

Notes and Comments

SEBI'S CONSULTATIVE PAPER ON INDEPENDENT DIRECTORS: A REVIEW

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Abstract—One of the many obstacles encountered by a Board of Directors when making executive decisions is balancing the multitude of interests of the various stakeholders in the business. The institution of Independent Directors (IDs) plays an important role in this governance. According to the Companies Act of 2013, the institution of IDs offers perspective and lends technical business acumen and independent judgement on the Board's deliberations. They deal on various issues ranging from developmental strategy & risk mitigation to performance evaluation. They thus ensure the corporate governance principles of objectivity in the functioning of the board. Think of IDs as that vanguard of the company who holds a truth saber.

The concept of IDs was first introduced in 1998 CII Report and endorsed through the Kumar Mangalam Birla Committee Report in 1999¹. Under its mandatory recommendations the Committee recommended that "Audit committees should contain 3 independent directors with one having financial and accounting knowledge." IDs were described to have a key role in the entire mosaic of corporate governance. This role has ever been strengthened by SEBI over the years through various committee recommendations and has been

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¹ Report of the Committee appointed by the SEBI on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla, as published on October 1, 1999, Ref. No. PR 229/99.

backed under the Companies Act of 2013² and under the Code of Conduct of IDs.

This paper analyses the “Consultative Paper on the Review of Regulatory provisions related to Independent Directors” published by SEBI on 1st March 2021³. An attempt is made to comprehend the necessity to bolster the independence of the institution of IDs by ensuring that the process of selection, appointment and resignation is more transparent on a holistic level. This paper echoes the concept that by inculcating transparency into the present system, minority shareholders will get the voice they need to be more adequately heard and addressed. Although this may many tireless efforts to practically inculcate, but this overhaul would come as the much-needed relief package.

Keywords: SEBI, Independent Director, Corporate Democracy,

I. BACKGROUND OF SEBI'S PAPER

Securities and Exchange Board of India's (SEBI's) Consultation Paper on Review of Regulatory Provisions Related to Independent Directors (SEBI 2021) has been published on SEBI's website for public comments on March 1, 2021⁴. SEBI's paper (sometimes referred to as 'the paper') is an attempt to strengthen the mechanism of independent directors, which has been dwindling consistently. The grey areas surrounding the appointment, re-appointment, removal, resignation and remuneration have been in the limelight since more than two decades. The lax attitude of independent directors has failed to watch out for potential red flags in governance, leading to governance failures, scams, frauds and embezzlement. Further, boardroom politics have uncovered the vulnerabilities facing independent directors and their position in the company.

² Companies Act, 2013, §149(6).

³ Consultation Paper on Review of Regulatory Provisions related to Independent Directors, as published on March 1, 2021, Reports for Public Comments.

⁴ *Ibid.*

II. INDEPENDENT DIRECTORS: DUTIES, ROLES AND LIABILITIES

SEBI rightly identifies the three duties of the Independent Directors viz. enquiring into integrity of financial information, related party transactions and safeguarding interests of minority shareholders.⁵ Independent Directors are tasked with bringing in unbiased judgment on the boards' deliberations, thereby bringing in an impartial, neutral and expert perspective in the Company ruminations. Their opinion shall be substantially influential on matters of strategy, performance, risk assessment and management, resources, key appointments and standards of conduct, leading to an objective evaluation of the board's performance.

The concept of ID is dynamic and has evolved to serve as an ethical guard against incessant profit motives of entities and to contest corporate actions which are contrary to public interest.⁶ ID's having a key role in the integrity of financial statements and related party transactions, are also crucial for audit committees. The paper depicts the role of the audit committee of that being responsible for approving related party transactions; oversight of financial reporting process and, ensuring sanctity of financial information. The substantiality of the role of independent directors can be well comprehended by the fact that the formation of the audit committee comprising of majority of independent directors is to ensure that the statement of accounts of the company reflect the true and fair financial position of the company.

The paper recognizes the lacuna in the present system of appointment of the independent directors, stating the present system is devised to allow the promoters to influence the appointment of independent directors.

III. UNCALLED FOR RESIGNATIONS OF INDEPENDENT DIRECTORS

However, the paper dwindles in some constructions. It rightly points out that independent directors often excuse themselves from the boards, to join other boards or to rejoin the same company in the capacity of an executive director. It, nevertheless, forgets one of the main reasons for a person to either join as an ID or continue as an ID, which is 'liability'. Given the enhanced liability, IDs are wary of running the risks of corporate governance failures, leading to loss or damage to personal reputation.

⁵ Companies Act, 2013, §149(6)(a).

⁶ Kaushik Dutta, *Handbook for Independent Directors Upholding the Moral Compass*, Lexis Nexis (2nd edn. 2016).

Between 2017 and 2018, as many as 616 IDs have left various boards without citing any reason, whereas only 7 resigned to join other boards.⁷ 216 IDs have left citing ‘personal reasons’: whereas 205 cited pre – occupation. It can be observed that majority of the resignations failed to cite reasons, between 2017 – 18 (Upadhyay 2018). Highlighting upon the findings of Prime Database (2018) it is seen that 561 IDs have stepped down from Nifty – listed entities without citing any reason (Vijayraghavan & Philip 2019)⁸. The total number of exits by Independent Directors doubled in 2019, which stood at a tall figure of 1393. Thereafter, out of these 1393, we have seen the fall out of as many as 550 IDs citing pre – occupation (The Economic Times 2019)⁹. It can thus be evidenced that the slightest of red flags irk the IDs to quit.

Given this scenario, coupled with the fact that good faith requires that all the endeavours of the directors should be directed to the benefit of the company, the directors err in resigning boards for joining other companies. These actions of misleading resignations are more dishonest than negligent. Thus, deliberate *mala fide* actions need to be checked. The directors are expected to maintain a standard degree of skill and diligence, as they occupy a fiduciary duty with respect to the company. Misfeasance of a director constitutes a breach of trust.¹⁰ At times, the line between liability for breach of trust and breach of fiduciary duty may blur. The directors’ powers are limited to the provisions of memorandum and articles of association. Therefore, the articles may dictate the terms of employment of directors which may also restrict the directors from joining rival companies. This shall also not be construed to be in violation of agreements in restraint of trade provision in Section 27 of the Indian Contract Act 1872. Right to resignation, however, may not be absolute, but the tenure is certainly at the pleasure of the director. In *Fateh Chand Kad v. Hindsons (Patiala) Ltd.*¹¹ the court held that even when the articles do not spell out whether a director may resign or not, a director is entitled to relinquish his office at any time he pleased and that *his resignation was not dependent upon the acceptance by the company*. He may vacate the office as soon as he tenders the resignation, and that this position remains unchanged under the 2013 Act also.¹² Section 168 contemplates that resignation is independent of acceptance by board or company.

⁷ Rica Bhattacharya, “Resignations by Independent Directors Double in 2019 as Risks Grow”, *The Economic Times*, December 26, 2019.

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ K.D. Raju, “Company Directors Fiduciary Duties and Liabilities under the Indian Company Law”, Eastern Law House (2013)

¹¹ *Fateh Chand Kad v. Hindsons (Patiala) Ltd.*, 1956 SCC OnLine Pepsu 11 : (1957) 27 Comp Cas 340.

¹² L.V.V. Iyer, *Guide to Company Directors: Powers, Rights, Duties, Liabilities and Corporate Responsibilities*, Lexis Nexis (4th edn. 2016).

That said whether the need is now felt to mandate the IDs to provide a reason for resigning, or will it really hinder their right to personal liberty, is a moot point. SEBI's paper suggests that detailed reasons for resigning should be attributed while tendering of the resignation, which shall be put before the shareholders. One may argue that this may infringe the personal liberty of the director to work with any company he or she chooses to as well as the fact that he has such a right guaranteed under the Constitution of India, albeit with reasonable restrictions. There may be several reasons for leaving a company, which the paper has consciously left out, like conflict with the board, which the Independent Director may not wish to cite. Rather than demanding detailed reasons, the paper could have concentrated on the reasons for leaving, reasons which are more realistic. Often Independent Directors do not have enough mechanisms to represent their ideas and position effectively, and in such a situation, the ID will also be tormented to carry on work with a board, he or she doesn't believe in.

Greater or enhanced risks under the Companies Act, 2013 put together with the SEBI Regulations (Listing Obligations and Disclosure Requirements), 2015 has also been one of the greatest reasons for these dramatic exits. Begging a case for IDs who can now be made personally liable for acts of omission or commission by a company, with his/her knowledge or consent or connivance, or in cases he has not acted diligently appears to be a necessary evil.

Companies Act, 2013 allows a maximum of 15 directors. SEBI, further, caps the maximum number of independent directorships at seven. Although the paper proposes, a cooling off period of one year, there are plenty of directorships available and may also allow a person to accept another post before resigning on one. The proposal may only be useful in cases where an ID is planning to resign and join the same board as an Executive Director. It may well be suggested here that the right to resign may accrue only at a time when no other board has been joined in previous 6 months followed by a cooling off – period of one year as proposed by the paper. This will also negate the need for a detailed resignation.

In 2019, the Ministry of Corporate Affairs announced an Online Self – Assessment Proficiency Test for IDs to be held by the Indian Institute of Corporate Affairs (IICA) under the amended Companies (Appointment and Qualification of Directors) Rule, 2014.¹³ The rules, therefore, have become more stringent to avoid the entry of those who are nominated just by promoters or those who lack basic knowledge about the role they ought to play. The dual approval rule, however, furthers the entry of truly 'independent' directors. This, on one hand, does ensure the independence of directors, but also attracts

¹³ Aparna Sharma, "How to Crack the New Test for Independent Directors", Livemint, 12 March 2020.

less talent. Fewer individuals are now interested in joining boards as IDs, and the pool of talented IDs will also shrink.

IV. CONCLUSION

The attempt though noble, the paper leaves gaps for various righteous issues. It seems as though it is an attempt to theoretically stronghold the position of IDs but it fails to address many practical issues of the day. Statistically speaking, rights of IDs are far from realization and liability imposed can be easily exploited. Corporate democracy advocates for the voices of minorities and an intense re examination of these proposals are thus required. It is a welcome move by SEBI to recognize the presence of IDs and attempting to envision the nuances, however the proposals need to be categorized using data tools to avoid opening a pandora's box for litigation. With the proposed timeline of January 2022, SEBI through this paper is looking at formulation of new norms for qualifications and methods to check on resignations. The issues of accountability, liability and applicability of provisions however need definitions to ensure this attempt made by SEBI's paper is not being reduced to a mere window-dressing.