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WHETHER INDEPENDENT DIRECTORS SHOULD RECEIVE STOCK OPTIONS?

Julie Roy[*]

An array of corporate scams throughout the world has triggered the growth in Committee Reports in various jurisdictions. In India, there have been multifarious Committee Reports and their recommendations have culminated in the Companies Bill, 2012 which is yet to see the light of the day. Most jurisdictions are moving towards a realisation of the corporate governance standards in the activities of the companies. In this context, we enquire into the broader subject of independent directors and how their independence may be safeguarded. An important aspect of ensuring that independent directors have an impetus to serve in that position in a company is to adequately remunerate them. However, though the remuneration provided to an executive director may include profits of the company, it cannot be so for non-executive directors. This is because the underlying principle based on which the concept of independent directors has evolved is independence of judgment. For this purpose, the independent directors must be free from any pecuniary interest in the company. Specifically, this paper seeks to delve into the issue of shareholding as a form of remuneration for independent directors and to what extent are ESOPs a pecuniary interest of the independent directors in the company.

[*] Candidate, B.P.Sc. (Hons) LL.B. (Hons), National Law University, Jodhpur 2014. Email: julieroy.nluj@gmail.com

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I. Introduction

An essential quality which non-executive directors should bring to the board's deliberations is that of independence of judgement.

- Cadbury Committee Report.[1]

After a number of scams and multifarious committee reports which were brought out in the UK and USA, there was a proliferation of the concept of Independent Directors (ID) in India. This came in the form of recommendations that were first given in 1998 in the Desirable Code of Corporate Governance.[2] Although most of them were voluntary in nature, they have resulted in the culmination of the Companies Bill, 2012. Hence, steps have been taken towards codification of these principles of corporate governance.

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[1] Committee on the Financial Aspects of Corporate Governance, 1992, *Cadbury Committee Report*, United Kingdom, *available at* http://www.ecgi.org/codes/documents/cadbury.pdf.

[2] Confederation of Indian Industries, *Desirable Corporate Governance: A Code,* 1998, *available at* www.nfcgindia.org/desirable_corporate_governance_cii.pdf.

To ensure good corporate governance, we must secure the independence of directors. The independence of directors can, in essence, be safeguarded by rendering the independent directors free from any pecuniary interests in the company. Thus, it is in order to protect the independent nature of these directors that they should not even be permitted to have any shareholding in the company. However, Employee Stock Option Schemes (ESOPs) are in the nature of right to subscribe to securities offered by the company at a predetermined rate at a future date. Whether this can amount to a pecuniary interest in the company or not is a matter of debate. Therefore, the pertinent issue to be answered is whether independent directors should be permitted to get the benefit of ESOPs. Although it is known that in case of listed companies, an independent director cannot be a substantial shareholder owning two percent or more of the block of voting shares, a grey area exists for unlisted company for there is no such limitation on the maximum shareholding of the independent directors.[3] This grey area is thus open to interpretation. A more favourable interpretation would be that the independent directors should not be allowed to exercise stock options because this would mean tampering with their independence.

This paper seeks to delve into the concept of independent directors. Thereby, coming to the conclusion as to what are the factors which secure the independence of the director. Specifically, we aim to get an astute insight into the question of whether exercising stock options schemes at a future dates would compromise the independence of judgment of the independent directors. Ultimately, we enquire into the domainwhether independent directors should be offered ESOPs or not.

II. Statutory Provisions Relating To Directors' Remuneration

In order to inquire into the manner in which directors are generally remunerated for their services, we must look into the statutory provisions in the Companies Act, 1956. This would help us to understand the source of directors' income. This is pertinent to note as the concept of an independent director requires him to be free from any

[3] Clause 49, Listing Agreement, *available at* http://www.nse-india.com/getting_listed /content/clause_49.pdf.

pecuniary interest in the company. For this purpose, it is asserted that independent directors should not ideally be offered stock options.

The term 'remuneration' is defined in the explanation to Section 198 of the Companies Act, 1956 to include, "*any expenditure incurred by the company in providing any rent-free accommodation, or any other benefit or amenity in respect of accommodation free of charge to the company's directors and managers; any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate; any expenditure incurred by the company in respect of any obligation or service; any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for the directors and the managers*". The provisions regarding the remuneration of directors can be found in Section 309 to Section 311 of the Companies Act, 1956.

Section 198 is titled '*overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits*.' This section states that the total managerial remuneration payable by a public company or a private company which is a subsidiary of a public company to its directors and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of that company for that financial year. It also states that the remuneration of the directors shall not be deducted from the gross profits. The provision also provides that if in any year the company has no profits or the profits are inadequate the company shall not pay to its directors, including any managing or whole-time director or manager, any remuneration without the prior approval of the Central Government.[4]

This eleven percent is exclusive of the fees to be paid under §309(2). The director would receive remuneration by way of a sitting fee for each meeting of the Board, or a Committee attended by him as

[4] §198(4), the Companies Act, 1956.

per Clause 2 of §309. A director who is either in the whole-time employment of the company or a managing director may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company which should not exceed five percent of the net profits.[5] §309(4) states that a director who is neither in the whole-time employment of the company nor a managing director can be paid remuneration in two ways: by way of a monthly, quarterly or annual payment with the approval of the Central Government; or by way of commission if the company by a special resolution authorises such payment. Even though, the Companies Act does not specifically include provisions as to the remuneration of independent directors, §309(4) allows for separate limits and restriction to be made applicable on the remuneration of independent directors. The remuneration paid to such director or such directors should not exceed one percent of the net profits of the company, if the company has a managing or whole-time director; or three percent in any other case.

Section 310 is the provision for increase in remuneration to require Governmental sanction and Section 311 is the provision for increase in remuneration of managing director on re-appointment or appointment which would require Governmental sanction.

Sitting fees means remuneration by means of a fee under Section 309(2). Sitting fees is paid to the directors in accordance with the articles of the company. Rule 10-B of Companies (Central Government) General Rules and Forms, 1956 provides that companies having a paid-up capital and free reserves of Rs. 10 crores or above, or companies having a turnover of Rs. 50 crores or above can pay sitting fees not exceeding Rs. 20,000 and other companies can pay sitting fees up to Rs. 10,000. These are the provisions relating to directors remuneration in the Indian legal system.

III. Who is An Independent Director?

The Cadbury Committee Report of 1992 stated that an essential quality which non-executive directors should bring to the board's

[5] §309(3), the Companies Act, 1956.

deliberations is that of *independence of judgement.*[6] Therefore, the Committee recommended that the majority of non-executives on a board should be independent of the company. In other words apart from their directors' fees and shareholdings they should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Thus, although the Cadbury Committee Report did not rule out the possibility of independent directors having a shareholding in the company, they did suggest that it is better for them not to participate in share options. It was stated in the report that: '*In order to safeguard their independent position, we regard it as good practice for non-executive directors not to participate in share option schemes and for their service as non-executive directors not to be pensionable by the company.*"

In India, although the importance of independent directors was recognised by the Desirable Code of Governance,[7] the term 'independent director' was first defined and enunciated in the K. K. Birla Committee Report. In the K. K. Birla Committee Report it was agreed that "*material pecuniary relationship which affects independence of a director*" should be the *litmus test* of independence and the board of the company would exercise sufficient degree of maturity when left to itself, to determine whether a director is independent or not.[8]

Clause 49 of the Listing Agreement, which deals with Corporate Governance norms that a listed entity should follow, was first introduced in the financial year 2000-01 based on

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[6] *Supra,* note.2.

[7] Confederation of Indian Industries, *Desirable Corporate Governance: A Code,* 1998, *available at* www.nfcgindia.org/desirable_corporate_governance_cii.pdf.

[8] Securities Exchange Board of India, *Report of the Kumar Mangalam Birla Committee on Corporate Governance,* May 7, 1999, *available at* http://web.sebi.gov.in/commreport/corpgov.html.

recommendations of Kumar Mangalam Birla Committee.[9] The Listing Agreement defines an "Independent Director" as a non-executive Director of the company who as far as shareholding was concerned, is not a substantial shareholder of the company, i.e. owning two percent (2%) or more of the block of voting shares. Nominee directors appointed by an institution that has invested in, or lent money to, the company are also treated as independent Directors.

In 2002, the Naresh Chandra Committee Report observed that Companies Act, 1956, prescribes the ceiling on remunerations that can be paid to Non Executive Directors (NED) and independent directors, including stock options, restricted stocks, sitting fees and commissions on net profit, if any, subject to approval of shareholders.[10] Currently, NEDs, including independent directors, may be paid compensation within the limit of 1% of the company's stand-alone net profits for the year (or 3% in case it does not have any whole-time director).[11]

In 2003, the N. R. Narayana Murthy Committee on Corporate Governance addressed the issue in the context of independence which is whether independent directors are entitled to any material benefits from the company other than sitting fees, remuneration, and travel and stay arrangements.[12] Such benefits include stock options and performance bonuses that executive directors may be entitled to. The central issue that was considered was whether such benefits serve as incentives or hindrances to the objectivity of decision-making and hence, compromise its quality. Thereafter, it defined the term "independent director" similarly as in the Listing Agreement: as a non-executive director of the company who *inter alia* is not a substantial

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[9] Dilip Kumar Sen, *Clause 49 of Listing Agreement on Corporate Governance*, THE CHARTERED ACCOUNT, December 2004, *available at* http://www.icai.org /resource_file/10980dec04p806-811.pdf.

[10] Department of Company Affairs, *Report of the Naresh Chandra Committee on Corporate Audit and Governance,* Dec. 23, 2002, *available at* http://www.mca.gov.in/Ministry/latestnews/Draft_Report_NareshChandra_CII.pdf.

[11] *Id.*

[12] Securities and Exchange Board of India, *Report of the SEBI Committee (N. R. Narayana Murthy) On Corporate Governance,* February 8, 2003, *available at* http://www.sebi.gov.in/commreport/corpgov.pdf.

shareholder of the company, i.e. owning two percent or more of the block of voting shares.

The considerations as regards remuneration paid to an independent director shall be the same as those applied to a non-executive director.[13] Therefore, even though the committee did not rule out the right of independent directors from holding shares, they stated that the director cannot be the substantial shareholder of the company i.e. owning two percent or more of the block of voting shares.

The CII Taskforce on Corporate Governance of 2009, in keeping with the line of recommendations of the Combined Code in England, gave recommendations on remuneration for voluntary adoption.[14] It recommended that the Companies Act, 1956, be amended so that companies have the option of giving a fixed contractual remuneration to NEDs and independent directors, which is not linked to the net profit or lack of it. Therefore, companies should be given the option to choose between:

a. Paying a fixed contractual remuneration to its NEDs and IDs, subject to an appropriate ceiling depending on the size of the company; or

b. Continuing with the existing practice of paying out upto 1% (or 3%) of the net profits of the standalone entity as defined in the Companies Act, 1956. For any company, the choice should be uniform for all NEDs and independent directors, i.e. some cannot be paid a commission of profits while others are paid a fixed amount.

If the option chosen is (a) above, then the NEDs and independent directors will not be eligible for any commission on profits. The current limits and constraints on sitting fees and stock options or restricted

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[13] Clause 49, Listing Agreement, *available at* http://www.nse-india.com/getting_ listed /content/clause_49.pdf.

[14] Confederation of Indian Industries, *CII Taskforce on Corporate Governance,* November 2009, *available at* http://www.mca.gov.in/Ministry/latestnews/Draft_ Report_NareshChandra_CII.pdf.

stock may remain unchanged. *If stock options are granted as a form of payment to NEDs and independent directors, then these must be held by the concerned director until one year of his exit from the Board.*

In 2009, taking the recommendations of the CII taskforce as well as suggestions received from other stakeholders, the Corporate Governance Voluntary Guidelines were formulated by the Ministry of Corporate Affairs.[15] The guidelines as to remuneration of independent directors stated that they should be paid sitting fees which may depend on the twin criteria of net worth and turnover of company. It is important to note that the guidelines also stated that the IDs may not be allowed to be paid stock options or profit based commissions so that their independence is not compromised.

IV. ESOPS: Definition And Meaning

Conventional stock option plans give an employee of the company the right but not the option to buy, i.e., option to buy a fixed number of shares of the company at a stated price at a specified period, often at a discount from the market price at the date of grant.[16] The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 ('SEBI Guidelines') defines "employee stock option" as the option given to the whole-time Directors, Officers or employees of a company which gives such Directors, Officers or employees, the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price. ESOPs are also defined in the Companies Act.[17] This definition was inserted vide circular dated June 30, 2003.[18] Issuance of sweat equity shares or formulation and implementation of Employee Stock Option Plan or Scheme 'ESOP' or 'ESOS' by unlisted companies (public or private) is primarily governed

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[15] Ministry of Corporate Affairs, *Corporate Governance Voluntary Guidelines,* 2009, *available at* http://www.mca.gov.in/Ministry/latestnews/CG_Voluntary_Guidelines_2009_24dec2009.pdf.

[16] Satyajit Dhar and Subhabrata Dey, *ESOP Accounting in India: Measurement and Disclosure Issues*, JOURNAL OF BUSINESS AND ECONOMIC ISSUES, VOL. 1 NO.1, JANUARY 2009.

[17] §2(15A), the Companies Act, 1956.

[18] Circular no. SEBI/PMD/MBD/ESOP/2/2003/30/6 dated June 30, 2003, *available at* http://www.sebi.gov.in/circulars/2004/esopcir03.html.

by the relevant provisions of Companies Act, 1956 and Unlisted Companies (Issue of Sweat Equity Shares) Rules, 2003.[19]

Sweat equity is issued by the company to its directors /employees at a discount or for consideration other than cash i.e. to say that the consideration is generally kind and not cash. The basic idea behind the issuance of sweat equity shares is to incentivise the employees by providing them with some direct stake in the company.[20]Although there may be some similarities between the two but there are some differences as well. For example, sweat equity shares is grant of shares at discount or without any monetary consideration whereas ESOPs are grant of an option to purchase shares at a predetermined price.[21]

Under the SEBI Guidelines in Sub-clause (1) of Clause 2, an employee has been exhaustively defined to include a director of the company, whether a whole-time director or not.[22] Rule 4.3 of the SEBI Guidelines provides that "*A director who either by himself or through his relative or through any, body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company shall not be eligible to participate in the ESOS*." In view of Clause 4 of the SEBI Guidelines, as long as the non- whole-time director is not a promoter or does not belong to the promoter group or who, by himself, or through his relative or through any, body corporate, directly or indirectly, does not hold more than 10% of the equity shares of the company, such a non-whole-time director being an employee within the

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[19] ESOP for Unlisted Private Limited Companies in India, 2011, *available at* www.indiajuris.com/esopulcs.pdf.

[20] Ankit Mishra, *Laws Relating to "Sweat Equity Shares" in India,* May 2, 2010, *available at* http://indianlegalspace.blogspot.in/2010/05/laws-relating-sweat-equity-shares-in.html.

[21] *Id.*

[22] LVV Iyer, *Some Work & Some Pay,*May 17, 2003, *available at* http://articles.economictimes.indiatimes.com/2003-05-7/news/27524928_1_esop-guidelines-employee-stock-option-scheme-companies-act.

meaning of the ESOP guidelines shall be eligible to participate in the stock option scheme of the company.[23] The SEBI Guidelines state that the following persons are not eligible to participate in the ESOS: (a) an employee who is the promoter or belongs to the promoter group; (b) a director who either by himself or through his relative or anybody corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company. Thus, it is clear that the company is not specifically prohibited from allocating options to the Independent directors. As far as the limits are concerned of the grant of ESOPs and ESOS, the Guidelines state that the Board of Directors must disclose in the Directors Report, employee-wise details of employees who receives a grant in any one year of option/share amounting to 5% or more of option granted during that year and identified employees who were granted option/share during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant.[24] Such information must also be furnished in the statement to be filed with the Stock Exchange.[25] If employees are granted options/shares equal to or exceeding 1% of the issued capital of the company in a year approval of shareholders by way of separate resolution in the general meeting shall be obtained by the company.[26]

The SEBI then concludes, "*Therefore, to prevent any possible misuse of trust and to ensure transparency in operations, independent non-executive directors should make proper disclosures as per the Regulations whether they hold the shares in their individual name or in the name of the trust.*"[27]

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[23] *Id.*

[24] 12.1(j) and 19.1 (c), SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, *available at* http://www.sebi.gov.in/guide /guide9.html.

[25] 12.1(ii) and (iii), SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, *available at* http://www.sebi.gov.in/guide /guide9.html.

[26] 6.3 (b) and 17.5(a), SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, *available at* http://www.sebi.gov.in/guide /guide9.html.

[27] Mihir Naniwadekar, *SEBI informal guidance - ESOP, Insider Trading and independent directors,* October 4, 2008, *available at* http://indiacorplaw.blogspot .in/2008/10/sebi-informal-guidance-esop-insider.html.

ESOP policies are formulated by a Compensation Committee of the Board of directors consisting of a majority of independent directors. Shareholder approval is essential for grant of ESOPs because no ESOS can be offered to employees of a company unless the shareholders of the company approve ESOS by passing a special resolution in the general meeting. It is through this special resolution that the shareholders can identify the classes of employees entitled to participate in the ESOS. The SEBI has recently clarified that a company is not specifically prohibited from allowing options to independent directors of the issuer company.[28] Also since, independent directors in would be 'insiders' as per Regulation 2(e) read with Regulation 2 (c) of SEBI (Prohibition of Insider Trading) Regulations, 1992, they should make proper disclosure about their shareholding whether they hold it in their name or in the name of a trust.[29] Therefore, the law presently does not explicitly prohibit independent directors from holding share options but it does give the shareholder of the company some discretion in determining whether the independent directors can get employee compensation in the form of ESOPs.

V. Should An Independent Director Receive ESOPS?

An argument in favour of prohibiting IDs to be eligible for ESOPs would be in the nature and extent of their liability. It is considered that IDs would incur liability of a lesser magnitude than an executive director because they are not involved in the day to day activities of the company and also because they have no interest in the company, so their actions are disinterested as far as it concerns themselves. If the IDs are prohibited from having any pecuniary interest they cannot be said to have a personal interest in doing a particular impugned act. Hence, if they are permitted to hold ESOPs then automatically they would have an interest in the company and

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[28] Clarification in the matter of Nucleus Software, August 29, 2008, *available at* http://www.sebi.gov.in/informalguide/nucleus.pdf.

[29] *Supra,* note 15.

therefore would involve themselves directly or indirectly in the affairs of the company to protect their interests. This is because even though it is a right to purchase securities at a future date, the independent director would still incur an interest in the company since they would think of their future interest and conduct themselves presently. Dishonesty may creep in somehow or the other due to this future possibility of holding shares even if shareholding is limited to a certain percentage.

Om Prakash Khaitan v. Shree Keshariya Investment Ltd and Ors.[30] was a step towards distinguishing the duties of an executive director and from that of an ID. The court relieved the director of any liability because it held that was unreasonable to fasten liability on directors for the defaults and breaches of a Company where such directors are either the nominee directors or are appointed by virtue of their special skill or expertise.[31] In such cases, the directors should be relieved of their liability unless they are directly involved in the acts or omission complained of or have otherwise not acted honestly or reasonably or have financial involvement in the company.[32]

The object of having IDs was to secure some independence in the day to day governance, so that there remains a check in the acts of the executive directors of the company. The IDs were to serve as a balance. An aspect of corporate governance is to reduce their liability for the matters of the company. This would again be another impetus to them for occupying the position of an ID. However, holding ESOPs would be a form of financial involvement in the company. This would not only compromise their independence but would also make them equally liable for all acts like the executive directors.

Their liability would be deterrence for individuals to serve as IDs.[33] The IDs fears about their personal liabilities escalated after the

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[30] Om Prakash Khaitan v. Shree Keshariya Investment Ltd and Ors, [1978]48CompCase 85(Delhi).

[31] ¶ 5, *Ibid*.

[32] ¶ 5, *Ibid*.

[33] Rajesh Chakraborty and Krishnamurthy V. Subramanian, *Deterrence for Independent Directors and Corporate Boards: Evidence from a Natural Experiment,* March 2012, *available at* www.isb.edu/faculty/.../images/After_the_ crisis_ 1Apr2012.pdf.

Satyam fiasco.[34] This was followed by the charges filed against NimeshKampani who was the independent director on the Board of Nagarjuna Finance from 1998-1999. In 2002, the company failed to repay crores of rupees to its depositors and the independent director was also charged apart from the promoters and the executive directors.[35] Recently, Ministry of Company Affairs, Government of India (MCA) has issued a circular No.2/13/2003/CL- V, on 25 March 2011, to all Registrar of Companies (ROC), clarifying, that it should take extra care in examining cases where independent directors are identified as "officer in default".[36] Unfortunately, there is lack of clarity on the exact liability of independent directors.[37] The Indian judiciary has observed that liability of a director is a result of his acts or omissions and not be the mere fact of holding an office.[38] IDs can be made liable like the executive directors because of no strict delineation of liabilities even though admittedly they are not involved in the day to day affairs of the company.

Therefore, if IDs are barred from holding ESOPs, the consequent action of the Government should be to reduce their liability and restrict it to specific circumstances. This would foster confidence among individuals who serve as IDs. Instead of awarding them ESOPs, their sitting fee could be increased significantly. IDs may give strategic inputs to the organizations, so if you say they should not be held criminally liable for the doings of the company then they should not get remuneration which is like remuneration of an executive. Therefore, if

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[34] *Supra,* note 9.

[35] Vikramaditya S. Khanna and Shaun J. Mathew, *Role of independent directors in controlled firms in India,*NAT'L. L. SCH. OF INDIA REV. 22, P. 35 (2010), *available at* http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan050216.pdf.

[36] Renu Gupta, *Liabilities of independent non-executive directors in India*, 26th April 2011, *available at* http://justlawandpolicy.wordpress.com/2011/04/26/liabilities-of-independent-non-executive-directors-in-india.

[37] Deepak Parekh, *Independent Directors Liabilities Not Defined*, August 2011, *available at* http://www.indiacsr.in/en/?p=1587.

[38] S.M.S. Pharmaceuticals Ltd. v. Neeta Bhalla, (2005) 8 SCC 89.

they are given any upside on the profits like ESOPs or profit share then they are taking part in the decisions where they are a party.[39] Therefore, an argument can be raised in increasing their sitting fees.

Case Study: India

In May 2008, Life Insurance Corporation (LIC) had sought an injunction from the Bombay High Court restraining its nominee director on the board of Larsen & Toubro from dealing in shares of L&T acquired under an employee stock option scheme.[40] LIC had objected to the nominee director Mr Sinha obtaining 20,000 equity shares at a rate of Rs 35 per share (the current market price is around Rs 1,700 per share).[41] LIC has stated that the acceptance of stock options was in contravention of directions given by LIC to its nominee directors. The question that was involved was whether nominee directors could be restrained considering that the SEBI guidelines do not prevent them from exercising the options. The court then passed an order restraining Kranti Sinha, nominee director of LIC on L&T, from dealing on the shares. But the issue still remains unclear.[42] The two independent directors who had received ESOPs worth Rs 4.5 crore and Rs 3.5 crore, respectively, were dismissed.[43] Allotment of ESOPS to independent and nominee directors is a grey area and is open to interpretation.[44]

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[39] Ashok Banerjee, *Should Independent Directors receive ESOPs, available at* http://www.moneycontrol.com/india/newsarticle/news_print.php?autono=410366&sr_no=1.

[40] TNN, *LIC moves HC to restrain from selling Esops,* 8th May 2007, *available at* http://articles.economictimes.indiatimes.com/2007-05-08/news/28421756_1_life-insurance-corporation-lic-kranti-sinha.

[41] *Supra*, note 33.

[42] Money Control, *Bombay HC restrains LIC Dir from dealing with L&T ESOPs,* 8th May 2007, *available at* http://www.moneycontrol.com/news/business/bombay-hc-restrains-lic-dirdealinglt-esops_280138.html.

[43] Dev Chatterjee, *FIs remove two L & T Nominee Directors*, 11th May 2007, *available at* http://www.business-standard.com/india/news/fis-remove-two-lt-nominee-directors /284160.

[44] Rabin Ghosh, *LIC nominee on L&T Board Can't Get ESOP Booty,* 7th May 2007, *available at* http://www.dnaindia.com/money/report_lic-nominee-on-l-and-t-board-cant-get-esop-booty_1095394.

VI. Conclusion

Reiterating the basis underlying principle behind the evolution of the concept of independent directors, of ensuring independence in judgment, in conclusion, it is justified in believing that independent directors must not receive ESOPs as employees' compensation. As far as directors' remuneration is concerned, the sitting fees of the independent directors may be increased so as to remunerate them sufficiently and at the same time keeping them free from having any interest in the activities of the company.

In UK, the non-executive directors can hold shares but they must stay independent of management and dissociate themselves from corporate business and other activities that may affect their ability of making independent judgment. Even though in UK, substantial shareholding by a non-executive director is discouraged though not prohibited, in the US, substantial shareholding by an independent director is not prohibited. The New York Stock Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding. This is because of the nature of independent directors. Their appointment by the Board of Directors of the company itself raises doubts as to their independence. Hence, shareholding is not considered deterring independent judgment in these jurisdictions.

Due to the recent spate of events where independent directors have been made liable for the company, it would be feasible if the IDs are made completely independent of any pecuniary interest in the company. Therefore, there would not be any conflict of interest. After *Worldcom, Enron* and *Satyam* in India, the IDs have resigned *en masse* and this is cause for concern. The legal principles governing the liability and remuneration of the IDs give them no incentive to hold such a position because it is no different from that of an executive director. Even if there is delineation in the treatment given to executive and non-executive directors, it has clearly defined boundaries. Thus,

there arises a confusion regarding remuneration of Ids and the question as to whether the IDs should receive ESOPs. It is the time for identifying the issues pertaining to and the issues obstructing the efforts of policy makers at safeguarding the independence of the IDs. There is an urgent need for legislative policies which do not act as deterrence for individuals acting as IDs of a company. The recommendations of the Naresh Chandra Committee as to the directors and the limits to their shareholding must be enacted and incorporated into legislation. Finally, the legislative policies regarding independent directors must move towards securing the independence of judgment.