KEEPING IDs IN THE BOARDROOM
July 15, 2020

SUMMARY OF DISCUSSIONS

Background

Covid-19 came with not much of advance notice and wrought, and continues to wreak, untold havoc on the lives and health of humankind, across continents, and the economic health of most nations. In the corporate world, managements are waging continuing battles to ensure crisis management of a high order. Boards of Directors have become more active than in the past, since they have to work more closely with managements in addressing the problems caused by Covid-19, and at the same time, constructing a post Covid scenario for the company. As a result, Independent Directors (IDs) and other Non-Executive Directors (NEDs) have had to assume a much higher level of involvement in the affairs of the company.

IDs by their very nature, are part time Non-Executive functionaries. They do not have any direct involvement in the decision-making relating to the operations of the company. At the Board level, they along with the other elements of the Board, as well as Senior management, help to put together the strategy of the company, as well as hold management accountable for the proper performance of the company. As part time Non-Executive functionaries, they suffer from asymmetry of information. It has however been found in recent times that when there are allegations of some fraudulent activity taking place, IDs are also being hauled up by investigating agencies, and before Courts. This is clearly a worrisome development. In such situations, the D&O Liability Insurance Policy is of limited help, since the best among them additionally provide only for payment of legal fees, while an ID seeks to protect himself/ herself. The statutory protection under Section 149 (12) of the Companies Act, 2013 is also of no help since it can be invoked only in the event of allegations relating to offences under the Companies Act, 2013. As a result, IDs are feeling threatened by the possibility of being involved in litigation on account of an increasing number of liabilities visited on them. What can an ID do to protect himself/ herself in these circumstances? Is there any worthwhile legal protection available? Should companies travel the extra distance to address the problems caused by the attachment of assets, including bank accounts, of IDs?

DISCUSSIONS

- There was a time, when persons with long years of rich executive experience, looked forward to becoming Directors on Boards. But now, most of them are sceptical.
- There is a need to have good Directors in boardrooms to improve governance standards in companies. However, this exercise has become a major challenge, since many competent persons are reluctant to get onboarded as Directors for the following reasons -
    - Increasing accountability and liabilities of IDs.
    - Lack of clarity on what IDs should be held responsible for.
    - Presumption of guilt before any charge is proven.
    - Attachment of personal assets of IDs, and on occasion, of their family members, before any guilt is established.
- In the event of unjustified prosecutions, it is not clear to IDs what defences are available to them to protect themselves. The protection, if any, is at present very limited, and is more imaginary than real.
- Better understanding, by itself, of laws, rules and regulations does not make a person a better ID. It is qualities of mind, integrity and courage that are more important. There is a view that if IDs, including prospective IDs, understood the extent of their responsibilities, derived from laws, rules and regulations, they would stay far away from the boardroom.
- The risk-reward trade-off for IDs is very unfavourable. It does not make sense for persons to serve on Boards of companies which are not their own, and take on unlimited risk, often extending to attachment of

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their personal assets, and impairment of their reputation. Since the institution of IDs should not be dispensed with, the disproportionate burden on them has to be addressed.

- At present, the tendency is to hold all Directors, including the IDs, responsible, should something go wrong in a company. Sometimes charges are also levied against former IDs who are no longer serving on the Board.
- The bigger problem is not civil liability, but prosecution. If cases are properly contested, IDs would not be found guilty in most of them. The problem is the harassment, adverse publicity and negative public opinion, as also the resultant loss of reputation, health and wealth suffered by IDs before the case reaches the Court. This should be urgently addressed. Taking the position that guilt or innocence will be ultimately determined in a Court of law is not an answer to the current situation.

LEGAL PROVISIONS

- There is a need to have a very clear division between operational matters and Board matters, especially those for which IDs can be held responsible.
- IDs have protection under Section 149(12) of the Companies Act, 2013. It is understood that in the original draft, this provision was to the effect that - "Notwithstanding anything contained in this Act or any other law for the time being in force…". This *non-estante* clause was diluted to - "Notwithstanding anything contained in this Act…". Considering that Directors are often charged with alleged violation of the provisions of other laws, Section 149(12) provides very limited protection. The dilution is understood to have been made because several laws fell under the State list, and it was inappropriate to grant immunity in respect of offences under those laws by making a *non-estante* provision in a central enactment. However, it should have been possible to provide immunity at least under all Central laws, but that too was not done.
- There is a need to restore the earlier language of this section because protection has to be in respect of alleged offences under all laws. Insofar as any act of omission or commission cannot be attributed to an ID, and there is no indication of connivance, it should be concluded that the ID should not be held accountable for any alleged offence. While there might be instances of ignorance or even being a party to a wrong decision, there should be no assumption of criminality, and administrative remedies rather than prosecution could be considered.
- On the basis of experience so far gained, it would be worthwhile to attempt a list of purely operational matters where IDs being non-executive part-time functionaries, should have no responsibility. IDs suffer from asymmetry of information, and therefore, there is no way by which they can independently satisfy themselves that the company is compliant with all acts, rules and regulations that are applicable to its operations. IDs can draw some comfort from a comprehensive Compliance Certificate from the management at each Board meeting, stating that there are no instances of non-compliance. This is the only instrument available to the IDs to satisfy themselves on this count.
- Whenever an offence is alleged against a company, all the Directors, executive or non-executive, are named in the complaint. If there is no application of mind at this stage, it will result in indiscriminate issue of summons, and on occasion, charge sheets to all the Directors. This could arise when the Court of the Magistrate treats the Board as a collective entity, and does not distinguish between Directors, based on whether they are executive or non-executive. In India, unlike in some of the developed jurisdictions, the process of investigation and trial, as well as proceedings in the Appellate Court, often takes many years, and the question whether a person is guilty or not is of no more than academic interest after sufficient harm has been visited on her before judgement.
- At present, the tendency is to presume an ID guilty, and leave it to her to prove that she is not guilty. In public perception, the burden of proof has been transferred to the person proceeded against.
- Many IDs are selected for Board positions because of their previous track records and having regard to the value that they bring, and will continue to bring, to the Board. Often these are persons with a public persona. This enhances their vulnerability on account of the likely impact on reputation in the event of

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allegations against them. The media and unfortunately, some investigative agencies, tend to look at such IDs as soft targets. If the institution of IDs is considered important enough to ensure Corporate Governance, the Government should intervene effectively to prevent an unjustified presumption of guilt on the part of those being investigated.

- Routinely asking for, and obtaining, all manner of personal details of NEDs, including, but not limited to, bank account details, Aadhar card and passport copies, is fraught with needless adverse consequences for the person concerned. Such information should be sought only if it is relevant to the matter being investigated, and not in a routine fashion.
- A contrasting view was expressed that the Government and the Regulators are cognizant of the problems faced by IDs, and have issued circulars and guidelines from time to time stating that unless there is a prima facie indication of an ID being involved in the commission of an offence, she should not be routinely proceeded against. There is however no indication that this has put the problem to rest. This would not preclude investigating agencies from seeking information/ assistance from IDs at the stage of investigation.

ROLE OF IDs

- The institution of IDs is relatively new in India, and therefore needs to be developed. This requires careful nurturing by the Government and by the Regulators.
- Expectations from IDs are very high. At the same time, there is a perception that most IDs are doing very little.
- There is lack of good training material for IDs to keep them updated in a rapidly changing environment.
- The selection process of IDs has traditionally been flawed, with friends of the promoter becoming IDs, even though they are not independent in spirit. Increasingly, IDs now quit problem Boards because in case the promoter is guilty of a wrongdoing, the ID would not want to be seen as a part of the problem, and would much rather retain the friendship of the promoter.
- Many IDs do not read agenda papers, and only go with what the management says. They need to be made aware of their responsibilities and the legal implications of their actions. It is not necessary for them to have an intricate knowledge of all the affairs of the business. However, they need to have a clear sense of what is right or wrong.
- IDs need to clearly understand their duties, role and responsibilities. The statute clearly defines the duties of IDs. This includes some duties relating to the day-to-day activities of the company. This is not correct. IDs are non-executive part-time Directors, and come for meetings 4-8 times in a year. Irrespective of the information provided to them, or the questions asked by them, they cannot do adequate justice to the long laundry list of duties prescribed by law. Duties of IDs should focus on Board level items including, but not limited to, strategy, succession planning, and protection of the interest of minority shareholders. Operational activities should be outside the area of responsibility of IDs. This would help IDs to be more effective.
- Penalties imposed on IDs should also be commensurate with their responsibilities. They should not be held guilty for operational activities.
- The context under which a company's circumstances change should also be considered. There have been instances when situation in the company has drastically changed for the worse in 1-2 quarters, courtesy the act of one of the Key Managerial Personnel (KMPs), who was earlier performing well.

ENGAGEMENT WITH GOVERNMENT

- It would seem that there is a basic disconnect between the Government's understanding of the role of IDs, and what their role actually is. To treat them as an additional set of auditors is incorrect. The basic responsibility of the IDs is to add value to the company, and to its various stakeholders. Governance and ethical behaviour are only necessary conditions, but not sufficient conditions, for a business to perform well on a sustainable basis.

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- The Ministry of Corporate Affairs (MCA) has taken a major step in the right direction by initiating legislation to decriminalise some of the offences under the Companies Act, 2013. This is a welcome move.

ENGAGEMENT WITH REGULATORS/ INVESTIGATIVE AGENCIES

- It must be brought to the attention of the Regulators that most other countries do not seem to be holding IDs responsible for most of the things that go wrong in a company. The trend in India seems to be to create greater accountability of Directors, including IDs.
- There is no clarity that the MCA or the Regulators have factored in the non-executive nature of IDs in determining their accountability. This is presumably because neither the MCA nor the Regulators interact with IDs to ascertain what actually transpires in boardrooms and to what extent, and in what manner, IDs contribute to the decision-making process.

ROLE OF MEDIA

- Sensationalism in media reports, partly for getting higher readership or viewership, has resulted in considerable injustice to IDs.
- Trial by media, sometimes based on misinformation, causes considerable harm while investigation, or trial by the Courts is going on.
- While allegations against IDs get disproportionate prominence in media reports, the finding of absence of guilt, following a Court process, and that too after a long period of time, barely gets mentioned.
- Based on reports of the high levels of compensation that a handful of IDs get from a very limited number of companies, an impression has been sought to be created that IDs are overpaid and underworked persons.

D&O LIABILITY INSURANCE

- While there is a regulatory prescription that companies should have D&O Liability Insurance policies, the coverage of some of the policies has been found to be inadequate. It is only very recently that some policies have incorporated provisions for expenses on legal fees to be reimbursed before the trial is completed.
- In the past, these policies have not been found to be uniformly effective. Companies should ensure that the scope and coverage is adequate, especially having regard to the possibility of class actions suits.

WAY FORWARD

- Some of the solutions have to be short term, to convince the current IDs to stay on the Boards.
- It is important to engage with the Government constructively to understand what is expected of IDs. There can also be engagement with Parliamentarians, who are members of the Standing Committee.
- There is a need for a representative body of IDs through which Regulators can convey their expectations to IDs, so that they can work towards fulfilling those expectations.
- There should be a formal communication by the Government to the Regulators and law enforcement agencies stating that KMPs should be primarily held responsible/ liable for the day-to-day operations of a company. IDs should be held responsible only for acts of commission or omission attributable to gross negligence or connivance by IDs. The basic premise is that IDs should be held accountable only for matters that they get to know through a formal Board process, and where they have been parties to malafide decisions. The difference between the responsibility of the Board and that of the management needs to be understood and articulated clearly.
- The unfortunate habit of presuming that an ID is guilty, unless proven otherwise, needs to be given up.
- There should be communication with the Regulators, with the MCA and with investigative agencies, to make them focus on the real perpetrators of the transgression.
- There is a need to implement the Safe Harbour Rule.
    - In case an ID is found to be guilty, the actions against her could include disqualification from being a Director, and clawback of commission and sitting fees paid to her. The punitive action

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should not extend to freezing or attaching personal assets which have no relationship whatsoever to earnings from the delinquent company.
    - Given the present scenario, it would be a good idea for IDs to ringfence their personal assets through Trusts or other legal arrangements.
- The possibility of IDs being subject to self-regulation, as in the case of chartered accountants and lawyers, should be examined. A separate Disciplinary Authority could be considered to be set up, to deal with cases against IDs. This is important because the members of this Authority could be former IDs who factor in their boardroom experience when trying to determine guilt or innocence.
    - Three issues could be looked at by the Authority – whether there was criminality involved, whether it was a case of negligence, or a case of business failure.
    - There could be a forum for screening of allegations against IDs. If such a forum is established by law, and has the blessings of MCA, SEBI and other Regulators, it would prevent a number of minor transgressions having to be looked at by investigative agencies.
- Since self-regulatory organisations have not been very successful in India, the alternative that could be considered is a screening body, with 3 eminent members, to look at cases against IDs, in order to determine whether there is criminality, requiring the matter to be referred to an investigative agency. This screening body could be set up on the lines of the Advisory Board for Bank Frauds. In the alternative, there should be an Ombudsman appointed, with the backing of law, who should sign off before action is initiated against an ID.
    - This screening body may be required to look at cases before the stage of prosecution. The intention is not to prevent any conversation that investigative agencies might have with IDs to obtain information or seek assistance. The worry is that the interaction with investigative agencies often results in avoidable harassment against which the IDs presently have no protection.
- As a long-term solution, it would be useful to have the nature and extent of liabilities of IDs gone into by the Law Commission. The views of the Commission can then be appropriately captured through amended legislative provisions.
- Sectoral Regulators should take the initiative in creating/ restoring a balance between responsibilities and liabilities of NEDs. Separately, chambers of commerce and industry, which have a large number of corporates as their members, could also promote meaningful dialogue and discussions on this matter.
- An external agency can be brought in once every 2-3 years to validate that the governance processes in the company are commensurate with the size of the company, and its complexity. With awareness around governance increasing, this would be a welcome move.
- There should be a clear understanding that IDs will not be held responsible for matters of a purely operational nature, which lie in the realm of the management.
- D&O Liability Insurance policies by themselves are not enough to keep IDs inside boardrooms.
- Academies such as the National Judicial Academy and the state-level Judicial Academies sometimes conduct familiarisation programmes on various aspects of corporate laws, including securities laws. Since these programmes are attended by judicial officers of different levels, it would be useful to incorporate, in the programme relating to securities laws, a component detailing the structure and functions of the Board, and the responsibilities attached to different categories of Directors, based on their different roles. Similar familiarisation inputs should also be provided in training programmes for officers of investigative agencies.
- There is a need to engage with the media and educate them.
    - A forum can be created where experienced IDs can interact with senior editors to present their point of view.
    - There could be a need for media familiarisation, as distinguished from interaction, with them. This could help in a better appreciation of roles and responsibilities.

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- The Government should be given a detailed paper, which would also factor in the experience of IDs who have served/ continue to serve on badly governed companies, focussing on managerial practices as well as governance practices. This could help the Government understand and appreciate the situation, and convince it to strengthen the institution of IDs.

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EXCELLENCE ENABLERS PRIVATE LIMITED

Excellence Enablers Private Limited (EEPL) is an initiative that focuses on implementation of better corporate governance practices, improvement of Board performance, including audit and evaluation, training of directors and engagement with stakeholders of governance. It is founded on the firm belief that the gap between performance and potential can, and must, be bridged. Consistent with that belief, all our offerings are tailor-made to the specific needs of the organisation or the individuals concerned.

Given that our founder, Mr. M. Damodaran, introduced Clause 49 of the Listing Agreement, dealing with corporate governance in India, and has been a part of both public sector and private sector Boards, as well as performing and underperforming Boards, we offer experience based consultancy and courses on the journey from compliance through governance to performance. Further, given his success in turning around organisations that had been written off, we are uniquely positioned to offer courses on leadership, organisational transformation, and building winning teams.

EEPL has a number of highly experienced and renowned consultants and faculty members who have helped, and continue to help, us deliver programmes that have been well received.

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