

## INDEPENDENT DIRECTORS AND CORPORATE GOVERNANCE

Recent scams have brought the Independent Directors or the Non-Executive Directors (NED), under scrutiny. They are generally considered to be insignificant and the companies appoint just one, to comply with the regulation and as someone without whom an investor cannot hope for a profitable prospective.

Kumar Mangalam Birla Committee defined independent director as a director who apart from receiving director's remuneration does not have any material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of Board may affect independent judgment of directors.

The perceived role of independent directors is to act as the watchdogs of the shareholders and the stakeholders and they are appointed to ensure an efficient and unbiased composition of the board. Independent directors are said to be (i) contributive to the board when they challenge the making of policy decisions and company strategy; (ii) responsible for scrutinizing the managerial performance and ensure their accountability for their actions; (iii) their independence allows them to accomplish their tasks more proficiently. Although, they are accountable for company's dealings, they are unlikely to be affected by self-interest in their actions.

However, no one can deny that they primarily have been passive and indifferent to their role or themselves are a part to the wrong done. Satyam scam can be considered as an example of Independent Directors indifference even though Satyam had some of the finest and qualified Independent Directors. More can be illustrated with the example of the Mr. V. K. Kaul, who being an independent director was accused of insider trading. This along with DLF Land Deals and Coal India Case has brought into question as to the value of having an independent director on the board.

In the case of Satyam where the NED were acquitted on the grounds that they were kept in dark or they were provided with false information. It raises the question whether an independent director appointed to watch over the functioning of corporation canfray away from their responsibility by relying on the information given to them by the management. In the case of *Australian Securities and Investment Commission V. MacDonald* wherein the Australian High Court held executive and non-executive for a false statement in the prospectus, the court specifically held that non-executive directors are duty bound to apply their own mind and not to rely on the information given to them by the management. This when applied in Indian scenario would make it difficult for NED's to use it as their defense

and rely for acquittal just for the reason of lack of information.

Presently several gaps in the present legislation creates doubts on the independence of the Independent Directors.

### **Appointment**

India has majority of its companies as a promoter-run company and their board comprises of puppets of promoters. The Companies Act remains silent on the qualifications for an independent director. In case of listed Companies the appointment of independent director is administered by the SEBI Regulation whereas for unlisted company there are no legal requisites. Here the appointment of independent director is just a matter of simple legal & statutory compliance and most of the time independent director are the ones 'handpicked' by the promoter who prefer to appoint a friend in place of a watch dog to protect the interest of the minority shareholder and stakeholders, this further questions them being independent.

### **Qualification**

As stated above the Companies Act and The Listing Agreement are silent on the qualification of an independent director. Taking advantage of this companies most of the time appoint someone who is not an expert or not even remotely related to the substratum of the company, so as to make their post inefficient and non-significant.

### **Limited Jurisdiction**

Independent Directors are not to interfere with the details of day to day functions of the company and are only there when they suspect any misdeed and are to support the management in running the company. However, there is no legal protection for independent directors against the management.

Be it the appointment, qualification or jurisdiction an Independent Director *prima-facie* is dependent on the management.

The Companies Bill, 2012 (the bill) has further stepped up the interest in this subject and has introduced the concept of independent directors in clause 149. The definition is far more comprehensive than the existing definition in clause 49 of the listing agreement. An independent director should be a person of integrity with relevant expertise and experience although no litmus test has been prescribed for determining the integrity which is a relative concept. It is therefore left to the collective decision of the board to set the criteria for determining the bench marks for the person sought to be appointed for the post.

There are numerous noteworthy provisions introduced in the bill with regard to independent directors.

- The bill proposes that nominee directors to not be classified as independent directors as they represent and safeguard the rights of a specific financial institution, not the whole shareholder body.
- The bill has included a certain class of people, like auditors, practicing company secretary, material supplier etc. within the scope of people who are not allowed to be classified as independent directors of the company as such relations can potentially arouse conflict of interest situations.
- The director's shareholding criterion has been extended by including the shareholdings of the relatives as well.
- The bill has introduced a provision that at least one-third of the total number of directors would be independent directors and the central government has been authorized to prescribe the number of independent directors in case of any class or classes of public companies.
- The Bill also contains many provisions bringing out the clarity in the position and powers of independent directors.

It is pertinent for the Independent Directors to understand that in order to protect themselves from legal action they have to proactively play a supervisory role and bring objectivity to the decisions made by the board of directors. They do not need to take part in the company's day-to-day affairs or decision making but they should at least ask the right questions at the right time regarding the board's decisions and by raising the appropriate red flags at the right time which would help them avoid the occurrence of unwanted situations and their consequences to a great extent.

## **Conclusion**

It can be stated that the institution of independent directors is absolutely indispensable to the corporate governance regime and, hence, it would not be wrong to say that they are in a way insurers of good corporate governance practices. The Satyam episode has though proven to be tragic, but it should be considered as a wakeup call to many as this case brought out the failure on the part of the independent directors. In the contemporary scenario, independent directors are still the only hope to instill discipline in the corporate finance world, provided their independence is not being compromised with and their position strengthened. Thus, it is the need of the hour that the Independent Directors be more proactive in the boardroom for the dual purpose of corporate governance and to protect themselves against the liability. Further, the Companies Bill, 2012 has introduced the concept of independent directors and it can be said that independent directors will play a major role in the functioning of corporate governance after the said bill is in effect with a more defined role.

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**National Consumer Disputes Redressal Commission (NCDRC):  
Emirate Airlines v. Dr. Rakesh Chopra, First Appeal No. 204 of 2008,**

**Decided on April 11, 2013**

An appeal filed by Emirate Airlines challenging the order of Delhi State Consumer Disputes Redressal Commission, directing it to pay Rs. 2 Lakhs to the passenger while holding the Airlines guilty for negligence and deficiency in service for failing to keep the luggage in safe custody and deliver it to the passenger, was dismissed by NCDRC. The passenger, Dr. Rakesh Chopra, had alleged before Commission that when the doctor travelled by Emirate Airlines to Athens for a conference one of his bags was misplaced, which has not been found till date, and on the return journey his second bag was damaged. He further alleged that the Airlines paid a very meager amount as compensation. While hearing the complaint of the Doctor, State Commission has held that loss of luggage amounted to deficiency and awarded Rs. 2 lakh as compensation. NCDRC, which was in agreement with the findings of the Commission upheld the order of the Commission and said, "In the instant case, no doubt the Appellant Airlines had sought to settle the consumer's grievance purely in terms of the notional monetary loss suffered by him as per the relevant provisions of Carriage by Air Act, 1972". However, as discussed earlier, because there was deficiency in service on the part of Appellant Airlines in losing and mishandling the Respondent's luggage, which caused him harassment, agony, mental tension and loss of professional face apart from monetary loss, he is entitled to compensation for this deficiency in service on Appellant's part as per the provisions of the Consumer Protection Act, 1986. Keeping in view these facts, the State Commission has awarded a compensation of Rs.2.00 Lakhs. The Commission did not find any reason to disagree with the compensation awarded, which, we feel, is fully justified under the circumstances.

<http://164.100.72.12/ncdrcprep/judgement/00130411095236884FA20408.html>

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### **Supreme Court Cases (SCC): Kandla Port v. Hargovind Jasraj, Civil Appeal No. 153 of 2013, Decided on January 9, 2013**

For maintaining suit for declaration that termination of lease was invalid, lessee need not be dispossessed from leased property as dispossession is different from termination of lease. Ownership is distinct from possession. **((2013) 3 SCC 182)**

<http://judis.nic.in/supremecourt/imgs1.aspx?filename=39971>

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### **Post-award application u/s 9 not maintainable if the claim is dismissed by arbitrators**

Recently, in Dirk India Pvt. Ltd. v. Maharashtra State Electricity Generation Co. Ltd., Appeal No. 114/2013, a Division Bench of the Bombay High Court has held that a

petition under section 9 of the Arbitration and Conciliation Act, 1996, is not maintainable after the award if the claim has been dismissed by the arbitrators. Section 9 of the Act states that a party may, before or during the arbitral proceedings, or at any time after the making of the arbitral award but before it is enforced, can apply for interim relief. The Division Bench held that an application under section 9 is not maintainable at the request of a claimant after the award, if the claim has been dismissed by the arbitrator.

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## **Amendment to SEBI (Mutual Funds) Regulations**

The SEBI (Mutual Funds) (Amendment) Regulations, 2013 was notified on April 16, 2013. The key highlights of the amendment regulations pertains to Infrastructure Debt Funds and are listed below:

### **Placement Memorandum**

Private Placement to less than 50 investors has been permitted in case of Infrastructure Debt Funds. In case of private placement, the mutual funds would have to file a Placement Memorandum with SEBI instead of a Scheme Information Document and a Key Information Memorandum. However, all the other conditions applicable to Infrastructure Debt Funds earlier such as kind of investments, investment restrictions, etc. would be applicable. The Placement Memorandum shall be filed with SEBI as per the prescribed format.

### **Long term FIIs included as Investors**

The universe of strategic investors in the Infrastructure Debt Funds has been expanded to include, inter alia, FIIs registered with SEBI which are long term investors subject to their existing investment limits. The Amendment Regulations have designated the following categories of FIIs as long term investors only for the purpose of investment in Infrastructure Debt Funds- (i) Foreign Central Banks, (ii) Governmental Agencies (iii) Sovereign Wealth Funds (iv) International/ Multilateral Organizations/ Agencies (v) Insurance Funds (vi) Pension Funds.

## **News 10 @ a glance**

### **SEBI on Collective Investment Schemes**

SEBI while adjudging the matter of Ossian Art Fund has cleared the doubts over few of the provisions of CIS Regulations thereby cautioning the prospective issuers of CIS. It firstly ruled that only a company

structure and no other structure (including Trusts) can be used to issue a CIS. Further it ruled that CIS Regulation are not limited to a particular class of assets but include any class of assets and lastly it limited the scope of CIS Regulation to 'public offerings' only.

### **Combination Regulation Amended**

CCI has amended Competition Commission of India (Procedure in Regard to the Transaction of Business Relating to Combinations) Regulations 2011 {Combination Regulation}. By exempting the creeping acquisition CCI has brought the Combination Regulation and Takeover Codes further closure. Next it has further relaxed the requirements of getting approvals for the transaction which essentially internal restructuring by laying down the requirement of control over of 50% of shares or voting Rights of an enterprise(s) within or outside the group.

### **Common Dictionary Word not a ground to justify an infringement**

Intellectual Property Appellate Board while issuing an ordering favor of English Car Manufacturing Company Jaguar Cars rejected the argument of Swiss Company, Manufacture Des Montres Jaguar, that the word "Jaguar" is a common Dictionary word hence there can't be any trademark infringement in using the word. IPAB ruled that just

because "Jaguar" is a common Dictionary word no one can be allowed to abuse it without realizing the market reputation allied with it.

### **Kit Kat now a registered Trademark**

IPAB in a ruling dated 20th April 2013 has finally settled a 26 year old dispute between the Swiss multinational Societe des Produits Nestle S.A and the Calcutta based Kit Kat Food Products over the matter of use of the trademark "Kit Kat". IPAB, on the grounds that Nestle was a prior user of the Trademark and both the companies are having almost similar production line and customers confusion is bound to occur, granted the Trademark to the Swiss Company.

### **CCI slams Rs 8,000 crores penalty in 19 cases**

Competition Commission of India (CCI) has penalised 19 business entities for anti-competitive practices of Rs.8,000 crore by the end of financial year 2012-13. As on March 31, 2013 CCI had received 347 cases regarding violations of anti-competitive practices and the commission has closed 262 cases. In 28 cases, cease and desist orders have been passed while in 19 cases total penalties of Rs.8,013 crore have been imposed along with cease and desist orders. According to the Competition Act, CCI can issue, cease, and desist order to refrain the company from pursuing

any anti-competitive practices.

### **Clean Chit in the matter of M/S Axis Bank Ltd.**

The Assessing Officer after conducting an investigation on the Notice, who was accused for trading in shares of KSK Energy Pvt. Ltd. and another company while acting as a Merchant Banker, has acquitted them on the grounds of lack of evidence and benefit of doubt. However, it's quite unreasonable to base its decision on the dates of initiating the negotiation and conclusion proceedings of MOU.

### **Gift of Shares to Family Trust Exempted**

SEBI in its decision of a case involving Gujarat Organics Ltd. has exempted the promoter owning 71.15% of shares from the takeover regulations in transferring the said shares to a trust called HD trust, of which he is a trustee and the other trustees comprise of his family member.

SEBI classifying it as a gift to family trust has exempted it from takeover regulation on the grounds that it is a prima-facie reordering in holdings which does not count as change in control of company and additionally it was just a family arrangement facilitating succession proceedings.

### **Google under CCI investigations**

The Competition Commission of



India (CCI) is investigating the search giant Google. The Comision Nacional de Defensa de la Competencia in Argentina, the Competition Commission of India and the Korea Fair Trade Commission in South Korea have opened investigations into certain business practices of Google.

### **Judgment against “Market Abuse”**

The Supreme Court in its judgment while commenting on the constantly mushrooming “market abuse” and the role of SEBI in curbing emphasized on the following points, firstly when shares of a company are placed in the market there should be a proper disclosure of the pricing of the companies share along with all the required disclosures as per the Companies Act. Secondly it called in a stricter approach on the part of SEBI while regulating the market. Thirdly and most importantly it re-elaborated the liability of a director for mismanagement in a company, it said that a Director cannot argue that he was assigned a particular department of the company and is not liable for the wrong done in any other department, all Directors are responsible for what the books of account of a company represent about the functioning of a company. This judgment although not laying down a law does show its inclination towards a fair play in the security market.

## **First Ever Compulsory License To Indian Generic Company**

The Controller General of Patents upheld the grant of first ever Compulsory License to the Hyderabad-based Natco Pharma Limited, a generic drug maker, to manufacture and sell a generic version of 'Sorafenib Tosyalte', a patented cancer drug of multinational pharma major Bayer Corporation. This judgment may bring down the prices of the costly lifesaving drugs.