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International Governance: Serving as a Global Director

In her regular column on corporate governance issues, Holly Gregory explores considerations for those that are contemplating serving on the board of a company incorporated, or with a significant majority of its assets and operations, outside of the US.




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Holly counsels clients on a full range of governance issues, including fiduciary duties, risk oversight, conflicts of interest, board and committee structure, board leadership structures, special committee investigations, board audits and self-evaluations, shareholder initiatives, proxy contests, relationships with shareholders and proxy advisors, compliance with legislative, regulatory and listing rule requirements, and governance best practice.

The globalization of business operations and investments has broadened opportunities for US citizens to serve on boards of directors of foreign companies, as well as on boards of domestic companies that have a majority of their assets and operations outside of the US. These opportunities are broadening as US companies reincorporate overseas, including through tax-driven inversions, and as foreign companies seek to tap into the market of accomplished female US business executives to help satisfy diversity quotas and targets.

However, service on the board of a global company brings unique challenges. While corporate governance laws, regulations and expectations have converged to significant degree since the Organization for Economic Co-operation and Development (OECD) first published its OECD Principles of Corporate Governance in 1999, international differences in the roles, responsibilities and liabilities of directors remain.

 Search [Inversions to Ireland](#) and [IRS Issues New Anti-inversion Rules](#) for more on inversions.

Recent news reports of director resignations in the wake of new banking rules in the UK, which could impose jail terms on non-executive directors for reckless misconduct, highlight that there is international variation in director liability standards. Persons contemplating opportunities to serve on foreign boards or boards of companies with substantial foreign assets and operations need to:

- Understand that other jurisdictions may have different expectations of directors and different cultures of governance than they are accustomed to.
- Be aware of the laws that govern director responsibilities and the potential for liability.

This article examines:

- The demand for global directors.
- The laws governing directors' fiduciary duties, including the internal affairs doctrine.
- Unique fiduciary duty concerns.
- Recent Delaware guidance on the expectations of directors.

DEMAND FOR GLOBAL DIRECTORS

Both US and foreign companies seek directors from other jurisdictions for a host of reasons. For example, they may have a need for specific international or geographic expertise with respect to strategy, business objectives and operations and risk management. It has long been recognized that oversight of significant international business operations may call for having persons on the board who:

- Understand how business is conducted in a particular geographic region.
- May have useful contacts.

Adding directors from other jurisdictions can also enhance investor confidence. For example, a foreign company listing shares on the NYSE or NASDAQ may seek to enhance investor confidence by adding US directors to its board. Similarly, a company that is substantially operated in a foreign jurisdiction may incorporate in Delaware or another US state and seek US directors to gain credibility with investors.

Further, in some foreign jurisdictions adding directors from other jurisdictions can increase compliance with gender quotas. While women make up a growing proportion of business executives and professionals, these increases are not yet reflected in proportionate numbers on boards in many countries. A number of countries have adopted or are considering adopting quotas and disclosure requirements relating to board diversity and pressure for regulation is growing.

For example, in November 2013, the European Parliament approved a proposal that would require boards in European Union (EU) member states to be comprised of 40% women by 2020. Companies that do not meet the target will be banned from bidding on public contracts. EU member states will need to ratify the law for it to become effective. The rule is currently pending joint adoption by EU member states and European Parliament.

OECD Principles of Corporate Governance: 2004 Revision

The OECD Principles of Corporate Governance identify the key elements of corporate governance that a nation's regulatory framework should support (available at oecd.org). These include, in part:

- The protection and facilitation of shareholder rights.
- Equitable treatment of all shareholders, including minority and foreign shareholders.
- Cooperation between companies and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises.
- Timely, accurate disclosure on all material matters regarding the company, including financial situation, performance, ownership and governance.
- Effective monitoring of management by the board, and the board's accountability to the company and its shareholders.



Search [International Developments in Corporate Governance](#) for more on initiatives to increase board diversity.

THE INTERNAL AFFAIRS DOCTRINE

The jurisdiction in which a company is incorporated generally provides the law that governs the internal affairs of the company, including the duties of directors in relation to the company and its shareholders. For example, in the US, the corporate law of the state where a company is incorporated governs the fiduciary duties of the directors of that company.

A similar choice of law rule generally applies in the UK and in other EU member states. Therefore, in the EU the law of the jurisdiction of incorporation determines the duties of the members of the board (in a single-tier board system) or the supervisory board (in a two-tier system). Outside of the US and EU, it is likely that a similar rule applies with respect to defining director duties in most instances.

However, there are circumstances in which the laws of the jurisdictions in which the company operates could impact director liability for corporate actions. Examples of the kinds of corporate actions for which directors may be held liable in various jurisdictions include:

- Failure to pay wages to employees.
- Failure to withhold and pay employment taxes.
- Actions taken while the company is insolvent.
- Environmental damage.

Questions Director Candidates Should Consider

Candidates for a seat on a foreign board or a board of a domestic company with significant foreign operations should consider a number of questions before accepting an invitation to serve. Consideration should be given to the potential legal risks related to director obligations and the systems that the company has in place to ensure that it is in compliance with the applicable laws and regulations.

Director candidates should also undertake due diligence regarding their anticipated responsibilities and obtain assurance that the company has adequate controls in place related to legal and regulatory compliance, as well as appropriate information systems. Director candidates are also well-advised to engage in honest self-reflection about whether they feel they have the capacity to serve as a fiduciary in potentially difficult circumstances.

Below are a series of questions exploring topics that director candidates should consider before agreeing to serve.

FIDUCIARY DUTIES

- What is the role and what are the duties of the board under the specific laws of the jurisdiction of incorporation?
- What are the duties of individual directors?
- Can individual directors be held personally liable for a breach of their duties?
- Who can enforce director duties or bring actions for breach?
- In which courts are actions for director breach heard, and how competent are they to deal with sophisticated issues?

ADEQUATE CONTROLS

- What controls and procedures are in place to give directors reasonable assurances that the company complies with laws and regulations in all of the jurisdictions in which it operates?
- What information systems are in place to ensure that all directors are well-informed about corporate activities?
- What is the tenor within the company and in its primary jurisdictions of operations with respect to ethics and integrity?

D&O INSURANCE COVERAGE

- Does the company have adequate D&O insurance coverage with a reputable carrier and appropriate indemnification provisions?
- Are there any unusual exceptions or exclusions that apply to its D&O insurance coverage?

LEGAL COUNSEL AND ADVISORS

- Does the company have a strong internal legal team with a leader who has a respected position in the senior executive team?
- Are high-quality advisors in place that can assist with questions concerning legal and financial obligations?
- Are high-quality advisors in place that can help to bridge gaps in understanding that may arise due to language and cultural differences?

LANGUAGE AND CULTURAL CONSIDERATIONS

- How will language differences be addressed?
- Will discussions and documents be in a language that all directors are fluent in?
- Will discussions and documents need to be specially translated for some directors?
- What systems are in place to ensure that directors can take a deep dive into underlying information as necessary?
- Are there any significant differences in business, cultural and ethical expectations in the primary jurisdictions of operations that could lead to misunderstandings or disagreements among directors, or between members of the board and management?

BOARD COMPOSITION AND CHALLENGES

- What is the board's reputation for effective governance?
- What specific governance challenges has the board faced and how has it handled them?
- Under what circumstances have directors recently left the board?
- Are there any special circumstances that may impact the ability of independent directors to have meaningful influence? For example, circumstances related to a controlling shareholder or sovereign wealth fund.

PERSONAL CONSIDERATIONS

- Do I have the time, attention and capacity to serve as a prudent fiduciary in circumstances that will likely present significant travel demands, potential language barriers and cultural challenges?

Therefore, understanding the specific areas of potential liability for a director related to the jurisdiction of incorporation and the jurisdictions in which the company operates requires advice of counsel.

DUTIES OF CARE AND LOYALTY

In most jurisdictions, directors owe duties that include concepts of care and loyalty, although there is significant variation in how the duties are framed and who can enforce them. Additionally, in some jurisdictions, directors may have circumstance-driven obligations to provide heightened consideration to the interests of specific constituents. For example, in some jurisdictions the board may have specific obligations to employees or, in certain circumstances, to creditors.

What constitutes prudent care by directors in a particular jurisdiction is context-driven. To serve as an effective steward requires a general awareness of the business operations of the company. It also requires oversight regarding compliance with the laws and regulations that apply, including those that may extend well beyond the jurisdiction of incorporation. For example, the laws of the jurisdiction in which a company has operations will generally apply to issues such as labor relations, business conduct and contracts, and environmental protection in that jurisdiction. Other laws have broad extraterritorial reach, for example anti-bribery and anti-corruption laws such as the US's Foreign Corrupt Practices Act of 1977 and the UK's Bribery Act 2010.

Generally, individual directors are not expected to have expertise regarding the laws and regulations that apply in all of the jurisdictions in which the company operates. However, directors should confirm that the company has access to adequate internal and external legal counsel. Directors should also confirm that the company has established compliance and reporting systems that are designed to ensure that the company abides by applicable legal and regulatory obligations.

GUIDANCE FROM DELAWARE

In an unusual bench ruling from February 2013, Chancellor Strine of the Delaware Court of Chancery addressed the obligations of directors of a company incorporated in Delaware with significant assets and operations located outside of the US (*In re Puda Coal, Inc. Stockholders Litig., Consol. C.A. No. 6476-CS (Del. Ch. Feb. 6, 2013)*). The ruling essentially outlines the actions that directors of foreign-based companies must take to fulfill their fiduciary duties.

The case involved a breach of fiduciary duty claim brought by shareholders against the independent directors of a Delaware company that operated solely in China. The lawsuit claimed that for 18 months the independent directors failed to notice and stop the chairman of the company from appropriating and selling off a majority of the company's assets. When the directors finally realized the extent of the fraud, rather than sue to retrieve the company's assets, they resigned, leaving the company in the hands of the chairman.

In denying a motion to dismiss, Chancellor Strine chastised the directors, "There's no such thing as being a dummy director in Delaware, a shill, someone who just puts themselves up and represents to the investing public that they're a monitor." (*Puda Coal, at 21*). As for finding a breach by the independent directors, Chancellor Strine stated that the facts supported a finding for a breach even under the *Caremark* standard for personal liability owing to lack of good faith.

Chancellor Strine advised that to meet the obligation of good faith, outside directors who oversee companies situated in China should:

- Spend a significant amount of time physically present in China.
- Have in place a system of adequate controls for a public company.
- Retain accountants and attorneys who are equipped to maintain a system of controls for a public company.
- Possess the language skills to navigate the environment in which the company is operating.

(*Puda Coal, at 17-18.*)

Chancellor Strine noted that directors cannot discharge their duty of loyalty simply by remaining in the US and participating in conference calls four times a year (*Puda Coal, at 21*). Further, there will be special challenges that deal with linguistic, cultural and other issues in terms of the effort that directors must put in to discharge their duty of loyalty (*Puda Coal, at 21*).

Chancellor Strine indicated that directors should be concerned about taking on service as a fiduciary in a culture where the flow of information is in a language they do not understand and the legal strictures, structures and ethical mores may not be as advanced as those with which they are generally familiar (*Puda Coal, at 22*). By emphasizing the relation between these issues and the duty of loyalty, Chancellor Strine put directors on notice that serving on the board of a company with significant foreign operations without appropriate attention, and the opportunity to provide that attention, poses a significant risk of personal liability.



Search [In re Puda Coal: Delaware Court of Chancery Describes Efforts Required of Directors of Foreign-based Delaware Corporations](#) for more on this decision.

The views stated above are solely attributable to Ms. Gregory and do not necessarily reflect the views of Sidley Austin LLP or its clients.