Independent directors, not directors sans culpability

Govt shielding independent directors from prosecution undermines Companies Act vision of better corp governance

GIVEN THE DRAMATIC rise in the number of resignations by independent directors, from 767 in 2018 to 1,393 in 2019, perhaps because of increasing risk of prosecution following corporate fraud and misgovernance, it is not surprising that the government should want to take some steps to check this. After all, if there aren't enough people willing to take up this job, how will corporate India find enough independent directors that are now required as part of the law? The corporate affairs ministry has ordered that no criminal or civil proceedings should be initiated against independent directors and non-executive directors of a company unless there is proof of complicity in an act of fraud/default; in any case, it has said that no prosecution can be initiated without the explicit approval of the government.

There is, however, a flip side to this. The idea behind having independent directors on a company's board was to get another check on management and promoters—that is why the independent director was not to be related to the management/promoters, nor have a business relationship with them. But, if the independent director is to be completely shielded, and continue to get fat salaries/commissions from firms, what is to even ensure s/he will function as well?

In the IL&FS case, the risk management committee met just once between 2014 and 2018, when the group's consolidated debt ballooned from ₹48,671 crore to ₹91,091 crore, and leverage rose to 13 from just 2.6. It is true that smart managements can, often, hide the truth from their boards, but consolidated debt can't be that hard to find if one if looking for it; even if the actual number is difficult to pin down, surely the fact that the group's annual report said it had anywhere between 176 and 251 entities—both numbers were mentioned in the report—should have raised suspicion. Later on, the Kotak panel found it had 348 entities. Allegations against its Gift City project were first made public in 2015, when a PIL was filed in court, and the flagship Noida toll bridge contract was cancelled by the Allahabad High Court in 2016; by then, the project, which was supposed to cost ₹408 crore, had seen costs escalate to ₹5,000 crore. As a result of this, a 30-year concession had got extended to a 100-year one. And, this is when Hemant Bhargava, LIC MD and chair of the risk management committee—LIC owns 25% of IL&FS—was the company's non-executive chairperson (independent director) while other high profile independent directors on the risk-committee included Maruti Suzuki chairman RC Bhargava, and former shipping secretary MP Pinto. Indeed, the IL&FS's renumeration committee, headed by former LIC chairman SB Mathur, had cleared a ₹20 crore annual salary for IL&FS chief Ravi Parthasarathy.

Even if the government argues that these independent directors weren't actually a part of the fraud committed by the management led by Parthasarathy, their director fees should at least have been clawed back, and they should have been barred from serving as independent directors of other companies for life, or for a fixed period. Choosing to do nothing now, and forever in the future, paves the way for toothless independent directors. If they continue to get paid handsomely by the firm, and there is no fear of government action in case something goes wrong, it will be a rare independent director that will blow the whistle.