

Corporate Governance under the Companies Act, 2013

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Abstract: *The thrust of this article is confined to the role of independent directors in the scheme of corporate governance and more particularly, the provisions contained in the recently passed Companies Act, 2013 (the new Act). In a way it can be said that the Companies Act, 1956, was perhaps the first enactment responsible for introducing some form of corporate governance for all types of companies. An independent director is required to uphold ethical standards of integrity and probity and work objectively and constructively while exercising his duties. For the first time the law makes a provision about resignation by a director including an independent director and in the process has removed the prevailing ambiguity in the law. Although, in reality, the said section does not define the term 'independent director' it mentions several negative attributes or disqualifications which would render a person incapable of being appointed as an independent director. Concept of Independent Director Who is an independent director and what is meant by an independent director?*

I. Introduction

To ensure better corporate governance the Stock Exchange Listing Agreement requires the appointment of independent directors on the boards of listed companies. Going further the Companies Act, 2013 has made it mandatory for companies to appoint independent directors and has also prescribed the requisite qualifications. This article explains the implications of the new provisions relating to independent directors. Today the corporate sector constitutes the backbone of the economy. With huge public funds riding on its back and involving the interests of multiple stakeholders, directly and indirectly, the corporate sector carries a huge responsibility on its shoulders. Whether the corporate sector will discharge its obligations effectively is an issue that has been engaging the best of minds in India and abroad.

II. Background

During the last decade, Corporate Governance has become one of the most widely discussed topics in the business world, in India as also in countries like the United States of America and United Kingdom. As stated by the Narayanamurthy Committee Report, "Corporate Governance is about ethical conduct in business. The Corporate Governance is beyond the realm of law. Therefore, continuous efforts are being made to effect changes in the applicable laws so as to improve the standards of Corporate Governance.

In a way it can be said that the Companies Act, 1956, was perhaps the first enactment responsible for introducing some form of corporate governance for all types of companies. Similarly, the listing agreement brought in a modicum of corporate governance specifically applicable to listed companies only. For many years the listing agreement was primarily meant to ensure that every listed company protected the interest of its shareholders by ensuring certain minimum compliances like timely dispatch of share certificates, annual accounts, dividend, etc.

For the first time, as a result of the Kumar Mangalam Birla Committee Report, the term 'Independent director' became a part of corporate lexicon. To give legal character to the newly introduced concept and to make it compulsory for the listed companies, SEBI effected changes in the listing agreement by introducing a new clause in the form of clause 49, exclusively devoted to Corporate Governance. Clause 49 also prescribes several other requirements, Audit Committee being the most important.

The thrust of this article is confined to the role of independent directors in the scheme of corporate governance and more particularly, the provisions contained in the recently passed Companies Act, 2013 (the new Act).

Interestingly, though the concept of independent directors was brought into force so far as listing companies are concerned, no specific definition of the term "independent director" exist in the Companies Act, 1956 (the Act). The Birla Committee put the onus on the management to decide as to whether a particular director was an independent director or not for meeting the requirements as stipulated in clause 49

Although, in reality, the said section does not define the term 'independent director' it mentions several negative attributes or disqualifications which would render a person incapable of being appointed as an independent director. Concept of Independent Director Who is an independent director and what is meant by an independent director? Do we mean a person who is independent of the influence of the promoters and the

management or is he a person who does not care about the management and is always in an adversarial roles? Or is he a person of experience and expertise whose wise counsel will be available for the benefit of the company?.

Independent Directors Role and Responsibilities under the Companies Act, 2013

Independent Directors Role and Responsibilities under the Companies Act, 2013 1041 CHARTERED SECRETARY September 2013 Article [A-344] While performing the role expected of him, there is every possibility that he could fall foul of the promoter group who has the control over the board and in such a situation his mettle will be tested. The law expects him to stand up for what is right in the circumstances; in case it is not possible for him to convince others of his views, it will be his duty to ensure that his dissent is recorded in the minutes of the proceedings of the board meeting. It is an accepted fact that it is not easy to define an 'independent director', but the new Act has attempted to provide a definition by stipulating for the first time, the qualities and qualifications that a person should have to make that person eligible for appointment as independent director rather than listing the grounds of disqualification as has been the case before.

Section 149(6) of the new Act prescribes several qualifications expected of an independent director in relation to a company. One requisite is that he should be a person of integrity. On first thought it may sound ludicrous that it is necessary to specify that a person wanting to be an independent director should be a man of integrity, because it should be without saying that every person on the board of a company should be a man of integrity.

Unfortunately, experience indicates that many directors over the years have failed in discharging their fiduciary duties; perhaps that is why the lawmakers have felt the need to provide in law that such a person should be a man of integrity. However, at the same time it should be noted that ethics and morality cannot be legislated though ethical standards of conduct may be specified by the law. As if the so many qualifications listed in the clause are not enough, the Government has kept for itself the residuary power to prescribe such other qualifications as the Government may deem fit.

One can only hope that the additional qualifications that may be prescribed by the Government should not make the task of getting independent directors still more difficult. The ten requisites mentioned in Section 149(6) of the new Act for eligibility to be an independent director indicates the intent of the Government to ensure that an independent director is not only a capable and experienced person, but he should not have any material pecuniary or other relationship with the company that would come in the way of his discharging his duties without fear or favour.

Role of Independent Directors

In the existing Act there is no provision for appointment of independent directors; it is only the listing agreement which provides for the same. Strictly viewed, under the Act, except for the managing and whole-time directors, all the other directors being non-executive directors, also called ordinary or part-time directors, enjoy similar status and responsibilities. Therefore, one could wonder as to the exact nature of the role to be played by independent directors.

Schedule III of the new Act provides a comprehensive code for independent directors covering the following aspects:

- I. Guidelines of professional conduct:** An independent director is required to uphold ethical standards of integrity and probity and work objectively and constructively while exercising his duties. He is expected to act in a bona fide manner in the interest of the company and devote sufficient time and attention to his professional obligations for informed and balanced decision making. At the same time he should not abuse his position and must refrain from any action that would lead to loss of his independence.
- II. Role and functions:** The role that he has to play includes 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. He has a role to play while fixing the remuneration of executive directors and key managerial personnel and plays a prime role in appointment and removal of executive directors, key managerial personnel and senior management.
- III. Duties:** The Schedule has stipulated thirteen different duties to be performed by an independent director. Some of the duties include:
 - 1) Regularly updating and refreshing the skills, knowledge and familiarity with the company
 - 2) Participate actively in all meetings of the Board and the committees and general meeting
 - 3) Keep well informed about the company and the external environment in which it operates. He is also expected to pay attention and ensure that adequate deliberations are held before approving related party transactions and assure himself that the same are in the interest of the company. He cannot disclose

confidential information, including commercial secrets, technologies, unpublished price sensitive information, etc., except as required by law.

- IV. Manner of appointment:** For the first time the law stipulates that a formal letter of appointment has to be given to an independent director mentioning all those items stated in item (4) of this clause in the schedule.
- V. Re-appointment:** For the first time the law makes a provision about resignation by a director including an independent director and in the process has removed the prevailing ambiguity in the law.
- VI. Separate meetings:** An interesting duty that has been cast upon the independent directors is that they will have to hold at least one meeting in a year, without the attendance of nonindependent directors and members of management. The objective of such a meeting being to afford an opportunity to the independent directors to review the performance of the company, flow of information from the management to the Board, etc. It is expected that such a meeting must be attended by all the independent directors of the company.
- VII. Evaluation mechanism:** The most revolutionary provision is the one that requires the performance evaluation of independent directors. As of now there is no formal requirement for conducting any evaluation of non-executive directors or independent directors. The Board will keep in view the report of performance evaluation while determining the suitability of extending or continuing the term of appointment of the independent director
- VIII. Appointment and Term** There is a provision in Schedule IV regarding the manner of appointing an independent director, but Section 150 of the new Act stipulates that an independent director has to be selected from a data bank maintained by authorised bodies / institutions. Such bodies / institutions will be notified by the Government. It is only to be hoped that the Government will not have any direct role in the appointment of independent directors. An independent director shall hold office for a term up to five consecutive years on the Board of a company.

III. Conclusion

However, a question that needs to be addressed in this context is about the degree of involvement of an independent director in the affairs of the company and the liability that is fastened on his shoulders. There has been a demand in certain quarters, particularly from the Chambers, that independent directors be given protection from legal proceedings.

This in a way limits the scope of offences for which an independent director can be personally held liable. However, it is imperative that independent directors act diligently while discharging their duties and be conscious and cautious. It would have been better if the provision was made more specific and direct in nature. Further, although, the law is attempting to limit the scope of offences in respect of independent directors, at the time of prosecution, all directors irrespective of their category are issued summons.

Are Independent directors the panacea for all the corporate ills? Even if all the listed companies which are required to have independent directors, on their boards have done so, would that automatically result in better Corporate Governance? Will such boards ensure that there would be no recurrence of Harshad Mehta and Ketan Parekh and NSEL scams? Quite unlikely. If legal provisions alone could change the scene, then India should have been miles ahead of all the countries as India is one of the most legislated countries in the world.

The new Act mandates that every listed public company shall have atleast one third of its total number of directors as independent directors. The Central Government will prescribe the minimum number with respect to unlisted public companies. Private companies are not required to have independent directors.

The key to successful corporate governance lies in the commitment of the management of a company to achieve the same. For independent directors to really succeed and make corporate governance what it should be, then apart from the promoters' attitude, there has to be ethical conduct in public life which should be the norm and not an exception.

IV. Disclaimer

This paper has been compiled based upon documents and information available in public domain. Anybody wishing to act on the basis of this paper should do so only after cross checking with original document. We do not present any opinion on any matter whatsoever and matters expressed herein should not be taken as directive or opinion for any reason. We have tried to highlight the significant changes.

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