration with Trade Innovations Services, Jaipur on March 14th, 2019

Mrs.S.Kalpana

Assistant professor of Law

Mrs.S.Kalpana, presently Assistant professor of Law, VelTech Rangarajan Dr. Sagunthala R & D Institute of Science and Technology, Avadi. Formerly Assistant professor of Law, Vels University in the year 2019 to 2020, Worked as Guest Faculty, Chennai Dr. Ambedkar Law College, Pudupakkam. Published one book. Published 8 Articles in various reputed Law Journals. Conducted 1 Moot court competition and participated in nearly 80 National and International seminars and webinars conducted on various subjects of Law. Did ML in Criminal Law and Criminal Justice Administration. 10 paper presentations in various National and International seminars. Attended more than 10 FDP programs. Ph.D. in Law pursuing.



Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC - NET examination and has been awarded ICSSR - Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

ABOUT US

INTERNATIONAL JOURNAL FOR LEGAL RESEARCH & ANALYSIS
ISSN

2582-6433 is an Online Journal is Monthly, Peer Review, Academic Journal, Published online, that seeks to provide an interactive platform for the publication of Short Articles, Long Articles, Book Review, Case Comments, Research Papers, Essay in the field of Law & Multidisciplinary issue. Our aim is to upgrade the level of interaction and discourse about contemporary issues of law. We are eager to become a highly cited academic publication, through quality contributions from students, academics, professionals from the industry, the bar and the bench. INTERNATIONAL JOURNAL FOR LEGAL RESEARCH & ANALYSIS ISSN 2582-6433 welcomes contributions from all legal branches, as long as the work is original, unpublished and is in consonance with the submission guidelines.

The Concept of Independent Directors: An Analysis

AUTHORED BY: SAURABH MISHRA

Institution: Chanakya National Law University, Patna

Abstract

This research paper titled 'The Concept of Independent Directors: An Analysis' discusses the importance and relevance of independent directors in a company. The paper briefly explores the origin of this concept in India and how it further developed with the maturity of the Indian market. An enterprise cannot achieve appropriate corporate governance without independent directors on its board. The paper aims to discuss the role of independent directors in achieving the desired level of corporate governance and how they can play an important role in the timely prevention of corporate mismanagement.

Introduction

Independent directors' roles and responsibilities are becoming more popular as they are being held more accountable for fraud and poor management in listed businesses. When corporate fraud is discovered, their obligations take on greater importance. The Indian corporate system has been plagued by numerous corporate scams, ranging from the ten years ago Satyam scandal, which is now worldwide infamous, to the most current Nirav Modi scam. After the independent directors of one of the biggest corporate frauds, the "ABG Shipyard Company", came under scrutiny, the idea became a hot topic of discussion. Recent scams have demonstrated how crucial an independent director's role can be in preventing corporate fraud.

From the perspective of strong corporate governance, an independent director involves a company's commitment to operate its companies in a lawful, ethical, and transparent manner. Presence of independent director on board can give a sense of extra security to shareholders and other investors.

A Brief Account on The Rise of The Independent Director in India

Independent directors and the definition of independence:

"The Committee on Corporate Governance has recommended that the board of a company have an optimum combination of executive and non-executive directors, with not less than fifty

percent of the board comprising the non-executive directors. The committee believes that the definition of independence should be broad and flexible, focusing on material pecuniary relationships that affect a director's independence. The committee also emphasizes the importance of independent directors in bringing an independent judgement to bear on board deliberations, particularly on issues of strategy, performance, conflict management, and standards of conduct.

Good corporate governance requires a board composed of individuals with certain personal characteristics and core competencies, such as recognition of the board's tasks, integrity, accountability, track record of achievements, and ability to ask tough questions. The committee also emphasizes the importance of adequate compensation packages for non-executive independent directors to attract talent and ensure they are adequately compensated for their work.

The Committee recommends that the board should have an optimum mix of executive and non-executive directors, with at least one-third of the board comprising independent directors and at least half of the board being independent. This is a mandatory recommendation for companies with non-executive and executive chairman positions.”¹

Clause 49 of the Listing Agreement is a set of regulations issued by the Securities and Exchange Board of India (SEBI):

Many of the above said recommendations were then incorporated in the Revised Clause 49 that is seen as an important statutory requirement. Further, Following the passage of the 2013 Companies Act, SEBI updated Clause 49 in 2013 to conform to the new Act.

It regulates the corporate governance procedures for Indian listed companies. Since its initial introduction in 2000, the clause has undergone a number of revisions.

All publicly traded companies must have at least one-third of their board members who are independent directors. Independent directors must also be free of any material conflicts of interest, possess the knowledge, skills, and experience necessary to contribute effectively in the boardroom, be able to challenge management and voice their concerns to the board, and be paid fairly for their work.

The Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, as

¹REPORT OF THE KUMAR MANGALAM BIRLA COMMITTEE ON CORPORATE GOVERNANCE, *Report of the Committee Appointed by the SEBI on Corporate Governance* (1999).

issued by the Securities and Exchange Board of India (SEBI) and companies Act 2013

Section 149(6) of the Companies Act of 2013 (the "Act") and Regulation 16 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations of 2015 (the "LODR") both define independent directors. While section 149 of the Act's requirements must be followed by unlisted firms, listed companies and those planning to list must also abide by the LODR. The LODR defines an independent director as a person who is not associated with the company, either as a promoter or director of the company, its group companies, who does not have a material financial relationship with the company or its group, as well as a person who has not held a recent position where he might have been associated with the company in a way that would have given him the ability to influence decisions.

Independent Directors' Role in Corporate Governance

There is no question that good corporate governance benefits a company's reputation, staff, and clients. However, you also cannot view corporate governance in a business-neutral manner. On the one hand, you cannot have effective corporate governance while engaging in dishonest business practices. How you integrate your beliefs and ideals into every facet of conducting business is what corporate governance is all about.

The appropriateness and effectiveness of corporate governance influence the development and future of any capital market and economy, which is almost a given. Studies of businesses in India and overseas have demonstrated that markets and investors pay attention to, respond favorably to, and reward well-managed businesses with greater valuations. A country having strong and transparent corporate governance laws are generally ranked high in the "ease of doing business index". A transparent corporate governance is not only beneficial for the business of the corporation but also have many other advantages such as benefit of the investors, foreign investment and also a improves the global reputation. These businesses have the trait of having processes in place that give boards and management the latitude they need to innovate and move their businesses forward while yet operating within a framework of effective accountability. They have a system of sound corporate governance, to put it another way.

The importance of independent directors has been highlighted in reports from the Blue Riband Committee of the USA and other committees. However, the law does not distinguish between the various types of directors, and all directors are legally equally and jointly liable for the board's decisions and acts. It is believed that both independent and

non-independent non-executive directors contribute to the board's deliberations, particularly on matters of strategy, performance, conflict management, and standards of behavior. Therefore “Kumar Mangalam Birla Committee” accordingly placed a strong emphasis on the non-executive directors' qualifications, particularly those of the independent directors.

According to good corporate governance, the board must be made up of people who possess a specific set of personal qualities and core competencies, such as an understanding of the significance of the board's duties, integrity, a sense of responsibility, a history of achievements, and the capacity for challenging assumptions. The directors must have a high level of devotion to the business and set aside enough time for meetings, preparation, and attendance, in addition to possessing financial literacy, expertise, leadership skills, and the capacity for strategic thought. The “Kumar Mangalam Birla Committee” also suggested that it's critical to provide non-executive independent directors with an attractive package of pay, both to ensure that they are adequately compensated for their work and that these positions become financially attractive enough to draw talent.

Guidelines On Integrity and Transparency in Governance and Responsible Code of Conduct the CII Code 2020

The concerned person's standing, capacity to raise concerns and proposals in a constructive manner, and focus on attaining common success for the Board must all be taken into consideration when evaluating independence. The Board ought to be diverse, and gender diversity is a crucial part of the board's overall diversity. The method used to choose independent directors is crucial. They offer critical insight and sincere comments on how the organization is perceived by the outside world, which can substantially aid board strategy and function.

Relevant expertise is a key factor in choosing independent directors, but other factors, such as the organization's size and nature, as well as the candidate's qualifications, should also be taken into consideration. As an illustration, the Board of a start-up would have different expectations and requirements than a large, established company that leads the market, and independent directors should be chosen based on the needs of an organization, not on pre-set criteria (like a specific amount of experience). Particularly if they are members of the Audit Committee or Risk Management Committee, independent directors should have the necessary training and expertise.

An independent director must devote enough time to the organization's business and be well

aware of his or her rights and obligations in both those capacities. He or she should independently analyze the offered material and, if he or she disagrees with the management's or important shareholders' evaluation, question them (in the organization's interest). When a lead independent director is selected, the organization should make it easier for him to carry out his duties. Additionally, the organization should facilitate meetings between the lead independent director and other independent directors as well as between independent directors and higher-ranking staff members (at least that one level below management) and outside stakeholders.

“Recommendation 5:

- a. While constituting and reconstituting the Board, it will be ensured that one or two independent directors compulsorily have industry expertise in which the company operates, to be able to contribute positively in providing advice to the management on operational matters as well. In fact, for listed entities, it is a requirement to state not just the relevant expertise or experience while proposing to appoint an independent director, but also the skills/expertise/ competence required by the listed entity, and those available with its board members.
- b. As has been established, women directors add a different perspective to the Board. This has been established by many successful women directors who are making notable contribution to corporate Boards. Given their competence and expertise, all entities should strive to improve gender diversity at the board by inducting more women directors.
- c. Independent directors should be fully cognizant of their role and responsibilities; they should allocate sufficient time to the organization's Board and spend it productively; challenging management and significant owners; Board evaluation; management representations made to external stakeholders etc. As an independent fiduciary, independent directors should address their role and responsibilities with prudence and care.
- d. It may be considered (for other than listed entities for whom it is a requirement) to hold at least one meeting in a year, of only the independent directors (where there are more than one independent director(s)), where the independent directors may discuss such matters as they deem fit, including review of the quality, quantity, timeliness and sufficiency of information flow between the management and the board of directors.

- e. If a lead independent director has been appointed, the organization will facilitate the lead independent director in aiding interaction among other independent directors in context of the company's matters and communicating their collective view to the Chairman and management as appropriate.
- f. The organization shall also facilitate the interactions of independent directors with key external stakeholders like auditors, and employees that are one level below the management.
- g. The Chairman will speak to independent directors and gather their views outside the board room. This will ensure everyone gets to express their views frankly while helping the Board achieve its aim efficiently.”²

Legal framework related to independence of independent directors

Following the loss of a significant company like Satyam Computer Services, the Parliamentary Standing Committee on the Companies Act, 2009 noted that the position of independent directors took tremendous significance. The fact that the Companies Act of 2013 clarified the roles, responsibilities, and obligations of independent directors was one of its key characteristics. Prior to that, the position of independent directors was unclear because neither the Companies Act of 1956 nor the Securities and Exchange Board of India (SEBI) Listing Agreement gave any guidelines in this regard. The ability and moral character of the company's directors play a major role in how successful the business is. According to the Companies Act of 2013, the appointment of independent directors is carefully regulated.

The Companies Act of 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations of 2015:

“Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.”³

“In case of a listed company, where the Chairperson of the Board of Directors is a non-executive director, at least one-third of the Board of Directors shall comprise of

² CONFEDERATION OF INDIAN INDUSTRIES ('CII'), *Guidelines on Integrity and Transparency in Governance and Responsible Code of Conduct the CII Code 2020*.

³ The Companies Act, 2013, § 149(4).

independent directors and where the listed entity does not have a regular non- executive Chairperson, at least half of the Board of Directors shall comprise of independent directors.”⁴

“The listed public company's board of directors shall be composed as follows: (a)the board of directors shall have an optimal combination of executive and non-executive directors, with at least one-woman director and not less than half of the board of directors comprised of non-executive directors;

[Provided that the top 500 listed entities' boards of directors must have at least one independent woman director by April 1, 2019, and the top 1000 listed companies' boards of directors must have at least one independent woman director by April 1, 2020.”⁵

Qualifications and Appointment of Independent Director

Method of appointment:

The selection of independent directors shall be made independently of corporate management, and the Board shall ensure that the composition of the Board is appropriately balanced in terms of knowledge, skills, and experience to enable the Board to carry out its responsibilities and functions. The shareholders must approve the appointment of the company's independent director(s) at the annual meeting. A letter of appointment detailing the terms and additional requirements is required to establish the appointment of independent directors.

Tenure and the process of reappointment:

Independent directors in India are appointed for a maximum of 5 years and are eligible for reappointment for additional terms, per section 149(10) of the 2013 Companies Act. To re-appoint someone, a special resolution must be approved. Furthermore, the Nomination and Remuneration Committee (NRC) will make recommendations regarding whether or not Independent Directors should be reappointed based on an annual evaluation of their performance. No independent director may serve more than two terms in a row, despite what is indicated in sub-section (10), however such an independent director shall be eligible for appointment three years after ceasing to be an independent director.

Requisite Qualities:

⁴ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 17(1)(b).

⁵ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 17(1)(a).

In regard to a firm, an independent director is defined as a director who is not the managing director, a whole-time director, or a nominated director and who, in the Board's opinion, possesses the essential knowledge and experience. A person who possesses the additional qualifications that the Companies Act of 2013 may specify. An independent director must have the necessary education, training, and experience in one or more of the following areas: corporate governance, finance, law, management, sales, marketing, administration, research, and other sectors relevant to the company's activities.

Declaration on independence:

A statement on the declaration made by an independent director to be presented before a company in its general meeting before the board of directors that he complies with all the requirements of an independent director as set forth in Section 149(6) of the Companies Act, 2013, and the provisions of Regulation 16(1)(b) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015, and that he has the necessary qualifications and is not disqualified under any law for the time being in force.

Restricted professional and pecuniary relationship:

According to “Companies Act, 2013, S. 149(6)”, an independent director is a director who is not a managing director, whole-time director, or nominee director. They must be an integrity-conscious individual with relevant expertise and experience, not a promoter of the company or its holding, subsidiary, or associate company, not related to promoters or directors in the company, its holding, subsidiary, or associate company, and have no pecuniary relationship with the company, its holding, subsidiary, or associate company during the two preceding financial years or the current financial year.

Relatives of the director must not hold any security or interest in the company, be indebted to the company, have given a guarantee or provided security in connection with the indebtedness of any third person, or have any other pecuniary transaction or relationship with the company, its holding, subsidiary, or associate company amounting to two percent or more of its gross turnover or total income.

The director must not hold the position of a key managerial personnel or be an employee of the company or its holding, subsidiary, or associate company in any of the three financial years immediately preceding the financial year in which they are proposed to be appointed. They must also not be an employee of a firm of auditors, company secretaries, or a legal or consulting firm that has or had transactions with the company, its holding,

subsidiary, or associate company amounting to ten percent or more of its gross turnover. In addition, the director must not hold two percent or more of the total voting power of the company or be a Chief Executive or director of a nonprofit organization receiving twenty-five percent or more of its receipts from the company, its promoters, directors, or its holding, subsidiary, or associate company, and should possess other qualifications as may be prescribed.

Thus, we can see that the provisions of the Act have mandated the conditions not only for the individual proposed to become independent director but also to his relatives. By this way the Act has tried to make sure that the individual is in no way attached to the company and can take tough stand when required in the best interest of the company and the shareholders.

Restriction on Voting Powers:

The independent director should not share more than 2% of the voting power of the firm with his relatives, per Section 149(6)(e)(iii) of the Companies Act, 2013. Because of this, these requirements guarantee that the independent director is actually "independent" of the corporation and is free to carry out his or her duties impartially and without favor or bias.

Duties Of Independent Director

“Duties: The independent directors shall—

- (1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;
- (2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;
- (3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;
- (4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;
- (5) strive to attend the general meetings of the company;
- (6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;
- (7) keep themselves well informed about the company and the external environment in

which it operates;

(8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

(9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;

(10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

(11) report concerns about unethical behavior, actual or suspected fraud or violation of the company's code of conduct or ethics policy;

(12) acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees;

(13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.”⁶

Effectiveness Of the Institution of Independent Directors

Concerns regarding the independence of independent directors have been raised by corporate mismanagement and a lack of governance in Indian corporations. Due to problems like those with Jet Airways and Infrastructure Leasing and Financial Services' (IL&FS) failure to make payments, many independent directors have resigned from their seats. Why these directors failed to raise caution flags when they ought to have been the subject of an investigation by the Ministry of Corporate Affairs (MCA).

According to reports, the IL&FS Risk Management Committee, which includes independent directors, had not met in the preceding four years. Even while independent directors claimed they were unaware of internal concerns; the majority of people think that even outsiders were aware of them. The significance of independent directors in corporate governance is thus seriously questioned.

Despite some independent directors speaking out against suspected corporate governance shortcomings, the outcomes were terrible. For instance, questions concerning the efficiency of the institution of independent directors were highlighted by Nusli Wadia's involvement in the

⁶ The Companies Act, 2013, Schedule IV, Item 3

Tata-Mistry dispute. The removal of an independent director because his opinions differed from those of the majority shareholder raises questions about the functioning of the institution, even if the National Company Law Tribunal dismissed Cyrus Mistry's claims of oppression and mismanagement.

The government and regulatory bodies like SEBI need to come up with ways to make sure independent directors are motivated and encouraged to work while also giving them the necessary authority and protection to do their jobs.

Although Cyrus Mistry's claims of oppression and poor management were rejected by the National Company Law Tribunal (NCLT), the removal of an independent director because his opinions differ from those of the majority shareholder raises serious questions about the efficacy of the institution of independent directors.⁷

However, it is not very simple to answer whether the institution of independent director has been effective or not in improving corporate governance. The recent amendments in SEBI LODR which made it mandatory for listed entities to have a proper vigil mechanism and whistleblower policy will surely enhance the independence of the independent directors. Moreover, the protection given by SEBI in reappointment of the independent director by amending the existing provision of the LODR regulations clearly shows that the institution of independent director is effective in improving corporate governance.

Conclusion And Suggestions

In India, the idea of an independent director has changed over time to reflect the shifting demands and expectations of the many stakeholders, particularly the shareholders who depend on them to uphold sound corporate responsibility and governance. Finding qualified candidates, maintaining their independence and effectiveness, and balancing their rights and obligations are just some of the difficulties and restrictions the idea faces. In order to make the independent director concept in India more applicable and advantageous for businesses and society, it needs to be constantly reviewed and improved. It is not always stringent conditions that improve things, sometimes a good incentive may also work.

From the very starting the approach has been to fix the pecuniary interest of the independent director so that they will take decisions without getting influenced. But if we

⁷ Bhumesh Verma, *Independent Directors: Role, Responsibilities, Effectiveness*, (2019) PL (CL) July 75.

look at the other side of the coin, then we can also question that why will a well qualified person give his 100 % effort for a fixed remuneration? There has to be something more than it so that the IDs may give their 100 % to the corporation and improve the corporate governance.

