A Note on Independent Director - A New Law in Co Act

A NOTE ON INDEPENDENT DIRECTORS

The term Independent Director is not a new for us. Provisions in relation to Independent Director was well incorporated by the SEBI in the listing Agreement. Now the Companies Act, 2013 also introduced the definition and various provisions with regard to Independent Directors,

As per section 149(6) of the Companies Act, 2013:

Independent Director is a Director other than a Managing Director or a whole time Director or a nominee Director, who should

• Not be a PROMOTER or DIRECTOR of the company of the company or its subsidiary company.

• Not be a Relative of PROMOTER OR DIRECTOR in the company, its holding, subsidiary or associate company .

• Have no Pecuniary relationship with the company's holding, subsidiary or associate company, or their promoters, or directors, during the 2 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 50 lakh rupees or such higher amount as may be prescribed, whichever is lower, during the 2 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 3 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 3 financial years immediately preceding the financial year in which he is proposed to be appointed, of

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;

i. holds together with his Relatives 2% or more of the Total Voting power of the company; or

ii. is a Chief Executive or director, by whatever name called, of any Nonprofit organization that receives 25% or more of its receipts from the 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; or

iii. who possesses such other qualifications as may be prescribed.

The Term Pecuniary Relationship has not been defined in the act so one can presume that it basically means relationship as holding voting power or relationship like a relative.

**Guidelines of professional conduct:**

An independent director shall:

1. uphold ethical standards of integrity and probity;

2. act objectively and constructively while exercising his duties;

3. exercise his responsibilities in a *bona fide* manner in the interest of the company;

4. devote sufficient time and attention to his professional obligations for informed and balanced decision making;

5. not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making;
6. not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;

7. refrain from any action that would lead to loss of his independence;

8. where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;

9. assist the company in implementing the best corporate governance practices.

**Role and functions:**

The independent directors shall:

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;

2. bring an objective view in the evaluation of the performance of board and management;

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;

5. safeguard the interests of all stakeholders, particularly the minority shareholders;

6. balance the conflicting interest of the stakeholders;

7. determine appropriate levels of remuneration of executive directors, key managerial personnel and senior management and have a prime role in appointing and where necessary recommend removal of executive directors, key managerial personnel and senior management;

8. moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

**Duties:**

The independent directors shall—

1. undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;
2. seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;

3. strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;

4. participate constructively and actively in the committees of the Board in which they are chairpersons or members;

5. strive to attend the general meetings of the company;

6. where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;

7. keep themselves well informed about the company and the external environment in which it operates;

8. not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

9. pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;

10. ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

11. report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;

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

13. not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

**Other qualifications**: An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

**Strength of Independent Directors**

**Listed Companies**: at least 1/3 of total number of Directors

**According to the listing agreement** : Board of Directors shall optimum combination of executive and non executive and non executive directors.
Where Chairman of the Board is a non-executive, 1/3 rd of the Board should have independent directors. And where chairman is executive one – ½ of the Board should comprise of independent Directors.

At least one half of the Board of the Company shall consist of independent directors.

**Other Companies** The following class or classes of companies shall have at least 2 directors as Independent directors –

(i) The Public Companies having paid up share capital of 10 crore rupees or more; or

(ii) The Public Companies having turnover of 100 crore rupees or more; or

(iii) The Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees:

**Manner of Appointment:**

i. The appointment of independent director of the Company shall be approved by the members of the Company by special resolution.

ii. The explanatory statement attached to the notice of the meeting include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfills the conditions specified in the Act and the rules made hereunder and that the proposed director is independent of the management.

iii. The appointment shall be formalized through a letter, which shall set out:

   - The term of appointment
   - The expectation of the Board from the appointed director
   - The fiduciary duties
   - Provision for Directors and officers insurance, if any
   - The code of Business ethics
   - The list of actions that a director should not do while functioning as such in the Company
   - The remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.

**Tenure:**

- An independent Director shall hold office for a term upto 5 years on the Board.
- Eligible for re-appointment on passing of special resolution by the company
• Eligible to hold office for not more than two consecutive terms

• But such independent director shall be eligible for reappointment after the expiration of 3 years of ceasing to become an independent director. Such 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 re-appointment of Independent Director shall be on the basis of report of performance evaluation.

• The provisions in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors

Remuneration:

• An Independent Director may receive remuneration by way of fee which shall not exceed Rs. 1,00,000/- per meeting of the Board or committee.

• He/She is also liable for reimbursement of expenses for participation in the Board

• Other profit related commission as may be approved by the members.

Resignation or Removal:

Resignation

i. An Independent Director may resign from his office by giving a notice in writing to the Company.

ii. The Board on receipt of such notice take note of the same and the Company shall intimate the Registrar within 30 days from the date of such notice in Form DIR-12.

iii. The Company shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the Company.

iv. A director shall also forward a copy of resignation in DIR-11 within 30 days.

Removal

i. A Company may, by ordinary resolution, remove a director, before the expiry of his period after giving a reasonable opportunity of being heard.

ii. A special notice is required of any resolution, to remove a director under this section, or to appoint somebody in place of a director so removed.

iii. A copy of notice should be sent to the concerned director and shall be entitled to be heard on the resolution at the meeting.
iv. A vacancy created by the removal of a director under this section may, if he had been appointed by the Company in
general meeting or by the Board, be filled by the appointment of another director in his place at the meeting which he is
removed.

v. The director removed from the office shall not be appointed as a Director by Board of Directors.

The vacancy created by the resignation or removal shall be replaced by a new independent director within a period of
not more than 180 days.

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:

   i. Review the performance of non-independent directors.

   ii. Review the performance of the Chairperson of the Company.

   iii. 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.

Evaluation Mechanism

1. The performance evaluation of independent directors shall be done by the entire Board of Directors, excluding the
director being evaluated.

2. 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.

Reporting / Compliance

1. Every independent director shall give a declaration that he meets the criteria of independence as provided in sub
section (6) of section 149 of the Companies Act, 2013 in following way:

   • At the first meeting of the Board in which he participates as a director

   • At the first meeting of the Board in every financial year

   • Whenever there is any change in the circumstances which may affect his status as an independent director
2. Every person who has been appointed shall on or before the appointment furnish to the Company within 30 days a consent in writing to act as such in Form – DIR-2.

3. The company shall within 30 days of appointment file such consent with the Registrar in Form DIR-12.

4. In case of resignation, the director shall forward a copy of the resignation along with the reasons for the resignation in form DIR-11.

5. The Company shall within 30 days intimate the registrar regarding resignation of a director in form DIR-12 and post the information on the website of the Company.

6. Disclosure of appointment and re-appointment of the independent Director should be in the Board’s report.

7. The terms and conditions of appointment of independent directors shall also be posted on the Company’s website.

8. 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.

Recommended Read

- Credit Note accounted in the Audited annual financial statement but not in GST
- GST: A Note on Applicability of Sec 49A - New offset method