

FAQs



FAQs on appointment of independent directors

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Updated June 10, 2014

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FAQs on appointment of independent directors

FAQs

The old mindset on appointment of directors – appointment as additional director first, then regularisation in a general meeting, followed by retirement by rotation etc – all of this will have to change completely in case of independent directors. The key point is Schedule IV, (1) (2) and (3). The language of the Schedule suggests that the appointment will have to be done by the general meeting.

Seemingly the provisions of the Act, 2013 and the rules issued thereunder relating to appointment and qualification of directors and independent directors are creating a lot of confusion. As a result Ministry of Corporate Affairs (MCA) on 9th June, 2014¹ has issued clarification on the same vide General Circular No. 14/2014 (**clarification circular**) after examining various representations received.

In the light of the above-mentioned, the FAQs below seek to answer some common questions:

Criteria for independence:

1. **Is there a difference in the criteria of independence as per clause 49, revised Clause 49 and as per section 149 (6) of the Act, 2013?**

Yes, the criteria of independence as per Clause 49 and that as per Section 149 (6) of the Companies Act, 2013 (Act) differs. In addition to those mentioned under section 149 (6) of the Act, Clause 49 lists out the following as well:

Criteria under Old Cl. 49	Criteria under S.149(6) of Act, 2013	Criteria under revised Cl. 49 (wef 1st Oct 2014)
apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director	who has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the 2 immediately preceding financial years or during the current financial year;	apart from receiving director's remuneration, has or had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the 2 immediately preceding financial years or during the current financial year
-	none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or	none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or

¹ The circular may be viewed at http://www.mca.gov.in/Ministry/pdf/General_Circular_14_2014.pdf



FAQs on appointment of independent directors

FAQs

Criteria under Old Cl. 49	Criteria under S.149(6) of Act, 2013	Criteria under revised Cl. 49 (wef 1st Oct 2014)
	associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or Rs. 50.00 lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year	associate company, or their promoters, or directors, amounting to 2% or more of its gross turnover or total income or Rs. 50.00 lakh or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
is not related to promoters or persons occupying management positions at the board level or at one level below the board	i) who is or was not a promoter of the company or its holding, subsidiary or associate company; ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company	i) who is or was not a promoter of the company or its holding, subsidiary or associate company; ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company
has not been an executive of the company in the immediately preceding three financial years	-	-
is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following: i) the statutory audit firm or the internal audit firm that is associated with the company, and ii) the legal firm(s) and consulting firm(s) that have a material association with the company	neither himself nor any of his relatives— i) holds or has held the position of a KMP or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed; ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which	who, neither himself nor any of his relatives — i) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed; ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be



FAQs on appointment of independent directors

FAQs

Criteria under Old Cl. 49	Criteria under S.149(6) of Act, 2013	Criteria under revised Cl. 49 (wef 1st Oct 2014)
	<p>he is proposed to be appointed, of—</p> <p>a. a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or</p> <p>b. any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;</p>	<p>appointed, of –</p> <p>a. a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or</p> <p>b. any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;</p>
is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director		who, neither himself nor any of his relatives is a material supplier, service provider or customer or a lessor or lessee of the company
is not a substantial shareholder of the company i.e. owning 2% or more of the block of voting shares	<p>who, neither himself nor any of his relatives;</p> <p>holds together with his relatives 2 per cent. or more of the total voting power of the company;</p>	<p>who, neither himself nor any of his relatives;</p> <p>holds together with his relatives 2 per cent. or more of the total voting power of the company;</p>
not less than 21 years of age		<p>Who is less than 21 years of age.</p> <p><i>This seems to be a drafting lacuna.</i></p>
	who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience	who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;
	<p>who, neither himself nor any of his relatives;</p> <p>is a Chief Executive or director,</p>	<p>who, neither himself nor any of his relatives;</p> <p>is a Chief Executive or director,</p>



FAQs on appointment of independent directors

FAQs

Criteria under Old Cl. 49	Criteria under S.149(6) of Act, 2013	Criteria under revised Cl. 49 (wef 1st Oct 2014)
	by whatever name called, of any non-profit organisation that receives 25% or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company	by whatever name called, of any non-profit organisation that receives 25% more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company

It is to be noted that for the purpose of the Companies Act, 2013, “associate company”, means a company in which that other company has a control of at least 20% of the total share capital² or of business decisions under an agreement, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

However, for the purpose of Clause 49, the meaning of the word “associate” is derived from AS 23, and which means an enterprise in which the investor can participate in the financial and/ or operating policy decisions of the investee but cannot control those policies and which is neither a subsidiary nor a joint venture of the investor.

2. How does a director self certify and intimate his independence to the company? At what point of time does this need to be done?

An independent director shall self certify that he satisfies the criteria laid down under section 149 (6) of the Act, 2013 at the following points of time:

- 2.1. at the first board meeting in which he participates as a director
- 2.2. at the first board meeting in every financial year
- 2.3. whenever there is a change in the circumstances which may affect his status as an independent director

3. Is there any particular form for self certification of independence?

No, there is no particular format for self certification of independence. He may make a declaration in the format given in the [Annexure](#)

² means the aggregate of the - (a) paid-up equity share capital; and (b) convertible preference share capital;



FAQs

4. How should one determine the existence of a pecuniary relationship?

The language in section 149 (6) (c) uses the word “pecuniary relationship”, while in section 149 (6) (d), the words used are “pecuniary relationship or transaction”. The word *material* which featured in clause 49 of the listing agreement has not been included here. Further clause (d) specifies the monetary limit beyond which the value of the transaction will be seen as impacting the independence of the director.

The intent of the law is not to bring each transaction of the independent director under the scanner. So long as the transactions are executed on arms length basis, it should not be regarded as a disqualification.

MCA has also specified the same in its clarification circular that transactions entered into in the ordinary course of business at arm’s length price will not fall under the purview of “pecuniary relationship” stated in section 149 (6) (c) while determining the independence of the director.

Further, the remuneration received from one or more companies, by way of a fee u/s 197 (5), reimbursement of expenses for participation in the Board and other meetings, profit related commission approved by the members in accordance with the provisions of the Act, 2013 will also fall outside the purview “pecuniary relationship” stated in section 149 (6) (c) while determining the independence of the director

Tenure of an Independent Director

5. What will be tenure of appointment of independent directors?

As per sub-sections (10) and (11) of section 149 of the Act, 2013 an independent director can be appointed for a term up to five consecutive years and thereafter can be re-appointed for another term of up to five consecutive years only after passing of a special resolution in general meeting. The re-appointment shall happen only after performance evaluation is done by the entire board. However, an independent director cannot hold office cannot for more than two consecutive terms. The Act, 2013 also provides for a cooling off period of three years after which he can again be appointed as the independent director.

As per revised Clause 49, an independent already holding tenure for 5 or more years can be appointed for only one term of 5 years.



FAQs

6. Will the existing tenure be counted?

The Act, by way of an explanation to sub-sections (10) and (11) of section 149, clearly states that any tenure of an independent director as on the date of commencement of the Act shall not be counted as term under the abovementioned sub-sections.

Clause 49 states that a person who has already served as an independent director in a company for five or more years as on 1st October, 2014 shall be eligible to be appointed for one more term of up to five years only.

Hence, if we summarise the above, the substance emerges is as follows:

- For listed companies:
 - If the independent director has already serve five or more years as on 1st October, 2014 – He can be appointed for only one more term of up to five years.
 - If the independent director has served a tenure which is less than five years as on 1st October, 2014 – He can be appointed for not more than two consecutive terms of up to five years each.
- For unlisted companies: The existing independent directors can be appointed for not more than two consecutive terms of up to five years each.

7. Can a Company appoint an independent director for a term of less than 5 years?

In view of the representations received by MCA asking whether an independent director can be appointed for a term of less than 5 years, the clarification circular specifies that the same is permissible. However, any appointment whether of 5 or less than 5 years will be regarded as 'one term'. Section 149 (11) clearly stipulates that no person can hold office as an independent director for more than 'two consecutive terms'. Thus, irrespective of the duration of each of the two terms (whether the same aggregates to 10 years or less) a person holding office for two consecutive terms shall be eligible for re-appointment only after the expiry of three years of ceasing to become an independent director.



FAQs

- 8. Some companies are taking the view that the expression “term upto five consecutive years” used in sec. 149 (10) may mean a 5-year term starting from 1st April 2014, that is, the date of implementation of sec 149. Accordingly, these companies are appointing their independent directors upto 31st March 2019. Is this view correct or advisable?**

The word “year” usually means a calendar year, and therefore, it is fair to say the term of 5 years, starting from 1st April 2014, ends on 31st March 2019. However, the word year is not used as a self-standing word here. It is used in conjunction, so to lead to the expression “term upto five consecutive years”. It is a *stare decisis* that a director’s appointment is done at an AGM. It continues, in case of rotational directors, upto the 3rd AGM after the present one, and in case of directors appointed for a fixed term, upto such fixed term. Therefore, the expression “term upto five consecutive years” must mean the time gap between the present AGM and the 5th AGM after the present one.

Any other interpretation will lead to a completely unworkable situation. For example, if the directors were to be appointed upto 31st March 2019, then what about the filling up of their places on 1st April 2019? Sure enough, the company cannot wait for the AGM of 2019. So, either the AGM of 2018 itself has to reappoint the director prospectively from 1st April 2019, or the director’s office will remain vacant upto the date of the 2019 AGM.

Such an interpretation disturbs a settled rule that directors’ term starts at an AGM and continues upto an AGM. The word “year” appearing here does not have to be read as a self-standing “calendar year”. Sec 3 of the General Clauses Act starts with the exception –unless the context otherwise requires. Therefore, the general meanings of words given in the General Clauses Act do not have to be mechanically applied. This is particularly so in case of terms of offices, which are appointed in a particular manner.

- 9. Is there a conflict between the requirement of the Act and the Listing Agreement?**

As per Companies Act 2013, a person may be appointed as an ID for a term upto 5 years, and then he may be reappointed for one more term upto years, on the strength of a special resolution. However, the revised Clause 49 of the Listing Agreement seems to provide for only one more term. The relevant clause reads:

Provided that a person who has already served as an independent director for five years or more in a company as on October 1, 2014 shall be eligible for appointment, on completion of his present term, for one more term of up to five years only.



FAQs

If one examines closely, there is no conflict between the requirements of the Act and the Listing Agreement, if the directors are appointed before 1st October 2014. Sure enough, the AGM of 2014 will be over before 1st October. So, if the appointment is done before 1st October 2014, it becomes a “present term” as on 1st October 2014, and therefore, the term of 5 years will start running only after the expiry of the “present term”.

Limit on number of Directorships held

10. Is there any limit on the number of companies in which a person can act as an Independent Director?

As per Companies Act, 2013 there is a limit on number of directorships prescribed under section 165 (1) of 20 companies (including any alternate directorship). There is no separate limit specified for Independent directors.

However, revised Clause 49 prescribes a limit on the number of companies in which a person can act as Independent Director. A person cannot serve as an Independent Director in more than seven companies. Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in maximum three listed companies.

Regular appointment of independent directors:

11. Who will do the regular appointment of independent directors?

The identification of prospective independent directors shall be done by the Nomination and Remuneration Committee and be recommended to the board. Thereafter, the appointment of independent director(s) of the company has to be approved in the meeting of the shareholder. It may be noted that the appointment of an independent director can be done only at a general meeting and not by way of postal ballot. This is deduced by way of para IV (2) of Schedule IV to Act, 2013.

The explanatory statement attached to the notice for the meeting approving the appointment of independent director shall contain a statement that in the opinion of the board, the person proposed to be appointed as the independent director fulfils the conditions set down in the Act and the Rules and is independent of the management.



FAQs

12. Can an existing independent director be treated as a non-executive, rotational director?

The existing independent directors cannot be treated as rotational directors. They will continue to act as independent directors till one year from the enforcement of this section (i.e. up to 31st March, 2015) and since the Explanation to section 152 (6) says that for the purpose of calculating total number of rotational directors, independent directors shall not be included, hence, it is very clear that they cannot be treated as non-executive rotational directors.

Vacancies in the office of independent directors:

13. What are the various ways in which vacancy can arise in the post of an independent director?

Vacancy may arise in the following ways:

- 13.1 Death
- 13.2 Incapacity to act
- 13.3 Ineligibility of a director
- 13.4 Resignation
- 13.5 Removal by members, or by NCLT

14. If a vacancy arises, how does it have to be filled up?

This question has to be seen from two aspects:

- 14.1 Schedule IV, VI (2) of Act, 2013 says where an independent director resigns or is removed, then the vacancy has to be filled up by a replacement director within 180 days. However, the clause does not say who will fill the replacement.

However, sub-clause D(4) of clause 49 states any vacancy caused by way of resignation or removal from the board in the post of independent director shall be filled up not later than the immediate next Board meeting or three months from the date of such vacancy, whichever is later.

- 14.2 Further, we shall also refer to second proviso to the Rule 4 (iii) of the Companies (Appointment and Qualification of Directors) Rules, 2014 which refers to intermittent vacancy in the post of independent director. The meaning of the term “intermittent vacancy” in the Rules seems to be



FAQs on appointment of independent directors

FAQs

between the dates of two general meetings. “Intermittent” means something occurring in between, and therefore, since there is no general meeting currently in the offing, and the company does not have the required number of independent directors, the Rules permit the Board of directors to cause the appointment. Further, such intermittent vacancy has to be filled within not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.

The revised Clause 49 remains silent on the procedure of filling up the vacancy.

Hence, the substance that emerges from the above is as follows:

	Listed company	Unlisted company
Vacancy caused by resignation or removal	Filled up by the board at the immediate next board meeting or within 90 days from the date of vacancy	Filled up by at the general meeting within 180 days
Vacancy caused by death, incapacity or ineligibility	-do-	Filled up by the board at the immediate next board meeting or within 90 days from the date of vacancy

15. How long will the replacement director hold office?

- a. In case of appointment by the board, the director should hold office till the coming General meeting.
- b. In case of appointment by a general meeting, he may anyway be appointed for a full term of 5 years.

Existing independent directors

16. Will the existing independent directors have to be reappointed at the forthcoming AGM?

Quite likely the existing independent directors have been appointed as rotational directors. As per the new law, independent directors become non rotational. This change in terms of appointment can only be done by the general meeting. Accordingly, we are of the view that the existing independent directors may be reappointed for a term of 5 years at the coming AGM.



FAQs

Section 149 (5) provides a transition time of 1 year to ensure compliance with provisions of sub-section (4) relating to appointment of independent directors by eligible companies. MCA in its clarification circular has specified that any tenure of the independent director on the commencement of the Act, 2013 shall not be counted for his appointment/holding office of director under the Act, 2013. The companies have to necessarily appoint existing independent directors, who fulfill the eligibility and other prescribed conditions, under the Act, 2013 under section 149 (10) & (11) read with Schedule IV of the Act. The time frame to comply with same is a period of 1 year from 1st April, 2014.

Thus, the existing independent directors will be appointed under the new Act, 2013 and compliances with respect to obtaining of consent to act as Director and requisite form filing and compliances will be required to be done.

Special notice for appointment of an independent director:

17. Is a special notice required for appointment of an independent director?

Para IV of Schedule IV of Act, 2013 requires the appointment of the independent directors to be approved by at the meeting of the shareholders for which a notice has to be served with an explanatory statement containing the opinion of the Board that independent director proposed to be appointed fulfils all the conditions set down in the Act, 2013 and Rules and that the person is independent from the management. The requirement of special notice seems irrelevant to an independent director whose candidature is proposed by the board himself..

18. Is a pre-deposit of Rs 100000/- as provided in section 160 (1) applicable to the appointment of an independent director

Section 160 of Act, 2013 corresponds to section 257 of Act, 1956 and pertains to appoint a *competing* director in place of the director retiring by rotation and proposed to be re-appointed at the general meeting. Since, the appointment of a director is two-tiered i.e. identification by nomination and remuneration committee and thereafter consideration by the board and expression of opinion by the board, the author is of the opinion that the requirements u/s 160 and consequent deposit of Rs. 1,00,000/- shall not be applicable for the appointment of an independent director.



FAQs

Letter of appointment:

19. Is the letter of appointment to be given to the independent director required to be placed at the general meeting where he is being appointed?

Clause IV (4) of Schedule IV requires furnishing of a formal letter of appointment to the appointed independent director setting out the matters stated therein. MCA has specified in its clarification circular that in view of the specific provisions of the Act, 2013 the requirement of furnishing formalized letter of appointment is applicable for appointment of independent director under Act, 2013. Thus, existing independent directors appointed under provisions of 149 (10) and (11) will also be furnished with a formalized letter of appointment.

However, neither the Act, 2013 nor Clause 49 says that the letter of appointment should be placed at the general meeting where he is being appointed. Clause IV (5) of Schedule IV simply requires the company to keep the terms and conditions of appointment open for inspection at the registered office of the company for the members during normal business hours and Clause IV (6) requires the company to post the terms and conditions of appointment of Independent Directors on its website.

Clause 49 (revised) requires the company to disclose the terms and conditions of appointment of the independent directors to the stock exchange and on the websites of the company within one working day from the date of such appointment. Thus, there is no need to make the contents of the appointment letter a part of the general meeting notice.

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FAQs

Annexure

Declaration by Independent Directors
[Pursuant to section 149(7)]

To

----- (Name of the company)

----- (Address of the company)

Subject: Declaration of meeting the Independence criteria

I, allotted with Director Identification Number hereby declare the following with respect to each of the criteria as provided in clauses (b) to (f) of sub-section (6) of Section 149 of the Companies Act, 2013 read with Companies (Appointment and Qualification of Directors) Rules, 2014 and of sub-clause (1) of Clause 49 II B of the Equity Listing Agreement:

(1) (i) I am/ was not a promoter of the company or its holding, subsidiary or associate company;

(ii) I am not related to promoters or directors in the company, its holding, subsidiary or associate company;

(2) I had no pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(3) none of my relatives have or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(4) Neither me nor any of my relatives—

(i) holds or has held the position of a key managerial personnel or is or has been an employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year;

(ii) is or has been an employee or proprietor or a partner, in any of the three



FAQs on appointment of independent directors

FAQs

financial years immediately preceding the financial year, of—

(A) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm;

(iii) holds together with my relatives two per cent. or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent. or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent. or more of the total voting power of the company;

(v) is a material supplier, service provider or customer or a lessor or lessee of the Company;

(5) I am above 21 years of age;

(6) I possess appropriate skills, experience and knowledge in one or more fields of finance/ law / management/ sales/ marketing/ administration / research/ corporate governance/ technical operations or other disciplines related to the company's business.

I further declare the following with respect to each of the criteria as provided in sub-clause (2) of Clause 49 II B of the Equity Listing Agreement:

a. I do not serve as an independent director in more than seven listed companies.

b. I am not serving as a whole time director in any listed company and therefore the requirement to serve as an independent director in not more than three listed companies is not applicable to me or



FAQs on appointment of independent directors

FAQs

I am serving as a whole time director in ___ listed company viz. M/s and including current directorship I am serving as an independent director in not more than three listed companies.

Signature:

Date:

Place: