Shell directors not liable in U.K. for climate change policies

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To add to climate change litigation in the recent past years, the United Kingdom High Court has now dismissed an environmental organization's derivative action against the board of directors of Shell plc (Shell). In *ClientEarth v. Shell plc and others* [2023] EWHC 1137 (Ch) , the High Court found that the plaintiff failed to establish that the directors, in adopting Shell's energy transition strategy, were not acting reasonably in Shell's interests.

Background

The plaintiff, ClientEarth, is a private non-profit environmental law organization and registered charity. ClientEarth held a nominal number of shares in Shell, which allowed it to bring a derivative claim against Shell's directors under s. 260(1) of the U.K.'s Companies Act 2006. ClientEarth argued that Shell's directors failed to set appropriate emissions targets and that Shell's energy transition strategy was not aligned with the Paris Agreement on Climate Change 2015 (GTO).

ClientEarth argued that the directors failed to set an appropriate emissions target for Shell, that the directors' current climate strategy did not establish a reasonable basis for achieving a net-zero emissions target, and that the directors failed to comply with a Dutch court order which imposed a 45 per cent emissions reduction obligation on Shell to be achieved by 2030.

Under the U.K. Companies Act 2006, the court must authorize a shareholder to continue a derivative action against a company's directors. In order to obtain the court's permission to continue their claim, ClientEarth had to demonstrate that they had a *prima facie* case of there being no basis on which Shell directors could reasonably have come to the conclusion that their actions were in Shell's best interests.

Decision

While the Court found that ClientEarth established that Shell faces material and foreseeable risks as a result of climate change, ClientEarth did not demonstrate a *prima*

facie case of actionable breach of duty by the directors in the management of those risks.

ClientEarth's argument relied on two statutory duties: the duty to promote the success of the company and the duty to exercise reasonable care, skill and diligence. ClientEarth also argued that Shell's directors were also subject to six "necessary incidents" of their statutory duties:

1. a duty to make judgments regarding climate risk that are based upon a reasonable consensus of scientific opinion;
2. a duty to accord appropriate weight to climate risk;
3. 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 GTO;
4. a duty to adopt strategies which are reasonably likely to meet Shell's targets to mitigate climate risk;
5. a duty to ensure that the strategies adopted to manage climate risk are reasonably in the control of both existing and future directors; and
6. a duty to ensure that Shell takes reasonable steps to comply with applicable legal obligations.

The Court found that these six "incidental duties" did not apply to Shell's directors. The Court agreed with Shell that these "duties" were a way to impose specific obligations on the directors. This was not permissible; it was for the directors themselves to determine, in good faith, how best to promote the success of Shell.

Additional issues arose with respect to the remedies sought by ClientEarth, which consisted of mandatory orders requiring Shell to: (a) adopt and implement a strategy to manage climate risk in compliance with its statutory duties, and (b) comply immediately with a Dutch court order made by the Hague District Court in 2021. In *Milieudefensie et al. v. Royal Dutch Shell*, ECLI:NL:RBDHA:2021:5339, the Hague District Court ruled that Shell was "obliged" to reduce emissions by 45 per cent by 2030 compared to 2019 levels, after environmentalist groups brought a class action against Shell for the breach of an "unwritten standard of care" rooted in article 162 of the Dutch Civil Code. In turn, ClientEarth sought Shell's immediate compliance with the Dutch order. The U.K. High Court took issue with the nature of the relief ClientEarth sought, finding it was not sufficiently precise as to how it would be enforced.

ClientEarth's materials raised significant evidentiary issues. ClientEarth's claim was supported by witness statements by two ClientEarth lawyers. The Court placed very little weight on the opinions expressed in these witness statements, finding that they did not establish a case that Shell's directors were managing Shell's business risks in a manner that was not open for a board of directors acting reasonably. Additionally, the witness statements were not expert evidence on which the Court could properly rely.

The Court found that the evidence did not support a *prima facie* case that there was a universally accepted methodology as to the means by which Shell might be able to achieve its targeted reductions. The Court concluded that it was therefore difficult to treat ClientEarth's evidence as a proper basis to support an argument that the directors' "pathway to achievement" of the targets was not reasonable.

The Court also found that the “fundamental defect” in ClientEarth’s case was that it “completely ignores” the fact that the management of a business of Shell’s size requires its directors to take into account a range of considerations that often compete. The Court was “ill-equipped” to interfere with such management considerations.

Finally, the Court ruled that ClientEarth had an ulterior purpose for bringing the proceedings. ClientEarth only had nominal shares in Shell, while using an exceptional procedure in the form of a derivative action. ClientEarth sought relief of a considerable scope, complexity and importance. These factors gave rise to a “very clear” inference that ClientEarth’s real interest was not promoting the success of Shell for the benefit of its members as a whole. The Court also noted that member support for Shell’s current ESG goals counted strongly against granting permission for ClientEarth’s derivative action.

Takeaways

With the dismissal of ClientEarth’s lawsuit, the United Kingdom has declined to find directors liable for climate change policies. With that said, the U.K. High Court did not foreclose the possibility of finding a *prima facie* case if there was sufficient evidence of climate change impacts and complying with targets being brought in other circumstances, such as a smaller business model.

The issue of director liability for climate change has not yet been tested in Canada; however, this U.K. decision may have some influence on the prospect of director liability. Under provincial and federal corporate statutes, Canadian courts have adopted a comparable test for determining whether directors have used reasonable skill and judgment in discharging their duties. The ClientEarth decision may influence Canadian courts’ assessment of director liability.

Environmental considerations are currently being incorporated into statutes and guidelines that impact the Canadian industry, among others. Notably, Canada’s Office of the Superintendent of Financial Institutions (OSFI) has recently released a new Guideline on Climate Risk Management. The Guideline recognizes the impact of climate change on managing risk in Canada’s financial system and shall be effective fiscal year-end 2024 for certain domestic banks and insurance groups headquartered in Canada, with a broader rollout for federally regulated financial institutions in 2025. The Guideline could provide guidance on the expectations in Canada for various industries.

Given the evolving governmental and legal framework regarding climate change policies, it is possible that a similar action to *ClientEarth v. Shell plc* could be brought in Canadian courts. This U.K. decision could signal that such a claim would be as unsuccessful against a Canadian energy company, especially without sufficient evidence, but nevertheless it remains a warning of the material risks that Canadian directors may face in the future.

Contact us

We encourage you to reach out to the contacts below or any BLG lawyer from our Climate Change or Environmental Disputes groups if you have any questions related to the above decision, or for more information on related topics.

The author would like to thank Janelle Gobin, Articling Student, for her generous contribution to this text.

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