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REVISED ROLE OF INDEPENDENT DIRECTORS IN THE FRAMEWORK FOR SCHEME OF ARRANGEMENT BY LISTED ENTITIES: ARE THEY EQUIPPED?

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Abstract

Companies majorly take the route of scheme of arrangement for the purpose of restructuring. A scheme of arrangement is a court sanctioned agreement undertaken between a company and its shareholders or creditors and is initiated to alter the business structure. Apart from assessment of the scheme by the stock exchanges where the draft scheme is filed and the company's Audit Committee, independent directors are now tasked with the responsibility of recommending that the scheme is not detrimental to the shareholders of the listed entity. This rule is a recent dictate of the Securities Exchange Board of India (SEBI), made effective from November 17, 2020, to bring in stricter scrutiny, accountability and ensure protection of interests of shareholders. While the role of an independent director is strengthened, a corresponding enhancement in authority lacked. The institution of independent directors has long been plagued by the liability-authority mismatch, restricting them from exercising any meaningful function. In view of this, SEBI, on March 1, 2021, proposed far-reaching changes. Through this paper, the author aims to examine the new role of an independent director in the framework of scheme of arrangements of listed companies and its implications, while delving upon the larger debate of the idea of 'independence'. The approach adopted is founded on secondary research. In conclusion, the author seeks to make recommendations to strengthen the institution in the backdrop of the recent changes proposed by SEBI.

Keywords: *Independent Director, LODR, SEBI, Scheme of Arrangement, Shareholder*

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Introduction

The landscape of mergers and acquisitions **(M&A)** in India is quite contemporaneous and also likewise developing in view of modern-day realities. Corporate restructuring in any manner has become inevitable for corporations to survive in this fast-paced business ecosystem.[1] Mergers, acquisitions, amalgamations, compromises or arrangement are varied forms of corporate restructuring common to the corporate world. All the decisions of a firm including those relating to restructuring are made with the objective of maximizing the value of shareholder's wealth.[2] It is mandatory for corporate houses to seek approval from various regulatory authorities and adhere to the applicable legal provisions.

A scheme of arrangement can be termed as a compromise or arrangement that takes place between the company and its creditors or between the company and its members.[3] The term encompasses reorganisation of the company's share capital by consolidation of shares of distinct classes or splitting up of shares into shares of varied classes or by both these modes. With the objective of streamlining the regulatory structure governing scheme of arrangements under Companies Act, 2013 **(Companies Act)** and Listing Obligations and Disclosure Requirements, 2015 **(LODR)**, SEBI issued a Circular dated March 10, 2017[4] **(Main Circular)**, which laid down the framework for schemes of arrangement by listed entities and relaxation under Rule 19(7) of the Securities Contracts (Regulation) Rules, 1957. Subsequently, SEBI issued a Circular dated November 03, 2020[5] **(Amendment Circular)** amending the Main Circular. It has been made applicable to all the listed entities purporting to undertake schemes with effect from November 17, 2020. It principally aims to enhance the levels of transparency and disclosures with respect to schemes of arrangement. However, in pursuit of the said objective, there appears to be an underlying tenor of weight from the additional responsibility that has been imposed on the Independent Directors **(ID)**, among other bodies, to evaluate the feasibility of the proposed schemes. Increased liability without commensurate authority weakens the very institution of IDs.

[1] *Deepika Dhingra & Nishi Aggarwal, Corporate Restructuring in India: A Case Study of Reliance Industries Limited (RIL), 6 GJFM 813 (2014).*
[2] *Dr. Anurag Pahuja, Corporate Restructuring: Creating Value for the Organizations, 6 IJMR 76 (2007).*
[3] *Section 230 of Companies Act, 2013.*
[4] *SEBI Circular No. CFD/DIL3/CIR/2017/21.*
[5] *SEBI Circular No. /HO/CFD/DIL1/CIR/P/2020/215.*

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With the aim of revolutionising the foundation of ID, SEBI has floated a Consultation Paper[6] proposing significant changes to the regulatory provisions.

The author aims to assess the changing dimension of the role of IDs in the backdrop of the Amendment Circular while examining the larger issue of 'independence'. The principle analysis in this paper pertains to (a) key changes brought in by the Amendment Circular, (b) its implication on the role of IDs, (c) assessment of 'independence' of IDs, (d) analysis of the Consultation Paper, followed by (e) recommendations to strengthen the institution.

Overview of Framework for Scheme of Arrangement

A scheme of arrangement/merger/amalgamation by a listed entity must adhere to the provisions of LODR and the Companies Act. Chapter XV (Section 230 to 240) of the Companies Act lays down provisions on compromises, arrangements and amalgamations. The procedural aspects involved are covered under the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The LODR, particularly Regulations 11 and 37, govern the requirements applicable to listed companies. In order to effectively adhere to the aforementioned regulations and implement the compliance, SEBI issued the Main Circular laying down the framework for schemes of arrangement by listed entities.

A listed company in pursuit of scheme of arrangement must acquire an 'Observation' or a 'No-objection' Letter from the stock exchanges ascertaining that the draft scheme of arrangement complies with the applicable laws.[7] The scheme shall not be filed before the National Company Law Tribunal **(NCLT)** by the company unless the Observation Letter has been obtained. The stock exchange shall submit the said Observation or No-objection Letter on the draft scheme of arrangement, as the case may be, to SEBI within a period of 30 days from the date of receipt of draft scheme or within 7 days of receipt of opinion clarification from the listed entity, if so sought by the stock exchange.[8] Upon receipt of Observation or No-objection Letter from the

[6] *SEBI Consultation Paper on Review of Regulatory Provisions related to Independent Directors, 2021, https://www.sebi.gov.in/reports-and-statistics/reports/mar-2021/consultation-paper-on-review-of-regulatory-provisions-related-to-independent-directors_49336.html.*

[7] *Regulation 37 (1), SEBI (Listing Obligations and Disclosure Requirements) 2015.*

[8] *Regulation 94 (2), SEBI (Listing Obligations and Disclosure Requirements) 2015.*

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stock exchange, SEBI shall issue a Comment Letter. In case of companies being exclusively listed on regional stock exchanges, Comment Letter shall be issued by SEBI upon receipt of Observation or No-Objection letter from the Designated Stock Exchange.[9] Further, the company has to obtain a report from the Audit Committee recommending the draft scheme. The Committee has to take into deliberation, among other things, the Valuation Report of the listed entity.[10] It is only after obtaining the Observation Letter and disclosures made to the stock exchange, wherever the securities of the company are listed, the provisions of Section 230 to 232 of the Companies Act are to be applied.

Post-Amendment Scenario

The objective behind introduction of the Amendment Circular is to augment the scrutiny and compliances pertaining to schemes of arrangements proposed by listed entities. Certain additional responsibilities have been conferred on the IDs and the Audit Committee, showing increased reliance of SEBI on these institutions in pursuit of the stated objective. Following are the key changes brought in, relevant to the present paper:

A. Audit Committee Report

The Audit Committee is responsible for commenting upon the proposed scheme of arrangement on the basis of the valuation report placed before it. Additionally, it has introduced explicit parameters to be essentially taken into consideration and remarked upon by the Audit Committee of the company proposing to undertake the scheme of arrangement.[11] In furtherance of recommending the draft scheme to the Board of Directors after considering the valuation report, the Audit Committee, in praesenti, is required to comment upon:

i. Business and economic rationale
ii. Need for the arrangement
iii. Synergies of business of the entities involved in the Scheme
iv. Its impact on the shareholders and;

[9] *Para B (4), SEBI Circular No. CFD/DIL3/CIR/2017/21.*
[10] *Para A (2)(c), SEBI Circular No. CFD/DIL3/CIR/2017/21.*
[11] *Para A (2)(c), SEBI/HO/CFD/DIL1/CIR/P/2020/215.*

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v. Cost benefit analysis of the Scheme

Mandating an examination of the aforementioned factors by the Audit Committee is in tandem with the broader purpose of the Circular to warrant a stringent scrutiny of the scheme.

B. Report of the Committee of Independent Directors

A key measure brought in by the Amendment Circular is the requirement of a report from the Committee of IDs recommending the draft Scheme on ascertaining, inter alia, that the scheme is not detrimental to the interests of shareholders of the company. It is parallel to the obligation cast on the Committee of IDs in case of an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 **(Takeover Code)**, to make recommendations on the open offer for the shareholders. However, the onus created by way of the Amendment Circular is of an enhanced degree, comparatively.

1. Institution of Committee of Independent Directors

It is pertinent to note that the Amendment Circular has proposed the concept the 'Committee of IDs' which up until now does not find recognition in any of the rules or regulations issued by SEBI, save for the Takeover Code. Consequently, this prerequisite of a report by such Committee of IDs would necessitate explicit establishment of such a Committee comprising of all IDs. The nature of such a Committee, whether permanent or ad hoc, is not clear. An Audit Committee comprises of two-third IDs.[12] Requisition of a report from a Committee of IDs comes across as a repetitive step in the process.

2. Determination of Detriment

The Committee of IDs is conferred with the obligation to recommend the draft scheme to the Board based on the understanding that the proposed scheme is not 'detrimental to the interests of the shareholders.' It places substantial burden on the IDs. Further, no parameters at the outset for such determination have been laid down. As a consequence, the notion of detriment remains subjective and highly susceptible to opposition. Further, ascertaining detriment or its absence entails a rather wide ambit of study inclusive of all classes of shareholders.

[12] *Regulation 18 (1), SEBI (Listing Obligations and Disclosure Requirements) 2015.*

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C. No-objection Letter by Stock Exchanges

Prior to the amendment, stock exchanges had the discretion to furnish either an Observation Letter or a No-objection Letter with respect to the draft scheme. However, the present position mandates the stock exchanges to offer a No-objection Letter in coordination with each other, in lieu of discretion of offering mere observations on the scheme. In view of the amendment, the concept of Observation Letter has been abolished. Now, SEBI can only issue a No-objection Letter on the basis of receipt of a similar letter by the stock exchange.

Implication

The unprecedented move by the regulator may turn out to be a positive change. The Indian financial market has been plagued by numerous frauds owing to abuse of power by key personnel of the companies. The IDs will now cautiously deliberate upon such proposals and offer their assessment. The minority shareholders may draw a sense of ease. However, the very institution of IDs is increasingly being subjected to criticism due to myriad of inherent and emerging challenges. In the backdrop of this new-found increased reliance on IDs, it is critical to understand if the measure undertaken by SEBI will in fact further the object of enhanced scrutiny or does it merely create a false sense of security in the minds of shareholders.

A. Information Asymmetry

The added responsibility introduces a new facet to the role of an ID. The said responsibility is analogous to one of the roles played by the NCLT of granting its approval to the schemes.[13] It is settled law that the courts/tribunals have to inspect the bona-fides of the schemes. One of the essential factors of consideration is whether the proposed scheme is detrimental to the interests of the creditors/members or public interest.

The approval provided by the Committee of IDs by way of report is now a significant piece of document for any scheme. The IDs may find it exigent to extend such a recommendation signing off on a scheme. It is pertinent to note that the Amendment Circular uses the expression ‘inter

[13] *Section 230 (6) of Companies Act, 2013.*

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alia' with respect to the ID Report. Consequently, the interest of the shareholders is only one among several factors that will have to be taken into account and objectively assessed by the Committee. As the IDs are not engaged in the day-to-day affairs and management of the company, they may not be in possession of requisite information, knowledge and material to reach an opposite conclusion for the Report. This will require them to heavily rely on the management's presentation of the facts and circumstances, which does not serve the purpose of the ID Report.

B. Independence: A Myth?

A key issue has been the appointment of IDs. While regulations specify who cannot be an ID, they are practically silent on qualifications/experience. The ambit is wide open for the appointment of people who can be described as 'home-directors' i.e. friends, school/college mates, ex-colleagues, relatives (not covered by definition), etc. Appointment of IDs and Women Directors has been largely reduced to mere numerical compliance. Onboarding eminent people like professionals, academicians and retired bureaucrats is not rare, but this is done at the outset to send positive signals to the market and potential investors that they are open to public scrutiny.

As per the criteria prescribed for appointment, a person cannot have any pecuniary relationship with the company.[14] However, the pecuniary relationship that gets established after becoming an ID is the real problem. The Nomination and Remuneration Committee (**NRC**) is mandated to identify and recommend persons for the position of ID,[15] a process which, by and large, has become a sham and mere formality in controlled corporations. The ownership of most of the public companies is highly concentrated in India.[16] In promoter driven companies, the committees end up recommending such persons as are suggested to them by the promoter. Hence, it's a paradox that an entity like ID is appointed by the very promoter whose actions are to be scrutinized by the ID in exercise of 'independent and objective' judgement.

[14] *Section 149 (6) of Companies Act, 2013.*
[15] *Section 178 of Companies Act, 2013.*
[16] *OECD, Ownership Structure of Listed Companies in India (2020), http://www.oecd.org/corporate/ownership-structure-listed-companies-india.pdf.*

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C. Role as a Check-post

Another arguable point is whether the IDs have been able to detect/prevent fraudulent activities. Corporate scandals have been blowing up with disturbing regularity. The IDs, by and large, do not have forensic skills, and many do not possess profound knowledge of finance. In India, on an average, an ID devotes less than 9 days per year to Board work.[17] This is rather low when compared to the average work commitment in top international companies which stands at 40 days.[18] While the Companies Act requires active participation from an ID, mere 8% of the companies in India follow the concept of a lead ID, who principally evaluates and advises the board on agendas.[19] Only 35% of the companies have the board meeting agenda authored by IDs, thus diminishing their active participation.[20] Hence, envisaging them to be in a position to detect wrongdoings/actions detrimental to the interests of shareholders is idealistic.

If we trace back India's history of corporate frauds, Satyam scam figures prominently. What strikes at the foundation of the scam is what conspired behind the closed doors right before the multi-crore scam came to light. Not long before the scam unearthed, the Board passed a resolution to buy Maytas Infra and Maytas Properties for $1.6 billion.[21] Within a day of the company's approval of the acquisition of the two companies, the decision was reversed, not because of the IDs or other directors but owing to the uproar of the investors. This is how the scam came to light. It is important to note that the Board consisted of some of the most distinguished academics and eminent persons.[22] More than a decade after Satyam, corporate governance related discrepancies still subsist. The role and possible culpability of the IDs of IL&FS, who failed to red-flag the malfeasance, is being examined by the Serious Fraud Investigation Office.[23] Several IDs resigned hastily when Jet Airways crashed out.[24] The ICICI

[17] *Indian Board Report (2015-16), https://indiacorplaw.in/wp content/uploads/2017/03/TheIndiaBoardReport2015-16.pdf.*
[18] *Chinta Bhagat & Conor Kehoe, High-performing boards: What's on their agenda? (Apr. 1, 2014), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/high-performing-boards-whats-on-their-agenda#.*
[19] *Supra, note 17.*
[20] *Id.*
[21] *J.P. Singh, Naveen Srivastav & Shigufta Uzma, Satyam Fiasco: Corporate Governance Failure and Lessons Therefrom, 9 IJCG 4 (2010).*
[22] *Rahul Satyan, The Satyam Affair: Past, Present and Future, 2 ILJ 4 (2011).*
[23] *Top management, auditors and independent directors: SFIO identifies 'coterie' that defrauded IL&FS, THE ECON. TIMES, (June 02, 2019), https://economictimes.indiatimes.com/industry/banking/finance/banking/top-management-*

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Bank debacle demonstrated yet again how the IDs often toe the view of management instead of acting as the custodians of corporate governance. The Board failed to bring to light the issues of nepotism and conflict of interest.[25]

Analysis – SEBI Consultation Paper on Review of Regulatory Provisions related to Independent Directors dated March 1, 2021

The enhanced responsibility of the IDs significantly raises the liability. Without corresponding increase in authority/power, it will have a counter-effect on the willingness of individuals to take up this position.

On March 1, 2021, SEBI proposed long-awaited changes to provisions governing the IDs with an aim to enhance the quality of corporate governance. The changes majorly touch upon the appointment and removal process of IDs, remuneration of IDs, composition of Audit Committee, necessary disclosures by Nomination and Remuneration Committee **(NRC).** Some of the points of change are discussed and analysed below:

A. Appointment & Removal

As per the Companies Act, appointment of an ID is a three-step process. The NRC formulates the criteria for determining qualifications, positive attributes and independence of a director. Subject to various requisite criteria of independence being fulfilled[26], they are appointed by the Board. Post that, approval is sought by way of an ordinary resolution i.e. by simple majority, in a general meeting of the shareholders. Re-appointment of an ID however requires a special resolution, therefore having a higher threshold.[27] Any director on the Board can be removed by an ordinary resolution at a general meeting.[28] The provision does not make any distinction

auditors-and-independent-directors-sfio-identifies-coterie-that-defrauded-ilfs/articleshow/69621075.cms?from=mdr.

[24] *Jet saga: All board members are equally liable for the crisis,* BUSINESS STAN., *(Apr. 23, 2019), https://www.business-standard.com/article/companies/jet-saga-all-board-members-are-equally-liable-for-the-crisis-say-lawyers-119042201238_1.html.*

[25] *Dozing Doorkeepers?,* BUSINESS TODAY, *(Sept. 9, 2018), https://www.businesstoday.in/magazine/the-hub/dozing-doorkeepers/story/281446.html.*

[26] *Section 149 (6) of Companies Act, 2013.*

[27] *Section 149 (10) of Companies Act, 2013.*

[28] *Section 169 of Companies Act, 2013.*

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between independent and non-independent director. With an aim to bridge this gap and balance the powers of the Board, an amendment was introduced wherein an ID serving a second term can only be removed through a special resolution, i.e. 75% of shareholders.[29]

1. Nomination & Remuneration Committee

Nomination of right members to the Board is the principal influence on the management of the company. In view of the critical role played, attention must be paid to the legitimacy of NRC in view of the trust reposed in it by the shareholder community. In the backdrop of IDs sitting in judgment on the activities of the company, their appointment or removal from the Board must ideally be driven by the NRC. Allowing promoters/controlling shareholders to exercise significant influence on the appointment and removal of IDs utterly undermines the integrity of the entire process. It hinders their ability to take a view contrary to that of the management. The Board's role is often reduced, in exercise, to mere endorsement of conditions parleyed in advance by the controlling shareholders.

As a means of strengthening the process, SEBI proposed that the NRCs take the assistance of external agencies for shortlisting candidates and also disclose the channels used for the same. Further, the composition of NRC has been proposed to be modified to 2/3rd IDs instead of a majority of IDs.[30]

2. Shareholders' Approval

Considering the Indian market majorly constitutes controlled corporations, the present requirement of a mere simple majority for appointment/removal tilts the power heavily in favour of controlling shareholders. To address this anomaly, SEBI has proposed a dual voting structure for the appointment and removal of IDs, to impart greater representation to the minority shareholders.[31] The proposed change is derived from the practise in UK, which follows a dual voting process in case of premium listed controlled corporations.

[29] *Section 169 (1) of Companies Act, 2013.*
[30] *Para 4.4 (4), SEBI Consultation Paper on Review of Regulatory Provisions related to Independent Directors, 2021.*
[31] *Para 4.2 (4), SEBI Consultation Paper on Review of Regulatory Provisions related to Independent Directors, 2021.*

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Mandating the same for appointment and removal of an ID by way of:

(i) majority by all shareholders and,

(ii) majority of the minority shareholders; will go a long way in strengthening the system.

B. Remuneration

Presently, an ID is entitled to sitting fees and commission.[32] A maximum of Rs. 1 lakh per meeting is permitted as sitting fees.[33] Commission based on profits is allowed to a maximum of 1% of the company's net profits.[34]

1. Employee Stock Ownership Plan (ESOP)

SEBI has proposed to enhance the remuneration by two ways: increasing sitting fees and allowing grant of ESOP with a minimum of five years holding period, to replace profit-based commission.[35] Aim is to ensure that the IDs stay committed to value enhancement of the company keeping in view its long-term interests. The underlying concern in case of a profit-linked commission is that it may encourage short-termism and lead to conflict.[36]

2. Profit-linked Commission v. ESOP

Profit-based commission is commensurate with profitability of the company and helps align the interests of the IDs with the performance of the corporation. However, the amount explicitly depends on profits earned on yearly basis. A higher profit in a financial year will result in increased proportion of commission. Remuneration directly based on yearly performance has a tendency to result into rather short-term interests of the IDs. Due to this, a check on decisions possibly damaging the company from long-term perspective is left out of periphery.

The question is – does ESOP address this gap?

[32] *Section 149 (9) of Companies Act, 2013.*
[33] *Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.*
[34] *Section 197 (1) of Companies Act, 2013.*
[35] *Para 4.8 (4), SEBI Consultation Paper on Review of Regulatory Provisions related to Independent Directors, 2021.*
[36] *Id.*

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While profit-linked commission entails short-term interests of the IDs (yearly performance) in the company, introduction of ESOPs for IDs takes into view a broader picture and long-term interests in favour of the company. Since a specific minimum holding period of 5 years is suggested by SEBI, it culls out the possibility of misuse by IDs in terms of mere short-term prosperity of the company. Rather, it brings into focus the share price at the end of the vested period, which is a fairly long phase.

The underlying principle governing both, profit-based commission and ESOPs, is alignment of interests of IDs with the company. Both components ultimately depend upon the performance of the company. Driven by the same force, ESOP is a more favourable option vis-à-vis profit-based commission, to ensure the focus of IDs on long-term prosperity of the company. The argument of independence being compromised in case of ESOPs when even the present system of commission is based on performance of the company, does not hold good. The proposal to allow companies to grant ESOPs with a long vesting period to IDs is a positive and executable move, with right checks and balances put in place by the regulator.

3. Cons of ESOP

ESOP may cause further problems for smaller companies who already find it difficult to attract the right talent. Small cap companies are mainly not tracked by broking houses and financial analysts.[37] Most of these are under-researched and have fewer broking houses and mutual funds tracking them vis-à-vis big or medium cap companies. Their improved performance may not be truly reflected in the stock market prices. Hence, ESOPs as a component of remuneration may not help the small cap companies in attracting valuable directors, further weakening their position in this aspect of corporate governance.

C. Qualification

Notwithstanding a distinct code of conduct for IDs in the Companies Act, the independence of IDs has come under scanner more often than not. As one of the solutions, the Ministry of Corporate Affairs **(MCA)** introduced an online proficiency self-assessment test for IDs. The Indian Institute of Corporate Affairs **(IICA)** has also been conferred with the responsibility of

[37] *Be cautious when buying small-cap funds,* LIVEMINT, *(Mar. 31, 2020), https://www.livemint.com/money/personal-finance/be-cautious-when-buying-small-cap-funds-11585595136922.html.*

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preparing basic study material and online lessons for these tests. The MCA is required to maintain an online databank of IDs.[38] It consists of all material information about the director as well as pending criminal proceedings initiated against him, if any.

While the intent of the MCA is admirable, an online assessment test does not serve the purpose. Knowledge of basic company law and SEBI Regulations, requiring 60% passing marks, does not appear to be enough for corporate governance. Furthermore, companies functioning in different sectors require different domain of knowledge and skills. A company operating in the finance sector will require an ID to exercise due diligence in approving of loans, recovery of loans, etc. Expecting IDs, who do not have understanding of nuances of banking and finance and rely on the management for presentation of information, to detect plausible wrongdoings and ask the right questions, is far-fetched. Though theoretically, IDs have access to all the resources and information, but do they have requisite expertise and time, after attending only a few meetings, to unearth shams? Hence, a common assessment test does not solve the issue of lack of requisite knowledge.

This aspect is not addressed by SEBI in the Consultation Paper.

D. Exit

A concerning development in the recent times is that of rising resignations of IDs. A record 1,393 ID posts were vacated in 2019, compared with 767 in 2018 and 717 in 2017.[39] While there are no clear answers as to why IDs resign, it is broadly due to greater liability, rising number of corporate governance cases, increasing fear of fraud risk and chances of personal reputation being at stake.[40] With respect to reasons for resignations, corporate governance issues are hardly brought to light. It leads to creation of a false sense of security for the public. Professionals and retired bureaucrats are often found to resign when they sense anything erroneous as the fear of investigation, legal consequences and reputation loss becomes worrisome. Recently, taking note

[38] *Clause 3 of the Companies (Creation and Maintenance of Databank of Independent Directors) Rules, 2019.*
[39] *Resignations by Independent Directors double in 2019 as risks grow,* THE ECON. TIMES, *(Dec. 26, 2019), https://economictimes.indiatimes.com/news/company/corporate-trends/resignations-by-independent-directors-double-in-2019-as-risks-grow/articleshow/72972968.cms.*
[40] *Id.*

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of this situation, the present SEBI Chairman called on the IDs resigning over governance concerns to come forward and state the same clearly to the public at large.[41]

In view of this distressing situation, SEBI proposed that the IDs stepping down citing pre-occupations, other commitments or personal reasons will not be able to join the board of another company until lapse of a period of one year.[42] Further, full text of the resignation letter should be disclosed to the stock exchanges.[43] Mandatory cooling-off period and enhanced disclosure of reasons aims to curb possible compromise in independence.

Recommendations

Following are the recommendations to strengthen the institution of IDs in the light of proposals made by SEBI:

- IDs may be better equipped for their role by way of special training programs addressing risk management, fiduciary duties, industry-based knowledge and awareness on securities regulations, to begin with. It will help IDs think beyond the scope of legal provisions, in lines of what is right from shareholders' perspective and not merely what is legally right.
- A pre-requirement of appropriate business education qualification and/or a minimum experience in the corporate arena may be made applicable as necessary eligibility criteria for all IDs.
- Those eligible to become IDs and registered with the databank maintained by the MCA should be allowed to be recommended for the position by the authority after an affidavit from the ID that he is not in any way a related party. The candidate can further be assessed by the NRC on set parameters. This may help to an extent to ensure that the companies do not pick family and friends with no merit purely to meet the quorum requirements of presence of Woman Director and IDs, denying the concept its true essence. It will also be in line of proposal of SEBI directing NRC to seek external assistance.

[41] *Independent directors quitting over governance issues should state it clearly: Sebi, FIN. EXPRESS, (Oct. 22, 2020), https://www.financialexpress.com/market/independent-directors-quitting-over-governance-issues-should-state-it-clearly-sebi/2111168/.*

[42] *Para 4.6 (5), SEBI Consultation Paper on Review of Regulatory Provisions related to Independent Directors, 2021.*

[43] *Para 4.6 (4), SEBI Consultation Paper on Review of Regulatory Provisions related to Independent Directors, 2021.*

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- Consistent with the principle that executives should not be in a position to decide their own remuneration, NRC, being the starting point of process of appointment of IDs, may be an entirely independent committee instead of the present proposal of 2/3rd IDs.
- In terms of liability, crucial mitigating factors such as lack of knowledge or involvement of IDs in legal infractions of the company must be given substantial weightage. IDs must not be exposed to unjustified legal proceedings. It is in line with the principle that monitoring day-to-day compliances of the company is not the function of IDs.
- ESOP as a form of remuneration seems more appropriate for large cap companies i.e. top 100 companies in terms of market capitalization, as compared to mid and small cap companies. An alternative to this may be explored in the form of varied hybrid remuneration structures for companies falling under different categories of market capitalization i.e. – (i) sitting fees and ESOPs for large cap companies; (ii) sitting fees with an option of partly ESOPs and partly profit-linked commission for mid cap companies and; (iii) sitting fees and profit-based commission for the small cap companies. The underlying principle of proposing this divergence is – one size does not fit all.
- The vesting period of ESOPs may be extended for a specific term (for instance, 1 year) after the end of 5-year tenure of IDs, to ensure greater accountability.
- SEBI ought to be alarmed at untimely resignations and follow up with interaction with the IDs to perceive the trouble brewing in the companies from which they have resigned. Exit interviews may be conducted to grasp the underlying issues of corporate governance.

Conclusion

Internationally, a key aspect of corporate governance has been the institution of IDs. It has been created to avert the ever-rising occurrences of mismanagement at the instance of promoters/management wrongfully enriching themselves at the cost of minority shareholders. IDs are expected to bring a facet of fairness and objectivity that is wide in ambit and not merely restricted to narrow corporate interests. Therefore, to be able to add value to the concept of corporate governance in any meaningful way, the foremost pre-requisite is their independence from the promoters; else, the whole purpose becomes futile. They are expected to guide the company with their knowledge and expertise. It is this 'knowledge' which plays a key role in

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dispensation of functions. While it is unfair to make an ID, who may not have any material understanding of the nuances involved and complete knowledge, scapegoat in cases of a corporate fallouts, it is equally imperative to understand that they are not above any form of accountability. Persons being offered these coveted positions should only accept if they are certain of doing justice to the role, in terms of requisite domain knowledge and unsurmountable integrity. Apart from this, before delegating additional responsibilities to the IDs, steps must be taken to strengthen the very institution in the first place. The proposed changes by SEBI are in the right direction. The proposals are largely positive and reflect the enhanced expectations of the regulator and stakeholders from the institution of IDs. Further clarity is required in certain aspects, as discussed in the paper. Without addressing the concerns regarding deteriorating standards of the corporate governance, added regulatory compliances may only prove to be counter-productive.

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