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*Case Note*

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# Corporate strategy on climate risk in the courtroom: Not worth powder in shot

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**Abstract**
In *ClientEarth v Shell Plc*, ClientEarth brought 'ground-breaking' derivative litigation against the board of directors of Royal Dutch Shell Plc by alleging their corporate strategy on climate risk was determined in breaches of duties under the Companies Act 2006, ss. 172 and 174. This analysis of *ClientEarth* demonstrates the importance of the decision for climate litigation. First, it confirms that corporate strategy on climate risk is a matter for the directors and is not actionable because there is no accepted methodology on managing climate risk that can evidence the strategy is unreasonable. Second, it confirms that even if corporate strategy on climate risk is determined in breach of duty, it is still not worth powder in shot to pursue derivatively. The decision means climate risk is left to the private ordering of the company. That should send a message to Parliament because the directors' determination of what is best for the company is not frictionless with environmental law goals. Without effective public ordering, the friction risks the UK failing to meet its international climate obligations.

**Keywords**
Derivative claims, civil procedure, climate change, directors' duties, shareholder rights, environmental law

## Introduction

In *ClientEarth* v *Shell Plc*,[1] ClientEarth brought what it called a 'ground-breaking' derivative claim against the directors of Royal Dutch Shell Plc (hereafter 'Shell').[2] As a shareholder in Shell, ClientEarth alleged that the board of directors' corporate strategy on climate risk was unreasonable, amounting to breaches of duties

1. For the judgement on papers see, *ClientEarth* v *Shell Plc* [2023] EWHC 1137 (Ch) (*ClientEarth* 1); For the judgement on the oral hearing to reconsider the decision on papers under Civil Procedure Rules 19.15(10) see, *ClientEarth* v *Shell Plc* [2023] EWHC 1897 (Ch) (*ClientEarth* 2).
2. ClientEarth, 'Our groundbreaking case against Shell's Board of Directors' (19 May 2023), at https://www.clientearth.org/latest/latest-updates/news/we-re-taking-legal-action-against-shell-s-board-for-mismanaging-climate-risk/

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owed to the company under the Companies Act (CA) 2006. If the claim had been successful it would have reposed in activist shareholders a useful weapon to challenge corporate strategies on climate risk. However, the High Court refused to grant permission to ClientEarth to bring an action derivatively, holding that a difference of opinion on corporate strategy is not prima facie actionable because it is a matter for the directors to determine. The confirmation of this in *ClientEarth* is trite law but the decision also confirmed that derivative litigation on challenging corporate strategies determined in breach of duty under ss. 172 and 174 is not worth powder in shot. These confirmations should send an important message to Parliament. The board's strategy was not actionable as there is no accepted methodology on how to manage climate risk. It could not, therefore, be evidenced that the strategy was determined in breach of duty. However, directors are incentivised to do what they think is best for the company, which is not frictionless with environmental goals. *ClientEarth* shows this friction risks the subordination of the latter to the former and without effective public ordering, it means the UK may not meet its international climate obligations.[3]

## Challenging derivatively the lawfulness corporate strategy

The derivative litigation brought by ClientEarth alleged that the corporate strategy was determined in breaches of duties under the CA 2006, ss. 172 and 174.[4] These duties require the directors to act in a way they consider, in good faith, to be in the best interests of the company, and to discharge their role with due care, skill and diligence.

As a shareholder, ClientEarth did not have a right of standing to enforce those duties. Duties of a director are owed to the company and the cause of action for any breach of those duties is vested in the company as a legal person.[5] However, an exception to the rule is recognised in circumstances where those who control the company are the ones who have committed a wrong against it. Without this exception, there would be a wrong without redress.[6] The exception allows a shareholder of the company to pursue the cause of action vested in the company in the company's name. However, a shareholder does not automatically have standing. To do so would collapse the rule into an exception. A shareholder must first claim permission from the court to derive the right of action vested in the company to enforce its rights against the wrongdoers. This is the derivative claim.

The derivative claim is now enshrined in the CA 2006 as a two-part procedure.[7] First, ClientEarth faced an evidentiary burden to disclose a prima facie case that the claim falls within the proper boundaries of the statutory exception to the rule.[8] The formal boundaries of the procedure include the cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.[9] To discharge the burden, the shareholder must evidence that the company would be entitled to judgement in the absence of an answer from the defendant.[10] If they do this, the court has discretion on whether to grant permission at the second stage, subject to three mandatory bars.[11]

3. See, for example, the Paris Agreement on Climate Change 2015; Her Majesty's Government, *Net Zero Strategy: Build Back Greener* (October, 2021).
4. *ClientEarth* 1, above n. 1 at [27].
5. CA 2006, s. 170(1); *Salomon v A Salomon & Co Ltd* [1897] AC 22; *Foss v Harbottle* (1843) 2 Hare 461.
6. See, *Wallersteiner v Moir (No 2)* [1975] QB 373 at 390.
7. CA 2006, pt 11.
8. Ibid., s. 260, 261(2); *ClientEarth* 1, above n. 1 at [8]–[9]; citing *Iesini v Westrip Holdings Ltd* [2010] BCC 420 at [78]; and *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204 at 222.
9. CA, ibid., s. 260 also requires the claimant be a shareholder; the cause of action is vested in the company; and the shareholder is seeking relief on behalf of the company.
10. *ClientEarth* 1, above n. 1 at [9]; citing *Abouraya v Sigmund* [2015] BCC 503 at [53]; see also, *ClientEarth* 2, above n. 1 at [14].
11. CA 2006, s. 263.

## *Legal standards for establishing a prima facie case*

The specifics of the allegations are set out in detail in the case,[12] but in general, ClientEarth had alleged that the strategy 'fell outside the range of reasonable responses to climate change risk and will cause harm to Shell's members' which put them in breach of the duties mentioned.[13] It was alleged that there was: a failure to set appropriate emission targets; no reasonable basis for achieving its net zero target; and a failure to comply with a Dutch Order.[14] The evidence for these allegations was from two witness statements from ClientEarth's own lawyers.[15]

Starting with section 172, what is best for the company is for a good faith, subjective determination by the directors.[16] In discharging, this duty they must have regard to stakeholder interests, including the environment.[17] Therefore, a director is required by law to act in a way they think will promote the best 'interests of the company as a whole'.[18] Provided the director does so in good faith, the 'cornerstone' for liability,[19] the court will not, and by extension will not allow the shareholders to, question the decisions of directors 'honestly arrived at'.[20] It is not subject to a qualification of reasonableness.[21] However, a director may be in breach if the conduct is not in the interests of the company. The court described this as requiring evidence that 'there is no basis on which a director could reasonably have come to the conclusion that the actions that have taken have been in the interests of Shell'.[22] For example, a director who arranged a company pension for his wife had no basis for concluding it was in the interests of the company[23] but a director who grants a week's wages as gratuities for the company's employees would have.[24] Finally, a director who does not consider the interests of the company may also be in breach of duty.[25]

As for section 174, the standard of liability is objective.[26] The decision taken must not fall outside the range of reasonable options available.[27] However, there is no standard to objectively hold the directors'

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12. *ClientEarth* 2, above n. 1 at [39]–[57].
13. Ibid. at [38].
14. Ibid. at [39]; citing *Milieudefensie v Royal Dutch Shell Plc ECLI:NL:RBDHA:2021:5339* (May 26, 2021).
15. *ClientEarth 2*, above n. 1 at [18] noted that the witness statements were provided by Mr Benson, senior lawyer at ClientEarth, and Mr Hooker, partner in Pallas Partners LLP who were acting pro bono for ClientEarth.
16. CA 2006, s. 172(1); *ClientEarth* 1, above n. 1 at [19], [47]; citing *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306; see also, *ClientEarth* 2, above n. 1 at [29]; *R (on the application of People & Planet v HM Treasury)* [2009] EWHC 3020; A. Keay, 'Section 172(1) of the Companies Act 2006: an interpretation and assessment (2007) 28(4) *Company Lawyer* 106.
17. CA, ibid., s. 172(1)(d).
18. *Greenhalgh v Arderne Cinemas* [1951] Ch 286 at 291; see also *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306; *Hutton v West Cork Railway Co* (1883) 23 Ch D 654 at 673.
19. *ClientEarth* 2, above n. 1 at [29].
20. *ClientEarth* 1, above n. 1 at [25]; citing *Howard Smith Ltd v Ampol Ltd* [1974] AC 821 at 832; see also; A. Keay, J. Loughrey, T. McNulty, F. Okanigbuan, and A. Stewart, 'Business Judgement and Director Accountability: A Study of Case-Law Over Time (2020) 20(2) *Journal of Corporate Law Studies* 359; A. Keay, J Loughrey, T McNulty, F. Okanigbuan, and A. Stewart, 'Reviewing Directors' Business Judgements: Views From the Field' (2020) 47(4) *Journal of Law and Society* 639 (hereafter Keay *et al.*, 'Reviewing Directors' Business Judgements').
21. *ClientEarth* 2, above n. 1 at [38].
22. Ibid. at [38].
23. *Re W&M Roith Ltd* [1967] 1 WLR 432.
24. *Hampson v Price's Patent Candles Co* (1876) 45 L.J. (Ch) 437.
25. *Charterbridge Corp v Lloyds Bank Ltd* [1970] Ch 62 at 74 held in the absence of an actual consideration of the company's interests by the director, only then the test becomes 'whether an intelligent or honest man in the position of a director of the company concerned, could… have reasonably believed that the transactions were for the benefit of the company'.
26. CA 2006, s. 174, determines the objective standard is a minimum standard of liability that may be raised to a higher subjective standard if the director has skills beyond the objective minimum.
27. *ClientEarth* 2, above n. 1 at [32]; citing *Sharp v Blank* [2019] EWHC 3096 (Ch) at [631].

substantive business judgements to say it fell outside that range.[28] Therefore, like what is best for the company, whether the strategy is a reasonable one, it is an autonomous decision for them to take.[29]

## *No accepted methodology on climate risk*

ClientEarth's evidence failed to establish a prima facie breach of either duty.[30] The law makes clear that corporate strategy is a matter for the board of directors unless it can be shown to be unreasonable, either because it was devised without care under section 174 or there was no basis for it being in the interests of the company under section 172.[31] This exposition of the duties' standards of liability highlights the fundamental problem with ClientEarth's allegations. The witness statements submitted as evidence may have alleged that the strategy was unreasonable but these expressed differences of opinion as to whether the strategy would meet the targets and not fact.[32] ClientEarth had not evidenced prima facie that the strategy was unreasonable in fact because there is no accepted methodology on how to manage climate risk to show it fell outside the range of reasonable options available or had no basis for its pursuit.[33] The absence of a methodology on managing climate risk made it 'very difficult' to treat Shell's strategy as unreasonable.[34] The witness statements, while expressing genuinely held views,[35] were mere differences of opinion that the court could not 'properly rely' because neither were from experts and were 'plainly insufficient'.[36]

That was not all. It may well be that the strategy exposes Shell to climate risk and the targets may not be met, as ClientEarth alleged.[37] However, those risks, even if evidence as fact, do not make the strategy unreasonable under either duty because directors have 'competing considerations' to balance when determining the corporate strategy to pursue.[38] Failing to prioritise climate risk is not unreasonable.[39] Climate risk does not have an 'overriding status'[40] on other considerations and the judge is not well placed to question that balancing act except in a 'clear case'.[41] Likewise, the strategy was not evidenced to be prima facie in breach of section 172 as one that did not consider the interests of the environment because, by ClientEarth's own admission, there was a corporate strategy on climate risk.[42]

These legal standards will stymie most, if not all, derivative litigation challenging corporate strategy on climate risk because the evidence required to disclose prima facie an actionable breach of duty is unlikely to exist. If there is no accepted methodology on how to manage climate risk, and corporate strategy is

28. This is distinct from failure by the directors to monitor the company's affairs, which can constitute a breach of section 174. See, for example, *Lexi Holdings v Luqman* [2009] EWCA Civ 117; *Re D'Jan of London Ltd* [1993] BCC 646.
29. *ClientEarth* 1, above n. 1 at [47].
30. This is the first reported case to fail to do so. See, D. Gibbs-Kneller and C. Ogbonnaya, 'Empirical analysis of the statutory derivative claim: de facto application and the sine quibus non' (2019) 19(2) *Journal of Corporate Law Studies* 303 at 319–23; see also, Hansard HL Vol 679, Official Report, 27 February 2006, col GC14; and B. Hannigan, *Company Law* (2nd edn, OUP 2009) 451 who considered the threshold as a straightforward hurdle to overcome.
31. *ClientEarth* 1, above n. 1 at [34].
32. *ClientEarth* 2, above n. 1 at [61].
33. Ibid. at [64].
34. *ClientEarth* 1, above n. 1 at [47].
35. *ClientEarth* 2, above n. 1 at [41].
36. Ibid. at [59].
37. Ibid. at [41].
38. Ibid. at [31].
39. *ClientEarth* 1, above n. 1 at [48]; *ClientEarth* 2, above n. 1 at [31]–[32].
40. *ClientEarth* 2, above n. 1 at [32], [67].
41. Ibid. at [28]; citing, *Iesini*, above n. 8 at [85]; Keay *et al.*, 'Reviewing Directors' Business Judgements', above n. 20.
42. *ClientEarth* 1, above n. 1 at [48].

determined autonomously by the directors balancing a range of considerations,[43] any expert evidence produced is likely to express only disagreement about its reasonableness. The evidentiary burden is not lightened merely because it is difficult to obtain expert evidence.[44] The court rejected ClientEarth's suggestion that their evidence should be taken 'at its highest', and thus accept the allegations without critical evaluation. The evidentiary burden is on the claimant who must satisfy the court that the company is prima facie entitled to the relief sought.[45] To take ClientEarth's evidence at its highest would be to shift the evidentiary burden onto the directors without ClientEarth having first evidenced a prima facie breach of duty.

Therefore, the evidence did not disclose that the strategy devised was one that 'no reasonable director could properly have adopted' to breach either duty.[46] Differences of opinion do not create prima facie actionable breaches of duties because strategy is a matter for the board of directors.[47] Without evidence of bad faith, the court concluded that while there were 'fundamental disagreements' on what is best for the company, the court 'respects the autonomy' of the directors.[48]

### *Prima facie actionable breaches are not worth powder in shot*

If we suppose that ClientEarth's evidence was sufficient to disclose prima facie actionable breaches of duties under ss. 172 and 174, the court's obiter remarks confirm that derivative litigation challenging strategy on climate risk may still not be worth powder in shot. This is because permission is a discretion resting with the court exercised on established principles.[49] Since the origins of the procedure are equitable,[50] permission is a 'matter of grace'.[51] If a principle is established, then permission will not be granted to the shareholder as the 'proper person' to enforce the breaches in the name of the company.[52] Deference to discretionary principles shows that shareholders should still be wary of pursuing derivative litigation on challenging the lawfulness of the corporate strategy on climate risk under ss. 172 and 174, even if they can evidence prima facie breaches of duties. Directors have the assets of the company at their disposal and it is unlikely that they will be unable to come up with at least one principled reason for the court to exercise their discretion to refuse permission for such allegations.[53] This will then leave the claimant shareholder liable for costs, as they are allocated on English-rule loser pays,[54] and thus the claim is not worth powder in shot.

*ClientEarth* follows the judicial deference to discretionary principles that show most, if not all, derivative litigation on prima facie breaches of ss. 172 and 174 is likely to be refused, including those seeking to

43. *ClientEarth* 2, above n. 1 at [61]–[62].
44. Ibid. at [62].
45. Ibid. at [14].
46. *ClientEarth* 1, above n. 1 at [48].
47. *ClientEarth* 2, above n. 1 at [61].
48. Ibid. at [64].
49. *Cinematic Finance Ltd v Ryder* [2010] EWHC 3387 (Ch) at [14]; Gibbs-Kneller and Ogbonnaya, above n. 30 at 310–11, 326–29; *Stainer v Lee* [2010] EWHC 1539 (Ch) at [29]; *Hughes v Weiss* [2012] EWHC 2363 (Ch) at [33]; *Kleanthous v Paphitis* [2011] EWHC 2287 (Ch); (2011) 108(36) LSG 19 at [40]; Hansard HL, Vol 679, Official Report, 27 February 2006 Col GC26; Law Commission, Shareholder Remedies, Cm 3769 (1997) paras 6.4, 6.71–73.
50. *Wallersteiner*, above n. 6 at 390; see also, Gibbs-Kneller and Ogbonnaya, above n. 30 at 304.
51. *Airey v Cordell* [2006] EWHC 2728 (Ch) at [72]; citing J Gower, *Principles of Modern Company Law* (4th edn, Sweet & Maxwell, 1997), 652; see also, *Nurcombe v Nurcombe* [1985] 1 WLR 370 at 376.
52. See, Gibbs-Kneller and Ogbonnaya, above n. 30 at 323–29.
53. Gibbs-Kneller and Ogbonnaya, above n. 30 at 321 – successful claims are usually, if not exclusively, based on a breach of fiduciary duty, ss. 175–177.
54. Civil Procedure Rules, 44.3(2)(a); see also, *Wallis v Duke of Portland* 3 Ves. Jun. 494 *per* Lord Loughborough; D. Gibbs-Kneller and D. Gindis, 'De Jure Convergence, De Facto Divergence: A Comparison of Factual Implementation of Shareholder Derivative Suit Enforcement in the United States and the United Kingdom' (2019) 30(6) *European Business Law Review* 909 at 917.

challenge the reasonableness of corporate strategy on climate risk.[55] In *ClientEarth*, there was not one but four discretionary reasons for refusing permission. These were ClientEarth acting for an ulterior purpose;[56] they had adequate alternative remedies;[57] they lacked the support of independent shareholders;[58] and a director acting in accordance with section 172 would not continue the claim, or would attach little weight to it.[59] It is the court's treatment of the latter two principles that offer the strongest evidence of why most derivative litigation challenging corporate strategy on ss. 172 and 174 would be denied permission.[60]

Consider first the principle that if a director acting in accordance with section 172 would not continue the claim,[61] or attach little weight to it,[62] permission will not be granted. To satisfy either requirement, the court approaches the question according to the strength of the claim's legal merits because it is not well placed to consider commercial considerations except in a 'clear case'.[63] The legal merits must then be in a state that meets the court's somewhat nebulous threshold that they disclose an 'obvious breach of duty',[64] a 'strong case'[65] or the like.[66]

Prima facie breaches of ss. 172 and 174 are likely to be challenged by directors with evidence to the contrary that would prevent the claim from meeting the relevant threshold. Indeed, ClientEarth was able to do this for Shell. The court noted that it was 'part of ClientEarth's own case that the directors do have policies and targets to achieve [net zero] by 2050' and is 'inconsistent with any suggestion that the directors have not in fact considered what is in the best interests of Shell … when addressing the most appropriate manner in which to deal with climate risk'.[67] Likewise, the absence of a methodology on managing climate risk and the range of considerations a director must balance in discharge of their duties evidenced an autonomous decision had been exercised that the court could not interfere with unless it was unreasonable.[68] Therefore, the fact directors have devised a strategy would in most, if not all, litigation cast significant doubt over any prima facie breach of duty to prevent them from meeting the relevant threshold for permission.

The legal merits of prima facie breaches of ss. 172 and 174 are also unlikely to sufficiently strong to have weight attached to it at the court's discretion because of the remedial relief required to enforce them. In *ClientEarth*, a mandatory injunction was 'too imprecise to be suitable for enforcement' and it was 'likely that any such order would have a disruptive impact on Shell's business' because the 'court would be required to adjudicate on disputes over whether or not a business is being run in accordance with its terms'.[69]

55. This was hypothesised generally based on the de facto application of the statutory derivative procedure under the early case law. See, D. Gibbs-Kneller, 'No Real Prospect for Success: ClientEarth's Derivative Litigation Against the Directors of Shell' Oxford Business Law Blog (8 April 2022), at https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/no-real-prospect-success-clientearths-derivative-litigation-against; Gibbs-Kneller and Ogbonnaya, above n. 30 at 329–31.
56. *ClientEarth* 1, above n. 1 at [61]–[65].
57. Ibid. at [55]–[58].
58. Ibid. at [67]–[70].
59. Ibid. at [59]–[60], [66].
60. See, for example, Law Commission Report, above n. 49 at para 6.41; Gibbs-Kneller and Ogbonnaya, above n. 30 at 329–31.
61. CA 2006, s. 263(2)(a).
62. Ibid., s. 263(3)(b); *Iesini*, above n. 8 at [86]; see also, *SDI Retail Services Ltd v King* [2017] EWHC 737 at [68]–[75].
63. See, *Iesini*, above n. 8 at [85]; Gibbs-Kneller and Ogbonnaya, above n. 30 at 324–25; Law Commission Report, above n. 49 at paras 6.71–74.
64. *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch) at [37].
65. *Hughes*, above n. 49 at [38].
66. For examples of other language used by the court to describe this threshold, see Gibbs-Kneller and Ogbonnaya, above n. 30 at 323–25.
67. *ClientEarth* 1, above n. 1 at [48].
68. Ibid. at [29], [47]–[48].
69. Ibid. at [56]–[57]; citing *Cooperative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] 1 AC 1 at 12; see also, *ClientEarth* 2, above n. 1 at [80]–[82].

Therefore, *ClientEarth* shows that claims challenging corporate strategy on climate risk under ss. 172 or 174 are likely to be of doubtful legal merit to satisfy this principle at the court's discretion. In *ClientEarth*, the court concluded the claims were such that no director would continue them and would, therefore, be barred under section 263(2)(a),[70] let alone being 'an obvious breach of duty' that a director would attach weight to them.[71]

Now consider the principles concerning the views of shareholders independent of the claim.[72] A court will consider whether the conduct is likely to be authorised or ratified[73] and particular regard must be given to the views of those members with no personal interest in the matter.[74] If they do not support litigation then it is another discretionary reason for refusal.[75] In litigation on ss. 172 and 174, the majority of independent views are likely to support the directors, even if there is a breach of duty, due to a range of factors.[76] Therefore, all the directors need to do to have permission refused is to have independent support put in confirmatory terms because, provided it is not illegitimately obtained,[77] the court will not review how that decision was reached.[78] As the court expressed in *Kleanthous*, the disinterested majority are in a better position than the court to decide whether the litigation is in the interest of the company.[79]

This general approach has translated into the decision in *ClientEarth*.[80] Despite inaccurate media fanfare that their litigation 'has already received support from institutional investors who together hold over 12 million shares in the company',[81] support for the litigation was actually uncertain and 'very small'.[82] Its disapproval of the strategy garnered greater support but still only represented a minority interest.[83] The majority of shareholders did not favour the litigation, which the court accepted as another principled reason to dismiss the claim.[84] As such, even if there is a breach of duty in determining a company's strategy on climate risk, the majority of views independent of the claim are unlikely to support it, resulting in permission being refused with costs.[85]

## *ClientEarth's appeal*

ClientEarth is appealing the decision. They may quibble about part of the reasoning that there was no prima facie case, but there is little prospect that permission will be allowed on appeal to encourage shareholders to challenge corporate strategy derivatively.

70. *ClientEarth* 1, ibid. at [59].
71. Ibid. at [66].
72. See *ClientEarth* 2, above n. 1 at [84].
73. CA 2006, s. 263(3)(d); see also CA 2006, s. 239.
74. Ibid., s. 263(4).
75. See, for example, *Bridge v Daley* [2015] EWHC 2121 at [56]; *Kleanthous*, above n. 49 at [75]; *Stainer*, above n. 49 at [46]; *Barrett v Duckett* [1995] 1 BCLC 243 at 368–69; *Smith v Croft (No 2)* [1988] Ch 114; Gibbs-Kneller and Gindis, above n. 54 at 922–23; Gibbs-Kneller and Ogbonnaya, above n. 30 at 328–29.
76. For discussion on why see, A Reisberg, *Derivative Actions and Corporate Governance,* (OUP, 2007) ch 3.4.1.2; J. Coffee and D. Schwartz, 'The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform' (1981) 81 *Columbia Law Review* 261 at 283; in respect of claims on fiduciary breaches of duty, where shareholders are less likely to support the directors, see, for example, *Stainer*, above n. 49 at [46].
77. *Stainer*, above n. 49 at [46].
78. *Kleanthous*, above n. 49 at [31], [75].
79. Ibid.; see also, Reisberg, above n. 76 at ch 3.4.1.1.
80. See also, *Bridge*, above n. 75 at [55]–[57], [68].
81. ClientEarth (19 May 2023), above n. 2
82. *ClientEarth* 1, above n. 1 at [69].
83. *ClientEarth* 1, above n. 1 at [29], [70].
84. Ibid. at [67]–[70].
85. *ClientEarth v Shell plc* [2023] EWHC 2182 (Ch).

The inaccuracy in the reasoning was that the court incorrectly, and without authority, considered discretionary factors of the second stage 'must be taken into account' in its determination about the first stage.[86] The mistake made by the court was not distinguishing the company's cause of action from the shareholder's claim to enforce it. If a shareholder seeks to derive a right of action from the company contrary to principle, that principle prevents them from doing so. For example, equity requires the claimant to come with clean hands, so a shareholder who seeks permission in bad faith will be denied permission to stand.[87] That is distinct from the company enforcing its rights. It may still be in the interests of the company to enforce the duty it is owed by the director, even though a shareholder seeks to do so in bad faith. It does not excuse the prima facie breach of duty owed to the company. The company, as a legal person, has not acted in bad faith.

The error is unlikely to result in the appeal being allowed because the discretionary factors merely confirmed that ClientEarth has failed to evidence that their claim disclosed a prima facie case. It is still the case that their evidence hinged on witness statements differing in opinion on the reasonableness of the corporate strategy, which were not actionable breaches of duties. Unless new evidence is produced, there is no reason to believe the court will allow the appeal.

Even if this is wrong and there is a prima facie case, the consideration of the discretionary factors only evidence that ClientEarth would not be given permission. When a court applies a discretion it is a general principle that in the exercise of judicial discretion, while there may be room for 'legitimate difference of judicial opinion' it will only be overturned if it 'proceeded upon some erroneous principle or was plainly and obviously wrong'.[88]

## A message for parliament

*ClientEarth* echoes the existing message of the court that corporate strategy is for the company itself to decide and the court will not 'pioneer' new methods to regulate it.[89] If there are disagreements about corporate strategy on climate risk, the proper forum for such disputes is the company's own internal mechanisms.[90] Parliament should hear that message because it risks the UK not meeting its international obligations on climate change.[91]

If corporate strategy on climate risk is left to the private ordering of the company's own internal mechanisms, without effective public ordering the tension between corporate law's purpose and environmental law goals risks the subordination of the latter to the former because the corporate contract allocates almost complete discretion to the directors who are incentivised to do what is best for the company as a whole, not the environment.[92]

The problem this friction creates for environmental law goals can be explained briefly through a couple of examples. First, the purpose of corporate law is to maximise the wealth of the company and it is achieved

86. *ClientEarth* 2, above n. 1 at [16], [61], [85]; Law Commission Report, above n. 49 at para 6.76; Gibbs-Kneller and Ogbonnaya, above n. 30; A. Keay and J. Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (201) *Journal of Business Law* 151 at 156–57.
87. *Nurcombe*, above n. 51 at 378.
88. See, *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803, 815–16. While consideration of the discretionary factors in *ClientEarth* was only obiter, there is no reason to believe the observations were not a legitimate judicial opinion that an appeal court would interfere with. This unwillingness to challenge judicial discretion appears to translate into this context. See, for example, *Singh v Singh* [2014] EWCA Civ 103.
89. See *Prudential Assurance*, above n. 8 at 224; see also, *Iesini*, above n. 8 at [85]; *Mozeley v Alston* (1847) 41 ER 833 at 837; *Carlen v Drury* (1812) 35 ER 61 at 62.
90. *ClientEarth* 1, above n. 1 at [58].
91. See The Paris Agreement on Climate Change 2015.
92. See CA 2006, ss. 33, 172.

by approximating the efficient contract between directors and shareholders to maximise their aggregate welfare.[93] It is approximated, in part, by allocating decision-making to the directors who are legally required and incentivised to do what is best for the company as a whole.[94] If corporate law was instead structured to do what is best for stakeholders, such as the environment, it may fail to meet corporate law's purpose. If directors were legally required to act in a way that is best for the environment, the company's wealth will be subordinated to environmental law goals, thus failing to approximate the efficient contract.[95] Shareholders, for example, may pay less for the company's shares due to the increased risk exposure from the subordination of their interests.[96]

Now consider this friction with the way directors are remunerated. Directors' remuneration incentivises them to achieve the corporate purpose, assessed through metrics such as total shareholder return and earnings per share.[97] The directors' remuneration predominately vests over three years, but net zero targets are set between 2030 and 2050. The long-term consequences for the company of any decisions made by current directors will be borne by future incumbents. As such, directors of today will not be primarily concerned with the future consequences of climate risk when their rewards are based on more immediate pressures, such as their own remuneration or re-election.[98] The incentive structure for directors to maximise the value of the company is then inherently in tension with what is best for the environment.[99]

*ClientEarth* shows that with private ordering alone some boards will not lightly act in the interest of the environment if it affects the interests of the company, with Shell's strategy committing to new investments in fossil fuels projects.[100] To address this friction, it is argued that better public ordering of corporate strategy is needed if the UK is to fully decarbonise its power supply by 2035.[101] Regulation needs to require companies to move to cleaner energy rather than leaving it to the board to decide whether it is in the interests of the company or not.

Banning certain activities, such as drilling for oil and gas, may well be treated with hostility as a matter of principle, but should not be ruled out.[102] Perhaps a more palatable option is to regulate how corporate strategy on climate risk should be managed. A one-size-fits-all model is unlikely to be appropriate[103] and it may

93. See, for example, H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439; C Mayer, 'Corporate Governance, Competition and Performance' (1997) 24 *Journal of Law and Society* 152 at 155.
94. CA 2006, s. 172(1); The Companies (Model Articles) Regulations 2008 No 3229, Sch. I Art 3, Sch. III, Art 3.
95. See, for example, Hansmann and Kraakman, above n. 93; D. Gibbs-Kneller, D. Gindis, and D. Whayman, 'Not by Contract Alone: The Contractarian Theory of the Corporation and the Paradox of Implied Terms (2022) 23 *European Business Organization Law Review* 573; D. Attenborough, 'Empirical Insights into Corporate Contractarian Theory' (2017) 37(2) *Legal Studies* 191; M. Moore, *Corporate Governance in the Shadow of the State* (Hart Publishing, 2013).
96. See, for example, J. Coffee, 'Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role' (1989) 89 *Columbia Law Review* 1618.
97. See Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); albeit some firms may include other metrics but there is no common approach. See, for example, R. Ritz, 'Linking Executive Compensation to Climate Performance' (2022) 64(3) *California Management Review* 125.
98. See, for example, J. Deckop, K. Merriman, and S. Gupta, 'The Effects of CEO Pay Structure on Corporate Social Performance' (2006) 32(3) *Journal of Management* 330.
99. For a general exposition of this tension, see, for example, M. Roe, H. Spamann, J. Fried, and C. Wang 'The Sustainable Corporate Governance Initiative in Europe' (2020–2021) 38 *Yale Journal on Regulation Bulletin* 133; D. Park, 'The Board's Role in Sustainability Governance: Connecting Long-Term Value Creation and Executive Compensation' in R. Leblanc (ed) *The Handbook of Board Governance: A comprehensive guide for public, private, and not-for-profit board members* (Wiley, 2016) ch 31.
100. *ClientEarth* 2, above n. 1 at [39].
101. See *Net Zero Strategy: Build Back Greener*, above n. 3 at p 19.
102. BBC, 'Rishi Sunak defends granting new North Sea oil licences' BBC (31 July 2023), at https://www.bbc.co.uk/news/uk-scotland-66354478
103. See, *Net Zero Strategy: Build Back Greener*, above n. 3 at p 20 which notes that some industries rely on low carbon energies.

be difficult to agree on accepted methodology on reducing emissions, as *ClientEarth* evidenced. Instead, the UK could learn from private efforts to reduce emissions in specific sectors, such as shipping,[104] and mandate that they are reduced in accordance with the Paris Agreement, leaving the flexibility to individual companies to determine how to meet that target. An alternative is to learn from other jurisdictions, such as Fiji or the European Union, which places specific obligations on directors in the discharge of their duty of care,[105] something not present under the UK's statutory duty.[106] A failure to exercise that care may then become an actionable breach of duty that shareholders could enforce derivatively.[107] While rules on directors' remuneration could be amended to require incentives to meet environmental goals, it should be part of a wider effort to ensure companies reduce their emissions. Such incentives in isolation are unlikely to have a meaningful impact on director behaviour to prefer environmental goals over corporate purpose.[108]

## Conclusion

*ClientEarth* confirms that corporate strategy on climate risk is an autonomous decision for the directors and is not prima facie actionable under ss. 172 and 174 when shareholders disagree on whether it is a reasonable strategy. It also confirms prima facie breaches are not worth powder in shot to pursue such breaches derivatively because of the court's deference to discretionary principles and English rule on costs. ClientEarth's appeal is unlikely to change that.

The legal duties described above do not prevent a director from aligning corporate purpose with environmental goals. Many companies do so. Nonetheless, by leaving the decision of corporate strategy to the board of directors, the friction between corporate purpose and environmental law goals presents a distinct problem to the UK meeting its international climate obligations. Left to the status quo, directors are incentivised to prefer the interests of the company. Public ordering must be considered to address this friction so that companies adopt strategies that meet environmental law goals. The status quo, however, remains for now because, for 'ground-breaking' derivative litigation, ClientEarth did not break soil.

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104. For discussion on climate clauses in shipping see, for example, P. Reblo, 'Climate clauses in charterparties' (2023) 23(5) *Lloyd's Shipping & Trade Law*; P. Reblo, 'BIMCO's Carbon Intensity Indicator Clause (CII) for time charters: towards a new era of climate drafting' (2022) 28 JIML 240.
105. See, J. Setzer and C. Higham, 'Global Trends in Climate Change Litigation: 2023 Snapshot' (London School of Economics and Political Sciences' Grantham Research Institute, 2023) at [38]; citing Figi's Climate Change Act; European Parliament's proposed Corporate Sustainability Due Diligence Directive; T. Chan and C. Higham, 'Evolving regulation of companies in climate change framework laws' London School of Economics (21 February 2023), at https://www.lse.ac.uk/granthaminstitute/news/evolving-regulation-of-companies-in-climate-change-framework-laws/
106. *ClientEarth* 2, above n. 1 at [20]–[37].
107. CA 2006, s. 174; *Lexi Holdings*, above n. 28 which held the failure to oversee the corporate strategy complies with the law would be a recognised actionable breach of duty for failing to monitor the company's affairs.
108. See, for example, Ritz, above n. 97.