# ClientEarth v Shell Plc: High Court Rejects Climate Change Activist Group's Application for Permission to Bring Derivative Suit

**5 September 2023**

## Introduction

In a significant decision, the High Court has dismissed ClientEarth's attempt to launch a derivative action on behalf of Shell plc ("**Shell**") against the directors of the company ("**Directors**") in respect of alleged failures to properly address the risks of climate change.

The judgments ClientEarth v Shell Plc [2023] EWHC 1137 (Ch) and ClientEarth v Shell Plc [2023] EWHC 1897 (Ch) offer useful insight into how the English courts are likely to approach the use of derivative actions by shareholders against the directors of companies in the context of ESG litigation and make clear that derivative actions will only be appropriate in rare cases.

The High Court's decision that pursuing a derivative claim with an ulterior motive (i.e., to push an environmental agenda) meant that ClientEarth's claim was not brought in good faith and thus capable of being dismissed under the court's broad discretion is a significant finding. Indeed, it would appear that claims of this nature, at least insofar as they are brought by minority shareholders who are not typical investors (e.g., NGOs and other non-profits such as the claimant in this case), are going to be very difficult to get off the ground.

## Background

ClientEarth, a non-profit environmental law organisation and a minority shareholder in Shell, sought to bring a derivative claim against the Directors under s. 260 of the Companies Act 2006 ("**CA 2006**").

Claimants are only entitled to bring a derivative action in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach

of duty or breach of trust by one or more of a company's directors. The procedure for bringing a derivative action in the English courts requires the claimant to apply to the court for permission to continue the claim to a full hearing. The court will initially determine the application on the papers, applying the test of whether a *prima facie* case for the grant of permission is established. In the event that permission is denied at the first stage, the claimant may exercise its right to ask for an oral hearing.

In its derivative claim, ClientEarth argued that the Directors had breached their directors' duties by failing to: (i) act in a way to promote the success of the company (having regard to a list of non-exhaustive considerations, including the impact of the company's operations on the environment (s. 172 CA 2006)); and (ii) exercise skill and diligence that may reasonably be expected of them (s. 174 CA 2006).

The alleged failings relied upon were in relation to: (i) Shell's climate risk management strategy (e.g., an alleged failure to set an appropriate emissions target and ensure a measurable and realistic pathway to meeting the net-zero target before 2050); and (ii) Shell's alleged failure to comply with an order made by the Hague District Court in May 2021 which imposed a 45% emissions reduction obligation on Shell to be achieved by 2030 (the "**Dutch Order**").

ClientEarth sought (i) a declaration that the Directors had breached their duties; and (ii) mandatory orders requiring the Directors to implement a strategy to manage climate risk in accordance with their alleged statutory duties and to comply with the Dutch Order.

## First Judgment (Written Submissions)

On 12 May 2023, at the first stage of the proceedings, Trower J held that ClientEarth was unable to establish a *prima facie* case for the court to grant permission for a derivative claim. This was after consideration of both parties' written submissions.

The substantive test as to whether permission should be granted is set out in s. 263 CA 2006. Under s. 263(2) CA 2006, the court is to refuse permission if it is satisfied that a person acting in accordance with his duty to promote the success of the company would not seek to continue the claim. Additionally, s. 263(3) CA 2006 sets out a number of discretionary factors which the courts must take into account in reaching its decision, including, among others, acting in good faith in seeking to continue the claim, whilst s. 263(4) requires the court to have particular regard to any evidence before it as to the views of members of the company who have no direct or indirect personal interest in the matter.

The key points arising from the first judgment are as follows:

- **Wide Discretion Afforded to the Decision-Making of Directors:** ClientEarth alleged that the Directors owed a number of "*incidental duties*" derived from the statutory duties under ss. 172 and 174 CA 2006, such as a duty to adopt strategies which are reasonably likely to meet Shell's targets to mitigate climate risk and a duty to ensure that the strategies adopted to manage climate risk are reasonably in the control of both existing and future directors. Trower J disagreed that the Directors were subject to such incidental duties and accepted Shell's arguments that these (i) were inherently vague and incapable of constituting enforceable personal legal duties, (ii) cut across the basic principle of company law that it is for directors themselves to determine (in good faith) how best to promote the success of the company for the benefit of its members; and (iii) were incompatible with the subjective nature of the duty under s. 172 and amounted to an unnecessary and inappropriate elaboration of the duty under s. 174.

  In reaching this conclusion, the court emphasised that directors, especially of large corporates, should have the flexibility and discretion to decide what is best for the company and its members. This would inevitably involve weighing a wide range of competing considerations.

  To succeed in showing that the Directors had breached their statutory duties, ClientEarth would have had to establish a *prima facie* case that the current strategy of the Directors fell outside the range of reasonable responses to climate risk and caused harm to Shell's members. This was a rigorous standard; ClientEarth would have had to show that there was no basis on which the Directors could reasonably have concluded that their actions were in the interest of Shell. Trower J ultimately held that ClientEarth failed to establish such a case.

- **Duties Relating to Foreign Orders**: ClientEarth argued that the Directors had breached their duties by failing to take reasonable steps to ensure compliance with the Dutch Order. However, Trower J held that there was no established English law duty requiring the Directors to ensure compliance with an order of a foreign court (as opposed to the obligation on directors to take reasonable steps to ensure that an order made by an English court is obeyed). Trower J also placed weight on the fact that the Dutch Order recognised that Shell was not presently acting in an unlawful manner with respect to emissions reductions targets, and that it was a matter for Shell and its Directors to determine how to comply with the Dutch Order. Trower J held in light of these factors that the Directors had not breached their duties by failing to comply with the Dutch Order.

- **Relief Sought**: Trower J emphasised that it was appropriate for the court to consider at the permission stage the precise nature of the relief sought and the prospects of the court granting it if proceedings were to be continued. As noted above, ClientEarth sought: (i) mandatory orders requiring the Directors to implement a strategy to manage climate risk in accordance with their alleged statutory duties and to comply with the Dutch Order; and (ii) a declaration that the Directors had breached their duties. In relation to (i), Trower J held that it would fall foul of the "*constant supervision*" principle, especially given that the terms of the relief sought (e.g., to "*adopt and implement a strategy to manage climate risk*") were too imprecise for the court to be able to enforce such obligations. In relation to (ii), Trower J stressed that it was not the court's function to express views about the Directors' conduct that had no substantive effect or legally relevant purpose; the proper forum for generating those types of views as to the Directors' conduct would have been by way of a members' vote in a general meeting, a remedy which ClientEarth was entitled to take steps to procure in its capacity as shareholder.

- **Good Faith**: A discretionary factor that the court was required to take into account was whether the applicant was acting in good faith in seeking to continue the claim (s. 263(3)(a) CA 2006). Shell argued that the application was an attempt by ClientEarth to publicise and advance its own policy agenda. Trower J held that the examination of this issue did not just entail a consideration of whether ClientEarth genuinely held the belief that its claim was in the best long-term interests of Shell; it also involved an assessment of whether ClientEarth was bringing the proceedings for an ulterior purpose, which was particularly relevant given ClientEarth held only 27 shares in Shell. Applying the 'but for' test, Trower J concluded that it could not be said that 'but for' ClientEarth's climate-related policy agenda, the claim would nonetheless have been brought. Thus, ClientEarth's real interest was to promote its own policy agenda and not to best promote the success of Shell for the benefit of its members. An important factor that the court considered in reaching that conclusion was that ClientEarth's position was not one supported by a significant majority of Shell's shareholders but only a "*very small proportion of the total shareholder constituency*."

## Second Judgment (Oral Hearing)

Following the judgment of 12 May 2023, ClientEarth exercised its right to request an oral hearing for the court to reconsider its decision, which took place on 12 July 2023. In a judgment handed down on 24 July 2023, Trower J again refused ClientEarth's application for permission to bring a derivative claim. Whilst Trower J largely applied

the same reasoning as at the first stage, the second judgment addressed the following additional points:

- **Establishing a *Prima Facie* Case**: The court emphasised that whilst the purpose of the permission stage could be described as filtering out any "*unmeritorious*" claims, it also imposed an evidential burden on the applicant at the outset to establish a *prima facie* case for giving permission. Trower J held that the claimant's evidence ought to be critically evaluated and taken at its "*reasonable highest*" rather than its highest, such that the court is not bound to assume that the facts alleged by the claimant are true. This finding had implications for Trower J's scrutiny of the evidence relied upon by ClientEarth. For example, ClientEarth filed a letter by a Dutch lawyer relating to an alleged breach of the Dutch Order, which omitted any reference to the passage of the Dutch Order that recognised that Shell was not presently acting in an unlawful matter and could determine how to comply with the Dutch Order. ClientEarth argued that the court should not have expressed views about the quality or admissibility of that letter (as it did in the first judgment) or have had recourse to the Dutch judgment (instead taking the evidence at its highest and in effect without further enquiry). Trower J disagreed with this analysis, stating that the court was not "*bound to adopt a passive and uncritical approach to the evidence with which is faced, particularly where there is a passage in the judgment which seems to cut across ClientEarth's case as directly as this one does*."

  Furthermore, ClientEarth submitted that courts at the *prima facie* stage were not required to consider the discretionary factors set out in s. 263(3) CA 2006. Trower J disagreed, holding that the court must consider the factors when deciding whether to grant permission, as well as when "*assessing whether the evidence adduced* […] *establishes a prima facie case*."

- **Incidental Duties**: ClientEarth shifted its position at the oral hearing regarding the alleged "*incidental duties*" of the Directors. Whilst ClientEarth's written submissions stated that directors of companies "*such as Shell*" would necessarily be subject to the pleaded incidental duties (e.g. that they are under a duty to adopt strategies to meet Shell's targets to mitigate climate risk), ClientEarth's oral submissions contended that the incidental duties arose as a matter of logic once the directors identified "*its climate strategy is a commercial objective which is most likely to promote the success of Shell.*" Essentially, ClientEarth argued that even if it would be wrong for the court to intervene in the Directors' commercial decision to adopt the energy transition strategy that it had, there was no reason why the court should not intervene to give directions as to the way in which the strategy should be implemented once adopted. Trower J rejected this argument, as this would be "*inconsistent with the well-established principle that it is for directors themselves to determine (acting in good faith) how best to promote the success of a company for the benefit of its members as a whole.*"

- **Expert Evidence**: The evidence adduced by ClientEarth in support of their application mainly comprised of a witness statement from a member of ClientEarth's in-house legal team. In the first judgment, Trower J held that "*the court can place very little weight on the opinions expressed*" and that "*it amounts to what he considers to be an accurate reflection of a consensus of opinions relating to what on any view is a very complex series of topics*." ClientEarth argued that it would be unreasonable for the court to require expert evidence to be adduced at the *prima facie* stage. Trower J disagreed, holding that ClientEarth's inability to establish a *prima facie* case without "*properly admissible expert evidence*" merely showed "*the very serious nature of the case* […] *and attendant difficulties,*" and this did not mean that the rules on the admissibility of opinion evidence should not apply.

## Costs Judgment

On 31 August 2023, Trower J ordered ClientEarth to pay Shell's costs of the proceedings on the standard basis. In doing so, the Court disapplied the normal approach outlined in CPR PD 19A para 2, which provides that where the company volunteers submission or attendance at the *prima facie* stage of an application for permission to commence a derivative claim, the company will not normally be allowed its costs of doing so. Shell had volunteered its participation in the proceedings, as opposed to participating on the basis of an invitation from the court.

Trower J concluded that it was just to apply the general rule contained in CPR 44.2(2) that the unsuccessful party pays the costs of the other party, as it was appropriate and proportionate for Shell to attend the oral hearing and make submissions. In reaching this conclusion, Trower J noted that "*this is a case which is far from the norm*" and took into account the following factors: (i) the significant publicity garnered by the application, which meant that the mere finding of a *prima facie* case would have an adverse impact on Shell's affairs, (ii) the fact that serious claims of breach of duty were made against the Directors and concerned its future strategy rather than specific acts of wrongdoing, (iii) ClientEarth's small number of shares and lack of wide shareholder support for the derivative action, (iv) the foreseeability of a costly and resource-intensive application; and (v) the reasonable expectation on ClientEarth that the court would have extended an invitation to Shell to participate in the proceedings, even if Shell had not volunteered its participation.

## Key Takeaways

The ClientEarth litigation is a high-profile example of the novel approaches that are being deployed by claimants in the expanding arena of climate change litigation. However, these High Court decisions indicate that it will be very challenging for claimants to use derivative actions as a mechanism to achieve their objectives. The decisions are likely to be of considerable comfort to boards of directors and corporates. The key takeaways are as follows:

- **Competing Considerations**: It is clear that courts will place great weight on the fact that directors have to balance competing considerations as to how to promote the success of the company for the benefit of the members as a whole. Claimants will have to overcome this hurdle by establishing a *prima facie* case that the directors have erred in balancing and weighing the many factors which should go into their consideration a range of how to deal with climate risk, as opposed to the many other risks that impact the company's business, such that "*no reasonable director could properly have adopted the approach that they have*." Courts will be extremely reluctant to interfere with the proper balancing of these factors, which is a "*classic management decision*." This means that it will be a particularly challenging task for claimants to succeed where defendants are large multinational corporations such as Shell, as its directors will have a myriad of factors to consider when assessing what decisions would be in the best interests of the company.

- **Good Faith/Ulterior Motive**: The court's emphasis on good faith dilutes the ability of environmental groups to acquire shares in large corporates for the purpose of instituting climate-change litigation. The court's expectation that such claimants provide "*sufficient evidence to counter the inference of collateral motive*" places the onus and burden on claimants to convince the court that the primary purpose of bringing the claim is not an ulterior motive, which is likely to be challenging where the claimant is an activist organisation with a policy agenda.

- **Expert Evidence**: One area that will be interesting to watch develop is the extent to which future claimants seek to improve their position with fuller and more developed expert evidence. For NGOs and other non-profits, the significant cost of producing such evidence may present significant challenges, especially when dealing with a topic as complex as climate change.

- **Costs**: Courts are prepared to take a critical approach to costs. In circumstances where applicants seek to use derivative actions in novel ways and outside of the conventional jurisdiction, they can expect challenge both on the merits and in terms of costs exposure.

On 24 July 2023, ClientEarth announced that it will seek permission to appeal Trower J's decision.

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Please do not hesitate to contact us with any questions.

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