Briefing

Managing Subsidiaries: A Balancing Act

INSTITUTE OF DIRECTORS IN IRELAND

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Effective management of subsidiaries can be a challenge for corporate groups. A balance must be struck between control of a subsidiary (essential for risk management and compliance) and the autonomy that it needs to operate as an independent legal entity. This briefing looks at some risk areas for directors and parent companies where too much control is exercised over a subsidiary and at some practical steps to achieve a balance.

Risk Areas

A duty to whom?

A subsidiary must not be seen as an extension of the parent company. Even if a subsidiary is wholly-owned it is still a separate legal entity. In making decisions which affect the subsidiary its directors can consider the interests of the parent company or the group as a whole but they have a duty to act in the interests of the subsidiary.

This can cause problems where the subsidiary's interests are at odds with or conflict with those of the parent - where the directors of a subsidiary prefer the interests of the parent company, they risk breaching their duty to the subsidiary. This is difficult to avoid where there are common directors between parent and subsidiary companies.

Control and management

Although the parent entity, typically being the sole shareholder of the whollyowned subsidiary, is entitled to appoint the directors of the subsidiary, the board of the subsidiary must be allowed to manage the affairs of the subsidiary and the parent should not interfere excessively.

Declarations of restriction have been made against directors of an Irish subsidiary alleged to have operated as a division of the parent company where the court has taken account of the fact that board minutes of the subsidiary related mostly to local regulatory matters of the company and not to the operation of the subsidiary's business.[1]

Depending on the involvement of the directors of the parent company in the management of the subsidiary, they may be considered as shadow directors (although a parent company itself is not to be regarded as a shadow director of its subsidiaries).[2] Shadow directors are liable in many of the same ways as registered directors.

There are instances where regulators and the courts have powers to impose liability on the parent for a subsidiary breach in areas such as environmental damage, health and safety and bribery.

Practical Steps

There are practical steps to avoid an overcontrolling parent company:

- insofar as is possible, avoid having common directors between parent and
- subsidiary companies and consider appointing non-executive directors to the boards;
- have clear internal group policies extending to subsidiaries on matters such as conflicts, major transactions and related party transactions, borrowing and the provision of guarantees;
- directors of subsidiaries must understand that their role is not a token role but one that carries duties and responsibilities;
- hold separate board meetings for each group company (on different days, where possible);
- a parent company should carefully consider "approving" actions of the subsidiary board and avoid giving directions;
- ensure that inter-group transactions are at arm's length where possible (otherwise take professional advice);
- maintain up-to-date registers of directors' interests;
- carefully document and minute board decisions and the rationale for making those decisions.

1 *Re 360Atlantic (Ireland) Ltd, O'Ferrel v Coughlan* [2004] IEHC 410.
2 Section 221(2) of the Companies Act 2014.

Conclusion

Clearly, the parent must have the control and visibility over its subsidiary companies that is necessary to reduce operational risks and subsidiary companies do need to operate within group policies in certain areas. However, this should not be used by the parent as a mandate to pressurise subsidiary directors into acting in accordance with the parent's interests when those interests are not aligned with those of the subsidiary. Directors of a subsidiary are expected to run the subsidiary as an autonomous entity and the independence of the board of a subsidiary to make decisions on its own management, separate from the parent group, must be emphasised and also facilitated in practice.

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