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## Independent Directors

➤ The new Companies Act of 2013 has mandated the appointment of independent directors to ensure that the affairs of the company are conducted properly and that Satyam like scams do not take place. Who are eligible for appointment as ID, what is their role and responsibility, how they are to be appointed and removed have all been briefly highlighted here.

**T**he Companies Act, 2013, for the first time, defines an 'Independent director' and the definition in Section 2(47) is identical to the one provided in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, a regulation applicable only to listed companies. Section 2(47) says that an 'independent director' means an independent director referred to in sub-section (6) of Section 149.

### WHO CAN BE AN INDEPENDENT DIRECTOR

Section 149(6) of the Companies Act, 2013 specifies as to who can be an independent director. In simple words, any of the following persons can be termed as independent director:

- A person who is not a Managing Director nor Whole-time Director nor a Nominee Director; in other words, a director who is either non-executive or part time professional director.
- A person with relevant experience, expertise and integrity in the opinion of Board of Directors. Therefore, while considering the appointment of Independent Director, the Board has to deliberate as to whether the person is a man of integrity

and possess experience and expertise and thereafter pass a resolution. Though the word 'relevant' is used it does not narrow down the choice about the person. The person may be having experience in the line of business in which the company is engaged and others may have experience in the fields such as law, finance, economic, management, business, trade, commerce etc.etc.

- A person who neither was nor is a promoter of the company nor its holding or subsidiary or associate company. 'Associate company' has been defined in sub-section (6) of Section 2 of the Companies Act, 2013.
- A person who neither has nor has any pecuniary relationship with the company, its holding, subsidiary, or associate company or their promoters, or directors during the preceding two financial years or during the current financial year.
- A relative who has or had pecuniary relationship or transaction with the company, holding company, subsidiary company, associate company or their promoter director or director and the value of such relationship or transaction does not exceed 2% of its gross turn-over or its total income or Rs.55,00,000 or such higher amount as may be prescribed during the immediately two preceding financial years or during the current financial year.
- A person who neither himself nor his relative had held or holding the position of KMP or currently is or has been the employee of the company, its holding, its subsidiary

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or its associate company during any three financial years immediately preceding the financial year in which he is sought to be appointed.

- A person who neither himself nor any of his relatives is or has been (i) an employee or proprietor or a partner, in any of the immediately preceding three financial years, in the firm of auditors, company secretaries in practice or cost auditors of the company or in its holding company or subsidiary company or associate company; or (ii) in any legal or consulting firm that has or had any transaction with the company, its holding company, subsidiary company or associates company, amounting to 10% or more of the gross turnover of such firm or (iii). a person who either holds together with his relatives two per cent or more of the total voting power of the company; or (iv) a person who is neither Chief Executive nor Director, or by whatever name called, in any Non-Profit Organization that receives twenty five percent or more of its receipts from the company or any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting of the company.
- A person who possess such other qualification as may be prescribed.

An important question that arises for consideration is as to whether an Advocate or any person who is either partner or sole proprietor of legal or consulting firm can become independent director in the company to which they are providing legal services. There is no legal bar so long as such Advocate or his legal consulting firm is raising bills which do not exceed 10% or more of its gross annual turnover. However, in case of (a) firm of auditors (b) company secretaries in practice or (c) cost accountant there is a total bar irrespective of their turnover. If the intention of the legislature was to put an embargo upon an Advocate or his Consulting Firm, the word "legal or consulting firm" would have found place in Section 149(6)(e)(ii) (A) itself and would not have related to its gross annual turn over. In other words, if a person is an employee, proprietor or partner in any firm of Auditors, PCS or Cost Accountant, during any preceding three years, is not at all entitled to be appointed as an independent director whereas an Advocate can be appointed as an independent director so long as he himself or his consulting firm raises bills of the value not exceeding 10% or more its annual gross turnover. In fact, the Ministry of Corporate Affairs in its Circular No.13/75 dated 5.6.1975 has clarified that a contract of professional services is not violative of Section 297 of Companies Act, 1956. There is a change

in law but still, professional services rendered by an Advocate does not come in the way of his becoming independent director so long fee bill does not exceed the limit as stated above.

According to Rule 5 of the Companies (Appointment and Qualification of Directors) Rules, 2014, 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 operation or other disciplines related to the company's business. The word "other disciplines related to the company's business" would include those areas peculiar to the lines of the business in which the company is engaged in.

## STRENGTH OF INDEPENDENT DIRECTOR

Section 149(4) requires every listed company to appoint minimum one-third of the total number of directors as independent directors. For companies, other than the listed companies, Rule 4 of The Companies (Appointment and Qualification of Directors) Rules, 2014 provides that following class of public companies shall have at least two persons as independent directors:-

- Public Companies having paid up share capital of Rs.10 Crores or more
- Public Companies having turn over of Rs.100 Crore or more
- Public Companies having outstanding loan, debentures and deposits, in aggregate, in excess of Rs.50 Crore.

## PROCEDURE FOR APPOINTMENT

Section 150(1) says that an independent director may be appointed from out of the data bank maintained by any association, body, institute as may be notified by Central Government. It is clarified that it is not mandatory that independent director should be appointed only from the data bank in view of the word 'may'





# Article

INDEPENDENT DIRECTORS

➤ It is clarified that it is not mandatory that independent director should be appointed only from the data bank in view of the word 'may' appearing in the Section. Needless to say, appointment of independent director shall first be considered in the meeting of the Board of Directors and later on approved by the company by way of ordinary resolution in general meeting as per Section 152(2). However, the second tenure of five consecutive years shall be by way of special resolution passed in the general meeting.

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## PAYMENT OF SITTING FEE/COMMISSION

According to Section 149(9), the independent director is entitled to receive

- (a) sitting fee for Board/Committee meetings as may be prescribed under second proviso under Section 197(5)
- (b) reimbursement of expenses for attending the board/committee meetings
- (c) commission related to profits of the company subject to the provisions of Section 197 and 198 ( one percent of the net profits if there is a Managing Director or Whole-Time Director or Manager and three percent of the net profits in any other case). The net profits shall be computed in accordance with Section 198. The independent director , however, shall not be entitled to receive any "stock option".

## TENURE OF OFFICE

The independent director is entitled to hold office for a term of

five consecutive years and shall be entitled to appointment for a further term of five years subject to approval of shareholders by way of special resolution in the general meeting and disclosure to this effect in the Directors Report. The independent director shall not hold office in excess of two consecutive terms of five years but shall be eligible to be appointed after the expiry of three years of ceasing to become independent director. Besides the above, as per mandate of Section 149(11), he shall not be entitled to be appointed or associated with the company either directly or indirectly for a period of three years. The Explanation to sub-sections (10) and (11) of Section 149 further provide that the existing tenure of the independent director shall not be reckoned with for the purpose of calculating the tenure of one or two terms of five years, as the case may be.

## RESIGNATION/REMOVAL

The independent director may resign by sending a letter of resignation in writing to the company and such letter shall be considered in the meeting of Board and when accepted the prescribed return shall be filed with ROC. The Director's Report (immediately following the date of resignation) shall contain a reference of such resignation. It is also incumbent upon such director to send such letter of resignation, containing detailed reasons to the Registrar of Companies within a period of thirty days. In the Companies Act, 1956, there was no legal obligation for an independent director to send a copy of the letter of resignation to the ROC.

An independent director can also be removed by the company by passing an ordinary resolution in general meeting after giving him a reasonable opportunity of hearing pursuant to a Special Notice as permissible under Section 169 of Companies Act, 2013. The procedure for sending notice and hearing is the same as was provided under old Act. Appendix I to Schedule IV prescribes that vacancy so arisen shall be filled within a period of 180 days from the date of either resignation or removal.

## EXCLUSIVE MEETING OF INDEPENDENT DIRECTORS AND BOARD EVALUATION OF INDEPENDENT DIRECTORS

The independent directors shall hold an exclusive meeting of themselves once a year without the presence of non-independent directors and members of management. It is expected that all independent directors must attend such meeting. This meeting is expected to review the performance of (a) non independent directors and board as a whole (b) review the performance of the Chairperson after taking into account the views of executive directors and non-executive directors; and (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.





The Board of Directors (excluding the persons who are to be evaluated) shall have to evaluate the performance of independent directors. On the basis of the Evaluation Report, the Board of Directors will decide about the continuance or otherwise of the independent directors, as per Appendix-I of Schedule IV.

## LIABILITY

An independent director or non-executive director (not being promoter or KMP) shall be liable only for those acts of omission or commission of the company which had occurred with his knowledge derived (a) during board process (b) with his consent or connivance in the commission of offence; or (c) where he has not acted diligently or prudently.

In case, the Registrar of Companies, Serious Fraud Office, or some other agency or person files a prosecution either before a Chief Metropolitan Magistrate or National Company Law Tribunal, as the case may be, in relation to the offences committed by the company, sub-section (12) of Section 149 provides "protection" to the independent director, which, it is felt, is only on paper and is completely illusory. In order to establish that the offence has not been committed with his consent, connivance, knowledge or board process, one has to undergo the process of trial. At the time of issuance of summons by the MM, the accused persons are not entitled to be heard. The ACMM, while issuing summons to the accused person, is guided by the following principle of law enunciated by the Supreme Court in the case of *Alpic Finance Ltd v. P Sadasivan* MANU/SC/0106/2001:

"The Magistrate while issuing process against the accused should satisfy himself as to whether the allegations in the complaint, if proved, would ultimately end in the conviction of the accused. It was held that the order of Magistrate issuing process against the accused could be quashed under the following circumstances:-

- (1) Where the allegations made in the complaint or the statements of the witnesses recorded in support of the same taken at their face value make out absolutely no case against the accused or the complaint does not disclose the essential ingredients of an offence which is alleged against the accused.
- (2) Where the allegations made in the complaint are patently absurd and inherently improbable so that no prudent person can ever reach a conclusion that there is sufficient ground for proceeding against the accused.
- (3) Where the discretion exercised by the magistrate in issuing process is capricious and arbitrary having been based either on no evidence or on materials which are wholly irrelevant or inadmissible.
- (4) Where the complaint suffers from fundamental legal defects, such as, want of sanction, or absence of complaint by legally competent authority and the like:

There is no provision in the law which entitles the accused person to be heard before the MM after receipt of summons from the court and prove his innocence. His guilt or innocence could be established only after the trial is over or at best at the stage of framing of charge. The criminal trial, as per current scenario, prolongs to a period ranging from 5 to 10 years. Needless to say, during this period, an independent director has to personally appear on each date of hearing either before Ld CMM or NCLT during the entire period of trial unless he is exempted from appearance for sufficient reasons being adduced in an application for exemption. However, there is no procedure for grant of permanent exemption by the Trial court unless the High Court, on a petition under Section 482 of Cr PC/Criminal Writ under Article 226/227 of Constitution of India, grants exemption from personal appearance and allowed appearance through an Advocate.

In the celebrated case of *State of Haryana v. Ch. Bhajan Lal* MANU/SC/0115/1992, the Supreme Court has laid down principles for quashing of criminal of complaints and has held that the criminal prosecution could be quashed, in the initial stage, only in rarest of rare cases. However, of late, for alleviating the hardship of innocent persons, it has pronounced that interference is possible by the High Court in cases where there is absolutely no set up by the prosecuting agency against the accused person. The Supreme Court in the case of *Manna Lal Chamaria v. State of West Bengal* MANU/SC/0219/2014 has upheld the order for quashing the criminal complaint by holding that the allegations in the complaint are bald and general and no specific role has been assigned against each of the accused persons. The court observed:

"The law on the subject is now very well-settled by a series of decisions rendered by this Court and it is not necessary to repeat the views expressed time and again. Suffice it to say, that the law has once again been stated in *A.K. Singhania v. Gujarat State Fertilizer Co. Ltd.* MANU/SC/1081/2013 to the effect that it is necessary for a complainant to state in the complaint that the person accused was in charge of and responsible for the conduct of the business of the company. Although, no particular form for making such an allegation is prescribed, and it may not be necessary to reproduce the language of Section 138 of the Negotiable Instruments Act, 1881, but a reading of the complaint should show that the substance of the accusation discloses that the accused person was in charge of and responsible for the conduct of the business of the company at the relevant time. From the averment made in the complaint, which is reproduced above, it can safely be said that there is no specific or even a general allegation made against the Appellants.

The concept of appointment of independent directors is commendable and laudable provided the independent directors are committed and dedicated to the company with which they are associated and do not conceive the idea of 'desertion' immediately after the emergence of first sign of sickness. CS

