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Independent Directors and their Roles Towards Corporate Governance

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Abstract

With the introduction of corporate governance in India, the importance of Independent Directors (also known as "ID's") was recognized. The Companies Act, 1956 (referred to as "the Act, 1956") makes no mention of IDs because no such provision exists regarding the mandatory appointment of IDs to the Board of Directors. The necessity for IDs arose from the need for a solid corporate governance structure in the company's operations. Their position and duty are becoming "more important." The ID Act of 2013 distinguishes the job of IDs from that of executive directors. For good corporate governance, an ID is given a variety of functions, responsibilities, and liabilities. He assists a corporation in safeguarding minority shareholders' interests and ensuring that the board of directors does not favour any one group of shareholders or stakeholders. They play a broad role in a firm, including increasing corporate credibility, governance standards, and risk management. The only and exclusive goal of establishing the notion of ID is to make unbiased decisions and to double-check the management's and majority stakeholders' decisions.

Keywords: corporate governance, shareholders, liability, prospectus

INTRODUCTION

"A LIVE PERSON POSSESSES A MIND THAT CAN CONTAIN INFORMATION OR INTENTION, AS WELL AS HANDS WITH WHICH TO ACT OUT THAT INTENTION. A CORPORATION DOES NOT HAVE ANY OF THESE, HENCE IT MUST ACT THROUGH LIVING INDIVIDUALS."

Humans have both hands and the ability to think. As a result, they are capable of making sound decisions and adopting appropriate actions. However, because a corporation
lacks these basic components and so is unable to act or make a decision. Rather, it necessitates a conduit via which it can act and make decisions.

As a result, the company's independent directors serve as the required conduit for completing the corporation's decision-making and action-taking tasks. "A company is an artificial being that is invisible, intangible, and only exists in the eyes of the law." It is impossible for a business to have the intention. It is only the purpose of its agents that makes it accountable for torts or criminal wrongs.

A corporation's identity is distinct from that of its stockholders and representatives. When considering the importance of agents in carrying out a company's mission, the function of independent directors becomes critical.

Agents, trustees, and managing partners are all terms that are used to describe independent directors. However, each of these terms is employed not as a full list of their abilities and responsibilities, but as a means of expressing helpful points of view from which they might be regarded for the time being and for the specific purpose.

POSITION OF INDEPENDENT DIRECTORS

Explaining the role of independent directors in a firm is a difficult assignment. They are the experts employed by the corporation to handle its business. They are not the company's servants, but rather the company's officers. "An independent director is not a servant of any master," LUSH J. wrote in Moriarty v. Regent's Garage & Engg Co. He cannot be described as the company's or anyone's servant." "An independent director is in fact a director or controller of the company's affairs," said Mc CARDIE LJ. in the same instance. He isn't a slave."

Independent directors are held accountable for their actions on behalf of the firm under the Companies Act of 2013. In addition to the legislative tasks that independent directors must fulfil in order to ensure full compliance with the Act's different requirements, they also have fiduciary responsibilities to the firm.

To file a return of allotment: Section 75 of the Companies Act, 1956 requires a company to file a return of allotments with the Registrar within 30 days, providing the relevant particulars.

No irredeemable preference shares, shares, or shares redeemable after 20 years will be issued: Section 80 of the Securities Exchange Act of 1934, as amended by the Amendment Act of 1996, prohibits a business from issuing irredeemable preference shares or preference shares redeemable after 20 years. Any independent director who makes such an issue could be held accountable as an officer in default and face a fine of up to Rs. 10,000/-.

To declare an interest: In the case of contracts with independent directors, Section 299 requires an independent director to disclose the nature of his concern or interest (direct or indirect), if any, before a Board of Directors meeting. The said section states that if a contract or arrangement is proposed, the mandatory disclosure must be provided at the Board meeting during which the decision to enter into the contract or agreement is first considered. In the case of any other contract or arrangement, the disclosure must be made at the first Board meeting following the independent director's involvement in the contract or arrangement.

In M/s. Raj Cylendrs & Containers v. Hindustan General Industries Ltd, the Delhi High Court held that where independent directors have a personal interest in the deal, the contract is to the company's detriment and hence not binding.

Any money received by the independent directors from the transferee in connection with the transfer of the company's property or undertaking must be notified to the company's members and approved by the company in general meeting. Otherwise, the money will be held in trust for the firm by the independent directors. This money could be in the form of remuneration for the loss of an office, but it could also be compensation for the transfer of control of the company.

Receipt of compensation from a share transferee must be disclosed: If a loss of office occurs as a result of the transfer (under specific conditions) of all or all of the company's shares, the directors will not be compensated by the transferee unless the transfer has been agreed by the company in a general meeting prior to the transfer. Any money received by the directors will be retained in trust for the shareholders who have sold their shares if permission is not sought or the proposal is not adopted.

Attendance at Board Meetings: The Board of Directors exercises a number of the company's powers at their meetings, which are held on a regular basis. Although a director may not be able to attend all meetings, his office will automatically become vacant if he fails to attend three consecutive meetings or all meetings for a period of three months, whichever is longer, without the Board's approval.

Other responsibilities:

- To call statutory, annual general meetings (AGMs), and special general meetings.

Prepare and present a report on the company's affairs, including the Board of Directors' report, at the AGM, together with the balance sheet and profit and loss account.
The annual financial statement must be authenticated and approved.

- To appoint the company's first auditor.
- To designate the company's cost auditor.
- In the event of a member's voluntarily winding up, to issue a statement of solvency.

General responsibilities:
The directors have a duty of good faith to act in the company's best interests. The company's interest entails the interests of the company's current and future members on the assumption that the company will continue to operate as a going concern.
In the case of **Burland v. Earle**, the independent director was told to buy some real estate for the corporation. However, he first bought one for himself before selling it to the corporation for a profit. The lower court ruled him accountable for the profit he made, which was in the company's equity. However, the Privy Council's Judicial Committee overturned the lower court's verdict.
By retiring from his position as a director in order to make a profit later, an independent director cannot avoid his obligation to account for his profit.
Duty of care: A company's independent directors must perform their duties and obligations with the skill and diligence that a reasonable person of their knowledge and experience would expect. A self-employed director must take great care in carrying out the tasks that have been given to him. He is, however, required to use only the level of caution that a prudent individual would exercise in his own situation. Any provision in the company's Articles or any arrangement that exempts the independent directors from liability for carelessness, default, misfeasance, breach of duty, or breach of trust is null and void. The corporation is unable to protect the independent directors from such liabilities. The duty of care extends universally to all independent directors of a corporation, whether they are executive or non-executive directors, according to Jorchester Finance Co. Ltd. v. Stebbing.
The High Court of Allahabad ruled in **G.D. Bhargava v. Registrar of Companies** that protection under Section 633 of the Companies Act is not available where the independent director's negligence amounts to an offence that attracts the provisions of the IPC relating to fraud or forgery.
Duty not to delegate: As an agent, an independent director is bound by the maxim delegates not protest delegate, which states that a delegate cannot delegate further. As a result, a director must carry out his responsibilities on his own. He may, however, transfer his under specific circumstances.

LIABILITIES

1. LIABILITY TO THE COMPANY:

Breach of fiduciary obligation: An independent director will be found accountable for breach of fiduciary duty if he behaves dishonestly in the company's best interests. The majority of the powers of directors are trust powers, which means they should be exercised in the best interests of the firm, not the independent directors or any particular group of members.
Ultra vires acts: Independent directors are expected to act within the bounds of the Companies Act, Memorandum, and Articles of Association, which set the parameters for the company's activities and, as a result, the powers of the Board of independent directors. Furthermore, the independent directors' abilities may be restricted by particular constraints set down in the Articles of Association. Acts that are ultra vires

the corporation or the independent directors will result in the independent directors being held personally accountable.

Negligence: The independent directors' duties to the firm are fulfilled as long as they work within their powers with reasonable competence and care, as would be anticipated of a responsible businessman. However, if they fail to exert reasonable care, skill, and diligence in the performance of their obligations, they will be judged negligent and will be liable for any loss or damage that results.

Mala fide acts: Independent directors are trustees for the company's money and property, as well as the use of the authorities entrusted to them. If they exercise their powers and perform their duties dishonestly or in a fraudulent manner, they will be held accountable for breach of trust and may be compelled to compensate the firm for any losses or damages incurred as a result of such fraudulent conduct. They are also liable to the firm for any hidden earnings they may have made while performing obligations on the company's behalf. Independent directors can also be held liable for misbehavior, such as malfeasance or willful abuse of power.

2. LIABILITY TO THIRD PARTIES:

Liability under the Companies Act:

Prospectus: An independent director is personally liable for damages to a third party if he or she fails to declare any particulars as required by section 56 and Schedule II of the act, or if facts in the prospectus are misstated. Section 62 of the Act states that an independent director is liable to compensate any person who subscribes for shares or debentures on the basis of the prospectus for any loss or damage incurred as a result of any incorrect or misleading statement included therein.

In terms of allotment: Irregular allotment, i.e., allotment before the minimum subscription is reached (Section 69), or without fiduciary responsibility may potentially expose independent directors to personal culpability. Under section 71(3), any independent director of a company who knowingly contravenes or willfully authorizes or permits the contravention of any of the provisions of sections 69 or 70 with respect to all allotment is liable to compensate the company and the allottee for any loss, damages, or costs incurred as a result.

Failure to return application fees in the event that the minimum subscription is not received within 120 days of the issue's opening: If funds are not repaid within 130 days of the prospectus's release date, per section 69(5) and SEBI standards, the money will be forfeited. On the 130th day, the company's independent directors will be jointly and severally liable to refund that money plus interest at the rate of 6% per annum. An independent director, on the other hand, is not accountable if he can show that the failure to reimburse money was not due to any malfeasance or negligence on his side.

Failure to reimburse application fees when a securities listing application is not made or is denied: In accordance with clause 73(2). If the firm has not applied for or has not been granted authorization to list its shares on the stock exchange, the company must restore all cash received from the applicants immediately and without interest, and if any such money is not repaid within eight days after the company becomes liable to repay, the company and every independent director of the company who is an officer in default shall be jointly and severely liable to repay that money with interest at such rate, not less than 4% and not more than 15%, as may be prescribed, on and from the expiry of the eighth day.

Limitless liability:

Where their liability is made unlimited pursuant to section 322(i.e., via Memorandum) or section 323, independent directors will be held personally liable to third parties. (i.e., through passing a special

resolution altering the Memorandum). The Memorandum of a corporation may make the liability of any or all independent directors or managers unlimited under section 322. In that situation, the independent directors, manager, and member proposing a person for appointment as an independent director or manager must include a statement in the petition for appointment indicating the person holding the office will have unlimited responsibility. The promoters, independent directors, manager, and officers of the company must notify him in writing that his liability will be unlimited.

Furthermore, if approved by the articles, a limited liability company may amend its Memorandum by passing a resolution to make the liability of its independent directors or any independent director or manager limitless. However, the change making an independent director's or director's or manager's responsibility limitless will only take effect if the concerned officer consents to his liability being rendered unlimited. Unless specifically agreed to by any or all independent directors, this change will not take effect until the current term of office expires.

Fraudulent trading:

An order of the court under section 542 can make independent directors personally accountable for a company's debts or liabilities. The court will issue such an injunction if the independent directors have been found guilty of fraudulent trading. In this case, Section 542(1) states that if it appears that any business of a company has been carried on with the intent to defraud creditors of the company or any other person, or for any fraudulent purpose, the court, on the application of the Official Liquidator, may order the company to be wound up, If the court deems it appropriate, the liquidator or any creditor or contributory of the company may declare that any persons who were knowingly parties to the carrying on of business in the manner aforesaid shall be personally liable for all or any of the company's debts or other liabilities as the court may direct.

Furthermore, under section 542(3), anyone who was knowingly a party to the carrying on of the business in the way specified is punishable by imprisonment for a term of up to two years, or by a fine of up to fifty thousand rupees, or by both.

3. LIABILITY FOR BREACH OF WARRANTY:

Independent directors are expected to work within the parameters of their authority. As a result, if they conduct business in a manner that is ultra vires the company or ultra vires the articles, they may be held personally liable for any loss suffered by a third party.

4. LIABILITIES FOR FAILURE TO COMPLY WITH STATUTORY OBLIGATIONS:

Under several parts of the Companies Act, 1956, independent directors are required to perform a number of statutory obligations. Failure to comply with these responsibilities has legal ramifications. The numerous statutory penalties that independent directors may face for failing to comply with the provisions of the Companies Act are discussed in their respective sections.

5. LIABILITY FOR ACTS OF CO-DIRECTORS:

Except for topics to be dealt with by the company in general meeting and not by the other members of the Board, a director is the company's agent. As a result, no action taken by the Board can make a director liable if he or she did not engage in it or was unaware of it. He must either be a party to the improper act or subsequently assents to it to be held liable. As a result, a director's absence from a Board meeting does

not make him accountable for a co-fraudulent director's act on the grounds that he should have found the fraud.

6. CONTRACTUAL LIABILITY:

Directors are required to use fair and reasonable diligence in carrying out their responsibilities, as well as to act honestly and with the care that is reasonably expected of them, given their knowledge and expertise. "A director will be personally accountable for a corporate contract where he has accepted personal liability either openly or implicitly," it was concluded in R.K. Dalmia and others v The Delhi Administration. A company's directors are its agents or trustees."

7. CIVIL LIABILITY TO THE COMPANY:

Directors' liability to the company may emerge if the directors are negligent, have breached trust, have committed misfeasance, or have acted extra vires, and the company's money have been used for such an act.

A director must behave honestly and diligently, applying his thinking and carrying out his responsibilities as a prudent individual of his abilities and expertise would. As indicated by Justice Romer in Re City Aquintable Fire Insurance Company, it has been explained in the duty of directors as to what is required of him in terms of standard or due care and diligence. Misfeasance encompasses any intentional wrongdoing or culpable negligence. "A director must act as a man of affairs dealing with his own affairs with reasonable care and circumspection could fairly be expected to act," it was held in Re Duomatic Ltd.

8. CRIMINAL RESPONSIBILITY:

If a director assisted, abetted, counselled, or procured the commission of an offence by the firm, he may be held criminally accountable. Companies owe a duty not to poison our water and food, not to pollute our rivers, beaches, and air, just as individuals owe a duty not to damage or injure others in society without justification, not to allow their workplaces to put their employees' and the public's lives in danger, and not to sell or provide transportation that will kill or injure people.

In Assistant Commissioner, Assessment-ll, Banglore & Ors. v. Velliappa Textiles Ltd & Anr., the Supreme Court held that because an artificial person, such as a company, cannot be physically punished, such a section, which makes it mandatory to impose a minimum term of imprisonment, cannot apply to such a case. However, in Standard Charted Bank v. Directorate of Enforcement, the Supreme Court specifically overruled the lower court in a 3:2 majority judgement in 2005.

In Standard Charted Bank v. Directorate of Enforcement, the appellant filed a writ petition in the High Court of Bombay, challenging various notices issued under section 50 read with section 51 of the Foreign Exchange Regulation Act, 1973, claiming that the appellant company was not liable to be prosecuted under section 56 of the FERA Act, 1973. Against the High Court's decision, the appellant filed a special leave petition with the Supreme Court, arguing that no criminal proceedings can be brought against the appellant company under section 56(1) of the FERA Act, 1973, because the minimum punishment prescribed is imprisonment for a term of not less than six months and with fiduciary responsibility.

The issue before the court was whether a firm or corporation, as a juristic person, can be punished for an offence that carries a mandatory sentence of jail and a fine. Prosecution is required before any punishment can be imposed. It is clear from the Standard Charted case that a prosecution can be started and a fine can be imposed even if the mandatory punishment is imprisonment with a fine.

9. LIABILITY IN THE EVENT OF A WINDING-UP:

A director of a company in liquidation must work with the liquidator to realise the company's assets and distribute them among the company's creditors and contributors. If they do to comply, they may face imprisonment for up to five years as well as a fine. As a result, Directors are accountable if the company's property is stolen or if false accounting is made. Directors may face criminal charges for a variety of reasons.

10. SPECIAL LIABILITY PROTECTION UNDER THE LAW

The Act provides further protection for a liability that was incurred in good faith. A good example is the early case of Re Claridge's Patent Ashphalt Co, in which the Court concluded that the Directors were acting in the best interests of the company and received the best advice from the company's solicitor, and thus could not be held accountable. The Bombay High Court awarded relief to the Directors in the case of Gautam Kanoria v. Asst ROC, where the AGMs and annual returns could not be held and filed due to the government's ownership of the firm and events beyond their control. The totality of the circumstances must be considered when deciding whether or not relief should be granted. In Om Prakash Khaitan v. Shree Keshariya Investment Ltd, it was also stated that directors should be relieved of the consequences of defaults and breaches unless they are directly involved in the acts or omissions complained of, or have otherwise not acted honestly or reasonably, or have financial involvement in the acts or omissions complained of.

Conclusion

Independent directors' responsibilities must be rigorously regulated by their contracts with the company, statute, the company's memorandum and articles of organization, and common law. Independent directors are also expected to execute the company's business with care, expertise, and diligence. When an independent director fails to exercise the appropriate skill, care, and diligence and, as a result, breaches the duty of care due to a third party, the independent director may be held personally liable for any losses incurred as a result of the breach.

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