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Is there any Advantage or Annoyance for Independent Directors under Companies Act, 2013

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Abstract

The Companies Act, 2013 sets to refurbishment of the provisions relating to independent directors entirely by conferring greater power and responsibility in the governance of a company. The need for the Independent Director got awakened due to the need of a strong framework of corporate governance in the functioning of the company. The Act, 2013 makes the role of Independent Director's very different from that of executive directors. The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders. The Code is a guide to professional conduct for independent directors. As per new act some compulsory attendance by independent director on the committees is required for efficient working. The Companies Act, 2013 makes an effort to differentiate between the liability of an independent director and non-executive director from the rest of the board. They should enhance corporate governance and ensure the management and affairs of the companies are conducted in the interest of stakeholders.

Keywords: Independent Directors, Companies Act, Corporate Governance, Stakeholders

Introduction

Companies Act 2013 has made new provisions regarding Independent Directors. The Companies Act, 1956 (referred as "the Act, 1956") do not directly talk about ID's, as no such provision exists regarding the compulsory appointment of Independent Director's on the Board. In Companies Act, 1956 their role and responsibility was not very clearly defined. It is mentioned in SEBI under clause 49 of register agreement regarding appointment of independent director on the board. The Companies Act, 2013 sets to refurbishment of the provisions relating to independent directors entirely by conferring greater power and responsibility in the governance of a company.

The Ministry of Company Affairs enforced the 98 sections of the Act through the notification dated September 12, 2013. In this regards, section 149 of the Act, 2013 also deals with the appointment and qualification of Independent Director's on the board of the Company and respected their importance in virtuous corporate governance in the Company. However the same section has not been implemented till date and will come into force as may be notified in the Gazette. A need has been felt to update the Act and make it globally compliant and more meaningful in the context of investor protection and customer interest.

The company's board, completely freedom from peripheral influences is dangerous and straight relative for effective corporate governance. Therefore, requirement of detailed and strong law relating to independent directors turn into dynamic controlled for the performance of the Act.

An Overview - Independent Director:

The 2013 Act [raises the limit for number of directorships that can be held by an individual from 12 to 15 [section 149(1) of 2013 Act]. As per new condition with respect to directors is that at least one director to have stayed in India for at least 182 days in the previous calendar year [section 149(3) of 2013 Act].

The need for the Independent Director got awakened due to the need of a strong framework of corporate governance in the functioning of the company. There is a "growing importance" of their role and responsibility. The Act, 2013 makes the role of Independent Director's very different from that of executive directors. An Independent Director is vested with a variety of

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roles, duties and liabilities for good corporate governance. The person helps a company to defend the interest of minority shareholders and ensure that the board does not favour any particular set of shareholders or stakeholders. An Independent Director brings the accountability and credibility to the boards' process. These ID's are the trustees of good corporate governance.

The Definition of Independent Director has been clearly defined in Companies Act 2013. Independent Director is a Director other than a Managing Director or a whole time Director or a nominee Director, who should

- Not be a Promoter or Director of the company or its subsidiary company and even relative of the same.
- Have no Financial relationship with the company's holding, subsidiary or associate company, or their promoters, or directors, during the immediately preceding financial years or during the current financial year;

Process for Appointment

In Companies Act, 2013 makes the appointment process of independent directors which shall be independent of the company management; while selecting independent directors the Board shall ensure that there is an appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively. The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders. The appointment of independent directors shall be formalised through a letter of appointment, which includes the term of appointment; the expectation of the Board from the appointed director; in which the director is expected to serve its tasks; the Code of Business Ethics that the company expects its directors and employees to follow.

A drawback of constituting a panel of independent directors is that it may discourage people from registering with the panel and in that sense limit the options available to a company for appointment of independent directors. The re-appointment of independent director shall be on the basis of report of performance evaluation.

Code for Independent Director

The Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment 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.

The 2013 Act includes Schedule IV 'Code for Independent Directors' (Code) which broadly prescribes the following for independent directors:

- **Professional conduct:** As per this guideline uphold ethical standards of integrity and probity, act objectively and constructively while exercising duties, devote sufficient time and attention, not abuse his position to the damage of the company.
- **Role and functions:** They shall help in bringing an independent judgement to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, and appointments. Its further added to this satisfies the performance of management in meeting

agreed goals and objectives and monitor the reporting of performance.

- **Duties:** ID's have to undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company. They shall participate constructively and actively in the committees of the Board in which they are chairpersons or members and strive to attend the general meetings of the company.

- **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 Act. At the time of this situation, there shall be replacement in the company by a new independent director within a period of not more than 180 days.

- **Holding Separate Meetings:** The Independent Directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors and members of management. In this case all the independent director of the company shall make every effort to be present at such meeting.

- **Evaluation Mechanism:** The performance evaluation shall be done by the entire Board of Directors, excluding the director being evaluated. The term of the Independent Director has been decided as per their report of performance evaluation.

Committees on the Board

There have been significant inroads made by the Ministry of Corporate Affairs in the recent past with respect to giving cognisance to use of electronic media in day-to-day operations of corporate. As per new act some compulsory attendance by independent director on the committees is required for efficient working.

(1) Audit committee

The requirements relating to audit committees was first introduced by the Companies (Amendment) Act, 2000. Audit committees are a measure of ensuring self-discipline, constituted with the object to strengthen and oversee management in public companies and to ensure that the board of directors discharge their functions effectively. The 2013 Act acknowledges the importance of an audit committee and entrusts it with additional roles and responsibilities [section 177 of 2013 Act].

Audit Committee should be constituted as per following requirements:

- There must be minimum three directors.
- In this committee independent directors should be in majority and they should have ability to read and understand all financial matters.
- Chairperson of the audit committee need not be an independent director.
- Terms of reference to include certain processes like approval of related party transactions and their modifications and scrutiny of inter-corporate loans and investments.
- Directors must be having skills for evaluation of internal financial controls and monitoring the utilization of funds.

(2) Nomination and Remuneration Committee:

The Companies Act, 2013 includes this new section requiring constituting the nomination and remuneration committee by every listed company and the following classes of companies as per prescribed in the draft rules.

- (a) Every listed company
- (b) Every other public company that has a paid-up capital of 100 Crore INR or more or which has, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 200 crore INR.

This committee should consider and recommend to the Board, the companies policy, like eligibility criteria for directors, recommend remuneration policy for directors, key managerial personnel and other employees, criteria for determining qualifications, affirmative features and independence of a director.

(3) Stakeholders Relationship Committee

The Board of Directors of the Company which consist of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders-relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the board. It is mandatory for every listed company to incorporate a committee with three or more non-executive directors out of which one-half must be independent. This committee shall consider and resolve grievances of the security holders of the company. It includes appointment and removal of directors, evaluate director's performance and formulate suitable remuneration policy.

(4) Corporate Social Responsibility (CSR) Committee

The Ministry of Corporate Affairs (MCA) had introduced the Corporate Social Responsibility Voluntary Guidelines in 2009. These guidelines have now been incorporated within the 2013 Act and have obtained legal sanctity. This committee constitutes as per following requirements:

- (a) Section 135 of the 2013 Act, seeks to provide that every company having a net worth of 500 crore INR, or more or a turnover of 1000 crore INR or more, or a net profit of five crore INR or more, during any financial year, shall constitute the corporate social responsibility committee of the board.
- (b) This committee needs to comprise of three or more directors, out of which, at least one director should be an independent director.
- (c) The composition of the committee shall be included in the board's report. The committee shall formulate the policy, including activities like Eradicating extreme hunger and poverty, promotion of education, promoting gender equality and empowering women, reducing child mortality and improving maternal health ensuring environmental sustainability social business projects and employment enhancing vocational skills.
- (d) The committee will also need to recommend the amount of expenditure to be incurred and monitor the policy from time-to-time. The board shall disclose the contents of the policy in its report, and place it on the website, if any, of the company. The 2013 Act mandates that these companies would be required to spend at least 2% of the average net-profits of the immediately preceding three years on CSR activities, and if not spent, explanation for the reasons thereof would need to be given in the director's report (section 135 of the 2013 Act).

Liability of independent directors

The Companies Act, 2013 makes an effort to differentiate between the liability of an independent director and non-executive director from the rest of the board and as a result inserted a provision to provide immunity from any civil or criminal action against the independent directors. The intention and effort to limit liability of independent directors is demonstrated from the section 149(12) of the 2013 Act which inter-alia provides that liability for independent directors would be as under:

“Only in respect of such acts of omission or commission by a company which had occurred within his knowledge, attributable through board processes, with his consent or connivance or where he had not acted diligently.”

The section seeks to provide immunity from civil or criminal action against independent directors in certain cases. Further, in accordance with the requirement of section 166 (2) of 2013 Act, whole of the board is required to act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interest of the company, its employees, the shareholders, the community and for the protection of the environment.

It is very much clear that independent directors have little or no defence and their obligations continues to remain a debatable topic since they would still be treated equivalent to the other directors by holding them responsible for decisions made through board processes.

Conclusion

In this regards, new provisions regarding independent director is welcome step for good corporate governance in India. The Act empowers independent directors with proper checks and balances, so that such extensive powers are not exercised in an unbridled manner, but in a rational and accountable way. It provides greater empowerment to the lead them to ensure that the management and affairs of a company is being run honestly and efficiently. They should enhance corporate governance and ensure the management and affairs of the companies are conducted in the interest of stakeholders. With the great expectation of that it will destroy corporate scandals in coming years and protect shareholders interest.

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