Chapter 6 Emerging Role of Independent Directors in India

6.1 The Satyam Saga

In January 2008 corporate sector in India received a rude shock when B. Ramalinga Raju, the founder and then-chairman of Satyam Computer Services, confessed to having orchestrated an accounting fraud on Satyam’s books. Satyam Computer Services Ltd (Popularly known as Satyam), a publically traded private company was one of the most reputed software companies in the country. Being a listed company, Satyam’s shares were traded Bombay Stock Exchange (BSE), National Stock Exchange (NSE) in India and also New York Stock Exchange (NYSE) in United States. This evidently means Satyam had to comply with Clause 49, Sarbanes Oxley Act and all such prescribed rules and regulation.

Satyam’s spiralling downward effect was discovered in two phases. One, an aborted related party transaction involving company’s promoter and two, fudging of accounts in Satyam’s books of accounts. Problems in Satyam begin when on December the 16th, 2008 when its chairman Mr Ramalinga Raju, in a surprise move announced a $1.6 billion bid for two Maytas companies i.e. Maytas Infrastructure Ltd and Maytas Properties Ltd. These two companies had been promoted and controlled by Raju’s family. Despite concerns raised by some of the independent directors, the Board adopted (“without any dissent whatsoever”) a unanimous resolution to proceed with the proposed acquisition. Satyam notified the stock exchanges of the board approval as required under the listing agreement. The market reacted badly to the news and within eight hours of the announcement, Satyam was compelled to withdraw the Maytas proposal.

252 On December 16, 2008, Satyam’s Board convened a meeting to consider the proposed acquisition of Maytas Infra Limited and Maytas Properties Limited, companies focused on real estate and infrastructure development. Two major issues in the proposed transaction surfaced. First, the Maytas companies were focused on real estate and infrastructure development – two industries unrelated to Satyam’s core IT business Second, the Raju family owned approximately 30% of the Maytas companies. At this time, Ramalinga Raju served as Chairman of the Board, and B. Rama Raju served as the Managing Director and Chief Executive Officer. This made the proposed deal a “related party transaction

253 See Varottil, Evolution of Independent Directors, supra note 23, at 335.
At last, on January 7, 2009, B. Ramalinga Raju announced confession of over Rs. 7800 crore financial fraud and he resigned as chairman of Satyam. He revealed in his letter that his attempt to buy Maytas companies was his last attempt to “fill fictitious assets with real ones”. He admitted in his letter, “It was like riding a tiger without knowing how to get off without being eaten”. Satyam’s promoters, two brothers B Ramalinga Raju and B Rama Raju were arrested by the State of Andhra Pradesh police and the Central government took control of the tainted company. The Raju brothers were booked for criminal breach of trust, cheating, criminal conspiracy and forgery under the Indian Penal Code.\textsuperscript{254}

The Satyam episode has brought out the failure of the present corporate governance structure that hinges on the independent directors, who are supposed to bring objectivity to the oversight function of the board and improve its effectiveness. The Satyam Board was too lax to put hard questions to the promoters. The independent directors failed to question management’s strategy and use of leverage in recasting the company; they were also extremely slow to act when it was already clear that the company was in financial distress. Paradoxically as scholar Umakanth Varottil notes, “At a board level, it can be said that very few Indian boards can lay claim to such an impressive array of independent directors”\textsuperscript{255} and despite having such an impressive array the fraud could not be averted.

As noted earlier, seven out of nine directors were present at the board meeting where the unanimous decision to acquire Maytas Infra and Maytas Properties was taken. And despite concerns being raised, a unanimous decision was taken to acquire Maytas companies. It was only when the share market reacted very strongly against the bid and prices plunged by 55 % on concerns about Satyam’s corporate governance, that some of the independent directors came into action by announcing their withdrawal from the Board, by than it was too late. While standards set by NYSE and Clause 49 of SEBI were met,\textsuperscript{254, 255}

\textsuperscript{254} The Central Government reconstituted Satyam’s board that included three-members, HDFC Chairman Deepak Parekh, Ex Nasscom chairman and IT expert Kiran Karnik and former SEBI member C Achuthan. The Central Government added three more directors to the reconstituted Board i.e., CII chief mentor Tarun Das, former president of the Institute for Chartered Accountants (ICAI) TN Manoharan and LIC’s S Balakrishnan.

\textsuperscript{255} See Umakanth Varottil, Evolution and Effectiveness of Independent Directors in Indian Corporate Governance, 6 HASTINGS BUS. L. J.281 (2010)).
independent directors did not ask hard questions about the company sitting on such huge pile of cash (which was later revealed never existed).

6.2 Post-Satyam reforms and responses

In February 2009, the Confederation of Indian Industry (CII) convened the CII Task Force on Corporate Governance to “recommend ways of further improving corporate governance standards and practices in both letter and spirit”. The Task Force, chaired by former Cabinet Secretary Naresh Chandra, released its findings and recommendations in November 2009. Considering Satyam as a ‘one-off incident’, the report observed that overwhelming majority of corporate India is well run, well regulated and does business in a sound and legal manner.

Similarly, the Council of the Institute of Company Secretaries of India (ICSI) subsequently promulgated a set of recommendations to reform corporate governance in light of the events at Satyam. The National Association of Software and Services Companies (NASSCOM), also formed a Corporate Governance and Ethics Committee chaired by Mr. N. R. Narayana Murthy. In December 2009, drawing upon the findings of the CII Task Force and the ICSI report as well as suggestions from various other stakeholders, India’s Ministry of Corporate Affairs, issued Corporate Governance Voluntary Guidelines 2009.

The recommendations of these reports have been examined to decipher what is contained for independent directors. The following points summarise recommendations delineated with reference to independent directors.

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258 the premier trade body and the chamber of commerce of the IT-BPO industries in India.

1. **Nomination Committees.** All three of the reports recommend that boards should select independent directors through a nomination committee comprising a majority of independent directors, including the chairman.\(^{260}\) They also recommend that this committee evaluate and recommend individuals for executive director positions.\(^{261}\)

2. **Executive Sessions.** The CII report recommends that independent directors meet at regularly scheduled executive sessions outside the presence of management, and that the audit committee should also hold executive sessions with both internal and external auditors.\(^{262}\)

3. **Access to Management and Other Resources.** The Ministry’s Voluntary Guidelines suggest that independent directors have the option and freedom to meet with corporate management on a periodic basis. Moreover, these guidelines recommend that boards make available to independent directors the systems, procedures and resources necessary to enable independent directors to make informed, quality decisions about the company and otherwise effectively discharge their duties.

4. **Remuneration.** The Ministry’s Guidelines recommend that independent directors be paid “adequate sitting fees” based both on the company’s net worth and turnover. However, in an effort to prevent a director’s independence from being compromised, these Guidelines expressly discourage the issuance of stock options or profit-linked compensation. The CII report, on the other hand, would permit stock options, but would prohibit an independent director from exercising any such options until a full year after his or her departure from the board.

5. **Related Party Transactions.** The CII committee also suggested that the audit committee preapprove all related party transactions not undertaken in the ordinary course of business or transacted at arm’s length.

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\(^{260}\) See, CII Report, Supra note 256, at 6

\(^{261}\) See, CII Report, Supra note 256, at 6

\(^{262}\) See, CII Report, Supra note 256, at 13.
6. **Shareholder Activism.** The CII Task Force also appeals to institutional shareholders in particular to be more active in their oversight capacities.\(^{263}\)

7. **Director Training.** Both the Ministry’s Voluntary Guidelines and the ICSI report recommend that boards make mandatory training programs for newly inducted directors and should also develop training programs for the ongoing development of all directors.\(^{264}\) The ICSI report suggests that director training is especially important so that directors become sufficiently technically competent to perform their duties, including in the area of financial expertise, which the report suggests is critical to a director’s comprehension of the workings of the audit committee.\(^{265}\) With respect to continuing director development, the ICSI report suggests directors be kept abreast of recent developments in corporate governance, technologies, products, markets, etc. through ongoing education, site visits, seminars and courses.\(^{266}\)

Interestingly, of all these reports NASSCOM report categorically states that ‘the fundamental objective of “good corporate governance and ethics” is to ensure the commitment of an organisation in managing the company in a legal and transparent manner in order to maximise the long-term value of the company for its shareholders, customers, competitors, employees and all other partners.’\(^{267}\) The Committee’s recommendations are therefore structured to attain an effective management that involves all stakeholders such as board of directors, customers, competitors, employees and partners. Thus distinctive features of the Nasscom recommendations are that they adopt a more holistic approach and focus heavily on the protection of stakeholders in a company. To that extent, they represent a marked departure from previous governance reform measures that focus almost solely on protection of shareholder interests. Nasscom seems to prefer a stakeholder approach to corporate governance rather than a pure shareholder approach. All of this is again consistent with lessons from the Satyam episode where it was not only the shareholders, but other constituencies such as employees

\(^{263}\) See, CII Report, supra note 256, at 24.
\(^{264}\) See ISCI report, supra note 257
\(^{265}\) Id.
\(^{266}\) Id.
\(^{267}\) NASSCOM report
and customers (and possibly the standing of the entire IT/BPO industry in India) that were left vulnerable to management actions, until the company itself was rescued and subsequently sold to another industry player.  

As can be observed from these developments, independent directors have been assuming significance in corporate board rooms. While earlier expectations were narrowly focused on discharging advisory duties towards the management, more recent development have expanded the scope further. In addition to performing conventional duties of acting as trustees, agents of the company, independent directors assume criticality to serve as vanguards of protecting interests. If someone was to ask what interests and whose interests, the answer lies in combinations of interests. First, protecting interest of shareholders from management; second that of minority shareholders from majority shareholders; third protection of company where management is functioning hand and glove with controlling shareholder and fourth interests of stakeholder which is a much recent development. As is evident, recent committee reports in post-Satyam era has been emphatically suggesting that independent director’s duties may not be confined only to resolving traditional management-shareholder agency problem but needs to be refurbished to cater to stakeholders’ expectations as well. Resonating this popular sentiment one finds that Company Act 2013 has translated these aspirations and expectations into a legal mandate.

6.3 Redefining duties and liabilities

Satyam episode and the functionality of independent directors therein proves to be a live example of what Donald Langevoort was attempting to emphasise. Donald Langevoort defines “independence” as “a subjective concept that connotes a willingness to bring a high degree of rigor and skeptical objectivity to the evaluation of company management and its plans and proposals.”²⁶⁹ In the context of family-influenced public firms, independence also requires both the willingness and ability to sustain such “rigor and skeptical objectivity” when its object is sponsored by or especially beneficial to the family. This is where independent directors failed to assert themselves in presence of founder members. The instance where the Satyam gave a nod to acquisition of two related companies despite being into totally unrelated business demonstrates lack of rigour and sceptical objectivity. By the time independent directors realised, it was too late.

In the light of such real life instances and influence of controlling shareholders within family firms it is possible to identify several functions that independent directors are uniquely positioned to exercise so that they can serve as useful counterweights.²⁷⁰ Some of these functions are conventional duties attached to the position of director whilst some are newly emerging duties. In a highly commendable move, Company Act 2013 made a remarkable improvement over its predecessor and categorically delineated duties and liabilities to independent directors in a forthright manner. Sec. 149(8) read with Schedule IV²⁷¹ of the Company Act 2013 comprise of a Code that describes set of professional ethics, functions, duties, appointment, resignation, remuneration and so on. This is a combination of several conventional duties and emerging expectations that have been formulated over years of experience, judicial wisdom and expectations.

²⁷¹ Sec. 149 (8) The company and independent directors shall abide by the provisions specified in Schedule IV.
6.3.1 Real and not tokenistic involvement

It is crucial for an independent director to clearly bear in mind that they are supposed to discharge duties in real sense of terms and not merely a tokenistic presence. In other words, independent directors are not only there to make the board look pretty. They need to ask hard questions. For instance at the December 16, 2008 Board meeting of Satyam, independent directors questioned the proposed transaction. Dr. Mangalam Srinivasan questioned the initiative and timing of the proposal. She also suggested that the Board be involved in the transaction from the beginning to avoid the impression that the Board was being used as “rubber stamp to affirm the consequent or decision already reached.”

6.3.2 Vigilance

Another function that is closely tied up with the real function is the conventional watchdog function. Vigilance is all the more significant for independent directors in family controlled firms. Take for instance the stand taken by independent directors in case of Dow Jones. It demonstrated exercise of vigilance on behalf of the firm’s public shareholders, as in the refusal of Dow Jones’ board to accede to demands that some or all shares owned by Bancroft family trusts be acquired by News Corp. at a higher price even if the consequence was to lower the price received by holders of nonfamily shares.

Moreover, vigilance by independent directors should extend to legally problematic self-dealing or related transactions between the controlling shareholder and the corporation. For instance, what Satyam proposed to engage

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272 Schedule IV Code for Independent Directors II Role and Functions (1) 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 (3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance (4) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible
273 See Umakanth Varottil, Evolution and Effectiveness of Independent Directors in Indian Corporate Governance, 6 HASTINGS BUS. L. J. 281 see also Satyam Computer Services Limited, Minutes of the Meeting of the Board of Directors of the Company Held on Tuesday, Dec. 16, 2008 at 4:00 p.m. at Satyam Infocity, Hitech City, Madhapur, Hyderabad – 500 081, available at http://online.wsj.com/public/resources/documents/satyam01115.pdf. (last visited on 12th December 2013)
274 Id.
into was a related transaction of acquisition of two companies owned and controlled by family members; the board should not have allowed such a proposal to go by. Evidence suggests that Professor M. Rammohan Rao and Vinod K. Dham were concerned about Satyam venturing into a wholly unrelated business.\(^{275}\) Others were concerned with verifying the benefits to shareholders if the transaction was completed, especially due to the related parties in the transaction.\(^{276}\) Therefore, it was not that independent directors did not smell the danger, they just prevented short of asking hard questions.

A controlling shareholder who retaliates against a vigilant independent director, for example by removing the director from the board, has taken a visible step that may attract unwanted external attention. It is also demonstrable that independent directors can negotiate effectively on behalf of public shareholders when the controlling shareholder proposes to cash out the public equity in a going-private transaction, depending of course on how powerfully the directors are armed with negotiation tactics, including the power to reject the transaction.

### 6.3.3 Act as Sounding Board

Independent directors’ expertise and experience is helpfully to complement or challenge the perceptions of management and the controlling family.\(^{277}\) This may protect the primacy of the firm’s business needs and interests, while assuring that high-level decision-making is not dominated by spill over from intra family dynamics. Independent directors can serve as sounding board where management or promoters can get an altogether different dimension and strategic guidance. This function of independent director may complement the strategic decisions and can also be used to shout a warning message to all other stakeholders. For instance, if we revisit the Satyam scenario independent directors could have

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\(^{276}\) Id.

\(^{277}\) Schedule IV supra note 272 (2) bring an objective view in the evaluation of the performance of board and management
confronted the decision of the promoter to acquire two family run companies. However, it was the markets that reacted to this stance rather than the independent directors.

6.3.4 Attendance to the Meeting and Performance appraisal

It goes without saying that in order to effectively discharge aforementioned functions of vigil and sounding board, it is crucial that independent directors duly attend board meetings and seek information from the board wherever necessary. The Company Act 2013 also requires that in addition to the meetings of the board, independent directors have a separate meeting of their own without management and non-independent directors. The underlying objective of having at least one such meeting during the financial year perhaps is to let independent directors talk freely without the watchful eyes of management so that any possible controversy or inconsistency may come to light which otherwise remained unnoticed. Such meeting shall also review performance of the Board and the Chairperson.

278 VII. Separate meetings:
(1) 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;
(2) All the independent directors of the company shall strive to be present at such meeting;
(3) The meeting shall:
(a) review the performance of non-independent directors and the Board as a whole; (b) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;
(c) 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
6.3.5 Declaration of Independence

In a welcome move recently enacted Company Act 2013 mandates that independent director shall give a declaration in the first meeting of the Board and thereafter every financial year that he/she meets the criteria of independence as prescribed under the Act and also give full disclosure about any change in status with regards to his independence.\(^\text{279}\)

6.3.6 Protecting interest of stakeholders

Conventionally directors are expected to protect interest of public shareholders from management and in the wake of hostile takeovers the same extended to taking defensive actions for protection of company.\(^\text{280}\)

In such situations directors have an obligation to determine whether an offer is in the best interest of the corporation and its shareholders and that the board's decision on this issue "should be no less entitled to the respect they otherwise would be accorded in the realm of business judgment."\(^\text{281}\)

Apart from evaluating whether the offer made is strategically in the best interest of shareholders, judicial interpretations also expected to weigh its impact on stakeholders other than shareholders. In addition to inadequate value, appropriate considerations in evaluating takeover threats include the "nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders . . . the risk of non consummation, and the quality of securities being offered in the exchange."\(^\text{282}\)

\(^\text{279}\) Sec. 149 (7) 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 as provided in sub-section (6).

\(^\text{280}\) Schedule IV supra note 272 (5) safeguard the interests of all stakeholders, particularly the minority shareholders (6) balance the conflicting interest of the stakeholders (7) determine appropriate levels of remeration 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 (8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder’s interest.

\(^\text{281}\) Paramount, 571 A.2d at 1150.

\(^\text{282}\) Id at 1153.
6.3.7 Oversight to Corporate Social Responsibility

Recently Company Act 2013 in India has mandated that every such company whose turnover exceeds the prescribed limits shall have to contribute two per cent of its profits to Corporate Social Responsibility tasks. For this purpose the company shall set up a Committee where at least one director shall be an independent director.  

283. (1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

(2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

(3) The Corporate Social Responsibility Committee shall,—

(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;

(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and

(c) monitor the Corporate Social Responsibility Policy of the company from time to time.

(4) The Board of every company referred to in sub-section (1) shall,—

(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and

(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy: Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (a) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation.—For the purposes of this section "average net profit" shall be calculated in accordance with the provisions of section 198.
6.3.8 Liabilities

Company Act 2013 makes an improvement over its predecessor in terms of fixing up liabilities on independent directors. By way of a non-obstante clause it specifies that independent directors will 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.\textsuperscript{284} This is appears to cover range prescribed by Delaware Court in \textit{In re The Walt Disney Co. Derivative Litigation} that included bad faith, negligence and the grey area of wilful negligence.\textsuperscript{285}

\textsuperscript{284} Sec. 149 (12) Notwithstanding anything contained in this Act,—
(i) an independent director;
(ii) a non-executive director not being promoter or key managerial personnel, 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.

\textsuperscript{285} For detailed discussion see chapter 4.
6.4 Comparative Analysis under the Companies Act 1956 and 2013

6.4.1 Section 2(69) of the 2013 Act: Promoter and Corresponding to Section 62(6) (a) of 1956 Act

- Definition of “promoter’ in the 1956 Act was section-specific. Section 2(69) of the 2013 Act contains general definition applicable to all provisions of 2013 Act which refers to ‘promoter’.
- Section 62(6)(a) of the 1956 Act defined ‘promoter’ as a person who is party to untrue statement in prospectus. The 2013 Act gives an exhaustive definition of the term ‘promoter’ which covers promoters named as such in its annual returns, persons who control the company and shadow directors. Persons acting merely in professional capacity will not be regarded as shadow directors and as promoters.286

6.4.2 Section 149 of the 2013 Act: Company to have Board of directors- Corresponding to Section 252 and 253 of 1956 Act:

Section 149 of the 2013 Act contains the following new provisions which were not there in the 1956 Act:

- At least one of the directors shall be a person who has stayed in India for 182 days or more in the previous calendar year.
- Such class or classes of companies, as may be prescribed, shall have a woman director.

Every Listed public company shall have at least one-third of the total number of directors as independent directors. The Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies. An independent director shall not be entitled to stock options. He shall not be entitled to any remuneration other than sitting fee, reimbursement of expenses for participation in the Board and other meetings and profit-related commission as may be approved by the members.

- Maximum number of directors is 15. A company may appoint more than 15 directors after passing a special resolution. No need for Central Government

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approval as under the 1956 Act to increase number of directors beyond permissible maximum.

- Section 149(12) of the 2013 Act provides that notwithstanding anything contained in this Act,-
  
  (i) an independent director,

  (ii) a non-executive director not being promoter or key managerial personnel, shall be liable, only in respect of such acts of omissions 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.

There was no such limitation of liability of non-executive directors under the 1956 Act.

6.4.3 Section 150 of the 2013 Act: Manner of Selection of Independent Directors and maintenance of data bank of Independent Directors

- New provision.

- New provision introduced by the 2013 Act. There was no concept of Independent Directors in the 1956 Act.

6.4.4 Section 151 of the 2013 Act: Appointment of Director Elected by small shareholders – Corresponding to Section 252 of 1956 Act

- The 1956 Act contained an enabling provision permitting public companies with paid up capital of Rs. 5 crores or more and having 1000 or more small shareholders to have a director elected by small shareholders in such manner as may be prescribed.

- The 2013 Act enables a listed company to do so irrespective of it’s paid up capital and number of small shareholders.
6.4.5 Section 152 of the 2013 Act: Appointment of Directors—Corresponding to Sections 254, 255, 256 and 264 of 1956 Act

The following are the new requirements in the 2013 Act for appointment of directors which were not there in the 1956 Act:

- Every person proposed to be appointed as a director shall furnish (i) his DIN and (ii) a declaration that he is not disqualified to become a director under this Act.
- In the case of appointment of an independent director, the explanatory statement for appointment annexed to the notice of the general meeting shall include a statement that in the Board’s opinion he fulfils the conditions specified in the 2013 Act for such an appointment.
- For determining the “Not less than two-thirds of the total number of directors of a public company” liable to retire by rotation, “Total number of directors” shall not include independent directors, whether appointed under this Act or any other law for the time being in force.287

6.4.6 Section 153 of the 2013 Act: Application for allotment of Director Identification Number—Corresponding to Section 266A of 1956 Act

- No change in the provisions.

6.4.7 Section 154 of the 2013 Act: Allotment of Director Identification Number—Corresponding to Section 266B of 1956 Act

- No change in the provisions.

6.4.8 Section 155 of the 2013 Act: Prohibition to obtain more than one director identification number—Corresponding to Section 266C of 1956 Act

- No change in the provisions.

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6.4.9 Section 156 of the 2013 Act: Director to intimate director identification number- Corresponding to section 266D of 1956 Act
   - No change in the provisions.

6.4.10 Section 157 of the 2013 Act: Company to inform director identification number to registrar- Corresponding to section 266E of 1956 Act
   The provisions of section 157 of the 2013 Act are the same as those of section 266E of the 1956 Act except in the following two respects:
   - The time limit of furnishing DIN to ROC extended by the 2013 Act from one week under the 1956 Act to 15 days.
   - There was no specific penal provision for contravention of section 266E of the 1956 Act. Non-compliance with section 266E of the 1956 Act was punishable under section 629A of the 1956 Act with fine upto Rs. 5000 and continuing offences, a fine upto Rs. 500 per day during which default continues. Section 157 of the 2013 Act provides hefty specific penalties if company fails to file DIN particulars of ROC even within the extended time limit of 285 days with additional fee.

6.4.11 Section 158 of the 2013 Act: Obligation to indicate director identification number- Corresponding to section 266F of 1956 Act
   - No change in the provisions.

6.4.12 Section 159 of the 2013 Act: Punishment for Contravention- Corresponding to section 266G of 1956 Act
   - Penalties enhanced substantially. Otherwise, no change in the provisions.

6.4.13 Section 160 of the 2013 Act: Right of persons other than retiring directors to stand for directorship- Corresponding to section 257 of 1956 Act
   - Section 257 of the 1956 Act was applicable only to public companies. On the other hand, section 160 of the 2013 Act applies to all companies.
   - Section 257 of the 1956 Act provided for refund of deposit only if candidate got elected as a director. Section 160 of the 2013 Act provides for refund of deposit even if candidate gets more than 25% of total votes cast.
• The deposit under section 257 of the 1956 Act was Rs. 500 while under section 160 of the 2013 Act it is Rs 1,00,000 or such higher amount as may be prescribed under the Rules.

6.4.14 Section 161 of the 2013 Act: Appointment of Additional Director, Alternate Director and Nominee Director—Corresponding to Sections 260, 262 and 313 of 1956 Act

Alternate Directors

• Section 313 of the 1956 Act empowered the Board of Directors to appoint a person, to act as an alternate director for a director (‘the original director’) during his absence for a period of not less than three months from the State in which meetings of the Board are ordinarily held. Section 161 of the 2013 Act provides that Board of Directors may, appoint a person, to act as an alternate director for a director during his absence from India for a period of not less than three months.

• Section 313 provided for vacation of office by alternate director if and when the original director returned to the State in which board meetings are ordinarily held. Section 161 provides for such vacation of office when the original director returns to India.

• Section 161 of the 2013 Act requires that person appointed as alternate director should not be a person holding any alternate directorship for any other director in the company. In 1956 Act contained no such requirement.

• Section 161 of the 2013 Act further provides that a person who is proposed to be appointed as an alternate director for an independent director should be qualified to be appointed as an independent director under the provisions of this Act. There was no such requirement in the 1956 Act.

Nominee Director

• Section 161 of the 2013 Act provides that subject to the articles of the company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or State
Government by virtue of its shareholding in a Government company. There was no such provision in the 1956 Act.

**Additional Director**

- As regards appointment of additional directors, section 161 of the 2013 Act provides that the Board of Directors shall not appoint a person who fails to get appointed as a director in a general meeting as an additional director. Such a provision was not there in the 1956 Act.  

6.4.15**Section 162 of the 2013 Act: Appointment of Directors to be voted individually- Corresponding to Section 263 of 1956 Act**

- While section 263 of the 1956 Act applied only to public companies section 162 of the 2013 Act applies to all companies.

- Section 263 of the 1956 Act provided that where a resolution so moved (in contravention of the section) is passed, no provision for the automatic re-appointment of the director retiring by rotation in default of another appointment shall apply. The 2013 Act omits this provision.

- The 1956 Act exempted companies not carrying on business for profit/companies prohibiting payment of dividend [see section 263A of the 1956 Act] from the provisions of section 263 of the 2013 Act. There is no exemption for such companies from the provisions of section 162 of the 2013 Act.

6.4.16**Section 164 of the 2013 Act: Disqualification for appointment of Director- Corresponding to Sections 202, 274 and 283(2) of 1956 Act**

(A) The 2013 Act permanently debars from directorship of a company any person who is convicted of any offence and sentenced to imprisonment of 7 years or more. There was no provision in the 1956 Act.

(B) Section 164 of the 2013 Act contains the following two new grounds for disqualifying a person from directorships of companies which were not there in section 274 of the 1956 Act-

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288 A Comparative Study of Companies Act 2013& Companies Act 1956 by Taxmann’s pg 2.100-2.102
• He has been convicted of the offence dealing with related party transactions at any time during the last preceding five years;
• He has not obtained Director Identification Number.

(C) The disqualification in section 274(1)(g) of the 1956 Act has been retained in section 164(2) of the 2013 Act. However, under the 1956 Act, a person was disqualified from directorships of he was a director of a defaulting public company which had committed either of the specified the defaulting company is a public company or not. Any person who is a director of such a defaulting company shall be disqualified to be re-appointed as a director of that company or appointed in other company for a period of five years from the date of the specified default.

(D) The 1956 Act [See section 274(2)] empowered the Central Government to remove disqualification to be a director arising out of conviction for offence of moral turpitude or out of non-payment of calls. The 2013 Act omits this power of the Central Govt.

6.4.17Section 165 of the 2013 Act: Number of Directorships- Corresponding to Section 275, 276, 278 and 279 of the 1956 Act

• Section 278 of the 1956 Act provided for exclusion of certain directorships for the purposes of computing the limit on number of directorships the 2013 Act omits these exclusions.
  The exclusion was (i) directorships of unlimited companies (ii) directorships of not-for-profit associations (iii) alternate directorships.
• As per the 2013 Act, maximum number of directorships that an individual can hold including alternate directorships is 20 of which not more than 10 can be public companies. In computing the limit of public companies, directorship of private companies that is either holding/subsidiary company of public company shall be included. In the 1956 Act, the limit was 15 directorships.
• As per the 2013 Act, general meeting by special resolution can specify lesser number than 20/10 companies in which a director of the company can act as a director. There was no such provision in 1956 Act.

6.4.18 Section 166 of the 2013 Act: Duties of Director- Corresponding to Section 312 and 388 of 1956 Act

• There was no codification of the general principles governing duties of directors in the 1956 Act. Section 166 of the 2013 Act attempts such codification and provides the following duties of directors:

• A director of a company shall:
  (a) Act in accordance with the company’s articles.
  (b) 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 environment.
  (c) Exercise his duties with due and reasonable care, skill and diligence shall exercise independent judgement.

• A director of a company shall not:
  (a) Involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company. Achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates. If he is found guilty of making any such undue gain he shall also be liable to pay an amount equal to that gain to the company.
6.4.19 Section 167 of the 2013 Act: Vacation of office of Director—Corresponding to Section 283 of 1956 Act

(A) Under the 1956 Act, failure to obtain within the time specified, or at any time thereafter ceasing to hold, the share qualification, if any, required of him by the articles of the company was a ground for vacation of office. This is no longer a ground for vacation of office under the 2013 Act. Provisions related to share qualification in section 270 of the 1956 Act are omitted from the 2013 Act.

(B) Further, section 283 of the 1956 Act provided that a director’s office shall become vacant if he absents himself from three consecutive meetings of the Board of Directors, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board. Section 167 of the 2013 Act provides that if a director absents himself from all the meetings of the Board of Directors held during a period of 12 months with or without obtaining leave of absence from the Board, his office shall become vacant. Section 167 of the 2013 Act is much more liberal as compared to section 283 of the 1956 Act in the sense that it requires director to attend at least one board meeting during a period of 12 months. However, section 283 of the 1956 Act authorised the Board to sanction a director’s absence for any period of time which is not possible now under section 167 of the 2013 Act.

(C) Section 167 of the 2013 Act provides that where all the directors of company vacate their office as above, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting. Such a provision was not there in the 1956 Act.
6.4.20 Section 168 of the 2013 Act: Resignation of Director

- New provision
- There was no provision in the 1956 Act as regards resignation of director. Section 168 of the 2013 Act is a new provision dealing with the resignation of director. The section requires that director should resign in writing - by written notice to the company. The resignation shall take effect from the later of the following two dates:
  (i) date on which his notice is received by the company
  (ii) date, if any, specified in the director in his notice.

  The director shall also forward a copy of his resignation along with detailed reason for resignation to ROC within 30 days.

6.4.21 Section 169 of the 2013 Act: Removal of Directors Corresponding to Section 284 of 1956 Act

- No change in the provisions except that special notice for intended resolution of removal can only be given by members who satisfy the numerical/shareholding criteria in section 115 of the 2013 Act.
- The 1956 Act conferred a right on the director sought to be removed to make written representations to the company against the removal and had a right to request the company to circulate the same to members. This was subject to the condition that the representations should not exceed reasonable length. The 2013 Act omits this condition regarding reasonable length of representations.
6.4.22 Section 170 of the 2013 Act: Register of Directors and Key Managerial Personnel and their shareholding- Corresponding to Section 303 and 307 of 1956 Act

- Section 170 of the 2013 Act requires that a return containing such particulars and documents as a prescribed, of the directors and the key managerial personnel shall be filed with the Registrar within 30 days from the appointment of every director and key managerial personnel, as the case may be, and within 30 days of any change taking place. This requirement was not there in the 1956 Act.

- Section 307(10) of the 1956 Act provided that a director of a company shall be deemed to hold, or to have an interest or a right in or over, any shares or debentures, if a body corporate other than the company holds them or has that interest or right in or over them, and either-
  (i) that body corporate or its Board of directors is accustomed to act in accordance with his directions or instructions; or
  (ii) he is entitled to exercise or control the exercise of one-third or more of the total voting power exercisable at any general meeting of that body corporate.

Provision of section 307(10) of the 1956 Act have been omitted from the 2013 Act.

6.4.23 Section 171 of the 2013 Act: Member’s right to inspect – Corresponding to Section 304 of the 1956 Act

- Under the 1956 Act, members were not entitled to take extracts of the register of directors and KMP and their shareholding nor were they entitled to copies off the register. Members were only entitled to inspect the register. The 2013 Act confers a right on members also to (i) take extracts from the register and (ii) to request copies from the register. When requested copies to be provided free of cost within 30 days.
• The 2013 Act requires that the register to kept open for inspection at every AGM and shall be accessible to every person attending the AGM. This was not the case under the 1956 Act.
• The 1956 Act entitled the company to limit inspection hours to 2 hours every day. This power has been taken away by the 2013 Act.
• The power to compel inspection transferred by CLB to ROC by the 2013 Act.

6.4.24Section 172 of the 2013 Act: Punishment

• New provision
• This new section provides that where a company contravenes any of the provisions of Chapter XI of the 2013 Act and no specific punishment is provided therein, the company and every officer who is in default shall be punishable with fine.\textsuperscript{289}

\textsuperscript{289} A Comparative Study of Companies Act 2013& Companies Act 1956 by Taxmann’s pg 2.102-2.107
6.5 Analysis of the Research questions

1) What theoretical basis were responsible for evolution of concept of independent directors in the country of its origin United States and other jurisdiction such as United Kingdom?

As discussed in the chapters the corporate entity emerged and proliferated from US and UK. The foundational theorising concept of Berle and Means in the Modern Corporation and Private published wherein it was observed that the diffusion in shareholding and such diffused shareholders are lack sufficient financial incentives to intervene directly in the affairs of the company. As a result “the separation ownership and control” was progressively ingrained as characteristic of the large, powerful business corporation. Thus, the foundation of independent director concept can be traced to the agency cost theory that primarily addresses the management-shareholder agency problem. Henry Manne put the point even more strongly, saying in 1987 that “(n)o field of American law has ever been so totally dominated by one work as the corporation law area by the Berle and Mean classic.” If one examines closely the existing form of Company Law largely draws from this problem so that it looks inwards in terms of defining relationships inter se and protecting one set of shareholders from the other, delegating power and duty.

The US and UK dominantly follow an outsider model of corporate governance. The core features of an outsider model comprise of: “1) dispersed equity ownership with large institutional holdings; 2) recognized primacy of shareholder interests in the company law; 3) a strong emphasis on the protection of minority investors in securities law and regulation; and 4) relatively strong requirements for disclosure.” Hence, the theories of agency as developed and on a close scrutiny it can be observed that the existing form of Company Law largely

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draws from these problems, so that it looks inwards in terms of defining relationships inter se and protecting one set of shareholders from the other, delegating power and duty.

2) What role and functionality was entrusted to independent director’s office in United States? How did judiciary responded to independent directors?

The history of Independent Directors in US could be traced from 1950 to 2005. Across this period corporate governance and laws contained several nomenclatures when talking about independent directors. Thus the terms outsiders, non-interested, disinterested, non-executive, non-employee and independent were frequently used interchangeably. However the modern day concept of independent director developed over this period. In the same breath if one examines the trend of inculcation of independent directors in the board, it emerges that the initial voluntary action took a mandatory turn. In the light of collapses of Enron, WorldCom, Tyco legislature and regulatory requirements were crafted in the form of the Sarbanes-Oxley Act, 2002 (hereinafter SOA) and stock exchange rules.

Delware laws and courts were considered to be most progressive when it came to corporate matters. A catena of decisions and judicial interpretations are helpful in the way in which courts perceived independent directors role in the overall conflict of interest issue. Interestingly, the court considered independent directors to be instrumental in resolving not only conflict of interest situation but also extended their role to protection from controlling shareholders, a concept which theoretical developed much latter. Hence, the answer to this question has been derived in a positive sense since the concept of independent directors has largely emerged in response to several agency and other related problems discussed in theory in the earlier chapters.

3) What is the scope and definition of independent directors in India?

The definition of independent directors and scope has been highlighted in the earlier chapters and therefore beginning form its post liberalisation era and various recommendation of the Mr. Kumar Mangalam Birla Committee to its adoption in the Companies Act 2013 which has taken place of Companies Act 1956 while this research was ongoing the definition and its scope has been highlighted in details. Hence there is a positive approach in adoption of the definition of the independent directors.

4) What is the difference between corporate sector and governance models in India and United States?

US jurisdiction explicitly recognises that independent directors are meant resolve agency problems between managers and shareholders and not the one between controlling shareholders and minority shareholders. Therefore when a logical extension of the same is made to Indian corporate sector and the predominant insider model of governance where there exists core issues of governance in controlled ownership as against dispersed ownership, concept of independent directors needs a closer look.

Hence, the evolution of the concept of independent directors has taken place from the concept of US and UK and in this way the researcher can analyse that by the adopting the same in the Companies Act 2013 India too has been adaptive to the concept of independent directors by imbibing the role and functions, duties, manner of appointment of the independent directors etc.
5) Does Indian statute and regulatory bodies imbibe this concept and its role in clear and unambiguous terms?

One of the perceived weaknesses in the existing system of independent directors in India is the lack of clarity regarding their role. It is not clear whether independent directors are to perform an advisory role or a monitoring role i.e by overseeing management and controlling shareholders. It is also not clear whether independent directors are to act in the interest of the shareholder body as a whole or whether they are required to pay any specific attention to the interests of the minority shareholders. Taking lessons from Satyam and as an important aspect of legal reform in the field of corporate governance, policy makers and legislators have been increasingly placing reliance as well as responsibility on independent directors to ensure that companies demonstrate high levels of corporate governance. That the role and functionality of independent directors have been expanding with passing time is well established. Company Act 2013 that is an excellent indicator of such extension.

The Indian statute and regulatory bodies has imbibe the concept and its clear and unambiguous terms or not will be decided over a period of time as some of the following points are taken into consideration as discussed in the suggestions like board composition, representation of small shareholders and mechanism of check and balances.

6) Is it possible to effectively expand and assign independent directors the task to ensure protection of interests of minority shareholders and stakeholders?

The answer to this question is in affirmative in the sense that the role of the independent directors on the aforesaid points makes it amply clear that the legal and regulatory merit in proactive steps being taken by the regulator to safeguard the interest of the minority shareholders. In this scheme of things, the board of
directors, and especially the institution of independent directors, becomes an important regulatory mechanism for the protection of other stakeholders as well.\textsuperscript{293}

\section*{6.6 Conclusion}

Thus it can be said that Indian Company Law statute has not only imbibed the independent directors in its everyday corporate functionality but also very clearly and specifically assigned tasks and job profile to them. It may not be an exaggeration to say that the recent Company Act has been much more progressive in accommodating and translating several recommendations of post Satyam committees. The manner in which existing statute mandates corporations to function, it explicitly recognises that the role of independent has progressed much more than merely resolving management-shareholders agency problem.

\textsuperscript{293} See chapter 6 for details.