

Directors' duties and climate change: navigating the shifting landscape of corporate environmental responsibility

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Introduction

In 2019, I gave a lecture comparing the response of company law in Australia and England & Wales to the growing challenges presented by climate change.¹ I noted that it was a feature of company law that company directors have a wide discretion about how to respond to the impact of climate change. Accordingly, civil society should press for responses from them which would align with the objective of reducing carbon emissions. But I also argued that in certain circumstances companies' interests might be so affected by climate change impacts that directors could come under a duty to cause their companies to take action to reduce their contribution to carbon emissions. Six years on, there have been significant environmental, political, economic and legal developments in this area.

The impact of climate change continues to be felt with ever growing intensity in the environment. The years 2023 and 2024 were in turn the hottest on record. 2024 saw the breach of the temperature limit set by the Paris Agreement on Climate Change 2015, the treaty in which states set the aim of keeping global temperatures below 1.5 °C above pre-industrial levels.² Extreme weather events have occurred across the globe. The UK had a severe drought in 2022 (the joint hottest summer on record)³ and 2024 brought severe floods and the wettest 12 months in England since 1836.⁴ The financial risk posed by the intensification of climate change is significant. The Bank of England estimates that inaction could result in billions of pounds of losses.⁵ Risks range from increased damage to physical assets from extreme weather to increased exposure to climate change related litigation.

* I am grateful to my Judicial Assistant, Monty Fynn, for his invaluable assistance in the preparation of this lecture.

¹ 'Directors' Duties and Climate Change: Keeping Pace with Environmental Challenges' (Anglo-Australasian Law Society, Sydney, 27 August 2019) <<https://supremecourt.uk/speeches/lord-sales-at-the-anglo-australasian-law-society-sydney>> accessed 14 February 2024.

² Copernicus, '2024 Is the First Year to Exceed 1.5°C above Pre-Industrial Level' <<https://climate.copernicus.eu/copernicus-2024-first-year-exceed-15degc-above-pre-industrial-level>> accessed 14 February 2025.

³ 'Joint Hottest Summer on Record for England - Met Office' <<https://www.metoffice.gov.uk/about-us/news-and-media/media-centre/weather-and-climate-news/2022/joint-hottest-summer-on-record-for-england>> accessed 14 February 2025.

⁴ 'National Drought Group Discusses Preparations for Extreme Weather' (GOV.UK) <<https://www.gov.uk/government/news/national-drought-group-discusses-preparations-for-extreme-weather>> accessed 14 February 2025.

⁵ Bank of England, 'Results of the 2021 Climate Biennial Exploratory Scenario (CBES)' <<https://www.bankofengland.co.uk/stress-testing/2022/results-of-the-2021-climate-biennial-exploratory-scenario>> accessed 12 February 2025.

In politics, the consensus that emerged following the Paris Agreement has fractured. There is strong disagreement between politicians advocating for greater action to mitigate climate change and those who are sceptical about the benefits of these measures. In November 2020, Donald Trump formally withdrew the United States from the Paris Agreement, arguing it placed an unfair economic burden on American workers.⁶ That was reversed by Joe Biden, who also engaged in large green infrastructure investments to combat climate change. When Donald Trump returned to the presidency in 2025, he again caused the United States to withdraw from the Paris Agreement and halted Biden's green infrastructure investments.⁷

In 2020 the European Commission approved the 'European Green Deal' with the aim of becoming the first carbon-neutral continent by 2050.⁸ This too has come under increasing criticism, with French President Emmanuel Macron and other leaders calling for a pause in the roll out of EU environmental regulation.⁹

In the UK politicians, companies and the public disagree over when, how and, sometimes, if, the UK should act on the climate. Labour's 2024 election manifesto committed to a zero-carbon electricity system by 2030.¹⁰ The Conservative opposition argue that an overreliance on renewables without the backup of traditional energy sources could leave the country vulnerable to energy shortages and undermine economic growth.¹¹

In the economic domain the early 2020s saw the rise of 'ESG-investing', which emphasises environmental, social, and governance considerations in addition to financial returns. This also reflected a growing awareness that climate change could have significant financial implications for companies. There was a rise in ESG-activism, where shareholders use their rights to influence a company's policy, including by electing directors who align with their sustainability objectives. For example, in June 2021, Engine No. 1, an ESG hedge fund, successfully replaced a quarter of the board of directors for the American oil giant ExxonMobil. Engine No. 1 won the support of other shareholders by arguing that the company's denial of climate change and failure to diversify towards renewables was partly to blame for its disappointing financial returns.¹² However, there has been criticism of ESG-investing, with some arguing that it

⁶ 'Climate Change: US Formally Withdraws from Paris Agreement' *BBC News* (4 November 2020) <<https://www.bbc.com/news/science-environment-54797743>> accessed 12 February 2025.

⁷ 'Putting America First in International Environmental Agreements' (*The White House*, 20 January 2025) <<https://www.whitehouse.gov/presidential-actions/2025/01/putting-america-first-in-international-environmental-agreements/>> accessed 14 February 2025; Amanda Chu and Jamie Smyth, 'Donald Trump Halts More than \$300bn in US Green Infrastructure Funding' *Financial Times* (22 January 2025) <<https://www.ft.com/content/fcaf50dc-6779-44d2-a7fa-264df798a4c1>> accessed 14 February 2025.

⁸ European Commission, 'The European Green Deal' (14 July 2021) <https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en> accessed 14 February 2025.

⁹ Leila Abboud, Roula Khalaf and Ben Hall, 'Europe Must Respond to Trump "Electroshock"', *Financial Times* (14 February 2025) <<https://www.ft.com/content/1ee43b51-9d3a-47d2-adf6-3315c38e1c38>> accessed 25 February 2025.

¹⁰ 'Make Britain a Clean Energy Superpower' (*The Labour Party*) <<https://labour.org.uk/change/make-britain-a-clean-energy-superpower/>> accessed 12 February 2025.

¹¹ Anna Gross, Jim Pickard and Rachel Millard, 'Britain's Political Consensus on Climate Starts to Fracture' *Financial Times* (24 November 2024) <<https://www.ft.com/content/ab0cb3fc-e45d-454b-83d9-c0284550aafe>> accessed 25 February 2025.

¹² 'Can a Tiny Hedge Fund Push ExxonMobil Towards Sustainability?' <<https://hbr.org/2021/01/can-a-tiny-hedge-fund-push-exxonmobile-towards-sustainability>> accessed 14 February 2025.

undermines market efficiency and imposes ideological agendas on corporate governance.¹³ Other critics have argued it is an ineffective substitute for government action on the climate.¹⁴ Engine No 1 has now dropped its activism and voted against a shareholder resolution that called for ExxonMobil to reduce its emissions.¹⁵ In August last year, BlackRock, the world's largest investment firm, stated it had significantly reduced its support for shareholder proposals addressing ESG issues, having previously supported 47% of such proposals in 2021.¹⁶ A report for the organisation ShareAction in February 2025 charts the decline in shareholder activism on ESG matters.¹⁷

Over the past six years the English courts have seen the first cases in which claimants have alleged that company directors managing a corporate pension fund trustee breached their duties by failing to act on climate change. In *ClientEarth v Shell*,¹⁸ an environmental NGO alleged that Shell's directors breached their duties by failing to adopt an adequate climate change risk management strategy. In *McGaughy v Universities Superannuation Scheme*,¹⁹ university pension fund members claimed that the fund's directors acted in breach of duty by failing to divest from fossil fuels, exposing the fund to the financial risks associated with climate change.

In this lecture, I reflect on these cases. They illustrate the difficult issues that will arise as the courts begin to grapple with the interaction between directors' duties and the evolving political and economic landscape surrounding corporate environmental responsibility.

1. The legal framework for directors' duties: The Companies Act 2006

The Companies Act 2006 provides the legal framework for directors' duties in England & Wales. Companies are considered legal persons in their own right, distinct from the human agents who own and control them. As artificial persons, companies rely on human agents to act for them and carry on their business. These agents include, most importantly, a company's directors.

The separation of the legal personality of the company from its shareholders and directors has many advantages. It means that the company can own assets, incur liabilities and enter into contracts independently from any natural person, encouraging risk-taking and incentivising economic growth. The corporate structure also ensures continuity beyond the involvement of any single individual, as directors can be replaced or appointed without disrupting the company's operations. Similarly, the large publicly listed companies which dominate modern

¹³ Brooke Masters and Patrick Temple-West, 'The Real Impact of the ESG Backlash' *Financial Times* (4 December 2023) <<https://www.ft.com/content/a76c7feb-7fa5-43d6-8e20-b4e4967991e7>> accessed 25 February 2025.

¹⁴ Silvia Amaro, 'Blackrock's Former Sustainable Investing Chief Now Thinks ESG Is a "Dangerous Placebo"' (CNBC, 24 August 2021) <<https://www.cnbc.com/2021/08/24/blackrocks-former-sustainable-investing-chief-says-esg-is-a-dangerous-placebo.html>> accessed 12 February 2025.

¹⁵ Ortenca Aliaj and Derek Brower, 'Exxon Nemesis Engine No. 1 Drops Activism in Hunt for New Identity' *Financial Times* (9 August 2023) <<https://www.ft.com/content/dc94222a-e6d9-43fa-aada-51e45c6d6ad0>> accessed 12 February 2025.

¹⁶ Michael Posner, 'How BlackRock Abandoned Social And Environmental Engagement' (*Forbes*, 9 September 2024) <<https://www.forbes.com/sites/michaelposner/2024/09/04/how-blackrock-abandoned-social-and-environmental-engagement/>> accessed 12 February 2025.

¹⁷ ShareAction, *Voting Matters 2024: Are asset managers using their proxy votes for action on environmental and social issues* (18 February 2025) <<https://shareaction.org/reports/voting-matters-2024>> accessed 25 February.

¹⁸ [2023] EWHC 1137 (Ch).

¹⁹ [2023] EWCA Civ 873.

economic life are owned by shareholders, sometimes numbering in their millions, and it would be impossible for them to manage the company's day-to-day operations collectively. Instead, it is the directors, acting as the company's agents, who run the business on behalf of shareholders.

However, the corporate structure also carries risks, as directors may prioritise their own interests over those of the company, or act negligently by failing to exercise proper oversight, leading to financial mismanagement and disastrous consequences for the company. This is a problem as old as the idea of the company itself. In the eighteenth century, when limited liability companies (then called 'joint stock companies') were beginning to emerge as the dominant business structure, the Scottish economist Adam Smith argued that:

‘The directors of such companies, being the managers of other people's money rather than of their own, cannot be expected to watch over it with the same anxious vigilance with which the partners in a private partnership frequently watch over theirs. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.’²⁰

Academics continue to debate whether Smith was right that a director will always run a company with less diligence than a partner with personal liability for a company's assets,²¹ but it is undeniable that directors may potentially abuse their position. English law has long recognised this risk and has addressed it by placing enforceable duties on directors. These duties were established gradually through the common law and equity, and originally derived from the duties a trustee owes to the beneficiaries of a trust. This connection to trust law is why many directors' duties are 'fiduciary' in nature, characterised by their obligation of loyalty to the company.²² Directors' duties have now been codified in Part 10 of the Companies Act 2006, the result of a major law reform programme led by the Law Commission, aimed at clarifying what was expected of directors and making the law more accessible.²³ The Companies Act places a number of general duties on directors, including to act within their powers²⁴ and to avoid conflicts of interest.²⁵

There are two sets of duties particularly relevant to climate change. First, section 172 provides that a director must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. The test to be applied in relation to this duty is normally subjective.²⁶ This follows the common law position, as articulated by Lord Greene MR in *Re Smith and Fawcett Ltd*, that directors “must

²⁰ Paraphrased from Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776, Roy H Campbell and Andrew S Skinner eds, W B Todd textual ed, 2 vols, Clarendon 1976) Book V, Ch 1, §107.

²¹ Gary M Anderson and Robert D Tollison, 'Adam Smith's Analysis of Joint-Stock Companies' (1982) 90 *Journal of Political Economy* 1237.

²² Sharif Shivji KC and others, 'Opinion: Nature-Related Risks and Directors' Duties under the Law of England and Wales' [42] <<https://commonwealthclimatelaw.org/company-directors-should-consider-companys-nature-related-risks-including-climate-risks-landmark-english-law-legal-opinion/>> accessed 14 February 2025.

²³ Mark Arnold KC, 'General Duties of Directors' in Mark Arnold KC and Simon Mortimore KC (eds), *Company Directors: Duties, Liabilities, and Remedies* (Oxford University Press 2024) 10.04.

²⁴ Companies Act 2006, s 171.

²⁵ *ibid*, s 175.

²⁶ Ekaterina Aristova and Lionel Nichols, 'Climate Change on the Board: Navigating Directors' Duties' [2024] *Journal of Corporate Law Studies* 1, 4.

exercise their discretion bona fide in what they consider—not what a court may consider—is in the interests of the company”.²⁷ Thus, the primary question for the court is “whether the particular director believes his actions were in the interests of the company, not whether with the benefit of hindsight the court finds it was not in the interests of the company or what the court might have done in the director’s place”.²⁸ This subjective test creates a high hurdle for claimants alleging a breach of duty in the domain of climate risk, because generally so long as directors consider the implications of climate change in good faith there will be no breach. However, the subjective test is transformed into an objective one where a director has not considered at all whether an action was in the interests of the company. Then the test becomes whether an intelligent and honest person in the position of the director could, in all the circumstances, have reasonably believed that the actions were for the benefit of the company.²⁹ The objective test also applies where the director unreasonably fails to take into account a “very material interest”.³⁰ This objective test could apply where a director completely fails to take into climate risk, or does not do so in good faith, leaving them more vulnerable to being found to be in breach of duty.³¹

The success of the company under section 172 is primarily understood in a financial sense. However, it also imposes a duty to have regard to six factors specified in section 172(1)(a)-(f). These include the likely consequences of any decision in the long term, the interests of the company’s employees and the impact of the company’s operations on the environment. This was one of the principal reforms introduced by the 2006 Companies Act and reflects Parliament’s intention of introducing the concept of ‘enlightened shareholder value’ into company law. Under this approach, directors are required to act in the collective best interests of shareholders but should not focus solely on short-term financial benefits. Instead, directors should make decisions that will maximize shareholder value in the long term.

The ‘duty to have regard’ therefore explicitly recognises the connection between the financial interests of a company and its impact on the environment. Such an approach is particularly relevant given the risk of climate change to a company’s long term financial position, for instance, where disregard for the environment may lead to adverse publicity or higher long-term production or supply costs resulting from short-sighted board decisions driven primarily by immediate profitability and returns on investment. Nevertheless, it is important to recognise that, whilst enlightened in this sense, the focus remains on shareholder value. The Act does not adopt a ‘pluralist approach’ to directors’ duties, whereby companies should be “required to serve a wider range of interests, not subordinate to, or as a means of achieving, shareholder value but as valuable in their own right”.³²

Another important aspect of this supplemental duty is that it is procedural in nature. By framing it as a duty ‘to have regard’, Parliament appears to have deliberately eschewed an outcome-based approach to wider social and environmental factors. Parliament also declined

²⁷ [1942] Ch 304, 306.

²⁸ *Regentcrest plc v Cohen* [2001] BCC 494 [120] (Parker J).

²⁹ *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 62, 74 (Pennycuik J).

³⁰ *Re HLC Environmental Projects Ltd* [2013] EWHC 2876 (Ch) [92].

³¹ Shivji KC and others (n 22) 37.

³² Mark Arnold KC and Marcus Haywood, ‘Duty to Promote the Success of the Company’ in Mark Arnold KC and Simon Mortimore KC (eds), *Company Directors: Duties, Liabilities, and Remedies* (Oxford University Press 2024) 12.02.

to ascribe any presumptive weight to any of the factors, which are also strictly non-exhaustive (as denoted by the words “amongst other matters”). This is borne out by the explanatory notes to section 172, which stress that it “codifies the current law and enshrines in statute what is commonly referred to as the principle of ‘enlightened shareholder value’” and is not intended to challenge a director’s “good faith judgment”.³³ The proviso to this in the explanatory notes is that “[i]t will not be sufficient to pay lip service to the factors, and, in many cases the directors will need to take action to comply with this aspect of the duty.”³⁴ This procedural duty imposes an obligation on directors to consider climate change, but it does not impose a duty to achieve any particular outcome.

The second relevant duty is found in section 174, which provides that a director must exercise reasonable care, skill and diligence. The standard of care is defined by the Act as primarily objective, with the courts requiring a director to act with “the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company”.³⁵ The Act also provides a subjective element by adding that the general knowledge, skill and experience of a particular director will be taken into account. But this subjective element cannot be used to water down the objective element of the test: if a particular director has less knowledge than can reasonably be expected of them, this does not mean they will escape liability. Instead, the subjective element establishes that if a director possesses greater knowledge than would reasonably be expected of someone in their role, they will be held to a higher standard.³⁶ However, whilst it is an objective duty, it is important to remember that the relevant standard is that which can *reasonably* be expected of a director. Therefore, the question for the court is whether the decision falls outside the range of decisions reasonably available to a director in their position.³⁷ This will vary depending on the type of business and the prevailing economic conditions. It may also change over time. This creates challenges for a court determining the appropriate standard of care in light of the increasing intensity of climate change on the one hand, and on the other, the fractured political and economic landscape which directors must currently navigate.

Turning from the duties themselves to their enforcement, the Companies Act makes clear that a director’s duties are owed to the company.³⁸ It is therefore the company which has the right to enforce any breach of these duties. This creates difficulties for enforcement as it is primarily the board of directors, as the company’s agent, which has the power to initiate litigation;³⁹ but, for obvious reasons, it is unlikely that directors will take action against themselves. The alternative is for a shareholder to seek to obtain the permission of the court to bring a derivative claim against the directors in the name of the company.⁴⁰ The procedure begins with an initial application to the court for permission to proceed with the claim. The court must first assess whether the application and supporting evidence establish a *prima facie*

³³ Explanatory notes to section 172 of the Companies Act 2006 at [325]-[327].

³⁴ *ibid* at [328].

³⁵ Companies Act 2006, s 174(2)(a).

³⁶ *Brumder v Motornet Service and Repairs Ltd* [2013] 1 WLR 2783 [46], cited in Shivji KC and others (n 22) [71].

³⁷ *Sharp v Blank and others* [2019] EWHC 3096 (Ch) [631] (Norris J)

³⁸ Companies Act 2006, s 170(1).

³⁹ *Foss v Harbottle* (1843) 2 Hare 461, 67 ER 189.

⁴⁰ Companies Act 2006, s 261.

case for granting permission; if they do not, the claim must be dismissed at this stage.⁴¹ Additionally, the court must consider specific factors when deciding whether to grant permission, including whether the applicant is acting in good faith in seeking to pursue the claim.⁴² It is the derivative action that has primarily been the vehicle for the first cases in the English courts regarding climate change and breach of director's duties.

There is also previous case law from the 1980s and 1990s on ethical investment decisions by pension fund trustees.⁴³ In *Cowan v Scargill*⁴⁴ the court addressed the issue of excluding investments in energy companies competing with coal from the investment policy of a miners' pension fund. The court held that the trustees must put aside their personal interests and simply achieve the best financial return for the fund beneficiaries. *Harries v Church Commissioners for England*⁴⁵ concerned a boycott on investment in companies from South Africa during the period of apartheid. It was held that the Commissioners' policy of excluding investments in certain business activities which would be likely to be offensive to some members of the Church of England on moral grounds was proper, because an adequate range of other investments remained open to satisfy the financial requirements of the pension fund. However, the court also held that the Commissioners were right to refuse to adopt a more restrictive policy which entailed taking into account non-financial considerations to an extent which would give rise to risk of significant financial detriment to the fund. Such a policy would conflict with the duty of the fund trustees to safeguard the financial returns provided by the pension fund.

2. The first legal challenges concerning climate change and directors' duties

I turn to the recent legal challenges concerning climate change and directors' duties. In *ClientEarth v Shell*⁴⁶ the claimant was an environmental organisation seeking to use the law to combat climate change. It held 27 ordinary shares in Shell, the multinational oil company, which entitled it to seek permission to bring a derivative claim against the directors. ClientEarth argued that Shell's directors had breached their duties to the company by failing to take adequate action in response to climate risks for Shell's financial position. Those risks were said to be commercial, regulatory, societal and physical.⁴⁷ They included changes in regulatory regimes leading to restrictions on greenhouse gas emissions, and rising public concern regarding fossil fuels resulting in a decrease in demand and which could result in its oil and gas assets becoming stranded, that is not capable of profitable utilisation. In order to

⁴¹ *ibid.*

⁴² *ibid.*, s 263.

⁴³ For comparison, see *Withers v NY Teachers Retirement System* (1978) 447 F Supp 1248. The Court of Appeals for the Second Circuit approved an investment by the teachers' pension fund in New York City Bonds as part of the plan to stave off the City's bankruptcy. The lower return compared to other investments was justified because of the risk that, if not made, the City would cease being able to contribute to the pension fund.

⁴⁴ [1985] Ch 270 (Ch).

⁴⁵ [1992] 1 WLR 1241 (Ch).

⁴⁶ [2023] EWHC 1137 (Ch). See the case note at (2025) 46 *The Company Lawyer* 135.

⁴⁷ ClientEarth, 'Particulars of Claim' [23]-[24] <<https://www.clientearth.org/latest/documents/particulars-of-claim-clientearth-s-case-against-shell-s-board-of-directors/>> accessed 15 February 2025.

be given permission to bring a derivative claim, ClientEarth had to establish a prima facie case of breach of duty.⁴⁸ Mr Justice Trower held it failed to do this.

ClientEarth relied on both the duty to promote the success of the company in section 172 and the duty to exercise reasonable care, skill and diligence in section 174. It was argued that there were six incidental duties regarding climate risk to which those general duties gave rise.⁴⁹ These included a duty to make judgments regarding climate risk that are based upon a reasonable consensus of scientific opinion and a duty to adopt strategies which are reasonably likely to meet Shell's targets to mitigate climate risk. The judge held ClientEarth's attempt to establish these incidental duties was misconceived, as they sought to impose specific obligations on directors as to how the management of Shell's business should be conducted. This was contrary to the subjective nature of the duty in section 172, which meant it was for directors to determine in good faith how to promote the success of the company.⁵⁰ Similarly, the only question under section 174 was whether the directors had exercised reasonable care, skill and diligence and the law did not "superimpose on that duty more specific obligations as to what is and is not reasonable in every circumstance".⁵¹

The judge considered whether Shell had made out a prima facie breach of the two general duties. The core of ClientEarth's case related to Shell's 'energy transition strategy', which set an overall target to become a net zero business by 2050 and comply with the global temperature objective of 1.5°C under the Paris Agreement. ClientEarth claimed that Shell had failed to put in place policies reasonably capable of achieving those objectives.⁵² It was claimed that Shell's strategy did not set out a realistic pathway to achieving Shell's stated ambition of achieving net-zero by 2030;⁵³ that Shell's directors proposed to make significant new investments in fossil fuel projects; and that Shell was failing to comply with an order of a Dutch court, which had imposed a 45% emissions reduction obligation on Shell to be achieved by 2030.⁵⁴

The judge found there was no prima facie breach of duty. The evidence for ClientEarth was given by a senior lawyer, who did not have expertise in climate science, or oil and gas economics; so it carried little weight.⁵⁵ There was no universally accepted method for achieving emissions reductions and therefore no basis for concluding that no reasonable board of directors could adopt Shell's pathway to achieving its goals.⁵⁶ ClientEarth argued that Shell's policies to achieve net-zero by 2050 were manifestly unreasonable; however, ClientEarth's evidence did not engage with the issue of how Shell's directors had gone wrong in their balancing of the competing considerations regarding climate risk and therefore did not demonstrate it was unreasonable.⁵⁷ As for the Dutch order, this had given Shell complete freedom as to how to achieve the 45% emissions reduction target and there was no *prima facie* case that Shell had failed to comply.

⁴⁸ *ClientEarth* (n 46) [9] (Trower J)

⁴⁹ *ibid* [16].

⁵⁰ *ibid* [19].

⁵¹ *ibid* [20].

⁵² Lord Carnwath, 'ClientEarth v Shell: What Future for Derivative Claims?' 3.

⁵³ *ClientEarth* (n 46) [38].

⁵⁴ *Milieudefensie v Royal Dutch Shell*, District court of The Hague, 26 May 2021, ECLI:NL:RBDHA:2021:5339.

⁵⁵ *ClientEarth* (n 46) [46].

⁵⁶ *ibid* [47].

⁵⁷ *ibid* [48].

The judge also considered the relief sought by ClientEarth was inappropriate. ClientEarth had sought a mandatory injunction, requiring Shell to implement a strategy to manage its climate risk, which conflicted with the general principle that injunctions will not be granted where they would require constant supervision by the Court.⁵⁸ The judge held that the declaratory relief sought by ClientEarth did not serve a legitimate purpose.⁵⁹ Finally, the judge held that the claim was not being brought in good faith, because ClientEarth's primary purpose in bringing the claim was not to benefit the company but to advance ClientEarth's own policy agenda.⁶⁰ The judge ordered ClientEarth to pay Shell's legal costs at the permission stage.

*McGaughey v Universities Superannuation Scheme*⁶¹ concerned a dispute between academics and the directors of the corporate trustee of their pension fund scheme. The relevant allegation was that the directors continued to invest in fossil fuels without an immediate plan for divestment contrary to the scheme's long-term interests. It was alleged that this prejudiced the financial success of the company in breach of the duty in section 172.

This was not a normal derivative action as the claimants were not shareholders in the corporate trustee, but instead were members of the pension scheme managed by it. They argued that they could bring a 'multiple derivative action', on the model of that allowed where shareholders of an ultimate holding company of a group have been permitted to bring proceedings against directors of a subsidiary company even though there are intermediate companies holding shares in between them.⁶² For this sort of claim the claimants had to show they had suffered a loss that was reflective of the subsidiary company's loss.⁶³

The claim was dismissed. The claimants failed to provide sufficient evidence of a financial detriment suffered by the company or the claimants themselves as a result of the directors' decision to continue to invest in fossil fuels. The claimants did not challenge the principle laid down in *Cowan v Scargill* held that a fund trustee's duty is primarily to act in the best financial interests of the fund beneficiaries, rather than making investment decisions based on ethical considerations.⁶⁴ The claimant's lack of evidence of any financial loss was therefore fatal.⁶⁵ On appeal the Court of Appeal upheld the judge's reasoning in all material respects.⁶⁶

3. Analysis: lessons from *ClientEarth* and *McGaughey* for the future of directors' duties and climate change

What do these cases tell us about the interaction of directors' duties and climate change?

First, in both cases the claimants' were constrained to focus on the financial implications of the directors' inaction on climate change. This is because shareholder value, in financial terms, is central under the Companies Act regime. But it is perhaps surprising that there was no reference to the concept of 'enlightened shareholder value' and the duty to have regard to

⁵⁸ *ibid* [57].

⁵⁹ *ibid* [58].

⁶⁰ *ibid* [64].

⁶¹ [2022] EWHC 1233 (Ch).

⁶² *ibid* [18].

⁶³ *ibid* [30].

⁶⁴ *ibid* [188].

⁶⁵ *ibid* [194].

⁶⁶ [2023] EWCA Civ 873 esp [122] and [169]-[175].

the environment in section 172. Whilst this duty is procedural in nature, the explanatory notes state that it cannot be satisfied by “mere lip service” which, in essence, was what ClientEarth was alleging was all that Shell had given in its climate action policy. Additionally, in my lecture in 2019, I argued that Parliament’s express endorsement of an ‘enlightened shareholder value’ approach casted a shadow over the *Cowan v Scargill* approach. Further, the rise of ESG-investing places pressure on the idea that investors are concerned solely with financial returns. But as there was no challenge to *Cowan v Scargill* these points remain to be explored.

Second, in both cases the claimants’ lack of evidence was fatal. This absence of evidence is somewhat surprising, given that there would seem to be plenty of experts who could give evidence. Perhaps it was too expensive to obtain such evidence. However, this leaves open the possibility that, if claimants can provide stronger factual evidence of financial harm, a claim may be more likely to succeed. However, given the debate regarding how to combat and adjust to climate change it is likely that opposing expert evidence would be called as well. A court may have difficulty in adjudicating such a dispute, and the nature of the directors’ duties would make it difficult for a claimant to show a breach. But it is possible that with better quality evidence a claimant could get over the permission stage for these sorts of claims.

Third, the subjective nature of the duty under section 172 was critical to the outcome in both cases. The directors had given consideration to climate risk and the subjective nature of the duty meant that the claimants faced a very difficult task. A claimant would be in a stronger position if directors have not considered climate risk at all. That is going to be unlikely. Perhaps, however, it might be shown that failed to consider specific climate risks, such as threats to particular assets from the growing frequency of extreme weather events. Given the increasingly widespread nature of climate change impacts, it may become more difficult for directors to monitor and consider them.

Fourth, the judgment in *ClientEarth* reaffirms that when a director’s care and skill is challenged under section 174, the test is whether the decision falls outside the range of decisions reasonably available to a director in their position. The judge did not have to consider this in detail as the claimants had failed to identify how they said the directors had gone wrong in balancing different factors. The test under section 174 is similar to that of *Wednesbury* reasonableness in public law.⁶⁷ The case law in this area shows that this is a high hurdle for a claimant to meet, but it is not impossible and there are public law cases concerning climate change where decisions have been found to be unreasonable.

In 2024 the High Court found that the Secretary of State had acted irrationally when adopting the Government’s carbon budget required under the Climate Act 2008 as part of the strategy to achieve net zero greenhouse gas emissions by 2050.⁶⁸ There was an unexplained evidential gap which failed to justify the Secretary of State’s conclusion.⁶⁹

In the judgment of the Grand Chamber of the European Court of Human Rights of 9 April 2024 in *Verein KlimaSeniorinnen Schweiz v Switzerland*⁷⁰ the court found a violation of human rights protections by the Swiss government in relation to impacts on the health of the

⁶⁷ *Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223.

⁶⁸ R (*Friends of the Earth Ltd*) v *Secretary of State for Energy Security and Net Zero* [2024] EWHC 995 (Admin).

⁶⁹ *ibid* [127].

⁷⁰ [2024] ECHR 304.

population from climate change. That finding followed from the facts that Switzerland had adopted the Paris Agreement target but had in place no credible strategy about how to achieve it.

This sort of reasoning, based on absence of evidence or gaps in strategic planning to meet defined objectives, may provide a model which can be used in the company law context. Nonetheless, the extent of disagreement as to how companies should respond to climate change will inevitably tend to broaden the ambit of decisions reasonably open to a director.

Therefore, the most effective form of legal challenge is likely to be procedural in nature rather than substantive. Because there is wide scope for disagreement about how best to react to climate change in substantive terms, it is intrinsically difficult to show that directors have reached an unreasonable and untenable view on the substance of those issues. But where there are procedural duties, an emphasis on enforcing them does not involve any challenge to the authority of directors to run a company's business by making relevant *business* judgments. To enforce compliance with procedural obligations is merely to insist that directors go about forming an opinion on the substantive business merits in the correct way. The same pattern of court intervention based on procedural breaches rather than substitution of judgment on substantive matters which the courts do not have constitutional authority to decide can be seen in the public law cases.

Finally, both *ClientEarth* and *McGaughey* show how the derivative action provides a novel avenue for activist investors and others to influence company decision-making. However, *ClientEarth* also illustrates the costs risk involved where a claim fails. In practical terms, the costs associated with a claim are just as significant as the merits, given that the risk on costs may deter future claimants from bringing a claim, particularly non-profit organisations or individual claimants who lack substantial financial resources.

Standing back, *ClientEarth* and *McGaughey* show that there are significant hurdles facing potential claimants bringing claims against directors due to inaction on climate change. But it would be wrong to suggest that they mean all future cases will have the same outcome. The claims failed due, in part, to a lack of evidence and the fact that the defendants had given consideration to climate risk. Other cases may be different.

Although I reserve my own opinion, I should also refer to criticism of the judgment in *ClientEarth* in an article by a former Justice of the Supreme Court, Lord Carnwarth.⁷¹ In the article, he criticises the judge's reasoning in *ClientEarth* in several respects.

First, Lord Carnwarth questions the judge's reliance on the fact that there is no "universally accepted methodology" for achieving emissions reductions, arguing that this does not address the core issue of whether Shell's directors had implemented any credible strategy to meet their stated climate targets. In his view, the judgment failed to engage with Shell's absence of policies to achieve their stated aims, as it is not apparent from the judgment what, if any, policies were relied upon by Shell in its submissions. As for relief, whilst Lord Carnwarth agreed that a mandatory injunction would be inappropriate, he finds it harder to understand the judge's reasoning that a declaratory remedy would serve no useful purpose. Similar declarations are common in public law and the directors would have felt bound to change their

⁷¹ Carnwarth (n 52).

actions. Finally, Lord Carnwath criticises the court's finding that ClientEarth's claim was driven primarily by policy advocacy rather than the company's interests. In that regard I think it can fairly be said that the separation between financial interests and wider policy questions may become more difficult to maintain in light of the rise of ESG-activism in finance and investors and the customers from whom companies earn their profits increasingly placing as much weight on environmental factors as financial returns when making their investment and purchasing decisions.

Conclusion

I think it is safe to assume that whilst these are the first cases in this jurisdiction on directors' duties and climate change, they will not be the last. As the pressure from climate change on society, on established norms of human life and on commercial and financial interests becomes greater and more acute, the pressure on directors to respond with something other than acknowledgement followed by inaction will grow as well. Sitting behind directors are the institutions of society: government, Parliament and the courts. As the pressure from climate change looks set to increase, the pressure on those institutions to respond will increase as well. The scope for climate change litigation in future may depend on how Parliament responds to the interaction between climate change and directors' duties in two ways.

First, if Parliament lays down clearer objective standards for directors' decision-making, it may be easier for claimants to show they have been breached.

Secondly, if Parliament takes no action, but the pressures from the impact of climate change become extreme, the courts may find that they are increasingly drawn into application of standards where reasonable behaviour is informed by those pressures, the parameters of what qualifies as reasonable are narrowed, and it becomes increasingly viable for claimants to bring claims against directors because of the smaller margin of reasonable judgment which in consequence is available for those directors. The pressure imposed by climate change on the political and legal system may make it difficult for company directors to avoid demands for a more active response from them in their conduct of business activities.

Although much has changed in the six years since I last visited this topic, and the pressure on society from climate change has increased, the law as to how that impacts on directors' duties remains relatively undeveloped. That pressure from climate change is not going away. It is increasing. In one way or another, that is likely to filter down to affect the conduct expected of company directors.

Thank you.