ClientEarth v Shell

High Court refuses permission for ClientEarth to bring derivative action on behalf of Shell plc against its directors

ClientEarth's application for permission to bring a derivative claim on behalf of Shell plc ("Shell") against Shell's board of directors ("the Directors") for alleged failure to manage and address climate change risks has been dismissed by the High Court of England and Wales.

The "ground-breaking" claim issued by ClientEarth was the first of its kind, seeking to hold directors of a company personally liable for allegedly failing to adequately address the "material and foreseeable risk" of climate change on their business.

In this article, Alex Sharples, Senior Associate and Annie Joseph, Associate in our Commercial Litigation team explore the implications of this decision which will no doubt provide some comfort to directors concerned with managing climate risks.

Whilst ClientEarth's claim may have fallen at the first procedural hurdle, the heat is still very much on businesses and their directors to ensure that they adequately manage the risks and impact of climate change on their business, if not for the obvious moral imperatives but also to mitigate the risk of climate related litigation. The claim serves as a useful reminder of the growing public and investor scrutiny placed on businesses to mitigate environmental risks and reduce emissions.

ClientEarth has been granted a hearing at which the Court will be asked to reconsider this decision so this is very much a matter of watch this space.

Background

ClientEarth issued a claim on 9 February 2023 alleging that one or more of the Directors had breached their duties to promote the success of the company and to exercise reasonable care, skill and diligence arising out of certain alleged acts and omissions.

ClientEarth is a non-profit environmental law charity and minority shareholder in Shell. Despite only owning 27 shares, ClientEarth sought to bring a derivative claim under S. 260(1) of the Companies Act 2006 against Shell, which is a process by which a shareholder can bring a claim in the name of a company against its directors, if they are alleged to have breached their duties.

Derivative claims are often threatened but not often pursued due to the fact that any relief granted by the Court is intended to benefit the company in question, rather than the shareholders seeking to bring the claim. Accordingly, this is a key example of the creative solutions deployed by activist shareholders seeking to bring businesses to account for climate related issues.

ClientEarth's claim has received unprecedented support from institutional investors, including large pension funds and asset managers holding more than 12 million shares in Shell and more than £450 billion in total assets under management. The case therefore highlights that such actions have the potential to capture public attention and generate significant adverse publicity for the businesses involved.

Relief sought

As part of their application, ClientEarth sought the following remedies:

- A declaration that the Directors had breached their duties (as discussed further below); and
- Orders requiring the Directors to:
    - Implement a strategy to manage climate risk in compliance with their statutory duties; and
    - comply immediately with a May 2021 order made by the Hague District Court, which requires Shell to reduce its Scope 1, Scope 2 and Scope 3 CO_2 emissions by 45% by 2030 (relative to the levels recorded in 2019).

The court's decision

As an initial step, under s.261(1) of the Companies Act, ClientEarth needed to obtain the Court's permission for the substantive application, by establishing that they had a prima facie case entitling them to proceed.

The reason being that derivative claims are an exception to the well-established principle of company law that the company itself, and not its shareholders, must determine whether or not to pursue a cause of action that may be available to the company.

The purpose of this requirement under the Companies Act 2006 is to filter out “unmeritorious” or “clearly undeserving” cases. The Court held that ClientEarth had failed to meet this procedural bar and has therefore dismissed the claim. In doing so, the Court made a number of key findings:

The Court is reluctant to interfere in commercial strategy and management decision-making, and the small size of ClientEarth's shareholding in Shell was seen as a key factor - Managing businesses of the size and complexity of Shell will require directors to take into account a number of competing considerations. The Court is not well equipped to interfere with these management decisions.

The Court is further reluctant to impose new and absolute duties on directors in relation to climate change and directors retain a wide discretion to make decisions on behalf of the Company - ClientEarth alleged that a number of incidental duties relating to climate risk arise from the Directors’ general duties under s. 172 of the Companies Act. However, the judge agreed with Shell that: (i) the duties alleged were “inherently vague and incapable of constituting enforceable personal legal duties”; (ii) it is for the Directors themselves to determine how best to promote the success of the company and how much weight to afford each of the factors which they are obliged to have regard to in their performance of this duty; and (iii) these alleged incidental duties are incompatible with the “subjective nature” of the duty to promote the success of the company.

The Court will have regard to the nature of relief sought; the Court will not grant mandatory injunctive relief if constant supervision is required - On this point the judge opined that it would be "difficult to see” what legitimate purpose a declaration would give, and the Court would not make the mandatory relief injunctive orders sought by ClientEarth because of the disruptive impact this would have on the conduct of Shell's business and the constant supervision of the Directors that would be required to ensure compliance

Motivation and the views of other shareholders are relevant; a shareholder intending to bring a derivative claim must be acting in good faith - The small size of ClientEarth’s shareholding in Shell gave rise to an inference that “its real interest is not in how best to promote the success of Shell for the benefit of its members as a whole” (which has to be taken into account under s. 263(3)(a) of the Companies Act), and found that a person acting to promote the success of the company would not seek to continue the claim. Further, the fact that 80% of Shell’s shareholders supported the Directors’ strategic approach to climate risk (i.e. Shell’s Energy Transition Plan) and that a “very small proportion of the total shareholder constituency” had expressed support for ClientEarth’s claim was also considered to be an important factor (as required under s. 263(4) of the Companies Act).

The need for persuasive and independent expert evidence in environmental disputes was demonstrated in the case - The judge found that the claim suffered from significant evidential difficulties given that the witnesses' expertise was in law and policy as opposed to climate science or other relevant areas. Neither ClientEarth nor its lawyer were able to give expert evidence on the issues of climate change upon which the Court could properly rely. Given the subject matter of the issues in environmental disputes of this type, this will be an onerous and expensive evidential hurdle for shareholders to overcome.

Finally, there is no specific duty to ensure compliance with the order of a foreign court - In relation to the May 2021 Order by the Hague District Court, the Court considered that there is no recognised duty owed by directors to a company in which they hold office to ensure that they comply with the orders of a foreign court.

Commentary

The decision which aligns with previous case law on derivative actions endorses the well-established principle that the Court is extremely reluctant to interfere in company management decisions, and directors retain a wide discretion to determine how to address business risks, including climate change. However, it is crucial for boards to ensure transparent communication of climate-related risks and targets, aligning with relevant disclosure obligations. Activist groups will likely continue to look for novel and creative ways to hold businesses accountable, so managing the risks posed by climate and wider ESG factors will be paramount.

Further, the broad discretion afforded to directors in relation to company management does not absolve them of their responsibilities in relation to dealing with climate change risk and actions. Directors must remain diligent in evaluating, managing, and reviewing climate-related risks and targets to mitigate the potential for legal disputes. It is crucial for boards to ensure transparent communication of these risks and targets, aligning with relevant regulatory disclosure obligations.

What's next for ClientEarth and the future of climate change litigation?

The present decision to dismiss the claim was made on the papers. Whilst ClientEarth may have fallen at the first procedural hurdle, the charity still has a "second bite of the cherry" having been granted the right for the Court to reconsider the decision at an oral hearing.

It is likely that ClientEarth will face a significant uphill battle in convincing the Court to overturn the decision in light of the clear reasoning underpinning the initial decision. This is not to say however that we will not see a rise in climate-based litigation against companies through this or other means going forward.

The rise of shareholder activism and climate change litigation is having a significant impact on corporate responsibility and accountability. Companies are increasingly being held to account for their environmental impact from a societal and regulatory perspective; investors are increasingly demanding greater transparency and action on climate risks. This is driving change in the way companies approach sustainability and environmental responsibility, with many adopting ambitious carbon reduction targets and investing in renewable energy as they look to their environmental impact.

As this landscape evolves, business owners and directors must take steps to guard against potential litigation by conducting appropriate risk assessments that evaluate their corporate exposure to climate change and environmental impact, developing viable low-carbon strategies and ensuring compliance by setting achievable targets and engaging with the public and investor scrutiny, viewing their ESG commitments as an opportunity as opposed to an area of risk.

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