

## **PRACTICE NOTE ON GOVERNANCE OF FOREIGN 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.*

### **Issue**

A group with international operations can have dozens – and in some cases, hundreds – of subsidiaries incorporated in countries around the world. For internal control purposes, the group must ensure the effective corporate administration of each subsidiary (hold director and shareholder meetings, make necessary company filings and registrations), develop and follow strict governance rules for each subsidiary (composition of board of directors, delegation of powers), and be able readily to access and update corporate data for each subsidiary.

### **Strategy**

The comments below relate to wholly-owned subsidiaries. Joint ventures will be subject to their own, negotiated governance rules.

### **Corporate Administration**

The objective should be to keep the corporate administration of wholly-owned subsidiaries as simple as possible in each country.

If a group is unable to handle the corporate administration of its subsidiaries internally, it should outsource statutory compliance work to a specialist service provider. Normally, this service is performed by local law firms or audit firms. In some countries (typically, former British colonies), they are performed by specialist company secretarial service providers (“company secretary” is a uniquely English profession). Some service providers are able to perform such services regionally, or even globally. If a group has more than one subsidiary in a country, it should consolidate the provision of company secretarial services with a single service provider to both reduce costs and improve internal control.

Routine statutory compliance work should include the following:

- Annual legal maintenance services, including drafting minutes of meetings of the board of directors and shareholders approving the annual accounts, the declaration of dividends, the appointment of auditors, etc., and making the related filings with the local commercial registry, as required under applicable law.

- Additional routine company secretarial services, including the drafting of routine resolutions for adoption by the board of directors and/or shareholders relating to the removal or replacement of officers, directors or auditors, and the amendment of by-laws, and making the related filings with the local commercial registry.
- Safe-keeping of the company's minute books and corporate records.

### Meetings

When a subsidiary is wholly-owned, the board of directors represents a single shareholder which eliminates the need to hold extended meetings to consider various company actions. In an effort to ease the time and expense of administration, it is therefore recommended that such subsidiaries hold the minimum number of meetings and adopt the minimum number of resolutions required to be in statutory compliance.

### Single Articles of Association Per Country

Ideally, all wholly-owned legal entities in each country should have identical Articles of Association which reflect current best practices in each country in order to facilitate corporate administration (e.g., provide for written consents in lieu of meetings, meetings by video or audio conference, appointment of proxies to attend meetings, convening of general meetings by any shareholder holding more than 10% of the shares of the company).

If possible, the Articles of Association should also include certain provisions intended to facilitate subsidiary governance, including the following:

- The shareholders can appoint new directors by written resolution in lieu of a meeting. (This provision is intended to avoid having to hold a general meeting simply to replace a director.)
- The shareholders or their representatives have unrestricted access to all the business and accounting records of the company, in both paper and electronic form. (This provision is intended to authorize the conduct of internal audits either by the group internal audit department or by external auditors mandated by the group.)

An English translation of the Articles of Association should be approved by the group before they are adopted by the local entities and registered with the necessary authorities.

The benefits of replacing the Articles of Association of all companies in each country may, however, not justify the cost, especially in those countries where changes to company law will be deemed to apply even if not included in the Articles. In those countries, it may be enough simply to amend the Articles to include the new subsidiary governance provisions.<sup>1</sup>

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<sup>1</sup> For more such provisions, see the Practice Note on Model Articles of Association/By-Laws of Wholly-Owned Subsidiaries.

## **Governance**

### Composition of Subsidiary Boards

The board of directors of a subsidiary represents the shareholder and oversees the management of the company. Consequently, control of the board should always be held by representatives of the group and not of the local management. Whenever possible under local law, the board of a subsidiary should ideally be comprised of:

- CEO of the subsidiary
- Supervisor of the CEO of the subsidiary (e.g., the Regional CEO)
- CFO of the supervisor of the CEO of the subsidiary (e.g., the Regional CFO)

In other words, to the extent possible the governance structure should mirror the management reporting structure.

To ensure compliance with this rule, the appointment (and removal) of all directors should be approved in advance by the group general counsel (or equivalent).

Board members are expected to act in good faith in what they reasonably believe to be in the best interests of the group, including ensuring that the entity is run in accordance with group policies.

Board members of majority-owned subsidiaries should normally be covered by the group's Directors & Officers insurance policy.

### Delegation of Powers

The board of directors can authorize individuals to act on behalf of the company by adopting resolutions to that effect. One of the most important powers is the so-called "treasury" power, authorizing the attorney-in-fact to operate the company's bank accounts. For better internal control, it is recommended that two signatures be required for all banking transactions, and that one of the two signatories be the company's finance director (or equivalent) – at least when large sums are involved.

In some countries, management authority can be held jointly as well as individually. For example, in Germany the authority of a "Geschäftsführer" (Managing Director) of a GmbH (limited liability company) can be formally and publicly registered as either individual or joint (together with another "Geschäftsführer" or a "Prokurist") and therefore be binding on third parties. In other countries, such as Spain, no limitation can be placed on a manager's plenary authority which is binding on third parties. A company may nevertheless impose a limitation of joint authority on the manager by way of a board resolution, and the manager's employment contract can stipulate that breach of such limitation would be grounds for termination for cause.

All powers of attorney should be limited in time – usually for one year – to avoid the logistical complications inherent in their revocation, especially if the original power cannot be located.

Finally, the company (and the group) should maintain and update a register of all powers of attorney listing the name and country of the issuing legal entity, the name

of the attorney-in-fact, the subject matter of the power and its geographic limitation (if any), the location of the original power, the date of issuance, and the date of expiration/revocation. It should also keep photocopies of the powers.

### Proxies for Attendance at Shareholder Meetings

Proxies authorizing a proxyholder to vote on behalf of the shareholder at shareholder meetings should be sent to the person responsible for corporate administration together with all information and documentation necessary to enable the responsible person to instruct the proxyholder to vote on the group shareholder's behalf. Proxies should be requested within the notice period required under local law.

Having the group receive proxies and all related information is a key control which makes sure that the group is aware of and approves corporate changes such as the appointment of new directors.

### **Corporate Database and Legal Structure Chart**

In order to be able to readily access subsidiary data, groups with dozens or hundreds of subsidiaries should consider licensing one of the sophisticated web-based corporate data management products that are available in the U.S. (e.g., Secretariat), UK (e.g., Blueprint OneWorld, GEMS) and in some other countries. Some databases can be used to prepare rudimentary legal structure charts, but a customized software (e.g., Visio) makes it possible to create data-rich legal structure charts.

In addition to the charts, it is recommended that every significant change of subsidiary corporate data be tracked separately and chronologically for historical reference purposes.

### Update Corporate Data

It is essential that the information in the group's corporate database of its legal entities be accurate and up to date and can be relied upon, for example, to determine whether the financial results of a legal entity should be consolidated with the group's results.

To ensure that the corporate database is accurate and up to date, the person responsible for maintaining the company secretarial data records of each entity should immediately notify the person responsible for maintaining the corporate database by e-mail of any of the following changes to a legal entity:

- Change of corporate name
- Change of corporate form (e.g., from a corporation to an LLC in the United States, or from an S.A. to an SAS in France)
- Change of registered address
- The appointment, re-election or removal of directors (providing the full name and position of each director)
- Change of share capital or nominal value per share
- Transfer of shares (identifying the number of shares, the transferor and the transferee)
- Creation or closing of a division or a branch
- Spin-off of an activity into a new company

- Merger into another company
- Liquidation or dissolution

Each notification should provide the exact date of the change and provide a digitally scanned copy of appropriate documentary proof of the change. In a country that has a commercial registry, the best documentary proof is an extract from the commercial registry that shows the change. For changes relating to the transfer of shares, a scanned copy of the signed share purchase agreement or the signed share transfer agreement should be provided.

Since it is foreseeable that not all changes will be notified, it is recommended that twice a year the person responsible for corporate administration send to each person directly responsible for each legal entity the company profile of the legal entity that is generated by the database and ask the responsible person to confirm that the database information is up to date. If it is not, the responsible person should promptly notify the person responsible for corporate administration of the changes as set forth above.

### **Conclusion**

Effective corporate administration of foreign subsidiaries, including implementation of appropriate governance rules, is an important internal control issue for international groups. Failure to provide such control may not only result in statutory compliance problems, but potentially in serious operational issues (e.g., as a result of loss of control of the board of a subsidiary). As with most legal risks, an ounce of prevention is worth a pound of cure.

1 June 2016