Journal of Corporate Governance and International Business Law
Volume 1, Issue 2
(July-December)
www.stmjournals.com

Exchange of Information between Promoter and Director with Reference to Infosys Saga

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Abstract

Exchange of information is a very important factor for the governance of any organization but in recent times it has become a point of dispute in organizations like and Infosys because opt-out promoters 'dissatisfaction with the current information exchange mechanism. This paper tries to understand the current equal treatment information exchange mechanism and the problem of equal treatment. The paper substantially covers two topics: firstly, the dispute in Infosys between the promoter Mr. NR Narayana Murthy and Mr. Vishal Sikka because of Infosys' insider trading policy, disclosure and transparency norms, composition of BOD and other financial aspects; and secondly, the paper discusses the report of the committee on corporate governance which is based on evolutionary rather than revolutionary approach. It deals with the problem of information exchange mechanism by providing various suggestions such as information exchange agreement, which will provide information to the parties to the agreement with special conditions attached to it. The report also tries to improve transparency in the organization with various suggestions. But if information exchange mechanism is governed only by a single agreement, then threat of centralization of power will arise and it will lead to evil consequences.

Keywords: *Committee on corporate governance, Equal treatment of information, Information exchange mechanism, Infosys dispute, New information exchange agreement*

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INTRODUCTION

Exchange of information is the backbone of any organization, whether professionally managed or not. This is the basic requirement of any organization to grow and establish good governance. But in recent times, we see disputes between the promoters and the directors of the company in organizations like Tata and Infosys. The crux of the dispute is the information sharing mechanism. The Promoter of INFOSYSY claims that after they opt out from the management, they did not receive information about the day to day management of the company. The basic reason behind this problem is that in India there is no special formal mechanism through which the directors can share information with the promoters. So, it is upon the discretion of directors how much information they would share with the promoter through informal mode. According to SEBI PIT (Prohibition and Insider Trading) Regulation, 2015 (hereinafter referred to as "SEBI PIT"), and SEBI LODR (Listing Obligations and Disclosure Requirements) Regulation, 2015 (hereinafter referred to as "SEBI LODR"), there is an equal treatment among the promoters and the shareholders. So, there is no specific provision regarding disclosure of information to the promoters [2].

Detail discussion on Infosys dispute, current information mechanism, and the recommendations of SEBI are given below in the following heads.

INFOSYS DISPUTE

It seemed that there was a dispute inside Infosys between a promoter and the CEO. The issue of dispute was old governance policy when matter relates to disclosure of major policy decisions. After Tata dispute, Infosys saga adds a new chapter in the book of India corporate wars. The crux of the dispute was sharp pay hike in Sikka's compensation, appointment of Punita Sinha, wife of a union minister as an independent director (ID), and hefty severance pay to some departing employees [3]. The chapter of dispute has been unfolded in the following sub-heads.

Composition of Board of Directors

The total number of directors in Infosys are ten, out of who might be IDs, one managing director, and one whole-time director [4]. One of the points of dispute was that the promoter Mr. Murthy was not happy with the appointment of Mrs. Punita Sinha as an ID, and also with the composition of the board [3].

Nomination and Remuneration Committee

Infosys comprises five members in their Nomination and Remuneration Committee, headed by Prof. Jeffrey S. Lehman [4]. The role of this committee is important in this saga because of the recent hike in salary of Mr. Sikka and providing 100%severance pay to some employee sin Feb 2016, which was opposed by Mr. Murthy [5].

Role of ID in the Dispute

Role of the ID became very critical as the matter related to resolving the dispute between the promoter and the director. The IDs represent the interests of minority shareholders. Infosys consists of eight IDs in their board but appointment of Mrs. Punita Sinha, and criteria of appointment, was another issue in the dispute.

Role of Mr. Murthy

After "opt-out" from Infosys, Mr. Murthy held 1% share because of SEBI LODR regulation, which says that in case where company becomes professionally managed, a promoter cannot hold more than 1% share after they "opt-out" from business [2]. But in this dispute, Mr. Murthy played a very important role despite the fact that he did not have large shareholding. He questioned the Panaya acquisition and through mail to SEBI and media in February 2017. He acted as a whistleblower; he also sent letters to the advisor questioning the leadership ability of Mr. Sikka [2].

Governance Issue

Governance issue was raised by both sides. Mr. Murthy claimed that he was not getting information from anyone on major policy decisions while Mr. Sikka countered by saying that there was no formal mechanism in India's Corporate Governance Policy, which bound him to disclose any kind of *unpublished price-sensitive information* (hereinafter referred to as "UPSI"). Around 1800 employees were not satisfied with the governance policy in Infosys; so, they wrote a letter to Mr. Murthy in this connection.

Current Provision of Infosys on Disclosures and Transparency

Currently, in Infosys there is a board-level stakeholder committee for solving the problems of stakeholders and investors. This committee directly reports to the board. But when a matter specifically relates to share certificate, dividend, and change of address, a shareholder needs to communicate with Karvy Computershare Private Limited [4]. Infosys mails their annual report to such members whose email ids are registered with the company, but there is no disclosure when the matter is relates to depository receipts or credit rating. There is no provision with respect to searchable format of disclosure reports and also no provision regarding disclosure of financial indicators such as debtor turnover, inventory turnover, etc. [2].

Current Information Exchange Mechanism

According to Infosys insider trading policy, SEBI PIT regulation, and SEBI LODR regulation there is equitable treatment of disclosure of UPSI [6]. Equitable means there is no specific formal mode through which a director can share information to (opt-out) promoter; all shareholders will be treated on equal basis. The crux of the dispute in Infosys related to this mechanism and Mr. Murthy rightly claimed that this type of governance policy is not effective in India because Indian listed entities continue to be promoter driven.

SEBI REPORT ON CORPORATE GOVERNANCE

After considering various disputes like in Tata and Infosys in our country, SEBI tried to resolve this problem and find out the main problem in this dispute. So, they formed a committee on corporate governance headed by Mr. Uday Kotak. This committee recommended various amendments and various suggestions on the matter of corporate governance. The report is evolutionary rather than revolutionary. Suggestions given in this report with reference to improvement of exchange mechanism are elaborated below under following heads.

Role of Directors in Information Exchange Mechanism

The committee pointed out that it is the general principal that in a corporate entity, the control, direction and affairs relating to its business lie with its board of directors. Currently, the Companies Act and SEBI LODR impose certain restrictions. The minimum number of directors in the board of a public limited company would be three, with at least one women director on the board of directors; there is no minimum number of attendance required; no specific regulations to disclose the required and available expertise of the board; at least four meetings in a year are compulsory; and there is no provision regarding the up gradation program of skills and knowledge of IDs in specific areas [2].

This report suggests various amendments and believes that composition and role of directors need some gradual reforms so they can deal with such kinds of situations easily and ultimately help the organization in smooth communication. The committee suggested that minimum number of directors should be increased to six, at least one women independent director, minimum 50% attendance is necessary, make it mandatory to disclose the diversity of board members, minimum number of meetings also increased to five and also make it mandatory to conduct skill and knowledge up gradation program for independent directors. The basic idea behind these suggestions is to make the board more skillful and competent to tackle such kinds of situations as seen in Infosys [2].

Role of IDs and Their Duty in the Process of Communication

The committee was very much concerned about role of IDs because IDs represent the interests of minority shareholders. The committee tried to empower ID position in listed entities, in the current situation according to the Companies Act and SEBI LODR regulations that impose that at least one-third of the directors in a board of a listed entity must be IDs. The ID is required to provide a declaration that he/she meets the legal criteria of "independence" given under Section 149(6) of the Companies Act and SEBI LODR 16(1) (b) regulation; also SEBI LODR does not prescribe the minimum compensation to be paid, no training provision is given for IDs and if any ID resigns before the expiry of his/her term, there is no specific time limit to disclose the reason behind the resignation [2].

The committee suggested that to enhance and improve the communication exchange mechanism, IDs should be empowered. The committee reported that the minimum number of IDs in the board should be increased to half of the total board composition; the report also suggested that the test for "independency" of an ID should be done on both "subjective" and "objective" and minimum Rs. 5 lakhs for top 500 companies should be fixed as remuneration for an ID. The basic idea behind fixing a higher amount of remuneration was to attract well-qualified persons, which would ultimately help the communication exchange mechanism because the ID will act as a mediator between the promoter and the board of a company [2].

Reclassification of Promoters

Currently, according to SEBI LODR regulation, if a company becomes professionally managed, then "opt-out" promoter should not hold more than 1% shareholding of the company [2]. As such, Mr. Murthy also holds 1% share in the company. This restriction imposes limitation on control and reduces the accountability of the directors towards the promoter. In a country like India, where the promoter group tries to drive business and affairs of the company, it will turn out to be hazardous.

So, the committee suggested that the maximum limit should be raised from 1% to 10% of total shareholding; the current recognition is helpful from both the promoter's and the director's point of view. The promoter viewed this as a relief that he/she should not release all his shareholding after "opt-out" from business, and also got reasonable amount of shareholding, it is beneficial for the business entity also because the amount of shareholding is not too large for a promoter that he is in the position to exercise *de facto* control.

New Mechanism for Information Sharing

Currently, the listed entities adopt equitable treatment of information as described above in the head of "current information exchange mechanism." There is no specific formal mechanism for the promoter. The committee pointed out that information flow occurs through informal mode. Generally, the information is related to acquisition, merger, UPSI, etc. These types of operations need support from promoters. In other words, we can say that information has been shared to promoters in shadow and in the absence of good relations between the director and the promoter; it will turn out to be a disaster for the company as seen in case of Infosys. Legal interpretation says that the promoter has the right to information when the matter is related to "legitimate purpose" or "need to know." In that situation, only the promoter can obtain UPSI [2].

The committee felt that there is an ambiguity in the current bench mark "legitimate purpose" because it varies from case to case and there is no fixed formal exchange mechanism. After due consideration, the committee recommended a regulatory framework through which a transparent framework regulating the information right of certain promoters and significant shareholders can be drawn when the matter relates to UPSI. The report suggests an agreement through which exchange of information should be done. The agreement is divided into three parts, as given below.

Definition

1. "Agreement" means an agreement which gives titled access of information to those who entered in this agreement.
2. "Counterparty" means a person
    i. Promoter of the listed entity and hold by itself or together with the member of promoter group, shareholding of more than 25 % in the listed company.
    ii. Is in direct or indirect control of the person specified in sub- clause (i)
    iii. Has nominated a director on the board
3. "Unpublished price sensitive information" means any information, which directly or indirectly relates to the company or its securities that is not generally available, which upon becoming generally available, is likely to materially affect the price of securities of the company.

Information Right under the Agreement

This part of the recommendation says that a listed entity may enter into an agreement and provide access to information including UPSI to the counterparty as per the terms of agreement but if a person has nominated a director on the board of directors, he shall be provided only such material information which is shared by the nominee director in the normal course.

Terms of Agreement

This head will include the terms of agreement which are given below:

1. It is the duty of the counterparty to maintain strict confidentiality of material information.
2. Every party should take appropriate safeguards in respect to procedure for communication and procurement of material facts, and also categorize the individual representative of the counterparty who is the recipient of UPSI as a 'Designated Person' as given under code of conduct sub-regulation (1) and (2) of Regulation 9 of SEBI Prohibition of Insider Trading Regulation, 2015.
3. The counterparty may be categorized as a 'Designated person' by the listed entity, at the time of entering into agreement or at any time during the subsistence of the agreement pursuant to an assessment by the board of a company.
4. The listed entity has no responsibility for the accuracy of the material facts.
5. The counterparty must disclose the use of information.
6. The information given according to the agreement should not undermine the

independence and autonomy of the board of directors.

7. The listed entity has the right to withhold the property, if the board of directors determines that:
   - *i* The access of information is against the interest of listed entity
   - *ii* There is a conflict of interest between the listed entity and the counterparty.
   - *iii* There is breech of agreement by the counterparty and this has been established by the investigation committee, established by board of directors.
9. Term and termination of the agreement:
   - *i* The term of the agreement shall not be less than one year.
   - *ii* If the counterparty was not eligible in the category defined above in the definition clause, then there will be automatic termination of the agreement.
   - *iii* The listed entity shall have the right to terminate the agreement with the consent of the majority of the directors.
10. In case of termination (other than expiry of normal time), the parties may enter into a new agreement. After entering into the new agreement, the entities shall disclose the fact of entering into agreement, names of counterparty and termination of agreement, and a listed entity may enter into an agreement after amending its articles of association [2].

Rules regarding Disclosure and Transparency

Currently, the Companies Act provides for disclosure of related party transaction in the board report on approval of the shareholders in certain cases. But annual report is mailed only to those members whose email ids are registered with the company and there is no specific provision in the Companies Act or SEBI LODR regulation with respect to 'search ability' of the disclosure [2].

In order to strengthen transparency on matters related to party transactions, the committee suggested the following things:

1. Half-yearly report on related party transactions should be disclosed, on the website of the company in a searchable format and within 30 days of publication of half-yearly financial result. Copy of the same be also submitted to the stock exchange. Also, strict penalties may also be imposed by SEBI if the legal entities did not file disclosure of related party transactions report.
2. In addition, the committee felt that currently there are certain promoters/promoter groups that are not treated as "related party" under SEBI LODR regulation. So, the committee suggested that all promoters/promoters group that hold 20% or above in a listed company will be treated as "related parties" for the purpose of SEBI regulation [2].

CONCLUSION

Information exchange mechanism is a part of corporate governance and corporate governance deals with not only *de jure* but also *de facto* aspect of the law. In this context, the role of SEBI becomes very vital to regulate this kind of policy. In India, where the promoter tries to drive an entity, it is important to inform him about the affairs of the company but it is a harsh reality that there is no specific formal provision for the promoters, through which they can get material information, which ultimately causes disputes like Infosys where the promoter claimed that he was not satisfied with the governance policy of the company. The committee headed by Mr. Uday Kotak recommended suggestions on every aspect of communication receiver, sender and communication channel (promoter, director and information exchange mechanism), these recommendations try to establish a base for formal exchange mechanism in India. But this committee also had some loopholes such as ministry of finance pointed out that increase in the limit of shareholding of the promoter in a professionally managed company from 1% to 10% is too high. So, they suggested to decrease it to 5% instead of the proposed 10% to protect the interests of the investors.

Since the current equitable treatment mechanism for information sharing is insufficient to tackle complex situations as seen in Infosys and recommendation of this committee will come into effect after 2020, so the time between these two major events, the listed entities must impose proper checks and balances so they can avoid disputes in their corporation.

ACKNOWLEDGMENT

I, Shrashank Tripathi and my co-author Yashashvi Mishra would like to express my special thanks of gratitude to my faculty Mr. Shail Shakya (Asst. Professor, Faculty of Law DSMNRU, Lucknow) who gave suggestion to do research on this wonderful topic "Exchange of Information between promoter and Director with reference to Infosys Saga" which also helped me in doing a lot of research and I came to know about so many new things.

CONFLICT OF INTEREST

The authors declare no conflict of interest.

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Cite this Article

Shrashank Tripathi, Yashashvi Mishra. Exchange of Information between Promoter and Director with Reference to Infosys Saga. *Journal of Corporate Governance & International Business Law*. November 2018; 1(2): 10–15p.