

## PROMOTION OF THE SUCCESS OF THE COMPANY – SECTION 172

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## OUTLINE

- ◆ What does s.172 say?
- ◆ Case law
- ◆ What does s.172 mean and how will it will applied?
- ◆ Enforcement issues?
- ◆ Directors' duties to creditors

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## INTRODUCTION

- ◆ Chapter 2 of Part 10 of the Companies Act 2006
- ◆ Section 172(1) in effect replaces the duty to act bona fide in the best interests of the company
- ◆ It is new and highly controversial
- ◆ Overlaps other duties
- ◆ Section 172(3) validates common law development

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## RELEVANCE AND AIMS

- ◆ Advising directors when the company is solvent – with later investigation in mind
- ◆ Advising directors when the company is in financial distress or even insolvent
- ◆ What actions might be available against directors where their company has entered formal insolvency regime and what are the problems

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## DUTY TO PROMOTE THE SUCCESS OF THE COMPANY

- ◆ Section 172(1) provides :
- ◆ "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."

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## CASE LAW

- ◆ *R (on the Application of People and Planet) v HM Treasury* [2009] EWHC 3020 (Admin)
- ◆ *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72; May 16, 2008 (Outer House, Court of Sessions, Scotland, Lord Glennie) at [21].
- ◆ *Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm)* [2009] UKHL 39

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## DERIVATIVE ACTION CONTEXT

- ◆ *Mission Capital Plc v Sinclair* [2008] EWHC 1339 (Ch)
- ◆ *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch); [2008] B.C.C. 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* (Ch Div, 04 February 2010)

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## WHAT DOES IT ALL MEAN?

- ◆ 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 bottom line is : did the action promote the success of the company for the benefit of the members?

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## DISCRETION

- ◆ the provision grants an unfettered discretion to the directors provided that they act in a way that they consider would most likely promote the success of the company for the benefit of the members. Prima facie there are no objective criteria that can be used to assess what the directors have done.

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- ◆ Arguably, the section enables directors to take into account non-shareholder interests when making decisions, without being in breach of their duties, BUT always providing that their ultimate decisions do in fact promote the success of the company for the benefit of its members as a whole.

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## GOOD FAITH

- ◆ This ensures that business decisions on, for example, strategy and tactics are for the directors, subject to their acting in good faith and not subject to decision by the courts.
- ◆ This appears to make it very difficult for courts to review what directors have done unless the directors' good faith assertion can be impugned
- ◆ Duty to Act Bona Fide in the Best Interests of the Company was assessed on the basis of a subjective test. (*Re Smith and Fawcett Ltd* [1942] Ch 304)

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## HOWEVER...

- ◆ it seems that a judge can always arrive, on the evidence, at the conclusion that the director(s) did not believe in good faith that the action impugned would promote the success of the company (*Charterbridge Corp Ltd v Lloyds Bank Ltd* [1979] Ch 62; *Regentcrest plc v Cohen* [2002] 2 BCLC 80).

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## MEMBERS AS A WHOLE

- ◆ The courts have tended to hold that it means the present and future shareholders (*Gaiman v National Association for Mental Health* [1971] Ch. 317 at 330; *Brady v Brady*(1987) 3 B.C.C. 535 at 552 (C.A.)). Is that what is meant here?

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## HAVE REGARD TO...

- ◆ The directors have to have regard to a number of factors – mainly stakeholders' interests, BUT...

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◆ The fact is that it really does not matter what is a good result for any of the constituencies mentioned in the provision, after directors have had regard for these interests, for the ultimate concern of directors is that their action promotes the success of the company *for the benefit of the members as a whole*

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### ENFORCEMENT

◆ What if directors fail to adhere to s 172?

◆ None?

◆ Shareholders may bring derivative actions – but why would they? They might if the directors acted ultimately to benefit non-shareholders.

◆ Constituencies mentioned in s 172 have no standing to bring proceedings

◆ Administrator or liquidator may bring actions later

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### FURTHER READING

◆ A. Alcock, "An accidental change of directors' duties?" (2009) 30 *The Company Lawyer* 362

◆ Chap 8 in Keay, *Directors' Duties* (Jordans, 2009)

◆ S. Kiarie, "At Crossroads : Shareholder Value, Stakeholder Value and Enlightened Shareholder Value : Which Road Should the United Kingdom Take?" (2006) 17 *ICCLR* 329

◆ Keay, "Section 172(1): An Interpretation and Assessment" (2007) 28 *Company Lawyer* 106-110

◆ Keay, "Enlightened shareholder value, the reform of the duties of company directors and the corporate objective" [2006] *Lloyds Maritime and Commercial Law Quarterly* 335.

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## DIRECTORS' DUTIES TO CREDITORS (SECTION 172(3))

- ◆ This provides that the duty imposed by s.172(1) is subject to any rule of law requiring directors in certain circumstances to take into account the interests of creditors.
- ◆ This provision sanctions common law development and makes the duty subject to some obligations, e.g. to avoid wrongful trading

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## BACKGROUND

- ◆ There is a line of authority extant in the UK and the Commonwealth to the effect that directors have a duty to the company to take into account the interests of creditors at certain times.
- ◆ Section 172(3) acknowledges that line and affirms it implicitly

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- ◆ The obligation acts as a form of creditor protection, inhibiting companies externalising the cost of their debts at the time of financial distress.
- ◆ Common law development
  - Wimborne v Walker* (1976) 137 CLR 1; (1976) 3 ACLR 529
  - Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215

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- ◆ *Liquidator of West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30 (CA).
- ◆ *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 Investment Management Ltd* [2004] 1 BCLC 217; [2004] BPIR 75; [2003] EWHC 227 (*Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch); *Re Bakewell Management Ltd* (unrep, 22 Feb 2008, Ch D, Robin Knowles QC).

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### THE BIG ISSUE – THE TRIGGER

- ◆ What are the circumstances when the s.172(1) duty is overtaken?
- ◆ Definitely when the company is insolvent (*West Mercia Safetywear Ltd v Dodd* at 33; *Re Pantone 485 Ltd* [2002] 1 BCLC 266 at 285)
- ◆ Near or in the Vicinity of Insolvency (*Gwyer v London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153 at 178; [2002] EWHC 2748 at [74]).
- ◆ Doubtful Solvency (*Brady v Brady* ((1988) 3 BCC 535 at 552; *Gwyer*)

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### ENFORCEMENT

- ◆ Directors cannot take action
- ◆ Shareholders have no reason to do so
- ◆ Usually left to a claim by the liquidator or administrator standing in the shoes of the company. It can be the substantive element of a s.212 misfeasance summons

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- ◆ Risk of insolvency (*Nicholson v Permakraft (NZ) Ltd* (1985) 3 ACLC 453 at 459; *Linton v Telnet Pty Ltd* ((1999) 30 ACSR 465 at 478)
- ◆ Financial instability – dangerous financial position (*Facia Footwear Ltd (in administration) v Hinchliffe*), financially unstable (*Linton v Telnet Pty Ltd*), or in financial difficulties (*Re MDA Investment Management Ltd* [2003] EWHC 227 (Ch) at [70]).

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### FURTHER READING

- ◆ Chap 13 in Keay, *Directors' Duties* (Jordans, 2009)
- ◆ Chaps 11-17 in Keay, *Company Directors' Responsibilities to Creditors*, (Routledge-Cavendish, 2007)

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### SUMMARY

- ◆ Section's meaning is uncertain
- ◆ Director discretion
- ◆ Directors only have to pay attention to other constituencies insofar as that action promotes the success of the company so as to benefit the shareholders.
- ◆ Reliance on good faith
- ◆ Section 172(3) will see judges applying case law as developed thus far

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