

Insights

HIGH COURT DISMISSES GREEN STRATEGY DERIVATIVE CLAIM AGAINST SHELL'S DIRECTORS

May 23, 2023

SUMMARY

In February 2023 ClientEarth issued a derivative action against Shell's 11 directors. ClientEarth alleged that the directors had breached their duties under the Companies Act 2006 (CA 2006) by failing to adopt and implement an energy strategy that aligned with the Paris Agreement on Climate Change 2015 to limit global warming to 1.5°C.

Given that it was bringing a derivative claim on behalf of the company, ClientEarth needed to obtain the permission of the court before the action could proceed. The application was considered on the basis of the papers before the court without the court hearing oral submissions. On 12 May 2023, the judge refused permission for the claim to proceed. The judge made several key points in his judgment which will be pertinent to future activist shareholder derivative actions.

RELIEF SOUGHT

ClientEarth applied for a mandatory injunction requiring the directors (a) to adopt and implement a strategy to manage climate risk in compliance with their statutory duties, and (b) to comply immediately with an order made in May 2021 by the District Court in The Hague, which required Shell to reduce its carbon emissions by 45% by 2030.

DIRECTOR'S DUTIES

ClientEarth argued that the directors had breached their duties to promote the success of the company and to exercise reasonable care skill and diligence. S. 172 CA 2006 requires a director of a company 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 as a whole, and lists various matters to which the director should have regard. The list is non-exhaustive and includes the likely long-term consequences of any decision, the impact of the company's operations on the community and the

environment, and the desirability of the company maintaining a reputation for high standards of business conduct.

ClientEarth argued that the director's duties, "*when considering climate risk for a company such as Shell*", included the following six "sub-duties":

- a. to make judgments regarding climate risk based upon a reasonable consensus of scientific opinion;
- b. to accord appropriate weight to climate risk;
- c. to implement reasonable measures to mitigate the risks to the long-term financial profitability and resilience of Shell in the transition to a global energy system and economy aligned with the global temperature objective of 1.5°C under the Paris Agreement;
- d. to adopt strategies which are reasonably likely to meet Shell's targets to mitigate climate risk;
- e. to ensure that the strategies adopted to manage climate risk are reasonably in the control of both existing and future directors; and
- f. to ensure that Shell takes reasonable steps to comply with applicable legal obligations.

The judge found that the directors were not subject to these duties because they cut across the basic principle of company law that it is for the directors themselves to determine the weight to be attached to the various factors for consideration specified in s. 172 CA 2006. The "sub-duties" argued for by ClientEarth were inherently vague and incapable of constituting enforceable personal legal duties. They were incompatible with the subjective nature of the duty to promote the success of the company and amounted to an unnecessary and inappropriate elaboration of the statutory duty of care.

THE HAGUE DISTRICT COURT ORDER

The judge found that there was no established English law duty which required the directors to take reasonable steps to ensure that the order of a foreign court is obeyed, let alone to ensure compliance with that order.

GOOD FAITH AND SHAREHOLDER SUPPORT

The judge highlighted that ClientEarth was proposing that it should be entitled to seek relief on behalf of Shell (such relief being "exceptionally expensive and time consuming to pursue") when it held only 27 shares in Shell and was supported by holders of only 12.2 million shares (comprising only 0.17% of Shell's shares). This gave rise to the "very clear inference" that ClientEarth's real interest was not how to promote the success of Shell for the benefit of its members as a whole. Its "single-minded focus on the imposition of its views" pointed strongly towards the conclusion that

its ulterior purpose for bringing the claim was to advance its own policy agenda: it could not be said that ClientEarth had brought the claim in good faith.

The court stressed that it was the views of the shareholder constituency as a whole should carry very considerable weight. Although 30.47% and 20.29% of votes were cast in favour of climate-change related resolutions proposed at the 2021 and 2022 AGMs, demonstrating a material minority support, the judge found that this fell “well short of demonstrating any member support for action of the type contemplated by this application”.

The judge’s conclusion was that ClientEarth’s evidence was insufficient to disclose a case for giving permission albeit that ClientEarth may renew its application at an oral hearing.

NEXT STEPS

ClientEarth has made clear that it intends to renew its application, asking the court to reconsider its decision at an oral hearing. Given the forceful nature of the court’s findings, a question mark must lie over the outcome of a second attempt at these proceedings. That said, a further hearing will undoubtedly shine the spotlight once again on ClientEarth’s assertions as to Shell’s energy strategy.

RELATED PRACTICE AREAS

- Litigation & Dispute Resolution
- Business & Commercial Disputes
- Environment

MEET THE TEAM



Georgia Henderson-Cleland

London

georgia.henderson-cleland@bclplaw.com
+44 (0) 20 3400 3714



Sharon Kennedy

London

sharon.kennedy@bclplaw.com
+44 (0) 20 3400 4798

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