

In order to engage with our readers and simplify the legal complexities of the infrastructure sector, EPC World has partnered with Rajani Associates, a full-service law firm for a series of legal Q&As. Through this Legal Q&A column, **SHISHAM PRIYADARSHINI**, Partner, Rajani Associates and **AMISH SHROFF**, Associate Partner, Rajani Associates, will endeavour to address the queries and challenges faced by our readers.



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Why is Corporate Governance important?

Corporate governance is of paramount importance to a company and is almost as important as its primary business plan. If the corporate governance is executed effectively, it can prevent corporate scandals, fraud and the civil and criminal liability for the company. It also enhances a company's image and is looked upon as a company that is responsible and worthy of shareholder and debt holder participation. In the absence of effective corporate governance, corners will be cut, products and services will be defective and management will grow complacent and corrupt. The basic idea of the corporate governance is to ensure that board of directors exercise appropriate scrutiny over management of affairs of the Company and undertake the business activities in a professional manner.

Who is an Independent Director?

An independent director is a director on the board of directors of a company who does not have a material or pecuniary relationship with the company or related persons, except to the extent of receiving sitting fees and such remuneration as may be prescribed under the provisions of the applicable statutes. In India, the significance of the term 'independent director' arose from the concept of Corporate Governance. The major development which came in this regard was the inclusion of Clause 49 in the erstwhile Equity Listing Agreement. The

role of independent director is considered to be of great significance in the corporate governance framework. However, surprisingly, the Companies Act, 1956 which dealt with company law for all those years never spoke about this concept. It was under the Companies Act of 2013 that the provisions dealing with the role of independent directors in a company were included. In terms of the provisions of the Act, every public listed company and certain unlisted public company are required to appoint independent directors on the Board of Directors.

What is the need for having Independent Directors on Board?

Essentially, the need for independent director arises from the need to have a strong framework of corporate governance in the functioning of the company. These independent directors are the trustees of good corporate governance. An active board consisting of professional and truly independent directors plays an important role in creating trust between a company and its investors, and is the best guarantor of good corporate governance. The role they play in a company broadly includes improving corporate credibility, governance standards, and the risk management of the company. The independent directors contribute to the Board by constructively challenging the policy decisions and company strategies. They also scrutinize the performance of the management and hold them accountable for their actions. Their independence, on account of lack of affiliation which is likely to prejudice their decisions, allows them to fulfill these tasks more efficiently.

Boards may not exercise efficient monitoring if they are composed of individuals who either maintain close ties to the management or lack the appropriate expertise. Independence is particularly crucial in those areas which involve a potential conflict of interests between the people in management and shareholders such as auditing of the company's performance, declaration of dividend, remuneration to be paid managerial personnel, taking expansion decisions. Above all, the objective of having an independent director is to add transparency, fairness and independence in decision making by any company in



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order to not only safeguard the interest of the shareholders but to ensure a proper functioning of the company for its long term growth.

Are there any qualifications and specific requirements to be taken into consideration before appointment of independent director?

In the Act, there is a list of qualifications and requirements to be taken into consideration before appointment of any independent director. In terms of the provisions, one such requirement is that an independent director must be a person of integrity and should possess relevant expertise and experience or any such other qualifications as may be prescribed. The terms 'integrity', 'expertise' and 'experience' are not the defined terms and it is not clear the manner in which such characteristics of an individual has to be determined while selecting an independent director. Due to the lack of clarity, the appointment of independent directors based on these conditions becomes very ambiguous and subjective. Further, the Act requires that an independent director should not be related to promoters or directors in the company, its holding subsidiary or associate company. It further provides that the independent director must not be either directly or any of the relatives of independent director holds or has held the position of key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three (3) financial years. The independent director is also required to give a declaration stating that he meets the criteria of independence as provided in section 149(6) of the New Companies Act.

Whether an independent director can be held responsible for the day-to-day operations of the company in which he is a director?

An independent director shall be held liable in respect of such acts of omission or commission by a company which had occurred with his knowledge or connivance or for failure to exercise due diligence in such acts.

What possible impact will the provisions of independent director have on the Companies?

One of the positive impacts with respect to the significance which is attached to the concept of independent directors is that the same will lead to better growth opportunities for the companies because of effective corporate governance under the

supervision of the independent director. Considering that the Act empowers the independent directors to hold separate meetings without the presence of other directors to access the performance of the Board of Directors there certainly is an element of supremacy for the independent directors under this act to voice their concerns if there is an instance of mismanagement in the company. In our view, the negative impact of the provisions of dealing with the independent directors can be understood in the sense the number of restrictions which have been imposed under this act, for a person to get qualified as an independent director, huge amount of responsibilities and duties, for corresponding lower amount of remuneration being given to them. In addition, the rules which have come into effect imposes additional responsibility on the company on the appointment and functioning of the independent directors in general. Considering the number of compliances required to be fulfilled for the appointment of the independent directors, it may be a major deterrent factor for their appointment. While some of the conditions are reasonable and necessary to maintain their independency (such as conditions with regard to term, remuneration), other conditions look ambiguous and may be seen in the nature of over policing, which may, in turn, shun away some individuals to take up the role of independent director in the companies.

What is the term of office for the Independent director?

Independent director can hold office for a term of five (5) consecutive years and such term can be extended by another five (5) years, if a special resolution is passed by shareholders and disclosure to that effect is made in Directors Report. However, he cannot be in office for more than two (2) consecutive years, and he would be once again eligible for the reappointment after the expiration of three (3) years period from the date of cessation of directorship. During this time, he shall not be appointment in or be associated with the company in any other capacity, directly or indirectly. An Independent director has to compulsorily give a declaration that he meets the criteria of independence as specified in Section 149(6) at the first board meeting held after his appointment and subsequently at every first meeting of the financial year. If any circumstance arises due to which he loses his independence, he must disclose to the Board about his inability to continue. EPCWorld