Saga of Independent Director Resignations Unfolds Again in India Inc.

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The Indian corporate governance landscape has once again witnessed resignations by independent directors in what was a seemingly promising startup. Soon after an interim order was passed by the Securities and Exchange Board of India (SEBI) against the promoters of the Gensol Engineering Limited (GEL), who are also the founders of BluSmart Mobility, three independent directors of Gensol resigned within a few days.

Current Fiasco and Repetition of a Well-Known Trend

SEBI received a complaint in 2024 about share price manipulation and fund diversion in GEL. The company was listed initially on the BSE-SME platform in 2019 and then on the Main Board of BSE and NSE in 2023. It reported a net profit increase from INR 2 crores to 80 crores between 2017

and 2024. The promoter shareholding was reduced to 35% in 2024 from around 70% in 2020. During its inquiry, SEBI found that letters for compliant conduct were issued by GEL to credit rating agencies for loans taken from Indian Renewable Energy Development Agency Ltd (IREDA) and Power Finance Corporation (PFC). Such letters indicated that GEL had regular and standard conduct as a debtor and there were no overdue or unpaid instalment or default in the payment of instalments. However, the issuance of such letters was categorically denied by both the lenders. SEBI further noted multiple instances of unreported irregularities and defaults in debt repayment, violating applicable regulations. It was also found that a business loan of INR 262.13 crores taken by the company was used for the personal purposes of promoters through layered transactions routed through its dealer Go-Auto for supposed purchases of electric vehicles. Therefore, SEBI in its interim order restricted promoters of GEL from holding the position of a director or a key managerial personnel and restrained them from buying, selling or dealing in securities too.

As soon as the interim order was issued, it is reported that one of the independent directors resigned raising concerns about high debt levels and financial sustainability of the company. Another independent director resigned citing other professional commitments, accepting the fact that the company is in difficult times. A third independent director resigned on the ground that the company could not create value for its shareholders. He presumed the company had good corporate governance but after the recent unfolding of events he indicated his inability to continue though he expressed his hopefulness that positive developments may follow in the company.

Such resignations remind us of the infamous Satyam case of 2008 in which too there was a serial resignation of independent directors.

Resignation by all the independent directors adversely affected the interest of minority shareholders of Satyam when a bail out was required for the company. The role for ensuring protection of minority shareholders assigned to independent directors remained unfinished due to such resignations.

Expectations from Independent Directors

A question arises as to what role independent directors play in a company and what one expects from them. Independent directors are expected to act in two-fold capacity: as advisors and as watch dogs. They are expected to bring to bear independence in decision making and specialised skills on boards, and participate and contribute through their suggestions as advisors. Their watch dog role requires them to be updated about the company and its operations, be vigilant about related party transactions, provide unbiased oversight, raise concerns about violations of ethics, policies, regulations and act within their authority to protect the interests of the company and its shareholders, especially minority shareholders. The Supreme Court in *Neera Saggi v. Union of India* in 2021 observed that independent directors have a vital role to play; while they are intended to be independent, they cannot remain indifferent to the position of the company. Although the rudder might be in the hands of the managing director or key managerial personnel, independent directors are under a duty to keep an eye on them and ensure that they steer a proper course.

Concept of Independent Directors

The repetition of such violations in listed companies demands a re-examination of the importance and emphasis placed on the mandatory presence of independent directors in listed companies in India. The concept of independent directors was borrowed from jurisdictions having

companies with dispersed shareholdings and applied to closely held companies in India. Both the Companies Act, 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the 'LODR Regulations') rely heavily on independent directors in improving corporate governance by ensuring vigilance to avoid frauds, financial misconduct, and conflict of interest. All regulatory efforts are made to enhance their independence, ensuring their functions to be free from the control of controlling shareholders or promoters. Section 149 of the Companies Act, 2013 adopts a broader definition of independence with an objective and a subjective criteria to ensure financial independence of the independent directors from the company, its board and promoters. It also envisions independence regarding any prior relationship of independent directors with the company. The subjective criterion requires an independent director to possess integrity, relevant experience, and skills and expertise in finance, law, management, and the like. It also prescribes the role and duties of independent directors. In addition, SEBI made extensive amendments to the LODR Regulations to avoid any possible compromise to their independent status, ensuring that such a position is not used as a stepping stone to move to a permanent position in the company. However, it is also true that many such attempts to modify existing regulations are made *ex post* rather than *ex ante* for achieving pre-determined goals regarding the role and position of independent directors. It is interesting to note that the protection of independent directors is also ensured by the Companies Act by limiting their liability. The liability of independent directors is limited for acts of omission or commission by a company which had occurred with their knowledge, attributable through board processes, and with consent or connivance or where they had not acted diligently. Even then we witness independent directors jumping ship the moment a corporate governance failure is reported

A Possible Way Out

In such a situation where independence is ensured and liability is limited by law, resignations by independent directors raise serious doubts about the reliance placed on their presence in listed companies. In situations where such directors might have raised concerns internally about financial impropriety or imprudence in the meetings and did not receive any satisfactory reply, they could have approached SEBI, the Ministry of Corporate Affairs (MCA) or even acted as whistleblowers. In the absence of adopting such an approach, the only option left for them may be to resign from the company. But when independent directors resign only after the interim order against violation is passed or violations are made public, such a conduct raises question about their liability towards decision making. Independence is exercised only at the time of resigning but not at the time of appointments or decision making. Other questions that remain to be answered is why independent directors generally resign in such situations and why personal reasons or other professional commitments become the cause for such resignations.

It is time to rethink whether to continue having straight jacket formula of depending upon independent directors for improving corporate governance when the success rate of such formula is repeatedly questioned. In a jurisdiction where compliance rate is questionable due to compliance on paper vis a vis the real compliance in practice, where the ethical compass is compromised and diversity is seen not only in types of companies, but their management style also, should we not think of some measures at different levels or threshold-based formula for improving corporate governance rather than simply relying on the mechanism of independent directors? The audit committee comprising of independent directors too seems to be ineffective in this case.

Dispensing with independent directors altogether may not be a solution. They may be the best possible bet out of a plethora of options for instilling corporate governance. There is a need to determine newer methods to strengthen the institution of independent directors. A possible solution may include having a supervisory body composed solely of independent directors, which acts as a watchdog on the entire management, like supervisory boards in German companies. Such a radical overhaul may not be feasible for all companies in India. The requirement of supervisory boards may be fixed based on certain thresholds of turnover and debt-to-equity ratio and listed companies with a promoter and promoter group shareholding of above 50%.

Too much reliance has been placed on presence of independent directors in promoter-controlled environments to have higher standards of corporate governance that simultaneously limit liability of independent directors. It is true that by claiming moral responsibility or resigning from the directorship, independent directors cannot protect themselves from their liability. Ignorance or the lack of knowledge or belief is also not accepted for waiving the liability especially in view of code of conduct prescribed by the Companies Act. Studies have not found any correlation between board composition with respect to independent directors and profitability or revenue growth in companies. The saga of resignations has again unfolded in the GEL case. Several larger questions surrounding the role and implications of independent directors have been raised from time to time. This is surely an opportune moment for a rethink.

– *Harpreet Kaur*