Introduction:

Having received the assent of the President of India, “The Companies Act, 2013” has come into existence on 29.08.2013 which will replace the old Companies Act, 1956. As per Section 1 of the new Act, different sections of new Act will come into force on different dates as may be decided by further notifications in the Gazette.

Overview:

The Companies Act, 2013(Act) contains 470 Sections and 7 Schedules. Implication of the most of the sections is not fully clear as Rules are yet to be made effective. The notable feature of the new Act is that it deleted many of the redundant provisions and regrouped related sections at one place, strengthened existing provisions by modification, added new definitions and brought in new concepts. The thrust of the Act was to ensure better corporate governance, speedy disposal of amalgamations and mergers, winding up process, prevention of frauds, provide mechanism to prevent frauds for ensuring investor protection.

An attempt is made in this article to highlight the provisions relating independent directors.
Independent Directors under Old Act: In the old Act, there is no definition of Independent Director. However one finds parameters mentioned in Clause no.49 (Corporate Governance) of the listing agreement to recognise a director as an independent director. According to this clause, independent directors are those who apart from receiving director's remuneration do not have any material pecuniary relationships or transactions with the company, promoters, senior management, holding company or subsidiary or associates which affect their independence. Besides this other factors such as relationship or association as partner, employee in audit firm, consultancy firm which are working for company or holding of 2% or more shares will disqualify him for the post of independent director.

All listed companies in the name of good corporate governance have been mandated to comply with provisions relating to composition of board, audit committee, remuneration committees, and manner of holding meetings meetings, duties and disclosures of remuneration to non executive directors, related party transactions with directors etc were to be reported in the Corporate Governance report. Now many of these requirements are made part of the New Act itself.

**Definition of Independent director:**

Section 2(47) states that Independent director means an independent director referred in Section 149(5) of Companies Act, 2013. In fact reference should have been made to sub section 6 of 149 as it describes the attributes of independent director with clarity. New Act now makes it mandatory for every listed public company to appoint at least one-third of the total strength as independent directors (fraction is to be rounded off to one). Central Government may, in case of any class or classes of public companies prescribe the minimum number of independent directors to be appointed. Since it will be difficult to meet this requirement, one year time has been given to the existing companies from the effective date to fall in line with the requirement.

**Criteria for selecting Independent Director:**

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.

Let us now see the qualities required for a person to be appointed as an independent director or to put it differently restrictions or disqualifications imposed.
1) He must be a person of integrity and possess relevant expertise and experience or any such other qualifications as may be prescribed.

2) He is or was not a promoter of the company or its holding, subsidiary or associate company

3) He is not related to promoters or directors in the company, its holding, subsidiary or associate company

4) He must not have any 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. This restriction applies in case his relatives had transactions having value of two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower. Period to be checked is the two immediately preceding financial years or during the current financial year

5) He must not either directly or any of his relatives hold 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

6) He will be disqualified to be an independent director, if he is or has been an employee or proprietor or a partner of:

- a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

- any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm

- holds together with his relatives two per cent. or more of the total voting power of the company or

- is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that hold two per cent or more of the total voting power of the Company.

**Manner of selection of Independent Director**

Section 150 (1) of the Act, indicates that the independent directors may be selected from a data bank of eligible and willing persons maintained by any Institute or Association as may be prescribed by Central Government. This section further stipulates that the appointment of independent directors has to be approved by members in a General meeting and the explanatory statement annexed to the notice must indicate justification for such appointment.
**Term of office:** Independent director can hold office for a term of 5 consecutive years and such term can be extended by another 5 years, if a special resolution is passed by shareholders and disclosure to that effect is made in Directors Report. Another relaxation given is that the same person can be considered for re-appointment after a lapse of 3 years period from the date of cessation of directorship. Further relaxation is that the period held by independent director prior to new act coming into existence is not considered for the above term of 5 or 10 years and retirement provisions u/s 152(6)(7) are not to be applied to independent directors. This relaxation is provided obviously as the law makers must have visualized shortage of independent directors.

**Disclosures:** An Independent director has to compulsorily give a declaration that he meets the criteria of independence as specified in Section 149(6) at the first board meeting held after his appointment and subsequently at every first meeting of the financial year. If any circumstance arises due to which he looses his independence, he must disclose to the Board about his inability to continue.

**Compliance with Schedule IV:** Both the company and independent directors have to comply with the provisions specified in Schedule IV. The essence of guidelines is that professional conduct is expected from independent directors and they should use their skill and independence in implementing the best corporate governance in the interests of shareholders. They are also duty bound to evaluate the performance of non-independent directors and Board as a whole. Similarly company is also to exercise care in selection or appointment of independent directors and issue appointment letter, evolve a system for evaluation of performance of independent directors. Appointment letter should spell out term, remuneration, duties expected of the independent director. The terms and conditions should be made available for inspection at the registered office of the company and also be displayed on the company's website.

**Remuneration:** An independent director is not entitled to any stock option. But he may receive sitting fees, reimbursement of expenses incurred for attending board or other committee meetings and commission linked to profits. The reason for denying monthly/yearly remuneration is to preserve his independency. However there is no logic in depriving stock options to Independent directors (Section 149(9)). Had it been allowed, it would have been an incentive in the absence of good remuneration.

**Liability:** 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 or connivance or for failure to exercise due diligence in such acts (Section149(12))
Conclusion: The positive feature of the new Act is that it empowers Independent directors to hold separate meetings without the presence of other directors to assess the performance of Board. This power certainly gives supremacy to independent directors to voice their concerns or sound alarm, if there is any mismanagement or things go wrong. However too many restrictions to be qualified as independent director, clearly defined duties and responsibilities, more particularly with a pittance remuneration or no stock options may not attract good qualified persons to act as independent directors. Let us hope the rules which are yet to be finalized will address this issue and qualifications properly.

G S Rao,
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Recommended Read
- Highlights of the Companies (Amendment) Bill, 2019
- Amendment through Companies Amendment Second Ordinance 2019
Thanks with regards for the knowledge sharing.

ANURADHA

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MANISH

very good knowledge is given towards independent director in the old companies Act, 1956 it is not so much clear. Thank you for giving such kind of information.

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JINAY

Thank you for the wonderful insight sir.

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Nice sir...) 

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MOHINDER SINGH

very nice sir u have added all the provisions relating to independent director.

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