ClientEarth v Shell plc & Ors [2023] EWHC 1897 (Ch).

On 24 July 2023, judgment was handed down confirming the dismissal of ClientEarth's application for permission to continue a derivative claim on behalf of Shell plc ("Shell") against its directors. The judgment followed a hearing requested by ClientEarth under CPR 19.15(10) to reconsider the earlier decision to dismiss its application on the papers: [2023] EWHC 1137 (Ch).

Shell was represented by Edward Davies K.C. and Jack Rivett, together with Robert Howe K.C. and Shaheed Fatima K.C., instructed by Slaughter and May.

The Proceedings

ClientEarth is a private company limited by guarantee, a non-profit environmental law organisation and a UK-registered charity. At the time of these proceedings, ClientEarth held 27 shares in Shell plc.

The proceedings were brought by ClientEarth in an attempt to pursue claims on behalf of Shell against its directors based on allegations that they had breached their duties in relation to Shell's management of climate change risk. The claims, therefore, were derivative claims, and in order to continue them ClientEarth was obliged to apply for permission from the court under Part 11 of the Companies Act 2006 ("CA 2006").

The procedure for obtaining the court's permission to continue a derivative claim has two stages. At the first stage, the court is required to determine whether the application discloses a prima facie case for giving permission to continue the derivative claim. That question is initially considered by the court on the papers. If it appears to the court that this prima facie test is not met, then the court must dismiss the application pursuant to s 261(2) CA 2006. If the claim is dismissed on the papers, the claimant may ask for a hearing to reconsider that decision (see CPR 19.15(10)). If the court is satisfied that the application does disclose a prima facie case for giving permission, the matter moves to the second stage, which is an inter partes permission hearing at which the court will determine whether permission should be given for the derivative claim to continue.

The criteria by which the court determines whether or not to grant permission are set out in s 263 CA 2006. Under s 263(2), there are three situations in which permission to continue must be refused, including where a person acting in accordance with the duty under s 172 to promote the success of the company would not seek to continue the claim. There are also a number of discretionary factors which the court is required under s 263(3) to take into account when reaching its decision, including whether the claimant is acting in good faith in seeking to continue the claim.

In the present case, ClientEarth's application for permission to continue its derivative claim had been dismissed by the Judge, Trower J, at the first stage on the papers. In a fully reasoned judgment, Trower J had held that ClientEarth's application and evidence did not disclose a prima facie case for giving permission: [2023] EWHC 1137 (Ch). ClientEarth then exercised its right under CPR 19.15(10) to have that decision reconsidered at a hearing.

The reconsideration hearing took place on 12 July 2023. Shell, which had filed written submissions for the purposes of the court's consideration of the matter on the papers, attended the reconsideration hearing and submissions were made on its behalf in opposition to ClientEarth's application.

The Claim

ClientEarth's claim was said to arise out of the directors' acts and omissions relating to Shell's climate change risk management strategy, as described in Shell's 'Energy Transition Strategy' published in April 2021 ("the ETS") and subsequent progress reports.

In particular, ClientEarth alleged that the directors had failed to set adequate emissions reduction targets or adopt an appropriate strategy so as to establish a reasonable basis for achieving its stated objective of becoming a net zero energy business by 2050. In addition, ClientEarth claimed that the directors had failed to procure that Shell complied with the order made by the Hague District Court on 26 May 2021 ("the Dutch Order") which had imposed certain requirements upon Shell in respect of emissions reductions by failing to adopt a plan that would allow the requirements of that order to be met.

By reason of these matters, ClientEarth contended that the directors had breached their duty to promote the success of the company (s 172 CA 2006) and their duty to exercise reasonable care, skill and diligence (s 174). In addition, ClientEarth alleged that the directors had breached six further duties, which were described in their Particulars of Claim as necessary incidents of the statutory duties when considering climate risk for a company such as Shell. These duties included, for example, "*a duty to make judgments regarding climate risk that are based upon a reasonable consensus of scientific opinion*" ("the alleged incidental duties").

For the purposes of the reconsideration hearing, ClientEarth's case evolved in certain respects. In particular:

- The breach of duty case was put explicitly as an 'irrationality challenge', it being said that if it could be established that the directors' decision-making was irrational, then it would follow that they had breached their duties under s 172 and/or s 174.
- ClientEarth sought to justify the existence of the alleged incidental duties by reference to actual decisions taken by the directors, arguing that these additional duties arose as a matter of logic given that the directors themselves had adopted the strategy of achieving net zero by 2050.

As to relief, ClientEarth sought declarations that the directors had breached their duties to Shell in the various ways alleged, as well as mandatory injunctions requiring the directors to adopt and implement a climate risk management strategy that complied with their statutory duties and to comply with the Dutch Order. In the course of the reconsideration hearing, it was indicated on behalf of ClientEarth that the declarations were the primary relief sought.

The Decision

Following the reconsideration hearing, Trower J gave judgment on 12 July 2023 confirming his previous decision that ClientEarth had failed to show a prima facie case for giving permission to continue its derivative claim. Accordingly, the Judge dismissed ClientEarth's application for permission to continue the derivative claim as required by s 261(2)(a) CA 2006, and he also dismissed the underlying claim.

The application failed for a number of different reasons. In short:

- ClientEarth had failed to establish a prima facie case in respect of the alleged breaches of directors' duties.
- The relief sought, in the case of the mandatory injunctions, fell foul of the basic principle that the court would not grant mandatory injunctive relief if constant supervision would be required, especially if the relief sought could not be precisely articulated and, in the case of the declarations, served no legitimate purpose.
- An independent director acting in accordance with the duty under s 172 CA 2006 would decline to continue the claim.
- There was substance in Shell's submission that ClientEarth's motivation in bringing the proceedings was different from a balanced consideration of what was in the interests of Shell, and ClientEarth had failed to counter the clear inference that it was acting for the single-minded and ulterior purpose of imposing its own views as to the right strategy for dealing with climate change.
- The high level of support that had been expressed for Shell's climate strategy at recent annual general meetings counted strongly against the grant of permission to continue the derivative claim.

Regarding the analysis of the duties relied upon by ClientEarth, the Judge held that the alleged incidental duties asserted by ClientEarth were inconsistent with the well-established principle that it is for the directors themselves, acting in good faith, to determine how best to promote the success of the company for the benefit of its members as a whole. Furthermore, the attempt by ClientEarth to argue that these additional duties were a logical consequence of the directors' own decision to adopt the climate strategy did not affect the analysis. It remained the case that the alleged incidental duties as formulated by ClientEarth were inconsistent both with the subjective nature of the duty under s 172 and also with the requirement imposed upon the directors under s 174 to continue to manage the business of Shell with an open mind and with regard to a range of competing considerations.

The Judge also rejected the attempt on behalf of ClientEarth to establish breach of duty on the basis of irrationality. It was held that it was not correct to conflate irrationality and good faith and that whilst irrationality could be "*part of the mix*" when it came to the assessment of the evidential question of whether or not the directors acted in good faith, it would not stand as a ground of breach of s 172 on its own.

Regarding the particular alleged breaches of duty, Trower J held that there were a number of fundamental reasons why ClientEarth's allegations of breach of duty did not establish a prima facie case. In particular:

- Very little weight could be placed on the evidence that had been filed on behalf of ClientEarth in support of its allegations that the directors had breached their duties in connection with the management of climate change risk. That evidence, which was contained in a witness statement by an in-house lawyer at ClientEarth, purported to describe a "*consensus of opinions relating to what on any view is a very complex series if topics*". However, as the Judge held, merely because these opinions were understood by the witness to be "*widely accepted and endorsed by governments and financial markets worldwide*", that did not mean that those opinions could be presented as fact.
- Crucially, the evidence, unsupported by expert analysis, failed to explain why the directors, faced with the need to weigh and balance a range of different considerations in the exercise of their duties, "*got the balancing exercise so wrong as to be actionable*". This was "*a fundamental defect*", because "*the management of a business of the size and complexity of that of Shell will require the directors to take into account a range of competing considerations, the proper balancing of which is classic management decision with which the court is ill-equipped to interfere*".
- The evidence also failed to establish 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 referred to in [the ETS]*". Absent expert evidence, there was no adequate evidential basis for alleging that no reasonable board of directors "*could properly conclude that the pathway to achievement is the one they have adopted*". In this context the Judge reiterated that the law "*respects the autonomy of the decision making of the directors on commercial issues and their judgments as to how best to achieve results which are in the best interests of their members as a whole*".
- In relation to the claims of breach of duty in respect of the Dutch Order, the Judge observed that the Dutch Court had accepted that Shell was not currently acting in an unlawful manner and that Shell had "*total freedom*" as to how it went about complying with the obligations that had been imposed under the Dutch Order. It was held that the evidence relied upon by ClientEarth did not "*come close to establishing a prima facie case that the directors have no genuine intention of procuring Shell to comply with its best efforts obligation under the Dutch Order in respect of its Scope 3 emissions*".

Comment

The decision of Trower J to dismiss ClientEarth's derivative claim against Shell at the first stage under the statutory procedure signals the preparedness of the court to give effect to the 'filter' afforded by the prima facie test in cases brought by 'activist' shareholders.

The Judgment is notable both for the guidance it contains regarding the application of the prima facie test and for its robust application of orthodox principles in respect of directors' duties.

Regarding the statutory derivative claim procedure, and specifically the approach to be taken to applying the prima facie test at the first stage, the Judge cited the dicta of David Richards J in *Abouraya v Sigmund [2015] BCC 503*, to the effect that the prima facie test is a higher test than a seriously arguable case and held that although that case had been under the common law rules for derivative claims, a similar approach would apply under the statutory regime. Thus, the question for the court at the first stage of the statutory procedure was "*whether, on the face of the case advanced by ClientEarth, and in the absence of an answer by Shell, ClientEarth will obtain the permission it seeks*".

For the purposes of the application of the prima facie test, Trower J rejected the notion that the claimant's evidence should be taken at its highest and held that the correct approach in considering whether the claimant had shown a prima facie case was to take the evidence adduced by the claimant at its "*reasonable highest*". Moreover, if the establishment of a prima facie case requires expert evidence, the Judgment firmly supports the proposition that it is incumbent upon the claimant to obtain the court's permission to adduce such evidence so that it can be considered at the first stage.

Regarding directors' duties, the Judge referred to well-established authority, including *Howard Smith Ltd v Ampol Ltd [1974] AC 821* and *Regentcrest plc v Cohen [2001] 2 BCLC 80*, as support for the fundamental proposition that it is for the directors themselves to determine, in good faith, how best to promote the success of the company for the benefit of its members as a whole. The attempts by ClientEarth to establish breach of duty on the basis of a 'rationality test' were rejected on the grounds that "*good faith, not irrationality, is the cornerstone and an honest but unreasonable and mistaken belief that a particular course of action is in the company's best interests is not sufficient*" to establish breach of s 172 CA 2006. This reiteration of the subjective nature of the duty under s 172 constitutes a firm rebuttal of the notion that a public law style test of irrationality might apply to company directors.

Likewise, the Judge held that the attempt by ClientEarth to introduce additional duties, whether as necessary incidents of the statutory duties in the case of a company such as Shell, or on the basis of particular decisions already taken by the directors, was misconceived. The alleged incidental duties would operate to restrict the decision-making freedom of the directors in a manner that was incompatible with the statutory duties, pursuant to which the

directors are required "*to continue to manage Shell's business with an open mind and to continue to have regard to a range of competing considerations*". In short, the duties to which the directors are subject are simply those as set out under CA 2006.

Finally, the Judge's view that a derivative claim brought for the primary purpose of advancing a particular policy agenda, in circumstances where, but for that purpose, the claim would not have been brought at all, will not have been brought in good faith, is particularly significant in relation to the prospects of future claims by activist shareholders.

Under s 263(3)(a) CA 2006, the court is required in deciding whether to permit a derivative claim to continue to take into account whether the claimant is acting in good faith. In the present case, Trower J held that ClientEarth had failed to rebut the "*very clear inference that its real interest is not how best to promote the success of Shell for the benefit of its members as a whole*", but was instead an ulterior purpose in the form of "*a single-minded focus on the imposition of its views and those of its supporters as to the right strategy for dealing with climate change risk*".

It is clear, therefore, that the court will be astute to recognise where there is a mismatch between the policy objectives espoused by a claimant, on the one hand, and the objectives that the directors are required to pursue in the discharge of their duties, on the other, and that where the pursuit of a singular policy objective is causative of the proceedings, this will militate against the grant of permission to continue. This approach presents an obvious impediment to the pursuit of derivative claims by activist shareholders.