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THE PURSUIT OF CORPORATE ACCOUNTABILITY: CLIMATE CHANGE LITIGATION AND THE USE OF SHAREHOLDER DERIVATIVE ACTIONS

CLIENTEARTH v Shell [2023] EWHC 1897 (Ch) is the first attempt to use the statutory shareholder derivative action (Part 11 Chapter 1 of the Companies Act 2006 (CA 2006)) to hold directors liable for breach of directors' duties for issues related to climate change. A derivative action can be used by shareholders in limited circumstances to bring an action of recourse on behalf of the company. Derivative actions are typically used to protect minority shareholders. Therefore, its use in *ClientEarth v Shell* is of interest, especially considering the ongoing discussion on the role and purpose of business in society. Although company law has primarily focused on profits, the more modern view is that companies should exist for profit, public interests and societal goals (See British Academy, Reforming Business for the 21st Century: A Framework for the Future of the Corporation). The ClientEarth case confirms and clarifies situations in which a claimant may obtain permission to continue a claim; and when an absolute liability may be imposed on directors for a climate change-related breach of director's duty in shareholder derivative claims. It raises questions around the prospects of success for future claimants due to the difficulty in establishing sufficient legal merit; and the relationship between stage one and stage two of the statutory regime.

In February 2023, ClientEarth, a non-profit environmental organisation with a limited number of shares in Shell plc filed a derivative claim against Shell's board of directors for breach of their legal duties under sections 172 and 174 of CA 2006. The claim also included allegations of Shell's failure to comply with an order made by the Hague District court (Milieudefensie v Royal Dutch Shell Plc HADC 19-379-26052021). ClientEarth alleged that Shell's directors had breached their duties both by failing to set an appropriate emission target and by not aligning the company's climate risk management strategy with the Paris Agreement. ClientEarth argued that the board's current energy transition strategy will hinder the move to an alternative business model, negatively affecting the company's long-term viability and ability to protect the environment, thereby increasing the company's risk on environmental matters. The relief sought was for a declaration that the directors had breached their duties as claimed and for a mandatory injunction requiring them to (1) adopt and implement a strategy to manage climate risk in compliance with their statutory duties and (2) comply immediately with the Dutch order.

In the English High court judgment following an oral permission hearing ([2023] EWHC 1137 (Ch)), the Court reaffirmed its decision ([2023] EWHC 1897 (Ch)) refusing ClientEarth permission to continue the derivative action. Part 11 Chapter 1 of CA 2006 has a two-stage process. *ClientEarth v Shell* was concerned with stage one (s. 261(2)). The issue was whether ClientEarth had disclosed a prima facie case (stage one) and could proceed with its substantive application for permission to continue the claim (stage two)

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(at [7]). Trower J. confirmed that the prima facie case must disclose a good cause of action and that the cause of action arises out of a directors' default, breach of duty, etc. (*Iesini v Westrip* [2010] B.C.C. 420). The test for the prima facie case is higher than a seriously arguable case (*Bhullar v Bhullar* [2016] 1 B.C.L.C. 106) and the question for the court at the first stage "is whether, on the face of the case advanced by the ClientEarth, and in the absence of an answer by Shell, ClientEarth will obtain the permission it seeks" (at [13]). In Trower J.'s view, the claimant's evidence must be sufficiently substantial without more to justify the court granting the claimant permission to continue the derivative claim (at [14]). The court must consider the criteria set out in section 263 under both stage one and stage two when the substantive hearing takes place (at [16]–[17]).

To demonstrate a prima facie case of actionable breach of directors' duty in Shell's board's management of the climate change risks, ClientEarth must show that the "Directors' current approach falls outside the range of reasonable responses to climate change risk and will cause harm to Shell's members" and that "there is no basis on which the directors could reasonably have concluded that the actions they have taken have been in the interests of Shell" (at [38]). Regarding the breach of failing to set appropriate emission targets and reliance on low carbon alternatives for mitigating exposure to climate risk, Trower J. found the prima facie case for permission had not been established (at [58]). This was for a number of reasons. First, there was a lack of relevant, reliable expert evidence establishing a prima facie case that the directors' approach to climate risk falls outside the range of reasonable responses open to the board of a company such as Shell (at [59]); second, there was an absence of admissible expert evidence supporting a prima facie case that there is a universally accepted methodology for how Shell could achieve the targeted reductions in its energy transition strategy and, additionally, a failure to prove that the way Shell's directors managed the business could not properly be regarded by them as in the best interests of Shell's members as a whole (at [64]); and, third, there was no substantial breach of section 172(1)(d) of the CA 2006 because the evidence showed Shell's directors have policies and targets aligned with the Paris Agreement. ClientEarth's issue was that the policies and targets are manifestly unreasonable and do not include an adequate pathway to achieve net zero goals (at [65]). There was a failure to show how the directors' balancing and weighing of section 172 factors in dealing with climate risk amongst many other risks was wrong and one which no reasonable director could properly have adopted and therefore contrary to their section 172 or 174 duties (at [66]). ClientEarth's plea that the directors' duties should include six necessary incidents of the statutory duties when considering climate change risks for companies like Shell was rejected. Trower J. relied on evidence provided by Shell and stated that the law does not impose specific obligation on directors as to how the company should be managed (at [27]).

The directors decide how best to promote the company for the members' benefit under section 172. In carrying out their duty under section 174, directors should ensure their decisions fall within the range of decisions reasonably available to directors. The incidental duties are contrary to the true nature of sections 172 and 174 duties (at [25], [28], [33]).

In considering the stage two test (s. 263(2)), mandatory criteria (s. 263(3)) and views of members with no personal interests (s. 263(4)) for the purposes of the stage one issue at hand, the court concluded that the findings counted strongly against the conclusion that ClientEarth had established a prima facie case for permission (at [86], [95], [98]). The court also considered the nature of the relief sought and the prospects of a court granting the relief if the proceedings went to a substantive hearing. The court rejected the mandatory injunction because of its imprecision and unsuitability for enforcement and found the declaratory relief incapable of serving any legitimate purpose (at [82], [83]).

The court's decision provides some clarity on the use of shareholder derivative actions. It aligns with current company law interpretation of the test for actionable breach of director's duties (Re Smith & Fawcett Limited [1942] Ch. 304; Regentcrest plc v Cohen [2001] 2 B.C.L.C. 80; Howard Smih Ltd. v Ampol Ltd. [1974] A.C. 821). However, the decision raises questions. First, contestability and uncertainty of the application of the prima facie test for stage one (see e.g. Leech J.'s consideration of the debate on the application of the prima facie test in McGaughey v USSL [2022] EWHC 1233 (Ch), at [44]). In the Court of Appeal case of McGaughey v USSL [2023] EWCA Civ 873, Asplin J. referred to the ClientEarth case and the test of prima facie case for relief but found ClientEarth to be of limited assistance because in ClientEarth, the prima facie issue arose before any evidence had been filed on behalf of the company (at [140]). The Court of Appeal therefore did not address the debate around the prima facie test for the first stage, leaving uncertainty as to the evidence required and factors which should be considered. Second, suitability of the derivative action for climate change litigation is problematic. The ClientEarth judgment suggests that the level and cost of expert evidence required at stage one for a similar claim is likely to be astronomical. Does this make the statutory procedural requirements easily accessible in line with the intention of Parliament, albeit acknowledging that the aim is not to encourage litigation against directors? Unfortunately, the Court of Appeal has refused ClientEarth's application for permission to appeal the High Court decision (ClientEarth Press Release, 15 November 2023) leaving the matters raised here still open to debate.

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