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ABSTRACT

The duty to promote the success of the company for the benefit of its members as a whole is the modern version of the duty of loyalties owed by directors, which is codified in 2006 under section 172 of The Company Act. The section makes various impacts on the directors, shareholders, stakeholders, employees, the community and the business in relation to paying more attention to stakeholders’ interests and benefits during corporate decision-making process.

Some academics state that the section has same approach regarding the ‘promote the success of the company’; however, others state the section is the modern, new, or modified version of the pre-existing law. Therefore ‘the company’s success’, ‘good faith’, ‘benefit members as a whole’ are needed to be evaluated in a wide range.

The proposal put forward an idea is that adequately determines the necessity of the Government to strengthen the protection of stakeholders’ interests in companies and still the interests of shareholders are left wholly to the discretion of directors not to any acts.

Key words: Companies Act 2006, company’s success, benefit of its members as a whole, duty of loyalty, director’s duty, good faith.

Research Article

2006 TARİHLİ BİRLEŞİK KRALLIK ŞİRKETLER KANUNU UYARINCA MÜDÜRÜN, ŞİRKETIN BAŞARILILIĞI BİR ŞEKILDE FAALIYET GÖSTERMESİNDE TÜM İLGİLİLERİN MENFAATLERİNE GÖZETMESİ GÖREVİNIN KAPSAM VE UYGULANABILIRLİĞİNIN DEĞERLENDİRILMESİ

ÖZ

2006 tarihli İngiliz Shirketler Kanunu’nda, şirketin bir bütün olarak başarılı şekilde faaliyet göstermesinin sağlanması görevi müdürlerin özen borcumun güncel halidir. İlgili maddede kurumsal karar alma sürecinde pay sahiplerinin menfaatlerine ve çıkarlarına daha fazla dikkat etmek için müdürler, pay sahipleri, işçilere, toplum ve faaliyet üzerinde çeşitli ekliler yaratmaktadır.

Bazı akademisyenler maddenin, müdürün şirketin başarılı bir şekilde faaliyet göstermesini sağlamak görevi ile benzer olduğunu; bazılarının ise eski maddenin güncellenmiş, değiştirilmiş, yeni ve modern halidirğini belirtmişlerdir. Bu sebeple şirketin başarılı bir şekilde faaliyet göstermesi, iyi niyet, ortakların bir bütün olarak menfaat sağlamanın genis bir şekilde yorumlanması gerekmedektir.

Bu çalışma devletin açık bir şekilde pay sahiplerinin şirketekki menfaatlerini daha güçlü hale getirmesine ihtiyaç olduğu ve madde ile pay sahiplerinin çıkarlarının halen kanuna değil müdürlerin kararlarına bağlı olduğu görüştüni ileri sürmektedir.

Anahtar Kelimeler: İngiliz Şirketler Kanunu 2006, şirket başarısı, ortakların bir bütün olarak menfaat, özen borcusu, müdürlerin görevleri, iyi niyet.

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1. Introduction

‘Weak governance across the spectrum of companies was a major cause of the financial crisis’\(^1\). Furthermore, The Treasury Committee in the UK states ‘important theme ... corporate governance failures in the banking sector, including failures by the boards’, so it is inferred that the issue of corporate governance was a basis of the financial crisis. It is significant that directors of companies play a dominant role in corporate governance and the company law principles also make directors responsible for how they overcome the affairs of their company, or how they manage risks which the company encounter. A considerable number of duties are imposed on how directors conduct the affairs of their companies. One of ‘the core duty\(^2\) and ‘controversial or challenging duty\(^3\) can be found in the Company Act 2006, as ‘duty to promote the success of the company’ under section 172. The duty to promote the success of the company is ‘the modern version of the most basic of the loyalty duties\(^4\) owed by directors. In addition, the duty is also classified as ‘the most wide-ranging duty of the general duties\(^5\) in the Act, because the term of promoting the success of the company may include a considerable number of duties.

This study seeks to shed some light on ‘promote the success of the company for the benefit of its members as a whole’, which are vitally important to the discussion on section 172 of the Companies Act 2006. Its first section is dedicated to a general introduction to the context of the section. Second section gives brief background information about the section. Third section makes a detailed analysis of the section, while explaining ‘the company’s success’, ‘good faith’, ‘benefit members as a whole’, ‘due regard to relevant factors’. In fourth section, the impact of the section is examined. The study concludes with some points on the issue.

2. The Section

According to the section 172 of the Company Act 2006\(^6\), the director 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—

(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.

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\(^1\) A R Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' [2010] ULSLCBL 1, 2
\(^2\) P L Davies and S Worthington, Principles of Modern Company Law (10th, Sweet & Maxwell, London 2016) 540
\(^3\) Ibid, A R Keay, p. 4
\(^4\) Ibid, P L Davies and S Worthington, p. 540
\(^5\) Ibid, A R Keay, p. 4
\(^6\) Section 172 of the Company Act 2006

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—
company for the benefit of its member as a whole’, then it regulates ‘a non-executive list’ of six matters to which the directors ‘have regard’ when deciding on appropriate strategy. It may be said that directors have always been under a duty to promote the company’s business with fulfilling the duty to act in good faith for the benefit of the company and its members. In addition, the directors do not only have regard the benefit of the company’s members, but they have also regard interests of the company’s employees, and other stakeholders. At a glance, section 172(1) makes the duty of directors clear to have regard the others while deciding how to promote the success of the company. Section 172(2) provides that where there is a company that includes purposes other than the benefit of the members, it operates as if the reference to promoting the success of the company for the benefit of its members were to achieving the purposes set by the company, such as community interest companies and charitable companies. Section 172(3) provides a duty of directors to take into account the interests of the creditors of the company in certain circumstances. However, it does not state when or in which circumstances creditors’ interests are to be considered, but the common law can readily make up for the deficiencies.

In general, the case of Re West Coast Capital8 qualifies the duty under section 172 as ‘the duty to act bona fide in the best interests of the company.’ The duty to promote the success of the company expresses the law’s view on how directors should discharge their functions on a day-to-day basis9. The minister overseeing the enactment of the companies legislation shares her opinion about section 172 of the Company Act ‘as marking a radical change in articulating the connection between what is good for a company and what is good for society at large.’10.

3. The background of the provision

The duty to promote to success of the company is ‘the modern version’11 of the most fundamental of the duty of loyalty owed by directors. The common law was regulated as one which required the directors to act in good faith in what they believed to be ‘the best interest of the company.’ However, the term of ‘interest of the company’ is not enough and clear to provide a guidance to directors in order to promote the success, so it is qualified as ‘meaningless’12. In addition, it is stated that there were some defects in the present law (the common law) and it did not corresponds to ‘accepted norms of modern business practice’13. This common law approach is different in crucial ways from section 172, because the new approach does not only

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7 Ibid, P L Davies and S Worthington, p. 541
8 Re West Coast Capital (LIOS) Ltd [2008] CSOH 72
9 Ibid, P L Davies and S Worthington, p. 540
10 Ibid, A R Keay, pp. 7
11 Ibid, P L Davies and S Worthington, p. 540
12 Ibid, P L Davies and S Worthington, p. 540
13 Ibid, A R Keay, pp. 10
require directors to act in good faith and interest of the company, but it also requires other matters, such as interests of stakeholders, or employees, company’s operations. The new approach is named ‘enlightened shareholder value’ in which directors are obliged to ‘achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose’ and this involved taking ‘a proper balanced view of the short and long term; the need to sustain effective on-going relationships with employees, customers, suppliers and others’ as well as to ‘consider the impact of its operations on the community and the environment’14. This approach is acknowledged as ‘development of the common law’, not ‘repetition’ of it15.

4. The scope of the section
The section has provided some new terms and concepts, but these terms are not enough to guide directors in order to promote the success of the company for the benefit of its member as a whole. In addition, the terms in the section, even though some of them were clarified during the previous common law system, may need to be re-defined in accordance with current law, business, culture, and technology. Similarly, the minister states ‘the new statutory statement captures a cultural change in the way in which companies conducts their businesses. For instance, it is crucial to clarify what the company’s success is or is not and to what extent it is accepted; similarly what the main criteria is to determine whether the conduct is acted in good faith or not; what the expression of ‘members as a whole’ is; and what the long termism is and not.

4.1. The company’s success
According to the Act 2006, the main objective of directors is to promote the success of the company. However, it is important to establish what the success for company is and to what extent conducts performed by directors are acknowledged. The same problematic issue had also been arisen under the previous law as ‘best interest’. Both these terms are vague and can be readily interpreted in favour of both sides. Therefore, the only position to interpret vague or ambiguous terms belongs to the courts and academics.

In general, success means what the members of the company want the company to achieve their objectives written in the company’s articles. It can be also defined ‘maximising the financial interests of their members’16. These definitions can be accepted as inadequate for the company law, because in the British legal system, the company law does not only comprise commercially oriented company, but it also include non-profit companies. Therefore, the appropriate definition of the company’s success may be the attainment of the aims for which the company has been set up, which is generally written in the article. Similarly, the section also ascertains the success as ‘achieving those purposes’, not only the benefit of its members. However,

14 Ibid
15 Ibid, P L Davies and S Worthington, p. 543
16 Ibid, P L Davies and S Worthington, p. 544
‘the success’ is criticised by some on the ground that it is superfluous\(^\text{17}\), and one important question may exist as to how success is to be identified where the criteria for it are not explicit from the company’s article. Lord Greene states in *Smith & Fawcett Ltd*\(^\text{18}\) that it is a crucial requirement that directors act ‘bona fide in what they consider is in the interest of the company’. Therefore, if the company’s purpose or aims of company is not clear to determine how the director promote and maintain the success of it, directors’ good faith business judgement can be the determining factor. Similarly, it is claimed ‘...what will promote the success of the company, and what constitutes such success, is one for the director’s good faith judgment.’\(^\text{19}\).

### 4.2. Good faith

Under the common law duty, it was required that directors act ‘bona fide in what they consider – not what a court may consider – is in the interests of the company.’\(^\text{20}\). Therefore, it may be inferred that it is the main requirement that the directors perform their duty in a manner which they considered in the interest of the company. If the directors demonstrate evidence that they acted in the best interest of the company, and if this evidence is accepted by courts, no breach of duty is imposed\(^\text{21}\). This approach may be criticised, because it does not provide a clear standard to establish whether the directors act in the best interest of the company or not. In *Re a Company*\(^\text{22}\), Lordship Harman J criticises the approach and states that ‘... vital to remember that actions of boards of directors cannot simply be justified by invoking the incantation ‘a decision taken bona fide in the interests of the company.’ It is also qualified as ‘largely subjective’ and it provides ‘no objective criteria’\(^\text{23}\). Furthermore, in *Extrasure Travel Insurance Ltd v Scattergood*\(^\text{24}\), the judge did not accept the director’s assertion as justifiable, though the director claims that to act in the best interest of the company, and decided that the director breached his duty of good faith. However, the section 172 has maintained the subjectivity. Under section 172, a director is required to act ‘in a way that he considers, in good faith, would be most likely to promote the success of the company’. According to the Explanatory notes, ‘the decision as to what will promote the success of the company, and what constitutes such success, is one for the director’s good faith judgment.’\(^\text{25}\). In addition, business decisions on tactics, strategy to promote the success belongs to the directors, and these are subject to good faith\(^\text{26}\).


\(^{18}\) Smith & Fawcett Ltd [1942] Ch 304

\(^{19}\) Companies Act 2006 (Explanatory Notes Commentary on Individual Duties) 2006 s 172(327)

\(^{20}\) Re Smith & Fawcett Ltd [1942] Ch 304

\(^{21}\) Regentcrest plc v Cohen [2001] 2 BCLC 80

\(^{22}\) Re a Company [1988] 1 WLR 1068

\(^{23}\) D French, S Mayson, C Ryan, Mayson, French and Ryan on Company Law (31th, Oxford University Press, Oxford 2014) 479

\(^{24}\) Insurances Ltd v Scattergood [2003] 1 B.C.L.C. 598

\(^{25}\) Ibid, Companies Act 2006 (Explanatory Notes Commentary on Individual Duties), para. 327

\(^{26}\) Ibid, Companies Act 2006 (Explanatory Notes Commentary on Individual Duties)
4.3. Benefit members as a whole

The expression ‘members as a whole’ is a new concept under the 2006 Act. Before the act was implemented into the law system, ‘the interest of the company’ was taken into account while assessing the director’s performances. It was criticised due to its vague meaning. It was claimed that the interest of the company could be interests of shareholders\(^{27}\); however, some state that it includes something more than the interest of shareholders\(^{28}\). What the new term, benefit members as a whole, means ‘the interests of both present and future members of the association’\(^{29}\), certainly regarding with companies for profit, or ‘corporate benefit’\(^{30}\). Therefore, it is necessary to see this importance that not only to benefit the majority shareholders, or any particular shareholder are required to be taken into account, so benefit members as a whole may be acknowledged as ‘collective body’\(^{31}\). The term benefit is defined as ‘the financial well-being of the shareholders’\(^{32}\). Therefore, it can be defined the ‘benefit members as a whole’ as the financial well-being of the present and future members of the association. In addition, in case of the director of a company being part of a group corporation, the directors are required to consider each separate company’s benefit, not the benefit of the group as a whole\(^{33}\). Thus if the interests of the company as a separate entity are in conflict with the interest of the members as a whole, the interest of the company should prevail\(^{34}\).

The last point, section 172(2) is designed to preserve the position on non-commercial objectives of companies, so in case of non-profit objectives, ‘the success of the company for the benefit of its members’ means to achieve those purposes written in the company’s articles.

4.4. Due regard to relevant factors

Section 172(1), one of the new concepts but not new duty, provides that the directors are, in the course of performing their duty to promote the success of the company for the benefit of its members as a whole, to have regard to a list of factors set out in (a) to (f). The term ‘have regard to’ means ‘thinking about’ other relevant matters, or ‘give proper considerations to’ listed interests\(^{35}\). Therefore, it may be said that the listed factors are important part of the duty to promote the success of the company as a whole.

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28 A Keay, 'Enlightened shareholder value, the reform of the duties of company directors and the corporate objective' [2006] Lloyd's Maritime and Commercial Law Quarterly 335, 345
30 Ibid, P J Davies and S Worthington, p 547
32 Ibid, A Keay, p. 17
33 Ibid, A Keay, p. 17
34 Charterbridge Corp v Lloyds Bank Ltd[1970] Ch 62
4.4.1. The long termism

It is difficult to establish what the short term is and what the long term is. Nonetheless, the short terms may be defined as ‘foregoing economically worthwhile investments with longer-term benefits in order to increase reported earnings for the current period’\(^{36}\). According to this approach, the company pays out all earned amounts as profit, and they do not consider any future investments and development of the company’s market. In addition, it also means ‘scrimping on research and development, and failing to renew plant and equipment…’\(^{37}\). Nonetheless, not only short term interests is sufficient to promote the success of the company as a whole, but the directors are also required to take into account the long term interests. It is possible to see short and long term thinking in the event of Shell\(^{38}\) in 2009 that the company decided to lay off its 5000 staffs in order to increase dividend values, this may be accepted short term interest, because the enhancement of the dividend values comprises only the current period, not the future, and it provides short time profits to the company and others. Then the company asked staffs to pay out in their salaries instead making employees redundant. This approach can be accepted as long terms interests, because the main idea behind this strategy is that the company did not both make its reputation lower in long period and lose its skilled workers just for ephemeral problems. Similarly, if pharmaceutical company stop to draw up a budget for the research and development, it may be also acknowledged as a failure to consider the long term interest\(^{39}\).

4.4.2. Employees

The interests of the company’s employees are required to have been regard. It is necessary to be acknowledged that employees are a significant stakeholder group in the company. Albeit the term ‘employee’ is regulated under the section 172, it is asserted that the section has little or no practical effect on the position of employee\(^{40}\), because the employees do not have special ways to enforce the director’s duty. Keay states ‘s.172 gives no power to stakeholders expressly or implicitly to take proceedings against miscreant directors’\(^{41}\). Therefore, this subsection is criticised by many jurists as ‘brings no improvement on employees’ position’, ‘to worse the position of them’\(^{42}\), and ‘deterioration in the rights of employees’\(^{43}\). Under section 309 of the 1985 Act, the directors were required to take account of the interest of the employees in the course of promoting the success of the company as well as its

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\(^{36}\) J Grinyer, A Russell & D Collison, ‘Evidence of Managerial Short-Termism in the UK’ [1998] BJM 9, 13

\(^{37}\) Ibid, A Keay, p. 23

\(^{38}\) Carl Mortished, ‘Shell to axe 5,000 jobs amid 73% profit fall’ (The Times 2009) <http://article.wn.com/view/2009/10/29/Shell_to_axe_5000_jobs_amid_73_profit_fall/> accessed 11.10.2018

\(^{39}\) Ibid, J Grinyer, A Russell & D Collison, p 13-14

\(^{40}\) E Lynch, ‘Section 172: a ground-breaking reform of director’s duties, or the emperor’s new clothes?’ [2012] C.L. 196, 196

\(^{41}\) Ibid, A Keay, p 27

\(^{42}\) Ibid, P J Davies and S Worthington, p 544

\(^{43}\) Ibid, E Lynch, pp 198
members. It can be readily stated that section 172 ‘diminishes the status of employee interests’.

4.4.3. Creditors
The directors are required to consider the interests of creditors of the company. The interest of creditors is not regulated under the list, so it is qualified as ‘a curious omission’. However, Lynch argued that the interest of creditors can be accepted under the concept of ‘suppliers, customers and others’. The common law, in circumstances where a director take into account a creditor’s interest, may fulfill the gaps where the section is not sufficient to solve problems. In addition, the section does not clarify when the interest of creditors is taken into account; it leaves it to the common law. It is a general approach to the interest of the creditor that if the company is under a financial stress, the directors are required to consider the interest of creditors, if not, vice versa. ‘A course of action which would jeopardise solvency’ may be acknowledged as a trigger point of considering the interest of creditors. However, in the case of doubtfully solvent, even though the company is not insolvent, the court may impose a duty to the directors in order to consider creditor’s interest.

4.4.4. Donations
Companies may make donations to any universities or institutions as a necessity of ‘the impact of the company’s operations on the community’ qualified as ‘profit-sacrificing social responsibility’, though it does not indirect benefit to the company, and its members. Furthermore to foster relationships with company’s employees, customers, and suppliers; and to maintain its business high standard reputation are also required to be considered as the needs of promoting the success of the company.

It may be inferred that the list of factors that directors are to ‘have regard to’ has been regulated with honesty of purpose, but it is not comprehensive and clear. In some circumstances, it is difficult to decide which way the directors conduct to promote the success. Similarly, the interest of members may contradict the interest of others. In this circumstance, which concern the directors take into account is vague.

5. The impact of the section
In terms of effect of the section, it may be said that the duty under the section brings some novelities and changes, so the new impacts of the section may be seen.

The section requires the directors to act ‘in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members.

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44 Ibid
45 Ibid, P I Davies and S Worthington, p 553
46 Ibid, E Lynch, p 199
47 Nicholson v Permakraft (NZ) Ltd [1985] 1 NZLR 242
48 Brady v Brady ([1988] B.C.L.C. 20
49 Evans v Brunner, Mond and Co Ltd [1921] 1 Ch 359
51 West Coast Capital (Lios) Ltd v Dobbie Garden Centres Plc [2008] CSOH 72; Cobden Investments Ltd v RWM Langport Ltd [2008] EWHC 2810
as a whole’ and a list of six matters are regulated in order the directors to have regard to them while deciding the best strategy for the company. However, this section was regulated under section 309 of the 1985 Act as ‘to act in the interest of the company’. It is criticised because it is asserted that the company was an artificial person and it was impossible to assign interests to it, and ‘fairly obscure and elusive concept’ so it might cause a ‘meaningless guidance’ for the directors. Therefore, the section clearly identifies the interests which are taken into account. It is also said that the section negatively impacts employees in terms of their status and interests. Section 309 of the 1985 Act, directors had to consider the ‘interests of the company’s employees in general, as well as the interests of its members.’ Therefore, it may be said that the interests of the employees had played an active role as well as the interests of the company’s members in the directors’ decision making. However, under the 2006 Act, the interests of shareholders are now the main ‘object of the directors’ which is not shared others. Therefore, the impact of the section is that the interests of shareholders have been maintained, but the interests of the employees are taken into account less than before while promoting the success of the company. It is qualified as ‘wrong in principle’, and it is suggested that the directors should balance the interests of the members with those of the stakeholders.

One of the main effects of the section is to bring the ‘enlightened shareholder value’ approach, which acknowledges that if the management of the company conducts its business, the success of the company is not likely to be advanced. Therefore, it is claimed that the section ‘makes explicit its true character’, and the interests of stakeholders, and ‘the community and the environment’. It also makes the interests of the company clearer for the directors, and it ‘prevents confusion between the interests of those who depend on the company and those of the members.’ Similarly, the Government believes that this section makes positive impacts on the interests of the company.

The section may also make a positive impact on the directors by justifying their actions on the enumerated factors; it may be asserted that the directors are in a better position than before in decision-making.

6. Conclusion

The duty to promote the success of the company for the benefit of its members as a whole is the modern version of the duty of loyalties owed by directors, which is codified in 2006 under section 172 of The Company Act. The main role of codification of the act is to make the director’s duty clear and more accessible. According to the section, the director 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 member as a whole’, then

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52 Ibid, P L Davies and S Worthington, p. 544
53 Ibid, p. 541
54 Ibid, p. 552
55 Ibid, A Alcock, p. 376
56 Ibid, DTI, column, p. 253
57 Ibid, DTI, column, p. 789
it regulates ‘a non-executive list’ of six matters to which the directors ‘have regard to’. Therefore, the director does not only consider the interests of shareholders, but the director also has regard to the interests of stakeholders, suppliers, the environment, and the community. In addition, it is significant that the director takes into account long-term consequences of what they do, rather than short-term. This duty was also regulated under the 1985 Act which required the directors to act in good faith in what they believed to be ‘the best interest of the company’. Some commentators state that the section has same approach regarding the ‘promote the success of the company’; however, others state the section is the modern, new, or modified version of the pre-existing law. It is necessary to clarify some terms under the section in order to draw the scope of the section. ‘the company’s success’ may be defined as the attainment of the aims for which the company has been set up, which is generally written in the article. There is no clear definition of the term ‘good faith’, but it may be said that it may be subject the decision as to what will promote the success of the company, and what constitutes such success, and these are require to be assessed in subjective test. The term, ‘benefit members as a whole’, can be clarified as the financial well-being of the present and future members of the association. In addition, the directors have regard to listed factors as a duty of to promote the success of the company. The section makes various impacts on the directors, shareholders, stakeholders, employees and the community and the business in relation to paying more attention to stakeholders’ interests and benefits during corporate decision-making process. Thus, it is still stated ‘the economic agency relationship – directors as agents and shareholders as principals – continues to dominate UK corporate governance’.  

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