

RESIGNATION OF DIRECTORS

The Last Fiduciary Duty

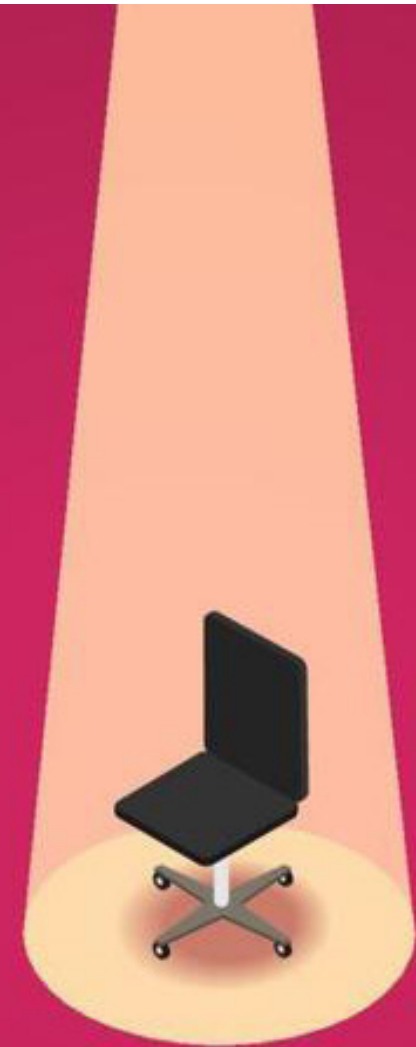


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Recently, the chair of India's largest private sector bank quit suddenly citing disagreement over values and ethics. Without elaborating on the differences, the chair resigned writing in his letter that "Certain happenings and practices within the bank, that I have observed over the past two years, are not in congruence with my personal values and ethics." This single sentence was enough to send the bank's stock in a tizzy. The Reserve Bank of India (RBI), that regulates the bank, had to immediately swing into action. It allayed public fears of misgovernance by issuing a release stating that there were no material concerns on record as regards the bank's conduct or governance. This episode has brought the resignation of independent directors into the spotlight.

Directors are permitted to resign at any time. The legislative history of resignation shows that it was regarded as a routine act. Consequently, under the former Companies Act, 1956, there was no specific provision regulating director resignations. Any expectation of transparency was based solely on general fiduciary principles, without any codified obligation to communicate the rationale for resignation. However, this position changed with the enactment of Section 168 of the Companies Act, 2013 (2013 Act), which formally recognized the concept of director resignation and required a



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resigning director to provide a written notice to the company. This marked the first codification acknowledging that resignation may have implications beyond the private act itself, especially for companies with a significant public interface. This change aligns with the expanded responsibilities and duties of directors introduced in Section 166 of the 2013 Act, emphasizing objectivity, oversight, and accountability.

Initially, Section 168 of the 2013 Act mandated that a resigning director also send a detailed explanation of the reasons for resignation to the Registrar of Companies (RoC) within thirty days. However, the Company Law Committee Report, 2016 recommended that this requirement be made optional. Consequently, an amendment to Section 168 of the 2013 Act was made in 2018, removing the mandatory obligation to disclose reasons and making it optional for resigning directors to forward their resignation letter along with detailed reasons to the RoC.

It is somewhat ironic that the original intent behind the Company Law Committee Report's recommendation was to curb the potential misuse by companies of a director's name after resignation. However, practical experience has taught us that, in some cases, it is the other way around. As a result, the shift in the law has been toward making disclosure of reasons mandatory rather than optional.

To that end, the Securities and Exchange Board of India (SEBI) formed the Kotak Committee on Corporate Governance (Kotak Committee) in 2017. In its report, the Kotak Committee acknowledged Section 168 of the 2013 Act but argued that the thirty-day disclosure period rendered the information potentially outdated by the time it was disclosed. Further, the Kotak Committee noted that there is no corresponding provision in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR Regulations) which requires (immediate) disclosure by listed entities to the stock exchanges in case of resignation of an independent director. Hence, it recommended that independent directors disclose their reasons for resignation immediately. The Kotak Committee also recognized that independent directors occupy a unique vantage point, with visibility into the internal functioning and governance standards of listed entities. Their resignation could signal governance issues or negative developments. Given the sensitivity of such exits and their potential to influence investor perception in listed companies, the Kotak Committee recommended that independent directors disclose detailed reasons for their resignation and confirm that no other material reasons influenced their decision. It encouraged independent directors to be transparent and forthright about their reasons, viewing this as a critical aspect of fulfilling their last fiduciary responsibility towards stakeholders. These recommendations were later incorporated into the SEBI LODR Regulations, promoting greater transparency.

Similarly, sectoral regulators have adopted a comparable approach. In a 2022 circular, the RBI observed cases where resignations of non-executive directors did not seem to be routine or personal in nature. The RBI speculated that the underlying reasons might include disagreements, misalignment with organisational culture, governance issues, anticipation of negative developments, or financial results. Accordingly, the RBI established a framework for immediate reporting of exits of non-executive

directors. This shift underscores a broader trend: leadership departures are increasingly viewed as significant governance signals that require transparent, substantive disclosure and oversight by regulators.

Generally, the reasons for directors' resignations tend to be routine, such as health issues, better opportunities elsewhere, or feeling overburdened with their duties. However, there are rare instances when directors resign to publicly denounce the company's business practices or governance standards. In the context of publicly listed companies, such outspoken resignations can serve as an important means of alerting the public shareholders to potential wrongdoing within the organization. On the other hand, if these reasons are vague, they can lead to serious negative consequences for the company and its share price. Hence, it is critical for directors to be forthright and transparent in disclosing the reasons for their resignation.

Today, the role of directors extends well beyond mere legal and regulatory compliance; it has evolved from a traditional, oversight-focused function into a more dynamic and strategic one. Directors play a crucial role as watchdogs, ensuring that shareholders in publicly listed companies are

provided with material and timely information about the company. Such information can often be communicated through the reasons they provide in their resignation letters. Therefore, it is vital for directors to recognize the importance of fulfilling their last fiduciary responsibility with transparency and integrity, benefiting both the company and its shareholders. Remaining silent when they should speak out can do a disservice to shareholders, who may only learn about serious issues too late, potentially jeopardizing their investments. At the same time, speaking in vague or uncertain terms can be equally catastrophic for the company.

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