

# **Role of the Subsidiary Director: Directors owe a fiduciary duty to no single shareholder. But what if the shareholder happens to be a parent company?**

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DAVIES



BY CAROL HANSELL

# Role of the Subsidiary Director

Directors owe a fiduciary duty to no single shareholder. But what if that shareholder happens to be a parent company?

**DIRECTORS OF SUBSIDIARIES** are often uncertain about how to relate to the parent company. If the parent company sets the strategic direction and makes major decisions for its subsidiaries (including budget and executive hiring decisions), then what is the function of the subsidiary company board? More importantly, from a liability perspective, how do directors of subsidiary company boards satisfy their fiduciary duty?

Canadian law is clear that directors owe their fiduciary duty to the corporation and not to any stakeholder of the corporation — including its shareholders. The Supreme Court of Canada removed any doubt about this issue in its decisions in *Peoples Department Stores v. Wise* and in *BCE Inc. v. 1976 Debentureholders*.

Long before these important decisions, the courts were clear that a director who had been nominated by a shareholder (often referred to as a “nominee director”) nevertheless owes his or her duty to the corporation. In *82009 Ontario Inc. v. Harold E. Ballard Ltd.*, the court noted that a nominee director cannot be a “yes man.”


If the subsidiary is wholly owned, it is a mistake to assume there will be no one to complain if the directors are inattentive or simply acquiesce to the wishes of the sole shareholder. The entities in question in both the *BCE* and *Peoples* decisions were wholly owned subsidiaries and in those cases it was the creditors who complained (albeit unsuccessfully in each case). If the subsidiary is regulated, the regulator will certainly hold the subsidiary company directors accountable for the conduct of the subsidiary (as the OSC did with the direc-

tors of RT Capital Management Inc. in 2000). Finally, if the subsidiary is sold, the new shareholder will have the opportunity to review the conduct of the directors. If they can make a case that the directors did not act in the best interests of the corporation, they may have a sustainable cause of action against the directors.

The reality is, however, that corporate families do typically operate pursuant to a common strategy that originates at the parent company level. A number of considerations are important in reconciling this reality with the duties of the subsidiary directors. First, in aligning the direction of the subsidiary with that of the parent company, it is legitimate for the subsidiary directors to take into consideration the value

executives from across the family of companies will typically provide input from their business or region and in so doing will contribute the development of the overall strategy, for example. The strategy developed for the subsidiary company as a result of this process should be presented by the subsidiary company management to its own board for approval. The subsidiary company board must be satisfied that the strategy is in the subsidiary’s best interests, but again, this evaluation will typically take into account the overall benefit to the subsidiary of its relationship to the parent and its sister entities.

Directors have become acutely aware of their responsibilities and the liabilities that can flow from not discharging these responsibilities appropriately. It is often difficult for subsidiary-company directors to discuss concerns about their role with the parent company. In some cases, the subsidiary’s directors are internal appointees who are not anxious to be seen to be raising issues that were not of concern to others. In other cases,

independent directors may not have relationships at head office that lend themselves to this type of discussion. There is an important role for in-house counsel and corporate secretaries to engage on this issue with parent company executives with responsibility for subsidiary entities and with the directors of those entities, to ensure that communications allow for subsidiary directors to discharge their responsibilities in a way that allows the subsidiary to be an effective and contributing member of the corporate family. 

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**IT’S A MISTAKE** to assume that, if a company is wholly owned, no one can complain about poor governance. Creditors, regulators and new owners will hold directors accountable.

to the subsidiary of being a part of the corporate family. Operating synergies, knowledge transfers, use of intellectual property, access to high-calibre executives as well as the brand value of the corporate family are among the many benefits that accrue to the subsidiary as a result of being a member of the corporate family. In return for these benefits, the subsidiary contributes to the success of the family of companies by cooperating with policies and strategies initiated by head office.

Second, the fact that strategies and policies may be initiated at the parent company level does not mean that the subsidiaries play no role in their development. Senior