An accidental change to directors' duties?

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An Accidental Change to Directors’ Duties?

For the first time, the general duties of directors have been given statutory form in the Companies Act 2006. This article concentrates on the duties of compliance (with the company’s constitution), proper purpose and good faith contained in sections 171 and 172. In the first judicial comment on these sections, Lord Glennie has said in passing, “these sections appear to do little more than set out the pre-existing law on the subject.”¹ But is that true?

The Companies Act 2006 (2006 Act) was a long time in gestation. An important stage in formulating proposals that eventually became part of the 2006 Act was the creation by the then Department of Trade and Industry (DTI) of a Company Law Review Steering Committee (CLRSG) in 1998.² Amongst the many subjects the CLRSG tackled were the general duties of directors, in particular, whether they should be ‘codified’³ and if so, should the principal duty be changed from one thought to be owed to shareholders to one owed to a variety of stakeholders. With such fervent supporters of the stakeholder or pluralist viewpoint as Professor Parkinson⁴ on the CLRSG, the arguments in its favour were bound to be put forcefully.⁵ However, at an interim stage, the CLRSG dismissed this approach as impracticable, pointing out that:

“If directors had a power to decide that other interests should override those of shareholders, this discretion would be unpoliced; if directors had a duty to take other interests into account, the effect could be to give a similarly wide discretion to the courts.”⁶

In dealing with responses to this position, the CLRSG later commented:

“A few still supported a ‘pluralist’ approach, imposing a duty to balance the interests of relevant parties without necessarily giving priority to those members; but none of these responses suggested a practicable means of dealing with the crucial question of how such a duty could be enforced. This is to our mind a key objection.”⁷

Instead, the CLRSG endorsed an ‘enlightened shareholder value’ approach which, as it put it in its final report:

¹ Re West Coast Capital (Lios) Ltd [2008] CSOH 72, where an application for an interim injunction was rejected
² Modern Company Law for a Competitive Economy, DTI March 1998
⁶ Chapter 3.24 of a later interim report, Modern Company Law for a Competitive Society: Developing the Framework, URN 00/656 (DTI March 2000) (‘Developing the Framework’)
⁷ Chapter 3.5 of Modern Company Law for a Competitive Society: Completing the Structure, URN 00/1335 (DTI Nov 2000) (‘Completing the Structure’)

“… makes clear the obligation of each director to act to serve the purposes of the company as laid down in the constitution and as set for it by its members collectively: that is, it sets as the basic goal for directors the success of the company in the collective best interests of shareholders. But it also requires them to recognise, as the circumstances require, the company’s need to foster relationships with its employees, customers and suppliers, its need to maintain its business reputation and its need to consider the company’s impact on the community and the working environment.”

It seems that the CLRSG really considered this to be a restatement of three existing common law duties imposed on directors:

1. ‘compliance’ with the company’s constitution;
2. exercising any power (under that constitution) for its ‘proper purpose’; and
3. acting ‘bona fide’ for the benefit of the company.

From this arise two key questions:

1. did these pre-existing common law duties really amount to an enlightened shareholder approach; and
2. does the wording of the equivalent duties adopted in the Companies Act 2006 (2006 Act) merely re-enact this pre-existing common law position?

A careful exploration of both questions is important because of the continuing relationship between pre-existing common law duties and new statutory ones as explained in section 170(3) and (4) of the 2006 Act which states:

“(3) The general duties are based in certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.
(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.”

If the wording in the 2006 Act replaces the common law duties (sub-section (3)), but is to be interpreted in the light of those pre-existing duties (sub-section (4)), that would appear to create a presumption that directors’ duties have not been changed by the 2006 Act except to the extent that the statutory wording is not compatible with the pre-existing position.

The proper purpose rule

The duty to comply with the constitution was obvious (though the consequences of not doing so, whether ultra vires or merely a breach of duty has required statutory

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8 Chapter 3.8 of *Modern Company Law for a Competitive Society: Final Report*, URN 01/942 (DTI July 2001) (‘Final Report’
intervention\(^9\); but it was perhaps, something of a surprise how ill-defined the common law position on the ‘proper purpose’ and ‘bona fide’ rules was after a century and a half of company law. The courts had ruled that where directors’ had powers to issue shares, those powers were restricted to the proper purpose of raising capital (and not just to changing voting majorities) in cases like *Punt v Symons & Co Ltd\(^{10}\) and *Piercy v S Mills & Co Ltd\(^{11}\)* but proper purpose only emerged as a clearly separate rule taking precedence over the bona fide rule in *Hogg v Cramphorn Ltd*. In that case, the directors issued shares to a trust in order to deter a threatened takeover bid from one Mr Baxter. Buckley J accepted:

“… that the board acted in good faith and that they believed that the establishment of a trust would benefit the company and that avoidance of the acquisition of control by Mr Baxter would also benefit the company.”\(^{12}\)

but nevertheless he found the directors to have misused their undoubted power to issue shares.

A key element of the proper purpose rule was that it was assessed ‘objectively’, ie. what in a court’s view was the proper purpose of the directors’ powers in question. By contrast, it had been established in *Re Smith and Fawcett Ltd*\(^{13}\) that the duty to act bona fide was ‘subjective’. The distinction was later well summarised by Jonathan Parker J in *Regentcrest plc v Cohen*:

“The duty imposed on directors to act bona fide in the interests of the company is a subjective one… The question is not whether viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director’s state of mind. No doubt where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company’s interests; but that does not detract from the subjective nature of the test…

The position is different where a power conferred on a director is used for a collateral purpose. In such circumstances it matters not whether the director honestly believed that in exercising the power as he did he was acting in the interests of the company; the power having been exercised for an improper purpose, its exercise will be liable to be set aside…”\(^{14}\)

It was clear, therefore, that to be effective, the proper purpose rule must take precedence over the bona fide rule. Apart from restricting the use of a power to issue

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\(^9\) See 2006 Act, ss 39 and 40  
\(^{10}\) [1903] 2 Ch 506  
\(^{11}\) [1920] 1 Ch 77  
\(^{12}\) [1967] Ch 254, 266G  
\(^{13}\) [1942] Ch 304, CA  
\(^{14}\) [2001] 2 BCLC 80, [120] and [123]
the proper purpose rule appears to have restricted the use of directors’ powers concerning forfeiture or transfer of shares to avoid liability for a call, making discriminatory calls, non-commercial refusal to pay dividends, and non-commercial transfers of assets.  

The bona fide rule

The objective nature of the proper purpose rule allowed courts some limited scope to intervene where they considered directors to be abusing their powers; but the subjective nature of the bona fide rule otherwise maintained the courts’ position of being very reluctant to review business decisions, a position that pre-dated registered companies as can be seen in one of Lord Eldon’s judgments in the early 19th Century:

“This Court is not to be required on every Occasion to take the Management of every Playhouse and Brewhouse in the Kingdom.”

This non-interventionist attitude was reiterated in the corporate age, most famously by Bowen LJ:

“A railway company, or the directors of the company, might send down all the porters at a railway station to have tea in the country at the expense of the company. Why should they not? It is for the directors to judge, provided it is a matter which is reasonably incidental to the carrying on of the business of the company… The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.

Now that, I think, is the principle to be found in the case of Hampson v Price’s Patent Candle Co. The Master of the Rolls there held that the company might lawfully expend a week’s wages as gratuities for their servants; because that sort of liberal dealing with servants eases the friction between masters and servants, and is, in the end, a benefit to the company.”

The language may be dated, but clearly Bowen LJ had enlightened shareholder value in mind. However, on the facts of the case, the court disallowed the payments to the

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16 Even since Hogg v Cramphorn Ltd the cases have not always been explicit about the basis of court intervention. For example, in Bishopsgate Investment Management Ltd v Maxwell (No 2) [1993] BCLC 1282, Hoffmann LJ described the gratuitous transfer of assets as ‘improper’, but whether in breach of the proper purpose rule restricting the directors’ powers to dispose of assets or a breach of a separate trustee like duty in respect of company assets was not stated.
17 Stanhope’s Case (1866) 1 LR Ch App 161; Bennett’s Case (1867) 5 De GM&G 284.
18 Galloway v Hallé Concert Society [1915] 2 Ch 233.
20 Bishopsgate Investment Management Ltd v Maxwell (No 2) [1993] BCLC 1282; Criterion Properties plc v Stratford Properties LLC [2003] 2 BCLC 129, CA although the House of Lords considered the enforceability of the ‘poison pill’ depended upon actual or apparent authority, requiring full trial to ascertain, [2006] 1 BCLC 729, HL.
21 Carlen v Drury (1812) 1 Ves & B 154, 158.
22 (1876) 45 LJ (Ch) 437.
23 Hutton v West Cork Rly Co (1883) 23 Ch D 654, 672 CA.
directors and employees because the company was to be wound up and so the payments could serve no continuing benefit to the company.

An unusual example of the non-interventionist attitude of the courts was found in Charterbridge Corpn Ltd v Lloyds Bank Ltd where the directors admitted that, in creating cross-guarantees of the debts of different companies in a group, they had considered the benefit to the group but not to each of the companies separately of which they were directors. Pennycuick J said:

“The proper test, I think, in the absence of actual separate consideration, must be whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company.”

Pennycuick J concluded that cross-guarantees could reasonably have been considered by the directors as for the benefit of each company. The case was originally brought on the basis of ultra vires rather than breach of duty, important for the purpose of standing (see below), but now the distinction has largely disappeared.

One of the most striking examples in the 20th Century of the courts allowing directors a wide discretion in determining what was in the interests, or for the benefit, of the company was the case of Evans v Brunner Mond & Co Ltd. A large chemical company had resolved in general meeting to make generous donations to universities and other institutions for scientific research. Eve J rejected claims that the resolution was ultra vires because, considering the cost, any benefit to the company would be too indirect, would benefit competitors and would really only amount to a benefit to the community at large. This case might even be going beyond enlightened shareholder value towards a pluralist approach, allowing what Professor Parkinson would have described as “profit-sacrificing social responsibility”. However, Eve J did, rather contentiously, conclude:

“… the company… has proved that the proposed expenditure will not only be to the direct advantage of the company, but is also conducive to, and indeed necessary for, its continued progress as chemical manufacturers.”

Of course, companies could always write into their constitutions non-profit making objectives as Buckley LJ pointed out in Re Horsley & Weight Ltd, though it has to be admitted that first instance courts did not always take a generous view of such non-commercial provisions. Where the courts remained most reluctant to allow interests other than those of shareholders to prevail was on the closing down of businesses. The most striking 20th Century case was Parke v Daily News Ltd. As in the West Cork Rly case, this involved payments to employees on the winding up of a business, if not

24 [1970] Ch 62
25 2006 Act, ss 39 and 40
26 [1921] 1 Ch 359, 369
27 [1982] 3 All ER 1045, 1052d, CA
28 Re Lee, Behrens & Co Ltd [1932] 2 Ch 46; Re W & M Roith Ltd [1967] 1 WLR 432; Simmonds v Heffer [1983] BCLC 298
29 [1962] Ch 927
here of the actual company. Despite supposed ‘ratification’ by vote in a general meeting, Plowman J held that the payments could in no way be a benefit to the company in these circumstances and could not be ratified, though not it seems on the basis of the original claim of ultra vires, but as being intra vires but nevertheless non-ratifiable. 30

The *Daily News* decision led to a specific statutory intervention allowing such quasi-redundancy payments on the cessation of a company’s business, what is now section 247 of the 2006 Act. It also led to a more general statutory amendment to directors’ common law duties which has not been carried forward into the 2006 Act. This provision, which was to be found in section 309 of the Companies Act 1985 (1985 Act), read:

“(1) The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company’s employees in general, as well as the interests of its members.
(2) Accordingly, the duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.”

Although sub-section (1) seemed to create a primary duty to consider the interests of employees, parallel to any duty to consider the interests of members, sub-section (2) excluded any easy way for employees to enforce this duty against directors ultimately reliant upon members’ votes for their positions. In effect the section merely created a defence for directors’ who might have allowed employees’ interests to override those of members. 31 One case where this may have played a unspoken part in the decision was *Re Welfab Engineers Ltd* 32 where Hoffmann J held directors not liable for favouring the sale of the company’s business to a party prepared to take on the employees rather than to a party prepared to offer a higher price but without the employees.

**What is ‘for the benefit of the company’?**

What became section 309(1) of the 1985 Act seems to have assumed that the pre-existing common law position was that the directors’ bona fide duty to the company was solely to have regard for ‘the interests of its members’. In support of this, attention was often drawn to the words of Evershed MR in *Greenhalgh v Arderne Cinemas Ltd*:

“In the first place, I think it is now plain that ‘bona fide for the benefit of the company as a whole’ means not two things but one thing. It means that the shareholder must proceed upon what, in his honest opinion, is for the benefit of the company as a whole. The second thing is that the phrase ‘the company as a whole’ does not (at any rate in such a case as the present) mean the

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30 [1962] Ch 927, 957 and 963 following the *West Cork Rly* case
31 For a discussion of the effect of this section, see Chapter 5.1.21-23 of Strategic Framework. See also *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363, CA, discussed below
32 [1990] BCLC 833
company as a commercial entity, distinct from the corporators; it means the corporators as a general body."33

The refusal of the court to stop a change to the articles favouring one group of members over another could be said to show a reluctance at common law to impose a ‘fairness between members’ duty on directors. Shareholders can now resort to the ‘unfair prejudice’ provisions of sections 994 to 996 of the 2006 Act.34

However, Greenhalgh was not about directors’ duties, but about shareholders using their proprietary right of voting to amend articles.35 The equating of the interests of the company with those of the current corporators was not clear in the 19th Century cases which just referred to the benefit or interests of the company and this did seem to have been considered a duty to the company as an entity which could include, for example, regard as to the interests of creditors36 (albeit not employees in a business being closed down). It was only in the 1980s in cases like Re Horsley & Weight Ltd,37 Multinational Gas and Petroleum Co v Multinational Gas and Petrochemical Services Ltd,38 and West Mercia Safety Ltd v Dodd39 that it became clearly established that the bona fide rule only concerned itself with creditors’ interests when a company was in financial distress. Even then, these decisions did not say directors could not consider creditors’ interests while the company was a going concern, merely that they did not have to in normal circumstances; but by contrast, once it was clear a company was no longer a going concern, a duty to creditors replaced any duty to shareholders. This was reinforced by the ‘wrongful trading’ provisions in section 214 of the Insolvency Act 1986.

Even after these cases, there remained some uncertainty about whether shareholders’ interests were supreme. Generally the commercial prosperity of a company and the interests of its shareholders coincide, but the interests of the company as an entity may not always coincide with those of (at least the majority of) the current shareholders. These tensions particularly emerge amidst takeover bids.

As we have already seen, even if directors genuinely believed the success of a threatened takeover might not be in the interests of the company, including those of the then current shareholders, the proper purpose rule restricted the directors from using any power to issue shares or dispose of assets to obstruct the takeover.40 Still, that left the question of what directors should recommend. In Heron International Ltd v Lord Grade, where the directors had concluded that the company would be taken

33 [1951] Ch 286, CA
34 The change in the articles in Greenhalgh had been rushed through because the predecessor to the unfair prejudice provisions, Companies Act 1948, s 210, was due to come into force.
35 Though it was cited by Plowman J with approval in Parke v Daily News Ltd [1962] Ch 927, 963
36 Of most concern was capital maintenance, Re Exchange Banking Co: Flitcroft’s Case (1882) 21 ChD 519; Trevor v Whitworth (1887) 12 App Cas 409, HL
37 [1982] Ch 442
38 [1983] Ch 258
40 Hogg v Cramphorn Ltd [1967] Ch 254; Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821, PC; Criterion Properties plc v Stratford Properties LLC [2006] 1 BCLC 729, HL. This contrasts with the acceptance of ‘poison pill’ arrangements as legitimate in the United States, see Paramount Communications Inc v Time Inc 571 A.2d 1140 (Del 1989); Unitrin v American General Corp 651 A.2d 1361 (Del 1995)
over and merely had to recommend between competing bids, it was held that the interests of the company became those of the current shareholders.\textsuperscript{41} However, that did not necessarily require recommendation of the highest bid in all circumstances. In another case, it was held that, although the directors must be clear about the terms of rival bids, they did not have to make any recommendation, particularly where the higher bid was in competition with one from the directors themselves.\textsuperscript{42}

In \textit{Dawson International plc v Coats Patons plc}, a Scottish case, a distinction was maintained between the interests of the company as a continuing entity and those of the current shareholders (in contrast to the dicta in \textit{Greenhalgh}). Lord Cullen said:

\textit{“What is in the interests of current shareholders as sellers of their shares may not necessarily coincide with what is in the interests of the company. The creation of parallel duties could lead to conflict. Directors have but one master, the company.”}\textsuperscript{43}

A similar point was later made by Neill LJ in \textit{Fulham Football Club Ltd v Cabra Estates plc}:

\textit{“The duties owed by the directors are to the company and the company is more than just the sum total of its members. Creditors, both present and potential, are interested, while section 309 of the Companies Act 1985 imposes a specific duty on directors to have regard to the interests of the company’s employees in general.”}\textsuperscript{44}

This distinction between interests of the entity and its shareholders could be an explanation for the decision in \textit{Re Welfab Engineers Ltd}, even if there had not been a section 309. It could also come into play where there was a highly geared bid for a company, perhaps a management buy-out. Any independent directors required to give advice to shareholders under rules 3 and 25 of the Takeover Code, might consider it was their duty not just to consider the value of the bid for current shareholders, but the risks to the future of the company as an entity (and with that, at least its creditors and employees) because of the cash extracting measures that a successful bidder would have to resort to, to pay down the gearing. It is interesting to note that such an entity maximisation and sustainability approach has received recent theoretical backing from Professor Keay. He describes it has having two elements:

\textit{“First, there is a commitment to maximise the entity. This involves, \textit{inter alia}, enhancing the company’s wealth, but unlike with profit maximisation, this is not always measured by how much profit has been made. The second part is to sustain the company as a going concern, that is, to ensure its survival and more. An important aspect of the model is that there is focus on the company as an entity or enterprise, that is the company as an institution in its own right.”}\textsuperscript{45}

\textsuperscript{41} [1983] BCLC 244, 265, CA. The position here is the same as in the United States, \textit{Revlon Inc v MacAndrews & Forbes Holdings Inc} 506 A 2d 173 (Del, 1986).
\textsuperscript{42} \textit{Re a Company} [1986] BCLC 383
\textsuperscript{43} (1988) 4 BCC 305
\textsuperscript{44} [1994] 1 BCLC 363, 393f, CA
\textsuperscript{45} Professor of Corporate and Commercial Law, University of Leeds in \textit{Ascertaining the Corporate Objective: an Entity Maximisation and Sustainability Model} (2008) 71 MLR 663, 679
Still, while a UK company was a going concern, it was shareholders ultimately that had the right, by ordinary resolution, to remove directors.46 Rather than voting directors off a board, the mechanism had normally been to sell voting shares to a bidder. Where, because of the closed nature of the company, a hostile bid was not practical, an individual shareholder wishing to challenge the decisions of the directors, found the courts not just reluctant to define too closely what ‘bona fide for the benefit of the company’ might mean, but resistant to allowing a case to be heard at all under the rule in *Foss v Harbottle*.47 Since most breaches of directors’ duties were ratifiable and only the company (controlled by the directors) could then bring an action, such challenges as there were, had to claim the directors had acted, not just in breach of their duties, but ultra vires (so not ratifiable). The need in many cases to frame the claim in terms of ultra vires to have it heard at all, may itself have deterred court intervention.

**What was the pre-existing common law position?**

Prior to the 2006 Act, the common law position on the directors’ three duties of compliance, proper purpose and good faith could be summarised as follows:

1. In addition to the restrictions imposed by a company’s constitution on the directors’ powers, the directors had a duty to use those powers only for what (the courts determined) were proper purposes.
2. In using their powers, the directors had a duty to act in what they believed (*not* what the courts determined) was for the benefit of the company.
3. Although the benefit of the company might normally coincide with the interests of the current shareholders, the courts did not equate them in all circumstances and allowed a very wide discretion to directors.
4. That discretion allowed an enlightened shareholder value approach, perhaps entity maximisation and even some profit sacrificing social responsibility. It did not enforce rigid shareholder supremacy.
5. However, where the company and/or its business had no long term future:
   a. if it was no longer a going concern, any duties owed to shareholders became duties owed to creditors; and
   b. if it was still solvent but going to be wound up, the duties owed to shareholders were paramount (except for payments to employees made within the terms of what is now section 247 of the 2006 Act)

**Section 171 – Compliance and Proper Purpose**

The eventual statutory form of the three duties is contained in sections 171 and 172 of the 2006 Act, but the exact form of these provisions went through a number of public drafts, namely:

1. Developing the Framework (2000);48

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46 What is now 2006 Act, s 168. The courts have, however, upheld provisions in articles or shareholders agreements that tend to defeat this provision, *Bushell v Faith* [1970] AC 1099, HL; *Russell v Northern Development Corporation Ltd* [1992] 1 WLR 588, HL
47 (1843) 2 Hare 461; see also *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204
48 Chapter 3.40
This last drafted the duties as a set of instructions to directors, reflecting perhaps the recommendation of the Law Commissions that a statement of duties:

“… should be set out on forms 10(2) and 288a; that when a director signs such a form he should acknowledge that he has read this statement; and that the DTI should consider how pamphlets explaining a director’s duties might be made available to directors.”

Otherwise, the drafting of the compliance and proper purpose rules remained reasonably constant through to section 171. The general reference to exercising powers ‘honestly’ in the 2000 version was dropped as being open to too wide an interpretation. The extension of the term ‘constitution’ to ‘decisions taken under it’ (including class decisions) in the 2000, 2001 and 2005 versions is now incorporated into the extended definition of ‘constitution’ contained in sections 17 and 257 of the 2006 Act. Specifying the overriding nature of the compliance and proper purpose rules in the 2000 and 2001 versions was dropped. However, as directors’ powers only exist within the framework of a company’s constitution and the proper purpose rule only makes sense if it takes precedence over the bona fide rule, their overriding nature is obvious without specifying that giving them ‘top billing’ in the list of duties gives these duties priority.

Section 171 of the 2006 Act reads:

“Duty to act within powers
A director of a company must –
(a) act in accordance with the company’s constitution, and
(b) only exercise powers for the purposes for which they are conferred.”

The absolute nature of these duties (“must act in accordance… and only exercise…”) makes it clear that they are objective in nature, which contrasts with the wording of section 172.

Section 172 – Good Faith

Section 172 of the 2006 Act reads:

“Duty to promote the success of the company
(1) A director of a company must act in the way 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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50 Chapter 7, Pt B of Company Law Reform Cm 6456 (DTI, March 2005)
51 Part 4, para 68 of Law Commission Paper
52 Chapter 3.13 of Completing the Structure
53 See Chapter 3.15 of Completing the Structure
(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 as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.”

Subsection (2) is clearly designed to preserve the position on non-commercial objectives highlighted in Re Horsley & Weight Ltd. Subsection (3) maintains the position in West Mercia Safety Ltd v Dodd as reinforced by the wrongful trading provisions that directors’ duties are owed to creditors once a company is no longer a going concern. The main issues therefore concern subsection (1).

“Act in the way he considers, in good faith” clearly indicates a subjective test which follows Re Smith and Fawcett and the 2000, 2001 and 2005 versions, although the verb in those versions changed from ‘believes’, to ‘decides’ to ‘considers’. Compared to believing at least, considering does imply conscious focusing on the issue, though perhaps not as strongly as deciding. That could mean that in a future case like Charterbridge Corporation Ltd v Lloyds Bank Ltd where the directors did not consider each separate company’s benefit at all, the directors could technically be found to be in breach of their duties, though what damages could be claimed if the non-considered act was still objectively reasonable is hard to see. However, what is even more problematic is what has to be considered.

“Would be most likely to promote the success of the company” appeared in both the 2001 and 2005 versions, but the 2000 version differed slightly, the wording being “best calculated… to promote the success of the company.” Is this the same as the common law’s “for the benefit of the company”? The statutory version(s) do seem rather more demanding. The directors in a future case like Evans v Brunner Mond & Co Ltd might be able to claim they considered the funding of university research could benefit the company, but could they claim that, compared to other uses of the money, they honestly considered it “would be most likely to promote the success of the company”?

This narrowing of focus is reinforced by the “success of the company” being stated as “for the benefit of its members as a whole”. This wording is taken from Greenhalgh v Arderne Cinemas Ltd and appeared in all of the 2000, 2001 and 2005 versions. This

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54 As, after 1 October 2009, a UK company will no longer be required to have any objects clause, such specified non-commercial objectives may become rarer, 2006 Act, s 31(1).
suggests that, except where subsection (2) or (3) comes into play, there is no longer any room for a distinction, as expressed in Dawson International plc v Coats Patons plc and Fulham Football Club Ltd v Cabra Estates plc, between the interests of the shareholders and those of the company as a separate entity. Given this strident affirmation of shareholder supremacy, what can the remainder of subsection (1) with its list of other interests achieve?

**Other Interests**

In the 2000 version non-intervention by the courts was also encouraged by references in the good faith duty to practicability and circumstances (eg limited information, time or resources). In the 2001 and 2005 versions these references were confined to the consideration of the list of other interests. Practicability survived into the Bill presented to the House of Lords, but was removed during the passage through Parliament, so that in section 172, there is no reference to either. As section 172 remains subjective, why directors held a mistaken belief should not matter in determining a breach of this duty. However, it could affect the application of the duty to exercise reasonable care, skill and diligence in section 174, which is objective in nature. I will have to return to the interaction between these duties.

The list of factors that directors are to “have regard to” has remained consistent over the various versions, but as the bracketed “amongst other matters” makes clear, is not comprehensive.
The introduction of the “need to act fairly between members” may just be a reminder to directors of the statutory unfair prejudice provisions, just as subsection (3) is, inter alia, of the wrongful trading provisions. As directors owe their duties to the company (and through that to the members as a whole), it is hard to see how an individual member treated unfairly could bring an action (except perhaps for an injunction) for breach of directors’ duty, unless he could show the unfairness had damaged the company itself. The wide discretion as to substance and remedies under the unfair prejudice provisions is going to remain more attractive, except perhaps for shareholders in quoted companies, where the courts have been reluctant to allow such actions.55

“Taking account of both the short and the long term consequences” did govern the whole good faith duty in the 2000 version and has been demoted to just a reference to the long term as a factor in section 172. Short term consequences, particularly in the current climate of just trying to survive, must be “amongst other matters” directors need to “have regard to”. However, this emphasis on the long term does imply that the “benefit of the members as a whole” could include future members where appropriate, although the CLRSG was resistant to this interpretation, preferring the argument that current company value was determined by prospective revenue generation.56 Still, this may help to counteract the sharper immediate commercial focus of the good faith duty, though the subordinate nature of the listed interests does not permit any interests other than those of shareholders (current and possibly future) to take priority, except as allowed under subsections (2) and (3). Any scope the common law may have allowed directors of a company with purely commercial objectives to indulge in entity maximisation or even a degree of profit-sacrificing social responsibility seems to have been removed.

So, for example, having regard to “the interests of the company’s employees” might not justify a future decision like that in *Re Welfab Engineers Ltd*, nor “the impact of the company’s operations on the community” a decision like *Evans v Brunner Mond & Co Ltd* since directors might find it hard to convince a court they that believed either was “most likely to promote the success of the company for the benefit of its members…” Marks & Spencer’s recent decision to become ‘carbon neutral’ could be justified on environmental grounds because the directors can claim that their customers are concerned about this, will be attracted to their stores because of it, and will be prepared to pay a premium price to pay for it, all benefiting shareholders. The

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55 *Re Blue Arrow plc* [1987] BCLC 585
56 Chapter 5.1.18, footnote 31 of Strategic Framework
directors of a discounter like Aldi, however, would find such justifications much harder. Indeed, it is interesting that Marks & Spencer itself used to make much of having 90% British suppliers, but under pressure from cheap imports, had to abandon them all overnight in order to survive, and “the need to foster the company’s business relationships with suppliers” proved illusory.\textsuperscript{57} Does this mean that the list of other interests in section 172(1) counts for nothing?

For directors of quoted (and even large private) companies, subject to public scrutiny,\textsuperscript{58} the listed interests almost certainly featured in their boardroom deliberations long before section 172 came into force. One imagines that the appearance of the statutory list will lead company secretaries to ensure that, whenever key decisions are before the board, the minutes will formally record consideration of each of the elements of the list.\textsuperscript{59} With a new statutory derivative action removing some of the absolute bars on shareholders bringing actions that existed under the rule in \textit{Foss v Harbottle},\textsuperscript{60} this degree of caution would be wise. Section 260(3) of the 2006 Act appears to contemplate derivative actions for any type of directorial breach of duty. Still, to launch an action, an applicant needs to show the court a prima facie case, and in effect, good reason for bringing it,\textsuperscript{61} which may bar pressure groups from buying a few shares and claiming the directors have failed to consider their ‘pet’ interest.

However, the list does not just apply to large or quoted companies and private companies are no longer required to have a company secretary, which could give rise to some unintended consequences. The majority of private companies are owner-managed and while going concerns, unlikely to find directors’ decisions challenged by shareholders as breaches of duty. However, sale to new owners or winding up can lead to scrutiny of past directorial decisions by new eyes. Detailed minutes of formal board meetings are unlikely to have been created. Should the company be in financial difficulties because of say, a falling out with a key supplier or customer, a public scandal about environmental pollution, or a protracted strike of key disgruntled workers, the directors may not have any evidence of prior consideration of these risks.

Although the listed interests may look like non-comprehensive guidance, courts have a habit of treating such guidance as establishing new expected standards. Soft law can quickly become hard law. Take for example, guidance given to auditors.\textsuperscript{62} Directors will still be able to point out that the duty to promote the success of the company remains one of good faith, ie honest subjective belief, but failure to consider interests on the list may be viewed not just as going to that duty, but also to the objective duty

\begin{footnotesize}
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\item For a case generated by this dramatic volte face, see \textit{Baird Textiles Holdings Ltd v Marks & Spencer plc} [2002] 1 All ER (Comm) 737, CA
\item Also for companies fully listed on the Stock Exchange, the requirement to ‘comply or explain’ non-compliance with the \textit{Combined Code on Corporate Governance}, (Financial Reporting Council, June 2008)
\item The CLRSG dismissed the danger of ‘pedantic, legalistic minute taking’ as unlikely, Chapter 3.24 of Completing the Structure. It would be interesting to do some empirical research on whether boardroom behaviour has changed in response to the statutory duties
\item 2006 Act, ss 260 to 269
\item 2006 Act, ss 261 and 263
\item \textit{Re Thomas Gerrard & Sons Ltd} [1968] Ch 455; \textit{Lloyd Cheyham & Co Ltd v Littlejohn} [1987] BCLC 303
\end{enumerate}
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to exercise reasonable care, skill and diligence. Where a company goes into insolvent liquidation, this might affect the directors in either of two ways:

1. the liquidator might be emboldened to bring an action under s 212 of the Insolvency Act 1986 for breach of duty if the director has assets worth pursuing; or
2. the courts may become stricter in imposing disqualification orders for ‘unfitness’ under section 6 of the Company Directors Disqualification Act 1986.

Conclusion

Returning to the two key questions posed earlier, it seems that the two duties of compliance and proper purpose contained in section 171 have not altered the pre-existing common law duties. However, the position of section 172 is less clear. The CLRSG seems to have believed that putting ‘enlightened shareholder value’ into statutory form was taking the pre-existing common law duty and ‘making explicit its true character.’ Given the presumption against change created by section 170(3) and (4), other commentators have taken the same view. For example, Professor Birds has said:

“On the whole it is thought that the effect of s 172 is more likely to be educational rather than in any sense restrictive and that business decisions taken in good faith will not be any more easily challengeable than they were before this provision existed.”

I am slightly less sanguine. Even without section 309 of the 1985 Act, I am not as certain as the CLRSG that the pre-existing common law bona fide duty was one purely based on ‘enlightened shareholder value’, although I accept that part of the historic reluctance of courts to intervene was the need for many claims to be framed on the basis of ultra vires rather than just breach of duty. The statutory provision is clearly focused on shareholder supremacy. As for the listed other interests, these may almost give rise to a Catch-22 for directors. If directors pay too much attention to one of these interests (creditors, employees, the environment etc) they may be challenged for being in breach of the primary duty towards shareholders. If they ignore any of these interests and that proves disastrous for the company, they may be challenged for breach of their duty to exercise reasonable care, skill and diligence.

In practice, the most likely circumstance in which a challenge may be raised is during an insolvent liquidation, either to obtain a contribution from the directors or to seek their disqualification. As all these duties are still owed to the company rather than individual shareholders, challenges while a company is a going concern will require the case to be brought by or on behalf of the company. That might occur after a change of ownership (and with it a change of directors), but otherwise will require a

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63 2006 Act, s 174
64 Chapter 5.1.22, though the CLRSG did accept that repeal of 1985 Act, s 309 was needed to remove an element that might go beyond shareholder value towards pluralism.
65 Professor of Commercial Law, University of Manchester in Chapter 15[10A] of Gore-Browne on Companies, 45th edition (Jordans, as at March 2009)
66 2006 Act, s 170(1)
derivative action. How much easier pursuing a derivative action will be under the new statutory provisions, only time will tell.

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67 A challenge for breach of duty could form part of an unfair prejudice action, 2006 Act ss 994 to 999