Best Practices in Global Subsidiary Compliance

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Increased Focus on Governance

- Scandal and financial disaster
  - WorldCom, Enron
  - Raised questions about board of director and auditor effectiveness
  - Increased federal government involvement in governance practices of public companies
- Sarbanes-Oxley
- FATCA - Foreign Account Tax Compliance Act
- FCPA – Foreign Corrupt Practices Act
- Federal Sentencing Guidelines
- Financial Services Act
- Anti Bribery Act
Good Governance

- The rules, processes, and practices by which a company is directed and controlled.
  - Critical for ensuring compliance by the corporation

- Governance involves the balancing of the interests of many stakeholders.
  - Shareholders, management, customers, employees, suppliers, financiers, government, community

- Maintaining good governance and corporate separateness mitigates risks

- Ensures accuracy of reporting and recordkeeping

- Governance reflects a company’s culture.
Under Delaware law, the courts generally respect the separate legal existence of different legal entities.

In appropriate circumstances, a court may “pierce the corporate veil,” i.e., disregard the legal separateness of a corporation or limited liability company and hold a parent corporation liable for the debts or actions of one of its subsidiaries.
• Under the Delaware General Corporation Law, unless the corporation’s certificate of incorporation provides otherwise, “the stockholders of a corporation shall not be personally liable for the payment of the corporation’s debts except as they may be liable by reason of their own conduct or acts.”

• Under the Delaware Limited Liability Company Act, “the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.”
• Delaware courts have been traditionally reluctant to disregard the corporate form absent a showing of extraordinary circumstances.
  

• No bright line rules
  
  • Because veil piercing is an equitable doctrine, there are no bright line rules that plainly establish when it will apply.
To prevail in a veil-piercing claim, a plaintiff must show that the corporation is the mere instrumentality or alter ego of its owners and the corporate form has been used to perpetrate a fraud or an injustice.

The alter ego analysis is a fact specific inquiry. The factors that the Delaware courts have considered include a consideration of whether:

- The corporation was adequately capitalized for the corporate undertaking;
- The corporation was solvent;
- Dividends were paid;
- Corporate records were kept;
- Directors and officers functioned properly;
- Other corporate formalities were observed;
- The dominant stockholder siphoned corporate funds;
- The corporation simply functioned as a façade for the dominant stockholder;
- There were overlapping directors and officers; and
- The subsidiary corporation and the parent entity shared the same address.
• Even if most or all of the alter ego factors are present, the Delaware courts will not pierce the corporate veil unless there is an element of fraud where continued recognition of the corporate form would work an injustice.

• Additionally, the fraud must come from an inequitable use of the corporate form itself as a sham, and not from the underlying claim.
Areas of Responsibility for Good Subsidiary Management

- Educate, provide advice and counsel on all aspects of subsidiary governance (including affiliates and JVs)
- Partner with business units on company transactions
- Prepare and file governance documents for subsidiaries, affiliates and joint ventures
- Assist foreign subsidiaries in the preparation of governance documents
- Maintain a central repository of governance documents
- Promote consistency and best practices
**BUSINESS NEED**
- High Risk Activity
- Joint Activity
- Tax Justification
- Separate Line of Business
- Local Requirements
- Acquisitions
Subsidiary Lifecycle

**PLANNING**
- Jurisdiction
- Type of Entity
- Tax Implications
- Directors and Officers
- Governance
- Reservation of Name
- Capitalization Requirements
Subsidiary Lifecycle

**DOCUMENTATION**
- Charter Documents
- Bylaws or Agreement
- Misc. Registration Forms
- Resolutions or Actions
- Database

**Steps in the Lifecycle**
1. **Business Need**
2. **Planning**
3. **Organizational Activity**
4. **Filing and Registration**
5. **Ongoing Maintenance**
6. **Exiting**

Each step is connected to the next, forming a cycle.
U.S. Formation: Governing Documents

• Corporation: Articles & Bylaws
  – Location of offices
  – Rules governing shareholder & director meetings
  – Number, election, removal of directors/creation of committees
  – Titles and duties of officers

• LLC: Operating/LLC Agreement
  – Style of management (member managed/manager managed), meetings, new members, indemnification
  – Number, election, removal, resignation, vacancy, powers and authority of managers
  – Officer titles and appointment/removal
  – Fiduciary duties (can be waived in Delaware)

• Partnership: Partnership Agreement
Each jurisdiction has its own requirements, which may be very different from the U.S.

- May need to file annual accounts and report changes in legal representatives, directors, shareholders, auditors and to the regulating authority
- May have limited authority (e.g., branches and representative offices)
- In most non-U.S. countries, directors have authority to sign documents on behalf of the company (very different from U.S.)
- May have governmental filings associated with increasing capitalization and these increases may be triggered automatically by sending employees into certain jurisdictions to perform duties

Potentially serious consequences for missing filing deadlines

- Directors may receive notices at their home addresses
- Directors may be detained by the authorities
- Directors may be subject to personal liability and sanctions

Consider having your service provider perform an audit to confirm that all legal requirements have been satisfied
FILING AND REGISTRATION

- Domiciliary State
- “Foreign” States
- “Overseas” Jurisdictions
- SS-4 EIN
- State and Local Taxes
Subsidiary Lifecycle

ORGANIZATIONAL ACTIVITIES

- Meeting
- Adoption of Bylaws or Ratification of Agreement
- Banking Resolutions
- Delegation of Authority
- Intercompany Agreements
Subsidiary Lifecycle

ONGOING MAINTENANCE

- Periodic Meeting or Consents
- Annual Meetings or Action of Shareholders or Parent and of Subsidiary
- Renewal with State Agencies
- Annual Compliance - domestic and foreign
- Capital contributions & dividends
SUBSIDIARY LIFECYCLE

EXITING
- Proper Planning
- Dissolution vs. Merger
- Documentation
- Withdrawal
- Filing Tax Returns
- DBAs
Unique Challenges with Joint Venture

- Joint ventures present many challenges for the corporate secretary’s office
  - Who maintains corporate records?
  - Who serves as corporate secretary?
  - What is the composition of the board?
  - Who has signature authority for the JV?
- Joint venture agreement should detail how these governance issues will be handled
- Directors and officers of joint ventures need to fully understand their duties and responsibilities – significant risks of conflicts of interest
Types of data managed

- Legal entity information
- Jurisdictional qualifications
- Stock/Capital & ownership information
- Officer, Director, Management records
- Registered offices
- Auditor information
- Bank accounts
- Minute books
- Organizational charts
- Information unique to your company
- Single repository for key company & governance information
- Security & Privacy
  - Disaster recovery for your data & documents
  - Controlled accessibility
  - Audit trail
- Communication & collaboration
- Document management
- Organizational charts
- Compliance Calendar
  - Alerts & notifications
- Reporting
Top Ten Tips for Subsidiary Compliance
10. Ensure You Have Necessary Resources

- Can be difficult in the current economic environment
- Utilize other departments if possible
- Document costs and expenditures, and look at ways that you can reduce them without adversely affecting your effectiveness
- Be honest about what you can deliver and the risks
9. Take Advantage of Technology

- Use and maintain a database that is appropriate for your company size and the number of subsidiaries
  - For some, an Excel spreadsheet is adequate while others need a more sophisticated package
- Utilize your registered agent’s website for ordering good standing certificates, forms, etc.
- Utilize other online resources (e.g., Secretary of State websites, Society of Corporate Secretaries & Governance Professionals websites)
8. Keep Your Information Current

- It is critical that your subsidiary information be kept current.
- Carefully consider what information you want to track in your database and the level of access to give to persons outside the corporate secretary’s office.
- Authorize only a few people to update your database and don’t update without first obtaining the signed written consents or minutes.
- Develop a system to annually audit and update your information.
7. Know and Review Your Service Providers

- Maintain a database of service providers – this is particularly important for non-U.S. entities where you will need assistance from service providers for most in-country activities
- Be honest with yourself about what you can do in-house and what needs to be handled by outside counsel (e.g., tax filings, etc.)
- Look for cost savings through consolidation of service providers
6. Train Your Subsidiary Directors and Officers

- Provide subsidiary directors and officers with training regarding their duties and responsibilities
- Survey your subsidiary directors and officers on an annual basis to ask:
  - Are your entities correct?
  - Are your appointments correct?
  - Do you accept and understand your corporate governance responsibilities for your roles?
5. Protect the Corporate Veil!

- Important to maintain corporate separateness – keep in mind when appointing overlapping subsidiary directors and officers
- Remember to hold annual meetings and obtain requisite approvals from the subsidiary’s board of directors and/or shareholders
- Document all intercompany transactions (e.g., intercompany loans, intercompany sales or service agreements)
4. Be Aware of Differences Between Jurisdictions

- Don’t assume that every state is the same as Delaware – When in doubt, read the statute
- Non-U.S. subsidiaries are a trap for the unwary. You need local advice and assistance in complying with local law
3. Periodically Review Your Corporate Structure

- Review dormant entities to determine if they can be eliminated (either through dissolution or liquidation)
- Keep up to date on changes in law that may affect your structure (e.g., changes in tax treaties that may affect offshore holding company structures)
- Be sure that management understands the costs associated with adding new entities to your corporate structure
2. Create Strong Internal Processes

- Develop standard policies, practices and procedures for subsidiary governance
- Develop process to make sure that all constituencies (Legal, Tax, Treasury, Accounting, Operations) are aware of and have signed off on actions to be taken
- Do not backdate documents (e.g., minutes, written consents, powers of attorneys)
- Calendar due dates for annual meetings, annual report filings, etc.
1. Network Within and Outside Your Organization

- Use your contacts in other parts of the organization (e.g., Human Resources) to help you keep up to date on developments affecting your subsidiaries
- Develop a core team of company contacts to assist on subsidiary management issues
- Increase awareness through a corporate secretary’s page on your intranet site, with links to important information
- Talk to your peers outside the company regarding best practices and to stay abreast of new developments
Questions?
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