

I. INDEPENDENT DIRECTORS:

Independent Directors play a pivotal role in maintaining a transparent working environment in the corporate regime. The Companies Act, 1956 did not expressly provide for Independent Directors except Clause 49 of the listing agreement that is applicable on all listed companies which mandates the appointment of Independent Directors on the Board. Independent Directors constitute such category of Directors who are expected to have impartial and objective judgment for the proper functioning of the company. Section 149(4) of the Companies Act, 2013 provides for a special class of Directors called "Independent Directors".

Every listed public company to have at least one third of the total number of directors as Independent Directors.¹The additional requirement of complying with Clause 49 of the stock exchanges' Listing Agreement means at least half the directors of listed companies will have to be independent if the chairman is an executive director. A significant number of listed companies already comply with the listing agreement's requirements of appointing independent directors. The Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies. The following class or classes of companies shall have at least two directors as independent directors-

- The Public Companies having paid-up share capital of ten crore rupees or more; or
- The Public Companies having turnover of one hundred crore rupees or more; or
- The Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees.²

Where a company ceases to fulfill any of three conditions as above for three consecutive years, it shall not be required to comply with these provisions until such time as it meets any such conditions.

The paid-up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

Qualification for Appointment of Independent Director***Independence defined***

An independent director in relation to a company means a director other than a managing director or a whole-time director or a nominee director. He must:

- be a person of integrity, possess expertise and experience,
- not be a promoter of the company or the holding or associate company,

¹ Section 149(4)

² Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014

- not be related to the promoter or directors of the company, or the holding or subsidiary or associate company,
- neither has or had any pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;
- whose relatives not have any pecuniary relationship or transaction with the company or the holding or associate company or their promoters, or directors, amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year; and
- neither he nor any of his relatives -
 - a) hold or has held any key managerial position or is or has been 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 he is proposed to be appointed.
 - b) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—
 - i. a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or
 - ii. any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten percent or more of the gross turnover of such firm;
 - c) hold together with his relatives two per cent or more of the total voting power of the company; or
 - d) is a Chief Executive or director, by whatever name called, of any non-profit organization that receives twenty-five percent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two percent or more of the total voting power of the company; or who possesses such other qualifications as may be prescribed.³

An Independent Director shall possess appropriate balance of skills, experience and knowledge in the fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations and other disciplines related to company's business.⁴

Declaration to be given by the Independent Director

Every Independent Director to give a declaration that he meets the criteria of independence, at the first meeting of the board in which he participates as a director and thereafter at the first meeting of the board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director.⁵

³ Section 149(6)

⁴ Rule 5, Companies(Appointment and Qualification of Directors)Rules, 2014

⁵ Section 149(7)

Entitlements of Independent Directors

An Independent Director shall not be entitled to receive any remuneration other than a fee and reimbursement of expenses, for attending the meetings of the Board or any Committee thereof or for any other purpose as decided by the Board. Such fees cannot exceed the amount as may be prescribed under Section 197(5) of the 2013 Act. He shall also be entitled to receive profit related commission as may be approved by the members. However, he shall not be entitled to receive the benefit of stock option. It may be noted that under Section 197(1) of the 2013 Act, commission on net profits payable to all Non-executive directors (including Independent Directors) is limited to 1% of net profits of the company. If there is no managing or whole-time director, this commission can be paid upto 3% of net profit.⁶

Tenure of Independent Directors

An Independent Director

- can hold office for a term up to five consecutive years⁷
- can be appointed as such for a further term, not exceeding 5 years, if the members pass a special resolution and disclosure of such appointment is made in the Board Report
- cannot hold office for more than two consecutive terms
- would be eligible for appointment after three years of ceasing to be an Independent Director
- but cannot be associated with the company during this three year period in any capacity shall not be liable to retire by rotation as provided in section 152(6) and (7) of the 2013 Act.

Selection of Independent Director

Section 150 of the Companies Act, 2013 lays down that an Independent Director may be selected from a data bank of persons willing and eligible to be appointed as independent director maintained by any institution as notified by the Central Government, and such data bank shall be placed on the website of the Ministry of Corporate Affairs.⁸ The company has to carry out the necessary due diligence before selecting the director, requiring approval by the company in a general body meeting.

Manner of Appointment

Appointment process of independent directors shall be independent of the company management. While selecting independent directors the Board shall ensure that there is appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.

⁶ Section 149(9)

⁷ Section 152

⁸ Rule 6, Companies(Appointment and Qualification of Directors)Rules, 2014

- The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders.
- The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the 2013 Act and rules made there under and that the proposed director is independent of the management.
- The appointment of independent directors shall be formalized through a letter of appointment, which shall set out the terms and conditions of appointment.
- **Reappointment:** The re-appointment of independent director shall be on the basis of report of performance evaluation. After 10 years of continuously serving on the board, an individual needs to disassociate from the company for at least three years to become eligible for reappointment.⁹
- **Resignation or removal:** The resignation or removal of an Independent director shall be in the same manner as is provided in sections 168 and 169 of the 2013 Act. An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not more than one hundred and eighty days from the date of such resignation or removal, as the case may be.¹⁰

II. DISQUALIFICATION FOR APPOINTMENT OF INDEPENDENT DIRECTORS:

The provisions regarding disqualification for appointment of Independent Directors are contained in Section 149(6) of the 2013 Act, already discussed under 'Qualification for appointment of Independent Directors'. Moreover, Clause 49 of the Listing Agreement, which has been updated so as to bring it in alignment with the new Companies Act, also prescribes certain additional disqualifications. SEBI can stipulate tougher standards than what the new company law has provided for, but cannot soften the provisions in the law.

- While SEBI would disqualify independent directors if they had a material relationship with the company, promoters, directors, management, subsidiaries or with its statutory or internal auditors or legal consultants in the preceding three years, the company law goes a step further and insists that even their relatives should not have been in the employment of the parties concerned. The new company law, however, does not disqualify the concerned individual or his relative who has worked with a legal or a consulting firm that had a transaction with the company for up to 10% of the gross turnover of the company.
- SEBI norms disqualify independent directors if they are material suppliers to the company while the company law does not.
- As per SEBI norms, a prospective independent director cannot hold 2% of the voting rights in the company while the company law disqualifies one who holds 2% in the company together with his relatives.

⁹ Section 149(11)

¹⁰ Schedule IV read with Section 149(8), Companies Act 2013.

- Revised Clause 49 also prescribes that an independent director should not be less than 21 years of age.
- It also prescribes that a person cannot serve as an Independent Director in more than seven listed companies. Moreover, a whole-time director of one company not to serve as an Independent Director in more than three listed companies.

III. **ROLE AND DUTIES OF INDEPENDENT DIRECTORS:**

The Schedule IV of the 2013 Act specifies responsibilities for the Independent Directors and lays down the duties and functions which is required to be performed by them. The companies would need to have mechanisms which would help familiarize the Independent Directors with these responsibilities. This Schedule is a guide to professional conduct for independent directors. Adherence to the standards prescribed in the Schedule by independent directors and fulfillment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

Guidelines of professional conduct

An independent director shall:

- uphold ethical standards of integrity and probity,
- act objectively and constructively while exercising his duties;
- exercise his responsibilities in a bona fide manner in the interest of the company,
- devote sufficient time and attention to his professional obligations for informed and balanced decision making,
- not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgement of the Board in its decision making;
- not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;
- refrain from any action that would lead to loss of his independence;
- where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly; and
- assist the company in implementing the best corporate governance practices.

Role and Functions of Independent Director

The independent directors shall:

- help in bringing an independent judgment to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;
- bring an objective view in the evaluation of the performance of board and management;
- scrutinize the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;
- satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;
- safeguard the interest of all stakeholders, particularly the minority shareholders;
- balance the conflicting interest of the stakeholders;
- determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management; and
- moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

Duties of Independent Directors

Independent directors shall:

- undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;
- 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;
- strive to attend all meetings of the Board of Directors and the Board Committees of which he is a member;
- participate constructively and actively in the Committees of the Board in which they are chairpersons or members;
- strive to attend the general meetings of the company;
- 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;
- keep themselves well informed about the company and the external environment in which it operates;
- not to unfairly obstruct the functioning of an otherwise proper Board or Committee of the Board;
- 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;
- 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;
- report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;

- acting within his authority, assist in protecting the legitimate interests of the company, shareholders and its employees; and
- 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.

Liability of Independent Director

An Independent Director would be liable for such acts of omission or commission by a company which has occurred with his knowledge and attributable through board processes and with his consent and connivance or where he has not acted diligently.¹¹

The mandatory insertion of Independent Directors in specified classes of companies is highly anticipated to pave the way for transparent and accountable corporate governance. One of the core objectives of appointment of Independent Director is to safeguard the interests of the minority shareholders. Independent Director as a regulatory authority is vested with the sole responsibility to monitor the proper conduct and impartial judgment owing to the interests of the investors. Hence, inclusion of Independent Directors is expected to act as a strong instrument to check intended corporate scandals in the future.

¹¹ Section 149(12)