

INDEPENDENT DIRECTORS: GUARDING THE GUARDIANS

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ABSTRACT

Transparency and accountability are two pillars of Indian Corporate Governance structure. Independent directors are qui vive of shareholders' democracy in corporate governance. The abuse of corporate veil for the biggest corporate scams and crisis raises a question about the robustness of the system guarded by regulators like SEBI, RBI and Ministry of Corporate Affairs. The normative structure of corporate governance has been more or less confined to listed public companies. Private companies have been aloof to the idea of corporate governance. This leads to cultural issues when a private company graduates to become a public company and goes for listing. The listing agreement, especially clause 49 along with SEBI LODR Regulations provide for norms of good corporate governance. The Uday Kotak Committee in 2017 recommended for time-bound changes in many aspects of corporate governance. But due to the COVID-19 pandemic, there has been huge disruptions. The SEBI on March 01, 2021 floated a consultation paper wherein it proposed the idea of 'Dual Approval System'. The Dual Voting Structure has been adopted in United Kingdom. On June 29, 2021 SEBI proposed many changes based on the consultation paper in the present corporate governance norms for making the institution of independent directors more authoritative which shall be effective from January 1, 2022. In this paper, the author has attempted to examine the institution of independent directors and its evolution in Indian Corporate Regime and changes proposed by SEBI recently, especially the utility of dual approval system.

Keywords: Independent Directors, Corporate Governance, Dual Approval System.

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I. INTRODUCTION

Corporate Governance in India stands for accountability and transparency. Entrepreneurs in India have always used corporate personalities for ‘maximization of profits.’ Corporations have equally played a pivotal role in providing quality goods and services to people of India and realization of social, economic and political justice. The corporate entities have been means and ends of economic justice. After liberalization, privatization and globalization, the corporate entities got bigger due to investment of public capital. Regulators like RBI and SEBI fostered economic growth of Indian Companies by creating a conducive environment. The current market cap of Indian Capital market is 3.1 trillion US\$.¹ Reliance Industries and TATA became one of the top 100 companies in the world. It shows the robustness of Indian corporations.

However, the scams and crisis like Satyam, Sahara, PNB, IL&FS, PMC have also shown the dark side of corporate entities whereby the rogues robbed Indian people of their legitimate money and Indian corporate structure limped under the mammoth NPA which amounted to Rs. 7,17,850 crores in 2019-20.² Writing off NPA of big PSBs like Punjab National Bank attracted criticism from people. This vicious cycle of scam

¹ *Live Stock Market*, BOMBAY STOCK EXCHANGE, <https://www.bseindia.com/> (last visited Oct. 23, 2021).

² RES. BANK IND., GOV^T OF IND., REPORT ON TREND AND PROGRESS OF BANKING IN INDIA (2019-20), https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/0RTP2020_F3D078985540A4179B62B7734C7B445C9.PDF.

infested corporate regime of India is a blot on the face of shining India. The incessant strive for the betterment of normative structure of corporate governance has been very fruitful but it has made entrepreneurship a hydra-headed task in the process. Industrial growth, start-ups, entrepreneurship has been hampered due to stringent norms mandated by SEBI, RBI and Ministry of Corporate Affairs (*hereinafter* referred to as “**MCA**”). Transparency & accountability are two important norms which are secured by many instruments like independent directors, periodic disclosures, compliances and vetting to regulators, prohibition of insider trading, fraudulent & unfair trading, abuse of trust, promoter’s shareholding, related party transactions, whistle-blower’s protection.

Corporate Governance in India was introduced with clause 49 of Listing Agreement which was confined to listing public companies attempting to infuse capital through Initial Public Offer (*hereinafter* referred to as “**IPO**”) or debentures. Public shareholding commands transparency in dealing as the corporate entities after raising capitals have often been found deviating from their goal and focus resulting in loss of money of honest and innocent investors. After emergence, SEBI, with the tagline ‘Har Investor Ki Taqat’, took the central position as a regulator of investor, intermediaries and issuer. It issued various guidelines and regulations to manage & regulate IPO process like the SEBI Disclosure and Investor Protection Guidelines, 1992 (*hereinafter* referred to as “**DIP**”), SEBI Disclosure and Investor Protection Guidelines 2000, SEBI Issue of Capital and Disclosure Requirement Regulations, 2009 (*hereinafter* referred to as “**ICDR**”), SEBI Listing Obligation & Disclosure Requirement Regulations, 2015 (*hereinafter* referred to as “**LODR**”). Alongside regulations, The Securities Contracts (Regulation) Act, 1956 and Companies Act, 1956 were realigned and Depositories Act, 1996 was passed to create an environment for infusing capital in corporations via issuing shares. In 2013, the new sleek Companies Act was passed and Department of Company Affairs changed to Ministry of Corporate Affairs in 2004. Scams and crisis between 2009 and 2020 became very ugly when we saw thousands of crores of rupees being siphoned off.

Scamsters and fraudsters fleeing away resulted in legislative responses like Fugitive Economic Offenders Act, 2018.

Various commissions and committees were appointed for betterment of norms of corporate governance and they recommended on various aspects of corporate governance. In 1978, Sachar Committee submitted on various issues of corporate governance, in 1992, Cadbury Committee (United Kingdom) submitted a report on various aspects of corporate Governance, in 1998, Rahul Bajaj Committee under the aegis of CII submitted Desirable Code of Corporate Governance, in 1999, Kumar Mangalam Birla Committee submitted its report relating to various issues of corporate governance, in 2003, Naresh Chandra Committee Report and Narayan Murthy Committee Report submitted on many aspects of corporate governance, in 2005 J.J. Irani Committee responded on various issues of corporate governance, in 2017, Uday Kotak Committee on Corporate Governance submitted a very comprehensive report on various aspects of corporate governance. In United Kingdom, Corporate Governance Code, 2018 was enacted. On June 16, 2020, the High Level Committee in chairmanship of Justice (Retd.) Anil R. Dave³ submitted a report on 'The Measures for Strengthening Enforce Mechanism of The Board and Incidental Issues'.

The Ministry of Corporate Affairs in 2009 made National Corporate Governance Voluntary Guidelines which was given a rejig in 2011 and was replaced by National Voluntary Guidelines of Responsible Business Conduct, 2018. SFIO, NFRA and NCLT were created in new corporate regime for better regulation.

³ SEC. & EXCH. BD. IND., MEASURES FOR STRENGTHENING THE ENFORCING MECHANISM OF BOARD & INCIDENTAL ISSUES (2020-2021), https://www.sebi.gov.in/reports-and-statistics/reports/jun-2020/report-of-high-level-committee-under-the-chairmanship-of-justice-retd-anil-r-dave-on-the-measures-for-strengthening-the-enforcement-mechanism-of-the-board-and-incidental-issues_46863.html.

Corporate Governance stands for accountability and transparency of corporate entities. Many jurists and institutions have given many definitions of corporate governance and certain are worth mentioning as Milton Friedman has defined the Corporate Governance as, “Corporate Governance is to conduct the business in accordance with the owner’s or shareholder’s desires which generally will be to make as much money as possible while conforming the basic rules of the society embodied in law and local customs.”⁴ Palmer defines it as, “Corporate Governance rules are concerned with the manner in which a company conducts its internal business mainly focusing at this level on the inter-action of the various organs of the complex corporate entities which issue securities on such regulated markets and their debt and equity investors.”⁵ Shardul S. Shroff explains that, “The central feature of corporate governance is recognition of the fact that the shareholders are true owners of the company and hence while the board of directors/managers should have freedom to take operational decisions, they remain accountable at all times and are in fact trustees of shareholders.” OECD says that, “Corporate Governance involves a set of relationships between a company’s management and its board, its shareholders and other stakeholders. Corporate Governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined.”⁶ With these definitions one may conclude that corporate governance stands for shareholder’s democracy, business based on ethics, running corporations on trusteeship model instead of ownership model and above all transparency and accountability. The author in this article is making an attempt to identify the importance of Independent Directors in Corporate Governance, shortcomings and demerits of this institution and critical appraisal of current changes by SEBI to strengthen its position.

⁴ INDIAN INSTITUTE OF CORPORATE AFFAIRS, CORPORATE GOVERNANCE (1st ed. 2015).

⁵ PALMER’S COMPANY LAW 5155 (Prof. Geoffrey Moss ed., 2013).

⁶ ORG. FOR ECON. CO-OPERATION & DEV. [OECD], PRINCIPLES OF CORPORATE GOVERNANCE, G20/OECD (2015), <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>.

II. INDEPENDENT DIRECTORS

The institution of independent directors was introduced on the recommendation of the Kumar Mangalam Birla Committee into the Indian corporate regime to bring the values of dissent, democracy, diversity on board. The element of independence, fearlessness, impartiality, risk management, independent judgment, strategy making, regulation of key appointment and standards of conduct could be met only when outsiders are brought on board. The issues of greed, malfeasance, misfeasance, nonfeasance, embezzlement, gorging, guzzling and gulping of public money, social responsibility of corporations, conflict of interests, sidekicks in related party transactions, fudging of books and accounts, partiality, biases etc. could be addressed by the institution of independent directors. In Companies Act, 2013, under Section 149(6), a proper definition of independent director has been given which is ever-expanding over the years via many amendments. Searching ability, standing, integrity, loyalty, impartiality, fearlessness like qualities in a society facing dwindling and deterioration of values like never before was like searching a diamond in a coal mine. Madhuryya Arindam writes that IDs were introduced in 1950 in US⁷ and UK for different reasons. Indian corporate entities mostly are ‘Gharana Controlled’ and are not suited to it. As the families promoting companies appointed kith & kin as IDs having no expertise or experience to run companies but now in changed times the companies are appointing IDs for separation of management and control of companies which serves many purposes meant to better corporate governance by bringing dissent and expertise to board.⁸

Section 149 itself is a complete code for independent directors (*hereinafter* referred to as “IDs”). According to section 149(6) an independent director means a director who is not an executive director

⁷ Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1473 (2010).

⁸ Madhuryya Arindam, *The Independent Director: Has it been Indianized Enough?*, 6 NUJS L. REV. 231, 271 (2013).

and is a person of integrity having relevant expertise & experience, is not promoter or related to promoter in company or its subsidiaries or associate and who has or had pecuniary interest up to 10% in two immediately preceding financial years or current FY. His relatives are not holding more than 2% shares in company or its subsidiaries in last two FYs or current FY. He is not borrower of company or its subsidiaries or surety of a third person to company. He has a pecuniary interest up to 2% of income or gross turnover of company or its subsidiary. He is not or has been KMP or employee of company or its subsidiary. He has not been member of auditing firm or legal firm which transacted with the company up to 10% of turnover of company. He alone or along with his relative holds 2% of voting power in the company. He is a CEO of a non-profit organization which receives 25% of total receipt from company.⁹

Such an elaborate and complicated definition which has been amended in 2018 is itself a proof of the complications involved in the institution of independent director. In the USA, the New York Stock Exchange Listed Company Manual lays down a comprehensive definition of who can be an independent director.¹⁰ In short, he must be a person of integrity having no pecuniary, official biases and his relatives must not have the same. The word 'relative' has been given wide meaning in section 2(77) of Companies Act, 2013.

III. UDAY KOTAK COMMITTEE REPORT

In 2017, the Uday Kotak Committee on Corporate Governance made several time bound (to be incorporated between 2018 and 2022) recommendations many of which have been duly incorporated via amendments in SEBI LODR Regulations 2015.¹¹ Many recommendations missed the deadline due to COVID-19. Many exemptions were given to

⁹ Companies Act, No. 18 of 2013, §149 (Ind.).

¹⁰ *Listed Company Manual*, NEW YORK STOCK EXCHANGE, <https://nyseguide.srorules.com/listed-company-manual> (last visited Oct. 23, 2021).

¹¹ Bhumesh Verma & Soumya Shekhar, *Strengthening Corporate Governance in India*, PRAC. L. 93 (2015).

many firms from compliance of clause 49.¹² Clause 49 and LODR Regulation provide for proper blending of executive and non-executive directors/independent directors. It provides for 4 meetings of board in a year with a maximum gap of 120 days. The board must have a code of conduct and it must maintain due diligence and proper compliance of regulators.

Uday Kotak Committee recommended for a minimum board size of 6 without differentiating between private and public company. The size must be logical, strategic and it must avoid celebrity ornamental people as director.¹³ Directors are like the captain of a ship and if there are more outsiders and diversity on board then interests of various stakeholders can be taken care of. In the USA around 2005, several CEOs were fired on account of lack lustre results and insider trading issues.¹⁴ Uday Kotak Committee recommended for one woman executive or independent director in top 500 listed entities from April 01, 2019 and one-woman independent director in top 1000 listed entities from April 01, 2019. Both the recommendations have been inserted in LODR Regulations.¹⁵

The Committee further recommended that director must attend at least half of the board's meeting and NED/IDs must be appointed after 75 years of age only after confirmation of shareholders which has been inserted in LODR Regulations.¹⁶

¹² Dhammika Dharmapala & Vikramaditya Khanna, *Corporate Governance Enforcement and Firm Value: Evidence from India*, 29 J. L. ECON. & ORG. 1056, 1082 (2013).

¹³ MINISTRY CORP. AFFAIRS, GOV'T OF IND., REPORT OF THE COMPANIES LAW COMMITTEE (2015-16), https://www.mca.gov.in/Ministry/pdf/Report_Companies_Law_Committee_01022016.pdf.

¹⁴ A.C. FERNANDO, CORPORATE GOVERNANCE: PRINCIPLES, POLICIES AND PRACTISES 204 (1st ed. 2016).

¹⁵ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

¹⁶ *Id.*

Committee recommended for five board's meeting in a year but this recommendation was not implemented. The committee recommended for meeting of NED/IDs once in a year for understanding corporate business, corporate capacity and managerial capacity. Committee recommended that listed entities, having 40% public shares w.e.f. April 01, 2020, shall appoint NED/ID as chairperson of the board. All listed entities w.e.f. April 01, 2022 shall appoint NED/ID as chairperson of the board. The committee recommended for cap for listed entities directorship to eight including seven as IDs and if he is Whole Time Director or Managing Director then he can serve three listed entities as IDs. The committee recommended that director's report must be submitted as part of corporate governance report.

The committee also recommended that w.e.f. April 01, 2019 in top 500 listed entities depending upon market capitalization and w.e.f. April 01, 2020 all listed entities shall appoint NED/IDs at least half of size of the board. The IDs must not be a member of promoter group. The performance and independence of IDs shall be evaluated by subjective and objective assessment by the board. IDs will disclose their conflict of interests on first meeting. The committee recommended for good remuneration to IDs to attract best people on the board and also for detailed reasons for resignation. All these recommendations have been inserted in LODR Regulations.¹⁷ Few companies like City Union Bank, Ramco Cements, Dr. Reddy Labs has more than 80% IDs on its board.¹⁸

Due to increasing risk, more and more IDs are resigning on account of pre-occupation and personal reasons. In the year 2017, 2018 and 2019 ,717, 767, 1393 IDs resigned respectively.¹⁹ We have witnessed such an

¹⁷ *Id.*

¹⁸ CFA INST., INDEPENDENT DIRECTORS IN ASIA PACIFIC REGULATIONS AND PRACTICE IN SELECTED MARKETS (2020), https://www.arx.cfa/-/media/regional/arx/post-pdf/2021/06/18/independent-directors-in-asia-pacific.ashx?sc_lang=en.

¹⁹ Ricca Bhattacharya, *Resignations by Independent Directors Double in 2019 as Risk Grow*, ECON. TIMES (Dec. 26, 2019)

exodus in 2009 post Satyam scandal when 620 IDs resigned.²⁰ In the light of the same, the Ministry of Corporate Affairs issued a circular no. 01/2020 dated March 02, 2020 on clarification on prosecutions against IDs for certain non-compliance and exempted the IDs from unnecessary civil and criminal prosecution.²¹

The committee recommended for D&O insurance for IDs in top 500 listed entities. The IDs must be formally inducted and trained once in every five years about nature of business industry, business model, their role & responsibilities in governance. We know that in capital market, once in five-year training is just a drop in ocean as the regulatory norms change very fast. The committee recommended for appointing lead ID. The vacancy of ID must be filled by a new ID in next board's meeting or within three months whichever is later subject to confirmation in next AGM.

Auditing fiasco puts corporations in bizarre situations. Auditing has been a matter of concern in corporate governance therefore, the Kotak committee recommended that the audit committee, which has a minimum three directors and 2/3 of which is IDs, must meet five times a year and nomination & remuneration committee (*hereinafter* referred to as “**NRC**”), stakeholder relationship committee (*hereinafter* referred to as “**SRC**”), risk management committee (*hereinafter* referred to as “**RMC**”) must meet once in a year. Frequent meeting of audit committee will focus the issues of audit. The chairman of NRC shall be ID. All these recommendations

<https://economictimes.indiatimes.com/news/company/corporate-trends/resignations-by-independent-directors-double-in-2019-as-risks-grow/articleshow/72972968.cms>

²⁰ Vikramaditya Khanna & Shaun J. Mathew, *The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidence*, 22 NLSIU REV. 35, 36 (2010).

²¹ MINISTRY CORP. AFFAIRS, GOV'T OF IND., CLARIFICATION ON PROSECUTIONS FILED OR INTERNAL ADJUDICATION PROCEEDINGS INITIATED AGAINST INDEPENDENT DIRECTORS, NON-PROMOTERS AND NON-KMP NON-EXECUTIVE DIRECTORS – REG., F. No. 16/1/2020- Legal (Mar. 02, 2020), https://www.mca.gov.in/Ministry/pdf/Circular_03032020.pdf.

mentioned above have been added in LODR regulations.²² The audit committee should review investment of 100 crores or 10 % of asset size in unlisted subsidiary including foreign company. In NRC 2/3rd members must be IDs. The NRC shall also recommend on remuneration of senior management. The SRC shall have three directors and one of them shall be ID. The quorum of NRC and SRC shall be two members or 1/3 whichever is greater and one of them shall be ID.²³ The committee recommended that Risk Management Committee in top 500 listed entities shall also address the issues of cyber security. It also recommended that companies may constitute Information Technology Committee to confirm digital and technology developments. The ID of listed entities shall be on board of subsidiaries including foreign company.

Insider trading and related party transaction have been the most pinching issues in capital market. Vishwanathan Committee in 2018²⁴ recommended that SEBI must be empowered for tapping phone calls to curb the menace of frauds, insider trading, surveillance and investigation etc.

The Kotak Committee on the issue of insider trading and related party transaction recommended that where promoters are not identified, then person holding 10% paid up equity shall be promoter. The promoter must disclose his shareholding pattern under SEBI PIT Regulations 2015. Any reclassification of shares of promoters on account of transfer or opt out shall be ratified by the board and shareholder where promoter and person acting in concert (*hereinafter* referred to as “**PAC**”) shall not vote.²⁵ The

²² Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

²³ *Id.*

²⁴ SEC. & EXCH. BD. IND., COMMITTEE ON FAIR MARKET CONDUCT (2017-18), <http://www.caparivaar.in/sebi-report-of-committee-on-fair-market-conduct-for-public-comments/sebi-report/>.

²⁵ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

disclosure requirement of related party transactions (*hereinafter* referred to as “RPT”) in case of promoters and PAC holding 10% paid up equity was recommended by Kotak committee.²⁶ In reference to RPT any party who belongs to promoter group holding 20% of paid-up equity has been included. Royalty payment has also been covered in RPT.²⁷ These recommendations have been implemented. The committee recommended for cap on remuneration on executive promoter director up to 5 crores or 2.5% of net profit whichever is higher for one and 5% of net profit for all such directors. If an ID/NED is paid 50% of designated remuneration for NED/IDs, then confirmation of shareholder is required. The RTP requires adoption of materiality policy which shall be reviewed once in three years. Annual Report of the companies must be published on website and sent to members in case of AGMs. Disclosure in XBRL or other searchable format in case of GDR, disclosure regarding key changes including debtors’ turnover, inventory turnover, interest coverage ratio, current ratio, debt equity ratio, operating profit margin, net profit margin, return or net worth compared to previous financial years, utilization of funds raised through preferential placement and QIP must be made. All these recommendations have been implemented.²⁸

The committee recommended for filing of details of director working as director of all companies and due certification by CS regarding his qualification must be submitted in corporate governance section in annual report. This must be also notified on the website. Listed public entities and its subsidiaries audited financial statement of relevant financial year must be uploaded on website 21 days before the AGM. The committee recommended that prior intimation to stock exchange of bonus share must be made due to being price sensitive information. The committee recommended disclosure requiring quantification of audit qualifications to

²⁶ Ami Galani & Nathan Rehn, *Related Party Transactions Empowering Boards and Minority Shareholders to Prevent Abuses*, 22 NLSIU REV. 29, 38 (2010).

²⁷ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

²⁸ *Id.*

be mandatory with exception of sub-judice matters. Group auditing standards in line of International Standard 600 was recommended. Many recommendations regarding financial results were made. Reasons of resignation by auditors must be given and fees paid to auditors must be disclosed in annual report.²⁹ The committee recommended on various issues of audit quality indicators, appointment of auditors, credentials of statutory auditors. The committee recommended for IND-AS accounting standards, revival of qualified audit report review committee. The committee recommended on power of SEBI regarding auditors based on PWC case. It also recommended for enhanced penal power of ICAI and separate cell to monitor disciplinary action against listed entities. Rajesh Chakrabarti argues that board quality depends on auditor quality.³⁰ The committee recommended for Quality Review Board (*hereinafter* referred to as “**QRB**”) as an independent oversight of auditors based on criteria of International Forum of Independent Audit Regulators. QRB must have financial resources and operational liberty to carry out responsibilities.

The committee recommended for live webcasting of meeting in top 100 listed entities by market capitalization and opening of e-voting till midnight of AGM. Committee recommended that w.e.f. April 1, 2021 no voting rights attached to treasury stock shall be exercised. The committee generally recommended for enhancing corporate governance in public sector enterprises like evaluation of government stake, avoidance of conflict of interests and autonomy. The committee recommended for leniency mechanism in whistle-blower system. The committee recommended for strengthening of SEBI for induction of people from private sector, formation of data science department, establishing a sub-unit for reviewing quality of audit (including forensic audit) to investigate. Most of these recommendations of the Uday Kotak Committee Report have been duly incorporated by 2019 amendment in LODR Regulations. Certain recommendations could not be relied due to Covid-19 pandemic disruptions.

²⁹ *Id.*

³⁰ Rajesh Chakrabarti, *Audit Quality and Board Independence*, 30 NLSIU REV. 51, 58 (2018).

IV. AFTERMATH OF KOTAK COMMITTEE

Searching IDs was one of the most difficult tasks at hand. In pursuance of duties casted under Section 150, the Central Government notified on October 22, 2019 the Companies (Creation and Maintenance of Databank of Independent Directors), 2019, known as Databank Rules for maintaining data of IDs and eligible person for IDs their name, DIN, gender, nationality, educational and professional qualifications, directorships and email address. The databank is being maintained by Indian Institute of Corporate Affairs (IICA).³¹ A person can enrol and after passing the test with 60% marks, the person can act as an ID. However, passing the course has found little support in people ready to act as an ID. By January 2020, 1000 persons registered as ID on this databank.³² This was a very welcoming step by IICA.

On March 01, 2021, SEBI floated a 'Consultation Paper on Review of Regulatory Provisions Related to Independent Directors'.³³ The consultation paper focused on eligibility of IDs, process of appointment/reappointment, removal of IDs, transparency in nomination and resignation of IDs, strengthening the composition of board committees.

The definition of ID in section 149(6) and Regulation 16 of LODR provides for many disqualifications and one of the same is that a person who has been KMP or employee or his relative has been KMP or employee in the company or its subsidiary/holding or associate including

³¹ *Independent Director's Databank*, IND. INST. CORPORATE AFF., <https://www.independentdirectorsdatabank.in/> (last visited Oct. 23, 2021).

³² Press Trust of India, *More than 1,000 Individuals Register with Independent Directors' Databank*, BUS. STANDARD (Jan. 7, 2020) https://www.business-standard.com/article/pti-stories/over-1-000-individuals-register-with-independent-directors-databank-120010600732_1.html

³³ SEC. & EXCH. BD. IND., CONSULTATION PAPER ON REVIEW OF REGULATORY PROVISIONS RELATED TO INDEPENDENT DIRECTORS (Mar. 1, 2021), https://www.sebi.gov.in/reports-and-statistics/reports/mar-2021/consultation-paper-on-review-of-regulatory-provisions-related-to-independent-directors_49336.html.

foreign company then different cooling off period for employment and material pecuniary relationship is provided which the consultation paper proposes to be made as uniform for three years. Relating to appointment or reappointment, in order to keep the appointment and re-appointment process uninfluenced by the promoters, SEBI in the consultation paper similar to Israel's model, proposed for appointment and re-appointment by minority shareholders.³⁴ SEBI like United Kingdom proposed that appointment and re-appointment of IDs shall be subject to 'Dual Approval'³⁵ taken through a single voting process and meeting following two thresholds; (i) approval of shareholders; (ii) approval by 'majority of minority' (simple majority) shareholders and here minority will exclude promoter and promoter group. The approval for appointment shall be through ordinary resolution and for re-appointment shall be special resolution. If dual approval is not met then appointment and re-appointment will fail and, in such a case, the listed entities may; (i) either propose a new candidate or (ii) or propose the same candidate as ID after a cooling off period of 90 days but within 120 days. Such approval will be through special reasons and notice of meeting shall include reasons for proposing the same person.

In appointment process still, the minority shareholders despite statutory provision to the contrary, don't have any substantive say. Regarding the removal of IDs, presently, he can be removed from his office by simple majority in first term and special majority in second term after giving him an opportunity of hearing and minority has no say in the process. The consultation paper of SEBI proposes that for removal of IDs also, the same dual approval mode for the first term through ordinary resolution and for the second term through special resolution can be adopted which will give a substantive say to minority shareholders in the whole process

³⁴ *Id.*

³⁵ See FIN. CONDUCT AUTH., The Listing Rules LR 9.2.2 in the FCA Handbook (2002); See also, FIN. REPORTING COUNCIL, THE U.K. CORPORATE GOVERNANCE CODE (July 2018), ¶ 17.

In the Tata case, certain IDs were prematurely removed which led to amendment in Section 169 of Companies Act, 2013³⁶ wherein now removal can be done only by special resolution. Regarding enhancing and bringing more transparency in the role of Nomination & Remuneration Committee (*hereinafter* referred to as “**NRC**”) certain proposals have been made. At present, the NRC is under an obligation to provide for the criteria of determination of qualifications, positive attributes and independence of a director, identify suitable persons for appointment and assess about extension or continuation of term on the basis of report of performance of IDs. This current system lacks transparency for choosing the right persons as IDs at NRC. SEBI proposes that for each appointment, NRC shall evaluate balance of skills, knowledge and experience on the board. In the light of this evaluation, a description shall be prepared of role and capabilities required for the particular appointment. The recommended person must have those capabilities. For identification of candidates, the NRC may use service of an external agency, consider candidate from diverse backgrounds, consider the time commitment of appointees. The notice of appointment of IDs at NRC shall include following disclosures; (i) skills and capabilities and how the candidate meets the same; (ii) channels used for searching the candidate. If he is recommended by a person, then the category of the person (*viz.* promoter, institutional shareholder, NED/ID, Executive Director etc.) shall be disclosed.

At present, appointment of IDs or filling up casual vacancy of IDs needs approval in next AGM which creates a huge time gap and that is not in the best interests of company especially for minority shareholder. Sometimes IDs appointment have been rejected despite the fact that they served on board for few months. The consultation paper of SEBI proposes that IDs shall be appointed on the board only with prior approval at AGM and in case of resignation, death, removal, failure to get

³⁶ Tata Consultancy Services Ltd. v. Cyrus Investment Private Ltd. & Ors., (2021) SCC OnLine 272 (Ind.).

reappointed the casual vacancy shall be filled by approval taken within a time period of three months.

Regarding resignation of IDs, now LODR requires detailed reasons of resignation from such IDs and it has been seen that IDs after resignation have joined the same company as executive director without giving any proper reason of this transition. The consultation paper of SEBI proposes that the entire resignation letter of IDs shall be disclosed along with complete details of his directorship of companies and membership in board committees. If ID resigns due to pre-occupation, other commitments or personal reasons then there shall be a mandatory cooling off period of 1 year before he can join another board. The ID shall observe a mandatory cooling off period of 1 year before he transitions as executive director after resigning as ID in the same company.

Regarding the composition of the Audit Committee, at present in LODR regulations, the Audit Committee (2/3rd of directors is IDs) does all important financial review like review of financial statements, scrutiny of inter-corporate loans & investments, valuation of undertaking and assets of listed entity etc. In related party transactions, approval of Audit Committee is mandatory. Committee of IDs should give their recommendation on open offers and scheme of arrangement. SEBI evaluating the current position of audit committee proposed in the consultation paper that Audit Committee shall comprise of 2/3rd IDs and 1/3rd NEDs who are not related to the promoter, including nominee directors³⁷. Amitava Banerjee writes that, “A Chartered Accountant must be independent in all aspects of his work. Persons like Bankers, prospective investors etc. who rely upon the accounts of the company must have faith in the independence and integrity of auditor. The auditor must be objective in his approach, fearless and capable of expressing an

³⁷ *Supra* note 33.

honest opinion based upon work undertaken by him and commensurate to his training and experience”.³⁸

Remuneration for IDs is an important issue. As per LODR regulations IDs are paid sitting fees (maximum Rs. 1 lakh)³⁹ & profit linked commission with an overall limit. IDs cannot be given stock options. Large or less payment has its own demerits. A debate has been mooted that profit linked commission must be removed and sitting fees must be increased which shall lead to IDs getting fixed fee without having any stake in long-term growth of company. On the other hand, performance linked commission may lead to short-termism and lead to conflicts and if it is supported by ESOPs to IDs with a long vesting period e.g., 5 years which is very popular these days in start-ups and technology company.⁴⁰ SEBI in its consultation paper has sought views of public about remunerating the IDs through ESOPs and maximum limit of remuneration through ESOPs. Harish Kumar, Partner, L&L Partners, has rightly expressed his concern regarding the revised remunerations limits fixed under Schedule V of the Companies Act, 2013, since they are understated considering the extensive scope of work and responsibilities of IDs.⁴¹

It may be concluded that the key sentiment that is echoed throughout the Paper is that by inculcating more transparency into the present system,

³⁸ Amitava Banerjee, *Are Auditors Watchdogs or Bloodbonds* in CORPORATE GOVERNANCE - EMERGING DIMENSIONS 200 (Dr. Ashish Kumar Srivastava & Dr. Vikesh Ram Tripathi eds., 1st ed. 2021).

³⁹ Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, Gazette of India, pt. II sec.3(i), Rule 4 (Mar. 31, 2014).

⁴⁰ N. Narayanan & M. Gogate, *'Skin in the Game': A Case for Incentivising Independent Directors*, 1 J. GOVERNANCE 695 (2012).

⁴¹ Ruchika Chitravanshi, *Profit or Loss, Independent Directors of Companies Must Get Paid: MCA, BUS. STANDARD* (Mar. 19, 2021) https://www.business-standard.com/article/economy-policy/mca-puts-limits-on-remuneration-of-non-executive-and-independent-directors-121031900599_1.html#:~:text=At%20the%20lowest%20slab%20of,board%20meetings%20in%20a%20year.

the voices and needs of minority shareholders will be more adequately heard and addressed.⁴²

SEBI on June 29, 2021 in its board meeting approved almost all proposal made in Consultation Paper of March 01, 2021 via amendments to Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations) pertaining to regulatory provisions related to Independent Directors (IDs). The amendments were; that appointment/Re-appointment and Removal of IDs shall be through a special resolution of shareholders for all listed entities. The process to be followed by Nomination and Remuneration Committee, while selecting candidates for appointment as IDs, has been elaborated and made more transparent including enhanced disclosures regarding the skills required for appointment as an ID and how the proposed candidate fits into that skillset. The composition of NRC has been modified to include 2/3rd IDs instead of existing requirement of majority of IDs. Shareholder approval for appointment of all directors including IDs shall be taken at the next general meeting, or within three months of the appointment on the Board, whichever is earlier. A cooling off period of three years has been introduced for Key Managerial Personnel (and their relatives) or employees of the promoter group companies, for appointment as an ID. Relatives of employees of the company, its holding, subsidiary or associate company have been permitted to become IDs, without the requirement of a cooling off period, in line with Companies Act, 2013. The entire resignation letter of an ID shall be disclosed along with a list of her/his present directorships and membership in board committees. A cooling-off period of one year has been introduced for an ID transitioning to a whole-time director in the same company/ holding/ subsidiary/ associate company or any company belonging to the promoter group.

⁴² Aarathi Das et al., *Independent Directors: SEBI Tightens the Framework*, NISHITH DESAI ASSOCIATES (Apr. 7, 2021) <https://www.nishithdesai.com/information/news-storage/news-details/article/independent-directors-sebi-tightens-framework.html>.

At least 2/3rd of the members of the audit committee shall be independent directors and all related party transactions shall be approved by only independent directors on the Audit Committee. The requirement of undertaking Directors and Officers insurance has been extended to the top 1000 companies (by market capitalization). These amendments shall be made applicable with effect from January 01, 2022. The Board also agreed to make a reference to the Ministry of Corporate Affairs, for giving greater flexibility to companies while deciding the remuneration for all directors (including IDs), which may include profit linked commissions, sitting fees, ESOPs, etc., within the overall prescribed limit specified under Companies Act, 2013.⁴³ SEBI did not approve dual approval structure for appointment, re-appointment, removal but it made it through special resolution.

UK and Israel adopted Dual Approval Structure in the light of corporate structure prevailing in the jurisdictions but Indian scepticism is relatable as corporate democracy watched by minority shareholders still is a distant dream. Minority's protection must not make corporations indecisive and stub. Special resolution will take care of minority interest for the time being.

Sushil Nathani, Managing Partner, Economic Laws Practice observed that, "The process as proposed however can create an atmosphere of potential conflict between the majority and minority shareholder." He further said that, "Given the recent experiences pertaining to management, remuneration and minority shareholder voting patterns, the construct of this methodology should permit the minority shareholder to have a voice but not make it adversarial process".⁴⁴ Anand Lakra, Partner

⁴³ Press Release, Security and Exchange Board of India, SEBI Board Meeting (June 29, 2021), http://www.sebi.gov.in/media/press-releases/jun-2021/sebi-board-meeting_50771.html.

⁴⁴ Reena Zachariah, *Independent Directors on SEBI Board Meet Agenda Next Week*, ECON. TIMES (June 24, 2021) <https://economictimes.indiatimes.com/markets/stocks/news/sebi-board-to-focus-on->

J. Sagar Associates on this issue observed that, “Increasing voting threshold for appointment of independent directors from 51% to 75%, public shareholders would play an important part in companies with low promoter stake”.⁴⁵

On Dual Voting Bombay Chamber of Commerce rejected the idea as it will hamper the search of good IDs and if appointment fails then searching a new replacement will become very difficult. It will also lead to benami holding to control minority shareholding.⁴⁶ Even removal by dual voting shall be counter-productive and lead to more complications. Lucian A. Bebchuk and Assaf Hamdani argue in their article that independence of IDs cannot be secured by people having controlling shares.⁴⁷ Majority has to honour and respect the value of dissent and minority however in corporate governance much depends upon ‘Rule of Majority’ again affirmed in TATA Case where minority has less to say.⁴⁸ Moreover, in all such moment of conflicts the best interests of company should be kept in mind.

V. CONCLUSION

Corporate Governance is an issue of culture and values. In India, Corporate Governance is based on a rule-based approach rather than a

independent-directors-next-week-discuss-appointment-and-removal-rules/articleshow/83797214.cms.

⁴⁵ *SEBI Tightens Norms on Independent Directors*, TIMES OF IND. (June 31, 2021) <https://timesofindia.indiatimes.com/business/india-business/sebi-tightens-norms-on-independent-directors/articleshow/83967458.cms>.

⁴⁶ BOMBAY CHAMBER COM. & INDUS., RESPONSE OF LEGAL AND GOVERNANCE COMMITTEE OF BOMBAY CHAMBER ON SEBI CONSULTATION PAPER ON INDEPENDENT DIRECTORS (2021), <http://bombaychamber.com/admin/uploaded/Reference%20Material/RESPONSE%20OF%20BOMBAY%20CHAMBERS%20ON%20SEBIS%20CONSULTATION%20PAPER%20ON%20INDEPENDENT%20DIRECTORS.pdf>.

⁴⁷ Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1315 (2017).

⁴⁸ *Tata Consultancy Services Ltd. v. Cyrus Investment Private Ltd. & Ors.*, (2021) SCC OnLine 272 (Ind.).

principle-based approach. The entrepreneurs see corporations as a *modus operandi* of maximization of profits and are often oriented for short-swing profits than long term gain. The good norms of corporate governance result in brand building, customer loyalty, good environmental & sustainable governance compliance, better goodwill. Entrepreneurs with their clean image built on corporate governance can create limitless opportunities and reach to cosmic heights. Independent director is the main arc pillar of structure upon which the corporate governance stands. However, since its introduction in Indian capital, its independence has been questionable. Many committees and regulators have always attempted to empower the institution of IDs. Recent changes by SEBI after Uday Kotak Committee are laudable. Most of the changes will boost the morale of IDs. however non-adoption of dual approval mode shows the lack of confidence in minority shareholders.

These changes are going to strengthen the position of IDs in capital market. We can train people to govern corporations but developing qualities of courage, conviction, honesty, loyalty, integrity etc. is not possible. Examination and training of IDs has its own limitation and it cannot develop virtues in human beings. Strong value-driven culture is also required where business is run on ethics. However certain issues about exodus of IDs on account of large-scale resignations are a cause of concern. SEBI and MCA have to create an environment which empowers the IDs to achieve the goal of transparency and accountability. Often IDs find it hard to maintain the role of conscious keeper of corporations. Pressure of peer and promoter force them to compromise with their independence which results in poor corporate governance. Honest and dedicated IDs are often made scapegoats in corporate scandals. Copious & mammoth compliances are forcing honest IDs to exit. Rule based system has its own inherent problems like extreme norms for some listed entities and almost no compliance for others and in case any scandal happens then extreme, coercive, corrective measures adopted by Government and Regulators make it difficult to comply to regulatory

norms for budding entrepreneurs which hampers innovation and entrepreneurship.