Subsidiary Focus
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Parent and Subsidiary Responsibilities and Oversight: A Primer for New Relationships

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By all accounts, 2021 has been an enormous year for mergers and acquisitions, far outpacing the pandemic-paused dealmaking efforts of 2020. As complex combinations take effect and begin operationalization, basic premises of good corporate governance hygiene remain important. Companies that were independent operators are now often subsidiaries to a parent company, and both parties are navigating their new roles. This article provides a high-level reminder of the powers held and obligations owed by subsidiary board members and how parent organizations can maintain oversight of subsidiary boards without micromanaging their operations and risking veil-piercing for lack of corporate independence.

1. Subsidiary directors are responsible for managing the subsidiary and owe the subsidiary fiduciary duties.

Individuals who serve on the board of directors are obligated to make decisions in the best interest of that organization. For some parent organizations, this concept may seem like they are ceding control of a key asset. However, subsidiary directors are generally beholden to the same five fiduciary obligations as those of parent directors:

- **Duty of care:** A director is obligated to use good faith to advance the corporation's best interest, using the same care that an ordinary person would use in such circumstances. Generally, this requires a director to be reasonably well-informed before making corporate decisions.
- **Duty of loyalty:** A director must put the corporation's interest ahead of their own when those interests conflict or diverge.
- **Duty of obedience:** A director is obligated to maintain the corporation's operations in compliance with its mission and applicable laws and regulations and to ensure that the corporation is not engaging in activities prohibited by law or the corporation's governing documents.

- **Duty of good faith:** A director must make decisions with a recognition that they are acting on behalf of the corporation in a morally commendable way that avoids intentionally oppressing others.
- **Duty of disclosure:** A director is obligated to share material information within such director's control when requesting shareholders to act.

While not all of these duties are enforced in every state, and not every duty applies to all corporate forms, in the aggregate they provide a comprehensive framework that can serve as excellent training and orientation material to instruct new subsidiary directors on the breadth of situations to which such duties apply (i.e., in all situations when acting as a board member). Discussing fiduciary duties also gives an opportunity to remind them of the expectations that a parent organization has for the subsidiary and that the subsidiary should have of its directors. Further, a failure to adhere to one's fiduciary obligations can lead to a board member being dismissed or

➜ Key Board Takeaways

- Training orientations are important for communicating board member expectations. Some key topics to cover include:
  - Fiduciary responsibilities
  - Corporate mission, ethics, and culture
  - Relationship to parent organization
  - Communication pathways
  - Conflicts of interest
  - Subsidiary board and subsidiary management relationships
- Questions that subsidiary board members should ask when onboarding and that parent organizations should ensure its subsidiary can answer are:
  - What is the parent corporation's level of oversight, including reserved powers?
  - How does the board define and manage conflicts of interest?
  - What are the subsidiary's short-term needs, and how do those align with the overarching mission?
  - Who else is on the board and how did they get there?
  - Who are our various stakeholders and how are we serving them?

asked to resign or, in situations involving gross negligence or reckless misconduct, a potential for personal liability.

2. Parent corporations can use formational documents and reserve powers to maintain oversight.

If a parent corporation does not want to rely solely on general corporate fiduciary duties to ensure that a subsidiary board is acting in the best interest of the corporation, provisions in corporate formational documents (i.e., articles of incorporation and bylaws) can prove useful in retaining some manner of oversight over key subsidiary actions. At a minimum, a parent organization often retains reserved powers to:

- Amend or approve the amendment of the subsidiary's articles of incorporation and bylaws.
- Nominate, elect, or remove directors and officers.
- Adopt or amend the subsidiary's mission or purpose.
- Approve an annual operating budget, including capital expenditures or incurrence of debt.
- Dissolve or wind-up the subsidiary's operations.

These reserved powers, among others crafted to address any applicable needs, allow the subsidiary directors to manage the subsidiary corporation while keeping intact the fundamental reasons for why the parent–subsidiary relationship exists.

3. Compliance with corporate codes and overall mission can keep directors focused on shared goals and expectations.

Along with formational documents, directors should also look to the corporation's mission, code of ethics, and code of conduct when beginning their service and managing the subsidiary corporation. These documents describe with increasing degrees of specificity the foundational principles that should undergird a board's decisions and define the corporation's identity.

The **mission statement** guides the organization towards using a unified, predictable voice. Directors' decisions should comply with and advance the organization's mission, particularly in charitable organizations where the mission justifies the entity's tax-exempt status.

A **code of ethics** often establishes overarching and broad expectations of behavior for officers, directors, and employees in ways that hearken back to elementary school. Be kind. Be inclusive. Conduct yourself professionally. Work together. Differences make us stronger. Keep secrets to yourself. Make decisions objectively. These principles apply to a director's duties to the company as well as the company's duty toward its customers and the community at large.

A **code of conduct** often focuses a director's behavior on the day-to-day work environment and provides a template for managing issues in a predictable and objective way. It is a useful document for outlining processes for disclosing conflicts of interest or for protecting proprietary company assets or intellectual property. It can also establish expectations regarding anti-bribery and corruption, safe work environments free from harassment or abuse, attendance and absence policies, and training expectations. If a parent corporation has grounds for removal for a director's failure to adhere to the code of ethics or code of conduct, these documents can be very effective at maintaining oversight of new boards.

4. Subsidiary directors should feel empowered to act.

Finally, subsidiary directors should remember that they are serving as a member of a board of directors because their presence is needed. Even in situations where a board is more advisory in nature rather than having significant decision-making authority, it is not a social club. With the honor of board membership comes responsibility. Members are nominated and elected because of the unique skills, abilities, perspectives, and experiences that they bring to the table. It can take time for a board to understand the corporation's operations and to establish internal trust that everyone is operating toward the same mission. But by establishing a framework of fiduciary responsibilities, clear expectations, respect for differences, and recourse for actions that steer the subsidiary afield, parent corporations can focus on advancing their own mission and empowering subsidiary boards to grow and flourish.

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