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Independent Directors and Corporate Governance in India: A Critical Analysis of Their Role, Accountability, and Effectiveness under the Companies Act, 2013

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Abstract:
Independent directors form one of the key pillars of corporate governance in India, especially after the adoption of the Companies Act, 2013, which officially institutionalized their presence in board oversight and accountability. The paper is a critical analysis of the effectiveness, accountability, and practical operation of independent directors in the statutory provisions of the Companies Act, 2013, with the supplement of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The paper assesses the legal frameworks that regulate independent directors, their appointment, term, responsibilities, and liabilities as well as their membership in important board committees and examines judicial interpretations and regulatory trends through 2019.
The study examines statutory provisions, official reports, and prominent judicial decisions including Sunil Bharti Mittal v. using a doctrinal and analytical approach. CBI and SMS Pharmaceuticals Ltd. v. Neeta Bhalla that elucidate the limited liability of the independent directors and stress that knowledge or negligence is necessary to impose the responsibility. The paper also uses empirical data on board composition based on published governance reports, which depict the trends of independent directors representation in Indian corporate boards and also reveal the problems of compliance, tenure concentration, and gender diversity. The comparative lessons of the United Kingdom and United States governance systems are also taken into account to put the Indian regulatory model into perspective and evaluate the best practices in the world.
The analysis concludes that despite the fact that the statutory regime has enhanced formal governance arrangements whereby independent representation and committee checks are required, there are still major challenges. These are information asymmetry between the management and the independent directors, promoter influence in the appointment of directors, lack of diversity in the board, and uncertainty regarding the enforcement practices. Although Section 149(12) offers a statutory defense against excessive liability, regulatory measures and enquiries in corporate scandals have created concern regarding the practical risks of independent directors.
The paper concludes that independent directors are still essential in enhancing corporate accountability in India, but their efficacy relies on significant independence, availability of dependable information, and equal enforcement of regulations. It suggests such reforms as better training and professional growth, open nomination, better information rights, and better liability standards. Enhancing these institutional protections would increase the functional independence of independent directors and their position as custodians of minority shareholder interests and corporate governance integrity.

Keywords: Independent Directors; Corporate Governance; Companies Act 2013; Section 149; Board Independence; Director Liability; SEBI LODR Regulations.

RESEARCH QUESTIONS AND METHODOLOGY

This research question is: What is the effectiveness and accountability of independent directors under the Companies Act, 2013? It scans (i) statutory requirements (CA 2013, Schedule IV; SEBI LODR) on IDs, (ii) ID responsibilities and liabilities, (iii) appointment, tenure and removal regulations, (iv) case law to 2019, (v) empirical data on board-composition, and (vi) UK/US practice. The approach is doctrinal and analytical: the primary legal sources and official reports are checked and peer-reviewed literature are considered. Empirical analysis is based on published data (e.g. NSE/SES board reports) on board composition, and mermaid diagrams are used to show legislative and procedural flows.

LEGAL FRAMEWORK

Section 149 of the Companies Act, 2013 codified the position of independent directors. Section 149(4) requires that all listed public companies should have independent directors in at least one-third of the number of directors.[1] Section 149(6) describes an independent director (ID) as a director who is not a managing director or a whole-time director or a nominee director, and who meets objective independence criteria (no pecuniary relationship etc, by Section 149(6)).[2] Section 149(10)-(11) says that an ID serves a term of up to five years (renewable by special resolution), and no individual may serve more than two terms in succession. The Companies (Appointment and Qualification of Directors) Rules, 2014 do not only stipulate that some large public companies must have at least two IDs appointed (Rule 4), but also provide residency, qualification and databank requirements.[3] Section 149(12) capped the liability of the ID: an independent director shall be liable, only in respect of such acts of omission or commission, which had been done with his knowledge, or where he had failed to act in good faith. Duties and standards of professional conduct (e.g. acting objectively, upholding integrity) are provided in Schedule IV (Code for Independent Directors).[4]

SEBI strengthened this legal framework by listing regulations. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 mandate that listed companies are to have audit, nomination and remuneration, and stakeholder committees that are chaired or populated by IDs.[5] As an example, Regulation 18 requires an audit committee to be majority of IDs, and Regulation 17(1A) to have at least one-third of the board of IDs (effective since 2019). These regulations make IDs central to the control of financial reporting, transactions involving related parties, and important appointments to management.[6]

APPOINTMENT, TENURE, AND REMOVAL

In India, the appointment of independent directors is done through both board and shareholder processes. The nomination committees (Sec 178) should nominate and suggest suitable ID candidates, and the appointment is usually approved by the Board. In the case of listed companies, a director appointment has to be ratified by the shareholders; the term of an ID (not exceeding 5 years) can be renewed only through a special resolution. An ID is required to have a three-year cooling-off period after two consecutive terms. The Companies Rules also mandate IDs to be registered in the databank of MCA and declare eligibility. In case of a vacancy, the board has to fill the vacancy within six months.

[1] Companies Act, 2013, s. 149(4).
[2] Companies Act, 2013, s. 149(6).
[3] Companies Act, 2013, ss. 149(10)-(11).
[4] Companies (Appointment and Qualification of Directors) Rules, 2014, r. 4.
[5] Companies Act, 2013, s. 149(12).
[6] Companies Act, 2013, sch. IV.

The general procedure under Section 168 of the Act applies to the removal of an independent director: shareholders may remove any director (including IDs) by ordinary resolution (on special notice under Section 169), but must pay compensation. The ID should be notified of the resolution and heard. No distinct just cause requirement exists to remove an ID, although an ID may challenge removal based on the violation of independence norms or improper procedure.

INDEPENDENT DIRECTORS AND THEIR DUTIES AND LIABILITIES

Under the Act and Schedule IV, the fiduciary duties of IDs are the same as those of other directors: they should act in good faith, with due care and skill, in the best interest of the company, and should not have conflicts of interest (Companies Act, Section 166). Schedule IV goes on to explain that IDs must manage but not be executives. As an illustration, IDs will examine financial statements, query related-party transactions and ethical decision-making. They should also spend enough time in the board work and should be able to oppose the management or voice dissent when it is justified.

The statute provides a strict limitation on ID liabilities. Section 149(12), as mentioned, specifically safeguards IDs against vicarious liability: an ID can only be liable in respect of omissions or commissions done with his knowledge, consent or connivance, or where he had not acted diligently. In Sunil Bharti Mittal v. The Supreme Court ruled that the non-executive/independent directors cannot be prosecuted simply by their status unless it is shown that they were actively involved or intended to be involved (CBI, 2015). On the same note, S.M.S. Pharmaceuticals Ltd. v. Neeta Bhalla (2005) and NSIC Ltd. v. Paintal (2010) reiterated that liability must be shown to have been knowingly participated in or negligently. This is reflected in regulatory practice: SEBI and courts are generally interested in whether IDs were recipients of information or were knowingly complicit in fraud. However, IDs are at risk of being investigated in corporate fraud cases (e.g. IL&FS), and enforcement agencies (SEBI, SFIO, ED) can name IDs in cases, which puts pressure on the need to have strong protection and transparency on due diligence requirements.

BOARD GOVERNANCE ROLE AND BOARD COMMITTEE

The listing norms and the Act focus on the ID participation in important committees. Section 177 mandates all listed companies to form an Audit Committee that comprises majority of IDs.[7] Audit committees have IDs that control financial reporting, internal controls and auditor independence. Section 178 requires a Nomination and Remuneration Committee (NRC) of at least three non-executive directors, at least half of whom are IDs.[8] The NRC establishes standards of director qualification (including independence standards) and suggests appointments and remuneration policies. In large firms (>1,000 shareholders), grievances of shareholders are settled by a Stakeholders Relationship Committee (one of which is often an ID). These structures have concentrated oversight power in IDs.[9]

Although committee participation is aimed at capitalizing on the independence of ID, it also focuses responsibility. Audit committee minutes are frequently subject to regulatory review to determine whether IDs have performed their oversight role, and codes demand that IDs meet at least once a year (without management). Nevertheless, as certain commentators observe, committee functions do not add to operational strength, IDs continue to depend on management and auditor-supplied information. Therefore, the quality of information and board culture is a determinant of effectiveness.[10]

[7] Companies Act, 2013, s. 177.
[8] Companies Act, 2013, s. 178.
[9] Companies Act, 2013, s. 178(5).
[10] Companies Act, 2013, sch. IV (Code for Independent Directors).

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TRIBUNAL CASE LAW JUDICIAL

The major rulings have influenced the interpretation of ID roles and protections. As it has been mentioned, Sunil Bharti Mittal v. CBI (SC, 2015) believed that directors (including IDs) could not be criminally liable by default without evidence of conscious complicity. SMS Pharmaceuticals v. Neeta Bhalla (SC, 2005) also decided that simple directorship is not a breach, but it is necessary to demonstrate specific knowledge or assent. NSIC v. Harmeet Singh Paintal (SC, 2010) warned against blindly prosecuting non-executive directors. Conversely, in Satyam (following huge frauds), SEBI and SFIO investigations held the promoter-directors liable, and also non-execs who disregarded red flags. The Chintalapati Raju v. The Satyam case was used to reinforce the appeal (SEBI, 2018) that ID oversight should be assessed based on the actual role and available information.[11]

ID impleadment has been dealt with by tribunals in insolvency cases. In the IL&FS crisis (2018), NCLT/NCLAT put boards of directors nominated by the government and began to investigate former IDs. The NCLAT, in NCAT Appeal No. 323 of 2019, emphasised that the ID should be scrutinised individually, rather than as a blanket category, when it comes to alleging that the ID has mismanaged the company. Even though IL&FS is not within our time-period, its consequences saw regulators (e.g. MCA circulars) require detailed disclosures by resigning IDs and emphasize due diligence by IDs. In general, the courts have been biased in favor of protecting IDs against automatic liability, and have stressed the necessity of proving their knowledge or negligence (in line with s.149(12) and Schedule IV requirements).[12]

EMPIRICAL DATA ON BOARDS AND ENFORCEMENT

Empirical research indicates the transformation of Boards in India with CA 2013. According to Stakeholders Empowerment Services (SES), in the case of NIFTY 500 companies (FY201417), the independent directors occupied approximately 5152 percent of the board seats. Indian private companies and MNCs had more than 50 percent of seats as IDs in FY201617, whereas PSUs had less (~38 percent). SES discovered that among 480 large companies, 50 did not have the necessary amount of IDs in FY201617; 64% of the non-compliant companies were PSUs (Table 1). Such loopholes were usually indicative of sluggish PSU reforms and dominance of promoters.

Table 1: Non-Compliance with ID Requirements (NIFTY 500, FY2016–17)

Company Category	# Lacking Required IDs	% of Non-Compliant Firms
PSUs	32	64%
Indian Corporates	17	34%
MNCs	1	2%

On the other hand, most companies went beyond the minimum norms: SES data indicate that approximately a quarter of independent directors in Indian corporates had tenure >10 years (which implies that they may have lost their independence). Gender diversity is a problem: in 2017, women (with women IDs) constituted only approximately 9-10 percent of directors in leading companies, even though most of the large companies have a requirement of at least one woman director.[13]

Enforcement measures have been noted: SEBI and stock exchanges have fined companies and their officers because of failures in disclosure of board composition, or misstatements that implicated IDs. As an illustration, SEBI imposed fines on previous IDs of Brightcom and Bombay Dyeing due to perceived

[11] Umakanth Varottil, *Corporate Governance in India: Law and Practice* (Oxford University Press).
[12] *Sunil Bharti Mittal v. Central Bureau of Investigation*, (2015) 4 SCC 609.
[13] Stakeholders Empowerment Services (SES), *Corporate Governance Reports on Board Composition in India* (2017).

violations of financial management (cases in 201819). Nevertheless, there are few statistics on enforcement of ID-specific violations; the majority of data are on general governance violations.[14]

COMPARATIVE PERSPECTIVES (UK AND US)

The independent director model is similar and different internationally. The Companies Act 2006 in the UK does not specify any ID quotas, however, the UK Corporate Governance Code (2018) (which applies to premium-listed companies) suggests strongly that boards should have a majority of independent non-executive directors (NEDs), and that audit and remuneration committees should be entirely independent. The UK practice focuses on a unitary board of balance, and the IDs are supposed to question the management constructively. The chairs of key committees (audit, remuneration) should be independent, which is reflective of India under LODR Regs.[15]

The framework in the United States is more rule-based. The Sarbanes-Oxley Act 2002 and the following SEC regulations demand that all companies listed on the NYSE/NASDAQ must have audit committees that are entirely made up of independent directors, and that the members of the audit committee must satisfy increased independence requirements. Majority of the directors are usually independent directors (not required by federal law, but exchange rules promote it). In contrast to India, the US does not impose a statutory limit on consecutive terms of IDs but the US stock exchange listing regulations (NYSE, NASDAQ) mandate periodic reviews of independence. Under state law, US directors (including IDs) have fiduciary responsibilities on liability, but the protections of business judgment rule tend to protect them unless fraud or gross negligence is demonstrated. The UK and US regimes are similar to that of India in the sense that they both seek to minimize agency problems by independent oversight, but the statutory imposition of IDs in India is more prescriptive.[16]

POLICY CRITIQUE AND RECOMMENDATIONS

Although the ID regime has enhanced formal governance, there are still challenges. Information asymmetry is a constraint to the effectiveness of IDs - boards do not have easy access to detailed information and IDs are disadvantaged (Judge Nariman has observed that IDs are dependent on materials presented by the management). The power of promoters in the choice and re-election of IDs may undermine the concept of independence; research indicates that most IDs are re-nominated by the same boards, which may cause some form of pressure. There are gaps in enforcement: despite the fact that the ID liability is limited by Section 149(12) of the law, in practice, many show-cause notices and arrests of IDs (e.g. in banking frauds or deposit scams) have been carried out, which makes many candidates unwilling to serve. The voluntary criteria of independence (e.g. not related to promoters) are wide and stock inquiries show that most IDs declare independence independently without objective verification.[17]

To deal with these, reforms must involve: (1) Improved training and information rights: IDs must be trained continuously and inducted to be technically skilled (not just to the 2019 proficiency standard). The information gaps could be minimized by strengthening access to company records (enabling IDs to seek external expert reviews when necessary). (2) Tighter application of selection norms: SEBI/MCA may audit the nomination process to make sure that there are diverse ID pools; encouraging outside lateral appointments. (3) Better liability guidance: Although case law is protective, it may be reassuring to IDs to provide more detailed guidance or safe-harbor rules (akin to U.S. Business Judgment Rule). Willful misconduct should be subject to regulation, rather than passive board membership. (4) Diversity

[14] Companies Act, 2013, s. 149(1); SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
[15] SEBI Orders in *Brightcom Group Ltd.* and *Bombay Dyeing & Manufacturing Co. Ltd.* Enforcement Proceedings (2018–2019).
[16] Companies Act 2006 (UK); UK Corporate Governance Code (2018).
[17] SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

objectives: Since the number of female directors is low, think about increasing the minimum number of women directors and encouraging genuinely independent appointments.

Policy can maintain the accountability advantages of IDs without deterring qualified professionals to serve by balancing the expectations with the practical authority and strengthening the true independence. The independent directors have been the key to the board reforms in India; it is important to refine their role and protection to achieve the effective corporate governance.