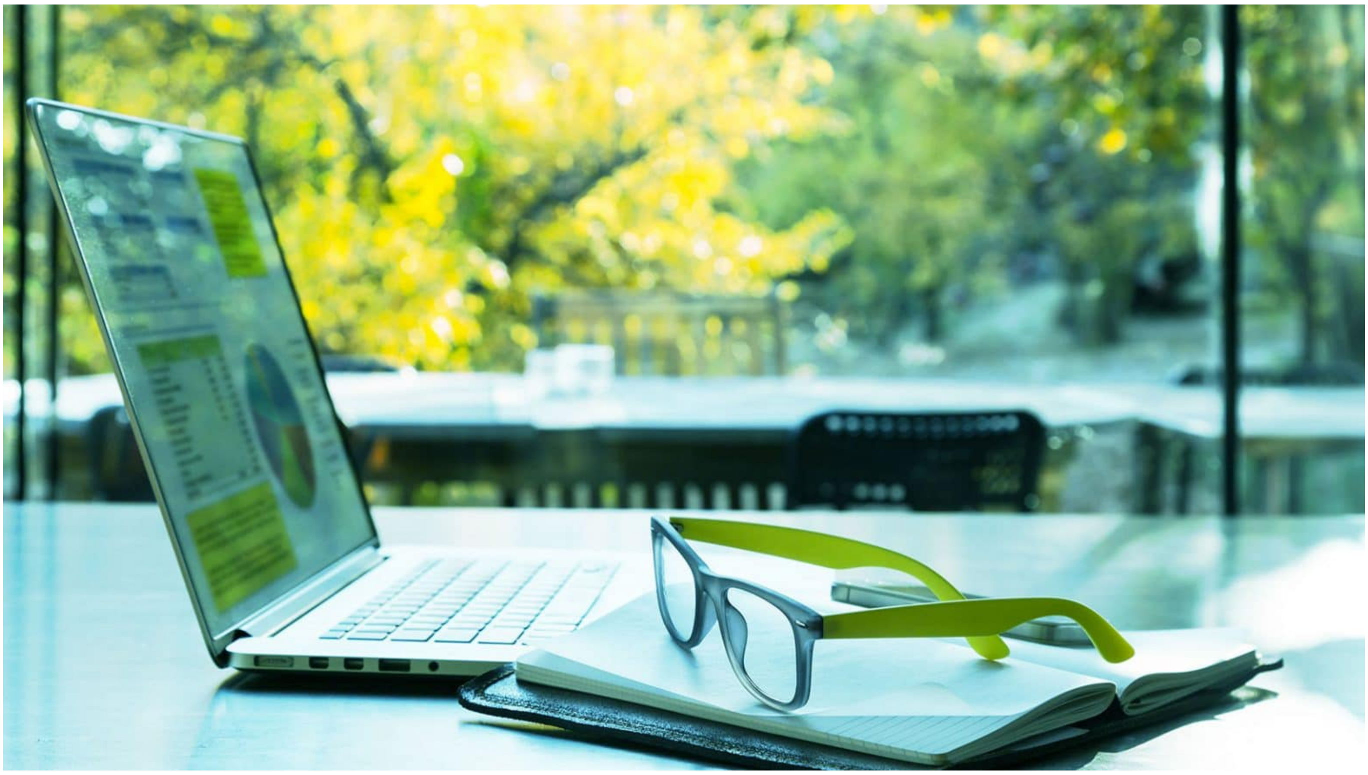
Reshaping director duties: ESG and corporate responsibility



In recent years, companies have faced increasing scrutiny from investors and consumers regarding their incorporation of ESG (Environmental, Social, and Governance) principles into their operations. This growing emphasis has given rise to a growing trend in the legal sphere: ESG shareholder activism. With society's growing expectations for corporate responsibility, particularly in the context of climate change, the questions arise: how do these expectations align with directors' duties, and can shareholders hold directors accountable for their ESG policies?

Since the introduction of the Companies Act 2006, directors are required to consider the impact of a company's operations on the wider community and the environment. Activist shareholders are increasingly seeking to utilise this provision to target directors who have fallen short of their ESG responsibilities.

An illustrative case in this context is *ClientEarth v Shell plc* [2023] EWHC 1897 (Ch), where ClientEarth, a minority shareholder in Shell and climate activist charity, sought permission to pursue a derivative claim against the company's directors. ClientEarth alleged that these directors breached their duties by inadequately managing the company's climate change strategy. They argued that the directors acted irrationally by failing to set appropriate targets for achieving the company's goal of becoming a net-zero energy business by 2050. Additionally, they claimed that the directors disregarded an order from the Hague District Court, further alleging breaches of their Companies Act duties to promote the company's success and to exercise reasonable care, skill, and diligence.

The court dismissed ClientEarth's application, citing several reasons, including the failure to establish a prima facie case for director's duty breaches.

In *McGaughey v Universities Superannuation Scheme Limited* [2023] EWCA Civ 873, the Court of Appeal upheld the High Court's decision to reject a derivative claim against the directors of a university pension scheme. Two members of the pension scheme claimed the directors had breached their Companies Act duties, asserting that they had failed to align the pension fund with the company's green aspirations. The court rejected the appeal, as the directors had acted in good faith and within their powers, supported by professional advice.

Key takeaways from these cases:

1. Directors must make good-faith judgments when balancing climate change concerns with other risks, and courts are hesitant to interfere in these decisions.
2. There is no obligation to make an objectively 'correct' decision.
3. Irrational or unreasonable management decisions are less likely to be seen as acting in good faith.
4. Seeking professional advice helps directors demonstrate their actions were for a proper purpose and in good faith.

ESG litigation is gaining prominence as investors scrutinise decarbonisation and climate strategies and directors' execution of them. Claims concerning published green credentials, such as "greenwashing" claims, are on the rise. The mere threat of climate-related litigation can harm a company's reputation and share prices, regardless of the ultimate claim outcome.

Whilst ClientEarth's case was dismissed, it raised awareness of climate responsibilities for company directors and prompted greater scrutiny of shareholder meetings. However, climate change litigation faces a substantial challenge: the absence of a universally accepted methodology for measuring climate action. This is something that Cripps has had to grapple with in its own journey towards achieving 'net zero' and carbon reduction programme.

As regulations develop, disputes may emerge, particularly over the interpretation of terms like "carbon neutral" or "net zero".

If you would like further advice on directors' duties, either as a director of a company or a shareholder interested in holding directors to account, then please get in touch.

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Zeroing in on... the law firms leading the legal charge towards Net Zero (netzeronow.org)

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Joanna Ford

Partner and Head of Commercial Dispute Resolution

Patricia Harriman

Associate