How 'Fred the Shred' Got Away With It: Loud Calls for Company Law Reform

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The article takes a critical review of s 172 (1) of the Companies Act 2006 in light of the financial crisis, noting the provision's lack of use and inability to respond to executive failures. The decisions taken by Fred Goodwin whilst at the helm of RBS are scrutinised against the legislation, leading the author to conclude that the section is a right without a remedy. However, the example portrays an overarching powerful message of the ineptness of company law in modern corporate governance. In response to regulatory gaps, the qualification of decisions taken by directors that invariably effect the wider populous is necessary to prevent another crisis. Therefore, the philosophical lineage of the section must be questioned and the shareholder and stakeholder dichotomy must be resolved once and for all. Only by utilising comparative jurisdictional tests can the lacuna in corporate governance be filled.

Following the near systemic collapse of the United Kingdom's economy, the failure of the Royal Bank of Scotland (RBS) has been acknowledged as one of the integral causes of the financial crisis leading to the bank's nationalisation.[1] Thus, a general consensus emerged that directors of financial institutions should have their ostensible authority fettered and be made personally accountable for

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[1] Cabinet Office Press Release 'Goodwin Knighthood Decision'(*Cabinet Office*, 31 January 2012) <www.gov.uk/government/news/goodwin-knighthood-decision> accessed 20 March 2013.

irresponsible and damaging corporate decisions.[2] It is trite to acknowledge that the former director of RBS, the then Sir Fred Goodwin, owed a statutory duty to the company.[3] This article seeks to establish whether or not Mr Goodwin can be made liable for the failure of RBS under s 172 of the Companies Act 2006. Yet the analysis is not confined to Mr Goodwin's liability, the plight of RBS is a powerful vehicle to establish a wider reaching point on the failures of UK company law and its inability to react and prevent systemic institutional economic failures. By taking an analytical assessment of the provision, the author questions its controversial philosophical lineage and seeks to resolve the contention between shareholder primacy and stakeholder pluralism. The inadequacies of the provision must be highlighted, whether or not it has erroneously raised the expectation of the shareholder must be investigated.[4] Is it therefore a commensurate conclusion to state s 172 is simply a 'right without a remedy'?[5] In order to rectify the current provision, the competing dichotomy between the judiciaries' hesitation to interfere with business initiatives and the demand for a transparent legal paradigm must finally be balanced.

The scope of the analysis of liability is limited to s 172 Companies Act 2006, a direct consequence of the dearth of evidence available for public knowledge. However, the section is dubbed the 'core duty'[6] and is broad enough in its scope; therefore, the evidence provided by the FSA report[7] is sufficient to potentially incur liability. Pursuant under s 172 is the duty to promote the success of the company,

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[2] Peter Tatchell, 'Economic Democracy: the Next Big Left Idea?' (***Red Pepper***, **5 May 2012) <www.redpepper.org.uk/economic-democracy-the-next-big-left-idea/> accessed 20 March 2013.**

[3] Companies Act 2006, s 170 (1).

[4] Stephen F Copp, 's.172 of the Companies Act 2006 Fails People and the Planet?' (2010) 31 Comp Law 406.

[5] Deryn Fisher, 'The Enlightened Shareholder - Leaving Stakeholders in the Dark: Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of Their Decisions on Third Parties?' (2009) 20 ICCLR 10.

[6] Paul L Davies, *Gower and Davies' Principles of Company Law* (8th edn, Sweet and Maxwell 2008) 506.

[7] Financial Service Authority Board Report, *The Failure of the Royal Bank of Scotland* (FSA November 2011).

replacing the former duty to act bona fide for its best interests. The section requires the director to 'have regard' to the six specific items listed in s 172(1) (a)-(d).[8] Despite s 172 being the definitive statement for each duty, the previous common law and equitable fiduciary duties owed by a director to their company retain their significance in relation to the content of the duties. Section 170(3) and (4) requires the court to have specific reference to them, regarding interpretation and expounding the duties themselves. The discussion now moves on to the actions taken by Mr Goodwin, and their application to s 172, whilst having regard to the former common law and equitable principles.

Prior to the 2008 financial crisis the banking system as a whole, and RBS in particular, was excessively dependent upon short-term wholesale funding.[9] Rapid expansion was the primary goal of Mr Goodwin for RBS, with such empire building activities eventually bringing the bank down. An aggressive culture to cut costs within the bank was a questionable strategy given that success was contingent upon enormous financial risks assimilated by the board. The ignorance of the CEO to identify the financial vulnerability of the bank is demonstrably terrible management, the acquisition of ABN AMRO was totally ill timed, and this one transaction exposed the bank to trading assets where the existing capital regime was most deficient, resulting in a £24.1 billion loss. It could be suggested that the bank would have made a profit if it were not for the transaction.[10] The FSA acknowledges that the transaction was dependent upon a due diligence assessment, however a reasonable and accurate due diligence assessment would have ascertained that both its credited portfolio and credit outlook were poor. Instead, the board was content to rely upon public statements made by the bank regarding

[8] (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 relationship with suppliers, customers and others; (d) the impact of the company's operations on the community and environment; (e) the desirability of the company maintaining a reputation for a high standards of business conduct; (f) the need to act fairly between members of the company.
[9] FSA (n 7) 37.
[10] ibid.

its financial position,[11] clearly inadequate due diligence. Additionally, the management decision to finance the acquisition primarily with short-term debt as opposed to equity both reduced an already low capital ratio and increased potential funding strains. Consequently, it is transparent that the venture was hazardous and over speculative, contributing to the near systemic financial collapse.

The author focuses on the ABN AMRO acquisition as the fundamental element of RBS's failure due to the FSA emphasis on its role and the action taken by Mr Goodwin in supervising and consenting to the transaction. It must be stressed that the bank would have made a profit if it was not for this transaction. The transaction's significance is further emphasised by the then chairman Sir Philip Hampton's statement:

> … I do not think there can be any doubt that the key decision that led RBS to its difficulties was the acquisition of ABN AMRO. That is the painful reality that we can now do nothing to change. With the benefit of hindsight it can now be seen as the wrong price, the wrong way to pay, at the wrong time and the wrong deal.[12]

In order to incur liability under s 172, Mr Goodwin must have failed to act in a way: (i) which he considered to be in good faith; (ii) one which would be likely to promote the success of the company for the benefit of the members as a whole, and; (iii) in doing so have regard to the listed factors. The duty imposed is subjective, as it asks a director to act in a way that is 'bona fide in what they consider - not what the court may consider - is in the interests of the company';[13] the court will not act as a supervisory board over decisions which

[11] ibid.
[12] RBS Press Release, 'Royal Bank of Scotland Group PLC - Annual General Meeting/General Meeting' (*RBS*, 3 April 2009) <www.investors.rbs.com/download/standard/RBS_News_2009_4_3_AGM3.pdf> accessed 20 March 2013.
[13] *Re Smith and Fawcett Ltd* [1942] Ch 304, 306 (Lord Greene MR); *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch).

the managers honestly arrived at.[14] Thus, a director must do his best to promote the business and act with complete good faith.[15] The question is whether or not Mr Goodwin held an honest belief that the transaction was actually for the benefit of the company. Reasonable acumen would deduce that when faced with such a question, Mr Goodwin would state he acted with good faith and held an honest belief that the transaction would benefit RBS. There is no evidence to indicate that the transaction was actually intended to imperil the company. Section 172(1) makes it clear that the director must have acted in good faith, however how can the element of good faith or an honest belief in the transaction actually be disproved? The difficulty is that there is no definite standard against which the directors' actions can be assessed; again Mr Goodwin can merely state he acted in good faith, and his position becomes totally unassailable.[16] The guidance on the Act emphatically states that 'it will not be sufficient to pay lip service to the factors',[17] yet it might be difficult to prove that Mr Goodwin has just paid lip service to the requirements in s 172.[18]

The evidential burden of negating good faith may be exacerbated by the notion that an act done with an unreasonable belief that the action was in the best interests of the company is not in breach of the duty, provided that belief was held honestly.[19] If Mr Goodwin genuinely held the belief that the transaction would benefit RBS, despite such a belief being unreasonable, then there is no s 172 breach as it is not sufficed by the company merely showing the damage inflicted. Clearly the law is not exhibiting a draconian application to directors in order to prevent interference with business objectives, as there will

[14] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 832 (Lord Wilberforce).
[15] *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324, 367 (Lord Denning).
[16] Andrew Keay, 'Section 172(1) of the Companies Act 2006: an Interpretation and Assessment' (2007) 28 Comp Law 106.
[17] David Chivers, *The Companies Act 2006: Directors' Duties Guidance* (The Corporate Responsibility Coalition, October 2007).
[18] Keay (n 16).
[19] *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 [90], [97].

always be an element of risk whilst investing. Yet the author submits that the requisite criteria of bad faith or a dishonest belief imposes an almost impossible burden upon a claimant company to establish that a director failed to promote the success of the company. It will only be clear that a director failed to act in good faith in egregious cases or where the directors' obliging left a clear record of their thought process leading up to the challenged decision.[20] Case law suggests a court could go further than sole reliance upon a subjective assessment of the directors' good faith: for example, Bowen LJ stated: '[b]ona fides cannot be the sole test. Otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide, yet perfectly irrational'.[21] Therefore, maintaining an overzealous subjective assessment of Mr Goodwin's good faith in the transaction that 'he has done what he feels ought to have done ... will be of little significance as a legal control'.[22]

Although Warren J has interpreted s 172(1) as subjective, concurrent to its precursor,[23] the author submits that the court must import Pennycuick J's objective considerations (in *Charterbridge Corporation Ltd*)[24] to compensate the inadequacies of the subjective test. 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. Keay notes that if this interpretation is not imported into a judicial consideration of s 172(1), 'there seems little to stop director's from asserting that they considered, in good faith, the interests of constituencies, but thought that what was done was appropriate'.[25] Therefore, one could suggest a subjective assessment should be but one of a number of considerations to determine whether Mr Goodwin has acted in good faith as there remains ap-

[20] Davies (n 6) 510.
[21] *Hutton v West Cork Rly Co* (1883) 23 Ch D 654 (CA), 671.
[22] Ross W Parsons, 'The Director's Duty of Good Faith' (1967) 5 MULR 395, 417.
[23] *Cobden Investments Ltd* (n 13) [53].
[24] *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62 (Ch), 74.
[25] Keay (n 16).

prehension that a judge is required only to take the word of directors themselves.[26]

Therefore, Mr Goodwin behaves improperly if he carries out an action, which he could not have reasonably believed would be in the best interests of the company, he does not have to go as far reasonably believing that it will be damaging. The law cannot use the benefit of hindsight when assessing director's actions;[27] however, there certainly is evidence that the transaction did raise much concern at the material time. It was advised that 'execution risk would be high' and that 'any bid for ABN-AMRO and subsequent integration would be more difficult than any previous transaction'.[28] The law cannot punish directors for bad business, yet, due to the level of risk taken and the systemic risk which failure posed to the wider market, it may in fact be reasonable to impose liability upon Mr Goodwin in order to curtail such strategies by other directors of financial institutions. Unless an objective interpretation is imported, a claimant will have an arduous task to establish Mr Goodwin acted in bad faith/dishonest belief whilst proceeding with the ABN-AMRO transaction. The limit to Pennycuick J's objective test is that it must only be considered where a director has failed to make an actual decision of whether the action taken was in the best interests of the company.[29] Therefore, its application may be of limited purpose[30] as it is unlikely that Mr Goodwin actually 'turned his mind'[31] to the ABN-AMRO acquisition.

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[26] Andrew Keay, 'Good Faith and Directors' Duty to Promote the Success of Their Company' (2011) 32 Comp Law 138.

[27] *Re Welfab Engineers Ltd* [1990] BCC 600 (Ch); *Re Sherborne Associates Ltd* [1995] BCC 40 (Ch). Lewison J made the same point in relation to an assessment of a director's conduct when hearing an application under the Company Directors' Disqualification Act 1986 in *Secretary of State for Trade and Industry v Goldberg* [2004] 1 BCLC 597, 613.

[28] Continuation of minutes of a meeting of the Board of Directors of RBS (28 March 2007), quoted in the Financial Service Authority Board Report (n 7) 410.

[29] *Charterbridge* (n 24).

[30] *Andrew Keay, 'Office-Holders and the Duty of Directors to Promote the Success of the Company' (2010) 23 Insolv Int 129.*

[31] ibid.

What does s 172(1) deem as achieving success? The difficulty is the term 'success of the company' is uncertain, and it is currently unclear how it will be interpreted.[32] Lord Goldsmith stated:

> … 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.[33]

Thus success is determined by the directors' good faith judgment.[34] However, pre-2006 case law suggests the interests of RBS as a separate legal entity may be preferred over the interests of its members. Arden J stated 'the law does not require the interests of the company to be sacrificed in the particular interests of a group of shareholders'.[35] However, as the company is a separate legal entity from its constituents, it is not easy to determine its best interests without having regard to the interests of present and future members.[36] Clearly the former view was that success was measured by the maximisation of profits,[37] but is such a view restricted by the requirement to have regard to the factors in s 172(1)? Keay disagrees as there is no reason to indicate this maxim is wrong, but equally success may mean the long term increase in shareholder value.[38] The ABN-AMRO investment was clearly intended to bring a substantial financial profit, however, the author submits that the acquisition was hindered on the basis of quick short-term gains. Such a conclusion is drawn from the fact that the actual decision was reactionary, catalysed by Bar-

[32] Andrew Keay, 'The Duty To Promote The Success Of The Company: Is It Fit For Purpose?' (August 2010) University of Leeds School of Law Working Paper <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1662411> accessed 20 March 2013.
[33] Lord Goldsmith, HL Deb 6 February 2006, vol 687, col GC258.
[34] Explanatory notes to the Companies Act 2006, para 327.
[35] *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155, 252.
[36] *Gaiman v National Association for Mental Health* [1971] Ch 317 (Ch).
[37] Keay (n 32).
[38] Keay (n 30).

clays attempted negotiations with ABN-AMRO.[39] The transaction would make RBS the fifth largest bank in the US and extend its global reach in the Middle East and capitalise on ABN-AMRO's payment systems. Essentially, RBS was ensuring it remained ahead of its competitors and executed the transaction to instantly increase its ever-developing size and profits. The new regime brings about a change in the approach and additional considerations that affect the decision-making nature of a director to determine whether they have achieved success. Does the new statutory regime aim to curtail high risk investments which potentially jeopardises the long term stability of the company, like the ABN-AMRO deal?

The philosophy behind the section is based upon 'enlightened shareholder value',[40] ensuring a director is more inclusive in his decision-making, namely taking into account the relationships which the company has with stakeholders in seeking to benefit the members.[41] This was designed to combat the inefficiencies with the former UK company law format, based upon 'shareholder primacy'; where the director's goal is to maximise the interests of the shareholder.[42] An antithetical approach is the 'pluralist', where the director maximises the interests of all stakeholders involved in the company. The adopted enlightened shareholder value theory aims to balance the dichotomy of the opposing principles, ensuring a director must 'achieve the success of the company for the benefit of the shareholders by taking

[39] Financial Services Authority Report (n 7) para 207.
[40] Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: The Strategic Framework* (DTI 1999) ch 5.1.11.
[41] Keay (n 32) 4.
[42] D Gordon Smith, 'The Shareholder Primacy Norm' (1998) 23 Journal of Corporate Law 277; Lynn A Stout, 'Bad and Not-So-Bad Arguments for Shareholder Primacy' (2002) 75 South California Law Review 1189; Jill E Fisch, 'Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy' (2006) 31 Journal of Corporate Law 637; Andrew Keay, 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (2010) 7 ECFR 369. It is to be noted that one commentator argues somewhat persuasively that the UK has a more shareholder-centric approach than the US: Christopher M Bruner, 'Power and Purpose in the 'Anglo-American' Corporation' (2010) 50 Virginia Journal of International Law 579.

proper account of all the relevant considerations for that purpose',[43] these considerations are enacted in s 172(1).

Thus s 172 emphasises that a director should not run a company for short-term gains alone,[44] but take into account long term consequences[45] under s 172(1)(a) the act emphatically reinforces the concept that a director must have regard to the consequences of any decision in the long term which suggests the interests of the commercial entity are as relevant now as they have always been.[46] As the ABNO-AMRO transaction and various financial strategies were being directed to gain short-term growth, does their failure deem liability upon Mr Goodwin for not considering the long-term interests of RBS?

The common law guidance suggests that long-term interests of a company can be favoured in situations where the immediate investment does not reap short-term gains. For example, in the US, in *Paramount Communications*[47] the court accepted that a company may prefer a takeover bid despite another bidder offering more money. The court itself is 'obliged to chart a course for a corporation which is in its best interests without having regard to a fixed financial horizon'.[48] The author suggests that Mr Goodwin must display evidence that his thought process hinders on a proportionality assessment where the investment is balanced against the long-term stability of the company. If the detrimental impact of the investment failing im-

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[43] Company Law Review Steering Group (n 40) ch2.19.
[44] 'Short-termism' has been defined as 'seeking short-term gain to the exclusion of long-term achievement' by David W Mullins in his foreword to: Michael T Jacobs, *Short-term America: the Causes and Cures of Our Business Myopia* (Harvard Business School Press 1991), as quoted in John Grinyer, Alex Russell and David Collison, 'Evidence of Managerial Short-termism in the UK' (1998) 9 British Journal of Management 13.
[45] '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* (FRC 2008) para 1; Company Law Review Steering Group (n 40) ch 5.1.17.
[46] Andrew Keay, 'Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model' (2008) 71 MLR 663.
[47] *Paramount Communications Inc v Time Inc* [1990] 571 A2d 1140 (Del 1989).
[48] ibid.

perils the stability of the company, then this is clearly not proportionate to the long-term stability of the company.

The banking sector is dependent upon the services, advice, and information it disposes to depositors to maintain their investment; in return, depositors expect high standards of professional behaviour. Section 172(1)(e) requires a director to have regard to the 'desirability of maintaining a reputation for high standards of business conduct'. A consequence of the ABN-AMRO transaction is that the reputation of RBS has been irreparably damaged. Arora raises the possibility of depositors, as unsecured creditors, suing for a breach of s 172(1)(f).[49] Does this section entitle an unidentified class of depositors a right to bring an action against Mr. Goodwin? Arora alludes to the decision in *BCCI* [50] where the court refused an action in negligence against the then UK Bank Regulator, the Bank of England, on the basis that depositors were too remote a class to whom a duty of care was owed (an unidentified class to whom proximity could not be established). However, unlike the Bank of England, directors do not possess a statutory immunity from such actions.[51] Director's owe duties to all different kinds of stakeholders as recognised by the factors listed in s 172(1). Yet, Arora believes lack of proximity may negate any action taken by depositors as unsecured creditors, and confusion remains of when the interests of a creditor are to be taken into account by a director due to their absence from the section.[52] Consequently, such an action may ultimately fail.

Another route of action under s 172(1)(d), requires a director to have regard to 'the impact of company's operations on the community and the environment, and s 172(1)(e) 'the desirability of the company maintaining a reputation for high standards of business conduct'. The near fatal collapse of RBS was a critical factor leading to the 2008 financial crisis; its collapse would have meant overwhelm-

[49] Anu Arora, 'The Corporate Governance Failings in Financial Institutions and Directors' Legal Liability' (2001) 32 Comp Law 3.
[50] *Three Rivers DC v BCCI & Bank of England* [2001] UKHL 16; [2001] 2 All ER 513.
[51] Banking Act 1987, s 1(4).
[52] Keay (n 30).

ing failure. Yet the Bank of England, as lender of last resort, bailed the bank out of crisis using £37 billion of tax payer's money. The by-product of RBS's demise is a significant loss in confidence in the banking sector as a whole; the credibility of the bank may never be redeemed with the general public. However, *R (on the application of People & Planet) v HM Treasury*[53] exposes the subsections' futility and the unwillingness of the judiciary to intervene in business decisions by directors, regardless of the consequences. Such action under s 172(1)(d) and/or (e) against Mr Goodwin's motion will surely fail just as the case involved in a similar action against the RBS board did. The claimants challenged the Government's approach to its ownership of RBS, given its contradiction with the Government's own stated policy on issues such as climate change. Mr Justice Sales held that under s 172(1)(d) and (e) there had been no breach by the RBS director, as such decisions were matters for the RBS directors' judgment and an antithetical view would have given rise to a real risk of minority shareholder litigation if share value had been detrimentally affected. It would therefore be wrong for HM Treasury '… to seek to impose its own policy in relation to combating climate change and promoting human rights on the board of RBS, contrary to the judgment of the Board'.[54] Although there was no 'absolute legal bar' to a different decision, to go beyond this decision would have 'cut across' the duties of the RBS director as set out in s 172.[55]

Sales J's judgment reinforces the position that decisions about the management of a company were matters primarily for directors and a shareholder could only influence directors to act within the constraints imposed upon them by their legal duties, in this case s 172.[56] Copp argues that by placing s 172(1)(d) and (e) 'on a par with each other':

> … demonstrates the lack of any real significance to inclusion on the list in s 172. The weighting of these factors ap-

[53] [2009] EWHC 3020 (Admin).
[54] ibid [35].
[55] ibid [34].
[56] Copp (n 4).

> pears assumed to have been a subjective matter for the directors, given the reference to management decisions being a matter for the directors' judgment, and therefore would be difficult to challenge.57

Again, by over relying on a subjective test the director is allowed to take risky strategies to gain financial profit, despite the wishes of stakeholders and the effects of such risky strategies.

The difficulty with the possible suggested actions under the factors listed in s 172(1) is that it is not clear what the clause 'have regard to' actual entails to the relevance of the factors. Some commentators believe a director will not be required to consider any of the factors beyond the point as to do so would conflict with the overarching duty to promote the success of the company.[58] This seems to be an accurate assessment as the enlightened shareholder value still places shareholder primacy as key. The essential obligation is to promote the success of the company whilst having regard to the listed factors, however if these factors are not consistent or prevent promoting the success of the company, they must surely be dismissed.[59] Also, it is apparent that when taking the long-term interests of the company into account this may conflict with the wishes of current members who will demand their needs come first in order to maximise their shareholding.[60] As the members hold a great deal of bargaining power over the company's agent, the director, therefore there will be exiguous situations when the director would not place his employers', the shareholder, first. Therefore, one cannot truly ascertain how a court may interpret the factors.

In relation to all possible routes of action under s 172, it will be very unlikely that Mr Goodwin will be found in breach. The overzealous reliance on a subjective assessment of the director's good faith under the act makes it all but impossible to disprove the director's own judgment. The stakeholder related subsections also appear to have a

[57] ibid 408.
[58] Margaret Hodge, SC Deb (D) 11 July 2006, cols 591-593.
[59] Keay (n 32).
[60] Company Law Review Steering Group (n 40) ch 5.1.15.

very limited application, the phrase 'have regard to' and the enlightened shareholder value still places complete reliance on shareholder primacy. *R (on the application of People & Planet) v HM Treasury* also exposes the judiciary's view that they are willing to interfere with business objectives, and the s 172(1) factors only allow an ability to influence the director, appearing to have no legally binding power. Has the provision actually changed the current legal framework? It appears not; Parliament has created a 'right without a remedy which the law abhors'.[61] Overall, s 172 has raised expectations that it cannot deliver and would be better replaced with a traditional statement of a director's fiduciary duty of loyalty.[62]

The discussion now considers proposals which may ameliorate the inadequacies of the sections, both to ensure a director like Mr Goodwin cannot avoid liability, and as a commensurate guide to safeguard the financial markets from future systemic failure. Paramount to a working system is to maintain a balance between the parameters in which regulation will allow business to be undertaken and innovate, and the ability of the board to develop and execute business strategy.[63]

A major criticism of s 172 is its philosophical lineage, the 'enlightened shareholder value' (which prioritises the central pillar of the shareholder value paradigm), blamed as one key factor resulting in the severity of the financial turmoil in this country.[64] Lilian Miles believes this philosophy catalysed the mismanagement of financial institutions, like RBS, as the ethos and culture remained totally unfettered shareholder primacy, with an exclusive focus upon short-termism.[65] Therefore, in light of the difficulty for a stakeholder to succeed in an action, is 'enlightened shareholder value' the correct

[61] Fisher (n 5).
[62] *Paramount Communications* (n 47).
[63] Arora (n 49).
[64] Shuangge Wen, 'The Magnitude of Shareholder Value as the Overriding Objective in the UK: the Post-Crisis Perspective' (2011) 26 JIBLR 325.
[65] Lilian Miles, 'A Philosophical Basis for the "Enlightened Shareholder Value" Approach' (2012) 308 CLN 2012 1.

philosophical basis to govern directors? If so, is a pluralist basis more appropriate?

The dichotomy between shareholder primacy and stakeholder 'pluralism' has caused conflict as to which principle should prevail; economists believe that the goal of a company is profit maximisation, whereas management academics believe that sustainable growth is dependent upon value given to the stakeholder.[66] Pro-shareholder academics believe the two concepts cannot co-exist as stakeholder business is accountable to all stakeholders, [67] with employees/managers being stakeholders themselves. The doctrine would therefore render them liable to themselves inter alia, without offering any explanation as to how such multiple self-accountancy is meant to work. To make the managers liable to all stakeholders is not just unjustified, but wholly unworkable. This is because an organisation that is accountable to everyone is actually accountable to no one.[68] However, the shareholder value ensures a clear objective: to maximise profit results in economic efficiency and competitiveness.[69] Also, with directors as the agents of the shareholder according to prevailing agency law,[70] the shareholder is in the optimum position to guide and discipline the directors in their duties.[71] Therefore a cynic may suggest the expectations of stakeholders have been falsely raised, as taking proper consideration of the stakeholder is unreasonable and inefficient, distracting the director from making astute business initi-

[66] Milton Friedman, *Capitalism and Freedom* (University of Chicago Press 1962).
[67] Grinyer (n 44).
[68] Elaine Sternberg, *Corporate Governance* (Institute of Economic Affairs 2004) 135.
[69] Sarah Kiarie, 'At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?' (2006) 17 ICCLR 329, 332.
[70] Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure' (1976) 3 Journal of Financial Economics 305.
[71] John H Matheson and Brent A Olson, 'Corporate Law and the Longterm Shareholder Model of Corporate Governance' (1992) 76 Minnesota Law Review 1313, 1328.

atives by permanently subjecting him to making decisions which are stakeholder-friendly.[72]

Antithetically, the stakeholder/pluralist will argue that the office of directorship is a fiduciary one, thus decisions must be fair[73] and balanced between differentiating classes of shareholder, which in modern context includes the stakeholder. This will guarantee both long and short-term interests to be taken into consideration, preventing the short-termism and laissez-faire culture of governance of directors'[74] which certainly exacerbated the situation at RBS.

This debate is not new. Following the Wall Street crash in 1929 in order to prevent a similar economic crisis, Berle advocated an increased emphasis on the doctrine that managerial powers are held in trust for stakeholders as sole beneficiaries of the corporate enterprise.[75] Dodd countered by arguing such an emphasis is undesirable as Business Corporation exists for the sole purpose of making profit for the shareholders.[76] This is backed by the legal tradition of favouring the treatment of business as an institution, directed by persons who are primarily fiduciaries for the institution rather than for its members.[77] The irony is a debate that took place almost a hundred years ago as to which approach should be applied in light of the worst global economic crash, is still taking place after the second most detrimental economic global crisis. Common sense would deem a solution to this debate must, at long last, be posed. As a legal institution this country will ultimately have failed to truly grapple and understand the failures in corporate governance that lead to the Wall Street crash and the recent economic crisis if the sharehold-

[72] Kiarie (n 69).
[73] Rutherford B Campbell Jr, 'Corporate Fiduciary Principles for the Post-Contractarian Era' (1996) 23 Florida State University Law Review 561, 593.
[74] Andrew Keay, 'Enlightened Shareholder Value: the Reform of the Duties of Company Directors and the Corporate Objective' [2006] LMCLQ 335, 338.
[75] A Berle Jr, 'Corporate Powers as Powers in Trust' (1931) 44 Harvard Law Review 1049.
[76] E Merrick Dodd Jr, 'For Whom Are Corporate Managers Trustees?' (1932) 45 Harvard Law Review 1145.
[77] ibid 1163.

er/stakeholder dichotomy is not balanced. An ignorance to history may invariably lead to another detrimental systemic economic failure.

Whereas in Japan the ESV was found not to be desirable for national business interests, and unacceptable to the stakeholder; and any form of codification would result in a loss of flexibility.[78] In Germany, the corporate governance of directors remains uncodified, but with a much more pluralist approach. Directors are therefore obliged to act in the best interests of the company (not individual shareholders) and to refrain from engaging in selfish and opportunistic behaviour, especially the exploitation of corporate opportunities and the infringement of confidentiality obligations.[79]

In light of both theories, the author submits ESV is actually the most fitting in UK company law. As noted by the CLRSG, the pluralist approach is not practically enforceable[80] due to the director having to weigh up competing interests within the corporate nexus, a duty which would be entirely subjective and impossible to ascertain whose interests receive priority.[81] ESV is the ideal way to clearly define acceptable corporate practices in order to prevent/reduce social damage.[82] By opening the way for an important norm to be embedded in corporate governance, s 172 has, at the very least, crystallised the important status of the stakeholder.[83] Therefore, s 172(1) gives a clear direction on a director that underlines company law. The interests of the shareholder are paramount, but he must 'have regard' to the stakeholder factors listed, with the statute amalgamating the

[78] John Kong Shan Ho, 'Director's duty to promote the success of the company: should Hong Kong implement a similar provision?' (2010) 10 JCLS 17.
[79] Ulrich Haas and Hildegard Ziemons, '§43 Haftung der Geschäftsführer [Liability of Directors]' in Lutz Michalski (ed), *Kommentar zum Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbH-Gesetz) [Commentary on the Law on Limited Liability Companies (Companies Act)]* (2nd edn, CH Beck 2010) para 91.
[80] Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (DTI 2000) ch 3.24.
[81] John Kong Shan Ho, 'Is Section 172 of the Companies Act 2006 the Guidance for CSR?' (2010) 31 Comp Law 207.
[82] ibid.
[83] Miles (n 65).

shareholder and stakeholder interests.[84] However, due to the confusion underpinning the section and the arduous endeavour of succeeding in an action, the author suggests that the execution of ESV must be improved.

In order to rectify totalitarian shareholder primacy, Miles believes the judiciary can aid stakeholders by interpreting and developing s 172 in a manner sympathetic to stakeholder interests.[85] Although a palpable and logical proposal, the author believes it is negated by the notion that as it is extremely difficult to bring an action, or to prove a breach, an opportunity may not arise to cultivate the section in a pro-stakeholder fashion. Other commentators believe strengthening the adequacy of external constraints on company action by implementing appropriate legislation in other areas, for example, additional banking statute to complement the section by making specific requirements to directors of financial institutions.[86] This suggestion contravenes the origins and intentions of the statutory framework of directors' which aimed to achieve clarity, accessibility and simplicity of the duties.[87] Forcing an additional onus on a director to ensure he acts within a secondary set of rules maybe asking too much and over complicating the matter.

The interpretation of what 'have regard to' actually means renders most commentators to conclude that the 'provision is not free from doubt and it appears to be imprecise'.[88] Keay interprets it to mean directors must take the interests of constituencies other than those referred to in s 172(1) into account insofar as this promotes benefits to shareholders,[89] hindering on the axis that increase in financial value is paramount. The author submits that the phrase could be

[84] Company Law Review Steering Group (n 80).
[85] ibid.
[86] David Ronnegard and N Craig Smith, 'CSR and the Legitimacy of the Shareholder Primacy Norm: A Rawlsian Analysis' (2010) INSEAD Working Paper 2010/01 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532225> accessed 20 March 2013.
[87] Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Final Report, Volume 1* (DTI 2001) paras 3.9-3.10.
[88] Keay (n 30).
[89] Keay (n 16).

changed to 'without jeopardising the interests of the listed stakeholders'. This renders the position of both shareholder and stakeholder clearly; shareholders' interests are paramount yet the stakeholder will only be considered where their interests are harmed. Therefore if his interests are jeopardised, he now has a legal tool at his disposal. This makes for practical business as the stakeholders interests do not have to be taken into account in every decision but only where it is clear that their interests are harmed. Secondly, the exclusion of the creditor as a stakeholder raises the notion that it fails to protect their interests,[90] the section ignores the magnitude of case law which provides that if a company is in financial difficulty the director must consider the creditors interests in the decisions which they make.[91] The author submits that their inclusion must be mandated for and the section could even go as far as to indicate which type of creditor will be included. The director can prioritise for the creditor and the possibility of a depositor as an unsecured creditor could be commissioned for.

Finally, the good faith discretion of the directors enables an unfavourable overriding jurisdiction for the court to set the outer bounds of what could be a reasonable belief, thus giving a director discretionary power to set any interest above that of the shareholders whenever their view of success required it.[92] Keay believes Parliament implicitly accepted that the courts would introduce objective considerations into an assessment of a director's actions under s 170(3) and (4);[93] expressly incorporating objective considerations into the legislation forces the judiciary to not rely totally on a subjective scrutiny which s 172 currently adheres to.

To conclude, an action against Mr Goodwin under s 172 will almost certainly fail due to the onus of displacing the subjective good faith requirement and the inability of the stakeholder subsections to trig-

[90] ibid.
[91] Andrew Keay, *Company Directors' Responsibilities to Creditors* (Routledge-Cavendish 2007) 151-178.
[92] Davy Ka Chee Wu, 'Managerial Behaviour, Company law, and the Problem of Enlightened Shareholder Value' (2010) 31 Comp Law 53.
[93] Keay (n 16).

ger liability. Objectively, a common sense assessment of whether a £45 billion loss, primarily triggered by one transaction, failed to promote the success of the company is obvious; Mr Goodwin undoubtedly failed. The current statutory framework is therefore inadequate; although the author favours the 'enlightened shareholder value' philosophy, its execution must be reformed. Failure to correctly address the situation may result in another systemic financial crash where a director exploits their ostensible authority, whilst the academics will still query: in whose interests are the company run?

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