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ClientEarth v Shell: Reflections on Company Law and Climate

Melinda Janki

Introduction

In February 2023 Client Earth (CE), an environmental law charity headquartered in London, brought derivative proceedings against Shell PLC and eleven of its directors under the Companies Act 2006 (CA2006) of England. It was in CE's words, "the first ever claim worldwide to seek to hold company directors liable for climate risk management."[1] CE's case was undoubtedly important, but this article concludes that the derivative action is of limited value in climate litigation and that a different litigation approach is needed to address the existential threat from fossil fuels.

CE's Case

CE claimed that Shell's directors had breached their duties under s172 and s174 CA2006 to promote Shell's success as a company and to exercise reasonable care, skill and diligence. Shell's directors adopted an energy transition strategy ("ETS") with an overall target for Shell to become a net zero ("NZ") energy business by 2050. CE claimed that the directors had failed to set adequate interim targets to reduce Shell's scope 3 emissions to NZ by 2050. CE also claimed that the directors' strategy did not establish any reasonable basis for achieving a NZ target and was not aligned with restricting temperature increase to 1.5^0C.[2] A second alleged breach was the directors' failure to comply with an order of the Hague District Court in *Vereniging Milieudefensie and others v Royal Dutch Shell PLC*[3] (the "Dutch Order"). CE said this failure harmed Shell's reputation and exposed Shell to significant unknown liability. CE asked the court for a declaration that the directors had breached their statutory duties, an order requiring the directors to adopt and implement a strategy to manage climate risk in compliance with their statutory duties, and an order requiring the directors to comply immediately with the Dutch Order.

The Proceedings in Court

Under common law and s170 directors owe their duties to the company not to shareholders. Under *Foss v Harbottle*[4] if a director breaches his duty, it is the company not the shareholder who has the right to a remedy. There are limited exceptions which allow a shareholder to bring an action on behalf of the company. Thus, CE's proceedings under s260 CA2006 sought relief on behalf of Shell. Section 261(1) required CE to obtain the court's permission in order to continue the proceedings. Section 261(2)(a) required the court to dismiss CE's application for permission and make appropriate consequential orders, if it appeared to the Court that the application and evidence filed by CE did not disclose a *prima facie* case. On 12th May 2023 the Hon. Mr Justice Trower ruled without a hearing that CE's application and the evidence adduced in support of it did not disclose a *prima facie* case and he dismissed it.[5] Following an oral hearing as requested by CE, Trower J again refused permission because CE had not made out a *prima facie* case.[6]

Normally the company does not take part at this stage unless invited by the court and would not recover its costs if it participates without the court's invitation it. Shell voluntarily filed a detailed skeleton argument and was represented by leading and junior counsel at the hearing. Trower J awarded costs to Shell. He stated that a mere finding of a *prima facie* case would have a significant impact on Shell's affairs, that Shell's participation was of material assistance, that CE's case made serious allegations against all the directors without distinction and looked to the future rather than to any specific wrongdoing which had caused measurable loss, and that it would have been prudent for CE to apply for a costs capping order.[7] He also refused permission to appeal. CE's application to the Court of Appeal for permission was also dismissed by the Rt Hon Lord Justice Newey who held that CE's appeal would have no real prospect of success and there was no compelling reason for the court to hear it.[8]

Section 172: Promoting Shell's Success

Section 172 requires a director to act in the way he considers in good faith would be most likely to promote the success of the company for the benefit of its members as a whole and in doing so the director must have regard to (a) the long term likely consequences of their decision; (b) the interests of the company's employees; (c)

1 *https://www.clientearth.org/late,st/documents/clientearth-v-board-of-directors-of-shell-plc-legal-briefing/.*
2 Particulars of Claim, paras 51 to 53.
3 Case C/09/571932/HA ZA 19-379.
4 (1843) 2 Hare 461.
5 [2023] EWHC 1137.
6 [2023] EWHC 1897.
7 [2023] EWHC 2182.
8 CA-2023-00186.

business relationships; (d) the impact of the company's operations on the community and the environment; (e) the desirability of the company maintaining a reputation for high standards of business conduct; and (f) the need to act fairly between shareholders. Climate is not mentioned but is covered by 'environment'. Section 172 "gives an unfettered discretion to the directors, provided that they act in a way that they consider, in good faith, to be most likely to promote the success of the company."[9] The matters in (a) to (f) are not ends in themselves but matters which impact corporate success. Section 172 says the directors must have regard to "other matters" without saying what they are. Such matters would include economic and regulatory risks as identified by CE.[10] Shell's directors had to balance these competing factors and adopt the decision most likely to promote Shell's success in carrying out its core business of oil, gas and petrochemicals. The test for breach of s172 is subjective:

> A court will not inquire whether, objectively, the decision was actually the best decision for the company, nor whether the directors honestly held belief was a reasonable one. Of course, the court may be persuaded that the director did not think that the action was in the company's best interests if it forms the view that no reasonable director could have concluded that a particular course of action was in the best interests of the company. However, the ultimate test as to compliance with this section is a subjective one.[11]

The court assumes that a director acted in good faith. The onus was on CE to show otherwise. However, CE did not put in evidence any correspondence, minutes of meetings or other documents to indicate that any director had acted dishonestly, was disloyal to Shell, or had otherwise not acted in good faith. CE was also unable to show that the directors' decision to refrain from setting scope 3 targets or a credible pathway was one that no reasonable director could make or that the Shell directors' decision was so grossly unreasonable, irrational or perverse as to raise a doubt in the court's mind whether the directors' decision was genuinely taken to promote Shell's success.[12] The judge concluded that CE's evidence, "did not engage with the issue of how the Directors have gone so wrong in their weighing and balancing of the many factors which should go into their consideration of how to deal with climate risk."[13] Lord Carnwath has pointed out that CE's case was that the directors had already drawn that balance in the ETS and that the issue was "whether they had any credible policies for achieving it."[14] However CE did not show that the alleged lack of credible policies could be attributed to the directors not acting in good faith. Furthermore, CE's position was not entirely consistent. CE did not ask for orders for the directors to set interim targets for scope 3 or publish credible policies to reach NZ by 2030. CE asked for an order for the directors to, "adopt and implement a strategy to manage climate risk in compliance with the Statutory Duties" without showing a *prima facie* case of breach of s172.

Section 174: Exercising Reasonable Care, Skill and Diligence

Was there a *prima facie* case of breach of s174 arising from the directors' alleged failure to set scope 3 targets or adopt a credible pathway to NZ by 2050? Section 174 requires a director to exercise reasonable care, skill and diligence, defined as the care, skill and diligence that would be exercised by a reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions of that director in relation to Shell and (b) the general knowledge, skill and experience that the director has. Thus, the test has both an objective and a subjective standard. The objective standard is the minimum and "sets the floor."[15] A director must meet this standard. A director with greater knowledge, skill and experience must meet a higher standard based on their greater capacity – the subjective standard. CE therefore had to show that each director had failed to meet either the objective or subjective standard.

However, CE did not adduce any evidence of the knowledge and experience of the individual directors by which a court could determine that the director had not met their subjective standard. Neither did CE adduce evidence of the objective (minimum) standard required of a director in a major company involved in the carbon producing sector. For example, there was no evidence that directors in comparable companies (such as BP, ExxonMobil or Chevron) had equivalent climate strategies and plans with reasonable pathways to NZ. On the contrary, at least one other carbon major, ExxonMobil Corporation, takes the position that targets and plans for reducing GHG emissions are prime examples of ordinary business operations for an energy company and require a detailed and balanced understanding of the company's business, global supply and demand, and other matters understood by management and the board.[16]

CE asserted that the directors strategy should anticipate

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9 Mark Arnold (ed), *Company Directors Duties, Liabilities and Remedies* (Oxford: OUP, 4th ed, 2024), 293 (para 12.09).

10 Particulars of Claim, para 7.2.

11 *Re Last Lion Holdings Ltd* [2018] EWHC 2347 [124].

12 See, the discussion at page 297 of Mark Arnold, supra note 9.

13 [2023] EWHC 1897 (Ch) [66].

14 *https://www.lse.ac.uk/granthaminstitute/publication/clientearth-v-shell-what-future-for-derivative-claims/*.

15 *Brumder v Motornet Services and Repairs Ltd* [2013] 1 WLR 2783 CA [46].

16 *ExxonMobil Corporation v Arjuna Capital, LLC et al*, United States District Court for the Northern District of Texas, Fort Worth Division, Case 4:24-cv-00069-P.

changes to legal, regulatory and financial conditions but did not show that the directors had failed to do so in the ETS. Similar companies ("Carbon majors") have successfully persuaded governments worldwide to distort the market in favour of fossil fuels through subsidies,[17] to refrain from imposing legal measures such as the polluter pays principle, and even to change national law to provide them with a more favourable business environment. Directors take into account their company's political influence when calculating legal/regulatory risk and they assess the impact of that risk on profits not climate.

According to Trower J, the core of CE's case was that the directors had policies and targets to reach NZ but these were unreasonable and did not include an adequate pathway to their goals.[18] In effect the judge had to decide between two opposing views. One was a commercial decision on how to deal with climate risk made by Shell's directors. The other was the opinion of CE, which describes itself as 'one of the world's most ambitious environmental organisations"[19], that the directors had not evinced a realistic approach to achieving the ETS.[20] CE's evidence comprised witness statements from two lawyers - William Hooker, a partner in Pallas Solicitors with the day-to-day conduct of the litigation, and Paul Benson, a solicitor employed by CE. Neither claimed any experience or expertise in running an oil/gas business. On the contrary Mr Benson candidly admitted in his witness statement, "I do not have expertise in climate science, macro-economics, oil and gas price forecasting, accounting, carbon pricing, carbon markets or related fields, and no part of this statement purports to articulate any expert opinion." In the absence of evidence to the contrary, it is reasonable to assume that Shell's directors were better placed to assess and determine a proper response to Shell's business risks (including climate risk) than CE. Moreover, the courts do not second guess directors. As Lord Wilberforce said, "It would be wrong for the court to substitute its opinion for that of the management …There is no appeal on merits from management decisions to courts of law..."[21]

The Dutch Order

CE claimed that the Dutch Order requiring Shell to cut its emissions was immediately enforceable and relied on an opinion to that effect from a Dutch academic. However, Trower J read the Dutch judgement for himself. He concluded that the Hague District Court had said that Shell had total freedom to comply with its obligation to reduce emissions as it saw fit. CE objected that Trower J should not have read the Dutch judgement but should have taken their evidence (the Dutch opinion) at its highest value. The judge disagreed, saying that the court was not bound to adopt a passive and uncritical approach to evidence particularly where there was a passage in the judgment which, "seems to cut across ClientEarth's case as directly as this one does." He also pointed out that the Dutch opinion did not comply with the rules for expert evidence but that even if it had, the court would be unlikely to accept it at a substantive hearing.

Conclusion

CE's case illustrates some significant difficulties in trying to use a derivative action to protect the climate. Firstly, the purpose of company law is to ensure that companies are properly managed. CA2006 required Shell's directors to have regard to the impact of Shell's operations on the environment but that was in order to promote Shell's success, not to protect the environment. There was undoubtedly climate risk to Shell but the directors had addressed this risk in the ETS. CE were unable to show a *prima facie* case that Shell's directors had breached their duties as directors in deciding how to manage that risk. CE did not show that the directors' decision fell outside of the range of decisions reasonably available to them. It is difficult to identify the legal basis for CE's claim that the directors breached a duty by not publishing targets to cut Shell's GHG pollution or showing how Shell would reach NZ by 2050. Realistically, corporations do not publish information which might be useful to their competitors unless required to do so by law. CE did not point to any legal obligation under common law or statute which required Shell to publish the information. CE referred to the Paris Agreement but it is an international treaty which binds governments not Shell.

Secondly, even if CE had been able to show a *prima facie* case, s263 required the court to consider whether the acts/omissions would be likely to be ratified by the company. The ETS had received over 80% support from shareholders while activist shareholder resolutions in 2021 and 2022 for Shell to publish targets to reduce emissions and report on strategies and policies for reaching the targets had been easily defeated.[22] It was likely that the company would ratify the directors' purported omission. CE claimed the support of members holding nearly 25 million shares, but this was less than 1% of the shareholding.[23]

Thirdly, shareholder activism to protect the climate conflicts with the company's purpose. Shell's business model of revenue from oil/gas is inevitably destroying the climate system. It is impossible to stop GHG pollution without stopping oil/gas. Even ExxonMobil has admitted that reducing GHG pollution requires an oil/gas company

17 See, IMF report *https://www.imf.org/en/Publications/WP/Issues/2023/08/22/IMF-Fossil-Fuel-Subsidies-Data-2023-Update-537281.*

18 [2023] EWHC 1897 (Ch) [65].

19 https://www.clientearth.org/about/.

20 [2023] EWHC 1897 (Ch) [67].

21 *Howard Smith Ltd v Ampol Petroleum Ltd* [1974]AC] 821.

22 W Hooker Witness Statement paras 32 to 42.

23 Shell had, in 2024, more than 3.2 billion issued shares.

to change the nature of its ordinary business or go out of business altogether.[24] Asking Shell to show how it will reach NZ GHG pollution by 2050 is akin to asking an armaments manufacturer to show how it will achieve zero deaths from its sales of lethal weapons by 2050. It cannot be done. As Lord Carnwath has pointed out it is difficult to think of a company whose interests are more implicated by climate change effects than Shell.[25] But whereas directors of most companies must now take into account climate risk in their business operations, Shell's directors face a different problem which is that their business model depends on GHG pollution to deliver shareholder value.

Fourthly, the derivative action requires a shareholder to act on behalf of the company. CE said that it genuinely believed its claim to be in the long-term best interests of Shell.[26] But no shareholder can argue that it is in the best interests of Shell to go out of business, even though that is necessary to protect the climate.

Finally, the derivative action raises a moral question. In light of Shell's record on human rights, why would CE want to act in Shell's long-term best interests? As the British MP Clive Lewis told the Westminster Parliament in February 2024: "Shell is responsible for some of the most brutal, violent, and repressive actions by a company, in this case against communities in the Niger delta. This includes complicity in the execution of the Ogoni nine, including writer and human rights activist Ken Saro-Wiwa.[27]

The fossil fuel industry has shown that it will continue to produce oil/gas until forced to stop by governments or market forces. There is clearly a role for litigation in bringing a safe end to fossil fuel production but, as this article has shown, derivative actions may not be the best option. Alternative litigation approaches are having some success by imposing liability on oil companies for pollution and requiring financial assurance in the form of insurance and guarantees,[28] challenging permits,[29] and challenging public authorities through judicial review.[30]

[Melinda Janki, is a member of the CLA Executive Council and winner of the CLC Lexis Nexis Rule of Law Award 2023. She is a qualified lawyer (England and Guyana) and formerly worked in the oil industry. She leads litigation against ExxonMobil's drilling off the shores of Guyana.]

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24 ExxonMobil Corporation v Arjuna Capital, supra note 16 .

25 *https://www.lse.ac.uk/granthaminstitute/publication/clientearth-v-shell-what-future-for-derivative-claims/.*

26 P Benson Witness Statement, para 8e.

27 *https://hansard.parliament.uk/Commons/2024-02-26/debates/4E99D274-6B1A-4C90-8379-903F9614DAEE/PointsOfOrder?highlight=shell#contribution-59CEEADE-D71F-4203-8E39-A21EB8281CF8.*

28 Eg *Collins and Whyte v EPA and Exxon Mobil Guyana* 2022-HC-DEM-CIV-FDA-1314.

29 Eg *Thomas v EPA and Exxon Mobil Guyana* 2020-HC-DEM-CIV-FDA 460.

30 Eg *R (Finch) v SCC* [2024] UKSC 20.