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Directors' Duties and Climate Change

Understanding the risk to seize the opportunity

Summary

Climate change has clear implications for many organisations and their financial success – companies that ignore climate change expose themselves to financial and liability risks, whereas in mitigating and adapting to climate risks, businesses can seize opportunities to develop and diversify in order to survive and thrive in a changing climate.

In the UK, directors have duties to act in their companies' best interests which are enshrined in the Companies Act 2006 ('CA 2006'). Commentators, academics and industry actors argue that directors are permitted, and some consider are required, to create credible climate strategies in order to fulfil their legal duties prescribed in the CA 2006. Recently, litigants have sought to test this theory in court – most notably in ClientEarth's derivative action against Shell's board of directors, commenced in the High Court of England and Wales in 2023.

This paper provides an overview of how climate change is linked to directors' duties and explains how this issue has been received by the English courts to date. It then summarises the direct litigation risk alongside related legal and non-legal risks, and finally suggests how understanding this issue could help businesses implement effective climate strategies.

Key points include:

- Conversations about directors' duties usually centre on risk, but an understanding of the link between legal duties and climate change may also give directors the confidence to implement ambitious climate strategies. Directors have a statutory duty to consider the impact of the company's operations on the environment and the likely consequences of any decision in the long-term to promote the success of their companies. This means that boards have a legal basis for embedding sustainability into their business strategies and capitalising on opportunities present in the transition to net zero and beyond.

- The business case for addressing climate change is becoming clearer. In addition to the physical impacts of climate change, 'transition risks' include a growing body of climate regulation, pressure from investors, and shifting consumer sentiment.

- Shareholder interests are central to the concept of corporate success in English law, but section 172 of the CA 2006 references a range of other factors, including the environment, to which directors must have regard when carrying out their duty to promote the success of the company. This not only suggests a litigation risk for climate laggards, but also that directors can look beyond short-term profits and implement long-term climate strategies without exposing themselves to liability.

- Climate litigation is rapidly expanding in scope to include claims against directors. Whilst English courts have, so far, tended to defer to the judgment of directors to evaluate business decisions where the management acts within their powers, judicial interpretations are constantly developing, and the recent *ClientEarth v Shell* judgment has been the subject of significant commentary. Derivative actions brought under different circumstances might have a higher likelihood of success.

- Climate reporting and disclosure rules are growing in scope and complexity, and due diligence laws are widely expected to become more stringent to address climate change in supply chains. Alongside broader environmental regulations such as carbon pricing, this evolving legal landscape is heightening businesses' exposure and is therefore an important consideration for directors.

1. Directors’ duties in the UK

Background

Fiduciary duties have existed in common law for many years in various professional relationships. An individual owes a fiduciary duty when they "act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence".[1] The relationship between a director and a company has always fallen under this general definition, but directors' duties were codified by the CA 2006, a move motivated by a desire to make these legal duties "more consistent, certain, accessible and comprehensible".[2]

The CA 2006 articulates six duties that directors owe to their companies:

Section 171

Duty to act within powers

Directors must only act in line with powers they have been given in accordance with their company's constitution and for the purposes for which those powers have been conferred. Section 171 has been invoked in a climate-related case brought against trustees of a superannuation scheme.[3]

Section 172

Duty to promote the success of the company

Directors must act in a way they consider, in good faith, would most likely promote success of the company for the benefit of its members. In doing so, they must have regard to a wide range of stakeholders and factors, including long term consequences of their decisions; the interests of employees, suppliers, customers, the community, the environment; maintain reputation and acting fairly as between members. This section has seen the most attention in the context of climate change given the express reference to the environment and perceived links between climate strategy and broader business success.

Section 173

Duty to exercise independent judgement

Directors must use their own, independent judgement when making decisions, except where authorised by the company or following the company's constitution.

Section 174

Duty to exercise reasonable care, skill and diligence

Directors must act with the care, skill and diligence expected of a reasonably diligent person with both the general knowledge, skill and experience of the director (a subjective parameter) and with the general knowledge, skill and experience that may be expected of such a person carrying out the functions of the director in relation to the company (and objective parameter). Failing to adequately address climate change risk has been argued to breach of this duty.

The CA 2006 articulates six duties that directors owe to their companies (continued):

Section 175

Duty to avoid conflicts of interest

Directors cannot put themselves in situations which are likely to give rise to conflicts of interest with the interests of the company, unless lawfully authorised by the board.

Section 176

Duty to not accept benefits from third parties

Directors cannot accept third-party benefits for any act or omission as a director, or because they are a director.

Section 177

Duty to declare interest in a proposed transaction or arrangement

Directors must declare interests (whether direct or indirect) in transactions or arrangements that might give rise to a conflict of interest unless other directors are already aware.

Considering that directors owe the above duties to their companies, the proper claimant in these cases is the company itself.[4] However, as the directors act on behalf of the company and the company needs a natural person to hold its directors to account for their duties, shareholders are able to bring ‘derivative actions’ on behalf of the company.[5]

The CA 2006 provides for certain relief or limits of a directors’ liability. If a director is in breach of their duties but has acted honestly and reasonably, a court may grant full or partial relief.[6] Directors may also avoid liability for breach of duties if shareholders have formally ratified the relevant conduct[7] or the conduct has received informal unanimous approval from shareholders (the ‘Duomatic Principle’).[8] Importantly, companies cannot make directors exempt from liability, or indemnify directors for breach of duty except under limited circumstances.[9] This does not prevent a company from arranging insurance against its directors’ liability, which is common through directors’ and officers’ (D&O) liability insurance.

Section 172 in focus – why is climate change relevant?

While sections 171 and 174 CA 2006 have been deployed concerning directors' duties in relation to climate change, the general duty to promote the success of the company under section 172 has been most central to such analysis by commentators, academics and industry actors.

Section 172 of the Companies Act 2006 [11]

(1) A director of a company 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, and in doing so have regard (amongst other matters) to:

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,
- (c) the need to foster the company's business relationships with suppliers, customers and others,
- (d) the impact of the company's operations on the community and the environment
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances to consider or act in the interests of the creditors of the company.

The basic argument is that by failing to adapt to climate change and the risks associated with the transition to net zero (and beyond), including political, societal and anticipated regulatory changes, directors' actions (or inaction) will negatively impact the performance and/or resilience of the business to the detriment of its members, stakeholders, and the wider community for the long-term.

Therefore, directors who ignore, or fail to adequately address, climate risks and opportunities may be in breach of their section 172 duty.

To what standards are directors held?

This section 172 duty requires that directors "must act in the way [they consider], in good faith, would be most likely to promote the success of the company". The wording makes clear that there is (necessarily) a subjective element, which is the director's honest assessment (made in good faith), of what action (or otherwise) would most likely fulfil this aim. Accordingly, the Courts have tended to interpret this element of section 172 that directors, and not judges, are best placed to make decisions about their businesses.[12] However, in assessing a director's actions, one invariably has to consider section 174 that requires directors to exercise reasonable care, skill and diligence, which contains both an objective test and a subjective test.[13]

What does it mean for a company to be successful?

Prior to the CA 2006, companies were governed according to the shareholder primacy rule, which required that the company operated solely for the benefit of generating maximum profit for its members, to the exclusion of all else. This rule was therefore very short-term focussed. However, section 172 presents a moderated version of the shareholder primacy rule and effectively enshrines the 'enlightened shareholder principle', or 'enlightened shareholder value' in statute. Section 172 softened the shareholder primacy rule, requiring that in the pursuit of profits for the benefits of its members, directors are obliged to consider other factors such as the long-term success of the company (not just short-term profits), the interests of its employees, suppliers, customers, and other, as well as communities and the environment.[14]
It is understood that the aims of these reforms were intended to be permissive for directors to act responsibly to ensure not just short-term profitability for shareholders but long-term results for all stakeholders, including the environment, for the success of the company as a whole. In that sense, this section 172 acts as a shield to allow longer-term considerations..

What must directors have regard to when fulfilling their section 172 duty?

Section 172(1)(a)-(f) provides a non-exhaustive list of factors to which directors must have regard (among other matters) when considering the success of the company. All of these factors are relevant in the climate context. The most obvious of which are sections 172(1)(a) and (d), being the likely consequences of any decision in the long term and the impact of the company's operations on the community and the environment. However, ensuring a successful transition to net zero could also require consideration of employees' interests, supply chains, reputation, and the need to act fairly as between a company's members – all of which will ultimately affect its financial success and longevity. Some argue that the position enshrined in the CA 2006 does not go beyond what was already implicit in common law fiduciary duties prior to codification in the CA 2006, but other commentators lauded section 172 as providing a statutory recognition for the fact that in order for a company to succeed, other factors such as the interests of its employees, customers, wider community and environment have to be taken into account. This is particularly relevant where climate change causes instability to the societies and markets in which companies operate, threatening the operation and success of those companies. The theory is that it is not possible to best serve the interests of the members of a company by excluding all other considerations (including climate change and the instabilities it could bring) and maximising short-term gains, since the company would eventually fail.

Section 172 and climate change

Climate change, a global issue with long-term and potentially catastrophic consequences, is generally accepted to be an issue to which directors must have regard under section 172. A large body of research now indicates that economies, sectors, and individual businesses are exposed to significant potential financial loss because of climate change. In addition to physical risks posed by climate change, policy responses, public attitudes and regulatory change may come at a great cost to firms that fail to effectively manage the net zero (and beyond) transition. Avoiding direct legal risks and even reputational risks associated with poor climate strategy is also relevant to this duty.

As actual and potential financial impacts of climate change have become clearer, a growing body of work looking into links between climate change and directors' duties has developed. In 2016, the first 'Hutley Opinion'[15] advanced the view that directors can, and potentially must, consider climate change when carrying out their duty of care and diligence under Australian law.[16] The opinion, written by Australian barristers Noel Hutley SC and Sebastian Hartford-Davis, observed that both physical effects of, and policy responses to, climate change are a foreseeable risk to many businesses. An update to the Hutley Opinion, issued in 2019, noted that physical and transition climate risks had only become more salient, arguing that this strengthened the link between climate change and directors' duties.[17] The first two Hutley Opinions primarily emphasised the existence of these intersections between climate risks and directors' duties, indicating that many directors are required to consider and disclose these risks. A third iteration published in 2021 went further – given the evolving regulatory environment and increasing pressure from investors and the public, the authors argued that directors "must also take reasonable steps to see that positive action is being taken", i.e. develop a net zero strategy. In writing a strategy, the opinion notes that directors may be exposing themselves or their companies to risk of litigation by 'greenwashing' but advises that specific and transparent strategies may be resilient to these risks. Although the Hutley Opinions address Australian corporate law rather than UK company law, they have informed similar thinking in the UK.

In an extrajudicial speech delivered in 2019, Lord Sales drew on the Hutley Opinions when commenting on how climate change intersects with directors' duties in the UK.[18] Lord Sales argued that the UK's legislative scheme indicates that "directors may and, increasingly, must take into account and accord significant weight to climate change in their decision-making". This position is even clearer in the UK compared to Australia given the direct reference to the environment in section 172(1)(4). While Lord Sales argued that "there is a clear case for these company laws to be modified" to ensure climate change is given adequate attention in the boardroom, he also suggested that the UK's existing legislative framework may be sufficient to address these issues because "the old dichotomy between a company's financial success and its environmental profile is collapsing" from increasing climate-related financial risks.

In a paper distributed to directors around the world through the Climate Governance Initiative, the Commonwealth Climate and Law Initiative cited this speech to emphasise the link between directors' duties and climate change.[19] More recently, as explored later in this paper, Lord Carnwath authored an article expressing similar views when reflecting on ClientEarth's derivative action against Shell's board of directors.[20]

Numerous academics and nongovernmental organisations have provided additional comments examining links between directors' duties and climate change,and, as this paper explores, litigants have begun testing these theories in court. There have been additional efforts to understand how the biodiversity crisis and nature-related risks more broadly are relevant to directors' duties,[21] and how climate change interacts with other requirements under the CA 2006 including the obligation for directors not to approve accounts unless they are a "true and fair" representation of the company's assets and liabilities.[22]

Interaction with other legal obligations

Companies face an increasing number of climate-related legal obligations, which may be relevant to directors fulfilling their duties. Climate-related reporting and disclosure requirements are becoming increasingly widespread, with many companies in the UK now required to report on their businesses' exposure to climate change risk, specifically their climate-related financial risk exposure and stress-test their climate resilience against scenarios.[23] Under the EU's impending Corporate Sustainability Reporting Directive, 'Double materiality' reporting requires in-scope companies to disclose not only how climate change is impacting their business, but also how their business is impacting the climate. This Directive applies to both EU-based companies and foreign companies with a significant presence in the EU, and, as noted above, will have implications on out-of-scope businesses in the UK with close links to or within the supply chains of in-scope businesses and similar legislation could be adopted by other jurisdictions in the future.

Directors failing to effectively ensure these obligations are met, could find themselves subject to claims for breaches of duty, including under sections 172 and 174. These reports and disclosures may also provide evidence of a board that is failing to consider climate risk (either adequately or at all), or conversely give shareholders undue confidence in their company's climate strategy and preparedness. In addition to these specific climate-related requirements, boards of large and publicly listed companies are required to provide a statement on how they have considered the factors listed in section 172 to which they must have regard.

Indeed, section 414C(1) of CA 2006 explicitly states that the purpose of a strategic report is to help members assess how directors have performed their duty under section 172. As explored above, climate change is relevant to all sectors and therefore, should be considered in the strategic report of all UK businesses that are required to produce one.

Directors must ensure compliance not only with domestic laws, but also laws of other jurisdictions in which they operate. For example, proposed European supply chain due diligence requirements apply to companies with a presence in the EU, even if they are not headquartered or listed there.[24] Climate litigation on other causes of action and in other jurisdictions may also impact UK—based companies and could inform the direction of travel for jurisprudence in England and Wales. For example, ClientEarth's claim against Shell's directors cited Shell's failure to comply with the ruling of a Dutch court in the Milieudefensie[25] case as evidence of the board's failure to fulfil its duties under English law. The broader landscape of climate regulation and litigation, which is growing in breadth and complexity globally, is therefore relevant to the scope and nature of directors' duties in the UK.

2.
Taking stock of the litigation risk

Climate-related claims against directors for breach of fiduciary duty

In recent years, litigants around the world have used a wide range of novel legal interpretations to bring claims against those who they believe are contributing to or otherwise not adequately dealing with the impact of climate change. Though early claims tended to focus on public bodies, private companies are increasingly in the crosshairs of climate litigation.[26] Given the generally understood links between climate strategy and corporate success outlined above, litigants are starting to bring claims against directors for breach of their duties.

In McGaughey *v* Universities Superannuation Scheme,[27] an academic brought a claim against directors of the corporate trustee of his pension scheme for breach of sections 171 and 172 CA 2006, as well of breach of fiduciary duty. One pleaded breach was an alleged failure to adopt an adequate plan for long-term divestment of investment in fossil fuels. This action was ultimately unsuccessful. Not long after, ClientEarth brought a case against Shell's directors,[28] alleging that their approach to climate change risk management strategy amounted to a breach of sections 172 and 174 CA 2006. Read a more detailed summary of ClientEarth *v* Shell in our legal insight on the case. In particular, ClientEarth alleged that Shell had not set an appropriate emissions target, that current climate risk strategies were insufficient to achieve Shell's net zero goal, and that Shell was not complying with the Hague District Court's ruling in Milieudefensie.

ClientEarth was a small shareholder in Shell, hence brought the claim as a derivative action under the CA 2006 mechanism. McGaughey was not a shareholder in the corporate trustee but, given there were no shareholders in the corporate trustee, he brought the case in his capacity as a beneficiary asserting that he had sufficient standing in circumstances where the sole corporate director was limited by guarantee (i.e. it had no shareholders to hold the directors to account vis a vis their compliance with their duties).[29]

Lessons from the Shell litigation – barriers and opportunities for future claims

To date, the courts in England and Wales have dismissed these derivative claims at the permission stage before the real substantive issues could be considered concerning the consideration of climate risk by fiduciaries or directors in McGaughey *v* USS and ClientEarth *v* Shell's Board of Directors. Whilst these claims did not proceed due to the courts denying permission to continue (McGaughey on appeal and ClientEarth at first instance), and ClientEarth was refused permission to appeal the High Court's decision, the judges in those two cases indicated that the claims would likely fail on their merits if they had been able to proceed. The barrier to successful derivative (or derivative-style) litigation can be challenging, but this does not mean the litigation risk should be ignored.

Section 263 CA 2006 sets out how courts should determine the criteria which must be met in order for a derivative action to be granted permission to proceed. Most importantly, permission should only be granted if the claimant can show a prima facie case. The High Court's reception to both procedural and substantive aspects of ClientEarth's claim against Shell highlights these barriers, but also reveals certain situations where claims might be met more favourably by the English courts. The table below, produced by the Commonwealth Climate and Law Initiative in collaboration with the Climate Governance Initiative, explains key parts of the High Court's reasoning, and how other cases might find more success.[30]

ClientEarth *v* Shell Board of Directors (source: Climate Governance Initiative and the Commonwealth Climate and Law Initiative)

Reason for application being unsuccessful	How a different claim might succeed
An English court cannot give permission to a shareholder to bring a derivative claim on a company's behalf without being satisfied that certain stringent criteria have been met.	In another jurisdiction there may be fewer entry barriers for a claim. Derivative actions are not possible in every country, are rarer in continental Europe than in the US, Japan, South Korea, Taiwan and China (although in Germany 'rescission lawsuits' have fewer barriers to entry). Common law countries such as Australia, Canada, and India may have similar limits to the UK. However, the complex interplay between each jurisdiction's local context (varying over time) and its company laws, particularly in Asia, makes it difficult to draw conclusions on which jurisdictions have more likelihood of claims. (See CCLI's country papers for further information.)
The claimant was seen to be primarily pursuing a policy agenda rather than being motivated by financial loss.	The claimant may be seen to be acting in good faith if the financial loss to the claimant (as a result of impact on the company's value) is more evident, prominent and/or the claimant is not a high-profile advocacy organisation, or if the claim relies more on actual rather than prospective financial loss. An investor that suffers climate change-related losses across its portfolio might be in a better position to demonstrate a good faith agenda in relation to a derivative claim centred on the directors' management of the company's emissions, but it should be noted that since a derivative claim is brought in the name of the company, such loss will not apply to the question of whether the company has suffered harm as a result of the directors' actions.
The claimant took the existing statutory duties and tried to elaborate on them with application to the context of the case. This was seen as an attempt to impose new duties on directors more specific than those required by law.	If the claimant describes how the statutory duties have been breached using accepted descriptions of the duties as found in case law, statute or parliamentary notes, they are less likely to be seen to try to impose new duties.
The application rests on a witness statement that summarises consensus opinion from a variety of sources rather than expert evidence.	The claimant produces expert evidence at an earlier stage in proceedings.
The directors had policies and targets to achieve net zero, so could not be said to have failed to consider climate risk.	If it is demonstrable that the directors have completely failed to show consideration of the strategic implications of climate risk, or that they have considered it but not taken actions that fall within a reasonable range of responses in relation to those implications. The procedures around arriving at a decision could be criticised if not the final decision itself.
Lack of evidence of universally-accepted methodology to achieve emissions targets.	Guidance on credible transition plans developed by the Science-based Targets Initiative, the ISSB, the UK's Transition Plan Taskforce (expected to have global influence), TCFD, GFANZ and OECD (and a wider range of organisations) on transition plans, combined with proposed UK, EU and US regulatory requirements will soon demonstrate consensus best practice methodology on emissions reductions. When combined with evidence that thousands of companies across the world are already preparing (although not necessarily publishing) transition plans, and investor expectations coalescing around the 'say on climate' initiative, the expectation of a viable transition plan is emerging as a business norm.

Reason for application being unsuccessful	How a different claim might succeed
The directors had policies and targets to achieve net zero, so could not be said to have failed to consider climate risk.	If it is demonstrable that the directors have completely failed to show consideration of the strategic implications of climate risk, or that they have considered it but not taken actions that fall within a reasonable range of responses in relation to those implications, the procedures around arriving at a decision could be criticised, if not the final decision itself. This might include where directors have created an audit trail giving an impression of considering these issues, but on deeper examination, they have not given due consideration to the implications of the evidence available – for example their decisions clearly conflict with scientific consensus.
In a large, complex business, directors are required to consider and balance a range of competing considerations – a management decision with which a court may not interfere (the 'business judgment' rule). It could not be said that no reasonable director could properly have adopted the approach of the directors in question.	If the claimants acknowledge the directors' agency to balance competing considerations but can demonstrate that the directors have either failed to adequately inform themselves in relation to the relevant considerations, or have somehow acted in a way that is manifestly unreasonable when balancing climate risk with other considerations. In Delaware, US the 'Caremark' case established that directors may breach their duties for failing to establish or monitor information systems for 'mission critical' risks. Since 2019, five similar cases have survived motions to dismiss (while not ultimately succeeding). Directors may be more exposed to such claims in future. Local company laws around the world differ on the weight that directors are expected to place on climate considerations. For example, in India directors must discharge their duties not just with regard to the shareholders, but also the community and the environment.
A person acting in accordance with the duty to promote the success of the company would not seek to continue the claim.	If it can be demonstrated that the claim is objectively in the company's interests and that a hypothetical director might pursue it.
A large majority of shareholders voted in favour of the climate strategy in question. The claimant represents a particularly small minority of shareholders.	If the majority shareholders are not aligned with the company's climate transition plans (or, in future, nature-related transition plans). Claimants representing a larger percentage of the overall shareholdings may have a higher chance of success. Given the growing support of institutional shareholders for this type of action, this is not inconceivable, and directors should therefore be prepared for evolving trends in shareholder expectations.
The court was unable to give an appropriate remedy (i.e. damages, injunction or order to perform specific obligations). The remedy requested was insufficiently precise. The claimant requested a declaration that the directors had breached their duties and an injunction compelling the directors to execute a specific climate risk strategy. It would not be appropriate for a court to grant an injunction that would require court supervision.	The claimant seeks a precise remedy that is within the powers of the court and does not require court supervision. The claimant can demonstrate that the remedy sought has substantive effect and is useful in serving a legitimate purpose.

ClientEarth's case against Shell was ambitious, and the above hypotheticals indicate only a few examples of a factual matrix that could pose an increased litigation risk to businesses. Importantly, this litigation risk may grow in the future. Given trends in both policy and society, as well as the physical impacts of climate change, insufficient climate strategies by businesses may pose increasing risks to corporate success. Consequently, there is likely to be greater scope to show actual, rather than prospective, financial losses. Directors can be held liable after they no longer sit on a board, as long as the breach occurred during their time in office, so the potential for greater evidence of climate-related losses in the future still poses a risk to today's directors.

Of course, even in cases more favourable to the claimants, barriers will remain. Fundamentally, courts do not want to make management decisions for companies – the threshold to a successful claim under sections 172 and 174 is very high, reflecting the importance of deference to those with expertise in running businesses currently. However, Lord Sales' comment that directors "may and, increasingly, must" consider climate change indicated not only a view of the current legal position but also a direction of travel. With the rate of social and policy change in relation to climate change, judicial attitudes and determinations are also likely to develop, which will see developing case law that may require increased consideration of climate-resilience and climate risk mitigation in directors' decision-making.[31]

In a recent article, Lord Carnwath called the High Court's decision in ClientEarth *v* Shell "unpersuasive on all points", indicating how a different legal interpretation might be more favourable to similar derivative actions.[32] In addition to disagreeing with the dismissal of ClientEarth's evidence at the permission stage, he argued that the lack of a 'universally accepted methodology' for reaching climate goals did not mean that the Court could not determine whether Shell's methodology was credible. Given ClientEarth's argument that Shell had already expressed how it balanced climate risk against other factors in its transition strategy, Lord Carnwath was unconvinced by the Court's emphasis on the fact that directors must weigh climate change against competing commercial considerations. Addressing the Court's assertion that ClientEarth had not brought the case in good faith, Lord Carnwath stated that despite ClientEarth's policy goals the success of the company remained the claim's dominant purpose. Finally, Lord Carnwath expressed concern about the Court's order for costs in favour of Shell, arguing that this departed from precedent and might create uncertainty for future litigants.

Lord Carnwath described the High Court's decision in ClientEarth *v* Shell as a 'missed opportunity', but there may be further opportunities down the line. Courts, and the cases brought before them, may become more favourable to such actions, presenting a real risk to directors who fail to address (adequately or at all) climate change. In the meantime, even where a derivative or other climate actions are ultimately unsuccessful, litigation can still be costly and may cause reputational damage.

Other potential routes to director liability

Directors' duties are not the only legal obligations which give rise to the possibility of liability for directors, other avenues include:

- Liability for 'greenwashing': directors who make misleading statements about their company's environmental impact or credentials may usher in multiple legal risks and new sustainability disclosure requirements are anticipated to be rolled out for all sectors.[33] Misstatements or omissions can lead to liability under section 90 of the Financial Services and Markets Act 2000 (FSMA) if made in listings or prospectuses. Additionally, whilst somewhat novel and only available in limited circumstances, shareholders may be able to recover losses from directors for fraudulent misrepresentation and breach of fiduciary duties, following a successful section 90A/schedule 10A FSMA claim against a company (noting section 90A/schedule 10A claims cannot be brought directly against directors and officers) for misstatements or omissions made by those offending senior managers, directors and officers in other corporate publications such as annual reports and accounts.[34] Common law causes of action such as negligent misstatement and fraudulent misrepresentation and statutory provisions under the Misrepresentation Act 1967 may also hold directors to account for greenwashing.
- Regulatory risk: directors and their companies may also be exposed to a range of regulatory risks depending on the sectors in which they operate. As the financial system transitions to net zero, directors of companies regulated by the PRA are already required to have senior management oversight and responsibility for financial risks arising from climate change and require directors to fulfil their commitments under the Senior Managers and Certification Regime.[35] It is understood that the Audit Reporting and Governance Authority, the Financial Reporting Council's imminent successor, will have increased enforcement powers over directors of public interest entities in relation to certain CA 2006 breaches.[36]

Indirect risks from climate litigation

Although the prospect of successful litigation presents the most acute risk to directors, even unsuccessful claims may damage companies. A 2023 study suggested that climate litigation filings had reduced firm value of oil & gas majors even before any unfavourable court decision.[37] In addition to any direct financial cost associated with addressing the claim (comprising of advisor costs and internal resources), climate litigation may pose a reputational risk to companies. If these claims become widespread, firms may face higher costs for D&O liability insurance, particularly those in sectors most likely to be targeted by climate litigation.

3. Moving forward: directors’ duties and effective climate strategies

Managing risk by seizing climate opportunities

Conversations about climate change often centre on risk, but the transition to net zero may well present business opportunities. Companies that capitalise on new markets and technologies may see financial success and gain a competitive advantage against their peers. All the incoming policy and legislative changes are geared to encouraging and enabling companies to seize climate-related opportunities as well as assessing, quantifying and adapting to and mitigating their climate risk. There is risk of litigation for both climate laggards and those companies and directors that misrepresent or overstate their climate actions and ambitions. However, boards that communicate and implement accurate, evidenced-based climate adaption and mitigations strategies and that are capitalising on the opportunities arising from the net zero transition, are not only gaining greater market share and competitive advantages but may be reducing their liability risk for future claims.

There are many ways to achieve net zero, but none of those consists of a 'business as usual' approach. Therefore, business leaders will need to make decisions in the face of uncertainty when designing and implementing a climate strategy. As long as decisions are reasonable and made in good faith, directors' legal duties should not make them hesitant to take action to assess, quantify, and adapt to climate risk.

Directors' duties as a shield for ambitious climate strategies

As explored above, the English courts are reluctant to tell directors how to run their businesses – this is a barrier to climate litigants, but it could also be a shield for climate-conscious directors. Certain shareholders may become disgruntled if they believe that climate risk mitigation is being pursued to the detriment of short-term profits. To defend against this, directors might be able to utilise the factors listed in section 172 to which directors must have regard.

Directors may counter arguments from such a shareholder by articulating why long-term thinking is vital for businesses, how climate change impacts corporate success, and ultimately how effective climate strategies can deliver value for shareholders on an ongoing, rather just short-term, basis.

Bringing the conversation to the boardroom

Directors' duties, in particular the duty in section 172, concern more than just the liability of board members. As explored above, section 172 ushers in questions about what it means for a company to be successful, and recent litigation has raised more specific questions about how businesses will continue their success through the net zero transition. A healthy dialogue between the board and shareholders on this topic could also ensure that any differences or disagreements about corporate success can be resolved long before litigation is contemplated.

For detailed guidance for board directors on directors' duties and disclosure obligations at a jurisdictional level see the 'Primer on Climate Change: Director's Duties and Disclosure Obligations' on the Climate Governance Initiative website.

References

1 Bristol and West Building Society *v* Mothew [1996] EWCA Civ 533

2 White Paper on Company Law Reform, 2005, Cmnd 5391

3 McGaughey and Davies *v* Universities Superannuation Scheme Ltd and Directors [2022] EWHC 1233 (Ch) and [2023] EWCA Civ 873

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

5 Claims can also be pursued against directors by third parties in circumstances where those directors have assumed such a responsibility or duty to them, and by liquidators or creditors under Insolvency Act 1986 procedures, both of which are beyond the scope of this note.

6 Companies Act 2006, s 1157.

7 Ibid., s 239.

8 Re Duomatic Ltd [1969] 2 Ch 365.

9 Companies Act 2006, s 232.

10 McGaughey and Davies *v* Universities Superannuation Scheme Ltd and Directors [2022] EWHC 1233 (Ch) and [2023] EWCA Civ 873

11 This was affirmed in ClientEarth *v* Shell Plc et Ors [2023] EWHC 1137 (Ch), in which the Court held that "the law respects the autonomy of the decision making of the Directors on commercial issues and their judgments as to how best to achieve results which are in the best interests of their members as a whole." at para 47

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13 Sections 174(2)(a) and 174(2)(b) CA 2006

14 It is worth noting that in the context of insolvency (or bordering insolvency) of a company, the directors' duties under section 172(1) shift from the interests of the members taking primacy, to the interests of the creditors become the paramount consideration in directors' decision-making (BTI 2014 LLC *v* Sequana SA and Ors [2022] UKSC 25).

15 'Memorandum of Opinion: Climate Change and Directors' Duties', Noel Hutley SC and Sebastian Hartford-Davis (2016). Link.

16 Corporations Act 2001, s180(1).

17 'Supplementary Memorandum of Opinion: Climate Change and Directors' Duties', Noel Hutley SC and Sebastian Hartford Davis (2019).

18 'Directors' duties and climate change: Keeping pace with environmental challenges', Lord Sales (2019). Link.

19 'Primer on Climate Change: Directors' Duties, and Disclosure Obligations', Commonwealth Climate and Law Initiative and Climate Governance Initiative (2022).

20 'ClientEarth *v* Shell: What future for derivative claims?', Lord Robert Carnwath (2024).

21 See Nature-related risks and directors' duties under the law of England and Wales, Sharif A. Shivji KC and Rebecca Stubbs KC (2024).

22 See George Bompas KC's opinion on this matter, which argues that certain climate transition strategies may amount to constructive obligations and that compliance with sustainability standards alone may not always be sufficient to meet this obligation.

23 Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 and the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022, which apply to reporting for financial years starting on or after 6 April 2022

24 See the draft Corporate Sustainability Due Diligence Directive. Link.

25 Milieudefensie *v* Royal Dutch Shell (2021) ECLI:NL:RBDHA:2021:5337. This case is the subject of appeal

26 See e.g. 'Global Trends in Climate Litigation: 2023 Snapshot', Joana Setzer and Catherine Higham (2023). Link.

27 [2023] EWCA Civ 873.

28 ClientEarth *v* Shell's Board of Directors [2023] EWHC 1897 (Ch).

29 This was not a statutory derivative action under CA 2006 but, rather, under common law. Depending on the particular allegations, the consideration was given to whether it was a double derivative action or a multiple derivative action.

30 'Developments in Climate-Related Litigation, Disclosures and Due Diligence Requirements: What Board Directors Need to Know', Commonwealth Climate and Law Initiative and Climate Governance Initiative (2024). Link.

31 The ruling by the district court of The Hague in the Netherlands, Milieudefensie *v* Shell (2021), is an example of such developing judicial attitudes and case law in a European context, noting this was not an English law case.

32 'ClientEarth *v* Shell: What future for derivative claims?', Lord Robert Carnwath (2024).

33 See for example the Sustainability Disclosure Requirements set out in the Government's Green Finance Roadmap. Link.

34 See, for example, the 'dog leg' claim against directors for fraudulent misrepresentation and breach of fiduciary duties in Autonomy and Ors *v* Lynch and Anor [2022] EWHC 1178.

35 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change' (SS3/19, Prudential Regulation Authority (2019).

36 'The new Definition of PIE', Institute of Chartered Accountants in England and Wales (2022).

37 'Impacts of Climate Litigation on Firm Value', Misato Sato; Glen Gostlow; Catherine Higham; Joana Setzer and Frank Venmans (2023). Link.

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Solar panels image and hydrogen fuel image by Dennis Schroeder / NREL

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The Centre for Climate Engagement at Hughes Hall, University of Cambridge plays a unique role in bringng leading academic research to a targeted audience of chairs and non-executive directors to accelerate climate leadership on boards in the private and public sectors.

The Centre is uniquely placed to develop insights drawing on academic expertise from across the University of Cambridge and the wider research community, together with independent expertise from the business sector.

The Centre supports new areas of research particularly relevant for board members with a specific focus on climate law, governance, and organizational change. Our research is carried out directly by postdoctoral researchers, and indirectly via partnerships and collaboration with relevant experts.

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