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## Removal of Independent Directors: A Sword of Damocles

The ongoing tussle between Tata Sons and Cyrus Mistry is spilling over to the boardrooms of the listed companies in the group. Soon after the independent directors of Tata Chemicals, which includes Nusli Wadia, issued a unanimous statement backing Cyrus Mistry, Tata Sons moved resolutions to unseat Nusli Wadia from the boards of Tata Chemicals, Tata Steel and Tata Motors.

Nusli Wadia, current Chairperson of the Wadia Group, is an old Tata associate. He has served as an independent director on the board of Tata Chemicals since 1981, on the Tata Steel board since August 1979, and on the Tata Motors board since December 1998. In a reciprocal arrangement, Ratan Tata had also served on the board of Bombay Dyeing, a Wadia group company, for 33 years before stepping down in 2013.

It therefore surprised markets when, as a senior independent director, he decided to go against the Tata Group and backed Cyrus Mistry's bid to remain Chairperson of Tata Chemicals. But what is more surprising is that among all the independent directors, Tata Sons has sought the ouster of only Nusli Wadia. Singling him out adds fuel to the rumours that the differences are personality-driven, rather than issue based.

While we await Tata Sons to formally announce a rationale for Nusli Wadia's removal – which will form the basis of our voting recommendation, the matter needs to be examined in the context of the following questions:

### **Do promoters have the right to seek removal of an independent director?**

Section 169 of Companies Act 2013 states that any director on the board can be removed by passing an ordinary resolution at a general meeting. The resolution may be proposed by the company or by the shareholders. For shareholders to propose such a resolution, they must collectively own 10% and call for an EGM by giving a special notice under Section 100 of Companies Act 2013.

In this case, Tata Sons holds more than 10% stake in each of the three companies. Hence, they are within their rights to seek removal of an independent director.

### **Does such a precedent exist in the Indian markets?**

There have been instances in the past where minority shareholders have proposed resolutions seeking removal of independent directors, recent examples being [S. Kumars Nationwide](#) and [Ricoh India](#). These instances are on account of shareholder activism or alleged mismanagement/fraud.

But a resolution being proposed by the controlling shareholder to remove an independent director is rare. One recent example is [Indiabulls Housing Finance](#), where the new management sought to induct a new board by replacing the previous set of directors. In this case however, the management had argued its position by saying it needed 'greater expertise' on the board.

**Will the move impact the autonomy of independent directors?**

The institution of independent directors is a key construct of a company's corporate governance framework. Independent directors have a fiduciary responsibility towards the minority shareholders and are expected to act independently, irrespective of the directives of the controlling shareholders.

The regulatory provisions in India, including the Companies Act 2013 and the SEBI (LODR), require listed companies to institute balanced boards with an adequate representation from independent directors. The overarching objective behind this requirement is that it will help strengthen the internal control mechanism and foster greater trust between the company and its stakeholders.

To carry out their duties efficiently, independent directors need to be able to exercise strong oversight on the actions of the company. The regulations have therefore tightened the definition of independent directors and have provided them additional powers while scrutinizing related party transactions, executive compensation, and financial statements of subsidiaries. Once appointed for a fixed term (of up to five years), independent directors are not liable to retire by rotation till the expiry of their contract. The measures ensure that independent directors get a free hand while dealing on company matters, without the influence and interference of the controlling shareholders and the management.

Given that independent directors sit in judgement of the actions of the company, their (re)appointment/removal from the board must be driven by the Nomination and Remuneration Committee (NRC). To lend credibility to the process, the decision of the committee must be backed by a rigorous board evaluation exercise and the results of the evaluation must be tested and benchmarked against some pre-defined criteria.

Allowing controlling shareholders to remove independent directors from the board undermines the integrity of the entire process and the institution of independent directors itself. Having said so, there may be mitigating circumstances under which their removal is sought. To give just two examples: when there is evidence of fraud and misconduct or when the director is being a disruptive force on the board. Regulators no doubt are closely watching these developments and we expect them to take meaningful steps to address this issue.

In the case of Tata Sons, [we had earlier opined](#) that independent directors need to provide shareholders with guidance on how they should vote on a resolution to remove Cyrus Mistry as Chairperson. By articulating their stance to back Cyrus Mistry, independent directors in Tata Chemicals and Indian Hotels have made their position clear on the issue. Tata Sons may be reacting to Nusli Wadia because they feel a sense of betrayal, but the logic must not be extended to all independent directors.

As a principle, such diversity of opinion should be promoted and not stifled. Healthy conflict and debate can bring in more openness in the boardrooms and prevent the risk of insularity. For this, independent directors must be given the freedom to exercise their own judgement without any fear of retribution. As it is, independent directors have rarely been found to be 'independent'. Hanging the Damocles Sword of eviction over their heads will be counter-productive. More importantly, it will be a great disservice to the minority shareholders.

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