

A blurred background image of a business meeting. In the foreground, two hands are shaking. In the background, a person is holding a tablet, and another person is pointing at a document on a table. The overall scene is professional and collaborative.

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Independent Directors are not liable for day to day activities

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Independent Directors are not liable for day to day affairs of the Company – SEBI.....

Independent Director – “An Eye-Bird View”

Requirement of Independent Directors (“IDs”) came from the good governance practice, where for the successful growth of an organization, independent ideas and view was necessity. The roles and responsibilities are demanding with the time and that the risk and liability of IDs are challenged with the increase in their roles and responsibilities. Because of the reliability on IDs, based on the nature of their appointment and duties, it becomes even more challenging for an individual to justify their duties for an organization. The Companies Act, 2013 widens the roles and responsibilities of IDs, whereby IDs are required to protect the interest of all the stakeholders.

Companies Act, 2013 – IDs:

Schedule IV of the Companies Act, 2013 makes it mandatory for the IDs to conduct one meeting in a year, without the attendance of non-independent directors and members. Thus, this meeting will be very crucial and vital for the company, as only IDs of the company will form part of the same, which will be beneficial in terms, that the independent ideas and observations can be discussed by the IDs among themselves and that the necessary steps can be initiated by them. Further to add, the performance evaluation of the IDs should be done by the entire Board members. This will help the management to review the performance of the IDs and to take the decision on extending their tenure as IDs in the company. This itself gives an explanation that the role of ID is very much important.

To maintain the independency, an individual can be appointed as ID for the two consecutive terms of five years. Once both the terms are over, the same person cannot be appointed as ID on the Board of the Company within 3 years. This will ensure that after the expiry of their terms, there is enough gap with the management of the company to justify their independence with the company. IDs will be held liable for the such acts of omission or commission by a company which had occurred with their knowledge.

Listing Regulations:

Listing Regulations as applicable to the listed companies, are lined up with more stringent compliance. All the listed companies are required to form committees like Audit Committee, Nomination and Remuneration Committee, etc., this mandatory committees are required minimum IDs to constitute it

legally and each of them have separate requirement of minimum IDs. In addition, Chairman of the Audit Committee should be one of the Independent Director and that the Chairman of the Audit Committee should be present at the time of conducting the Annual General Meeting, to answer the queries of the shareholders.

Corporate Governance practice also require Independent Director of the listed company should be on the Board of the unlisted material subsidiary incorporated in India. It is obliged on the Independent Director to review the performance of the Non-Independent Director and Chairperson. The listed companies should organize the familiarize programme for their IDs for understanding the nature and the business of the industry.

In the matter of Zylog Systems Limited:

Background of the Company:

Zylog Systems Limited (hereinafter referred to as "ZSL") is a listed company incorporated under Companies Act, 1956 with its Registered Office located in Chennai. ZSL is into IT sector, helping for more than two decades, companies to achieve their desired outcomes using our proven solutions and services. The shares of ZSL is listed on the Bombay Stock Exchange and National Stock Exchange. In addition to the IT enabled service, the ZSL are also deal into various other sectors for their customers.

Facts of the matter:

ZSL had declared the dividend to its shareholders at the rate of Rs. 5 per shares in the Annual General Meeting of the Company held on September 25, 2012 amounting to total dividend of Rs. 16,44,64,200. However, the Company failed to pay the dividend to its shareholders after the same was approved by the members in the AGM. On failure in making the payment of the dividend, SEBI received the complaint letter from the shareholders, putting an allegation on the company for the same. SEBI issued a notice on the Company asking the ZSL to furnish the information regarding the declaration and payment of dividends under the Companies Act, 1956 and reason for default.

On February 20, 2013:

ZSL in their reply, submitted that they had not been able to pay the dividend due to strain in the liquidity position of the company. Further to add in the reply, it was brought to the notice of the SEBI that Shri Sudarshan Venkatraman, Shri Ramanaujam Sesharathnam, Shri Parthasarathy Sirkanth, Shri Madurai Gajanathan, Shri S. Rajagopal, Shri V. K Ramani and Shri Vasanthakumar Ayyavu Palanichamy were the Directors of the ZSL, when the Company declared the dividend.

On October 20, 2016:

Show Cause Notice dated October 20, 2016 was issued by SEBI to all the Directors who were there on the Board of ZSL, asking them as to why SEBI should not initiate any action against ZSL and Directors for default in payment of dividend. SCN also stated that the directors were aware about the approval for the payment of dividend and that the company has defaulted in payment of dividend to its shareholders. Hence, all the Directors have failed to comply with the relevant provision and that all the Directors are liable for the same.

Provision of the Companies Act, 1956:

Extract of the relevant section:

Section 205 (1A): *“The Board of directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend.”*

Section 207: *“Where a dividend has been declared by a company but has not been paid, or the warrant in respect thereof has not been posted, within thirty days from the date of the declaration, to any shareholder entitled to the payment of the dividend, every director of the company shall, if he is knowingly a party to the default, be punishable with simple imprisonment for a term which may extend to three days and shall also be liable to fine of one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of eighteen per cent per annum during the period for which such default continues:”*

In reference of both the section 205 (1A) and 207, Directors should deposit the amount of the dividend in a separate bank account within 5 days from the date of declaration of the dividend and in case of any default in payment of the dividend, every director shall be liable for the fine of Rs. 1000 for each day of such default.

Response from Independent Director:

Both the Independent Director, who were there on the Board at the time of default in making payment of the dividend, gave their replies to the show cause notice issued by the SEBI:

- Default in non-payment occurred at the company’s administrative level and that without their knowledge as they were Independent Director and that both of them are not involved into day to day activities of the company.
- Mr. S. Rajagopal was unaware about the default and that same was brought to his notice after the certificate been furnished by the Company Secretary and Managing Director stating that the dividend for the year 2011-12 has not been paid
- Mr. S. Rajagopal was the Chairman of the Audit Committee and that in the meeting conducted on November 14, 2012, where it was discussed in detail, to bring this matter before the Board of

Directors and that immediate action is needed on the same. All such actions are noted in the minutes of the meeting.

- Mr. V. K. Ramani pointed out that it came to his notice about the default in payment of the dividend only in the board meeting dated November 14, 2012 and that he was designated as Independent Director only for his technical expert in IT field.

Both of the Independent Director took the matter very seriously in the Audit Committee and in the Board meeting. It brought to their notice only when the matter got serious and that the Independent Director had very less chance to rectify the action of the management of the company within the due course of time. Despite of the same, the strict action was directed by the IDs to be followed by the management to rectify their action.

Both the Independent Director relied largely on the discussion took place in the Board Meeting dated November 14, 2012:

- There was delay in the statutory payment of TDS and other statutory dues. It was requested by Mr. S. Rajagopal to management to meet the requirement immediately.
- Mr. S. Rajagopal stated to take drastic steps to be taken to meet the statutory payment without further delay to make sure that the moral of the staff
- PF and TDS were not remitted on time.

Immediately after the Board meeting, Mr. S. Rajagopal resigned from the post of Independent Director and Mr. V K Ramani resigned in January 2013. Hence, it was one of the justified move by the Independent Director, after the default in the payment of the dividend.

Stand by SEBI:

Both of the Independent Directors took the necessary action to rectify the action of the management. In default in payment of the Dividend, both the IDs took strict action directing the management and the Board of SZL to make the payment of the statutory dues without further delay. Both the IDs took strong steps to convince the management of the company and that both the ID acted promptly and diligently.

SEBI observed that the roles and responsibilities of the Independent Director is very crucial for the Company and that they do have the important role to play in guiding the management of the company. So that the interest of the company is protected and the interest of the small shareholders are safeguarded. Further to that, they are responsible to ensure the compliance is in length and that the company is fully compliant.

SEBI further observed that since both the IDs did not have the role in day-to day activities of the SZL and that both the IDs took prompt action to rectify the action of the management, which took place without their knowledge. Despite of the best efforts and diligence, management failed to rectify their

mistake. Hence, it took the stand that it is not deemed fit to pass any order against both the Independent Director of the company under section 11 and 11B of the SEBI Act.

Our take:

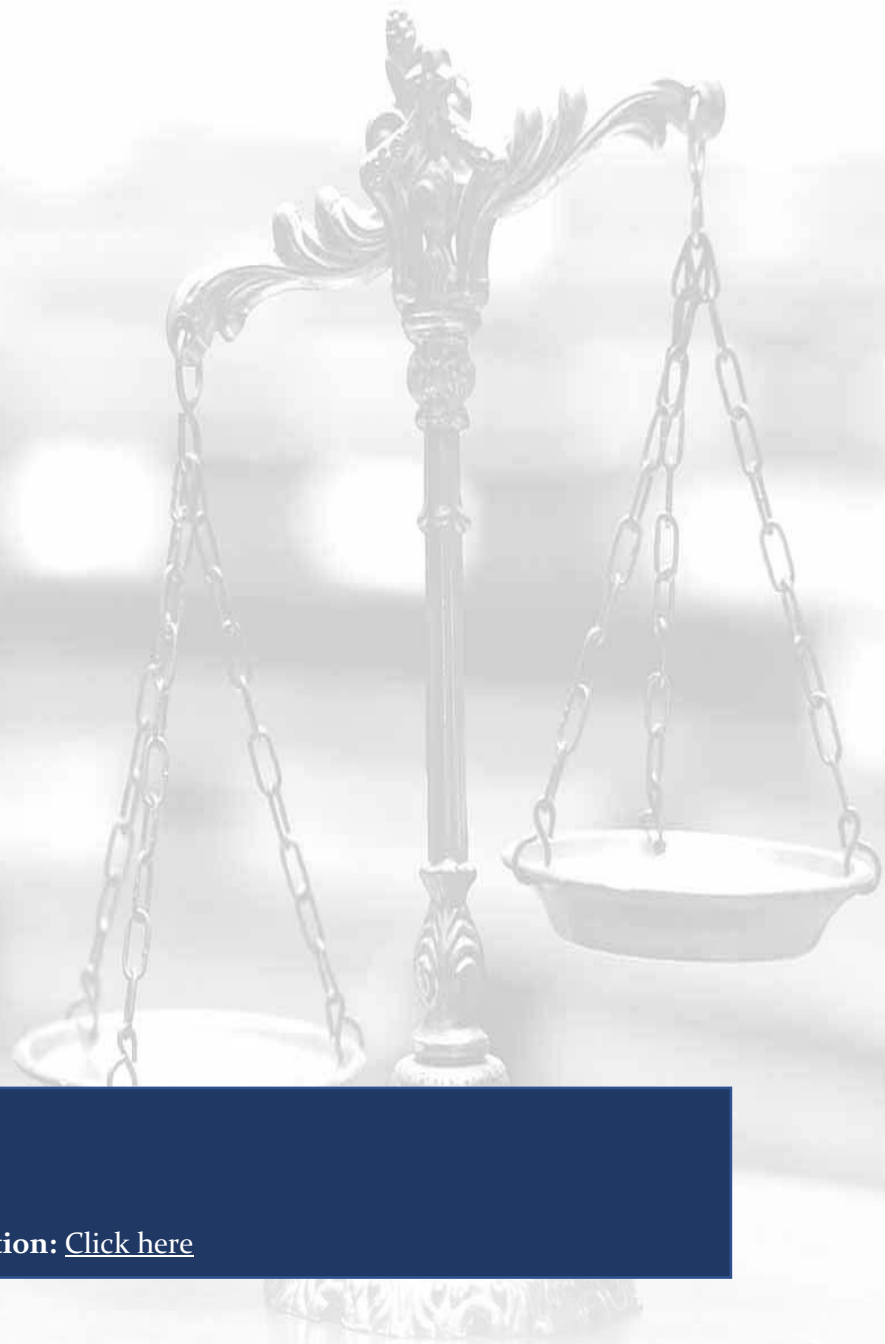
It is very crucial for all the Directors to make sure that their direction towards the management in case of any default, should be properly recorded in the minutes. The main crux of the matter which became the safeguard measures for the Directors to prove that the allegation on them is false and that the default took place without their knowledge, was the evidence of them taking the corrective action and the same was recorded in the minutes of the Audit Committee meeting and the Board meeting. Hence it becomes very much important for all the Directors to make sure that the voice raised by them, if they find any default by the management are properly recorded.

It is true that the Independent Director is responsible to make sure that the interest of all the stakeholders are protected and that the trust of the employees and shareholders are always built up. Independent Director have to play vital role in guiding the management and that the expansion and growth largely depends on them.

In this discussed matter above, Market regulator took a very essential decision by not taking any action against the Independent Director, based on their replies evidencing the prompt action taken by the Independent Director, on occurrence of the default by the company, after the same was brought to their notice. Further, Independent Directors should always ask for the compliance certificate from Managing Director and Compliance Officer, that will protect them from any default occurred.

How Company Secretary can play an important role in such matter?

Being Compliance Officer of the Company, it becomes very essential for the Company Secretary to make sure that the discussion and decision taken at the Board meeting and the Committee meeting are properly recorded in the Minutes of the respective minutes book. The reason why the Secretarial Standard 1 & 2 (collectively referred to as "SS") becomes very stringent at times, becomes it is more of safeguard measures for the Company Secretary and Directors on the Board of the Company, as many provision of the SS are stringent to comply, but its becomes protective thereafter, as Company Secretary need to circulate the draft minutes within 15 days from the meeting conducted and that the certified minutes within 15 days from the date when the Chairman sign the minutes. Hence, Directors and the members of the Committee can review the draft minutes well within time, in case of any objection been raised by them in the minutes, they can ensure that their comments are properly recorded in the minutes book. In case, if the said things are not found to be in line, Directors can reply with their observation on receiving the draft minutes and also at time of receipt of the certified minutes.



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