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THE FAILED DERIVATIVE ACTION BY CLIENTEARTH AGAINST SHELL'S DIRECTORS: MINORITY SHAREHOLDERS SHOULD NOT TRY TO DETERMINE A CORPORATION'S CLIMATE CHANGE STRATEGY THROUGH THE COURTS

WP 2023-10

Hans De Wulf
Financial Law Institute

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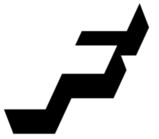

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Abstract

The author welcomes your comments at hans.dewulf@ugent.be

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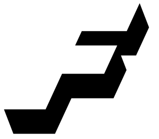

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1. *Introduction*

The decision by the High Court of Justice of England and Wales discussed here[1] is about one of the first[2] derivative actions brought against company directors in order to force them to change their company's climate change policies. The case was brought by an NGO, ClientEarth, which had bought a few (27) shares in Shell, against eleven directors of Shell plc[3]. The ruling by Mr. Justice Trower stopped this derivative action in its tracks, by refusing to grant permission for it to proceed.

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[1] ClientEarth v Shell Plc & Ors (Re Prima Facie Case) [2023] EWHC 1137 (Ch) (12 May 2023), available at https://www.bailii.org/ew/cases/EWHC/Ch/2023/1137.html. The internet is full of client briefings by law firms on the judgement. For a comment by a scholar, see the analysis of Umakanth Varotill at https://blogs.law.ox.ac.uk/oblb/blog-post/2023/06/clientearth-shell-english-court-rejects-climate-focused-shareholder(June 1 2023).

[2] Arguably, another case preceded this one: the High Court ruling of 24 May 2022 on a derivative claim brought by two university employees against the University superannuation scheme and some of its directors. One of the claims in this case was as follows: "The Claimants allege that in breach of sections 171 and 172 of the Companies Act 2006 the Directors have continued to invest in fossil fuels without an immediate plan for divestment contrary to the Company's long-term interests. They also allege that this has prejudiced (and will continue to prejudice) the interests and success of the Company which has suffered and will continue to suffer loss in consequence" (paragraph 186 of the judgement).

See the decision as available at https://www.bailii.org/ew/cases/EWHC/Ch/2022/1233.html. But this case was not really based on the Companies Act 2006 derivative action (though it was inspired by its provisions on derivative actions), but was brought as a common law derivative action, in which the defendants were not directors of a corporation.

[3] Formerly Royal Dutch Shell plc. The "Royal Dutch" part of the name was dropped when the company, already incorporated in the UK, moved its head office from The Hague (Netherlands) to the UK in December 2021. See e.g. M. Khan, "Shell's departure deals blow to Dutch pro-business credentials", *Financial Times*, November 25 2021.

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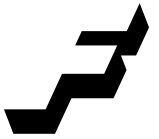

Court cases against the British-Dutch oil major Shell have over the past few years greatly contributed to the development of the law about responsibility and liability of corporations for environmental, climate and social matters. In the British case *Okpabi v Shell* [4]and the related Dutch case of *Oguru v Shell*[5],the liability of the European parent holding company for the damages to farmers, crops and livestock caused by oil spills that occurred as a result of leaks in pipelines owned by Shell's Nigerian subsidiary was at stake. In the ruling of the Dutch court of first instance at Den Haag of May 26, 2021 in *Milieudefensie v Shell*[6] ("the Shell Climate case") the Dutch court ruled, at the request of the NGO Milieudefensie ("defense of the environment") that based its standing on a Dutch civil procedure rule enabling general interest litigation[7], that Royal Dutch Shell plc , the holding company, had to use its influence throughout the Shell corporate group to make sure that the Shell group would by 2030 reduce its CO2 emissions with 45% compared to 2019 levels, thus making sure it contributed appropriately to reaching the goal of the Paris Climate Agreement to keep global warming below 1.5° C. Substantively, the Dutch court "found" the duty of Shell on which it based its injunction in the duty of care enshrined in the Dutch statutory provision on the tort of negligence[8] as interpreted in the light of the human right to life and to the protection of private and family life as enshrined in articles 2 and 8 of the European Convention on Human Rights. The Dutch court imposed a so-called "obligation of result"[9] on Shell concerning its scope 1 and 2 emissions, and "a best-efforts obligation"[10] concerning the vastly more important scope 3 emissions (which are said to constitute more than 96% of the emissions for which Shell is deemed to be responsible).[11]

Around 9 February 2023 ClientEarth, the international "parent" organization of which *Milieudefensie* is the Dutch branch, filed a derivative action under Part 11 of the UK Companies

[4] *Okpabi & Others v. Royal Dutch Shell Plc & Another* (2021) UKSC 3.

[5] Court of Appeal of The Hague, 29 January 2021. A summary in English by the Court, with links to its full judgement and to all other court decisions in this affair, is available at https://www.rechtspraak.nl/Organisatie-en-contact/Organisatie/Gerechtshoven/Gerechtshof-Den-Haag/Nieuws/Paginas/Shell-Nigeria-liable-for-oil-spills-in-Nigeria.aspx.

[6] District Court The Hague, May 26 2021, ECLI:NL:RBDHA:2021:5339, English translation (by the Court) available at http://climatecasechart.com/non-us-case/milieudefensie-et-al-v-royal-dutch-shell-plc/.

[7] Art. 3: 305a BW (Dutch civil Code).

[8] Art. 6:162 BW (Dutch civil Code).

[9] In Dutch law, this means Shell is under a strict duty to reach the desired emissions reductions, otherwise it will have breached its duties as established in the court order.

[10] Under Dutch law, this means Shell must make a serious effort to reach scope 3 emissions reductions, but if it does not manage to reach the emissions reduction targets, it will not be in breach of its obligations if it can show it made a reasonable effort to reach the targets.

[11] See paragraph 4.4.55 of the The Hague judgement (Fn.5). One may assume that the actual court order to Shell, in paragraph 5.3 of the judgement (dispositive part of the judgement, under the heading "decision"), where this distinction between scopes 1 through 3 is not made, must nevertheless be understood in light of these court considerations.

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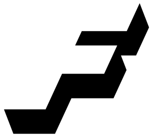

Ac with the English High Court against eleven directors of Shell plc.[12] ClientEarth had sent a formal "pre-action letter" to Shell about a year earlier. The British judgement that we are discussing in this case note refused permission for this derivative action to proceed. Indeed, under the CA 2006, a court must give permission before a derivative action can proceed[13].

ClientEarth's action was based on an alleged breach by the defendant Shell directors of their duties towards the company. According to claimants, the defendant directors had breached their duty of care in essentially two ways: by adopting an inadequate climate change risk management strategy for Shell; and by (allegedly) not taking sufficient action to implement the Dutch court order in the *Shell Climate Case* mentioned *supra*.

The plaintiffs in this case were certainly not pursuing damages from the defendant directors. Rather they pursued injunctive relief, with the clear goal to put pressure on Shell's directors to change Shell's corporate strategy, namely speeding up the transition into renewables and the exit from fossil fuel products so as to reduce the Shell Group's greenhouse gas emissions, with the ultimate goal of making it contribute to reaching the goals of the Paris Climate Agreement in a manner that ClientEarth deemed appropriate. That this -imposing its views on the appropriate climate change strategy for Shell instead of allowing the directors to develop such a strategy in good faith- was the real aim of the derivative claim, not enforcing existing duties of directors, was something the judge in the case also saw, and the essential reason why he denied permission for the action to proceed.

ClientEarth's derivative claim was supported by several investment funds[14] who did not, however, become joint plaintiffs. Under British law, there is no ownership threshold – in the sense of a minimum number or percentage of shares that claimant needs to hold- for bringing a derivative action.[15] ClientEarth itself owned a mere 27 shares in Shell. The supportive investment funds held about 12 million shares in Shell, amounting to 0.17% of the total number of Shell shares.

[12] ClientEarth's website contains information on why the case was filed, see also the FAQ on the case, see https://www.clientearth.org/media/lf4mcv3v/shell-directors-case-faq-2023.pdf.
[13] See s. 261 (1) Companies Act 2006 (hereafter "CA 2006").
[14] These funds included the British governmental pension fund Nest UK, Swedish state pension fund AP3, Danske Bank Asset Management and Danica Pension. See B. van Dijk, "Shell bestuurders voor rechter gesleept om klimaatbeleid", *Financieel Dagblad* 10 February 2023.
[15] But the plaintiff must as a rule be a shareholder ("member") when the derivative action is filed, see P. L. Davies, S. Worthington and Chr. Hare, *Gower. Principles of Modern Company Law,* 11th edition, London, 2021 15-010, p. 578, explaining that former members may not sue (not even for causes of action that arose while they were shareholders) but, on the other hand, members may sue for causes of action that arose before they became members (CA 2006 s. 260(4)). In this case note, we only refer to CA 2006 provisions dealing with the derivative action in England, Wales and Northern Ireland. CA 2006 s 265 ff. contain virtually identical rules on derivative actions in Scotland, but these need not detain us here.

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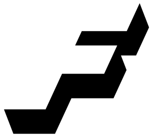

According to the British rules on statutory derivative actions, governed by Part 11 (sections 260 ff.) of the 2006 Companies Act ("CA2006"), a derivate action can only proceed if it receives permission from a judge to do so, through a so-called "judgement on the *prima facie* case" and it is this "prima facie judgement" that we are commenting upon in this case note.

2. *Derivative claims in the UK generally*

Derivative claims are here understood as claims belonging to the company that are brought not at the initiative of the normal corporate decision-making body (usually the board, sometimes the general meeting), but on behalf of the company at the initiative of one or more individual shareholders, who thus express the opinion that the company should exercise a claim it has. In our context, we're talking about derivative claims brought against directors for breaches of their duties.

The CA 2006 introduced statutory rules on the derivative action in the UK[16], insofar as the derivative action is based on claims brought in respect of a cause of action vested in the company, seeking relief on its behalf[17] and "involving negligence, default, breach of duty or breach of trust by a director of the company".[18] Before the CA 2006 was adopted, derivative actions had in principle been possible under the common law. But in practice they were made very difficult by what was known, after the leading case, as "the rule in *Foss v Harbottle*"[19]. In order to understand the approach to derivative claims under UK law, it seems important to note that under UK company law, it was and still is traditionally assumed that it is up to the board to initiate corporate litigation against the company's directors for breach of duty. This is different in France, Belgium and several other southern European countries, where statute

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[16] On the derivative action in British company law, see generally P. L. Davies, S. Worthington and Chr. Hare, *Gower. Principles of Modern Company Law,* 11th edition, London, 2021 , chapter 15 "corporate litigation and the derivative action", pp. 565-590. See also e.g. A. Reisberg, "Derivative Claims Under the Companies Act 2006: Much Ado About Nothing?" in J. Armour &J. Payne (eds.) *Rationality in Company Law. Essays in honour of DD Prentice*, 2009.

[17] See Davies et al. (Fn. 15), 15-009 p. 577.
[18] CA 2006 s 260(3).
[19] Foss v Harbottle (1843) 2 Hare 461. On this rule and on how its "proper plaintiff" requirement, implying that derivative actions would only be possible if the defendant was in control of the general meeting, could have survived the CA 2006, see D. Kershaw "The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle", January 30, 2013, available at ssrn https://ssrn.com/abstract=2209061. I believe it is by now (2023) clear that, though thinking along pre-2006 lines about derivative actions is not dead yet in the UK, this aspect of *Foss v Harbottle* has not survived, witness the lack of reference to any such ideas in the judgement annotated here.

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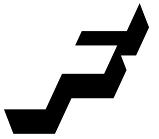

determines that directors can only be held liable towards the company for breach of duty at the initiative of the general meeting of shareholders -not the board- deciding through what the British would call an "ordinary resolution", i.e. with a simple majority (50% plus one vote) at the general meeting. Under British law, too, it was hesitantly accepted that there could be situations where the shareholders could decide the company should launch a claim against directors[20], but these are and remain exceptional.

It is obvious that in continental Europe, where controlling shareholders are prevalent in closed but also in listed companies, the majority of shareholders will often have no interest in suing the directors for breaches of duty, because they have close connections to the directors, who were appointed by them, and sometimes the controlling shareholder even becomes a director itself. It is even more obvious that in a system like the British where it is up to the board to decide whether to sue the directors for breaches of duties, the board will very often be conflicted, since it often would have to sue one or more of its own (former) members, and most board decisions are taken collectively[21]. Hence the idea of allowing a derivative action, to avoid these conflicts of interest. But in probably all European and North-American jurisdictions , there is also great reluctance to allow derivative claims, because such a claim always means a minority of shareholders is allowed to ride roughshod over the decision by either the majority of shareholders or -in the UK and the US- the board as the normally competent corporate body, not to sue the directors.

It's worth noting, also in light of the fact that one of the claims of ClientEarth in this derivative action was that Shell was failing to comply with the Dutch climate case court order, that in the Netherlands, to which Shell also has important links and where it indeed had its head office until December 2021, derivative shareholder suits against directors are next to impossible and in any case not enabled or regulated in statute, which remains completely silent on them.[22]

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[20] See Davies et al (fn. 15), 15-003, esp. p. 569-70.

[21] And there is a one tier board system, not a two tier board such as in e.g. Germany, where the supervisory board is competent to sue the members of the executive board for breaches of duty.

[22] See the policy-oriented analysis in M. J. Kroeze, *Afgeleide schade en afgeleide actie*, Deventer, Kluwer, 2004, 430 p; for the state of the law on derivative actions in the Netherlands, see Asser/Maeijer, Van Solinge & Nieuwe Weme 2-II* 2009, nr. 451 and nr. 216 (on the question when negligence towards the company can be regarded as negligence specifically towards shareholders, so that these could claim damages from the director). The *Hoge Raad* has developed a jurisprudence about the limited cases where third parties including potentially individual shareholders can claim "reflective damages" from the corporation or sometimes its directors (the leading case is Poot/ABP from 1994). The most recent important case is HR 20 June 2008, *NJ* 2009/21 (Willemsen/NOM). But these cases have not created a functional equivalent of the derivative shareholder action as developed in Delaware or in legislation in the UK and (for instance) Belgium.

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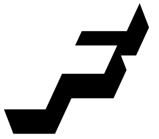

If a legal system thinks it would be unwise to simply allow any shareholder in a company to bring a derivative action, there are several possible rules one could introduce to subject the decision to bring a derivative claim to the approval of an entity /decision-making body larger than an individual shareholder. One could demand the approval of a majority of disinterested directors; or of a majority of disinterested shareholders -though it is difficult to give a workable definition of "disinterested" in the context of shareholders. As Davies and co-authors have clearly seen, the UK approach actually means that UK policymakers have through the CA2006 made the choice of awarding the power to decide whether a derivative action can be brought to an institution completely external to the company, namely a court.[23] The decision is left neither to the board nor to the shareholders. Of course, the initiative for such an action must be taken by a shareholder. But permission for the action to proceed must be given by a court.

In addition to the statutory derivative action under the CA 2006, other, "common law" derivative actions are still possible under British law, but these need not detain us here.[24]

3. *The criteria for granting permission*

What are the elements a court needs to consider in its decision on whether to grant permission to proceed with the derivative action? The court must dismiss the application for permission to proceed with the derivative action if it finds that a *prima facie* case for giving permission has not been established[25]. Quoting from the well-known *Jesini* case[26], the court explained that establishing a prima facie case for giving permission implied that the court finds both that the company itself has prima facie a good cause of action, and that that cause of action arises out of the default, breach of duty or breach of trust of the directors. The court then (paragraph 9) reiterated the position taken in several previous decisions on derivative actions, that establishing a prima facie case is a higher test than merely establishing there is a "seriously arguable case".[27]

The substantive test that the court must perform in order to ascertain whether it has[28] to reject the derivate action, is contained in s. 263 (2). It may be stressed from the outset that if a court is satisfied that the claim survives the s 263(2) hurdles, the court may still refuse the action to

[23] Davies et al (Fn. 15) 15-008 at 576 write: "… the CA2006… outsources the gatekeeping decision to a body outside the company: the court must decide whether it is in the company's interest for litigation to be commenced in any particular case".
[24] See about the importance of such common law derivative actions today, briefly Davies et al. (fn. 15) at p. 577, footnotes 81 and 85.
[25] See paragraph 7 of the judgement.
[26] *Jesini v Westrip holdings Limited* [2010]BCC 420 (at 78).
[27] See e.g. *Abouraya v Sigmund* [2014] EWHC 277 (Ch).
[28] That the court has no discretion once it finds a prima facies case for giving permission has not been established, is made clear in, for example, paragraph 7 of the annotated judgement.

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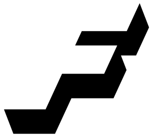

proceed, based on its analysis of the discretionary factors that it must take into account according to s. 263(3).

The first test the court must perform in accordance with s 263 (2) CA 2006 is whether the acts or omissions giving rise to the claim have been authorized or ratified by the company before or since they occurred. If they have been authorized or ratified by the company, the court has no discretion, and it must throw out the derivative action. To some (continental European) readers, this approach may seem puzzling, because it does not allow the derivative action to be used against the wishes of the majority of shareholders, who have decided to authorize or ratify a decision. The approach of English law does not allow the use of a derivative action as a tool to remedy the agency conflict caused by conflicted controlling shareholders, who may have ratified a directorial decision taken by themselves in their capacity as director, or taken by directors appointed and potentially dismissable under their influence. The formal logic of the British approach is probably that if the company has decided to approve the directors' behaviour, the company no longer has claim, so such a claim cannot be exercised derivatively either. Continental Europeans will not necessarily find this a persuasive line of thinking. For instance, under Belgian law, by contrast, derivative actions can *only* be brought *after* the company has condoned and in this sense ratified the action of the directors, by granting them discharge, i.e. the decision by the general meeting not to sue the directors for breaches of duty they performed in the accounting year to which the annual accounts pertained. The reasoning here is that derivative actions should only be allowed if it is clear that the majority -often though admittedly not always because it is conflicted- has decided not to pursue the directors for a breach of duty. In any case, in the case we annotated there clearly had been no formal authorization or ratification and this part of the test played no role.

The second, more interesting part of the substantive test the court must perform is whether the court is satisfied that a director acting in accordance with his duty to promote the success of the company (s. 172 CA 2006) would not seek to continue the claim. If the court is so satisfied -such a director would *not* pursue the claim- it again has no discretion but must reject the claim. This is sometimes called the "negative test".

If the court does not reject the claim based on a positive negative test -to put it more clearly: because the court is not convinced a loyal director would not pursue such a claim- it still may refuse permission for the action to proceed, based on several discretionary factors that should be used to perform the "positive test": would a director pursuing the best interest of the company actively pursue such a claim? 263 (3) mentions six discretionary factors the court must take into account, including whether the shareholder is acting in good faith in seeking to continue the claim. One factor, a seventh one, is mentioned separately, presumably to stress the importance the courts should attach to this factor: s.263 (4) CA 2006 requires the court to

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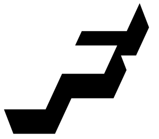

have regard to any evidence about the views of disinterested members, that is shareholders who have no direct or indirect personal interest in the matter.

If one reads s. 263 CA 2006 one gets the impression that Act wants judges to engage in a two-step analysis: first determine whether a person acting in good faith to pursue the success of the company would not proceed with such a derivative action (negative test). If the answer is affirmative -such a person pursuing the best interest of the company would not proceed with the derivative action- the court must refuse to grant permission. If, on the other hand, the action passes this negative test, the judge must in the second prong of the test form an opinion on whether continuing with the action would indeed positively promote the success of the company, and in this evaluation the judge must have special regard for the six factors listed in s. 263 (3) CA 2006, as well as have special regard to the opinion of the majority of members (s. 263 (4)) (positive test). However, it is to be expected, based on the heuristics that guide human judgement including that of court judges, that most judges will conflate the two tests and look at the matter in a holistic way. This is borne out by the judgement in the Shell case we're discussing here. The court first does indeed stress that if it finds that no reasonable director would pursue the action, the court is under a duty to refuse permission for the claim; it has no discretion in this regard. But in order to establish what a good faith director acting in the best interest of the company would or would not do, the court immediately seems to take the discretionary factors listed in the CA 2006 into account. I may also refer here to the fact that the court in paragraph 10 of its judgement first confirms that it has to go through a "two stage process" of which s 263 (2) is the first stage, but then, in paragraph 11, lists the two or three prongs of 263(2), (3) and (4) in one breath as collectively describing its task, and this is also how the court proceeds in its actual analysis of these factors.

4. *Claims and relief demanded by ClientEarth*

The relief sought by Client Earth was, first, a declaration that the directors had breached their duties, and second, an injunction requiring the directors to adopt and implement a strategy to manage climate risk in compliance with their duties and to comply immediately with the Dutch climate case judgement.

Of course, an injunction for directors to implement a climate risk management strategy in compliance with their duties would make no sense and could indeed not be issued if the court had not only first found that the directors at present had indeed breached those duties, and unless the court had an idea, probably to be specified in its final judgement, on what kind of strategy was acceptable/in conformity with the directors' duties. The court ruling on the substance of the matter would have needed to circumscribe the contours of such a climate risk management strategy. In other words, the court would have needed to substitute its own judgement for that of the directors. Otherwise its injunction in this respect would have

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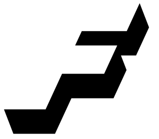

amounted to nothing more than "Directors, do your duty as you seem fit" -a very unhelpful form of relief, except that it would have made clear that directors needed to develop an explicit climate mitigation strategy. But ClientEarth did not allege that the Shell board had failed to develop and indeed disclose such a strategy, merely that in the view of ClientEarth it was wholly inadequate.

The relief was sought on the basis of the alleged violation of two of the statutory duties of directors under the 2006 Companies Act. The CA 2006 does indeed contain a list of seven directors' duties. The two invoked here were: the duty to promote the success of the company (s. 172); and the duty to exercise reasonable care, skill and diligence (s. 174). According to plaintiffs, when these duties are applied to the board's role in making sure the company deals adequately with climate change risks, they give rise to several "incident duties".[29] As formulated by plaintiffs, these boiled down to a duty for the directors to base judgements on climate risk on scientific opinion, a duty to appropriately weigh climate risks for Shell and a duty to mitigate those risks and adopt strategies to make sure Shell met its climate mitigation duties. The court would deny the existence of such incident duties[30]. ClientEarth had also pleaded two additional duties which it referred to as "additional obligations"(see paragraph 22 of the judgment), essentially boiling down to the statement that the Shell directors were aware of the Dutch court order and were therefore under a duty to take reasonable steps to ensure the order was obeyed. This was pleaded as a precursor to the allegation that Shell itself had not done enough to comply with "the Dutch order".

5. *Ruling by the court on whether a prima facie case had been established*

Though my summary does not do justice to the fine and fine-grained analysis of the judge, I believe I can fairly say that the application by ClientEarth was essentially rejected because the judge felt ClientEarth was attempting to use the derivative action to impose its views on an appropriate climate risk mitigation strategy on Shell. Whereas in the absence of relevant scientific or other definitive findings that could avoid the necessity for the directors to weigh conflicting interests in developing such a policy, ClientEarth, the judge, shareholders or anyone else should have deferred to the directors, as long as it could not be shown that the directors had acted in bad faith in trying to act in the best interests of the company. In other words, the basic message of the ruling is that the derivative action and courts may not be abused to second-guess the board's judgement in developing a corporate climate policy, especially not by NGOs who are only very minor shareholders and whose views on what is an adequate climate risk management policy for a company like Shell were clearly not shared by the majority of Shell shareholders.

[29] Paragraph 16 of the judgement.
[30] E.g. paragraphs 20 and 25 of the judgement.

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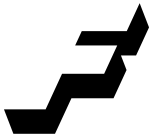

The judge starts his analysis by reminding everyone that the s. 172 CA 2006 directors' duty to act in a way that the directors consider in good faith would be most likely to promote the success of the company for the benefit of the members as a whole, is a subjective duty or, rather, the test to ascertain whether that duty has been met is a subjective one. By this is meant that it's up to the director to exercise good faith judgment, and there are no objective guidelines that could guide a judge let alone shareholder) to replace this directorial judgement with the judge's.

In rejecting the six "incidental duties" that, according to ClientEarth", flowed from the general s. 172 duty of the board, the judge in paragraph 19 declared that it was "plain" that ClientEarth was seeking

"to impose specific obligations on the Directors as to how the management of Shell's business and affairs should be conducted, notwithstanding 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. This has always been the law (e.g., *Re Smith & Fawcett Limited* [1942] Ch 304, 306 per Lord Greene MR) and is unaffected by the codification of the duty in section 172. It is an important principle because, as Lewison J observed in *Iesini* at [85]:

> "The weighing of all these considerations [as set out in s.172] is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case."

In subsequent considerations, the judge goes on to stress that in order to develop an appropriate climate strategy, including setting emissions targets, developing a strategy for dealing with the climate risks Shell's business is exposed to but also implementing the Dutch order, requires that the board balances various competing interests against each other (paragraph 25). By citing a dictum of Lord Wilberforce from an older case, the judge goes to the heart of what is wrong with what can indeed rightfully be seen as ClientEarth's attempt to substitute its own jugdments on appropriate climate policies for those of the directors:

"There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at"[31].

The judge continues in paragraph 48:

"*The evidence* (presented by ClientEarth -hdw)*does not engage with the issue of how the Directors are said to have gone so wrong in their balancing and weighing of the many factors which should go into their consideration of how to deal with climate risk, amongst the many other risks to which Shell's business will inevitable be exposed, that no reasonable director could properly have adopted the approach that they have. This is a fundamental defect*

[31] Lord Wilberforce in *Howard Smith Ltd v Ampol Ltd* [1974] AC 821 at 832E/F.

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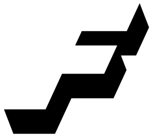

in ClientEarth's case because it completely ignores the fact that the management of a business of the size and complexity of that of Shell will require the Directors to take into account a range of competing considerations, the proper balancing of which is classic management decision with which the court is ill-equipped to interfere".

The judgement stresses that there is no evidence Judges stresses that there is no evidence (certainly not the one given by the witness in this respect of ClientEarth, who had admitted he was a legal expert and not an expert on climate science) as to what would amount to a "correct" climate policy, so that one would indeed have to rely on directors balancing competing interests in developing such a policy. Neither is there a universally accepted methodology as to the means by which Shell might be able to achieve the targeted reductions referred to in its emissions reduction plan.

The penultimate blow to CleantEarth's case was the conviction of the judge that the organization may have been animated by an ulterior motive to bring the derivative action, namely not in order to promote the success of the company, but rather to advance its own policy agenda, also in a wider societal context where it is competing for attention and impact as a civil society organization. In the academic literature, this type of litigation has been labeled "strategic litigation"[32]. In paragraph 64, the court wrote:

"In short, there is substance in Shell's submission that ClientEarth's motivation is driven by something quite different from a balanced consideration as to how best to enforce the multifarious factors which the Directors are bound to take into account when assessing what is in the best interests of Shell. It seems to me that ClientEarth has adopted 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, which points strongly towards a conclusion that its motivation in bringing the claim is ulterior to the purpose for which a claim could properly be continued."

Finally, the court also found that most "members" (shareholders) of Shell seemed to support its (written, and disclosed to shareholders) Energy Transition Strategy. The ETS received support of 88% of votes cast during the 2021 AGM, and though this fell to 80% at the 2022 meeting, and even though resolutions of activist NGO "Follow this" condemning the speed of Shell's climate transition efforts garnered about 30 and 20% support at the 2021 and 2022 general meetings, the court considered that the level of support among shareholders for Shell's ETs counted strongly against granting permission to proceed with the derivative action[33]. This was all the more so in view of the tiny percentage of shares in Shell held by ClientEarth and its letter-writing supporters.

An additional element for rejecting plaintiff's claims was the longstanding doctrine that an English court will not grant injunctive relief if constant supervision of the injunction is

[32] See *infra,* text at footnote 40 and the references in that footnote.
[33] See paragraphs 67 through 70.

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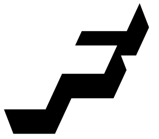

required, which would be the case if the court would be required to adjudicate disputes about whether or not a business was being run in accordance with the court order.[34] Since there were no scientific or indeed other guidelines on what an acceptable climate policy or acceptable measures to reach the emissions reduction targets imposed by the Dutch order would be, it was very likely parties would disagree about such polices, necessitating either the development of such a precise policy by the court or constant intervention by the court to interpret or decide the implications of its own injunctive order.

6. *The analysis of the alleged duty to comply with the Dutch "Shell climate judgement"*

A striking element in the judgement is its discussion of the allegation made by plaintiffs that the Shell directors had failed to comply with "The Dutch order", i.e. the judgement in the Shell climate case. The English judge cites Shell as saying in its submission"*that there is no recognized duty owed by directors to a company in which they hold office to ensure that they comply with the orders of a foreign court.*" The next sentence is: "*I also agree with Shell's submission on this point*". The (continental European) reader is struck, indeed taken aback, by this statement, because it seems to imply what it literally says, namely that, indeed, the directors of a company incorporated in England, have no duty under English law to comply with foreign court orders. Even after Brexit, this would be puzzling, assuming of course that the foreign judgement is recognised in the UK.[35] The judge concludes his discussion of this issue with the statement that "*the only question is whether their (the directors') response to the Dutch Order rendered them in breach of an English law duty*". At first, this may seem like a useful clarification -since the directors are directors of a UK company, their duties are governed by UK law, not foreign law, and this is especially relevant when one sues those directors under the UK derivative action on the basis of their alleged breach of their UK duties. But on a moment's reflection it does not really help. Surely the judge was not saying that directors of UK companies do not have to obey (foreign) court orders? Whether the court order emanates from a UK judge or a foreign one should be immaterial as soon as it has been established that the order in question is enforceable in the UK. Nevertheless that (there is no such duty) is what the judge literally says.

[34] See paragraph 57 of the judgement

[35] After Brexit and pursuant to the Withdrawal Agreement between the EU and UK, the Brussels I Regulation and Lugano Convention ceased to be effective in the UK on January 1 2021. This has as a consequence that judgements from UK courts are no longer automatically effective in EU member states, but need to go through the applicable exequatur procedures in order to be recognized and have legal effect, and the same goes in the opposite direction: court rulings from EU member states are not automatically recognized in the UK. For an overview of the state of play in early 2023 (with references to various, often conflicting opinions expressed by scholars), see the study on behalf of the JURI committee of the European Parliament, *Ensuring efficient cooperation with the UK in civil law* matters. *Situation after Brexit and options for future cooperation*, March 2023, 65 p., available at https://www.europarl.europa.eu/RegData/etudes/STUD/2023/743340/IPOL_STU(2023)743340_EN.pdf

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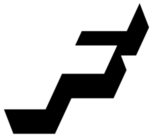

However, when one reads the whole of paragraphs 22 through 26 of the judgement, it becomes clear that the message of the judge was probably a different one, and is part of his refutation (which follows from paragraph 27 onwards) of the argument made by ClientEarth that from the duty of care flow several more precise so-called incident duties. In this reading the message of the judge was as follows: The CA 2006 contains seven statutory duties. This list does not contain a separate, stand-alone duty to obey court orders. There is authority in British case law for the position that when directors disobey the orders of a British court, they may have committed contempt of court.[36] But if a plaintiff wants to prove that disobeying a (foreign, but probably also British) court order is a violation of a person's duties as a director, that plaintiff will have to show which of the 7 statutory duties the corporate director violated, i.e. will have to show under which of these duties "violating a foreign court order" is subsumed; there is no separate, stand-alone duty "thou shalt obey court orders". This is especially so in cases (like the present one) where the court order was addressed to a corporation and not to the directors directly. In other words, if a company disobeys a court order addressed to it, that does not automatically mean that the directors breached their own duty (of care, for instance). If that is the correct interpretation of this passage in the judgement, then it seems to me to be a correct and respectable position, so we must assume this is what the court meant, and not the puzzling (and, outside Britain in any case, legally unacceptable) assertion that directors of UK companies would only have to obey UK courts, not foreign ones. Another reading still would be that the judge wanted to make clear that directors of a UK company must only obey foreign court orders under UK company law if that foreign court order has been recognized and thus become part of the UK legal order, but that is such an obvious point that it is unlikely that that was the message of the judgement, which nowhere contains explicit language to that effect.

7. *The wider context: European conceptions about the proper role of shareholders in setting corporate climate policies*

As we mentioned before, the derivative action against the Shell directors was clearly animated by a desire on the part of an NGO, ClientEarth, to determine Shell's climate transition policy. The NGO had bought a few (27) shares, not as an investment, but for purely instrumental reasons, namely in order to qualify for a derivative action. The litigation was the continuation of an activist war with other means. Another example of this type of litigation was the attempt by several NGOs including *Milieudefensie* to force the three major German carmakers (Volkswagen, BMW, Mercedes-Benz) through a court injunction to stop the production of fossil fuel cars by 2030 (this was before the EU had decided to phase out most of that production in the non-truck sector by 2035). The district court in Braunschweig, which dealt with the case against Volkswagen[37], rightfully rejected such a claim against Volkswagen, not based on the argument that courts cannot be used to determine a company's (climate) strategy, but on the in this case even better (and related) ground that private companies like

[36] See the reference in the judgement to *Attorney-General for Tuvalu v Philatelic distribution Corpn* [1990] 1 WLR 926 at 936E-F.

[37] I have no further information on the cases against BMW and Mercedes.

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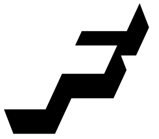

Volkswagen, that are not directly subject to treaties like the Paris Climate Agreement and that by definition are not legally bound by soft law, aspirational environmental and climate goals, cannot be held, on the basis of tort law, to a higher standard than governments and than the standard imposed by mandatory regulation in implementing a climate strategy.[38]

In a recent article, I offered a broader analysis of the efforts of NGOs in continental Europe to use shareholder activist tools, in particular the submission of shareholder proposals on environmental and social issues, as well as strategic stakeholder litigation as a part of ESG activism campaigns.[39] The Shell derivative litigation case discussed here may be labeled "strategic" in the double sense of being aimed at influencing corporate strategies and having aims that go beyond the individual case being litigated. Such litigation is part of a wider campaign to attract attention to deplorable situations and to change (government or corporate) policies.[40]

In several continental European jurisdiction, and especially in the Netherlands and Germany[41], the clearly dominant opinion is that shareholder proposals may be inadmissible -that is, cannot be put on the agenda of the general meeting for a vote- if they aim to determine (an aspect of) a company's strategy.[42] This includes the company's climate strategy.The thinking here is that

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[38] See Landgericht Braunschweig ruling 6 O 3931/21 of 24 February 2023, as discussed in "Zivilklage gegen Volkswagen AG wegen Verringerung der CO2-Emissionen erfolgslos", https://www.die-aktiengesellschaft.de/82788.htm (last consulted on April 30 2023).

[39] H. De Wulf, "Towards a political corporation? NGOs as ESG shareholder activists and litigators influencing corporate strategies in continental Europe" forthcoming in A. van Hoe and T. Vos (eds.) *Shareholder Activism in Belgium*, Antwerp, Larcier Intersentia, 2023, soon available at ssrn.com and https://financiallawinstitute.ugent.be/index.php/working-paper-series/.

[40] For a discussion of another example of such strategic litigation, see M. Bader, M. Saage-Maass, C. Terwindt, "Strategic Litigation against the Misconduct of Multinational Enterprises: an Anatomy of Jabir and Others v KiK", *Verfassung und Recht in Übersee*, vol. 52, 2019, 156-171. On the"model" of strategic litigation, see already J. Lobel, "*Courts as Forums for Protest*", 52 *UCLA Law Review*, 2004, 477.

[41] In Germany, there is no leading case law on the topic yet, though a case is pending before the Braunschweig district court, after Volkswagen refused to put a shareholder proposal on the AGM's agenda that, if adopted, would have forced Volkswagen to disclose its climate lobbying efforts. See on that case B. Fuhrmann and S. Röseler, "VW und die Leitungsautonomie – legitime Schranke für ESG-Aktivismus in Deutschland?", *Die Aktiengesellschaft* 2022, p. R 153. But the clearly dominant opinion in German scholarship is that shareholder proposals may not be used to impose a climate policy on public companies (AG), see Ph. Jaspers "Sustainable Shareholder Activism", *Die Aktiengesellschaft* 2022, 145; R. Harnos and Ph. M. Holle, "Say on climate", *Die Aktiengesellschaft*, 2021, 853-866; M-Ph. Weller and V. Hoppmann "Environment Social Governance (ESG). Neue Kompetenzen der Hauptversammlung?", *Die Aktiengesellschaft* 2022, 640; M-Ph. Weller and N. Benz, "Klimaschutz und corporate Governance", *ZGR* 2022, 563-601. A nuanced approach is taken in H. Fleischer and Ph. Hülse, "Klimaschutz und aktienrechtliche Kompetenzverteilung: zum Für und Wider eines 'Say on Climate'", *Der Betrieb* 2023, 41 (evaluating pros and cons of a say on climate).

[42] See Section V of my article cited in footnote 39, where I also discuss the less clear position under French law; see also S. Cools, "Climate Proposals: ESG Shareholder Activism Sidestepping Board

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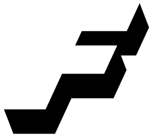

it is the exclusive competence of the board to determine a corporation's strategy should be safeguarded, free from shareholder instructions (even when those instructions are given, in a public company, through the general meeting). In the Netherlands, the highest court ("Hoge Raad") ruled in the landmark "Boskalis/Fugro"-case[43] that, since under Dutch law the executive board has the exclusive competence to determine corporate strategies, shareholder proposals that relate to corporate strategy or corporate policies, may not even be put on the agenda of the AGM for a non-binding vote; at most the general meeting may discuss such strategic matters, but it may not put pressure on the board by holding even a "merely indicative poll" on them.

In my view, the Dutch legal system at present a harbours a serious internal inconsistency concerning these matters: it outlaws shareholder proposals that touch upon a company's strategy (because determining that strategy is the board's exclusive legal prerogative), but at the same time admits climate litigation against companies at the initiative of NGOs representing external stakeholders, even though that climate litigation goes to the heart of a company's strategy, and courts are an even less suitable forum than a general meeting of shareholders to determine a company's climate policies. The English judge is to be commended for not going along with ClientEarth's strategy and stopping an undesirable use of the derivative action (as such an underused tool) in its tracks.

8. *Conclusion*

The reasoning of the judge in this case provides a convincing analysis of the legal issues at hand. Essentially, a director having the best interest of Shell at heart would not have pursued a claim like ClientEarth's. It was perfectly clear that the goal of ClientEarth in bringing the derivative action was to put pressure on the defendant Shell directors to change Shell's climate and greenhouse gas emissions policy, as well as the speed with which it tried to cut group emissions in order to comply with the "Dutch order". ClientEarth thus wanted to determine or at least greatly influence Shell's climate policies, even though it represented a negligible portion of the shareholder base and mainly represented the interests of "society at large"[44]. True, the Dutch court had already imposed a specific emissions reduction target on Shell. But that Dutch court order -which is still under appeal and will no doubt end up with the Dutch

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Authority" (March 2, 2023), forthcoming in Thilo Kuntz (ed.), *Research Handbook on Environmental, Social, and Corporate Governance*, Edward Elgar, 2023, available at https://ssrn.com/abstract=4377030.

[43] Hoge Raad, 28 April 2018 ("Boskalis/Fugro") ECLI:NL:HR:2018:652, available at https://uitspraken.rechtspraak.nl/#!/details?id=ECLI:NL:HR:2018:652. The case concerned an attempt by an activist shareholder to put a shareholder proposal on the agenda asking the board to consider dismantling certain defensive measures that hindered an ongoing hostile takeover bid.

[44] In the Dutch climate case, plaintiff "Milieudefensie", ClientEarths Dutch sister organisation, was said to represent "the interest of the residents of The Netherlands and the inhabitants of the " Wadden" area" (The "Wadden" are a series of coastal islands in the North Sea north of the Netherlands and Germany).

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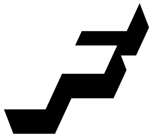

Supreme Court unless the parties reach a settlement – explicitly acknowledged that it was left to the discretion of Shell's board to determine by which route, that is through which kinds of measures, the CO_2 emissions reductions targets imposed by the court would be reached. (Had it not respected the board's discretion in this matter, the The Hague ruling would in my view have been incompatible with Boskalis/Fugro ruling of the Dutch Supreme Court discussed in the previous section[45]). It is true that British company law is different from that of most western European jurisdictions in that even in public companies, it allows binding instructions from the general meeting of shareholders to the board in areas for which the board is in principle competent to decide.[46] But that should not allow a minute minority shareholder to ask a court to impose a strategy on the company overruling not only the board but even going against the apparent wishes of the majority of shareholders. The UK has neither a statutory nor a judge-made Delaware- style business judgement rule, but with his ruling, the judge underscored that UK courts will respect the board's discretion when such respect is due.

[45] See Fn. 43.
[46] See art. 4(1) of the Model Articles for public companies, available at https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies.

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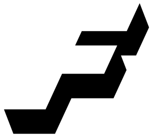

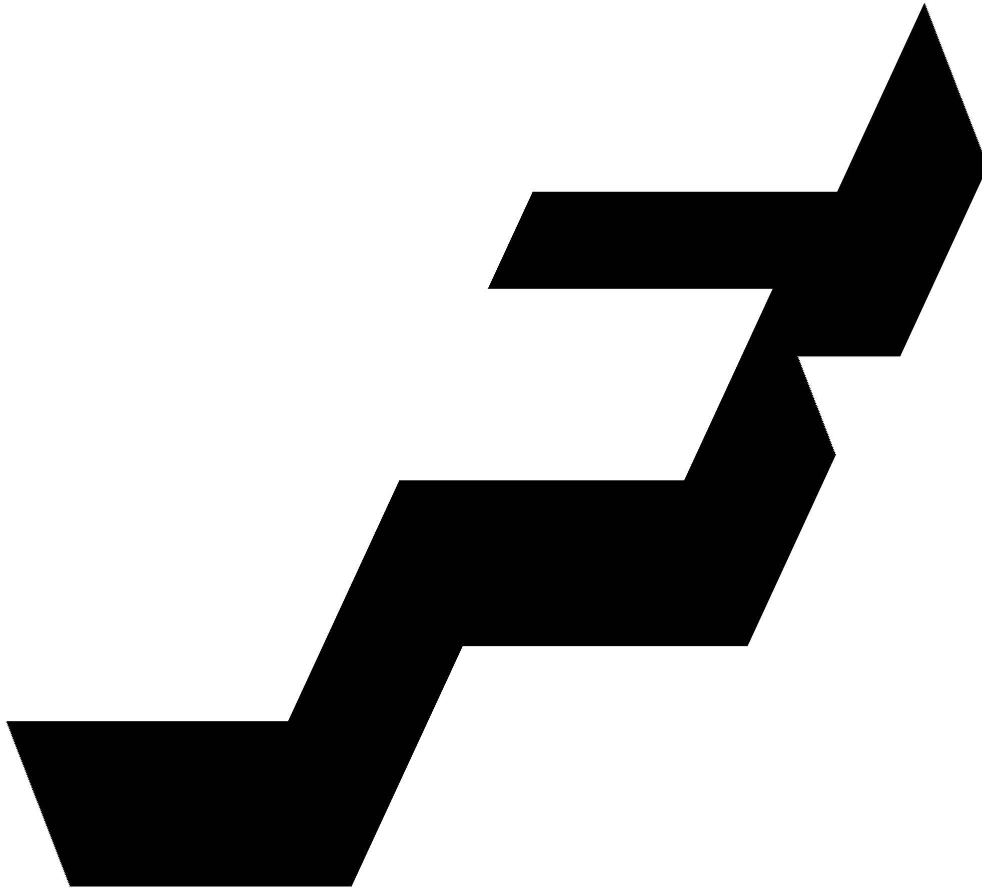

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