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INDEPENDENT DIRECTORS IN INDIA: SAFEGUARDS OR SCAPEGOATS?

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ABSTRACT:

The Independent Directors are placed in a central role in the framework of the modern corporate governance in India, which is imagined as unbiased custodians charged with the responsibility of ensuring transparency, accountability, and protection of the interest of minority shareholders. The changing enforcement environment in India however, suggests an alarming paradox. Civil and criminal liability towards Independent Directors is becoming a reality in matters of corporate fraud, mismanagement and statutory non-compliance, which is often without any evidence of involvement, knowledge or mens rea. This pattern poses a crucial issue on proportionality of liability, erosion of judicial protections against vicarious liability and the general consequences of the trend on board independence.The paper is a critical analysis of the question of whether or not Independent Directors in India serve the purpose of effective corporate governance safeguards or have in practice become the easy scapegoats in the enforcement processes. It utilizes a doctrinal and analytical approach, exploring statutory provisions, regulatory frameworks and judicial precedents, including some of the major decisions of the Supreme Court and the Securities Appellate Tribunal which outline the boundaries of director liability. The paper also assesses the systemic effects of over-criminalisation, such as its chilling effect on board engagement, the growing unwillingness of good professionals to accept independent directorships and the consequent erosion of governance frameworks.Based on the comparative lessons on the United Kingdom and the United States, especially on the application of the business judgment rule and the proportional enforcement measures, the paper maintains that the idea of accountability is essential, but the idea of placing all indiscriminate liability on the shoulders of independent directors is in itself destructive to the concept of independent directorship.

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INTRODUCTION:

Indian corporate governance reform has been significantly influenced by the occurrence of episodic corporate failures that have revealed structural weaknesses in board control, regulatory implementation as well as accountability systems. The Indian economy was liberalised in the early 1990s, which led to the development of the private enterprise and capital market, although it also brought forth the tricky governance issues due to the separation of ownership and control.[2] In the Indian context, however, the paradigm of concentrated ownership and the ubiquitous role of promoting groups give rise to a different paradox of outsourcing managerial opportunism, and expropriation of minority shareholders by controlling stakeholders.

It is as part of this that the institution of Independent Directors developed as an important regulatory measure. Independent Directors were originally conceived as the non-executive members of the board with neutrality, capable of objective judgment, alleviation of conflict of interest, and increased transparency in corporate decision-making,[3] as an external check on management and promoter control to ensure that corporate behavior conforms to the interests of a larger group of stakeholders.But a succession of high-profile corporate scandals has continued to cast doubt on the effectiveness of this institutional design. Of particular concern is how the Satyam Computer Services fraud in 2009, commonly referred to as the Enron moment in India, exposed how even highly regarded boards, including prominent[4] Independent Directors, could not notice long-term accounting anomalies. And how the collapse of Infrastructure Leasing & Financial Services (IL&FS) in 2018 was an expose of systemic governance failures in a complex web of subsidiaries, raising the following scandals such as the Punjab National Bank scam and the governance scandals at Yes Bank and Dewan Housing Finance Corporation Limited (DHFL) have further pointed to underlying flaws with regard to board-level supervision.

[2] *Lalita S. Som, Corporate Governance Codes in India, Econ. & Pol. Wkly. (2006)*
[3] *Companies Act, No. 18 of 2013, § 149 (India); SEBI (LODR) Regulations, 2015.*
[4] *Jayati Sarkar, Board Independence & Corporate Governance in India, 44 Indian J. Indus. Rel. 576 (2009)*

As a reaction to these failures, the Indian legislature and regulatory authorities have increasingly stepped up the legal framework of corporate governance. The codification of the duties of directors in the Companies Act, 2013, together with the prescribed requirements on eligibility of Independent Directors, and the use of stringent provisions regarding fraud and mismanagement, in some aspects, signifies the shift in the direction of more enforcement-oriented approach.[5] To supplement this statutory framework, the Securities and Exchange Board of India (SEBI) followed the Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, that require the independence of the board, the composition of the key committees, and the specific obligations of the Independent Directors.[6]Despite these reforms, a serious conflict has arisen between the growing accountability of Independent Directors and the growing number of liabilities to which they are exposed. Although the legal system stresses their functions as custodians of corporate governance, enforcement procedures have over time also assumed that they are actors of liability in instances of corporate misconduct, in many cases without evident active involvement or intentional negligence. This is especially apparent in the propensity of investigative agencies to go on a broad-brush, when it comes to implicating all of the board members in criminal proceedings, since this is not only contrary to the accepted principles of criminal jurisprudence, which employs the necessary elements of proving mens rea and individual culpability, but also erodes the doctrinal differentiation between executive management and independent oversight.[7]

The courts have tried to redress this imbalance by restating the case that directors cannot be vicariously liable simply by the fact that they are the directors. Regardless of these defenses, as the Supreme Court made it very clear in the case of *Sunil Bharti Mittal v. Central Bureau of Investigation*[8], Independent Directors are often dragged through an extended court battle, reputational damage, and regulatory investigation, despite the fact that the ultimate liability was not ultimately proved.[9]This inconsistency between theory and practice of law enforcement raises a fundamental question which is central to this research: whether the Independent Directors in India do work as effective checks and balances on corporate

[5]*Companies Act, 2013, §§ 166, 447–48.*
[6]*SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.*
[7]*Vikramaditya Khanna & Shaun J. Mathew, The Role of Independent Directors in Controlled Firms in India, 22 Nat'l L. Sch. India Rev. 35 (2010)*
[8]*Sunil Bharti Mittal v. CBI, (2015) 4 SCC 609.*
[9]*S.M.S. Pharms. Ltd. v. Neeta Bhalla, (2005) 8 SCC 89.*

governance, or have become in practice in the wake of corporate failure the scapegoats. The future of corporate governance in India is greatly dependent on the answer to this question. When the Independent Directors are seen to assume an unreasonable risk with no additional power or protection, the risk may be taken to untenable levels, and thus, the institution itself may not attract competent professionals to take up the board positions and, thus, undermine the quality of governance.Moreover, this imbalance is intensified by the lack of protections, including the most important one a codified business judgment rule. In contrast to the situation in other jurisdictions, where the directors have been granted a presumption of good faith in their decision-making as in the case of the United States, Indian law gives limited statutory protection against the liability due to bona fide business decision-making.

Against this backdrop, this paper will take a detailed look at the legal, institutional, and practical aspects of Independent Directorship in India. It is aimed at assessing whether the existing framework balances the issue of accountability and protection appropriately, or it is going against the goals that it is intended to advance. The paper seeks to add to current discussions on the reform of corporate governance in India by exploring statutory provisions, judicial precedents and real-life case studies and by providing comparative information to other jurisdictions to do so.In the end, the main argument that will be developed here is that although the presence of Independent Directors is crucial towards the operation of contemporary corporate governance, their usefulness depends on a legal system that balances accountability with authority and liability with responsibility. Without this alignment, the institution will tend to degenerate into a mere symbolic system of compliance whereby Independent Directors act not as governance guardians, but as a ready scapegoat to failures in the system that are outside their control.

1. CONCEPTUAL FRAMEWORK & LITERATURE REVIEW:

The theoretical basis of the independent directorship in the context of corporate governance rhetoric is embedded in the wider theoretical approach to the issue of agency conflicts in the corporate context. The classical corporate governance theory, which is as expressed by Jensen and Meckling, represents the firm as a nexus of contracts in which conflict is generated by the separation of ownership and control.[10] In the popularly held corporations,

[10]*Aronson v. Lewis, 473 A.2d 805 (Del. 1984).*

the conflict is traditionally viewed as a conflict between a group of dispersed shareholders and professional managers. Nonetheless, this paradigm is inadequate to explain the dynamics of corporate governance in India whereby ownership is concentrated and control by promoter groups. As a result, the issue of central governance in the Indian context is not only related to managerial opportunism, but also to the risk of minority shareholders being expropriated by the controlling party.

1.1 MONITORING MODEL OR WATCHDOG:

In this context, Independent Directors are understood as an institution mechanism, which is meant to reduce the agency costs and improve the effectiveness of the board. Two theoretical approaches have swept the literature on their role.[11] The former, also known as the monitoring model or watchdog, assumes that the Independent Directors are outside monitors, whereby the monitoring board oversees the management, examines the financial reporting and safeguards the interests of the minority shareholders by providing objective check on the decision making process in the corporation.

1.2 STRATEGIC ADVISOR MODEL:

The second model, usually referred to as the so-called strategic advisor model, focuses on the value-adding aspect of Independent Directors.[12] In this perception, the independent board members do not only play a role in monitoring but also contribute their expertise, professional networks and strategic advice to the corporate decision-making processes and the presence of independent board members is an indicator of good governance to investors and regulators. This two-fold position of being monitors and advisers makes Independent Directors the guardian of accountability as well as being players in corporate performance.

Despite these theoretical justifications, emerging market evidence such as that in India is a more convoluted scenario. Research has shown that as formal governance norms have been adopted, there has been less substantive independence even though this is more common in jurisdictions with concentrated ownership structures where Independent Directors are usually nominated by controlling shareholders.[13] Consequently, their independence can be more of a

[11] *Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305 (1976).*
[12] *Nand L. Dhameja & Vijay Agarwal, Corporate Governance Structure, 53 Indian J. Indus. Rel. 72 (2017)*
[13] *Id.*

nominal than an actual thing and this brings in concern on whether they would be able to effectively oppose decisions of the management or even promoters.

This dynamic is further complicated by the Indian corporate governance environment that is full of institutional and cultural entrapments. The inoculation of the Indian environment with Anglo-American models of governance has not always led to similarities in the outcomes of governance as observed by Som because of the dissimilarity in ownership, mechanisms of enforcement and corporate culture that make the board members act as effective monitors.[14]

Besides, the literature identifies an enduring confusion on the specific role and expectation of the Independent Directors in the Indian corporate boards. Using evidence based on interviews, Khanna and Mathew observe that no clear consensus exists on the roles of the Independent Directors, and as a result, the due diligence, knowledge and oversight are not well defined and thus are important in assessing liability in cases of corporate misconduct.[15]

This ambiguity has serious implications to the accountability framework that regulates Independent Directors. On the one hand, they are supposed to be watchdogs who can identify and help in curbing corporate malpractices. Conversely, they are constrained within the structure of operations restricting access to information and capacity to influence decision-making. This stress is mainly seen in instances where the Independent Directors are dependent on information given by the management and the external auditors in which the questions of whether they can reasonably be held liable to inadequacy of oversight arise.

The polarization of the Independence Directors as protectors and as scapegoats, therefore, becomes a key conceptual prism, according to which their role can be assessed. A safeguard means an institutional actor that has enough authority, information, and security to be able to execute functions of governance. Conversely, a scapegoat refers to a person who is unreasonably responsible of the consequences which are mostly outside his or her control. The growing trend to hold the Independent Directors to liability in the wake of corporate failures indicates a transition to the latter characterisation.

[14]*Lalita S. Som, Corporate Governance Codes in India, Econ. & Pol. Wkly. (2006)*
[15]*Vikramaditya Khanna & Shaun J. Mathew, The Role of Independent Directors in Controlled Firms in India, 22 Nat'l L. Sch. India Rev. 35 (2010)*

This change is also supported by the changing enforcement environment where the regulatory authorities and investigative agencies have shown a tendency to embrace broad interpretations of director liability. When combined with the structural constraints in the position of Independent Directors, these practices bring a disjunction of responsibility and control. Consequently, Independent Directors can be responsible to the governance failures even when they lack the necessary power and information to avoid them.

There is thus a inherent conflict within independent directorship in India which the literature highlights. Although the institution is meant to maximize the corporate governance and safeguard the interests of the stakeholders, its success depends on how the theoretical expectations are matched with the realities on the ground. Without such alignment, the danger is that the Independent Directors will be nominal members of governance frameworks, where they are charged with the responsibilities of holding the books to account, but do not have the ability to undertake any meaningful oversight.

This is the conceptual tension that the current study is based on the analytical foundation: the research attempts to assess whether the legal and regulatory framework that governs the role of Independent Directors in India is sufficient to curb these issues, or whether it is unintentionally entrenching a system where Independent Directors are prone to disproportional liability. Placing the discussion into the theoretical and empirical frameworks, the study will hopefully offer a subtle insight into the role of Independent Directors and how much they are acting as a guardian or a scapegoat in the Indian corporate governance system.

2. LEGAL AND REGULATORY FRAMEWORK:

Independent Directors Law and Regulation in India is a complicated relationship between the codification of law, prescriptive regulations, and new governance principles. Although the framework has continued to extend the scope of duties and responsibilities placed on the Independent Directors, it has also created a lot of ambiguity with reference to the boundaries of their liability. This part will discuss the development, the composition, and the restrictions of this framework, and specifically the conflict between accountability and protection.

The concept of institutionalisation of Independent Directors in India can be dated back to Clause 49 of the Listing Agreement which was introduced by Securities and Exchange Board of India (SEBI) in 1999 and was reinforced in 2004. The clause 49 brought about a paradigm shift in the Indian corporate governance, as it stipulated the independence of the board, and

mandatory percentage composition of non-executive and independent directors on the boards of listed companies,[16] but these provisions were mostly contractual and not given a statutory support.

Another major change was with the introduction of the Companies Act, 2013, which was the first law to formalize the notion of the Independent Directors in the legislative framework. The Act section 149 of the Act defines an Independent Director and sets out the specific eligibility criteria, such as the absence of pecuniary relationship, independence of the management and professional integrity,[17] which increases the boards independence of management of the listed companies and some classes of public companies to a statutory requirement as opposed to a regulatory expectation.

To supplement this, under Section 150 there is a formalised procedure that will assist in the selection of Independent Directors by use of a databank and the importance of the Nomination and Remuneration Committee in making objective appointments.[18] The Code of Independent Directors is brought out in more detail in Schedule IV of the Act[19], which lists the duties, responsibilities and the standards of expected behaviour of an Independent Director. These are protecting stakeholder interests, upholding the integrity of financial information, questioning management performance, and independence of judgment, yet are defined by loose and vague wording, giving rise to interpretive ambiguity on what exactly is obligatory.

Section 166 of the Companies Act, 2013 also specifies general fiduciary duties on all directors under Section 166 and makes it obligatory to act in good faith, with due care and diligence and avoid conflict of interest as well.[20] It is important to note that the duty is the same on both an executive and non-executive directors, including an Independent Director, and is not provided with a differentiated standard of The homogeneity of this imposition of duties brings about issues of the congruence of responsibility to actual control especially where the issue is concerned with Independent Directors who depend on information given by the management.

[16] *SEBI, Clause 49 of the Listing Agreement (1999; revised 2004).*

[17] *Companies Act, No. 18 of 2013, § 149 (India).*
[18] *Id. § 150.*
[19] *Id. sch. IV.*
[20] *Id. § 166.*

The growth of liability under the Act is also enhanced by the fact that it contains strong provisions in the form of penalties. Section 447 that addresses fraud provides harsh penalties including imprisonment and huge fines in cases of deception or misappropriation of money.[21]Likewise, Section 448 that addresses false statements in financial reports and documents carries hefty penalties which increase the risks exposure of directors greatly.[22]Despite the noble legislative purpose of deterring corporate wrongdoings, the lack of explicit limits in which the liability of Independent Directors can be assigned opens the possibility of going overboard.

The liability situation is further complicated by the concept of officer who is in default according to the Section 2(60) concept. This clause covers within its umbrella directors who have a level of responsibility to abide by statutory requirements, further extending the liability of directors who should be confined to cases of knowledge, consent, or negligence.[23] The statutory language however does not offer a clear safe-harbour in itself, and may be interpreted liberally by enforcement agencies.

Similar to the Companies Act, SEBI has been instrumental in influencing the norms of corporate governance, by the Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015. These rules focus and reinforce the previous governance standards that require board minimum numbers of Independent Directors and stipulate the membership of important committees. Reg. 18 ensures that the audit committee is mostly composed of Independent Directors, who are given charge of financial reporting and internal controls.[24] Reg. 19 also provides that the Nomination and Remuneration Committee, which makes board appointments and compensation structures, should comprise of majority Independent Directors.[25]

The obligations of the Independent Directors prescribed in regulation 25 of the LODR Regulations are, to a certain extent, the extension of the governance role of the Independent Directors, but the obligation to take appropriate induction and training, to be part of

[21]*Id. § 447.*
[22]*Id. § 448.*
[23]*Id. § 2(60).*
[24]*SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 18.*
[25]*Id. Reg. 19.*

evaluation processes, and to make sure that issues of unethical behaviour or suspected fraud are properly addressed, are extended without a clarification of the standards of liability.[26]

An important gap in Indian legal system is the lack of business judgment rule codification. The doctrine has become a strong defense against judicial and regulatory second-guessing of business decisions in places like the United States where the doctrine grants directors a presumption that they made their decisions in good faith, in an informed basis and in the best interests of the company.[27] Conversely, directors in Indian law have little statutory protection of acting in good faith, thus they are placed under more scrutiny and liabilities.

The mechanisms of mitigating risks like the Director and Officer (D&O) insurance cover and indemnification has come up as a partial protection in the Indian context. Nevertheless, they are not effective. D&O insurance is not a compulsory one and is frequently typified by gaps in cover especially in terms of criminal liability and fraud claims. Likewise, the indemnification in Section 463 of the Companies Act is discretionary and can be determined by the court, and only offers partial relief to directors.[28]

The net result of this legal and regulatory framework is that it creates a regime that has far-reaching obligations and liabilities on Independent Directors and is poorly protective of liability.The imbalance is especially problematic considering the structural limitations under which Independent Directors have to work, such as the information asymmetry, which depends on the management, and the lack of control over the corporate decision-making. As a result, the framework poses a very basic normative question: is the current egal regime the appropriate way of balancing the accountability/protection relationship, or does the current egal regime unwillingly weaken the institution of Independent Directorship by putting people at disproportionate risk? This is the focus of the greater inguiry this paper seeks to address because this question directly guides the debate on whether Independent Directors can be effective safeguards of corporate governance, or become scapegoats in the wake of corporate failure.

3. LIABILITY OF INDEPENDENT DIRECTORS :

[26] *Id. Reg. 25.*

[27] *Aronson v. Lewis, 473 A.2d 805 (Del. 1984).*

[28] *Companies Act, 2013, § 463.*

Liability regime of Independent Directors in India is the most controversial and analytically important aspect of corporate governance jurisprudence. Although the role of Independent Directors is by statute placed in the position of a non-executive in the corporate management, the increasing scope of civil and criminal liability has interposed the line of duty of oversight with the liability of wrongdoing. The section will discuss the outlines of such liability in terms of fiduciary duties, statutory and judicial interpretation with specific reference to the theories of vicarious liability and mens rea.

Firstly, it is important to differentiate between civil and criminal liability both of which are present in the Indian corporate system simultaneously. Independent Directors are mostly subject to civil liability due to breach of fiduciary liability in accordance with Section 166 of the Companies Act, 2013.[29] These are based on fair principles of doctrines in principle and can be enforced in a derivative or class-action suit under Section 245 of the Act.3[30] but the question of how these duties apply to the Independent Directors remains a complex issue; more so when they have limited involvement in the management of the company and are left to act on information brought forth by the executive management.

The civil liability model presupposes that directors have adequate information and power to affect the decision-making process in corporations. However, Independent Directors are generally faced with informational limitations, as they are dependent on board documents, management reporting, and independent expert opinions to a great extent. Such a discrepancy questions the assumption that Independent Directors should be subject to the same set of standards that applies to executive directors. The lack of a distinguished standard of diligence therefore makes a doctrinal inconsistency in which the liability is laid on without proper consideration of the structural limitations of the position.

The problem is even worse in the situation of criminal liability that has harsh repercussions, such as imprisonment and damage to reputation. Section 447 of the Companies Act, 2013[31] presents some of the toughest penalty provisions, the main point being that the law criminalizes fraud and prescribes a prison sentence of up to ten years as well as fines, thus

[29]Companies Act, No. 18 of 2013, § 166 (India).
[30]Id. § 245.
[31]Id. § 447.

leaving Independent Directors vulnerable to prosecution. Section 448 further also imposes liability for false statements in financial documents, as well as prospectus and board reports.[32]

It is based on the principle of mens rea that involves demonstrating intent, knowledge, or recklessness and it is on this basis that the doctrinal foundation of criminal liability in corporate law is based. But, in reality, enforcement bodies have often taken a broad-brush approach, applying the idea of vicarious liability to hold directors merely by dint of their office. This strategy is in principle completely contrary to the accepted traditions of criminal jurisprudence, which do not accept the imposition of liability without personal culpability.

Courts have been trying to restrain such over-reaching. In *Sunil Bharti Mittal v. Central Bureau of Investigation*,[33]the Supreme Court made it very clear that vicarious liability may not be applied to the directors without evidence of active role and criminal intent. Likewise, in *S.M.S. Pharmaceuticals Ltd. v. Neeta Bhalla*[34]the Court ruled that criminal complaints should include certain averments to show how the accused director contributed to the running of the business of the company.

This principle was also upheld in *Aneeta Hada v. Godfather Travels & Tours Pvt. Ltd.*[35] where the Supreme Court reminded that directors can only be prosecuted when the company is an accused, thus reiterating the derivative nature of the liability of directors. In the case of *Chintalapati Srinivasa Raju v. SEBI*,[36] the Tribunal said that Independent Directors cannot be found guilty as long as there is no evidence to prove their knowledge or involvement in the purported malpractices.

Although this has been a consistent judicial position, enforcement practices still indicate a lack of adherence to doctrinal principles. The investigative agencies often use a catch all method, which involves using all the directors in criminal cases to preclude procedural issues and to hold them more accountable. The practice is successful in overturning the burden of proving that Independent Directors have to move to quash proceedings or prove their lack of involvement by engaging in long-term litigation. The ensuing legal ambiguity is detrimental to the protective purpose of judicial precedents and is part of a culture of risk aversion.

[32]Id. § 448.
[33]*Sunil Bharti Mittal v. CBI, (2015) 4 SCC 609.*
[34]*S.M.S. Pharms. Ltd. v. Neeta Bhalla, (2005) 8 SCC 89.*
[35]*Aneeta Hada v. Godfather Travels & Tours Pvt. Ltd., (2012) 5 SCC 661.*
[36]*Chintalapati Srinivasa Raju v. SEBI, SAT Order (2018).*

The main problem in this regard is the uncertainties that exist regarding the standard of knowledge that must be established in order to hold a person liable. There is no specification in the Companies Act of what amount of knowledge is required to hold Independent Directors liable, which creates inconsistencies in interpretation. Practically, courts have attempted to differentiate between actual knowledge, constructive knowledge and wilful blindness. The lack of a statutory safe-harbour provision, however, leaves one wondering how far the Independent Directors can go using information given by the management or external experts.

Such a grey area is especially troublesome within a complicated corporate hierarchy, where the asymmetry of information is strong and the decision-making is decentralized, spread over numerous layers of management. Independent Directors do not have direct access to the working data and have to depend on the representations of the executives and auditors. The risk of holding them responsible in this situation would be enforcing an unrealistic omniscience, not practicable or compatible with the tenets of corporate governance.

This issue is further worsened by the notion of an officer in default under Section 2(60) that extends the list of people who can be liable of corporate offences. Although the provision has directors in charge of compliance, it fails to clearly specify situations in which Independent Directors can be considered as part of the provision. This ambiguity has allowed broad interpretations, thus making people who might not have participated directly in the misconduct they were underlying liable.

All these theoretical and pragmatic issues point to a basic disequilibrium in the liability regime. The independent Directors have very vast responsibilities and liability with no real power and safeguarding. This imbalance not only calls into question the quality of Independent Directors as a source of governance but also brings in more far-reaching issues on fairness and proportionality on the part of the legal system.

4. CASE STUDIES:

The theoretical and doctrinal conflicts of the role and responsibility of Independent Directors are getting more transparent when approached with the help of big business collapses in India. These case studies not only reflect the structural constraints on Independent Directors but also the changing propensity to project the blame on them in the wake of governance failure. A cross-case study displays a common trend: Independent Directors are regularly

questioned--and often accused--even though they have little access to information and minimal decision making powers, which further confirms their metamorphosis into scapegoats.

The *Satyam Computer Services scandal (2009)*[37] can be regarded as the turning point in the history of corporate governance development in India. Considered to be the Indian version of Enron scandal, Satyam entailed a huge accounting fraud perpetrated over a number of years by the founder-chairman of the company, Ramalinga Raju, who acknowledged to have inflated financial statements of the company. Notably, Satyam board had a number of eminent Indian Independent Directors with outstanding professional experience. Notwithstanding this, the fraud went unnoticed and this posed core questions on the effectiveness of board oversight.

Following the scandal, the Independent Directors were subjected to a lot of scrutiny by regulatory bodies, investors, and the people. The reputational damage and the threat of legal action brought about a wave of resignations in corporate India, although not all direct criminal liability was brought in equal measures. The Satyam episode therefore indicates a two-fold failure, that is, on one hand, the ineffectiveness of the Independent Directors to identify fraud because of informational asymmetry; and on the other, their susceptibility to post facto accountability processes.

Infrastructure Leasing and Financial Services (IL&FS) crisis (2018) a decade later further revealed the systemic flaws in corporate governance. The IL&FS, which is a large infrastructure financing conglomerate, was unable to meet several debt obligations, which led to a larger financial crisis. According to the investigations, there were massive governance failures, such as extreme leverage, obscure corporate organization and risk management malfunctions. The boards of IL&FS and subsidiaries were also investigated by investigative agencies such as the Serious Fraud Investigation Office (SFIO), and the boards of IL&FS and its subsidiaries included Independent Directors in their ranks.

The case of IL&FS is especially educative because of the intricacy of the corporate design and the dependency on the outside auditors and credit rating agencies. The Directors who were Independent and worked in such a multilayered structure of the organisation could not

[37] *Letter from B. Ramalinga Raju, Chairman, Satyam Computer Services Ltd. (Jan. 7, 2009) (admitting accounting fraud).*

easily see the financial health of the company. However, they got entangled in the enforcement action, which casts doubts on whether it is possible to impose any liability without direct participation. The case highlights the tension present between the anticipation of oversight and the reality of the limitations to accessing information.

The *Punjab National Bank (PNB) fraud (2018)* is an alternative aspect of governance failure, in which the errors occurred on the level of operational management of the bank branches. The fraud, in billions of dollars, was committed by the unauthorized issuance of Letters of Undertaking without due internal controls. Although the main blame was on the operational personnel and the internal system, the incident also led to an investigation of the oversight of the bank by its board of directors, including its Independent Directors. The case illustrates the danger of laying blame on board members who commit failures that are rooted at the bottom of the organisational hierarchy and thus increasing the oversight burden beyond reasonable levels.

Likewise, *the Yes Bank crisis (2020)* highlighted the role of the Independent Directors in the supervision of the executive decision-making. The bank was reported to have been in trouble due to lapses in governance which involved aggressive lending habits and purported understatement of non-performing loans. The Independent Directors were also criticised as not being able to challenge the management decisions. But the degree to which they had the information and authority to step in is disputed. The case shows how challenging it is to determine the passive acquiescence or informed decision-making in the complex financial institutions.

These issues are further supported by the collapse of *Dewan Housing Finance Corporation Limited (DHFL) (2019)*. DHFL was involved in financial mismanagement and diversion of funds claims that saw the intervention of the regulators and insolvency. The board had independent Directors who were investigated in the area of supervising the financial disclosures and the corporate governance practices. In this case, as in earlier cases, the question was whether these directors personally knew about these misconducts or whether they were simply acting on representations of the management and auditors.

An analysis of these cases in comparison demonstrates some common themes. To start with, the Independent Directors usually work in an environment that is highly asymmetric in terms of information with important financial and operational data being held by the executive

management. This diminishes their capacity to confirm information on their own and identify abnormalities. Second, the process of appointing directors, which is usually dominated by promoters or the majority shareholders, can undermine the independence of the directors and make them unwilling or incapable of questioning the management decisions. Third, enforcement practices often take the wide approach to liability, which means that all board members are involved, regardless of their role or participation.

Most notable, these cases, overall, illustrate the process of the development of a scapegoating relationship, as the Independent Directors are blamed of the failures of the system, which are out of their control. Overall, the case studies examined in this paper serve to highlight the main idea of the given paper, which is that the existing corporate governance system in India is on the verge of turning Independent Directors into a scapegoat. The continuation of this pattern underscores the fact that a badly needed change that would focus liability on real culpability and give directors operating in good faith sufficient protection is necessary.

5. PRACTICAL CHALLENGES AND THE CHILLING EFFECT:

The above doctrinal and empirical discussion indicates that the issues facing the Independent Directors in India are not just legal but very structural and institutional. Although statutory frameworks provide a wide range of duties and liabilities, the realities on the ground in which the Independent Directors are operating seriously limit the scope in which they can successfully execute their duties. This part discusses these issues, especially the so-called chilling effect created by disproportional exposure to liability and overreach by the regulatory authorities.

One of the main concerns is the widespread fear of criminal liability and arrest that has become one of the characteristics of the modern state of governance. Although Independent Directors are not involved in the day-to-day running of the organization they are implicated in the risk of criminal prosecution as a result of fraud, mismanagement, or non-adherence to regulations. The risk environment created by the harshness of fines imposed by provisions such as Section 447 of the Companies Act, 2013[38]- in combination with the reputational impacts of being identified in the criminal investigation process- has created a culture of fear whereby the Independent Directors feel obliged to take a defensive stance to governance instead of one of proactive oversight.

[38] *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Regs. 18–19.*

This issue is directly connected with the problem of information asymmetry that is, perhaps, the biggest structural limitation of Independent Directors. In comparison with executive directors, Independent Directors do not have direct access to the data about operations or internal processes. Their interpretation of corporate affairs is mostly based on board materials, management presentation and reports prepared by auditors and the consultants, which inherently leads to an imbalance of responsibility and knowledge because Independent Directors should be able to detect and eliminate irregularities without having the tools to verify the critical information on their own.[39] The issue is further aggravated in large corporate units, i.e. conglomerates, which have numerous subsidiaries, making effective control even more difficult.This is complicated by the indistinctness of norms of due diligence and knowledge. The Companies Act, 2013 is silent on the scope of inquiry or verification that should be made by the Independent Directors and it does not give any clear guidance on the extent to which the management or expert advice should be relied upon. Consequently, directors are left to act under unpredictable expectations and there is a risk that ex post facto judgments of their behavior might place unrealistic demands of vigilance. This lack of clarity is especially concerning when it comes to criminal liability in which the lack of a clearly-stated threshold to establish the mens rea makes it more probable that such enforcement will be arbitrary or unequal.

The appointment and removal of the Independent Directors is also another process which takes away their independence. Practically, Independent Directors can be frequently nominated by boards which are controlled by the promoters, which creates an implicit obligation and even a conflict of interest.[40] Although nomination and remuneration committees are supposed to be impartial in terms of their composition and functioning, they are often influenced by the controlling shareholders. This dynamic begs the question of whether or not Independent Directors can exercise their independence, especially in those cases where their future retention can be contingent on the acceptance of the very persons they are supposed to oversee.In this regard, any significant change in the corporate governance system should focus on this flaw by enhancing the existing protection mechanisms and implementing the new mechanisms that provide responsibility and

[39] *Lalita S. Som, Corporate Governance Codes in India, Econ. & Pol. Wkly. (2006)*
[40] *Vikramaditya Khanna & Shaun J. Mathew, The Role of Independent Directors in Controlled Firms in India, 22 Nat'l L. Sch. India Rev. 35 (2010)*

protection compatibility. The further use of Independent Directors as a pillar of governance in the company without these reforms can be unsustainable.

6. COMPARATIVE ANALYSIS: UNITED KINGDOM, UNITED STATES AND INDIA.

When comparing the corporate governance systems in India and South Africa it can be seen that the issues that the Independent Directors have to contend with in India are not a direct problem of the institution itself, but a result of how the legal system has developed the structure of liability and accountability. Other jurisdictions like the United Kingdom and the United States offer instructive comparisons especially in their methodology on curbing the accountability of directors and the undue liability protection. Such comparative understandings play a vital role in assessing whether the Indian framework has attained a proper set of balance or whether it needs to be recalibrated.

6.1 UNITED STATES:

In the United States, the judicial doctrines that have been developed under the Delaware law, which is the most influential corporate jurisdiction, affect corporate governance in the country. At its core is the business judgment rule that is a presumption that directors make informed decisions, in good faith, and by the honest belief that their actions are in the best interests of the corporation.[41]The rule of business judgment fulfills two important purposes. To begin with, it maintains managerial independence by enabling directors to take risky decisions without the fear of ex post facto liability. Second, it equates liability and culpability because it sets a high evidentiary standard that plaintiffs have to meet to hold directors liable. Besides this judicial protection, the law of corporations in the U.S. offers strong indemnification and insurance mechanisms. Director and Officer (D&O) insurance is common and usually involves defence expenses and settlements, and some regulatory measures, which greatly reduce individual risk.[42]

Moreover, the U.S. procedural law has rigorous pleading standards as was instated in a case like *Bell Atlantic Corp. v. Twombly and Ashcroft v. Iqbal*,[43] where plaintiffs are required to prove an adequate claim to go to trial. All these features, when combined, ensure that the

[41]*Aronson v. Lewis, 473 A.2d 805 (Del. 1984).*
[42]*Bernard S. Black, Brian R. Cheffins & Michael Klausner, Outside Director Liability, 58 Stan. L. Rev. 1055 (2006).*
[43]*Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007); Ashcroft v. Iqbal, 556 U.S. 662 (2009).*

governance environment has a culture of accountability that does not scare away competent people to join as directors.

6.2 UNITED KINGDOM:

Unlike this, the United Kingdom takes a principles-based approach to corporate governance, which is represented by the compliance or explain regime in the UK Corporate Governance Code,[44] where companies are supposed to follow the governance principles, such as board independence, but it allows them to do otherwise should they provide a reasoned explanation. This customised strategy acknowledges heterogeneity of corporate forms and eschews strict statutory requirements.Directors have their duties codified in the Companies Act 2006, and the duty to take reasonable care, skill, and diligence is contained in Section 174[45] although these duties are not enforced in the UK in the same way as they are in other countries, and are applied in practice more on the basis of civil liability or director disqualification than on the basis of criminal prosecution, except where there is clear fraud Financial Reporting Council (FRC) is involved in checking compliance and advancing best practice, but it is not a punitive body, but rather a guidance and control body.Significantly, UK framework has a cultural and institutional focus on proportionality and moderation in enforcement. Directors are hardly ever criminally liable in the absence of an evident indication of misconduct, and there is an increased dependence on market discipline and reputational penalty. This strategy will minimize the chances of over-deterrence and accountability will be ensured.

6.3 INDIAN FRAMEWORK:

Comparing the Indian framework to these jurisdictions shows that there are considerable divergences. India has inherited several structural elements of the Anglo-American system of governance, including board independence, committees, and disclosure provisions, but has failed to provide similar provisions to guard directors against disproportionate liability. It is noteworthy that it lacks a codified business judgment rule that would provide directors with an important defence in the face of retrospective review of their decisions.In addition, the enforcement fashion in India is also inclined to be over-inclusive, as regulatory bodies often tend to involve all directors in the process without proving the presence of prima facie cases of personal guilt. This is entirely different in the U.S. and UK where procedural and

[44] *UK Corporate Governance Code (Financial Reporting Council, 2018).*
[45] *Companies Act 2006, c. 46, § 174 (UK).*

substantive protections come into play to weed out baseless claims at an early stage. The outcome is a system where Independent Directors would experience greater legal ambiguity and exposure to risk, regardless of acting in good faith.

The other area of divergence is the vicarious liability. Although the jurisprudence of the U.S. and the UK require that a person must have committed an act, the Indian enforcement tradition typically obscures this distinction, especially in transactions where there is a complex business misconduct. It has been evidenced by jurisdictions like the United States and the United Kingdom that it can be possible to have strong accountability and at the same time shield directors in terms of undue liability.Finally, the comparative analysis supports the main idea of this paper that the efficacy of the Independent Directors as the guarantee of corporate governance is based on the presence of a legal framework which provides a balance between accountability and protection. Without this balance, the institution will be weakened through the same mechanisms that were put in place to bolster the institution. Using international experience, India can find a way to rebalance its governance model in such a way that it maintains accountability and independence.

7. SYNTHESIS, RECOMMENDATIONS AND CONCLUSION:

The above discussion has shown a structural paradox in the core of the corporate governance mechanisms in India. The independent Directors who are designed to be unbiased and to protect the transparency and accountability are being exposed to a regime of liabilities that is out of proportion to their position, authority and access to information. This lack of responsibility versus control does not only undermine the functionality of the Independent Directors, but it serves as an indication of larger issues about the integrity and viability of the governance architecture itself.

On a conceptual level, the legal regime of Independent Directors is typified by broad liability but unspecified limits on liability. Although both the Companies Act, 2013 and the SEBI (LODR) Regulations, 2015 present substantial fiduciary and oversight duties, they do not specify the circumstances in which the liability is supposed to be attributed, which is further exacerbated by the enforcement practices that often overlook the necessity of individual culpability and make the inclusion of Independent Directors in the civil and criminal

proceedings automatic.[46] These practices undermine the difference between the executive responsibility and the independent oversight, and practically turn Independent Directors into default defendants in the instances of misconduct on the corporation level.

The overall impact of such a regime is the development of a disproportionate liability regime, where Independent Directors have significant legal and reputational risks that are not proportional to their power or protection. This has had a chill-out effect on the participation of boards as shown by the case studies and empirical trends, where qualified professionals are not willing to take or retain the position of independent directors. This consequent narrowing of the pool of good directors presents a direct challenge to quality and credibility of corporate governance in India.

This is not only undesirable but also avoidable, in terms of normative point of view. Corporate governance is not only about blaming after failure, but establishing institutional factors that avert failure in the first place. Considering these results, the legal and regulatory framework needs to be recalibrated. This recalibration should be informed by the tenet that the liability must be in line with culpability and in line with the real-life ability of Independent Directors to affect corporate behavior. To accomplish this goal, a number of major reforms are required.

To start with, there is the urgent necessity to define the standard of knowledge and liability necessary to hold Independent Directors liable. The statutory amendments must clearly indicate that the liability will occur only when there was act of demonstrable knowledge, consent, connivance or gross negligence. Constructive knowledge should be understood in a very limited sense so that it does not imply the creation of unrealistic expectations of omniscience. Also, statutory safe harbour should be provided to Independent Directors, to act in good faith based on the information presented by management, auditors and other experts, provided such reliance is reasonable under such circumstances.

Second, a business judgment rule codified into India corporate law would be a crucial reform. This type of rule would create a default position suggesting that directors are acting in good faith and have acted on an informed basis, which would shield them against the accusation of making a bona fide business decision. The business judgment rule would bring Indian law in

[46] *Companies Act, No. 18 of 2013, §§ 149, 166 (India); SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.*

keeping with international best practices and offer much-needed clarity to directors by making plaintiffs or regulators prove bad faith or gross negligence.

Third, the framework that regulates the Director and Officer (D&O) insurance should be reinforced and homogenised. Compulsory coverage for listed companies in terms of D&O with minimum coverage level and reduced exclusions would improve the financial risks and increase director confidence. Although these types of insurance cannot and ought not to cover willful fraud, they ought to cover defence expenses and regulatory actions which are a major liability on Independent Directors.

Fourth, there is the need to initiate reforms to enhance independence of the nomination and appointment process. This can involve requiring minority shareholders to have more say in the nomination of Independent Directors, increasing the disclosure of nomination decisions and increasing the standards that there are no prior relationships with the promoters. In the absence of true independence at the appointment point, further demands of objective supervision are a mirage.

Fifth, procedural safeguards need to be immediately introduced before proceedings against Independent Directors are instituted. The regulatory authorities must be put on the requirement to prove prima facie evidence of particular culpability before they can pronounce Independent Directors as accused. Also, faster processes of quashing proceedings that do not have substantive merit would be a way of cutting down on the cost of litigation as well as reputation loss involved in unnecessary litigation.

Sixth, the institutional framework should also make sure that the Independent Directors have sufficient access to information and resources. This can be done by statutory acknowledgment of the right to independent professional advice at the expense of the firm and compulsory certification by the management that the information provided to the board is complete and accurate. Increasing informational capacity of Independent Directors through strengthening of whistleblower mechanisms and making sure that they have been implemented would improve the information capacity of Independent Directors even more.

To sum it up, the pivotal question of this paper which is whether Independent Directors in India play the role of safeguards or scapegoats has a subtle yet definite answer. Although the concept of the independent directorship institution is sound and cannot be done away with in the current corporate governance system, its current practice in India is characterized by the

systemic imbalance that has been gradually making the Independent Directors a scapegoat in the aftermath of corporate failure.

This is not a necessary and desirable outcome. It indicates a lack of consistency between the doctrine of law, law enforcement practice and institutional design, rather than a defect in the concept of independent oversight. The integrity and effectiveness of Independent Directors as true custodians of corporate governance can be restored by recalibrating the liability framework, enhancing safety and accountability and making it to match the real culpability.

After all, the validity of corporate governance is not considered by the harshness of the sanctions that are taken, but rather by the equity, transparency, and reasonableness of the system in which the latter takes place. A system that severely punishes the few with less control whilst not sufficiently attending to structural factors that lead to misconduct is likely to compromise on justice and effectiveness. Reform is, then, not just a question of preference of policy but an imperative to the further development and viability of the Indian corporate governance system.