INDEPENDENT DIRECTORS UNDER COMPANIES ACT, 2013

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Balancing the roles & the responsibilities

"Independent Directors" (ID) is one of the most often discussed topics in any forum on corporate governance the world over. As the name suggests, independent directors are those directors who are independent individuals, not having any other relationship or transaction with the company.

The concept of independent directors gained momentum in the late 1980s and early 1990s due to the uncovering of various corporate frauds and scams on the international front. Corporate governance became a pressing issue following the introduction of the Sarbanes-Oxley Act in the U.S., which was ushered in to restore public confidence in companies and markets after accounting fraud bankrupted high-profile companies such as Enron and WorldCom.

Closer home, few recent scams created deep dent in the confidence of shareholders, shaking their belief regarding effectiveness of corporate governance practices in board rooms of big listed companies. The concept of independent directors was confined only to listed companies, thereby meaning that all other entities were not mandated by law to appoint any independent director on their Board, irrespective of the size and spread of their shareholding, net-worth and scale of operations etc.

Though efforts were made by various ministries to lay down corporate governance guidelines, for example, "Guidelines on Corporate Governance for Central Public Sector Enterprises" issued by the Ministry of Heavy Industries and Public Enterprises in June 2007, "Corporate Governance Voluntary Guidelines 2009", issued by the Ministry of Corporate Affairs in December, 2009, these guidelines fell short in making their mark being voluntary in nature.

Companies Act, 2013 (Act) for the first time introduced this concept of independent director in the periphery of Companies Act itself. The Act and the relevant Rules made thereunder contain extensive provisions dealing with independent director. In fact, a whole schedule, namely Schedule IV has been prescribed under the Act which contains the "Code for Independent Directors". The listing agreement has also been amended since then, bringing the provisions contained therein in line with the requirements of the Companies Act, 2013.

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In the present article we have made an attempt to analyze the provisions of the Companies Act, 2013 relating to independent directors and also the recent prescriptions of listing agreement in this context.

From when are the provisions of the Act relating to Independent Directors Applicable ?

The provisions relating to independent directors prescribed under the Companies Act, 2013 were notified to come into effect from 01.04.2014.

Section 149(5) provides a transitional period of upto one year from, the date of commencement, to all existing companies to comply with the requirement of mandatory appointment of independent directors.

Which Class of Companies is Mandatorily required to appoint Independent Directors ?

At least 1/3rd of total directors to be independent directors

— Listed Company

At least 2 directors to be independent directors

— Public Companies having paid up share capital of Rs. 10 Crores or more

— Public Companies having turnover of Rs. 100 Crores or more

— Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding Rs. 50 Crores

Explanations provided in the Act and the Companies (Appointment and Qualification of Directors) Rules, 2014 in the above context:

- Any fraction contained in the 1/3rd number shall be rounded off as one.
- In case a company covered under this rule is required to appoint a higher number of independent directors due to composition of its audit committee, such higher number of independent directors shall be applicable to it.
- A company belonging to any class of companies for which a higher number of independent directors has been specified in the law for the time being in force shall comply with the requirements specified in such law.
- Any intermittent vacancy of an independent director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.
- Where an unlisted public company ceases to fulfil any of three conditions laid above for three consecutive years, it shall not be required to comply with these provisions until such time as it meets any of 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.

Term of Office of Independent Director

- Subject to the provisions of Section 152, an independent director shall hold office for a term upto 5 consecutive years on the Board of a company, but shall be eligible for re-appointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

- Notwithstanding anything contained in point above, no independent director shall hold office for more than 2 consecutive terms, but such independent director shall be eligible for appointment after the expiration of 3 years of ceasing to become an independent director provided that the independent director shall not, during the said period of 3 years, be appointed in or be associated with the company in any other capacity, either directly or indirectly.

- The provisions of sub-sections (6) and (7) of section 152 in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors.

Explanation provided in the Act in the above context:

- Any tenure of an independent director on the date of commencement of this Act shall not be counted as a term under the above provisions.

Contextual clarifications provided by MCA vide their general circular number 14/2014 dated 9th June, 2014

Clarification sought:

1. If 'IDs' appointed prior to April 1, 2014 may continue and complete their remaining tenure, under the provisions of the Companies Act, 1956 or they should demit office and be re-appointed (should the company decide so) in accordance with the provisions of the new Act?

2. Whether it would be possible to appoint an individual as an ID for a period less than five years?

Clarification provided by MCA

1. The matter has been examined in the light of the relevant provisions of the Act, particularly section 149(5) and 149(10) & (11). Explanation to section 149(11) clearly provides that any tenure of an 'ID' on the date of commencement of the Act shall not be counted for his appointment/holding office of director under the Act. In view of the transitional period of one year provided under section 149(5), it is hereby clarified that it would be necessary that if it is intended to appoint existing 'IDs' under the new Act, such appointment shall be made expressly under section 149(10)/(11) read with Schedule IV of the Act within one year from 1st April, 2014, subject to compliance with eligibility and other prescribed conditions.

2. It is clarified that section 149(10) of the Act provides for a term of "upto five consecutive years" for an 'ID'. As such while appointment of an 'ID' for a term of less than five years would be permissible, appointment for any term (whether for five years or less) is to be treated as a one term under section 149(10) of the Act. Further, under section 149(11) of the Act, no person can hold office of 'ID' for more than 'two consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case the person completing consecutive terms

of less than ten years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of three years.

Manner of Selection and Appointment of Independent Directors

Manner of Selection

- An independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors, maintained by any body, institute or association, as may be notified by the Central Government, having expertise in creation and maintenance of such data bank and put on the website of the Ministry of Corporate Affairs or on any other website as may be approved or notified by the Central Government for the use by the company making the appointment of such directors.
- Responsibility of exercising due diligence before selecting a person from the data bank referred to above, as an independent director shall lie with the company making such appointment. A disclaimer shall be conspicuously displayed on the website hosting the databank that a company must carry out its own due diligence before appointment of any person as an independent director and "the agency" maintaining the databank or the Central Government shall not be held responsible for the accuracy of information or lack of suitability of the person whose particulars form part of the databank.

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.
- The appointment of independent director shall be approved by the company in general meeting as provided in sub-section (2) of section 152 and the explanatory statement annexed to the notice of the general meeting called to consider the said appointment shall indicate the justification for choosing the appointee for appointment as independent director.
- The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall also include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made thereunder and that the proposed director is independent of the management.
- The appointment of independent directors shall be formalised through a letter of appointment, which shall set out the matters as detailed in Schedule VI of the Act.
- The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.
- The terms and conditions of appointment of independent directors shall also be posted on the company's website.

- The re-appointment of independent director shall be on the basis of report of performance evaluation.

Contextual clarifications provided by MCA vide their general circular number 14/2014 dated 9th June, 2014

Clarification sought:

1. With reference to Para IV(4) of Schedule IV of the Act (Code for IDs) which requires appointment of 'IDs' to be formalized through a letter of appointment, clarification has been sought if such requirement would also be applicable for appointment of existing 'IDs'?

Clarification provided by MCA –

1. The matter has been examined. In view of the specific provisions of Schedule IV, appointment of 'IDs' under the new Act would need to be formalized through a letter of appointment.

Provisions relating to Remuneration Entitlement or Independent Directors

- An independent director shall not be entitled to any stock option and may receive remuneration by way of sittings fee for attending meetings of the Board or committees thereof, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.
- The sitting fees payable to a director for attending meetings of the Board or committees thereof shall be such sum as may be decided by the Board of directors which shall not exceed Rs. 1 Lakh per meeting of the Board or committee thereto.
- For Independent Directors, the sitting fee shall not be less than the sitting fee payable to other directors.

Role, Reponsibilities and Duties of Independent Directors

- Every independent director shall 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, give a declaration that he meets the criteria of independence.
- The company and independent directors are required to abide by the provisions specified in Schedule IV of the Act.
- Schedule IV of the Act contains the "Code for Independent Dirctors" which is a guide to professional conduct for independent directors. The code is divided into 8 headings which are listed below:

  I. Guidelines of professional conduct

  II. Role and functions

  III. Duties

  IV. Manner of appointment

V. Re-appointment

VI. Resignation or removal

VII. Separate meetings

VIII. Evaluation mechanism

Extent of Liability of Independent Directors

- An independent director shall be held liable, only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

Relevant Provisions of Listing Agreement applicable with effect from 01.10.2014

Given below is a comparison of the provisions of listing agreement pertaining to independent directors (applicable from 01.10.2014) vis-a-vis the provisions of Companies Act, 2013. The comparison has been done taking the listing agreement as base and the provisions which are exclusively given under the Companies Act, 2013 have not been reproduced hereunder since they have already been covered in the foregoing portion.

Nature of requirement	*Provision of Listing Agreement*	*Comparative provision of Companies Act, 2013 read with relevant rules*
Composition of the Board	• The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than 50% of the Board of Directors comprising non-executive directors. • Where the Chairman of the Board is a non-executive director, at least 1/3rd of the Board should comprise of independent directors and in case the company does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors. • If the regular non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.	Every listed public company shall have at least one woman director and at least 1/3rd of the total number of directors as independent directors.

Nature of requirement	*Provision of Listing Agreement*	*Comparative provision of Companies Act, 2013 read with relevant rules*
	The expression 'independent director' shall mean a non-executive director, other than a nominee director of the company	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.
	who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience	Same requirement
	(i) who is or was not a promoter of the company or its holding, subsidiary or associate company; (ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;	Same requirement
	Meaning of associate company: "Associate" shall mean a company which is an "associate" as defined in Accounting Standard (AS) 23, "Accounting for Investments in Associates in Consolidated Financial Statements", issued by the Institute of Chartered Accountants of India.	Meaning of associate company: "Associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.
Qualifications for independent director	Apart from receiving director's remuneration, has or had no 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;	who has or had no 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.
	none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to 2% or more of its gross turnover or total income or Rs. 50 Lakhs or such higher amount as may be prescribed, whichever is lower, during the two	Same requirement

Nature of requirement	*Provision of Listing Agreement*	*Comparative provision of Companies Act, 2013 read with relevant rules*
	immediately preceding financial years or during the current financial year.	
	who, neither himself nor any of his relatives — (i) holds or has held the position of a key managerial personnel or is or has been 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; (ii) 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 — (A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or (B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to 10% or more of the gross turnover of such firm; (iii) holds together with his relatives 2% or more of the total voting power of the company; or	Point no v specified in listing agreement, namely "(v) is a material supplier, service provider or customer or a lessor or lessee of the company;" is not specified in the Act. This is an additional qualification prescribed in the listing agreement.
Qualifications for independent	(iv) is a Chief Executive or director, by whatever name called, of any non-profit organization that receives 25% or more of its receipts from the	

Nature of requirement	*Provision of Listing Agreement*	*Comparative provision of Companies Act, 2013 read with relevant rules*
	company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company; (v) is a material supplier, service provider or customer or a lessor or lessee of the company; who is less than 21 years of age (the word 'not' seems to have been missed out before the word 'less').	No such age related requirement has been prescribed under the Act. This is an additional qualification prescribed in the listing agreement.
Limit on number of directorships	A person shall not serve as an independent director in more than seven listed companies. • Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.	No such restriction has been prescribed under the Act. This is an additional restriction prescribed in the listing agreement.
Maximum tenure of Independent Directors	• An independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment for another term of up to five consecutive years on passing of a special resolution by the company. • A person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only. • An independent director, who completes his above mentioned term shall be eligible for appointment as independent director in	• Same requirement • Any tenure of an independent director on the date of commencement of this Act shall not be counted as a term under the above provisions. • Notwithstanding anything contained in point 1 above, no independent director shall hold office for more than 2 consecutive terms, but such independent director shall be eligible

Nature of requirement	*Provision of Listing Agreement*	*Comparative provision of Companies Act, 2013 read with relevant rules*
	the company only after the expiration of three years of ceasing to be an independent director in the company.	for appointment after the expiration of 3 years of ceasing to become an independent director provided that the independent director shall not, during the said period of 3 years, be appointed in or be associated with the company in any other capacity, either directly or indirectly.
Formal letter of appointment to Independent Directors	• The company shall issue a formal letter of appointment to independent directors in the manner as provided in the Companies Act, 2013. • The letter of appointment along with the detailed profile of independent director shall be disclosed on the websites of the company and the Stock Exchanges not later than one working day from the date of such appointment.	• Listing agreement itself specifies compliance of Companies Act, 2013 in this respect. • The appointment of independent directors shall be formalised through a letter of appointment, which shall set out the matters as prescribed in Schedule IV. The terms and conditions of appointment of independent directors shall also be posted on the company's website.
Performance evaluation of Independent Directors	• The Nomination Committee shall lay down the evaluation criteria for performance evaluation of independent directors. • The company shall disclose the criteria for performance evaluation, as laid down by the Nomination Committee, in its Annual Report. • The performance evaluation of independent directors shall be done by the entire Board of Directors (excluding the director being evaluated). • On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.	• First two points have not been prescribed under the Companies Act, 2013. These are additional requirements prescribed in the listing agreement.
Separate meetings of the Independent Directors	• The independent directors of the company shall hold at least one meeting in a year, without the attendance of non-independent directors	• Same requirements

Nature of requirement	*Provision of Listing Agreement*	*Comparative provision of Companies Act, 2013 read with relevant rules*
	and members of management. All the independent directors of the company shall strive to be present at such meeting. • The independent directors in the meeting shall, inter-alia: • review the performance of non-independent directors and the Board as a whole; • review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors; • assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.	
Training of Independent Directors	• The company shall provide suitable training to independent directors to familiarize them with the company, their roles, rights, responsibilities in the company, nature of the industry in which the company operates, business model of the company, etc. • The details of such training imparted shall be disclosed in the Annual Report.	• No such requirement has been prescribed under the Act. These are additional requirements prescribed in the listing agreement.