

**PRACTICE NOTE ON
MODEL ARTICLES OF ASSOCIATION/BY-LAWS
FOR WHOLLY-OWNED SUBSIDIARIES**

Practice Notes represent the author's view of good practice in a particular area. They are not legal advice and the author will not accept any legal liability in relation to them.

N.B. This Practice Note should be read in conjunction with the Practice Note on Governance of Foreign Subsidiaries.

Issue

When a company owns 100% of the shares in a subsidiary, it does not have to put in place elaborate procedures to protect the interests of minority shareholders. To save time and money, companies should take advantage of whatever tools are available to them under the local companies law to simplify the administration of their wholly-owned subsidiaries around the world.

The parent company should, however, make sure that it retains effective control, directly or indirectly through the Board of Directors, over the decision-making power of its subsidiaries – especially when they are out of sight in distant countries.

Strategy

Subject to local law, companies should strive to have the constitutional documents of their wholly-owned subsidiaries (such as the Articles of Association and By-Laws, which go by other names in different jurisdictions) provide for as much ease and flexibility in the subsidiaries' governance as possible by including the following provisions:

- The scope of business should be as broad as possible (so that it does not have to be amended if the company goes into a different business).
- The term of the company should be indefinite (so it does not have to be extended).
- The company should have the minimum capital required by law (so that it does not tie up more money than necessary).
- The accounting period of the company should mirror the parent company's accounting period (usually the calendar year).

- Board of Directors
 - The Board of Directors should be comprised of an odd number of three or more Directors (to avoid possible tie votes).
 - In general, no compensation should be paid to Directors (since they should normally be employees of the parent company who are already paid a salary by the parent company).

- Board of Directors Meetings
 - Any Director (not just the Chairman of the Board) should be able to call a meeting of the Board of Directors.
 - Board of Directors meetings should be able to be convened by e-mail.
 - Board of Directors meetings should be able to be held in any location and by videoconference or telephone conference call.
 - In lieu of meetings, the Board of Directors should be able to act by written consent signed by all Directors.
 - Directors should be able to give proxies to other Directors to attend meetings in their place.

- Shareholder Powers
 - To make sure that the parent company (which represents the shareholder and may be far from its foreign subsidiary) stays in the loop, the following matters should be reserved for decision by the shareholders:
 - Approval of financial statements
 - Approval of payment of dividends
 - Approval of amendments to the Articles of Association
 - Approval of increases or decreases in registered capital
 - Appointment of auditors
 - Appointment and recall of members of Board of Directors
 - Decision to merge, transfer business assets, convert legal form, liquidate
 - Other matters entrusted to shareholders by law
 - The shareholders or their representatives should also have unrestricted access to all the business and accounting records of the company, in both paper and electronic form (to authorize the conduct of internal audits either by the group internal audit department or by external auditors mandated by the group).

- Shareholder Meetings
 - The Board of Directors and any shareholder holding 10% or more of the shares in the company should be able to call a shareholders meeting (to make sure that a recalcitrant Board of Directors cannot prevent or delay the holding of a shareholders meeting – for example, to replace one or more of the Directors).

- Shareholder meetings should be able to be convened by e-mail.
- Shareholder meetings should be able to be held in any location and by videoconference or telephone conference call.
- In lieu of meetings, shareholders should be able to act by written consent signed by all the shareholders.

Conclusion

When drafting the constitutional documents for wholly-owned subsidiaries, the byword should be: Keep it simple. But make sure that the shareholder retains the authority and means to approve all major corporate transactions, and to replace the Directors and managers.

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