

18 AUG, 2010, 06.25AM IST, SHIKHAR KACKER & SIDDHARTH SHAH,

## Independent directors beware!

The Takeover Regulations Advisory Committee (TRAC) constituted by Sebi last year to review the Takeover Regulations of 1997 recently released its committee report along with the draft of the proposed Takeover Regulations for public comments. Recognising the fiduciary duty that a director owes his shareholders, TRAC observed that board of the target company ought not to play a mere passive role, especially in a takeover bid on the company.

Consequently, TRAC has recommended that a committee of independent directors constituted by the board of the target company considers and gives its reasoned recommendations on the open offer made by the acquirer to shareholders of the target company. These recommendations are required to be published by the target company at least two business days prior to the commencement of the tendering period.

To enable the independent directors take a reasoned decision, they have been granted the flexibility to seek advice from professionals such as merchant bankers, chartered accountants and lawyers under the expenses of the target company. TRAC's recommendations may be traced to those made by the Justice PN Bhagwati Committee Report on Takeovers, 1994, that proposed that the board of the target company may at its discretion send unbiased comments on any bid to shareholders.

While the Bhagwati Committee acknowledged that the mandatory requirement for recommendation to shareholders on takeover bid by the board of the target company should be the ultimate goal, the first step was agreed to restricting it to a voluntary requirement. The foremost beneficiaries of TRAC's recommendations are likely to be the widely dispersed retail shareholders who generally have little access to the professional advice as against institutional investors. Further, the recommendation appears to be in line with the best practices adopted globally.

In the US, UK and France, the board of the target company typically seeks an independent fairness opinion that is disclosed to shareholders.

Despite good intentions, TRAC's recommendations may fail to meet its objective. The proposal, prima facie, appears generic in nature and lacks definitive parameters or guidance in respect of the facts to be considered by the committee while giving its recommendations.

One may take a cue from the Takeover Regulations of Germany where the management and the supervisory board of a target company, in its response to the offer bid, has to specifically provide inter alia anticipated effect of a successful offer on target company, its employees and also consider whether the members of the management board and supervisory board of the target company intend to tender their shares into the offer.

Given the framework of the committee report, it needs to be tested if the recommendation of independent directors, more particularly in cases of competitive bid, would depend merely upon the financial strength of the acquirer; or if factors such as culture fit, goodwill and operational benefits that the acquirer could bring to the target company would be a consideration.

Further, the strict timelines for submitting the recommendation, may not provide a reasonable opportunity to the professional advisors appointed by the independent directors to conduct a comprehensive due diligence on the target company and the acquirer.

While the TRAC vests additional accountability on independent directors, it has not provided them any safeguards from liability that may arise while discharging their functions in good faith. The same assumes significance from the fact that the Indian Companies Act does not make a distinction between an independent director and an executive director, thereby exposing the independent directors to any liability or claim against the company and its directors.

This could reduce the universe of independent directors, who post the Satyam and Nagarjuna Finance cases, are already under pressure to perform a more active role in the affairs of the company. In India, presence of independent directors has generally been perceived as 'check the box' requirement for listing and we have hardly witnessed any independent director activism. Even institutional nominees have generally preferred to take a more passive role in the management. Such obligation casted on independent directors may now prompt more activism from such directors.

If the proposal is brought into effect in its current form, one can expect gradual formation of precedents on the role of independent directors vis-avis their responsibility towards shareholders. For now, one can expect a rush among independent directors to seek insurance cover for directors' liability to protect themselves from any law suits filed by shareholders or failed bidders, in respect of their recommendations.

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