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No green light (yet) for climate actions

Andrew Short KC & Helen Pugh examine the high hurdles still faced by claimants when bringing climate-related derivative actions

IN BRIEF

- The High Court has refused to permit claimants to continue with a derivative claim to challenge a company's continued investment in fossil fuels.
- The *Foss v Harbottle* test applicable to multiple derivative actions will make it particularly difficult for these types of claims to succeed.
- To persuade a court to interfere with directors' investment decisions, proposed derivative claimants will need to focus on adducing persuasive evidence of concrete financial loss to the company.

On 15 March 2022, ClientEarth announced it was pursuing a derivative action in its capacity as a shareholder of Shell, the energy giant, against Shell's board of directors for breaching their directors' duties.

With rather less fanfare, on 26 October 2021 two university academics commenced proceedings against directors of a corporate trustee of a pension fund, alleging, among other things, that a failure by the company to plan to divest in fossil fuels constituted a breach of their directors' duties. On 24 May 2022, in *McGaughey and another v Universities Superannuation Scheme Ltd and others (USSL)* [2022] EWHC 1233 (Ch), the High Court refused permission for that claim to continue.

McGaughey v USSL

The claimants were two members of a pension scheme established for the benefit of academic and comparable staff in universities and other UK higher education institutions. They issued proceedings against the directors of USSL, alleging breach of duty in various ways which were distilled into four claims. In a detailed and thorough judgment, Mr Justice Leech dismissed all four claims. For the purposes of this article, the focus will be on the fourth claim: the fossil fuel divestment claim.

The claimants' case was that:

- the continued investment in fossil fuels without a plan for divestment was a breach of their duties under ss 171 and 172 of the Companies Act 2006 (CA 2006) to act for proper purposes and for the success of the company;
- the directors were in breach of those duties for failing to take into account relevant considerations, including the Paris Agreement 2015 and demands by stakeholders for the scheme to divest itself of fossil fuel investments; and
- they were entitled to declarations that the absence of any adequate plan to divest from investment in fossil fuels was a breach of the directors' duties and had, or would, cause loss to the company.

USSL's evidence was that it and its investment subsidiary had had regard to environmental considerations when approving its investment strategy; that immediate divestment was not in the financial interests of the scheme; and that it did not accept that divestment in fossil fuels, as opposed to stakeholder action, was an appropriate way of achieving net zero.

Multiple derivative claims

Derivative claims are actions brought by third parties on behalf of a company to remedy a wrong done to that company by its directors. Statutory or 'single' derivative claims are brought by shareholders in a company against that company's directors and are governed by Pt 11, CA 2006.

Multiple derivative claims are a more nebulous category of derivative claims brought by persons other than direct shareholders. It includes indirect shareholders but extends to others, including members of a pension scheme who wish to bring a claim against directors of the scheme's corporate trustee—as in *McGaughey v USSL*. Such claims are governed by the common law.

At common law, a derivative claim will only be permitted if the following four requirements are satisfied:

a. the claimants have sufficient interest or standing to bring a derivative claim on behalf of the company;
b. there is a prima facie case that the claim falls within one of the exceptions set out in *Foss v Harbottle* (1843) 2 Hare 461;
c. there is a prima facie case on the merits; and
d. it is appropriate in all the circumstances to permit the derivative claim to continue.

Sufficient interest

Following and applying earlier multiple derivative cases, including *Waddington Ltd v Chan Chun Hoo Thomas* [2008] HKCU 1381, *Abouraya v Sigmund* [2014] EWHC 277 (Ch), [2014] All ER (D) 208 (Feb), and *Harris v Microfusion 2003-2 LLP and ORS* [2016] EWCA Civ 1212, Leech J held that a claimant would only have sufficient interest or standing to bring a multiple derivative claim if the company had suffered loss reflective of their own loss. The classic example is where a depletion of company assets has caused a depletion of the shareholder value and thus a reflective loss to the shareholders.

Although the claimants disputed the requirement for reflective loss, their case was that the company had suffered loss from the failure to divest. They did not

allege that their views on climate change would give them a sufficient interest, nor did they allege, in light of authority in *Cowan v Scargill* [1985] Ch 270, that the directors had a duty to divest for ethical as opposed to financial reasons.

The present state of the law is, therefore, that to have sufficient interest to bring a multiple derivative claim, there are two criteria:

a. that the company has suffered loss; and
b. that the claimant has suffered loss reflective of the company's.

Neither criterion was met in *McGaughey v USSL*. The reasoning is instructive to any claimant contemplating a derivative action for climate-related reasons:

- no particulars of loss to the company had been given;
- no particulars of loss personal to the claimants had been given;
- the claimants had not specified which investments USSL should have sold, or when, or what the consequences would have been (and whether it would have averted any loss); and
- the claimants had not specified what divestment plan USSL ought to have adopted.

The *Foss v Harbottle* exception

The principle that the proper claimant for a wrong allegedly done to a company is the company, and the principle that the court will not interfere with the internal management of a company acting within its powers, have become known as 'the rule in *Foss v Harbottle*.' That seminal case also set out four exceptions to that rule. These were described in *Daniels v Daniels* [1978] Ch 406 by Templeman J at p408G-H:

> 'The first exception is that a shareholder can sue in respect of some attack on his individual rights as a shareholder; secondly, he can sue if the company, for example, is purporting to do by ordinary resolution that which its own constitution requires to be done by special resolution; thirdly, if the company has done or proposes to do something which is ultra vires; and fourthly, if there is fraud and there is no other remedy. There must be a minority who are prevented from remedying the fraud or taking any proceedings because of the protection given to the fraudulent shareholders or directors by virtue of their majority'.

In *McGaughey v USSL*, the claimants relied upon the fourth exception. The court accepted, relying on *Daniels v Daniels*, that the meaning of 'fraud' in this context is extremely wide. It covers a deliberate or dishonest breach of duty, but also a breach of duty which personally benefits the directors.

The claimants alleged that the failure to create an adequate plan for divestment in fossil fuels was as a result of the directors putting their own beliefs with regards to fossil fuels above the interests of USSL and the members of the pension scheme. There was also an allegation that the directors had acted to avoid risking their prospects of future directorships at other organisations.

Both allegations were rejected by the High Court. There was no evidence of either.

The merits

As a result of the court's findings on the absence of loss, it was likely to be difficult for the claimants to show a prima facie case on the merits. Nonetheless, the court went on to consider the evidence of breach.

The claimants relied predominantly on newspaper articles to evidence that fossil fuel companies have performed badly since 2017 and that renewable energy portfolios had consistently performed better since 2010. The High Court was derisive about this evidence, considering the evidence so weak that the claim could have been struck out pursuant to CPR 3.4(2)(a) on the grounds that there were no reasonable grounds for bringing it.

The court looked at USSL's investment strategy in the context of pensions legislation which required the company to exercise its powers of investment in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole, to ensure diversification and to avoid accumulation of risk.

Leech J held that, while the claimants may disagree with USSL's climate-related and investment policies, 'they were well within the discretion of the Company in exercising its powers of investment.'

Discretion

Even if the fourth claim had met the criteria for granting permission to bring a derivative claim, Leech J held that he would not have exercised his discretion to permit them to do so. The declaration sought was too vague and it was more appropriate for the claimants to bring a direct personal claim for breach of trust against USSL.

Climate-related derivative claims in the future

There is little doubt that ESG—environmental, social and governance—claims will continue to be much-debated in the future. There is also little doubt that corporate cultures are beginning to be influenced by ESG considerations and the prospect of ESG litigation. However, *McGaughey v USSL* exemplifies the hurdles for those seeking to bring a derivative claim on ESG matters in the future.

In any derivative action, whether statutory or under common law, it is clear that the court will scrutinise both the evidence of breach and evidence of loss. The test in s 172, CA 2006 is subjective and the caselaw has repeatedly granted wide latitude to the informed judgement of directors (see, for example, *Smith (Howard) Ltd v Ampol Petroleum Ltd* [1974] AC 821 at p835 and *Extrasure Travel Insurances Ltd v Scattergood* [2002] EWHC 3093 (Ch)). A cherry-picking approach to news articles to support a general case that the heyday of fossil fuel investment is over will not suffice. In divestment claims, the court will expect claimants to identify particular investments which the company ought to divest from, replacement investments it ought to invest in instead, and to provide persuasive evidence of a benefit—likely in most cases to have to be financial—to the company in making this switch.

For indirect shareholders or others seeking to bring a derivative action at common law, the task will be that much harder:

a. it will be essential to prove both loss to the company and personal loss reflective of the company's loss. Reliance on loss or harm caused to society or to particular groups of shareholders with environmental interests will not suffice; and
b. it will be essential to prove that the directors either committed a deliberate or dishonest breach of duty or, failing that, that they benefited personally from the breach of duty. The mere assertion that directors personally benefit from the prospect of future directorships or from the furtherance of their personal views will not be sufficient. Some concrete evidence of personal benefit will need to be shown.

McGaughey v USSL will no doubt not be the last of the attempts to change corporate behaviour on climate issues through derivative actions. It does, however, exemplify the difficulty which claimants will have in pursuing this route. **NLJ**

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