THE DUTY TO PROMOTE THE SUCCESS OF THE COMPANY : IS IT FIT FOR PURPOSE?

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I. Introduction

It has been said that the underlying reason for the financial crisis of 2007-2009 and the attendant problems connected to it, was the mispricing of risk,[1] and/or the employment of foolish and irresponsible lending practices all the way down the finance chain.[2] Some have focused on the failure to manage risk as the reason for the crisis,[3] while others have identified a broader reason, namely the short-termist pressure placed on directors as a result of the demands of shareholders for unsustainable ever-increasing earnings growth that was possible only by way of the shortcut of over-leverage and reduced investment, and the dangerous route of excessive risk. Such commentators have emphasised the fact that the stability and financial strength needed to endure economic cycles were sacrificed for immediate satisfaction.[4] Some commentators have identified the complexity of the finance

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[1] T. Kirchmaier, "Inject Governance, and Not Just Cash: Some Thoughts on the Governance of Banks" (27 October 2008) and accessible at http://ssrn.com/abstract=130320 (last visited, 31 May 2010); G. Kirkpatrick, "The Corporate Governance Lessons from the Financial Crisis" (2009) 96 *Financial Market Trends* 1 at 4; M. Peters, "Corporate Governance of Australian Banking: A Lesson in Law Reform or Good Fortune?" and accessible at http://ssrn.com/abstract=1567726 (last visited, 23 June 2010).

[2] C. Jordan and A.Jain, "Diversity and Resilience: Lessons from the Financial Crisis," Research paper, Centre for Corporate Law and Securities Regulation, University of Melbourne, 8 September 2009, at 5.

[3] W. Sahlman, "Management and the Financial Crisis (We have met the enemy and he is us . . .)" 4 (Harvard Business School, Working Paper No. 10-033 and accessible at http://www.hbs.edu/research/pdf/10-033.pdf (last visited, 15 July 2010); G. Kirkpatrick, "The Corporate Governance Lessons from the Financial Crisis" (2009) 96 *Financial Market Trends* 1 at 17-23.; P. Rose, "Regulating Risk by 'Strengthening Corporate Governance'" and accessible at http://ssrn.com/abstract=1630122 (last visited, 15 July 2010).

[4] M. Lipton, T. Mirvis & J. Lorsch, "The Proposed "Shareholder Bill of Rights Act of 2009" Harvard Law School Forum on Corporate Governance & Financial Regulation (May 12, 2009), and accessible at : http://blogs.law.harvard.edu/corpgov/2009/05/12/the-proposed-%e2%80%9cshareholder-bill-of-rights-act-of-2009%e2%80%9d (last visited on 1 June 2010). Some support for this comes from the views of company officials interviewed in a small study of FTSE 350 companies in the UK : see, P. Taylor, "Enlightened Shareholder Value and the Companies Act 2006" (unpublished PhD thesis, May 2010), Birbeck College, University of London, at 179. The issue of immediate satisfaction is probably tied up with the fact that it had been said many years before the current crisis that the markets placed pressure on directors to meet their views of what results companies should be achieving. See C. Williams, "A Tale of Two Trajectories" (2006) 75 *Fordham Law Review* 1629 at 1654-1655; N. Sharpe, "Rethinking the Board Function in the Wake of the 2008 Financial Crisis" (2010) 5 *Journal of Business and Technology Law* 99 at 110-111. Also, see, J. Grinyer et al, "Evidence of Managerial Short-termism in the UK" (1998) 9 *British Journal of Management* 13 at 14, 15; J. Graham et al, "The Economic Implications of Corporate Financial Reporting" Duke University Research Paper, 11 January 2005 and accessible at http://ssrn.com/abstract=491627 (last visited, 21 June 2010).

products employed as a key reason for the crisis.[5] But many commentators have opined that failures in corporate governance in financial institutions caused the crisis,[6] even though it has been shown that the governance of these companies are no worse than companies conducting businesses in other fields.[7] Some might well argue that failures in risk management are themselves failures in corporate governance.[8] It is perhaps notable that UBS, the Swiss-based financial services company, linked the two when it provided a frank assessment of its risk management and governance failures to its shareholders.[9]

The OECD Steering Group on Corporate Governance has argued that weak governance across the spectrum of companies was a major cause of the financial crisis.[10] The UK's Treasury Select Committee supports the view that corporate governance problems were a cause of the financial crisis; it stated that it had spotted "important...corporate governance failures in the banking sector."[11] The Turner Review[12] stated that improvements in the effectiveness of firm governance are essential.[13] The Walker Review, undertaken in order to consider corporate governance in UK financial institutions, said that : "The need is now to bring

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[5] L. Buchheit, "Did we make things too complicated?" (2008) 27 (3) *International Financial Law Review* 24.

[6] T. Kirchmaier, "Inject Governance, and Not Just Cash: Some Thoughts on the Governance of Banks" (27 October 2008) and accessible at http://ssrn.com/abstract=130320 (last visited, 31 May 2010); G. Kirkpatrick, "The Corporate Governance Lessons from the Financial Crisis" (2009) 96 *Financial Market Trends* 1; M. Peters, "Corporate Governance of Australian Banking: A Lesson in Law Reform or Good Fortune?" and accessible at http://ssrn.com/abstract=1567726 (last visited, 23 June 2010); R. Adams, "Governance and the Financial Crisis" at 15 and accessible at http://ssrn.com/abstract=1398583 (last visited, 23 June 2010); W. Sahlman, "Management and the Financial Crisis (We have met the enemy and he is us . . .)" 4 (Harv. Bus. Sch., Working Paper No. 10-033 and accessible at http://www.hbs.edu/research/pdf/10-033.pdf (last visited, 15 July 2010); P. Mulbert, "Corporate Governance of Banks after the Financial Crisis – Theory, Evidence, Reform," April 2010, at 8-9, and accessible at http://ssrn.com/abstract=1448118 (last visited, 23 June 2010). Mulbert expresses some doubts as to whether poor corporate governance was a major cause : ibid at 27-28. Brian Cheffins posits a similar doubt : B. Cheffins, "Did Corporate Governance 'Fail' During the 2008 Stock Market Meltdown? The Case of the S & P 500" accessible at http://ssrn.com/abstract=1396126 (last visited, 24 June 2010).

[7] R. Adams, "Governance and the Financial Crisis" at 15 and accessible at http://ssrn.com/abstract=1398583 (last visited, 23 June 2010). Also, see B. Cheffins, "Did Corporate Governance 'Fail' During the 2008 Stock Market Meltdown? The Case of the S & P 500" accessible at http://ssrn.com/abstract=1396126 (last visited, 24 June 2010) where the learned commentator accepted that corporate governance mistakes were made more widely.

[8] P. Rose, "Regulating Risk by 'Strengthening Corporate Governance'" and accessible at http://ssrn.com/abstract=1630122 (last visited, 15 July 2010).

[9] UBS AG, Shareholder Report on UBS's Write-Downs, April 18, 2008 and referred to in P. Rose, "Regulating Risk by 'Strengthening Corporate Governance'" and accessible at http://ssrn.com/abstract=1630122 (last visited, 15 July 2010).

[10] See, G. Kirkpatrick, "The Corporate Governance Lessons from the Financial Crisis" (2009) 96 *Financial Market Trends* 1.

[11] House of Commons Treasury Committee, "Banking Crisis : Reforming Corporate Governance and Pay in the City" (London, Stationery Office, 2009) and quoted in M. Arden, "Regulating the Conduct of Directors" (2010) 10 *Journal of Corporate Law Studies* 1 at 1.

[12] FSA, "A regulatory response to the global banking crisis" March 2009.

[13] Ibid at para 2.8

corporate governance issues closer to centre stage...These entities [financial institutions] need to be better governed."[14]

It is trite to say that essential to any consideration of corporate governance is the role played by directors of companies. Obviously they are critical to any corporate governance system that exists. As part of this system, directors are made accountable for how they have conducted the affairs of their company, and this is achieved through a number of mechanisms. That is, they are, or may be, called to account in various forms for what they have done or not done. Importantly in this regard certain duties are imposed on how directors act in the managing of their companies' affairs. If they fail to fulfil these duties then the directors may be subject to legal proceedings and they may, ultimately, be held liable by the courts.

The position as far as duties of directors in the UK are concerned is that the law has seen a recent upheaval, at least on the face of things. After so many years when directors' duties were provided for by common law rules and equitable principles, the UK has now decided to follow other common law jurisdictions,[15] and it has codified the duties in the Companies Act 2006, principally in Chapter 2 of Part 10 of that statute. These duties, which became operational on either 1 October 2007,[16] or 1 October 2008,[17] will now act as guides for many of the management activities of directors and will determine whether directors have acted properly.

The statutory duties became operational at a time when the financial life of not only the UK, but much of the rest of the world, was in turmoil. Most of the actions of directors that related to this financial crisis, and even contributed to it, were regulated by the previous law on duties, and so whether directors are liable for what they did, or did not do, will depend on those previous duties. What this paper seeks to do, in light of the events of the financial crisis that began some three years ago, and which is still unravelling and having a significant effect on the UK and many parts of the world, is to look forward and assess whether one of the duties imposed by the Companies Act 2006 is fit for purpose. Is the duty likely to fulfil its purpose, as determined by the legislature, and will it prove to be effective in dealing with the aftermath of the crisis and provide the necessary potency in regulating how directors act for the future, so that the prospect of another serious financial meltdown is lessened?

The duty upon which the paper focuses is that contained in s.172 of the Companies Act 2006 ("the Act"). Arguably, this "core duty"[18] has been the most controversial

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[14] "A review of corporate governance in UK banks and other financial industry entities" 26 November 2009 at p9 (Executive summary). One of the problems that exist is the fact that little is known about the characteristics of boards of banks. See, D. Ferreira et al : "Boards of Banks" and accessible at http://ssrn.com/abstract=1620551 (last visited, 23 June 2010).

[15] For example, Australia, Malaysia, New Zealand, Ghana and Singapore.

[16] Sections 170-176 and 178. See Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 (SI 2007/2194).

[17] Sections 175-177. See Companies Act 2006 (Commencement No 5, Transitional Provisions and Savings) Order 2007 (SI 2007/3495).

[18] P. Davies, *Gower and Davies' Principles of Company Law*, 8th ed (Sweet and Maxwell, London, 2008) at 506.

and challenging duty that has been introduced in the Act,[19] and the one that has given lawyers, companies and their directors the most concern.[20] The provision led to more debate in the UK Parliament than any other provision contained in the whole Act, and, interestingly, the section has attracted quite a reasonable amount of interest and comment in the United States.[21] The section may be said to impose a duty on directors to require them to be more inclusive in their decision-making, namely taking into account the relationships which the company has with stakeholders in seeking to benefit the members. Unlike other duties such as that in s.175 which involves a revamping of the no conflict and no profit rules, it has no obvious precursor, although it has clear links to the duty to act bona fide in the best interests of the company, which was the predominant and core fiduciary duty owed by directors before the codification of the duties, and it is probably fair to see s.172 as a successor to this duty. The only cases that have addressed the provision, albeit briefly, have stated that s.172 merely sets out the pre-existing law on the subject, that is, decided in relation to the duty to act bona fide in the best interests of the company.[22] Having said that, some have argued that as the duty provided for in s.172 is obviously different from the duty to act in the best interests of the company it, therefore, requires fresh consideration.[23] Whilst the section does require fresh consideration, it is submitted that important aspects of the section will be interpreted and applied in conformity with judicial expositions of the previous law.

The duty is probably the most wide-ranging duty of the general duties in the Act, and clearly the most difficult to interpret at this stage. Thus, and because it is not as closely aligned to any previous duty when compared with other duties in Chapter 2 of Part 10 of the Act, parts of this paper, while informed by existing case law and academic opinion, involve some speculation.

This paper examines the duty in s.172 and assesses whether the duty is fit for purpose and whether, assuming that directors' duties are designed to facilitate, at least partly,

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[19] See, for example, the debates in the House of Commons in Standing Committee D on 11 July 2006 (at col 543) and accessible at http://www.publications.parliament.uk/pa/cm200506/cmstand/d/st060711/am/60711s01.htm (last visited, 31 May 2010).

[20] Institute of Chartered Secretaries and Administrators (ICSA), *Guidance on Directors' General Duties* – January 2008 at para 3.2.3.

[21] For example, see, C. Williams and J. Conley, "An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct" 38 Cornell In'l L J 493 at 500 (2005) and accessible at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=632347 (last visited 29 October 2009); V. Ho, "'Enlightened Shareholder Value' : Corporate Governance Beyond the Shareholder-Stakeholder Divide" abstract accessible at http:ssrn.com /abstract=1476116 (accessed on 10 December 2009); D. Millon, "Enlightened Shareholder Value, Social Responsibility, and the Redefinition of Corporate Purpose Without Law" and accessible at http://papers.ssrn.com/abstract=1625750 (last visited, 28 July 2010).

[22] *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72; 2008 Scot (D) 16/5 (Outer House, Court of Sessions, Lord Glennie) at [21]; *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch). The judgments did not go on to discuss the section at all.

[23] See, for example, Maclay Murray Spens *Guide to the Companies Act 2006*, available at http://www.mms.co.uk/ (last accessed 6 January 2006), at 6. Cf Cameron McKenna 'Companies Act 2006: Deferred Reform' Law-Now, 29 November 2006, available at http://www.law-now.com/ law-now/default (last accessed 22 March 2007), 6; Ashurst *The Companies Act 2006: Directors Duties* (November 2006), available at http://www.ashurst.com/publication-item.aspx?id_Content=2784 (last accessed 22 March 2007).

improved corporate governance, the duty is likely to ensure that better corporate governance is delivered. The paper does not focus only on financial institutions, the companies whose corporate governance has been called into question most often since the crisis. The paper seeks to consider large public companies in general, whilst accepting that much of it applies to the governance of financial institutions, because boards of financial institutions owe the same duties to their companies and shareholders[24] as non- financial institutions.[25] It is probably fair to say that not as much is known about the governance of boards of financial institutions compared with non- financial institutions as the empirical research undertaken has tended to be directed to the latter kind of companies.[26] The fact is that non-financial companies have suffered in the aftermath of the financial crisis, and their corporate governance may have contributed to the state in which they find themselves. One important thing to emphasise is that although s.172 was conceived and enacted some time before the financial crisis developed, at least publicly, it was not put in force until the financial problems causing the crisis had started to unravel. The provision had a long gestation period and was conceived during an economically halcyon period, certainly for the UK (latter part of the 1990s and first two years of this century). So it is important to recognise that the provision cannot in anyway be regarded as a response to the financial crisis.

The paper argues that s.172 is not fit for purpose. It is submitted that the provision does not fulfil the aims of the Government and we cannot have any confidence that it is going to address the problems with directors that have come to light in the wake of the financial crisis. The paper does not seek to examine[27] the views of some that the provision is moving the UK towards to a more "stakeholder conscious corporate society,"[28] that "UK corporations are now moving towards a more stakeholder centered model of governance,"[29] or that it is providing for an emerging third way, somewhere between shareholder primacy theory and stakeholder theory.[30] That really is another issue, laudable perhaps, but not totally relevant to the thrust of this paper.

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[24] Christopher Bruner is of the view that a new corporate governance paradigm might have to be developed for banks : "Corporate Governance Reform in a Time of Crisis" and accessible at http://ssrn.com/abstract=1617890 (last visited, 23 June 2010).

[25] Ibid.

[26] Ibid.

[27] For an article that does, see A. Keay, "Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That : Much Ado About Little?" and accessible at http://ssrn.com/abstract=1530990 (last visited, 17 July 2010).

[28] S. Kiarie, "At Crossroads : Shareholder Value, Stakeholder Value and Enlightened Shareholder Value : Which Road Should the United Kingdom Take?" (2006) 17 *International Company and Commercial Law Review* 329 at 329.

[29] A. Mickels, "Beyond Corporate Social Responsibility : Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the US and Europe" (2009) 32 Hastings Int'l & Comp L Rev 271 at 293.

[30] See, C. Williams and J. Conley, "An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct" 38 Cornell In'l L J 493 at 500 (2005) and accessible at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=632347 (last visited 29 October 2009); S. Kiarie, "At Crossroads : Shareholder Value, Stakeholder Value and Enlightened Shareholder Value : Which Road Should the United Kingdom Take?" (2006) 17 *International Company and Commercial Law Review* 329 at 339.

The paper develops as follows. First, it sets out the section and places it in context. Second, the paper provides some background to the evolution of s.172. Following this the paper addresses the section's purpose. Fourth, the main part of the paper provides an assessment of the duty and whether it is likely to be effective in the terms set out above. Fifth, some general reflections are given in relation to the section and its likely application. Finally, the paper provides some conclusions.

II. The Section

It is worthwhile, for exposition purposes, to set out s.172(1) in full. It provides that:

> "A director of a company must act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –
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> (a)The likely consequences of any decision in the long term
> (b)the interests of the company's employees
> (c)the need to foster the company's business relationships with suppliers, customers and others
> (d)the impact of the company's operations on the community and the environment
> (e)the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f)the need to act fairly between the members of the company."

While s.172 is regarded as imposing a new duty on directors, there are indications in previous case law that the directors have had a similar duty in the past. In the classic case of *Aberdeen Railway Co v Blaikie Brothers,*[31] Lord Cranworth said that :

> "A corporate body can only act by agents, and it is of course the duty of those agents so *to act as best to promote the interests of the corporation* whose affairs they are conducting."[32] (my emphasis)

More recently, in *Scottish Co-operative Wholesale Society Ltd v Meyer,*[33] Lord Denning said that the duty of directors "was *to do their best to promote its business* and to act with complete good faith towards it."[34] (my emphasis).

So, it would appear, as one might expect, that directors have always been under a duty to promote the company's business. This would surely require actions that would be consistent with fulfilling the duty to act in good faith for the benefit of the company.

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[31] (1854) 1 Macq 461.
[32] Ibid at 471, HL (Sc) per Lord Cranworth LC
[33] [1959] AC 324.
[34] Ibid at 367.

The Government stated that Chapter 2 of Part 10 of the Act can be viewed in one of two ways, either as simply codifying the existing equitable and common law obligations of company directors, or as marking a radical change in articulating the connection between what is good for a company and what is good for society at large, and the minister overseeing the enactment of the companies legislation said that s.172 of the Act falls into the latter category.[35] More about this shortly.

It is possible to say that this duty is the fundamental duty of directors, and that other duties mentioned elsewhere in the Act are applications of this duty.[36] Certainly, this is clearly the case with s.175 which deals with ensuring that directors are not in conflict situations and do not exploit company opportunities for their own benefit.

Although s.172(1) has attracted by far the greatest attention, s.172 does actually contain two other sub-sections, which provide exceptions to the duty laid down in s.172(1). First, s.172(2) provides that where there is a company that includes purposes other than the benefit of the members, it operates as if the reference to promoting the success of the company for the benefit of its members were to achieving the purposes set by the company. According to the Explanatory Notes to the Act this provision deals with altruistic, or partly altruistic, companies. Examples that are given are charitable companies and community interest companies, but the notes accept that it is possible for any company to have objectives that are unselfish and are paramount over the members' own interests. As to what the purposes of the company are, it is a matter for the good faith judgment of the directors. This is also the case, according to the Explanatory Notes, "where the company is partially for the benefit of its members and partly for other purposes, the extent to which those other purposes apply in place of the benefit of the members."[37]

The second exception is contained in s.172(3). It provides that the duty to promote the success of the company for the benefit of the members is subject to any enactment or rule of law requiring directors to consider the interests of the company's creditors. What the sub-section does is to recognise, inter alia, the common law development of a duty of directors to take into account the interests of the creditors of the company in certain circumstances.[38] The provision does not state when creditors' interests are to be considered in the course of the directors' decision-making. This is left to the common law.[39] The circumstances which will require directors to have to take into

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[35] *Duties of Company Directors* (DTI, June 2007), Introduction and Statement of Rt Hon Margaret Hodge. Clearly the Government was caught between business not wanting to see any change to the law, and many of the constituents of the Labour Party who wished to see the nature of companies changed. The Government sought to steer a course that took it down the middle. For an interesting discussion on this topic and others, see M. Bovey, "A Damn Close Run Thing - The Companies Act 2006" (2008) 29 *Statute Law Review* 11.

[36] See *Shepherds Investments Ltd v Walters* [2006] EWHC 836 at [106]; *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244; [2004] BCC 994; (2005) 2 BCLC 91 at [41] in relation to the previous law.

[37] Explanatory Notes to the Companies Act 2006 at para 330.

[38] The development of this area of the law may well reduce the incidence of risk-taking when companies are in financial straits.

[39] For some of the case law, see : *Winkworth v Edward Baron Development Co Ltd* ([1986] 1 WLR 1512; [1987] 1 All ER 114; *Liquidator of West Mercia Safetywear v Dodd* (1988) 4 BCC 30; *Facia Footwear Ltd (in administration) v Hinchliffe* [1998] 1 BCLC 218; *Re Pantone 485 Ltd* [2002] 1 BCLC 266; *Gwyer v London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153; [2002] EWHC 2748; *Re MDA*

account creditor interests involve situations where the company is insolvent and even where the company is in some form of financial difficulty, short of insolvency. Consequently, until the company has become solvent again or moved out of the financial mire in which it finds itself, the s.172(1) duty is suspended.[40]

Section 172(1) requires directors to have regard to the interests of various stakeholders, such as employees, yet many argue that this is what directors have done for many years, even when operating under a shareholder value approach to governance.[41] This approach was acknowledged in the Hampel Report when it was said that to ensure that there is long-term shareholder wealth, directors have to develop and sustain relationships with stakeholders.[42]

Section 172(1) was the first of two mechanisms that was to introduce the concept of enlightened shareholder value ("ESV"), as conceived by the Company Law Review Steering Group ("CLRSG") which was established in 1998 to review UK company law. Section 172(1) imposes a duty on directors to be more inclusive in their decision-making, namely taking into account the relationships the company has with stakeholders whilst seeking to benefit the members. The second mechanism was the requirement for listed companies to provide an Operating and Financial Review that would compel such companies "to disclose a range of 'qualitative' and 'forward-looking' information of a kind that is not normally found in traditional financial statements."[43] The Operating and Financial Review never actually saw light of day, but was replaced by the requirement to produce a Business Review.[44] The duty cannot be considered, given the aims of the paper, without some examination of the Business Review and that is done later n the paper.

It should be noted that more than just the duty in s.172 might apply to any directorial action or inaction. Section 179 of the Act plainly states that more than one duty may apply to any given breach.

Investment Management Ltd [2004] BPIR 75; [2003] EWHC 227 (Ch); *Re Cityspan Ltd* [2007] EWHC 751 (Ch); [2007] 2 BCLC 522; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch); *Re Bakewell Management Ltd* [2008] EWHC 3633 (Ch). The case law in other Commonwealth jurisdictions has been very influential. For example, see, *Walker v Wimborne* (1976) 137 CLR 1; 3 ACLR 529; *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215; 10 ACLR 395; *Jeffree v NCSC* (1989) 7 ACLC 556; 15 ACLR 217; *Spies v The Queen* [2000] HCA 43; [2000] 201 CLR 603; (2000) 173 ALR 529; *Nicholson v Permakraft (NZ) Ltd* (1985) 3 ACLC 453; *Hilton International Ltd (in liq) v Hilton* [1989] NZLR 442. For academic consideration, see, for example, D. Prentice, "Creditor's Interests and Director's Duties" (1990) 10 OJLS 265; V. Finch, "Directors' Duties : Insolvency and the Unsecured Creditor" in A. Clarke (ed), *Current Issues in Insolvency Law* (London, Stevens, 1991); A. Keay, *Company Directors' Responsibilities to Creditors* (Abingdon, Routledge-Cavendish, 2007) at 151-286; A. Keay, *Directors' Duties* (Jordan, Bristol, 2009), Ch 13.

[40] For suggestions as to how this would work, see A. Keay, "Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach" (2005) 64 CLJ 614.

[41] Michael Jensen has argued that it is part of his enlightened stakeholder value theory : "Value Maximisation, Stakeholder Theory, and the Corporate Objective Function" (2001) 7 *European Financial Management* 297.

[42] *Final Report of the Committee on Corporate Governance* (Hampel Report), 1998 at para 1.18.

[43] A. Johnston, "After the OFR : Can UK Shareholder Value Still Be Enlightened?" (2006) 7 EBOR 817 at 818.

[44] See s.417 of the Companies Act 2006.

III. Legislative Development

It is not intended in this paper to rehearse the background to the enactment of s.172 and what issues were considered first by the CLRSG,[45] and then the Government in their decisions to draft and to enact respectively the section as it is. That has been done elsewhere in some detail.[46] But a few words are appropriate to set the scene. Section 172 developed during the course of the CLRSG's consideration of duties of directors. The CLRSG believed that UK company law embraced the shareholder value approach (also known as "shareholder primacy" or "shareholder wealth maximization"), namely the directors are to manage the company so as to enhance ultimately the interests of the shareholders.[47] This is opposed to the stakeholder or pluralist approach which holds, to put it simply, that the directors must run the company so as to benefit all stakeholders of the company.[48] The CLRSG stated that directors were obliged to "achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose" and this involved taking "a proper balanced view of the short and long term; the need to sustain effective ongoing relationships with employees, customers, suppliers and others" as well as to "consider the impact of its operations on the community and the environment."[49] When the Government published, in July 2002, its first White Paper on what was going to be the new companies legislation,[50] it expressly endorsed the CLRSG's approach.[51] The draft Companies Bill that was part of the White Paper included an embryonic s.172. In its second White Paper, in March 2005, the Government confirmed that it was going to pursue the CLRSG's recommendations in relation to directors' duties.[52] The latter White Paper provided that there are two elements to the way in which directors are to run the company.[53]

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[45] The Group was charged in 1998 with the task of providing a comprehensive review of UK company law.

[46] A. Keay, "Enlightened shareholder value, the reform of the duties of company directors and the corporate objective" [2006] *Lloyds Maritime and Commercial Law Quarterly* 335; A. Keay, "Tackling the Issue of the Corporate Objective : An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach" (2007) 29 *Sydney Law Review* 577.

[47] For discussion of this approach, on which much has been written, see (for example) : D. G. Smith, "The Shareholder Primacy Norm" (1998) 23 *Journal of Corporate Law* 277; L. Stout, "Bad and Not-So-Bad Arguments for Shareholder Primacy" (2002) 75 *South California Law Review* 1189; J. Fisch, "Measuring Efficiency in Corporate Law : The Role of Shareholder Primacy" 31 J Corp L 637 (2006); A. Keay, "Shareholder Primacy in Corporate Law. Can it Survive? Should it Survive? available at http://ssrn.com/abstract=1498065 (last visited, 17 July 2010). It is to be noted that one commentator argues somewhat persuasively that the UK has a more shareholder-centric approach than the US : C. Bruner, "Power and Purpose in the 'Anglo-American' Corporation" (2010) 50 *Virginia Journal of International Law* 579.

[48] For discussion of this approach, see, for example : R. E. Freeman, *Strategic Management : a stakeholder approach,* (Boston, Pitman/Ballinger, 1984); R. Karmel, "Implications of the Stakeholder Model" (1993) 61 *George Washington Law Review* 1156; J. Clarke, "The Stakeholder Corporation : A Business Philosophy for the Information Age" (1998) 31 *Long Range Planning* 182; A. Campbell, "Stakeholders , the Case in Favour" (1997) 30 *Long Range Planning* 446; A. Keay, "Stakeholder Theory in Corporate Law : Has it Got What it Takes?" (2010) 9 *Richmond Journal of Global Law and Business* 249.

[49] Company Law Review, *Modern Company Law for a Competitive Economy*,: Developing the Framework (London, DTI, 2000) at para 2.19

[50] *Modernising Company Law* (Cm 5553, 2002, DTI).

[51] *Modernising Company Law* (Cm 5553-I, 2002, DTI) at para 3.6.

[52] Cm 6456, 2005, DTI.

[53] *Company Law Reform* (DTI, 2005), Explanatory Notes at para B17.

First, they are to do that which they consider, in good faith, is most likely to promote the success of the company for the benefit of the members as a whole. Second, in carrying out the first element, the directors are to take into account, where relevant, and as far as is reasonably practicable, several factors (in order to reflect wider consideration of responsible business behaviour) that are listed, but not intended to be exhaustive. These factors are now contained in s.172(1)(a)-(f).

IV. The Purpose of the Duty

Directors' duties have been provided by common law and equity since the beginning of the major developments of company law in the mid-nineteenth century. It has been said that to get a picture of the duties of directors one had to digest "a confusing and compendious mass of case law and the occasional statutory measure."[54] The purpose of codification was, according to the joint Report of the Law Commission and the Scottish Law Commission,[55] to restate the law on directors' duties in order to clarify it and make it more accessible, with the aim of bringing about a change in directors' behaviour by educating directors and providing them with greater certainty regarding what the law required of them.[56] Subsequently, in the debates on the Company Law Reform Bill 2005, later to be re-named the Companies Bill 2006, the Government, through the statements of Lord Goldsmith in the House of Lords, indicated that clarifying and making accessible the duties was the main reason for codification.[57] Earlier, the CLRSG, in its Final Report to the then Department of Trade and Industry gave three reasons for codification,[58] two of which reflected the points mentioned above. The Final Report said that codification would provide greater clarity on what is expected of directors and make the law more accessible. It was said that this would help to improve standards of corporate governance. A second reason was that a codified statement of duties would enable "defects in the present law to be corrected in important areas where it no longer corresponds to accepted norms of modern business practice."[59] Third, the CLRSG said that it would address the scope of duties, namely in whose interests are the company's affairs to be run?[60]

The purpose behind s.172, within the framework just discussed, was primarily to emphasise the fact that directors should not run a company for short-term gains alone,[61] but to take into account long-term consequences.[62] The policy intention is to

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[54] L Roach "The Legal Model of the Company and the Company Law Review" (2005) 26 Co Law 98.

[55] *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties*, Law Reform Commission, Report No 261 (Scot Law Commission No 173) (1999).

[56] Law Com No. 261, Scot Law Com No. 173 at para 4.40-4.41. The Law Commission and the Institute of Directors have expressed concerns in the past that directors have a generally low level of understanding of their duties: Company Law Review *Modern Company Law for a Competitive Economy*: Developing the Framework, (London, HMSO, 2000) at para 3.37; Law Com No. 261, Scot Law Com No. 173 at para 4.25-4.26 and Appendix B.

[57] *Lords Grand Committee*, 6 February 2006, column 254. For a consideration of the purpose behind codification, see A.Keay, *Directors' Duties* (Jordans, Bristol, 2009) at 56-58.

[58] Company Law Review, *Modern Company Law for a Competitive Economy*, Final Report, vol 1, June 2001 at para 3.7.

[59] Ibid.

[60] Ibid.

[61] Short-termism has been defined as "seeking short-term gain to the exclusion of long-term achievement" : D. Mullins, "Foreword" in M. Jacobs, *Short-term America* (Harvard Business School

encourage decision-making based upon a longer-term perspective and not just immediate returns. Also, the section, together with the Business Review (required by s.417 of the Act), was to make the process of management more enlightened and it did this so as to ensure that directors would consider a much wider range of interests, with the hope that there would be more responsible decision-making. The Business Review was introduced to try to ensure that the directors not only were more inclusive in their actions, but that they justified what they did. It might be that, in line with what the CLRSG had to say, the duty in s.172 would not make a great deal of difference to the present situation but felt that it would "have a major influence on changing behaviour and the climate of decision making."[63]

Besides the purposes set out above, and which might be regarded as ground-breaking, the section clearly was included to take over the role previously played by the duty to act bona fide in the best interests of the company. That is, to act as the central fiduciary duty, at the very heart of which is the requirement of loyalty, for loyalty is concerned, inter alia, with the exercising of power in a good faith effort to foster the interests of the company.[64]

V. Fitness for Purpose

A. Introduction

The paper now turns to a study of s.172 in order to assess how it is likely to be applied by the courts and with the ultimate objective of assessing whether the section is fit for purpose. Is it likely to achieve what the Government intended it to achieve? In addition the part seeks to ascertain whether the provision requiring loyalty to the company is going to assist in enhancing corporate governance and help to overcome the problems that existed during the period leading up to the financial malaise (and thereafter).

What has to be noted at the outset is that the provision includes either novel or elusive concepts, such as "success of the company" and "good faith." This means that the application of the section, to a degree, is uncertain. At this stage it is unclear how the new and uncertain concepts are to be interpreted.

Press, Boston, Mass, 1991) and quoted in J. Grinyer et al, "Evidence of Managerial Short-termism in the UK" (1998) 9 *British Journal of Management* 13 at 13 and "foregoing economically worthwhile investments with longer-term benefits in order to increase reported earnings for the current period." : Grinyer et al ibid at 15. There is some debate as to whether UK markets at the time of the CLRSG's reports was short-termist. See P. Marsh, *Short-termism on trial* (Institutional Fund Managers Association, London, 1990); D. Miles, *Testing for Short-termism in the UK Stock Market* (Economics Division, Bank of England, London, 1992).

[62] This accords with the UK's Combined Code, sanctioned by the Financial Reporting Council, for it provides in its preamble that : "Good governance should facilitate efficient, effective and entrepreneurial management that can deliver shareholder value over the longer term." (Financial Reporting Council, *Combined Code on Corporate Governance*, June 2008 (London), at para 1).

[63] Company Law Review *Modern Company Law for a Competitive Economy: The Strategic Framework* (London, DTI, 1999) at para 5.1.17.

[64] E. Pan, "Rethinking the Board's Duty to Monitor : A Critical Assessment of the Delaware Doctrine" and accessible at http://ssrn.com/abstract=1593332 (last visited, 17 July 2010). Also, see P. Davies, *Gower and Davies' Principles of Company Law*, 8th ed (Sweet and Maxwell, London, 2008) at 506.

Hitherto, and notwithstanding the fact that the section has been in force for nearly three years, there is little or no relevant case law to enable us to ascertain how s.172 might be viewed by the courts. The only decisions, outside of the derivative action cases,[65] that have really said anything about the section and are worth mentioning are the Scottish case of *Re West Coast Capital (LIOS) Ltd*[66] and the English case of *Cobden Investments Ltd v RWM Langport Ltd*.[67] In the former case Lord Glennie merely said that the provision seemed to do little more than set out the pre-existing law on the subject. In the latter case Warren J seemed to agree, saying

> "The perhaps old-fashioned phrase acting '*bona fide* in the interests of the company' is reflected in the statutory words acting 'in good faith in a way most likely to promote the success of the company for the benefit of its members as a whole'. They come to the same thing with the modern formulation giving a more readily understood definition of the scope of the duty."[68]

If all s.172 does is to reflect the previous duty then it is not fit for purpose as the Government had expectations that the section would achieve more than the previous duty did. As with the previous duty the duty is based on loyalty and it aims to have directors consider the interests of the company and to act in good faith, but the Government wanted more. Furthermore, the view that s.172 merely restates the previous duty does not sit well with the fact that the Government said at one point that the new provision "marks a radical departure in articulating the connection between what is good for a company and what is good for society at large."[69]

B. Application

The first thing to note is that s.170(1) states that directors owe their duties to the company. If that is the case, how does that line up with the s.172(1) requirement that directors have to promote the success of the company for the benefit of the members as a whole? It must surely mean that the directors' overall duty is to the company and that duty encompasses all of the individual duties contained in ss.171-177. If there was a possible conflict between the company's interests and those of the members the

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[65] There have been several other cases that have mentioned s.172 in dealing with an application by shareholders for permission (in England and Wales) or leave (in Scotland and Northern Ireland) (Section 263(2)(a) and applying to England and Wales and Northern Ireland. The equivalent provision for Scotland is s.268(1)(a) to continue a derivative action, but that has been simply because where a court is satisfied that a person acting in accordance with s.172 would not seek to continue the claim, the court must refuse permission or leave. For example, see, *Mission Capital Plc v Sinclair* [2008] EWHC 1339 (Ch); *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch); [2008] BCC 885*;Wishart* [2009] CSIH 65; 2009 S.L.T. 812; *Iesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch); *Stimpson v Southern Landlords Association (2009)* [2009] EWHC 2072 (Ch); *Kiani v Cooper* [2010] EWHC 577 (Ch); *Stainer v Lee* [2010] EWHC 1539 (Ch). None of these cases have cast any light on s.172 and its scope, and one would not really expect them to do so.

[66] [2008] CSOH 72; 2008 Scot (D) 16/5 (Outer House, Court of Sessions, Lord Glennie) at [21].

[67] [2008] EWHC 2810 (Ch).

[68] Ibid at [52].

[69] *Duties of Company Directors*, DTI, June 2007, Introduction and Statement of the Rt Hon Margaret Hodge, and available at http://www.dti.gov.uk/files/file40139.pdf

former should prevail. But provided that an action is not against the interests of the company, s.170(1) means that one duty that the directors have to the company is to act in such a way that will foster the interests of the members as a whole. Section 172 does not give the shareholders, individually or a group of them, short of a derivative action, the right to enforce the duty as it is owed to the company. This has always been the case. The company has always had to take any action for a breach of duties of directors as the company is the one to whom the duties were owed,[70] save where the courts were willing to apply one or more of a number of so-called exceptions to the rule in Foss v Harbottle.[71]

1. Good Faith

The first thing to note is that in line with the duty which was, loosely, its predecessor, s.172 requires directors to act in good faith. This concept is central to the provision. A director is to act in such a way that *he considers*, in good faith, will promote the success of the company. Under the predecessor duty directors were obliged to act "bona fide in what they consider – not what a court may consider – is in the interests of the company…"[72] The focus was very much on what the directors themselves considered. The courts would neither impose their own views as to whether the decisions made by the director were in the best interests of the company,[73] nor would they hold a director liable simply because his actions happen, in the event, to cause injury to the company."[74] Further, no reasonableness test was applied. Whether a director had breached his or her duty came down to a consideration of the director's state of mind and provided that directors believed in good faith that they were acting in the best interests of the company they could not be said to be in breach. In *Regentcrest plc v Cohen*[75] Jonathan Parker J, when dealing with the duty to act bona fide in the best interests of the company, said that if the directors give unequivocal evidence that they had honestly believed that they had acted in the best interests of the company,[76] and if that evidence were accepted, then there had been no breach.[77] The new duty would seem to attract the same approach. This is evident in the statement of the Government Minister responsible for the legislation, Margaret Hodge MP, when she said, in relation to s.172, that : "We believe it is essential for the weight given to any factor to be a matter for the director's good faith judgement. Importantly, the decision is not subject to the reasonableness test."[78]

Nevertheless, courts will not accept without question a director's statement that he or she acted in good faith, and where it is patent that the act complained of led to significant detriment to the company a director will have, according to Jonathan Parker J in *Regentcrest plc v Cohen*, a more difficult task in convincing the court that

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[70] See, *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189.

[71] Arguably there was only one true exception to the rule, namely the fraud on the minority ground.

[72] *Re Smith & Fawcett Ltd* [1942] Ch. 304 at 306 per Lord Greene MR.

[73] Ibid at 306; *Regentcrest plc v Cohen* [2002] 2 BCLC 80; *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598.

[74] *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598 at [90]

[75] [2002] 2 B.C.L.C. 80.

[76] Ibid at [124].

[77] Ibid at [125].

[78] *HC Standing Committee* D, Fifteenth Sitting, 11 July 2006, Cols 591-593.

he or she honestly believed the action to be in the best interests of the company.[79] The judge hearing the case simply might not believe the evidence of the directors as to his or her state of mind. This is, arguably, consistent with what Harman J said in *Re a Company*[80] where his Lordship said that : "It is, in my judgment, vital to remember that actions of boards of directors cannot simply be justified by invoking the incantation 'a decision taken bona fide in the interests of the company.'"[81]

So, an assertion by a director is not impregnable and judges are not prevented from declining to accept it. In *Extrasure Travel Insurance Ltd v Scattergood*[82] Jonathan Crow (sitting as a deputy High Court judge) plainly did not believe the directors when they said that they believed that they were acting in the best interests of the company. The learned deputy judge said : "I am satisfied that the defendants did not think, on 17 August 1999, that the transfer of £200,000 was in the best interests of Extrasure."[83] He was of view that the directors' evidence was not plausible, given the surrounding evidence, and he found against them.[84] But it is likely to be difficult to demonstrate, save in cases of really bad behaviour, that the directors have breached their duty of good faith.[85] It is challenging, in most cases, to impugn the actions of someone who is able to state clearly that he or she believed that what was done was for the company's best. Directors will normally assert that their motives were pure. Courts are going to be rather reluctant to decline to accept evidence given by directors concerning their motives. Paul Davies has opined that it is difficult to say that a director has failed to act in good faith "except in egregious cases or where the directors, obligingly, have left a clear record of their thought processes leading up to the challenged decision,"[86] and that is probably correct.

Nevertheless, there is *one* situation where reasonablenss might be an issue. This is where the director had actually failed to consider whether an action would be in the interests of the company. In *Charterbridge Corp Ltd v Lloyds Bank Ltd*[87] Pennycuick J said that in such a situation the court has to ask whether an intelligent and honest man in the position of a director of the company involved, could, in the whole of the circumstances, have reasonably believed that the transaction was for the benefit of the company.[88]

In *Cobden Investments Ltd v RWM Langport Ltd*[89] Warren J was of the view that the duty in s.172 is subjective, just as its precursor was.[90] This seems to be right as the

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79 [2002] 2 BCLC 80 at [90]. Also, see Arden LJ in *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244; [2005] 2 BCLC 91 at [52].

80 [1988] BCLC 570.

81 Ibid at 577.

82 [2003] 1 BCLC 598.

83 Ibid at [105].

84 Ibid at [106].

85 *Re Smith & Fawcett Ltd* [1942] Ch. 304.

86 P. Davies, *Gower and Davies' Principles of Company Law*, 8th ed (Sweet and Maxwell, London, 2008) at 510.

87 [1970] Ch 62; [1969] 3 All ER 1185.

88 *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 62 at 74; [1969] 3 All ER 1185 at 1194. Also, see *Shuttleworth v Cox Bros (Maidenhead) Ltd* [1927] 2 KB 9 at 23.

89 [2008] EWHC 2810 (Ch).

90 Ibid at [53].

section states that : "A director of a company must act *in a way that he considers, in good faith*, would be most likely to promote the success of the company..."(my emphasis). Such a view is confirmed by what the Explanatory Notes to the Act state. They provide that the decision as to what will promote the success of the company, and what constitutes such success, is one for the director's good faith judgment, and this ensures that business decisions on, for example, strategy and tactics are for the directors, and not subject to decision by the courts, always provided directors acted in good faith.[91]

In sum, the position under the old duty was that provided that courts believed directors when they gave evidence that they considered in good faith that the action that was taken was in the best interests of the company, the directors would not be liable for breach. However, a judge might, given all the evidence in the case, opine that the directors are not to be believed concerning their state of mind, and hold them liable. If a director did act in good faith, but unreasonably (in the view of the judge), then it would seem that he or she would not be in breach of the duty to act in the best interests of the company, provided he or she had considered that what they were doing was in the best interests of the company. There is nothing to suggest that the new provision will be interpreted any differently. Where a director has acted in good faith, but not reasonably, any claimant would have to seek to make out a case for breach of the duty of care set out in s.174.

2. Success

The directors must act to promote the success of the company.[92] Success is quite a slippery term and this might well be as vague as "best interests"[93] under the previous duty. In its response to the second White Paper and the draft Bill in 2005 the Law Society said, in relation to the clause that was the precursor to s.172, that the term would create practical problems of some significance.[94] The Confederation of British Industry in its submission was concerned about how success was to be measured.[95] It might be said that it means the achievement of the business objectives that the company has laid down for itself, and these could include financial, strategic or others. The Government's intention is that the decision as to what will promote the success of the company, and what constitutes such success, is one for the director's good faith judgement.[96] The directors' interpretation of any business objectives could be important. It might be argued that what is done to fulfil that interpretation cannot be impugned provided that it cannot be established that the directors did not have a good faith belief in the strategy they had for promoting the company's success.

Lord Goldsmith, in an address to the Parliament in February 2006, considered what success would entail. He said that :

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[91] Explanatory Notes to the Companies Act 2006 at para 327. Also, see Clause 64 of the Guidance to Key Clauses in the Company Law Reform Bill 2005

[92] For more discussion of this element, see A. Keay, *Directors' Duties* (Jordan, Bristol, 2009) at 118-120.

[93] See J. Edelman, "When Do Fiduciary Duties Arise?" (2010) 126 LQR 302 at 322.

[94] Law Society's Company Law Committee, June 2005 at 6.

[95] Submission to the DTI, June 2005 at 25.

[96] Explanatory Notes to the Companies Act 2006 at para 327.

> "…for a commercial company, success will normally mean long-term increase in value, but the company's constitution and decisions made under it may also lay down the appropriate success model for the company. … it is essentially for the members of a company to define the objectives they wish to achieve. The normal way for that to be done—the traditional way—is that the members do it at the time the company is established. In the old style, it would have been set down in the company's memorandum. That is changing … but the principle does not change that those who establish the company will start off by setting out what they hope to achieve. For most people who invest in companies, there is never any doubt about it—money. That is what they want. They want a long-term increase in the company. It is not a snap poll to be taken at any point in time."[97]

3. Benefit Members as a Whole

The previous duty to s.172 involved directors having to act in the best interests of the company. "The interests of the company" has probably been one of the most problematical expressions in company law, and it has often been misunderstood.[98] Many have said that it means the interests of the shareholders as a whole,[99] namely the shareholders as a general body, although there are cases in which judges have played down the pre-eminence of shareholders' interests. It has been argued that there is not a clear strain of authority running through UK and Commonwealth case law that holds that only shareholder interests are to be the concern of the directors.[100] A number of cases do suggest that the focus should be on shareholders, while others either merely state that the directors are to act in the interests of the company, or indicate that the interests of the company involves something more than the interests of shareholders.[101]

The Parliament has been congratulated for removing the reference to "interests of the company" and replacing it in s.172(1) with the expression "members as a whole."[102] This latter expression has been used on several occasions in company law and, consequently, one would assume that the judicial comments on the meaning of the expression would be pressed into service here. The courts have tended to hold that it

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97 *Lords Grand Committee,* 6 February 2006, column 256.

98 For example, see the comments of Nourse LJ in *Brady v Brady* (1987) 3 BCC 535 at 552.

99 Company Law Review, *Modernising Company Law : The Strategic Framework*, (London, DTI, 1999) at para 5.1.5.

100 A. Keay, "Enlightened shareholder value, the reform of the duties of company directors and the corporate objective" [2006] *Lloyds Maritime and Commercial Law Quarterly* 335 at 345. Also, see S. Deakin, "Squaring the Circle? Shareholder Value and Corporate Social Responsibility in the U.K." (2002) 70 *George Washington Law Review* 976 at 977.

101 See, for instance, *Fulham Football Club Ltd v Cabra Estates plc* [1992] BCC 863 at 876. Also, see A. Keay, "Enlightened shareholder value, the reform of the duties of company directors and the corporate objective" [2006] *Lloyds Maritime and Commercial Law Quarterly* 335 at 345.

102 P. Davies, "Enlightened Shareholder Value and the New Responsibilities of Directors," W.E. Hearn Lecture, delivered at the Law School, University of Melbourne, 4 October 2005 at 4-5.

means the present and future shareholders, certainly in relation to companies for profit.[103] In relation to this expression Lord Goldsmith said in Parliament that :

> "the duty is to promote the success for the benefit of the members as a whole – that is, for the members as a collective body – not only to benefit the majority shareholders, or any particular shareholder or section of shareholders, still less the interests of directors who might happen to be shareholders themselves."[104]

As far as the meaning of the benefit involved, the courts have tended to hold that it means the financial well-being of the shareholders.[105]

It would appear that the phrase "members as a whole" embraces future shareholders. The CLRSG certainly did envisage this as it said that directors should not ignore events that may occur after the present members have ceased being members.[106] All of this seems to indicate that the phrase is likely to be applied by many courts in the same way as "interests of the company" was under the old duty.

If that is correct, it makes the assessment of the decisions of directors difficult, for some actions can be more beneficial for the present shareholders than future ones and vice versa, depending on how much of a long-term view is taken.

4. The Prescribed Factors

One of the novel things which s.172(1) did was to provide that the directors are, in the course of discharging their duty to promote the success of the company, to have regard to[107] a list of factors. It must be noted that this does not introduce a new duty being owed to the constituencies who are referred to in s.172(1). The directors' duty is to the company, as required by s.170(1). Margaret Hodge made this plain when she said that : "a director will not be required to consider any of the factors [in s.172(1)] beyond the point at which to do so would conflict with the overarching duty to promote the success of the company."[108]

On one view the listing of these factors does not introduce anything new. Arguably, there was nothing in the existing case law that forbade directors from taking into account the long-term consequences of what they were proposing to do and even the interests of others besides shareholders, as long as the directors acted in good faith in the best interests of the company as a whole. In fact many have said that directors would be acting prudently if they considered the interests of the stakeholders in their

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[103] For instance, see *Gaiman v National Association for Mental Health* [1971] Ch 317 at 330; *Brady v Brady* (1987) 3 BCC 535 at 552 (CA).

[104] *Lords Grand Committee*, 6 February 2006, column 256.

[105] For instance, see ibid.

[106] Company Law Review *Modern Company Law For a Competitive Economy*: Developing the Framework (London, DTI, 2000) at para 3.54.

[107] For a discussion of the meaning of "having regard to," see A. Keay, *Directors' Duties* (Jordan, Bristol, 2009), at 138-143.

[108] *HC Standing Committee* D, Fifteenth Sitting, 11 July 2006, Cols 591-593.

decision-making. Naturally, the interests of shareholders are not likely to be enhanced if, for example, the company's workers are discontented or even on strike, or the company's customers are dissatisfied with the company's products or way of doing business.

Nevertheless, there are at least three potential problems with the requirement to have regard to the factors. First, how do directors have regard to the interests set out in s.172(1) where one or more of the factors are in conflict with promoting the overall success of the company? To make sense of s.172(1) it must mean that directors are to have regard to the factors and if they find that any or all are inconsistent with promoting the success of the company, they must surely dismiss them from their decision-making. This is consistent with what Margaret Hodge said above. Second, what if there is a conflict between one or more of the factors on the one hand, and interests of the members, on the other? The CLRSG recognised the fact that where the long-term interests of the company are in view, there will be a clash between the interests of those mentioned in s.172(1), on the one hand, and those of the shareholders, on the other.[109] Examples given by the CLRSG include the closing down of a plant or the termination of a long-term supply contract when the continuation of either will impact adversely on shareholder returns.[110]

Third, what if there is conflict between the various interests mentioned in s.172(1)(a)-(f) which does not impact on the promotion of the success of the company?[111] That is, favouring any one of the interests will promote the success of the company, but which one should be chosen? If there is a conflict, do the directors have to balance, in line with the stakeholder theory, competing factors where they conflict? If directors are to balance, how are they to do that? For instance, should a company purchase new technology that might benefit the environment, but which might also affect employees as there might be resultant job losses?[112] Also, what weight is to be given to each factor?[113] The concern of some is that directors could use a balancing exercise as an opportunity to foster their own self-interest.[114] With directors having greater discretion in deciding what interests to take into account, it might be thought that shareholders will have more difficulty in monitoring the performance of directors, and directors might resist claims of breach of duty on the basis that what they did was based on a consideration of the interests of one or more constituencies that are mentioned in s.172(1). Some might doubt whether company managers are in a position to carry out a fair and efficient balancing of the interests on the basis that

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109 Company Law Review, *Modern Company Law for a Competitive Economy* : "The Strategic Framework" 1999, London, DTI at para 5.1.15.

110 Ibid.

111 The same concern that was expressed in regard to the US constituency statutes. It has been said that these statutes place burdens on directors to consider a wide range of interests that might well conflict without "establishing sufficient standards by which directors may evaluate them" (J. D. Springer, "Corporate Constituency Statutes : Hollow Hopes and False Fears" (1999) *Annual Survey of American Law* 85 at 107).

112 Example given in CMS Cameron McKenna, "Companies Act 2006 : An Overview" September 2007.

113 For further discussion of this point, see, A. Keay, *Directors' Duties* (Jordans, Bristol, 2009) at 124.

114 M. Roe, "The Shareholder Wealth Maximization Norm and Industrial Organization" (2001) U Pa L Rev 2063 at 2065.

they might well be looking to take into account their own interests, often at odds with those of some constituencies.[115] This might be particularly pertinent when one considers s.172(1)(f) and the need to ensure that the directors act fairly between the shareholders of the company.[116]

The Explanatory Notes to the Act state that :

> "It will not be sufficient to pay lip service to the factors [these set out in s.172(1)(a)-(f)], and, in many cases the directors will need to take action to comply with this aspect of the duty."[117]

But it can be asserted, as we have seen, that when directors have acted in good faith the court is not to question, for the most part, the directors' actions and it is hard to see where there is a statement from the directors that they acted in good faith and considered the factors in s.172(1), how a court will be able to ascertain whether the directors just paid lip service to the factors, and even more what a court would do if it came to the conclusion that mere lip service was paid to the factors. Would a court be willing to make a business judgment and say that X should have been done rather than Y because the directors did not really have regard for one or more of the factors in s.172(1)(a)-(f)? It is unlikely given the fact that courts are often reluctant to decide on commercial decisions made by directors.

Although not overtly stated, it is likely that the duty to foster the success of the company for the benefit of the members and the duty to take into account other interests can be seen in a hierarchal way, with the former being regarded more highly than the latter. The CLRSG advocated a hierarchy of obligations when it proposed a similar approach,[118] and this involved the promotion of the benefit of the members' interests above those of the broader interests set out in paragraphs (a)-(f) of s.172(1). This causes one to wonder whether the provision provides any or significant enlightenment. The situation is as before; directors will consider stakeholder interests as far as they promote the success of the company, but only where it will benefit of shareholders.

C. The Section 417 Business Review

At one stage, before the Act was enacted, s.172 was only one part of the concept of enlightened shareholder value ("ESV") that the Government wanted to bring into force. The other half was the requirement for companies to prepare and publish an

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[115] J. Parkinson, "Models of the Company and the Employment Relationship" (2003) 41 *British Journal of Industrial Relations* 481 at 498. In a paper by the Special Representative of the Secretary-General (SRSG) on the Issue of Human Rights and Transnational Corporations and other Business Enterprises titled "Corporate Law Project : Overarching Trends and Observations", July 2010, (accessible at http://www.reports-and-materials.org/Ruggie-corporate-law-project-Jul-2010.pdf) (last visited, 28 July 2010) it was indicated that little guidance is provided around the world to assist directors in balancing.

[116] On which, see the decision pre-codification, in *Re BSB Holdings Ltd (No2)* [1996] 1 BCLC 155.

[117] At para 328.

[118] Company Law Review, *Modern Company Law for a Competitive Economy* : *Completing the Structure*, 2000, London, DTI at para 3.19.

operating and financial review ("OFR")[119] with the directors' report. The clause covering the need for the OFR provided that companies were to publish material information pertaining to the activities of the company and this was to include details concerning future plans, opportunities and risks. The Government envisaged the OFR providing a major benefit to a "wider cross-section of a company's stakeholders."[120] The material that directors had to consider were relevant to the interests of stakeholders other than shareholders, such as the company's policies in relation to : employment; environmental issues relevant to the company's business; and the company's policies on social and community issues relevant to the company's business.[121] But in the end the Government executed a U-turn[122] and enacted the Companies Act (Operating and Financial Review (Repeal) Regulations 2005[123] which in fact removed the need for quoted companies to file an OFR. The then Chancellor of the Exchequer, Gordon Brown, said that if companies were required to produce the OFR it would add to their administrative burdens. The need for the OFR was replaced with the requirement that all but small companies have to include a Business Review ("the Review") with the directors' report.[124] While this was a blow to many who had lobbied for the OFR, it must be acknowledged that the provisions providing for the Review require similar things to those required in the OFR.[125] But Andrew Johnson asserts that the Review will: "be considerably less prescriptive and will offer even less guidance than the OFR about what should be disclosed."[126]

Notwithstanding Johnson's concern, the information required under s.417 is, prima facie, quite extensive. Besides being required to include a fair review of the company's business and a description of the principal risks and uncertainties faced by the company,[127] quoted companies have to include, to the extent necessary to understand the development, performance and position of the company's business, information about environmental matters, the employees, social and community issues and the people with whom the company has contractual arrangements.[128] The Review ties in with s.172 in that the Review's objective was, as indicated in s.417(2), "to

[119] *Modernising Company Law*, Cm 5553-I, DTI at para 4.28. The need for such a review was included it in clauses of a draft Companies Bill attached to a White Paper in July 2002.

[120] Ibid at para 4.32. For a detailed discussion of the OFR and its withdrawal by the Government, see A. Johnston, "After the OFR : Can UK Shareholder Value Still Be Enlightened?" (2006) 7 EBOR 817.

[121] Clause 75(2).

[122] "Chancellor Gives ONS Independence," BBC News, November 28, 2006, available at http://news.bbc.co.uk/1/hi/business/4477516.stm; see also C. Williams and J. Conley, "Triumph or Tragedy? The Curious Path of Corporate Disclosure Reform in the U.K." (2007) 31 Wm & Mary Envtl. L. & Pol'y Rev. 317 at 327-361 and referred to in G. L. Clark and E. R. W. Knight, "Implications of the UK Companies Act 2006 for Institutional Investors and the Market for Corporate Social Responsibility" (2009) 11 U Pa J Bus L 259 at 275.

[123] SI 2005/3442.

[124] Andrew Johnson saw this as "a regressive step" ("After the OFR : Can UK Shareholder Value Still Be Enlightened?" (2006) 7 EBOR 817 at 842).

[125] Although one view put forward by respondents in an empirical study undertaken by Peter Taylor was that the preparation of the Business Review was, in comparison to the OFR, easier : P. Taylor, "Enlightened Shareholder Value and the Companies Act 2006" (unpublished PhD thesis, May 2010), Birbeck College, University of London, at 182.

[126] "After the OFR : Can UK Shareholder Value Still Be Enlightened?" (2006) 7 EBOR 817 at 841).

[127] Section 417(3).

[128] Section 417(5).

inform members of the company and help them assess how the directors have performed their duty under section 172." To this end, it is in the Review where directors should indicate the regard which they have had for the factors set out in s.172(1)(a)-(f). Nevertheless, there is nothing to prevent directors making quite neutral statements which give little detail about their thinking and discussions at board level. Davies seems to agree when he says that there is a risk that the Review : "will be productive of self-serving and vacuous narrative rather than analytical material which is of genuine use."[129] One outcome from a small empirical study conducted by Peter Taylor, involving interviews of senior officials of FTSE 350 companies and representatives of some institutional investors, undertaken since s.172 came into operation, was that companies were prepared to disclose in the Review how risk was managed as a formal process, but not what were the actual risks to the company's business and which might be critical to the viability of the business.[130] One institutional investor responding to questions asked in the study[131] was sceptical about the impact of the Review in relation to risk, and said that in most companies the risk disclosures are many pages of boilerplate risk factors (terminology used by another respondent[132]) as the focus is on defensive disclosures to ensure that the board is not sued. It is highly debatable as to whether the Review is able to verify whether directors have discharged their duty under s.172.

As indicated above, the Review is designed to inform members. While some members who might be said to have a social conscience or who are focused on long-term issues, may be concerned about environmental matters, the employees and so on, most members are likely to be concerned about the bottom line. Is the company making profits and what do the shareholders get out of it? The Review could be used in evidence in any claim against the directors for breach, but it has got to get to court, and as we shall see later, that is a problematic.

One interesting matter that is worth dwelling on, in light of the fact that at the outset of this paper it was noted that according to many one cause of the financial crisis was that companies embraced excessive risk, is the issue of corporate risk.[133] Will the requirement in s.417(3)(b) that companies must include in the Review a description of the principal risks and uncertainties that the company is facing be likely to make boards more risk averse to the point of not repeating some of the mistakes of the past decade (and perhaps longer) or enable shareholders to take action to thwart the board taking on unacceptable risk? The rather imprecise answer is "maybe." A positive response to either of the questions raised above is dependent on financial institutions rightly identifying the risks inherent in the deals in which they are, or about to be, engaged, so that they can disclose the risks in the Review. There are indications that boards of at least some financial institutions did not appreciate the full extent of the

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129 *Gower and Davies' Principles of Company Law*, 8th ed (Sweet and Maxwell, London, 2008) at 740.

130 P. Taylor, "Enlightened Shareholder Value and the Companies Act 2006" (unpublished PhD thesis, May 2010), Birbeck College, University of London, at 196.

131 Ibid.

132 Ibid at 187-188.

133 M. Lipton, T. Mirvis & J. Lorsch, "The Proposed "Shareholder Bill of Rights Act of 2009" Harvard Law School Forum on Corporate Governance & Financial Regulation (May 12, 2009), and accessible at : http://blogs.law.harvard.edu/corpgov/2009/05/12/the-proposed-%e2%80%9cshareholder-bill-of-rights-act-of-2009%e2%80%9d (last visited on 1 June 2010).

risks that their companies were taking, partly because they did not understand many of the transactions being entered into[134] and the possible ramifications of default, so they would not be able to disclose risk factors accurately. Furthermore, it is likely that many companies will be most reluctant to disclose their major risks as that might provide their competitors with ammunition and/or place themselves in a weak bargaining position when dealing with others.

D. Long Termism

Clearly at the heart of the concerns of both the CLRSG in its deliberations as far as directors' duties were concerned, and the Government when it introduced s.172, was to encourage companies to be managed for the long term. Whilst some who have advocated the employment of shareholder value in company management felt that businesses should be run for the long term,[135] not all have favoured such a view,[136] and for the most part shareholder value has been linked to short-termism, with Enron, the disgraced American energy company, and the effects of its business approach, being synonymous with short termism. According to several finance academics, the shareholder value approach produces a short-term focus and short-term earnings performance overshadows all else.[137] While logically shareholder value should not necessarily lead to short-termism, with a concomitant fixation on the quarterly earnings of companies and their share value,[138] in practice it often has. This was certainly the view of the CLRSG, for it said that :

> "the state of directors' duties at common law are often regarded as leading to directors having an undue focus on the short term and the narrow interests of members at the expense of what is in a broader and a longer term sense the best interests of the enterprise …"[139]

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[134] D. Arsalidou, "The Banking Crisis : Rethinking and Redefining the Accountability of Bank Directors" [2010] JBL 284 at 292.

[135] For example, see M. Jensen, "Value Maximisation, Stakeholder Theory and the Corporate Objective Function" (2001) 14 *Journal of Applied Corporate Finance* 8; H. Hansmann and R. Kraakman, "The End of History for Corporate Law" (2001) 89 *Georgetown Law Journal* 439 at 439; G. Dent, "Corporate Governance : Still Broke, No Fix in Sight" (2006) 31 J Corp L 39 at 57.

[136] M. Lipton, T. Mirvis & J. Lorsch, "The Proposed "Shareholder Bill of Rights Act of 2009" Harvard Law School Forum on Corporate Governance & Financial Regulation (May 12, 2009), and accessible at : http://blogs.law.harvard.edu/corpgov/2009/05/12/the-proposed-%e2%80%9cshareholder-bill-of-rights-act-of-2009%e2%80%9d (last visited on 1 June 2010) refers to the fact that short-termism is still rife. Also, see Aspen Institute, "Overcoming Short-Termism" Business and Society Program, 9 September 2009 (accessible at http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/overcome_short_state0909_0.pdf) (last visited, 28 July 2010).

[137] S. Wallman "The Proper Interpretation of Corporate Constituency Statues and Formulation of Director Duties" (1991) 21 *Stetson Law Review* 163 at 176-177; M. Lipton and S. Rosenblum "A New System of Corporate Governance: The Quinquenial Election of Directors" (1991) 58 U Chi L Rev 187, at 205-215; M. E. van der Weide "Against Fiduciary Duties to Corporate Stakeholders" (1996) 21 Del J Corp L 27 at 61.

[138] See, D Millon "Why is Corporate Management Obsessed with Quarterly Earnings and What Should be Done About it?" (2002) 70 *George Washington Law Review* 890, especially, 902.

[139] Company Law Review *Modern Company Law for a Competitive Economy*: The Strategic Framework (London, DTI, 1999) at para 5.1.17.

Perhaps a good example of neglecting the long term is where a company engages in drastic cost-cutting that might achieve short-term results by improving the bottom line for a short while, and providing shareholders with good dividends and an enhanced share value, but in the long-run this might deleteriously affect the company's business.[140]

A potential problem is that differentiating between what is the short term and what is the long term is not easy. As William Allen, the former Chancellor of the Delaware Court of Chancery, said extra-judicially : "[t]he law 'papered over' the conflict in our conception of the corporation by invoking a murky distinction between long-term profit maximization and short-term profit maximization."[141] Short-termism has been defined as : "foregoing economically worthwhile investments with longer-term benefits in order to increase reported earnings for the current period."[142] This could mean scrimping on research and development, failing to renew plant and equipment or making employees redundant (even though they might need to hire more in the medium term, it provides a short term boost to profits at least). It has been said that to apply a short-term approach strictly in this context would mean that the directors would be paying out to shareholders every amount earned as profit and with no consideration of investing funds and expansion of the company's market.[143] If maximising for long-term value, it might be thought that directors would aim to balance the seeking of opportunities to make profits now with opportunities to make profits in the future.[144]

While s.172 provides an entreaty, in s.172(1)(a), to manage whilst having regard for the long-term effects of an action, it is questionable whether it will in fact happen across the board. First, it is going to be difficult to enforce the long-term requirement, especially where directors resolutely maintain that they have acted in good faith. Second, managing for the long term is often antithetical to the interests of the company's managers. Managers could favour the short term because they only have a temporary interest in the company, primarily limited to their time in the job. Managers get no or little benefit from planning for the long term as it is likely to be their successors who will receive the plaudits, and benefit from rents that come to the company under that approach.[145] In fact planning for the long term could make the performance of today's managers look decidedly average, as the share price might not increase and higher dividends would not be paid as quickly as if short-term plans were implemented. Also managers' remuneration has often been aligned with short-term

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[140] E. Orts "The Complexity and Legitimacy of Corporate Law" (1993) 50 *Washington and Lee Law Review* 1565 at 1592.

[141] W. Allen, "Our Schizophrenic Conception of the Business Corporation" (1992) 14 *Cardozo Law Review* 261 at 273.

[142] J. Grinyer, A. Russell and D. Collision, "Evidence of Managerial Short-termism in the UK" (1998) 9 *British Journal of Management* 13 at 15.

[143] J. Heydon, "Directors' Duties and the Company's Interests" in P. Finn (ed), *Equity and Commercial Relationships* (Sydney, Law Book Co, 1987) at 135.

[144] See, S. Lydenberg, *Corporations and the Public Interest : Guiding the Invisible Hand* (Berrett-Koehler, San Francisco, 2005) and quoted in A. White, "What is Long-Term Wealth?" Business for Social Responsibility paper, September 2007 and accessible at http://www.bsr.org/reports/bsr_awhite_long-term-wealth.pdf (last visited, 30 March 2010) at 4.

[145] F. Allen and D. Gale, *Comparing Financial Systems* (Cambridge, Massachusetts, MIT Press, 2000) at 382.

shareholder interests (in order, it is said, to reduce agency costs). Third, and linked to the point just made, the short-term approach seems to have been favoured in the past in the UK and the US and, arguably, still holds sway due to a number of factors, including shareholder pressure. How long are shareholders going to keep their powder dry before they look at pressuring the board to oust a CEO (or other manager(s)) who does not seem "to be doing the business"? How long will they accept the directors' reports that things are being done for the long term and there will be benefits "down the track?" Christopher Bruner in dealing with the governance of financial institutions has said that authorities in the US and the UK should be seeking to devise structures "divorcing financial firm managers' interests from the short-term orientation of equityholders to the maximum degree possible,"[146] but that might not be possible in an Anglo-American environment.

While there is often emphasis placed on managers reacting to the pressure of shareholders, it is not just the shareholders who have to be kept on-side. It has been said quite recently by highly respected commentators in this field, Lipton, Mirvis and Lorsch that :

> "Short-termism is a disease that infects American business and distorts management and boardroom judgment. But it does not originate in the boardroom. [It] is bred in the trading rooms of the hedge funds and professional institutional investment managers who control more than 75% of the shares of most major corporations."[147]

Due to the threat of hostile takeovers, some directors may tend to act in the short-term interests of their shareholders – to keep the shareholders satisfied and so they would reject any takeover offer, and, therefore, keep them (it is hoped) in control of the management of the company.

Fourth, how are the actions of directors to be measured in order to ascertain if they have been acting in the long term? As suggested above, the concept of the "long term" is not precise. How far in the future are the directors of the company required to provide for in their decision-making? Defining what is the short term is difficult enough, but it has been argued that the long term is even harder to define.[148] For some businesses which are established for one or two specific reasons, next year is the long term and yet for more traditional businesses the long term will be much further into the future.

The common law permitted directors to consider short-term and long-term issues in making decisions. Now s.172 also appears to do so. It enables directors not

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[146] C. Bruner, "Corporate Governance Reform in a Time of Crisis" and accessible at http://ssrn.com/abstract=1617890 (last visited, 23 June 2010).

[147] M. Lipton, T. Mirvis & J. Lorsch, "The Proposed "Shareholder Bill of Rights Act of 2009" Harvard Law School Forum on Corporate Governance & Financial Regulation (May 12, 2009), and accessible at : http://blogs.law.harvard.edu/corpgov/2009/05/12/the-proposed-%e2%80%9cshareholder-bill-of-rights-act-of-2009%e2%80%9d (last visited, 1 June 2010).

[148] E. Elhauge, "Sacrificing Corporate Profits in the Public Interest" (2005) 80 NYULR 733 at 756.

necessarily to aim for a high increase in the market value of the company's shares. In the Company Law Reform Bill that was part of the Government's 2005 White Paper,[149] clause B3 stated, inter alia, that directors have to have regard to: "(a) The likely consequences of any decision in both the long and the short term." The omission of any reference to the short term in s.172(1) has led Mayson, French and Ryan to conclude that the long term is more important.[150] I am unsure whether one can necessarily draw that conclusion as undoubtedly the general thrust of the provision, with the benefit of members being the end result, would still permit consideration of the short term. The CLRSG had said that directors were obliged to "achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose" and this involved taking "a proper balanced view of the short and long term."[151] Perhaps the omission of any reference to the short term in s.172 is designed merely to emphasise the relevance of the long term when it has been eschewed by many in the past. The reference to the long term does not mean, it is submitted, that the directors are not able to focus on the short term if they believe that it will promote the success of the company for the benefit of the members.

Clearly, there appears to be a difference between the position that existed under the previous law compared with that under the new law, especially seeing that the Government said that the new provision "marks a radical departure in articulating the connection between what is good for a company and what is good for society at large."[152] But, as suggested above, prior to the inclusion of s.172(1)(a) directors of many companies did look at the long term in certain situations and did not only focus on the short-term effects of their decisions. For example, if a company were to expand and open a new factory, it would be clear that the short-term costs of facilitating this process[153] would be huge, but it might well produce handsome benefits in the long term.

Two recent contrasting approaches to dealing with the economic downturn might be useful in considering the long term as against the short term. It might be said that when the Shell board in late 2009, in order to boost the dollar value of the dividend by five per cent (notwithstanding a large decrease in profits), decided to axe 5,000 jobs,[154] it was addressing the short term. The approach of Shell might be contrasted with what BT did to address problems raised by the most recent recession, including £1.3 billion loss for the first quarter of 2009. It asked staff to take a pay cut in return

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149 Cm 6456, 2005, DTI.

150 *Company Law* 24th ed, (Oxford, OUP, 2007) at 457.

151 Company Law Review *Modern Company Law for a Competitive Economy:* Developing the Framework (London, DTI, 2000) at para 2.19. It has been said that directors should be at liberty to use their commercial judgment in order to balance short- and long-term considerations : Australian Parliamentary Joint Committee on Corporations and Financial Services "Corporate Responsibility: Managing Risk and Creating Value," 21 June 2006 at para 3.82 and accessible at: www.aph.gov.au/Senate/committee/corporations_ctte/corporate_responsibility/report/report.pdf (last visited, 17 July 2008).

152 *Duties of Company Directors*, DTI, June 2007, Introduction and Statement of Rt Hon Margaret Hodge, and available at http://www.dti.gov.uk/files/file40139.pdf

153 Including building the factory, creating more jobs and so on.

154 C. Mortished, "Shell to axe 5,000 jobs amid 73% profit fall" *The Times*, October 29, 2009.

for long-term holidays,[155] rather than making workers redundant. The strategy devised by BT would take into account two factors. First, the company was cognisant of the bad publicity that is so often associated with laying-off staff. Second, it did not wish to lose many of its skilled workers that it had trained, for when the economy strengthened they would need these workers again.[156] That might be regarded as long-term thinking.

Finally, what might constitute a failure to have regard to the long term? This depends on a lot of factors, such as the size of the company, the company's business and the nature of the relevant marketplace. The Institute of Chartered Secretaries and Administrators' Guidance on Directors' General Duties gives the example of a failure to consider the long term where a pharmaceutical company cuts the research and development budget.[157] Another possible strategy that could be regarded as long term is taking action that will increase corporate reputation, not perhaps in the short term, but it will lead to long-term benefits.

Importantly for the context of this paper, it has been asserted by several reputable commentators that banks have been operating under short-term strategies for years.[158] UBS reported to shareholders in 2008 that it had a culture that was focused on short-term profits and had "insufficient incentives to protect the UBS franchise long-term."[159] Certainly, there seems to be some evidence that the finance institutions in the period that preceded the crisis of 2007-2009 failed to take into account the long term for they embraced risks which proved lucrative in the short term, but have turned out to be catastrophic for future shareholders (and many others). Some will undoubtedly argue that convenient hindsight is being used to come to that conclusion, but it is suggested that there were indications at various stages in the time running up to the advent of the downturn, and before everything fell apart, that the risks adopted by these institutions were potentially too high, and, arguably, too short term.

Will s.172 change the approach of boards? Much of what we say amounts to speculation, although the empirical study undertaken by Taylor indicates that the pressure on short-termism in favour of more long-term thinking had not been reduced since the enactment of s.172.[160]

E. Enforcement

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[155] R. Henry, "BT in bid to cut staff pay in return for holidays" *The Times*, July 4, 2009.

[156] This second issue is illustrative of the change of circumstances in companies in recent times. Many companies are reliant on a skilled workforce that is not easy to replace. See L. Zingales, "In Search of New Foundations" (2000) 55 *Journal of Finance* 1623.

[157] February 2008, at para 3.2.1. Research and development is usually an investment made in order to generate future cash and profit flows: J. Grinyer, A. Russell and D. Collison "Evidence of Managerial Short-termism in the UK" (1998) 9 *British Journal of Management* 13 at 14.

[158] L. Bebchuk and H. Spamann, "Regulating Bankers' Pay" and accessible at http://ssrn.com/abstract=1410072; S. Bhagat and R. Romano, "Reforming Executive Compensation : Focusing and Committing to the Long-Term" (2009) 26 *Yale Journal on Regulation* 359.

[159] UBS AG, Shareholder Report on UBS's Write-Downs at 42 and referred to in P. Rose, "Regulating Risk by 'Strengthening Corporate Governance'" and accessible at http://ssrn.com/abstract=1630122 (last visited, 15 July 2010).

[160] P. Taylor, "Enlightened Shareholder Value and the Companies Act 2006" (unpublished PhD thesis, May 2010), Birbeck College, University of London, at 162.

As with the law that existed prior to the advent of the Act, the only persons who can enforce a breach of a duty by a director, if the board which is, usually, given the power to manage the company's affairs by the articles of association, does not take action, are the shareholders. This is despite the fact that s.172(1) might be seen as couched in stakeholder-oriented language. Just like the repealed s.309 of the Companies Act 1985, which provided that directors *must* take into account the interests of employees as well as shareholders, s.172 gives no power to stakeholders expressly or implicitly to take proceedings against miscreant directors. The CLRSG said that the benefit of a provision like s.309 is that it would "confer an immunity on the directors, who would be able to resist legal actions by the shareholders based on the ground that the directors had neglected their normal fiduciary duty to them …"[161] That might be true, but the problem is not usually that directors have considered the interests of non-shareholder interests and need protection; rather it is that the directors in fact failed to consider non-shareholder interests.

Even the shareholders' power might be somewhat circumscribed in the context of s.172. Shareholders have the right to take derivative proceedings against directors if they believe the directors are in breach, but they have to obtain the court's permission ("leave" in Scotland and Northern Ireland) to continue such proceedings.[162] Taking the reported decisions where shareholders have sought permission/leave to continue derivative actions against directors and decided thus far under the new regime, we can see that shareholders have generally found things difficult,[163] although the time in which the relevant provisions have been in force is relatively short. It is likely that there will be few occasions, especially in public companies, when derivative actions will be initiated. Importantly, any prospective litigant would have to take into account the fact that there is likely to be a cost element in any derivative claim. As one commentator has said : "Deep-pocketed hedge funds could be encouraged to take action to apply pressure on company boards to implement the sorts of strategy required to produce the high returns their investors demand,"[164] but they are unlikely to do so where directors have not had regard for the interests of other stakeholders.

There are only a few situations where one could envisage an action being brought by a member other than in the cases mentioned above. First,[165] where a member makes an investment in the company for the long term, and it is felt that the action of the directors does not have regard for the long term. Second, a member is also an employee of the company and is concerned that the directors did not, in what they have done, have regard to the interests of the employees. Third, a member is concerned that the directors have not had regard for the need to promote business relationships with suppliers, customers or others and it is likely to damage the company in the future. Fourth, there are members of the company living in the community in which the company operates, and they believe that the community will be adversely affected by the actions of the directors, and that will, as a consequence,

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[161] Ibid.

[162] See Companies Act 2006, ss.260ff.

[163] For an analysis of the relevant case law, see A. Keay and J. Loughrey, "Derivative Proceedings in a Brave New World for Company Management and Shareholders" [2010] JBL 151.

[164] P. Beale "Directors Beware" (2007) 157 NLJ 1033.

[165] The following is taken from, A. Keay, *Directors' Duties* (Jordans, Bristol, 2009) at 146-147.

affect the lives of those members. An example might be where a company, which operates several factories, decides to close one that is in the community where a member resides or has other business interests. Fifth, so-called shareholder activists, who have concerns wider than their own interests take proceedings because of a heightened sense of community interest or concern for the environment, and they believe that directors failed to consider community interests and/or the environment in the decisions which they have made.

In his empirical study, Taylor, found that all of the institutional investors interviewed were pessimistic about the successful use of derivative proceedings in this context. They indicated that they would not employ proceedings either at all or rarely.[166] This is consistent with the fact that the respondents in the study who were officials in companies did not see derivative proceedings as providing any threat to, or constraint on, directors in what they did or did not do.[167]

Besides derivative actions, shareholders might also be able to avail themselves of s.994 of the Act,[168] and argue that the director's breach of s.172 constitutes, alone or together with other breaches, conduct that has unfairly prejudiced them. However, while s.994 is able to be employed by a shareholder in a public company, it is rarely.[169]

As far as financial institutions are concerned Bruner is of the view that there is nothing to suggest that the provision of opportunities for shareholders to take legal action against directors will help the governance of such companies.[170]

Absent shareholders' actions or a decision by the board to initiate proceedings against a miscreant director, there is not going to be any proceedings unless either control of the company falls into the hands of different persons or the company enters administration or liquidation. In any case it may be difficult to establish that the directors should not have done what they did, perhaps several years in the past.

VI. Reflections

As far as the duty's effect on practice, it would seem that the views of practitioners vary from the duty being a "damp squib" which does not introduce any new liabilities or responsibilities for directors,[171] to assertions that the duty to promote the success of

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[166] P. Taylor, "Enlightened Shareholder Value and the Companies Act 2006" (unpublished PhD thesis, May 2010), Birbeck College, University of London, at 188.

[167] Ibid at 190.

[168] This provision entitles shareholders to bring proceedings where the affairs of the company have been carried out in an unfairly prejudicial way. It is arguable that the provision cannot be employed in public companies save in very limited circumstances. See *Re Astec (BSR) plc* [1998] 2 BCLC 556.

[169] A. Keay, "Company Directors Behaving Poorly : Disciplinary Options for Shareholders" [2007] JBL 656 at 678-679.

[170] C. Bruner, "Corporate Governance Reform in a Time of Crisis" and accessible at http://ssrn.com/abstract=1617890 (last visited, 23 June 2010).

[171] Bruce Hanton of Ashursts, quoted in *Financial Director* 26 November 2006 http://www.financialdirector.co.uk/financial-director/analysis/2169965/companies-act (last accessed on 26 March 2007).

the company will lead to "radical change"[172] and a real prospect of increased litigation against directors.[173] Loughrey, Keay and Cerioni found in a study of law firms' response to s.172 in 2007 that most were agnostic about whether the section would alter the outcome of directors' decisions in the ordinary course of business.[174] Although it is still early days the view that nothing much will change seems to be in the ascendancy with the fact that we see little movement as far as actions under s.172 are concerned. While the section has only been in operation for three years, one would expect by now that we would have seen some cases that have addressed it, certainly if there was any ground swell of opinion that the section made things significantly different. The fact that we have not seen any significant case law on the provision[175] could be because of one or more of a number of reasons. First, lawyers are uncertain of the meaning of the provision and its effect and have been counselling caution in their advice to would-be litigants (namely shareholders and office-holders like administrators and liquidators) who wish to take action against directors for breach. Second, actions that might be in breach of the section are still in the pipeline. Third, directors are simply not breaching the section, or at least patently. Directors might be taking extremely conservative action in line with legal advice, and this would be consistent with the fact that some firms have been concerned about the changes that would be caused by the introduction of s.172.[176] Fourth, litigants are relying on other breaches as the basis for actions against directors.

As actions under s.172 cannot be successful unless directors are shown to have failed to exercise good faith and as enforcement of any breach might be difficult, it might be thought that the section lacks effective teeth and directors will not have to be overly concerned with non-shareholder interests, and so the problems of the past where directors have focused on short-termism may not be rectified. We know that the banks, for example, paid out significant dividends after making huge profits in the years leading up to the financial crisis. For example the Royal Bank of Scotland paid out a final dividend of 17% in 2005, 22% in 2006 and 23% in 2007.[177] Lloyds TSB

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[172] J. Gauntlett and R. Dattani (Norton Rose) *Directors Duties Codified* (November 2006) http://www.nortonrose.com/html_pubs/view.asp?id=11331 (last accessed, 22 March 2007)

[173] G. Milner Moore and R. Lewis (Herbert Smith) *In the Line of Fire-Directors Duties under the Companies Act 2006* (hereafter "*In the Line of Fire*"), 4. http://www.herbertsmith.com/NR/rdonlyres/94EEE30C-72B6-4B74-8F81-4EB93F332FF6/2976/Inthelineoffirearticle.pdf (last accessed, 22 March 2007).

[174] J. Loughrey, A. Keay and L. Cerioni "Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance" (2008) 8 *Journal of Corporate Law Studies* 79 at 90 and referring to Cameron McKenna "Companies Act 2006: Deferred Reform" *Law-Now* 29 November 2006, at 4-5, http://www.law-now.com/law-now/default (last accessed on 22 March 2007); Freshfields Bruckhaus Deringer, *Companies Act 2006: Directors Duties* (November 2006), at 4. http://www.freshfields.com/publications/pdfs/2006/17062.pdf (last accessed on 22 March 2007).

[175] Cases that have mentioned it have not engaged in any exposition or explanation of the provision. For example, see *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72; 2008 Scot (D) 16/5 (Outer House, Court of Sessions, Lord Glennie); *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch).

[176] See the discussion in J. Loughrey, A.Keay and L. Cerioni, "Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance" (2008) 8 *Journal of Corporate Law Studies* 79.

[177] http://www.investors.rbs.com/our_performance/dividend.cfm (last visited, 7 June 2010). Also see the position of the Bank of New York Meillon which slashed its dividend payable in 2009 by 63% (Ben Steverman, "The Ever-Shrinking Bank Dividend" *Blomberg Businessweek*, April 21, 2009 and

had a similar record.[178] Arguably, the banks and other financial institutions did not take into account the interests of future shareholders and the long term (and other stakeholders). There are indications that not sufficient consideration was given to the possible default of borrowers in the sub-prime mortgage market and the problems associated with other risks. It would seem that in fact at least some involved in company management did not understand the deals in which a lot of company funds were tied up.[179]

It is debatable whether s.172 changes things much, or at all. John Birds is probably right when he states that the effect of the section is largely educational and that decisions taken in good faith are not likely to be more easily challenged than under the previous law.[180] The CLRSG was confident that the statutory code would have "a major influence in changing behaviours and the climate of decision-making" by deterring short termism.[181] This was not because the new formulation of directors' duties changed the law, for the CLRSG thought that it simply reflected existing law and best practice. However, it had noted considerable evidence that the law was widely misunderstood as a result of the manner in which it was expressed and interpreted.[182] Perhaps the CLRSG was hoping that a new provision would bring a change of approach by directors, lawyers and judges.

Arguably, one benefit of the ESV model is that it enables directors to take into account non-shareholder interests when making decisions, without being in breach of their duties, always providing that their ultimate decisions do in fact promote the success of the company for the benefit of its members as a whole. Of course, if the actions of the directors do achieve this objective it is unlikely that shareholders would be complaining about the fact that directors have considered the interests of other stakeholders. Absent where activist shareholders are moved to object to the fact that directors have not considered certain factors set out in s.172(1) the only scenarios where shareholders might take umbrage at what the directors have done is first where the company would have been more successful had the directors not taken into account non-shareholder interests or they had taken into account other non-shareholder interests, and second where shareholders with a vision for the long term would impugn the actions of the directors on the basis that the directors have not had regard to long-term considerations. It is probably true to say that the enactment of s.172 will make little difference to the state of affairs in corporate life in the UK as the list of interests that are found in s.172(1) were almost certainly considered by the directors of many listed companies and large private companies that were subject to

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accessible at http://www.businessweek.com/investing/insights/blog/archives/2009/04/the_ever-shrink.html (last visited, 7 June 2010).

[178] 23.5% in 2005 and 2006, 24.7 in 2007 : http://www.investorrelations.lloydstsb.com/ir/uk_dividend_history_page.asp (last visited, 7 June 2010).

[179] L. Buchheit, "Did we make things too complicated?" (2008) 27 (3) *International Financial Law Review* 24.

[180] A. Alcock, J. Birds and S. Gale, *Companies Act 2006 : The New Law*, (Jordans, Bristol, 2007) at 146.

[181] Company Law Review *Modern Company Law for a Competitive Economy*: Developing the Framework (London, DTI, 2000) at para 3.58.

[182] See Company Law Review *Modern Company Law for a Competitive Economy*: The Strategic Framework (London, DTI, 1999) at para 5.1.20 (for instance).

public scrutiny before the enactment of the provision.[183] One would expect that any company secretary worth his or her salt would now ensure that the minutes of board meetings record that the board, in making its decisions, considered the matters mentioned in the section.

In 2005, in the second White Paper dealing with the proposed companies legislation, it was said that :

> "The basic goal for directors should be the success of the company for the benefit of its members as a whole; but that, to reach this goal, directors would need to take a properly balanced view of the implications of decisions over time and foster effective relationships with employees, customers and suppliers, and in the community more widely. The Government strongly agrees that this approach, which [is] called 'enlightened shareholder value', is most likely to drive long-term company performance and maximise overall competitiveness and wealth and welfare for all."[184]

But, as mentioned above, it can be said that many companies practised the contents of s.172 before its enactment, mainly because it made sense and the shareholder value theory is often dependent on using the company's stakeholders as the means to the end that is the maximisation of the shareholders' wealth. Many adherents to the shareholder value theory always accepted the fact that it was wise to consider the interests of stakeholders where it would foster shareholder wealth. Section 172 appears to require the same, given the fact that the bottom line is : how do the shareholders fair as a result of what the directors have done?[185] The fact that stakeholder interests are actually enumerated in the section might, conceivably, persuade boards to take into account such interests in a more patent way than before s.172 emerged, and if this were the case it would be, to a degree, confirmation of the Birds' view that the impact is going to be, essentially, educational.

Can we conclude that s.172, together with s.417, is going to prevent the worst kind of short-termism so that there is some sustainability created by companies that are endeavouring to practice shareholder value? In line with many answers to questions on the subject the answer is "maybe." Undoubtedly it will depend on a lot of factors, including the attitude of shareholders and how far boards are willing to embrace the philosophy behind ESV. Taylor concludes from his study that the Review :

> "fails in its objective to provide investors with the information necessary for a full understanding of the businesses in which they invest. That being the case, it must also fail to provide

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[183] A. Alcock, "An accidental change of directors' duties?" (2009) 30 Co Law 362 at 368.

[184] *Company Law Reform* (DTI, 2005), Cm 6456, at para 3.3.

[185] Section 172 may be seen simply as codifying the shareholder primacy principle. In the bastion of shareholder value in the US, Delaware, there is judicial opinion that directors are entitled to have regard for the interests of constituencies other than shareholders provided that some benefit will accrue to shareholders. See *Revlon Inc v MacAndrews & Forbes Holdings Inc* 506 A. 2d 173 at 176 (Del, 1986).

> the means by which shareholders can verify that directors are performing their duties in accordance with S.172(1)."[186]

Many have called for more accountability, or a greater depth of accountability, where directors are concerned, and perhaps the main point to note is that there does not seem to be any framework in place to ensure that directors are held accountable for their decision-making process. As it is there are likely to be few occasions where a director is going to have to justify what he or she did. Of course, very often, and especially with what might be regarded as the daily affairs of the company, those constituencies which are mentioned in s.172(1) will not know what the directors have done (no mention of it being contained in the Review), and when they do become aware of it, it will be too late to do anything that is effective.

Members might be able to secure permission to continue derivative proceedings against directors where there is thought to be a breach of s.172(1), but save where directors have failed to benefit the members from the action that they have taken, such proceedings are likely to be few and far between. Those who are numbered amongst other constituencies in the provision will not be entitled to initiate any legal proceedings against directors, so where directors fail to have regard for the interests set out in the sub-section, it is unlikely that they will be called to account, except, perhaps, where activist shareholders are minded to take action.

One prominent issue with the application of s.172 is that non-executive directors will often lack the expertise and information that will enable them to say whether some action will promote the success of the company. This is a long-standing problem. It is one that is linked with the need for directors to ensure that they fulfill their duty of care to the company, and it is probably better left to a consideration of that duty than the one which is the subject of this paper. But suffice it to say, there are indications that some of the problems at board level experienced by some of the financial institutions were that there was a lack of expertise and understanding of the finance industry. Roman Tomasic, in his interesting study of Northern Rock,[187] said that :

> "the qualifications of the former chairman of Northern Rock, Dr Matt Ridley, did not escape comment in the media when it was noted in the *Financial Times* that he was a zoologist and a successful science writer. He had joined the board of Northern Rock in 1994 and then served as non-executive chairman from 2004 until 2007; he resigned after being criticised in Parliament for harming the reputation of British banking and for lacking financial experience." (footnotes omitted)

This state of affairs is not abnormal. An empirical study by Daniel Ferreira, Tom Kirchmaier and Daniel Metzger of 12,010 directors working for 740 large banks in 41

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[186] P. Taylor, "Enlightened Shareholder Value and the Companies Act 2006" (unpublished PhD thesis, May 2010), Birbeck College, University of London.

[187] "Corporate rescue, governance and risk taking in Northern Rock: Part 2" (2008) 29 Co Law 330 at 334.

countries found that few outside (non-executive) directors have had previous banking experience.[188]

Would the financial malaise that hit British banks and other financial institutions in 2007 and onwards have occurred if s.172 and s.417 had applied beforehand? Would boards have focused more on the long term? As I have said earlier, the actions that precipitated the crisis pre-dated the enactment of s.172, so the provision would not have applied. It is not possible to answer the questions which I have just posited with any degree of certainty. It is quite possible that the exact risks that the banks had adopted would not have been specified in sufficient detail for anyone perusing the Review to have appreciated the extent and seriousness of the risks. In the Taylor study[189] several respondents indicated significant apprehension about disclosing in the Review their companies' major risks and what was intended to be done to address them. Even if they had done so before the advent of the financial crisis, would shareholders have been in a position to have done anything? Due to the impotence of most shareholders,[190] it is doubtful. Institutional investors might have been able to do so, perhaps through discussions with the boards, but whether institutional investors have made, or are making, any difference as far as corporate governance goes is a moot point, for the evidence appears to be conflicting.[191]

One might think that given the fact that the CLRSG stated that the primary reason for rejecting the pluralist position in company law, namely requiring directors to take into account a multitude of stakeholder interests, was that it would grant an unpoliced discretion to directors,[192] it would not sanction the granting of a wide discretion to directors found. So, it is rather ironic that the CLRSG drafted, and the Government agreed to, a virtually unpoliced discretion to directors under s.172. Directors are granted a completely unfettered discretion as to what actions they take provided that they are acting in a way that *they* consider would most likely promote the success of the company for the benefit of the members. While the CLRSG rejected the pluralist position, inter alia, on the basis that it would involve directors having to consider the interests of all constituencies, and it would give no formal remedy for abuse by the directors,[193] this is apparently what we have with s.172. Arguably, the section might have the same failings that the CLRSG identified with the pluralist theory – how to

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[188] "Boards of Banks" accessible at http://ssrn.com/abstract=1620551 (last visited, 29 July 2010).

[189] P. Taylor, "Enlightened Shareholder Value and the Companies Act 2006" (unpublished PhD thesis, May 2010), Birbeck College, University of London, at 175.

[190] See, A. Keay, "Company Directors Behaving Poorly : Disciplinary Options for Shareholders" [2007] JBL 656.

[191] For instance, see B. Black, "Shareholder Passivity Reexamined (1990) 89 Mich. L. Rev. 520; J. Dean, *Directing Public Companies*, (London, Cavendish, 2001) at 49; S. Bainbridge, "Director Primacy : The Means and Ends of Corporate Governance" (2003) 97 *Northwestern University Law Review* 547 at 555 at 57; C. Williams and J. Conley, "An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct" (2004) and accessible at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=632347 (last visited, 17 July 2010); P. Hosking, "Fund managers 'soft on company directors" *The Times*, 28 April 2005; M. Goergen, L. Renneboog and C. Zhang, "Do UK Institutional Shareholders Monitor Their Investee Firms?" (2008) 8 *Journal of Corporate Law Studies* 39.

[192] Company Law Review, *Modern Company Law for a Competitive Economy*: Developing the Framework (London, DTI, 2000) at para 3.24.

[193] Company Law Review *Modern Company Law for a Competitive Economy*: Strategic Framework (London, DTI, 1999) at para 5.1.21 at 5.1.30.

choose between a number of competing and inconsistent constituent interests? We could end up with what has been said to be wrong with stakeholder theory, namely directors are left in a position of *not being accountable* for the stewardship of their company's resources.[194] Perhaps the real problem is that unlike in the past where the law has sought to require directors to meet acceptable standards of behaviour, such as not acting in self-interest, it is now seeking to compel directors to act in a particular manner,[195] and this is far harder to regulate.

It was indicated earlier that directors are accountable to the shareholders. It appears that s.172 dilutes the accountability to shareholders because of the fact that s.172 does not circumscribe the directors' discretion in determining what will promote the success of the company in any significant way, and the prosecuting of derivative actions might not be seen as a satisfactory control device. While accountability to shareholders is diluted, this state of affairs occurs without any commensurate creation of accountability to stakeholders as the latter have no locus standi if directors do not have regard for any factors in s.172(1).

What s.172 appears to permit is directors following a long-term strategy, provided that they have good reasons for saying that it will promote the success of the company. It would seem to prevent directors being forced by shareholders to pay dividends if they can establish that what they are doing falls within s.172, e.g. following a long-term plan, providing facilities for workers, etc. It would enable directors to pay out more modest dividends, compared with those paid out in recent years, on the basis that they need to build for the long term. However, whether directors could weather pressure from shareholders and the markets if they took this approach is another issue.

In the House of Lords during the debate on the Company Law Reform Bill 2005, Lord Goldsmith, who led for the Government, said[196] that the ESV principle is proper as it:

> "resolves any confusion in the mind of directors as to what the interests of the company are, and prevents any inclination to identify those interests with their own. It also prevents confusion between the interests of those who depend on the company and those of the members."

However, certainly at the moment it would appear that s.172 does not resolve confusion in the minds of directors or anyone else. This is recognised to some degree by what an Australian Joint Parliamentary Committee on Corporations and Financial Services report stated in 2006, when addressing the precursor of s.172 (clause 156) in the context of considering whether to recommend changes to Australian law. It stated that :

> "The committee does not support the British approach, which appears to introduce great uncertainty into the legal expression

194 M. Jensen "Value Maximisation, Stakeholder Theory and the Corporate Objective Function" (2001) 7(3) *European Financial Management* 297 at 305.

195 S. Worthington "Reforming Directors' Duties" (2001) 64 MLR 439 at 448.

196 *Lords Grand Committee*, 6 February 2006, column 255

> of directors' duties... Subclause (3) requires directors to have regard to a menu of non-shareholder interests, but gives no guidance as to what form this 'regard' should take, and therefore gives no guidance to directors on what they must do in order to comply."[197]

Clearly we are in need of judicial commentary on s.172 in the context of practical situations that cases provide, but, of course, cases have to be instituted. Until then we can only speculate based on the comments of the CLSG and the Government before enactment together with the case law dealing with the duty to act bona fide in the best interests of the company.

Whilst s.172 might have some benefits such as an educational role for directors, it is submitted that it will not make a lot of difference in practice. Directors will continue to be protected by a reliance on acting in good faith, in most cases, and it is unlikely that they will disclose major risks of their companies in the Review.

VII. Conclusion

It has been argued in this paper that while s.172, may have an educational impact, it is not likely to make a lot of difference as far as the corporate governance issues that were problematic in the period leading up to the credit crunch and financial meltdown were concerned. The Government wanted to ensure, in enacting s.172, that company directors should be more concerned than they have been to take into account long-term consequences of what they do, rather than merely being concerned with the next quarterly figures, and it wanted directors to be more enlightened in their approach to decision-making. It is not clear whether that state of affairs has or will come to pass. The paper has identified some pressures, such as shareholders desire for benefits and market demands, that may well militate against directors engaging in more long-term strategy, and it has been submitted here that the legislation might not correct that problem. Whether directors will take into account a broader range of interests than merely shareholders is uncertain. It is likely that the modus operandi employed in the past by directors will continue, that is considering wider interests to the extent that that action will enhance shareholder interests. And when all is said and done that appears to be the thrust of s.172.

The above conclusions can garner some support from the little empirical evidence we have at the moment. Generally speaking the respondents to the questionnaires and interviews administered by Peter Taylor in a study designed to ascertain the impact of s.172 on companies, indicated that directors and others involved in company management were sceptical about the utility of the duty considered in this paper.[198]

It might be argued that s.172 does little more than provide directors with "a get out of jail free card," if their actions are challenged, for it permits them to defend a case for

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[197] *Corporate Responsibility : Managing Risk and Creating Value*, June 2006 at para 4.46 and accessible at http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/2004-07/corporate_responsibility/report/index.htm (last visited, 16 December 2009)

[198] P. Taylor, "Enlightened Shareholder Value and the Companies Act 2006" (unpublished PhD thesis, May 2010), Birbeck College, University of London, at 189.

breach by asserting that they did what they did because they were considering the interests of non-shareholding stakeholders in deciding what would promote the success of the company. Along with this criticism another that can be levelled is that the legislation fails to provide little or no guidance either to directors that have to make corporate decisions, or to the courts which may be asked to review what directors have done. Neither the ill-fated OFR nor the Business Review provides much in the way of guidance, nor is the Review likely to require disclosure that will prevent further financial crises.

While the duty provided for in s.172 might be regarded as educational (as far as directors are concerned) it is vague and provides little direction or even guidance. It might well be seen as a general statement of principle hopefully encouraging directors to aim for the long-term success of the company and to demonstrate enlightenment, but there is certainly an enforcement problem with the provision.

William Sahlmann has asserted that "managers bear a disproportionate share of the responsibility for what transpired [in the financial crisis] and therefore for what must change."[199] Will s.172 have any role to play in this change? Sahlmann is sceptical about any corporate governance action making a difference and "will do little to decrease the likelihood or magnitude of the next bubble-panic cycle."[200] It is argued that s.172 is unlikely to have any great impact on company boards and how they transact business, and hence is not really fit for purpose.

The Conservative Party's former spokesman on the Companies Bill, Jonathan Djanogly, said in September 2007 that : "Ultimately, it will be for the courts to determine how far the new [directors'] duties extend as there is scope for interpretation and differing applications in practice. But any settled case law will take time to develop – so watch this space."[201] We have been watching, Mr Djanogly, and we are still waiting with bated breath!

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[199] W. Sahlman, "Management and the Financial Crisis (We have met the enemy and he is us . . .)" 4 (Harv. Bus. Sch., Working Paper No. 10-033 and accessible at http://www.hbs.edu/research/pdf/10-033.pdf (last visited, 15 July 2010).

[200] Ibid

[201] Speech to the Chartered Secretaries Professional Practice Group 6th Annual Technical Conference, 5 September 2007.