High Court Reaffirms Decision to Refuse Permission for Derivative Claim Against Shell's Board of Directors

July 31, 2023

On February 9, 2023, ClientEarth, a non-profit environmental law organisation and UK registered charity, brought a claim against the directors of Shell plc ("**Shell**") before the English High Court, alleging breaches of their duties as directors for failing to take certain steps to protect Shell against climate-change related risks.[1] The claim followed a 2021 ruling by the Hague District Court ordering Shell to reduce its worldwide CO_2 emissions (the "**Dutch Order**").[2]

On May 12, 2023, the English High Court refused permission for ClientEarth to continue its claim.[3] Following a hearing where ClientEarth presented oral submissions, on July 24, 2023, the court reaffirmed its decision, thereby dismissing ClientEarth's claim.[4]

The court's reasoning follows closely the reasoning of the May 12 Judgment. The court was unwilling to find directors subject to duties more specific than the general duties in the CA 2006, and reluctant to interfere with directors' management decisions, or to scrutinize whether the board had proper regard to other stakeholders' interests as required under s. 172 of the Companies Act 2006 ("**CA 2006**)".

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[1] Our alert memorandum relating to the commencement of these proceedings is accessible here. A follow-up set of Questions & Answers regarding derivative claims against directors in the context of ESG-related litigation is accessible here.

[2] The Dutch Order is accessible here. Our firm's dedicated alert memorandum on the Dutch Order and its implications (the "**2021 Alert**") is accessible here.

[3] *ClientEarth v Shell plc and others* [2023] EWHC 1137 (Ch) (the "**May 12 Judgment**"), accessible here. For further analysis of the May 12 Judgment, please refer to our firm's dedicated alert memorandum (the "**May Alert**"), accessible here.

[4] *ClientEarth v Shell plc and others* [2023] EWHC 1897 (Ch), accessible here. Unless indicated otherwise, paragraph references in this memorandum are references to this judgment.

I. Procedural context

As explained in our May Alert (accessible here), ClientEarth brought a derivative claim – an action against Shell's directors to enforce a claim and seek relief on behalf of Shell. Such derivative action requires permission from the court to proceed:

(i) ClientEarth must first establish a *prima facie* case, which is considered by the court on the papers in the first instance, followed by an oral hearing, if requested;

(ii) If a *prima facie* case is established, this is followed by a substantive application for permission, in the course of which the court must have regard to a number of factors set out in the CA 2006.

On May 12, 2023, the court dismissed ClientEarth's application for permission on the papers, finding that it did not establish a *prima facie*. That decision has now been reaffirmed after an oral hearing.

II. Judgment

(a) Duties relied on by ClientEarth

Directors' general duties under the Companies Act

ClientEarth argued that Shell's directors owed to Shell:

(i) a duty to act in the way they consider, in good faith, would be most likely to promote the success of Shell for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to a number of other stakeholder interests including: the likely consequences of any decision in the long term, 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 (CA 2006, s. 172); and

(ii) a duty to exercise the care, skill and diligence that would be expected from a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a director, and (b) the general knowledge, skill and experience that the directors have (CA 2006, s. 174).

The court accepted that the evidence establishes a *prima facie* case that each of the Directors was under such duties for at least part of the time in which the acts and omissions complained of occurred.[5]

"Incidental Duties"

ClientEarth further argued that apart from the general duties under s. 172 CA 2006, Shell's directors were subject to six "*necessary incidents*" of their statutory duties, i.e., more specific duties relating to consideration of climate risk specifically.[6] ClientEarth originally pleaded that directors of companies "*such as Shell*" will necessarily be subject to these incidental duties. However, at the oral hearing, ClientEarth's position was that these duties arise "*as a matter of logic*", given that Shell's energy transition plan already identified Shell's climate strategy as a commercial objective which is most likely to promote the success of Shell and necessary to protect shareholder value.[7]

Despite the "*subtle*" change in ClientEarth's approach, the court still rejected this aspect of its pleadings. It did so on the basis that this formulation of incidental duties seeks to impose absolute duties on directors that cut across their

[5] At [21].

[6] The six incidental duties are: (i) a duty to make judgments regarding climate risk that are based upon a reasonable consensus of scientific opinion; (ii) a duty to accord appropriate weight to climate risk; (iii) a duty 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 on Climate Change 2015; (iv) a duty to adopt strategies which are reasonably likely to meet Shell's targets to mitigate climate risk; (v) a duty to ensure that the strategies adopted to manage climate risk are reasonably in the control of both existing and future directors; and (vi) a duty to ensure that Shell takes reasonable steps to comply with applicable legal obligations (see [22]).

[7] At [24].

general duty to have regard to various competing considerations. As such, it has insufficient regard to the way in which the legislature has formulated general duties.[8]

More specifically, regarding the directors' duty to promote the success of the company, the court noted that ClientEarth's formulation is 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. Quoting Lewison J in *Iesini*, the court emphasised that the "*weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case*".[9]

The court also criticised ClientEarth's position that, if irrationality on part of the directors can be proved, that would establish breach:[10] the test for breach of s. 172 is a subjective one, requiring proof of conduct other than in good faith. While, in certain cases, it may be possible to infer from the irrational nature of conduct the absence of good faith, in general, irrationality (including an unreasonable, but honest, mistaken belief as to a particular course of action being in the company's best interests) is insufficient to constitute breach of s. 172.[11]

Regarding the duty to exercise reasonable care, skill and diligence, the court noted that the law does not superimpose more specific obligations as to what is, or is not, reasonable in certain circumstances. It requires directors to manage a company's business with an open mind and have regard to a range of competing considerations. It is partly for this reason that courts are ill-equipped to question the merits of directors' decisions. The question the court has to decide is whether the decision falls outside the range of decisions reasonably available to directors at the time.[12]

Compliance with foreign judgments

Lastly, ClientEarth contended that there is a duty for directors to take reasonable steps to comply with court orders of which they are aware.[13] ClientEarth alleged that the directors breached their duties by failing to comply with the Dutch Order.

Again, the court disagreed. The nature and extent of Shell's directors' duties are governed by English law (the law of Shell's incorporation), and there is no established English law duty (separate from directors' general duties) requiring directors to take reasonable steps to ensure that a foreign court order is obeyed.[14]

(b) Breaches alleged by ClientEarth

Having defined the duties of Shell's directors, the court went on to consider whether these duties had been breached. The court found that ClientEarth had not made out a *prima facie* case that Shell's directors are in breach of their duties, and, on that basis, dismissed the application.

The court examined again the evidence relied on by ClientEarth, mainly two witness statements, one by a senior lawyer employed by ClientEarth and another one by a partner at a law firm.[15]

The court accepted that a *prima facie* case had been established that Shell faces material and foreseeable risks as a result of climate change which have or could have a material effect on it.[16]

However, ClientEarth would need to demonstrate a *prima facie* case of actionable breach of duty by the directors in their management of those risks.[17] The

[8] At [27] and [37].

[9] At [28], citing *Iesini v Westrip Holdings Limited* [2010] BCC 420, paragraph [85].

[10] At [30].

[11] At [29].

[12] At [32].

[13] At [34].

[14] At [36].

[15] At [40] – [57].

[16] At [45].

[17] At [46].

court considered that the evidence adduced by ClientEarth was insufficient in this respect.[18]

Specifically, ClientEarth pointed to the financial risk to Shell's long-term viability, given value destruction of its fossil fuel business and, in particular, stranded-asset risk.[19] The court held, however, that the evidence ClientEarth adduced did not qualify as expert evidence on which a court could properly rely. In addition, it did not establish a case that Shell's directors were acting unreasonably,[20] even though ClientEarth pointed out that the directors had not presented a realistic approach to achieve Shell's own transition goals.

With regard to the first point, the court emphasised that the case ClientEarth advances (i.e., breaches by directors of their general duties under the CA 2006) are of a "*very serious nature*", and, accordingly, that it is not possible for ClientEarth to establish a *prima facie* case to this effect without properly admissible expert evidence.[21] The court drew an analogy in this respect with allegations of breaches of duties by professionals, which courts may in certain circumstances strike out unless expert evidence is adduced.[22]

The court further noted that the evidence did not support a *prima facie* case that there is a universally accepted methodology as to the means by which Shell might be able to achieve the targeted reductions. Given the decision-making autonomy the law affords to directors on commercial issues, that meant that there was no *prima facie* case that the way in which Shell's business is being managed by its directors could not properly be regarded by them as in the best interests of Shell's members as a whole.[23]

A further reason for dismissing ClientEarth's application was the following: given that the directors did in fact consider climate risk (by adopting an energy transition strategy), ClientEarth would have needed to show how the directors have gone so wrong in their balancing and weighing of the various considerations in the management of Shell's business that no reasonable director could properly have adopted the approach that they have.[24] In the court's view, ClientEarth failed to do so, which the court considered a "*fundamental defect*" in ClientEarth's case. The court reached this conclusion despite ClientEarth's submission that, on the evidence adduced, the directors had not presented a realistic approach to achieving Shell's transition strategy.

Dutch Order

The court also rejected ClientEarth's allegation that Shell's directors breached their duties by failing to take reasonable steps to comply with the Dutch Order.

The court placed emphasis on the Dutch court holding that *"[Shell] has total freedom to comply with its reduction obligation as it sees fit, and to shape the corporate policy of the Shell group at its own discretion*."[25] From this passage, the court inferred that the Dutch court (i) did not consider Shell to currently be acting in an unlawful manner, and (ii) recognised that it is a matter for Shell as to how it exercises its discretion. The court thought that this cuts across any suggestion that the Dutch court regards Shell's directors "*as being under any duty to Shell to take steps towards compliance with the Dutch Order in any manner other than through compliance with their duties to do that which they consider in good faith would be most likely to promote the success of Shell for the benefit of its members as a whole in accordance with s.172 of CA 2006*".[26]

[18] At [59].

[19] At [41] – [57], especially [44], [54] and [57].

[20] At [59].

[21] At [62].

[22] At [63], referring to the discussion of *Pantelli Associates Ltd v Corporate City Developments Number Two Ltd* [2011] PNLR 12 in *Whessoe Oil & Gas Ltd v Dale* [2012] PNLR 33 at [29ff].

[23] At [64].

[24] At [66] – [68].

[25] At [72].

[26] At [73].

At the oral hearing, ClientEarth submitted that the court should not have referred to the Dutch Order, but limited itself to the evidence adduced by ClientEarth (a letter by a Dutch law professor and law firm partner, annexed to one of the witness statements, discussing the Dutch Order and its implications).[27] Disagreeing with that submission, the court considered that it was appropriate to consider the judgment in itself, noting that a court is not bound to adopt a passive and uncritical approach to the evidence with which it is faced.[28]

The court's view that the Dutch Order did not require the directors to do anything other than to comply with CA 2006 s. 172[29] could be questioned. As discussed in our 2021 Alert (accessible here), the Dutch Order imposes an obligation to reduce emissions by net 45% by 2030 (compared to 2019 levels), which, for scope 1 and scope 2 emissions, is an "*obligation of result*", and for scope 3 emissions, an obligation to exert "*significant best efforts*". The Dutch Order is provisionally enforceable (and no appellate court has suspended that enforceability). A failure or open refusal to comply with the Dutch Order might be in breach of s. 172 CA 2006, for instance, because of the considerable risk of substantial damage claims (if the Dutch Order is upheld on appeal), and the requirement to maintain a reputation for high standards of business conduct.[30]

Relief sought

Another reason for rejecting ClientEarth's claim was the nature of the relief it sought (i.e., declaratory relief and a mandatory injunction that Shell adopt and implement a strategy to manage climate risk and comply with the Dutch Order), and the prospect of a court granting it.

The court noted that a mandatory injunction will not be granted where constant supervision is required, in particular in circumstances where the relief sought is insufficiently precise.[31] The court considered that the injunction sought by ClientEarth would fall foul of that principle, given that it would likely lead to disputes over compliance. Incidentally, the court considered that such disputes would also, of itself, adversely impact Shell's business (which is what ClientEarth's action is seeking to avoid).

ClientEarth's response to this, at the oral hearing, was that the court could fashion appropriate injunctive relief at the conclusion of the trial. However, the court rejected this argument on the basis that, in the circumstances, it would be inappropriate for a court to give permission to continue an action when the relief sought is not described in a form which is both precise and capable of supervision in the event of breach.[32]

That would have left ClientEarth with only declaratory relief. The court noted in this respect that it is concerned with the utility of substantive relief sought (rather than expressing views which have no substantive effect), and that it was difficult to see what legitimate purpose the grant of a declaration would fulfil.[33]

Factors relevant to the substantive application

Lastly, the court went on to consider a number of factors that would be relevant to the substantive application for permission (i.e., the application for which a *prima facie* case must be established).

The court first considered whether a person acting in accordance with their duty to promote the success of the company would seek to continue the claim. On this question, the court considered that "*the application and the evidence adduced in support of it admit of only one answer: ... a director would not do anything other than decline to continue the claim*".[34] On that basis, the court

[27] At [75].

[28] At [76].

[29] At [73].

[30] CA 2006, s. 172(1)(e).

[31] At [80].

[32] At [82].

[33] At [83].

[34] At [84].

would be bound to refuse ClientEarth permission to proceed.[35]

The court then went on to consider the discretionary factors that could be taken into account at the substantive application stage.

In this respect, the court considered that ClientEarth would not be acting in good faith in seeking to continue the claim. The court noted that the question of good faith required an assessment of whether ClientEarth is bringing the proceedings for an ulterior purpose. The appropriate test to determine this is to consider whether absent the potential ulterior purpose, the claim would not be continued at all.[36] The court then noted that ClientEarth holds only 27 shares in Shell, but that the claim is of considerable size, complexity and importance. This, the court considered, gave rise to an inference that ClientEarth's real interest is not in how to promote the success of Shell for the benefit of its members as a whole, but, instead, that ClientEarth is focused on imposing its views as to the right strategy for dealing with climate change risk. The court then found that ClientEarth had not adduced sufficient evidence to counter such inference of a collateral motive[37] – even though the evidence reflected opinions genuinely held by ClientEarth, and the evidence focused on financial risks to Shell rather than ClientEarth's climate objectives.[38]

Another factor which the court considered was evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter.[39] The court noted in this respect that the support for Shell's energy transition strategy was 88.4% at its 2021 Annual General Meeting ("**AGM**"), 80% at its 2022 AGM, and at a similar level at its 2023 AGM.[40] The court contrasted this with the levels of shareholding by members supporting ClientEarth (12.2 million shares, amounting to approximately 0.17% of Shell's share capital) and by those who had expressed that their position was aligned with ClientEarth (another 12.5 million shares). On the basis that it is the views of the constituency as a whole that is relevant, the court considered that the level of member support for Shell's energy transition strategy counted "*strongly*" against the grant of permission.[41]

III. Implications

The July 24 judgment, reaffirming the May 12 Judgment, will likely be seen as offering some comfort to board members that shareholders, especially those with only relatively small shareholdings, face considerable obstacles in challenging board members' decisions by way of derivative actions.

Aspects that stand out, in this respect, are: the court's unwillingness to find directors subject to duties more specific than the general duties in the CA 2006; the court's suggestion that s. 172 CA 2006 lists considerations that are "competing" with the interests of the members rather than elements to discern (or that are an integral part of) the interests of the members; the court's reluctance to interfere with directors' management decisions; the potential difficulty of fashioning a type of relief that the court would be willing to grant; and the investigation into ClientEarth's apparent motives of pursing the claim.

That being said, the dismissal of ClientEarth's claim does not in itself prevent the bringing of similar actions in the future. Such actions may, in themselves, be capable of putting pressure on companies and their share prices.[42] In fact, ClientEarth's lawsuit is part of a broader trend of climate litigation which will unlikely be affected by the High Court's refusal to grant ClientEarth

[35] CA 2006, s. 263(2)(a).

[36] At [89] – [92].

[37] At [93].

[38] See, e.g., at [59].

[39] CA 2006, s. 263(4).

[40] At [96].

[41] At [98].

[42] See in this respect the working paper published by Misato Sato and others, "Impacts of climate litigation on firm value", May 2023, accessible here.

permission to proceed with its claim. As noted in the recent 2023 Climate Litigation Report, co-published by the UN Environment Programme and the Sabin Center for Climate Change Law, "*Climate litigation is a growing field, and both the number of cases filed and the number of jurisdictions within which they have been brought have increased in recent years*".[43]

Perhaps more importantly, by clarifying for what reasons ClientEarth had failed to establish the requisite *prima facie* case, the court might be seen as having provided guidance to future litigants on how to conduct similar derivative claims. Particular aspects in this respect include the importance of adducing expert evidence and the need to focus on issues in respect of which boards have taken a position that no reasonable director would be able to arrive at, for instance, because even though there is no universally accepted methodology to achieve targeted reductions, the chosen plan made it objectively impossible to achieve the goals and avoid the climate damage.

Interestingly, the court also noted that, while ClientEarth enjoyed the support of only a very small proportion of shareholders, there had been "*material minority support*" (of 30.47% and 20.29% at the 2021 and 2022 AGMs) for resolutions for more information to be provided to Shell's shareholders on the energy transition strategy and underlying policies for reaching their targets.[44] It may well be that, even if ClientEarth's claim struggles to overcome applicable procedural hurdles, litigation requiring further disclosure may continue to be a viable route for activist shareholders.

ClientEarth has announced its intention to appeal the judgment.[45]

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[43] See "Global Climate Litigation Report: 2023 Status Review" by Michael Burger and Maria Antonia Tigre, accessible here, p. 13.

[44] At [98].

[45] See ClientEarth's press release on the July 24 judgment, accessible here.