
A STUDY OF INDEPENDENT FUNCTIONING OF DIRECTORS UNDER CORPORATE LAW

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Introduction

The success of the company is greatly influenced by its directors. A company can have a variety of director types and independent directors are one kind those that functions as the company's guardians. They often have no direct access to the company's management and are not involved in day-to-day operations. Rather, their role is to guarantee that the business is operating in an ethical, just and proper manner. The company benefits from having a variety of independent director categories with a range of backgrounds and expertise as they take into account various viewpoints, it aids the company in making better decisions. Independent directors are also termed to be similar to the majority of a company's trusted advisors. There is nothing personal at risk for them. They also assist in decision-making by taking interests into account.

“Independence is a status or condition of a person from being free from all i.e., dependence, subjection, or control.”¹ A director, who is said to be independent, should not be subject to any control, restriction, dictation or limitation given by controlling persons. Simply, he must be free from all factors which affect his independent judgment. Many international bodies have attempted to formulate a general definition to the term independence. *“Independence is precisely defined to ensure that these directors have no interest in the company that could adversely affect genuine independent and objective judgment.”²* Fundamentally, it means that an individual should be free to use reasoned judgment without being unduly influenced or restricted by pressure from management or any other dominant shareholder or stakeholder.

“If a director is subject to the influence of an interested party or other interested director, or if the director is so dependent on them that their discretion would be stifled, then the director lacks independence.”³

¹ Henry Campbell Black, *Black's Law Dictionary* (2nd edn, West Publishing Co 1910).

² Wilson Sonsini Commission, Definition of 'Independence' (constituted by New York Stock Exchange, Autumn 2009).

³ *Rales v Blasband*, 634 A.2d 927, 936 (Del 1993).

1.1 STATEMENT OF PROBLEM

The concept of independent directors is central to promoting good corporate governance, ensuring that the board acts in all the best interests of the company and its stakeholders. Despite the detailed legal framework introduced by the Companies Act, 2013, in India, there are significant concerns regarding the actual independence and effectiveness of these directors.

A key issue is the method of appointment and the close associations independent directors often have with the company or its promoters, which may compromise their objectivity. Furthermore, there are doubts about whether they possess sufficient authority to prevent mismanagement and unethical practices, especially when faced with dominant promoters or controlling shareholders. The problem is further compounded by a lack of clear performance standards for independent directors, leading to questions about their accountability and impact on corporate governance. Additionally, the limited training and resources available to independent directors can hinder their ability to carry out their roles effectively.

This study addresses the gap between the intended role of independent directors in theory and their functioning in practice under corporate law, with a focus on identifying the barriers to their independence and proposing solutions to enhance their effectiveness in improving corporate governance.

1.2 RESEARCH QUESTIONS

1. What are the legal frameworks governing the appointment, role and responsibilities of independent directors under corporate law in India?
2. How effective are the legal safeguards in ensuring the true independence of directors and what improvements can be made to enhance their independence?
3. What challenges do independent directors face in maintaining independence from company promoters and controlling shareholders?

1.3 RESEARCH OBJECTIVES

1. To analyse the legal framework governing the appointment, roles, and responsibilities of independent directors under corporate law in India.

2. To examine the strength independence of directors, powers, functions liabilities and independence of the independent directors.
3. To assess effectiveness of existing legal safeguards in ensuring the independence of directors and suggest potential reforms to enhance their autonomy.

1.4 RESEARCH HYPOTHESIS

The study hypothesizes that the existing legal framework governing the appointment, roles, responsibilities, and independence of independent directors under corporate law in India is insufficient to ensure their autonomy and effectiveness in promoting corporate governance. It is posited that while the Companies Act, 2013, and SEBI regulations provide a robust theoretical framework, practical challenges undermine its implementation. The appointment process of independent directors is hypothesized to lack transparency, often resulting in conflicts of interest with company promoters and controlling shareholders. Furthermore, the study suggests that independent directors face significant limitations in exercising their powers and fulfilling their functions due to dominance by major shareholders or promoters. Existing liability provisions under the Companies Act are hypothesized to discourage independent directors from taking decisive actions, as these provisions disproportionately burden them. Additionally, the study hypothesizes that current legal safeguards fail to address the practical needs of independent directors, such as access to adequate training, resources, and institutional support, thereby limiting their effectiveness.

It is also hypothesized that reforms aimed at strengthening eligibility criteria, implementing transparent appointment processes, and introducing performance-based accountability mechanisms will significantly enhance the independence and autonomy of independent directors. Moreover, empowering independent directors through stronger whistleblower protection laws and mechanisms to act against unethical practices is expected to improve overall corporate governance outcomes. Through these hypotheses, the study aims to critically assess the gap between the intended and actual roles of independent directors and propose actionable reforms to enhance their effectiveness.

1.5 RESEARCH METHODOLOGY

The methodology adopted for this study is the Doctrinal method. This research study may

include various journals, articles, books and other electronic materials to conduct an in-depth analysis and employ a comprehensive examination of existing legal doctrines, frameworks, and regulations related to minority shareholders. Additionally, electronic materials, primarily sourced from the Internet, serve as secondary sources, contributing valuable perspectives to enrich the overall understanding of the subject matter.

1.6 REVIEW OF LITERATURE

1. Committee Reports and Evolution of Corporate Governance Framework

The foundation of independent directors' roles and responsibilities in India can be traced back to key committee reports that shaped corporate governance frameworks. The Kumar Mangalam Birla Committee Report (1999) was a landmark initiative by SEBI, establishing the concept of independent directors to promote transparency and protect stakeholder interests. The Naresh Chandra Committee Report (2002) further enhanced these standards, focusing on the qualifications, appointment processes, and ethical obligations of directors in listed companies.

Subsequently, the Narayana Murthy Committee Report (2003) emphasized refining the definition of independence by excluding individuals with financial or familial ties to the company's management. The J.J. Irani Committee Report (2004) provided a comprehensive understanding of directors' roles, offering recommendations that served as a precursor to the Companies Act, 2013. Lastly, the Kotak Committee Report (2017) introduced critical reforms to strengthen board accountability, including increased representation of independent directors on corporate boards and improved disclosure norms. These reports collectively highlight the evolution of governance mechanisms in India to align with global best practices.

2. Legislative Framework: Companies Act, 2013

The Companies Act, 2013, under Section 149 and Schedule IV, codifies the responsibilities and conduct expected of independent directors. It mandates their inclusion in specified companies and outlines a code of conduct emphasizing integrity, fairness, and accountability. This Act provides a robust framework to protect minority shareholders and ensure that board decisions align with the company's long-term interests. It also incorporates a liability clause under Section 149(12), which holds independent directors accountable only when they have actual or constructive knowledge of wrongdoing.

3. Role of SEBI and LODR Guidelines

SEBI's Listing Obligations and Disclosure Requirements (LODR) regulations complement the Companies Act, particularly for listed companies. Regulation 25 of the LODR specifies duties, including participation in key committees like the Audit Committee and Nomination and Remuneration Committee, and imposes limits on the number of companies where an individual can serve as an independent director. These regulations emphasize active oversight and ensure that directors contribute meaningfully to decision-making processes.

5. Case Studies: Governance Failures

The role of independent directors in preventing corporate misconduct has been scrutinized through case studies of high-profile governance failures. In the Satyam Scam (2009), independent directors failed to exercise due diligence or identify red flags, leading to one of India's largest corporate frauds. Similarly, the Ranbaxy Laboratories Case (2013) highlighted the inability of independent directors to detect and address systemic malpractices, resulting in significant financial and reputational damages. These examples underscore the need for robust accountability mechanisms and enhanced training programs for independent directors.

6. Relevance of Websites and Online Resources

Resources such as the SEBI and MCA websites provide valuable insights into the regulatory framework governing independent directors. These platforms serve as repositories of guidelines, amendments, and compliance requirements, enabling directors to stay informed about their roles and responsibilities.

2. A STUDY OF INDEPENDENT FUNCTIONING OF DIRECTORS UNDER CORPORATE LAW

2.1 EVOLUTION OF INDEPENDENT DIRECTORS IN INDIA

Previously, common law principles governed the concept of independent directors in India. However, this has changed over time. *"It strengthened its corporate governance standards and adhered to international standards by appropriating and adapting the laws of other developed nations."*⁴ "This process is also called as legal transplantation. Though, because the political,

⁴ Umakanth Varottil, 'A Cautionary Tale of the Transplant Effect on Indian Corporate Governance' (2009) 21(1) *National Law School of India Review* 1, 24.

social and economic environments in various nations differ, there are a number of issues with this transplantation of legal principles. In India, for example, the pattern of shareholding is highly concentrated, usually with the controlling shareholder, while US companies have a more distributed shareholding. In an independent country, the board typically consists of combination of directors who serve as promoter and independent director representatives. Furthermore, unlike the US, the law in India stipulates that a simple majority resolution must be passed in order to remove or appoint directors. As a result, it's important to modify legislation during transplantation to reflect the requirements and circumstances of the receiving nation. *“Though India has not been completely successful but it has changed and is becoming better.”*⁵

The Kumar Mangalam Birla Committee first defined the term, "Independent directors" in 1999. Securities and Exchange Board of India, also known as "SEBI," established the committee with the goal of advancing and raising corporate governance standards throughout the nation. This committee has mandated that independent directors only be paid director's salary. Aside from that, they have no monetary interest in the company, so they are free to use their own discretion when making decisions. They must be capable of strategic thought, have leadership traits, and demonstrate some level of dedication to the company's progress. This led to the creation of the idea of independent directors. The Listing Agreement now has a clause titled 'Clause 49 - Corporate Governance' as a result of the recommendations under which this provision requires listed company's boards to appoint independent directors.

Thereafter, the idea of independent directors was always changing. The Ministry for Corporate Affairs (henceforth referred to as 'MCA') and SEBI established a number of committees to assess and improve the nation's corporate governance procedures. The committees' recommendations and reports played a crucial role in the development of independent directors. The Naresh Chandra Committee, appointed by the MCA, released its recommendations in 2002. It suggested how they should be appointed for entities that are listed. Additionally, it promoted the idea that listed companies have to formally appoint independent directors with letters of appointment. *“This letter needs to specify their responsibilities, obligations, and compensation in detail.”*⁶ Then, in 2003 SEBI constituted the Narayana Murthy Committee to review the corporate governance code for listed public companies.⁷ *“It anticipated a*

⁵ *Id*

⁶Naresh Chandra, *Report of the Committee on Regulation of Private Companies and Partnerships* (July 2003) 19.

⁷ Narayana Murthy, *Report of the SEBI Committee on Corporate Governance* (8 February 2003) 20.

revision to the definition of 'independent directors'.⁸ "It was suggested that among other things, they should not be related to the promoter or management, have any financial stake in the business, or have held an executive position in a company during the previous financial year. After that, in 2004, the J. J. Irani Committee released a report. The Company's Act was preceded by this report. As a result, it supports in interpreting the Companies Act's provisions and understanding the legislative intent. It was established under the MCA's auspices. "This committee provided a thorough definition of what independent directors are, what attributes they should have, and how they are appointed."⁹ "This helped to clarify what an independent director's "independence" really meant. Ultimately, SEBI established the Kotak Committee on Corporate Governance in 2017.¹⁰ "The committee proposed a number of changes to the establishment of independent directors. It pointed out that although the Companies Act requires independent directors to make up at least one-third of the board of directors, the LODR made no mention of this requirement. The committee suggested that independent directors should comprise of at least half of the board in accordance with Regulation 17 of the LODR. It also suggested changing the LODR's eligibility requirements for independent directors and the disclosures made upon their resignation. The Indian independent director regime was restructured as a result of these recommendations being adopted.

"At present, the Companies Act's Section 2(47) read with Section 149(6) defines the term 'Independent director'. They are described as directors who meet certain qualities and are not the managing director, whole-time director, or nominee director.¹¹ "These attributes include, among other things, not having a financial connection to the business, not being a member of the promoter group and in the board's opinion, having the necessary knowledge and experience.¹²" Section 149 of the Companies Act, in accordance with Rules 4 and 5 of the Companies (Appointment and Qualification of Directors) Rules, 2014, govern their appointment.

⁸ *Id.*

⁹ J J Irani, *Report of the Expert Committee on Company Law* (2005) 33–37. This report led to the introduction of the Companies Bill 2012, which was later enacted as the Companies Act 2013.

¹⁰ Uday Kotak, *Report of the Committee on Corporate Governance* (5 October 2017).

¹¹ Companies Act, 2013, §§ 2(47), 149(6).

¹² *Id.* § 149(6).

2.2 DUTIES UNDER THE COMPANIES ACT 2013

Independent directors are tasked with overseeing the affairs of the company and guiding the company to carry out its business efficiently with best practices. *“They also play a crucial role in protecting the interests of minority shareholders and ensuring accountability on the part of the management.”*¹³ *“While independent directors are bound to act in accordance with the articles of the company,”*¹⁴ they are also bound by the director’s duties enlisted in the Companies Act. Also, several other provisions of the Companies Act enlist the duties of independent directors, directly or indirectly.

Directors' responsibilities are listed in Section 166 of the Companies Act, as was previously mentioned. However, it does not make a distinction between full-time and nonexecutive directors. As non-executive directors, independent directors must likewise act in compliance with this section. *“This section imposes obligations on them, including the need to act in the company's best interests at all times, avoid situations in which their interests come into conflict with the company's, exercise independent judgement when making decisions, and act with reasonable care, skill, and diligence.”*¹⁵ *“In case they breach any of these duties a fine may be imposed.”*¹⁶

Schedule IV of the Companies Act contains a detailed code of conduct. Apart from the guidelines stipulated by the company, it offers guidelines for independent directors' professional conduct. Among other things, Schedule IV highlights the responsibilities, appointment process and role and function of independent directors. These include, but are not limited to, taking the appropriate actions on a regular basis, keeping up with skill updates and renewals, upholding moral standards of integrity and probity acting objectively and beneficially in the performance of his duties, making an effort to attend company general meetings, assessing management's performance in terms of achieving set goals and objectives, reporting concerns regarding unethical behaviour or fraud, helping to safeguard the legitimate interests of the company, its shareholders, and its employees, moderating and arbitrating in the company's interest, and engaging constructively and actively participating in committees of

¹³ Companies Act, 2013, sch IV.

¹⁴ *Id.* § 166(1).

¹⁵ *Id.* § 166(3)

¹⁶ *Id.* § 166(7).

which they are members, among other things. It is also clear from this that their overall responsibility is to oversee and keep an eye on the business's operations.

It's also important to remember that the Companies Act lays out a very comprehensive set of responsibilities for independent directors. Their responsibilities and range of performance are ambiguous and vague. *“For example, one of the responsibilities specified in Schedule IV requires independent directors to act within their authority to safeguard the company's, shareholders', and employees' interests.”*¹⁷ However, the statute is silent on the extent to which they can use their powers to safeguard the business, its shareholders, and its employees. It further specifies that no decision the business makes may be detrimental to the interests of the environment, the community, or the shareholders. The Companies Act, however, does not define these terms. Because of the broad meanings attached to these terms, it becomes unclear to what extent they have an obligation to protect the 'community' and the 'environment'.

2.3 DUTIES UNDER LODR

*“In 2015, SEBI sent out a notice about the LODR. In addition to the Companies Act, it sets forth rules for independent directors and places obligations on them.”*¹⁸ But the LODR only governs listed companies 'independent directors' behaviour. Private businesses and publicly traded companies that are not listed are not covered. This is so because the securities and capital markets are governed by SEBI. Its main goal is to safeguard securities market investors. If not, it may have long-term consequences for the credit markets, the economy, and public confidence in general. For example, because the public had heavily invested in Yes Bank's financial instruments, such as bonds, the bank's crisis had a severe effect on the credit market and investor confidence. Its financial effects would have been limited, though, if it had been a privately held or unlisted public company.

As a result, the LODR requires independent directors of listed companies to exercise greater caution and adhere to stronger corporate governance guidelines. But the Companies Act applies to all companies and does not distinguish between different types of companies. The LODR's *Regulation 25* outlines the responsibilities of independent directors. *“This Regulation states that a person is not permitted to hold the position of independent director for*

¹⁷ *Id.* § 134(3)(d)

¹⁸ SEBI (Listing and Disclosure Obligations) Regulations SEBI/LAD-NRO/GN/2015-16/013, Reg. 17 (Sep. 2, 2015)

*more than seven listed entities.*¹⁹” The functioning of the Audit Committee and the nomination and Remuneration Committee are governed by *Regulations 18 and 19*, which also govern the responsibilities of independent directors serving on these committees.” *It specifies the minimum number of meetings that must be held and the requirement to hold a minimum of one annual meeting wherein they can evaluate the quality and quantity of information flow between management and the board of directors and discuss the performance of non-independent directors.*²⁰ “Furthermore, the board of directors is required by the Companies Act to provide a separate code of conduct for all directors, including independent directors, as stated in even the LODR. This needs to be on top of the duties outlined in the Companies Act. Thus, the LODR governs not only a number of corporate governance-related issues but also the behaviour of independent directors of listed entities.

2.4 LIABILITIES OF INDEPENDENT DIRECTORS

Independent directors do not bear responsibilities for the daily operations of a company and, historically, were not held legally accountable for any defaults committed by the organization. This exemption was grounded in the rationale that, lacking authority over every process within the company, it would be unjust to expect them to address or rectify corporate misconduct. However, as corporate governance standards evolved, common law introduced a more nuanced approach, requiring directors to demonstrate reasonable competence in performing their roles and monitoring the company’s activities.

The Companies Act seeks to establish the criteria for assessing the culpability of independent directors when a company commits a wrongful act. Section 149(12) of the Act includes a ‘non-obstante’ clause, which limits the liability of independent directors. They are held accountable only for acts they had actual knowledge of, where the acts could reasonably have been expected to result from board decisions, or where the directors provided consent or were complicit in the wrongdoing. Additionally, liability arises if they failed to exercise due diligence in preventing such acts. Over time, jurisprudence has developed to include both actual knowledge and constructive knowledge as factors in determining a director's accountability.

Constructive knowledge, often referred to as "red flags," involves information that a director should reasonably be aware of, as it serves as an early indication of possible fraud or

¹⁹ *Id.* reg. 25.

²⁰ *Id.* reg. 25(3).

malpractice requiring investigation. In contrast, actual knowledge pertains to information that a director directly possesses. The significance of constructive knowledge is amplified by the independent director's mandatory roles in the Audit Committee and the Nomination and Remuneration Committee. These roles provide directors with greater involvement in the company's operations, equipping them with a more comprehensive understanding of its activities. This increased involvement places them in a better position to identify warning signs and take corrective action when necessary.

The Companies Act, therefore, aims to strike a balance between the responsibilities of independent directors and their roles in corporate governance. While independent directors are shielded from liability in cases where they lack knowledge or involvement, they are expected to exercise due diligence and respond appropriately to red flags. As members of key committees, their enhanced understanding of the company's functioning demands vigilance, allowing them to act effectively in safeguarding the company's interests and mitigating risks of non-compliance or fraud.

Due to the position they occupy and the problem they are seeking to address, it is possible for them to compromise them thus they should be liable to face consequences in case of breach. It would be quite absurd to appoint individuals only for them to have no implications of their actions or lack of them. As a result of the foregoing discussion, it is necessary to define the required type of diligence as well as type and scope of knowledge that they should possess as the current information is limited and confusing. Such a situation has often resulted in independent directors not meeting their expectations and responsibilities as well as their mandate in an organization, which the Punjab National Bank scam illustrated. Unfortunately, self-made directors did not decrease risk for shareholders and other stakeholders by disregarding the management's suspicions and trickeries. It is therefore important to establish the extent of their liability so as ensure they are well placed to the discharge of their mandate efficiently.

2.5 IMPORTANCE OF INDEPENDENT DIRECTORS

The directors are chosen by the shareholders, who act as the true owners, by simple majority vote at general meetings. As a result, the owners are responsible to the directors. Rather than the management, directors have a fiduciary duty to the shareholders. That does not imply an adverse or uncooperative board. Nonetheless, the management's strategy and viewpoints might

diverge from those of the investors. The non-executive directors of the company should raise their objections and act in the best interests of the shareholders if any management decision has an impact on those interests. This is the exact reason that 'independence' has grown to be so important when it comes to choosing the composition of a company's board of directors. With this notion, the securities market regulator, SEBI, insisted on including both independent non-executive and executive directors on the boards of listed companies.

The highest standards of corporate governance can only be attained by an active, informed, and independent board. The formation of the company's board should have this goal in mind. The appointment of independent directors will help to accomplish this goal. They are able to add objectivity to the Board process, and since they are neutral, the company's interests will be protected, which will benefit minority and smaller shareholders. The primary goal of appointing independent directors is to oversee every action taken by the board and guarantee its impartiality and independence.

Policies should be strengthened in light of the well-publicized corporate governance scandal involving Satyam Computers Ltd., the fourth-largest software company in India. The Companies Act of 2013 gives more significance to the development of corporate governance standards as a result of that failure and its lessons. It mandates the inclusion of independent directors and provides an explanation of their responsibilities, authority, roles, and liabilities in relation to the various provisions of the Act. In the Schedule IV of the 2013 Act, it provides independent directors a code of behaviour.

“The Act requires all listed companies to designate two independent board members and at least one-third of the total number of board members as independent members in other unlisted companies with paid-up share capital of at least 10 crore rupees, turnover of at least 1 crore rupees in a financial year, or the total amount of debt capital, including debentures and loans or borrowings exceeding 50 crore rupees.”²¹ Only listed companies that are listed are subject to the listing agreement's prescribed requirement ratio for independent directors. For both listed and unlisted public companies, the Board ratio specified in the 2013 Act is applicable.

2.6 FAILURE OF INDEPENDENT DIRECTORS IN INDIA

As a watchdog, an independent director has a duty to maintain constant vigilance in his

²¹ Companies Act 2013, s 149(4)

workplace. In actuality, however, the watchdog is unable to stop wrongdoers from doing wrong and to alert others to wrongdoing. Since the inception of this concept, this has frequently happened in India. Despite the fact that many independent directors have neglected to fulfil their responsibilities, very few complaints have been made and documented against them. Following are some cases where Independent Directors of a company failed to perform their duties.

2.6.1 Case law- Satyam Scam

Mr. Ramalinga Raju founded Satyam Computers Service Ltd. on June 24, 1987, in Hyderabad, as a private company that provided software development and related services to large companies. When it was first incorporated, it was a private company; on August 26, 1991, it changed its status to public. By the day the scandal came to light, it was doing business in sixty-six countries, with 175 Fortune 500 companies among its clients.

The proposal made by Mr. Ramalinga Raju, the founder of Satyam Computers Service Ltd., to acquire a fifty-one percent stake in Maytas Infrastructure Ltd. and a hundred percent stake in Maytas Properties Ltd. was approved by the board on December 18, 2008. The controlling shareholders and owners of both companies were Mr. Raju's family members. The acquisition price was estimated to be \$1300 million for Maytas Properties and \$300 million for Maytas Infrastructure Ltd. *“The Board approved the acquisition proposal without seeking approval from Satyam's shareholders.”²² “At the time the proposal was accepted, the Satyam Board was chaired by a number of highly renowned individuals, including Shri. Vinod K. Dhaam, who is widely regarded as the ‘father of Pentium’ and a former employee of Intel, Shri. Ram Mohan Rao M, the Dean of the Indian Business School, Shri. Raju U S, a former director of IIT, Delhi, Shri. Prasad T R, the Union Cabinet's secretary at the time, Srinivasan M, a professor at several U.S. universities, and Shri. Krishna Palepu, a professor at the Harvard Business School.”²³ “*

After receiving positive feedback from investors, the proposal to purchase the two family-owned businesses was cancelled in less than a day. Due to Satyam's offering improper benefits to bank officials and lack of documentation, the World Bank banned the company from

²² C.C. No 1 of 2010 (XXI Additional CMM Court-cum-Special Session Court, Hyderabad)

²³ Dev Chatterjee, 'The Penalty on Satyam was the Signal to All Independent Directors' *Business Standard* (10 December 2014) https://business-standard.com/article/companies/satyam-penalty-send-signals-to-all-independent-directors-1141320900792_1.html/ accessed 2 October 2024.

conducting any transactions or business with the bank's direct contracts for a period of eight years on December 23, 2008. Mr. Raju announced the accounting fraud and resigned from his position on January 7, 2009. The principal perpetrators of the fraud were the target of both criminal and civil proceedings.

- Penalty on Independent Directors of Satyam-

Even with the independent directors on the Board having professional experience, they remained silent and were powerless to stop the misgovernance. The six independent directors received punishment for improperly carrying out their duties. Mr. Krishna Palepu, a professor at Harvard Business School, was fined Rs. 2.66 crore, while the other independent directors each received a fine of Rs. 20,000.

2.6.2 Case law- Ranbaxy Scam

Ranbaxy Laboratories Limited was the biggest pharmaceutical company in India and ranked among the top 100 worldwide. It became a public company in 1973 after being incorporated in 1961. The company operated in 44 nations and provided services to clients in 100 nations worldwide. In 2004, the company reported \$1.18 billion in revenue. On June 11, 2008, Daiichi Sankyo acquired 34.83% of the promoters' preferential shares, or more than 50.1% of the voting rights in Ranbaxy. For Rupees 737, Daiichi acquired a share; the transaction value was approximately \$4.6 billion. *“After Sankyo Co., Ltd. and Daiichi Pharmaceutical Co., Ltd. merged in September 2005, Daiichi Sankyo was founded, becoming the third-biggest pharmaceutical company in Japan.”*²⁴

A claim was made against Ranbaxy in 2004 following the issuance and mandatory nature of the Corporate Governance Code by the SEBI, claiming that the company had engaged in systematic fraud to increase its investment. The Ranbaxy was sued in the United States under *“Civil Law”*²⁵ and *“Criminal Law”*²⁶ for selling adulterated drugs. The case was first investigated by the District of Maryland's Southern Division and Civil Division Courts in 2004. The Court held that the company had wilfully and knowingly made false, fictitious and

²⁴ Asish K Bhattacharyya, *'Failure of Corporate Governance at Ranbaxy?'* *Business Standard* (9 June 2013) <http://www.business-standard.com/article/opinion/corporate-governance-failure-at-ranbaxy-6071.html> accessed 2 October 2024.

²⁵ *USA ex rel Dinesh Thakur S v Ranbaxy United States of America Inc*, Civil Action No 1:07-00962-JFM (D Md).

²⁶ *USA v Ranbaxy USA Inc*, Criminal Action No JFM 13-0238 (D Md).

fraudulent statements in its annual reports. Ranbaxy was fined \$500 million by the court on January 2, 2013.

During that period, the Board of Ranbaxy had eight independent directors, including Shri. Tejendra Khanna, the then Delhi's Lieutenant Governor. The other independent directors were the then Chief Executive Officer of P&G India Shri. Gurcharan Das, a senior most cardiologist Shri. Joshi P S, the then Chairperson of JM finance Shri. Nimesh N Kampani, the then Partner of PWC Pvt Ltd Shri. Vivek Mehra, senior advocate Shri. Surendra Daulet-Singh, the international trade expert Shri. J W Balani and the famous DCM family member Shri. Vivek Bharat Ram. All the eight members were enlightened leaders in their own area. Though the Board had such progressive personalities, they couldn't prevent corporate governance failure in the company.

3. CONCLUSION & SUGGESTIONS

3.1 CONCLUSION

The role of independent directors within the corporate governance framework in India is crucial, as they serve as guardians of ethical conduct, transparency, and the interests of minority shareholders. The Companies Act, 2013, and subsequent regulatory frameworks by SEBI have provided a foundation for the institution of independent directors, underscoring their importance in balancing power dynamics within corporate boards. Despite this legislative progress, the practical functioning of independent directors often falls short of its intended purpose.

In fact, the concept of independent directors was supposed to bring objectivity in board decisions, sift the influence of the promoters, and ensure that the decisions of the company were in the long-term interest of all stake holders. However, close affiliations with the promoter or dominant shareholder often compromise the capability of independent directors to enforce independent judgment in most cases. There are quite a few instances where such an absence of actual independence and oversight of these directors has culminated in pretty serious governance failure-the Satyam and Ranbaxy scandals come to mind. That, too, spells out the limitations of the safeguards in vogue at present and how urgently reform is needed.

It has also meant that the appointment process is affected at the appointment level by

management, which tends to affect objectivity and the ability to act uninfluenced. In addition, although the legislative framework spells out duties very comprehensively, there is no clear definition of what can constitute limits of authority and accountability for independent directors. Ambiguous phrases like ‘protection of shareholder, community and environmental interests’ definitely provide much scope for interpretation and tend to result in minimum action when the important matters arise.

Independent directors are also facing common challenges in the form of inadequate information, under-training, and pressure to fall in line with majority decision-making. Moreover, no standards exist for benchmarks that trigger accountability for performance. Indeed, independent directors are somewhat in a difficult position in that they must balance fiduciary duties with very practical realities of operation with the management team that controls their appointment and, for many, their future corporate governance prospects.

The way independent directors are appointed, paid, trained, and held accountable needs to be completely redesigned in order to improve their status and influence in India. In order for independent directors to truly represent shareholders' interests and uphold the highest levels of corporate governance, policies must change. The ability of independent directors to enact significant corporate responsibility and oversight can only be realised by means of these reforms.

3.2 SUGGESTIONS

- a) **Strengthen Appointment Processes:** The appointment of independent directors may now be made rigorous, with a special focus on independence in reality. Companies can really circumscribe the preponderance of company promoters if they can create an independent body that vets or appoints such directors.
- b) **Mandate Continuous Training:** Regular training programs will keep them updated with emerging corporate governance practices, changing regulatory considerations, and also principles of ethics, which will enhance their ability to decide effectively.
- c) **Revise Legal Frameworks:** Provisions on Companies Act and of the SEBI regulations should clearly define what duties and authority independent directors have so that there is no vagueness. This should include the extent to which their responsibilities may reach

shareholders and then the community and the environment respectively.

- d) Enhance Accountability:** Independent directors must be held accountable to ensure that adequate monitoring is provided. This would include clear delineations of penalties in case of negligence and the mechanism for reviewing it periodically.

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